ECONOMIC COMMISSION FOR LATIN AMERICA
AND THE CARIBBEAN

ECONOMIC SURVEY OF LATIN AMERICA AND THE CARIBBEAN 1995-1996

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FOREWORD

This issue of the Economic Survey of Latin America and the Caribbean once again differs in important respects from earlier years. Like the issue published in 1995, it covers some aspects of economic performance during the first half of the current year, the aim being to provide continuity by following economic developments up to the time of writing insofar as information is available.

As in 1995, the Survey is in a single volume containing both a regional analysis and reports on individual countries. For the first time, however, the regional analysis includes a chapter on employment and wages and another on saving and investment, subjects treated the year before in the chapter on level of activity, inflation and employment. Other new elements are chapters on structural reforms and on the fragility of the Latin American banking system. Some statistical tables are presented in the volume, but most of the tables are contained in an annex on diskette, last year distributed separately but this year included with the printed Survey.

The most important new features concern the statistical data. First, 1980 is no longer used as the base year for the series of national accounts statistics at constant prices; beginning with this issue they are calculated taking 1990 as the base year. Second, a new methodology, based on the fifth rather than the fourth edition of the *Balance of Payments Manual* of the International Monetary Fund, has been used to analyse the external sector. The change in methodology affects series trends and composition in the following ways:

- The region's trade surplus (goods and services) at current prices and the loss due to terms-of-trade effects both appear smaller, because in 1980 the prices for the region's exports were higher than in subsequent years.
- The ratio of gross fixed investment to gross domestic product appears significantly higher (more than three percentage points), especially in the case of Brazil, Colombia and Peru.
- Output growth rates are somewhat different than when calculated on the old basis, the differences being due largely to the reduced importance of some primary sectors, such as agriculture in El Salvador and mining in Peru.
- The figures for exports and imports and hence their weight relative to services are increased considerably by the inclusion of transactions of the *maquila* industry, which in the previous issue were reported in the non-factor services account and only to the extent of their value added;

by the same token, the figure for services is lower under the new method.

- Transfers are no longer classified as private and official, but instead are divided into current and capital; the effect is to reduce the current account deficit significantly, since a considerable proportion of the official transfers that used to be reported on the capital account as official are now reported on the current account.
- The capital account, which has undergone major changes, is now referred to as the "capital and financial account"; investment in the reporting economy and investment abroad by residents are reported separately, whereas before only the net figure was given. Portfolio investment is no longer broken down into long- and short-term, a distinction that is made only for "other investment", which refers chiefly to loans by banks and by multilateral and governmental entities. Investment in bonds is now reported under portfolio investment, which is broken down into equity securities (stocks) and debt securities (bonds). The change is not trivial, because it means that portfolio investment can no longer be characterized as uniformly highly volatile.
- With respect to the financing of the overall balance (the items below the line), a new category has been added, that of "exceptional financing," comprising regular International Monetary Fund loans and funds from emergency aid packages like those granted to Argentina and Mexico in 1995, which involved very large sums. The category also covers interest payment arrears, which used to be sizeable for most countries, but are now large only for Nicaragua and Peru, although the latter has begun to settle its arrears.

FIRST PART

THE REGION

I. MAIN TRENDS

In 1995 the economies of Latin America and the Caribbean were deflected from the course they had been following since the start of the decade and suffered stagnation in regional output, a decline in investment and a rise in unemployment; on the other hand, inflation continued to decline in nearly all countries and external accounts improved. All these trends continued in the first half of 1996, although as the half ended there were signs of a recovery in level of activity.

The financial crisis that arose in Mexico at the end of 1994 was one of the factors that triggered the difficult situation that has since prevailed in the region. The crisis not only interrupted capital flows to Mexico, but also had major ripple effects in other countries, especially in Argentina, which experienced a similar withdrawal of financial resources. As a result, both economies suffered dramatic contractions.

The crisis did not have such extensive or lasting repercussions in the rest of the region as had at first been feared. As early as the second quarter of 1995 there were indications of a resumption of capital flows, a trend that was confirmed in 1996. However, new problems arose, particularly in Brazil and Peru, which were forced to adopt severe adjustment policies as they tried to consolidate stabilization gains. The Venezuelan economy became mired in even greater difficulties and also required drastic remedies.

In contrast, the performance of many of the other economies was similar to that of the period 1991-1994; they continued to grow, some at an even faster pace. These economies maintained and appeared to be consolidating an economic pattern characterized by good growth rates, moderate and decreasing inflation and a current account deficit financed by external capital. Although inadequate in job creation, the pattern nonetheless constituted a significant improvement over the stagnation and instability that afflicted the region during the 1980s.

Most of the economies continued growing in a climate of macroeconomic stability, but showed areas of vulnerability. In many cases growth was insufficient to compensate for the social deficits accumulated over previous years. Other causes of concern in 1995 were limited growth in export volume in some countries (notably Brazil), the persistence of clearly inadequate rates of saving, some setbacks in attempts to achieve fiscal balance and signs of weakness in the banking system. Moreover, the crisis alerted the countries to the dangers of a growing trade deficit, excessive dependence on inflows of short-term foreign capital and a low national saving rate and to the need for greater coordination in economic policy.

As in the past few years, the performance of most of the region's economies in 1995 depended on external capital flows. Although the crisis interrupted flows to Mexico and Argentina, they remained at their previous year's level in most of the other countries and rose considerably in Brazil. In Argentina and even more in Mexico, the net outflow of private capital was mitigated by a heavy influx of compensatory financing from the International Monetary Fund, the United States Government and official multilateral sources. Dependence on external capital was also reduced because the value of exports grew by some 21% in 1995, owing to an improvement in international prices for the second consecutive year and the strong increase in volumes exported by Argentina and Mexico.

In 1995 the Latin American and Caribbean countries were forced to adjust their economic policies to new external and domestic conditions. The impact of the Mexican crisis of late 1994 on international financial markets and the

turbulence experienced in domestic financial markets elicited a variety of responses in economic policy. Most countries of the region persisted in their efforts to stabilize domestic prices and expand international trade linkages. Stabilization programmes were widespread and set the tone of foreign exchange, fiscal and monetary policies, which were, with few exceptions, moderate or restrictive. The external liberalization strategy adopted entailed, in some cases, reinforcing the mechanisms of subregional integration, and this was particularly the case in the MERCOSUR countries.

Balanced fiscal budgets continued to be one of the chief goals of stabilization programmes. Five countries achieved a public-sector surplus: Chile, Dominican Republic, Mexico, Panama and Paraguay. Another nine managed a deficit equal to 2% or less of GDP: Argentina, Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Peru and Uruguay. Only Brazil, Haiti, Nicaragua and Venezuela posted a deficit greater than 4% of output; the surprise in this group was Brazil, which swung from an operating surplus of 1% of GDP in 1994 to a deficit of 5% in 1995. The approaches taken to reduce the fiscal gap largely aimed at increasing revenues, although there were also efforts to reduce expenditure. In most cases revenues were increased through indirect taxes, but some countries also raised real charges for State-provided goods and services.

In some countries monetary policy was made easier by better fiscal management and by greater demand for money in the light of expectations of low inflation, while in others monetary management was made more difficult by growing fiscal problems. Moreover, some economies continued to receive heavy external capital flows, and this complicated efforts to reconcile monetary expansion with growth and inflation targets. Domestic interest rates were used as a tool to mediate between the conflicting needs to develop competitiveness, meet monetary targets and finance the external current account deficit.

Foreign exchange policy underwent changes in Mexico, which adopted a floating exchange rate at the end of 1994; in Brazil and Ecuador, which introduced flotation bands; and in Honduras, which adopted an auction system with Central Bank intervention. Venezuela devalued its currency sharply in mid-December 1995 and again in April 1996 and finally resorted to a currency band system. The remaining countries adhered to the same foreign exchange systems they had applied in 1994.

Trends in real exchange rates varied. In some countries, the currency continued to appreciate, a tendency that helped to keep inflation down but undermined the ability of domestic products to compete with imports. In the three countries that suffered an interruption of external capital inflows, on the other hand, the local currency depreciated.

The process of structural reform in the region intensified, although there were major differences between countries in the pace of implementation and consolidation of changes. Progress was made in privatization, in improving regulatory systems in sectors where public services had been privatized and in establishing new regulatory mechanisms to ensure better functioning of the financial system. In the area of social security reform, a number of countries moved ahead in developing schemes based on capitalization of employee contributions. In the area of foreign trade, however, there were some reversals of the liberalization process, as non-tariff barriers were reintroduced or reinforced and some import duties were raised.

In general, an increase in international prices of commodities contributed substantially towards narrowing the external gap. In the countries hardest hit by financial turbulence, a decline in domestic demand combined with improved external competitiveness helped to boost export volumes and at the same time to restrain or reduce imports. On the other hand, in Brazil, Colombia and Peru, where domestic demand expanded, the current account deficit widened.

The solvency of the financial system was threatened in Argentina, Brazil, Ecuador, Mexico, Nicaragua, Paraguay and Venezuela, in the latter due to delayed effects of the previous year's crisis. In some countries, internal factors created the problem, and the illiquidity of some large financial institutions triggered the crisis; in these cases, the monetary authorities took steps

to reinforce security mechanisms and provided financial support to restructure the system. In other countries, massive withdrawals of short-term bank deposits at the time of the Mexican crisis caused a severe shortage of liquidity.

Growth in gross domestic product was only 0.3%, compared with 5.2% in 1994, and resulted in a decline of 1.5% in per capital GDP, following an increase of 3.3% in 1994 (see table I-1). This poor performance was due largely to the setbacks suffered by Mexico and Argentina. On the other hand, the regional output of the other countries averaged a little over 4%, just one point less than the rate in 1994, which had been the highest in the last 15 years. During the first half of 1996, growth remained slow; although the economies of Argentina and Mexico stopped contracting, signs of recovery were still modest. Meanwhile, the economies of Brazil and Peru stagnated while Venezuela suffered a downturn due to the implementation of its adjustment plan.

The factors behind the unequal performance of the economies also varied significantly from one group of countries to the next. In Mexico and Argentina, domestic demand, in terms ofgap both consumption and investment, dropped off sharply; only the strong performance of the external sectors of the two countries prevented even more drastic reductions in output. The volume of exports grew strongly (18% for Argentina, 28% for Mexico), while the volume of imports declined (13% and 16%, respectively). In the other countries, this situation was reversed; domestic demand expanded far more strongly than GDP, so that much of the demand was filled by imports. The volume of imports increased by 30% in Brazil and by 15% on average in the other countries, while export volume grew by barely 1% in Brazil and around 7% in the other countries (see table I-2).

Considered individually, the countries exhibited significant differences in 1995. In terms of economic growth, the range was wide, although narrowing. Five countries grew by more than 5%: Chile, Colombia, El Salvador, Guyana and Peru. In 12 other countries, output increased by between 2% and 5%. Apart from Argentina and Mexico, only Uruguay experienced a decline in GDP, while in Jamaica output was virtually stagnant.

Investment declined in Latin America (-5.2%) in a reversal of the upward trend prevailing since the start of the decade. Among the contributing factors were the moderate decline in national and domestic savings and the drastic contraction in external savings. The reduction was not universal, however, but reflected the downward trend in a few large countries, chiefly Argentina and Mexico. The investment rate in 1995 in Latin America as a whole was 21%, a point lower than the year before, and a very low rate both from a historical perspective and by comparison with other regions.

The regional inflation rate once again dropped sharply in 1995, down to 25% from 890% in 1993 and 340% in 1994, due largely to Brazil's stabilization programme, the effects of which more than offset the rise in prices in Mexico resulting from depreciation of the peso. The favourable trend persisted through the first half of 1996; only in Venezuela was there a significant increase in inflation.

In the other countries declining inflation was widespread. In 17 of 22 countries the consumer price index fell or held steady. It rose in only four, including Mexico, where inflation increased significantly, but did not reach the high levels recorded in some earlier years. Venezuela had the highest rate of inflation in the region in 1995 (57%), although the pace slowed in the course of the year; however, in December it began to climb once again and picked up speed in 1996, so that by July the 12-month inflation rate was 112%.

Inflation was minimal –less than 2% for the year– in three countries (Argentina, Barbados and Panama), and four others had single-digit inflation (Chile, Dominican Republic, Guatemala and Trinidad and Tobago). Quite a few countries (Bolivia, Colombia, El Salvador, Jamaica, Nicaragua, Paraguay and Peru) had inflation rates of between 10% and 20%, while another five (Brazil, Costa Rica, Ecuador, Haiti and Honduras) experienced price increases of between 20% and 30%. Uruguay's inflation rate was high (35%), but lower than in 1994, continuing the downward trend of the four preceding years, a trend that persisted into 1996 with a rate of 29% for the 12 months ending June 1996. Brazil, which for many years had suffered

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

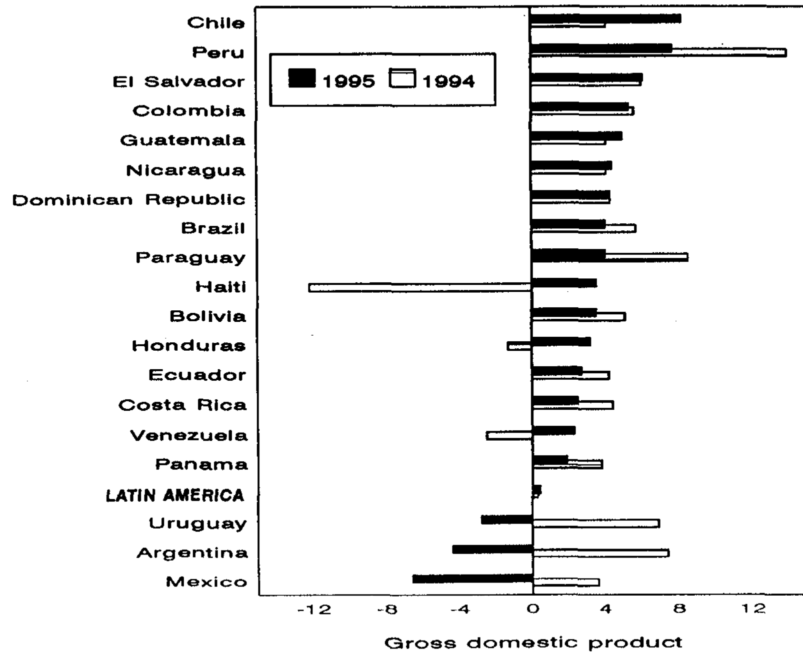
	1980	1990	1991	1992	1993	1994	1995[b]
	Indices (1990=100)						
Gross domestic product	90.9	100.0	103.3	106.0	109.9	115.7	116.0
Per capita gross domestic product	111.6	100.0	101.3	102.1	104.0	107.4	105.9
	Annual rates of variation						
Gross domestic product		-0.3	3.2	2.6	3.6	5.2	0.4
Per capita gross domestic product	-2.2	1.3	0.8	1.8	3.3	-1.4	
Consumer prices[c]	56.0	1 209.7	200.8	420.8	892.7	339.9	25.9
Terms of trade (goods f.o.b.)	10.1	1.4	-1.4	0.6	-1.6	2.9	2.5
	Percentages						
Urban unemployment rate [d]	6.2	5.8	5.8	6.2	6.2	6.3	7.1
	Billions of dollars						
External sector							
Exports (goods)	91.6	136.3	137.1	146.2	157.7	183.0	222.1
Imports (goods)	92.5	105.2	123.9	151.4	166.1	197.3	220.5
Merchandise trade balance	-0.9	31.1	13.2	-5.2	-8.4	-14.3	1.6
Balance on current account	-30.1	-1.8	-16.5	-35.3	-43.9	-49.2	-32.4
Balance on capital and financial account [e]	28.8	-6.8	22.5	49.6	56.9	40.2	26.8
Balance-of-payments position	-1.3	-8.6	6.0	14.3	13.0	-9.0	-5.6
Total disbursed external debt	220.4	443.1	446.5	462.7	501.9	532.5	587.0

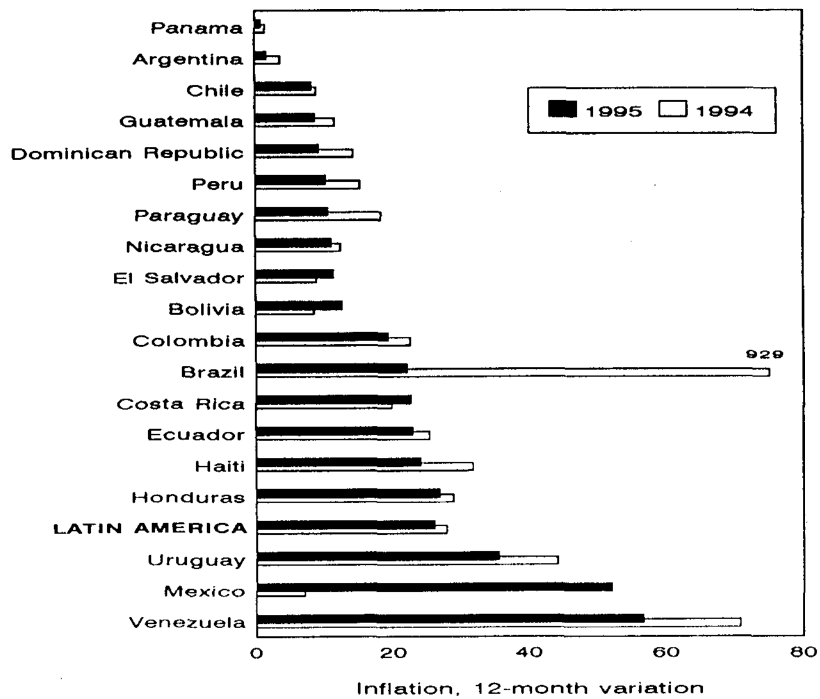
Source: ECLAC, on the basis of official figures.
[a] The figures given for gross domestic product and population correspond to the countries appearing in table V-1 (except Cuba), while those for consumer prices refer to the countries listed in table V-5. The data on the external sector (except for external debt figures) correspond to the countries shown in table VIII-17. The external debt figures correspond to the countries shown in table VIII-13. [b] Preliminary figures. [c] Decembe to December variation. [d] Weighted annual rate for the population of 17 Latin American countries. [e] Includes errors and omissions.

some of the highest inflation in the region, up into the four-digit range, in 1995 recorded a price rise of only 20%, compared with 930% in 1994 and 2,500% in 1993. In 1996 inflation continued to slow; the 12-month rate to June 1996 was 16%.

The employment situation worsened in 1995. Because of a steep rise in unemployment in some countries, the overall regional open unemployment rate weighted by country population rose from 6.3% to 7.1%, a proportional increase not seen since the beginning of the 1980s. In some of the region's largest countries (Argentina, Mexico, Venezuela), poor economic performance translated into a jump in open unemployment. In Costa Rica and Uruguay, low or negative growth also reduced employment, but to a lesser extent. In some countries, notably Argentina and Mexico, the crisis hit labour markets that were already going through a difficult period due to restructuring of the productive system or of the public sector. On the other hand, in countries with higher rates of growth (Brazil, Chile, Guatemala, Nicaragua and Peru), the unemployment rates dropped, although only slightly in most cases, since for the most part the growth was based on productivity increases rather than greater absorption of labour. During the first half of 1996, the regional unemployment rate remained at the same level as in 1995.

Figure I-1
LATIN AMERICA AND THE CARIBBEAN: MAIN MACROECONOMIC INDICATORS, 1994-1995
(Percentages)





Source: ECLAC, on the basis of official figures.

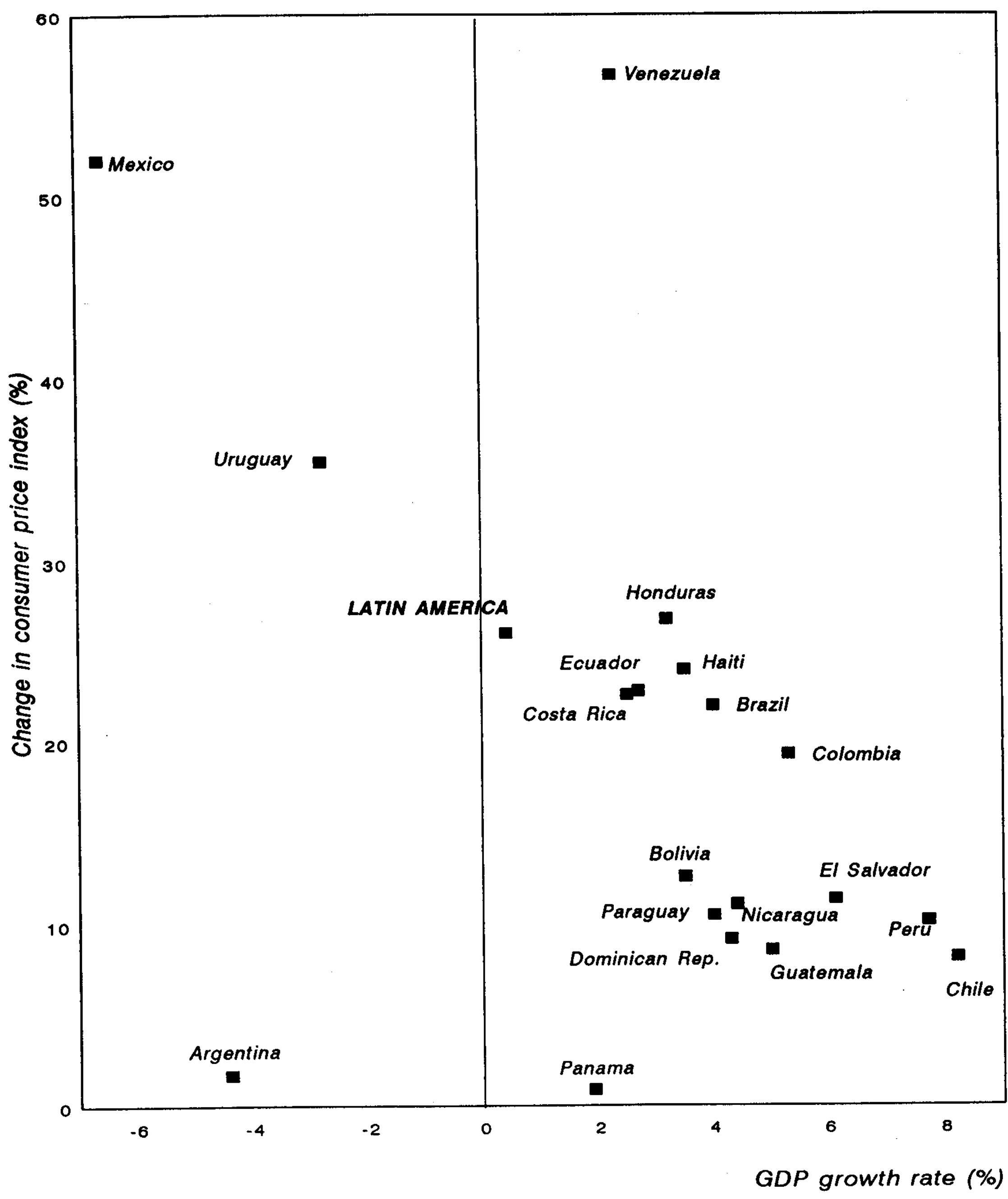
Table I-2

LATIN AMERICA AND THE CARIBBEAN: NATIONAL ACCOUNTS (BASE YEAR 1990)

	Rates of variation		Contribution to variation	
	1994	1995	1994	1995
Gross domestic product				
Region	5.2	0.3	5.2	0.3
Argentina	7.4	-4.4	7.4	-4.4
Brazil	5.7	3.8	5.7	3.8
Mexico	3.6	-6.6	3.6	-6.6
Other countries	4.6	4.8	4.6	4.8
Imports				
Region	12.6	4.6	2.4	0.9
Argentina	19.1	-13.3	2.3	-1.7
Brazil	21.6	31.9	2.0	3.5
Mexico	14.3	-15.8	4.0	-4.9
Other countries	4.8	14.9	1.5	4.7
Aggregate supply and demand				
Region	6.4	1.0	7.6	1.2
Argentina	8.7	-5.4	9.7	-6.1
Brazil	7.1	6.6	7.7	7.3
Mexico	5.9	-8.7	7.6	-11.4
Other countries	4.6	7.2	6.1	9.5
Domestic demand				
Region	6.0	-1.0	6.1	-1.0
Argentina	8.1	-7.4	8.4	-7.7
Brazil	7.1	7.3	7.0	7.2
Mexico	5.0	-16.5	5.3	-17.8
Other countries	3.8	7.2	3.8	7.3
Total consumption plus changes in stocks				
Region	4.7	1.1	3.7	0.9
Argentina	5.4	-5.0	4.5	-4.1
Brazil	5.5	7.9	4.3	6.1
Mexico	4.2	-8.6	3.4	-7.1
Other countries	3.2	5.2	2.5	4.0
Gross domestic investment				
Region	10.8	-8.2	2.4	-1.9
Argentina	18.9	-15.9	3.9	-3.6
Brazil	12.9	4.9	2.7	1.1
Mexico	7.8	-42.1	1.9	-10.7
Other countries	5.7	14.0	1.3	3.3
Gross fixed investment				
Region	10.9	-5.2	2.3	-1.1
Argentina	18.9	-15.9	3.9	-3.6
Brazil	12.9	4.9	2.7	1.1
Mexico	8.1	-29.1	1.7	-6.2
Other countries	5.0	9.7	1.1	2.1
Exports				
Region	8.8	12.5	1.5	2.3
Argentina	16.1	18.3	1.3	1.6
Brazil	6.5	0.9	0.8	0.1
Mexico	10.5	27.6	2.3	6.3
Other countries	7.5	7.1	2.2	2.2

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.

Figure I-2
LATIN AMERICA AND THE CARIBBEAN: OUTPUT AND INFLATION IN 1995



There was also a break in the steady increase in wages that had accompanied a strong rise in productivity in the region as a whole in the early years of the decade. Whereas in 1994 there had been a general increase in real average wages in the formal sector, in 1995 wages rose significantly only in a few countries.

Because the largest economies so heavily influenced regional aggregates, the overall figures for the external sector chiefly reflected the offset of trends in Mexico and Argentina against those in Brazil. As capital flows suddenly dried up, Argentina and Mexico were forced to make a major effort to reduce the large current account deficits they had accumulated since the beginning of the decade; their approach was to cut spending and increase exports. In Brazil, on the other hand, the stabilization plan released a surge in demand that fed a strong increase in imports, resulting in a deterioration in the current account balance that was covered by a heavy net influx of capital.

Intraregional trade continued to be a dynamic element. This was particularly true of MERCOSUR. Despite the external account problems of its two largest economies, transactions between group members accounted for 22% of their total trade, as compared with 19% in 1994.

The regional terms of trade deteriorated slightly, reflecting primarily declines in Brazil and Mexico, even while the ratio improved for most of the other countries, thanks to higher commodity prices. The countries most benefited by higher prices were Chile, Colombia and Peru, and to a lesser extent El Salvador, Honduras and the Dominican Republic. The terms-of-trade deterioration in Brazil and Mexico was due to the fact that both countries are primarily exporters of manufactures, although in Mexico the fall in service prices as a result of depreciation was also a factor.

The value of merchandise exports rose by 21%, the biggest increase since 1980; the region's external sales reached US$ 222 billion in 1995. Some 60% of the increase was attributable to Mexico and Argentina, which were forced to undertake the most drastic recessive adjustments. Apart from those countries, good export performance was largely due to a strong international economy; in most cases the increase in value reflected higher prices for exports.

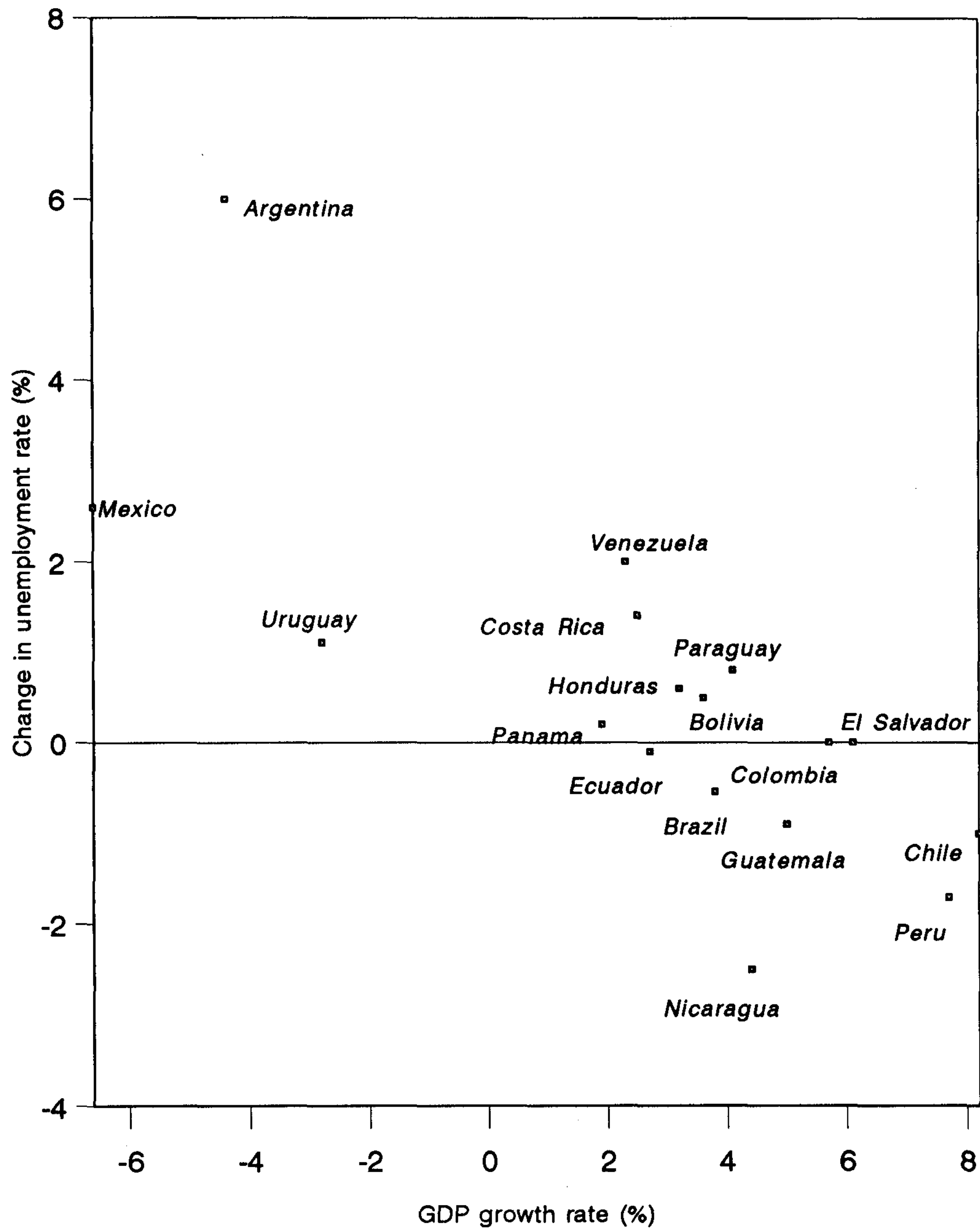
The value of the region's imports rose by 12%, a smaller increase than the previous year's, to a record level of over US$ 220 billion. The percentage increase was much higher (33%) excluding Argentina and Mexico, where crisis resulted in a substantial contraction in imports, although most of that increase was concentrated in just one country, Brazil. The indicator varied widely from country to country because of the multiple factors affecting import volume; unit prices changed very little, the slight rise being largely due to price increases in manufactures.

In addition to the improvement in the merchandise trade balance, there was a marked reduction in the region's deficit in trade in services, reflecting chiefly the improvement in Argentina's and Mexico's service balances resulting from their reduced external purchases. The trade deficit in goods and services narrowed substantially from nearly US$ 26 billion in 1994 to around US$ 9 billion in 1995.

The current account deficit also narrowed significantly in 1995, shrinking to US$ 32 billion after reaching US$ 49 billion in 1994. The same pattern of changes observable in the trade balance in goods and services was repeated in the current account; Mexico's large deficit disappeared, Argentina's declined and Brazil's ballooned. Over half of Venezuela's considerable surplus the previous year melted away.

Net capital flows to the region totalled US$ 26.5 billion in 1995, a much smaller amount than in 1994 and even smaller compared to the figures for 1992 and 1993. This balance resulted from an influx of US$ 21 billion in direct investment and US$ 15 billion in other types of long-term capital, less outflows of short-term capital and portfolio investment of some US$ 10 billion. It should be borne in mind that the region's capital flow figures were heavily influenced by net outflows from Mexico and Venezuela. Excluding those figures, the capital account balance for the remaining countries was US$ 44.5 billion. During the first few months of 1995 there was an exodus of short-term capital from a number of Latin American countries, and

Figure I-3
LATIN AMERICA AND THE CARIBBEAN: GROWTH AND UNEMPLOYMENT, 1995



Source: ECLAC, on the basis of official figures.

private financing virtually dried up. The International Monetary Fund and other multilateral organizations stepped into the breach by providing compensatory financing that enabled Mexico to meet its heavy short-term obligations and, along with Argentina, to regain

access to international financial markets. It should be noted that the compensatory financing is reported, not under the capital account, but under reserves.

The external debt of the Latin American countries totalled some US$ 587 billion, a nominal increase of 10% over 1994. The ratio of external debt to exports of goods and services for the region as a whole again declined, from 250% to 220%, the lowest percentage since 1980, thanks to a vigourous expansion of exports combined with a moderate increase in debt. The ratio of interest payments to exports of goods and services also declined slightly.

In 1995 the majority of the most heavily indebted countries of the region made substantial progress in renegotiating their external debt. Panama signed an agreement to restructure its commercial debt; Peru announced that it had also reached such an agreement; and Nicaragua arranged to buy back its debt to commercial banks at around 7% of face value. In addition, debt-restructuring agreements were signed with Paris Club countries.

II. ECONOMIC POLICY

The internationalization of the effects of the financial crisis that broke out in Mexico at the close of 1994 prompted differing responses by economic policy-makers in the various countries of the region. Specifically, the net volume of external financial inflows and the varying degrees of uncertainty prevailing in the different countries' markets as a consequence of external or domestic factors played an important role in determining which types of policy approaches were adopted.

Broadly speaking, the countries' responses fell into one of two categories. Argentina and Mexico, for their part, were obliged to pursue their economic policies within an environment marked by a sharp reduction in external finance and a steep downturn in domestic demand which hurt both production and fiscal revenues. In contrast, once the crisis' initial impact had dissipated, other countries were able to deflect the financial turbulence it had generated and to continue growing at a satisfactory pace, albeit under altered circumstances in terms of their control over the main macroeconomic variables.

Despite the differences in their economic climates, domestic price stability remained a high priority for all the countries of the region, and only Mexico and Venezuela experienced particularly high rates or steep increases in inflation. Against this backdrop, fiscal equilibrium continued to be a major objective, even though the management of public affairs was clearly hampered by unbudgeted military expenses, in some cases, and, in others, unplanned disbursements to prop up the financial system, along with higher interest payments and dwindling tax receipts as a result of flagging economic activity.

The authorities' persistent stabilization efforts led them to adopt monetary policies that wavered between prudence and outright restrictiveness. Real interest rates were positive, for the most part, and in those cases where real returns climbed significantly, the monetary authorities were once again faced with the dilemma of whether to allow capital inflows to drive down the real exchange rate or to sterilize the monetary impact of such flows at the risk of setting up a vicious circle whereby even greater capital inflows would be attracted to the country.

Exchange policy was modified only in Brazil, Ecuador and, late in the year, Venezuela; all the other countries held to their existing systems, although Mexico, of course, had made an abrupt change at the close of 1994. Trends in the real effective exchange rate varied. Some countries' currencies continued to appreciate as they continued to receive an ample supply of external resources; this helped to dampen inflation, but it also limited their external competitiveness. In others, depreciations (in some cases quite sharp, in others less so) of the local currency were observed due to the use of exchange policy as a means of buoying up the export sector or to various sorts of economic or political events that heightened the level of uncertainty among the relevant economic agents.

The countries' financial systems showed signs of weakness, and the relevant monetary authorities were therefore obliged to set up a safety net for these systems and help fund their restructuring efforts, all of which cost their Governments a great deal and hindered the management of monetary policy (see chapter IV).

1. Fiscal policy and public finance

Striking a fiscal balance continued to be a highly important component of the countries' stabilization programmes and, as a result, 14 of the 19 countries for which information is available managed to narrow their public deficits or widen their surpluses. Only five countries saw their deficits grow and, even in these cases, three of the five had deficits amounting to less than one point of GDP.

Five countries' public sectors posted surpluses (Chile, Dominican Republic, Mexico, Panama and Paraguay). Another nine had deficits of around 2% of GDP or less (Argentina, Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Peru and Uruguay). A deficit of more than 4% of GDP was recorded only in Brazil, Haiti, Nicaragua and Venezuela.

Efforts to reduce the fiscal deficit focused primarily on boosting income, although steps were also taken to cut spending. In order to attain the first objective, most of the countries set up mechanisms to improve the workings of the tax system and curb tax evasion. Most of the measures taken to boost receipts focused on indirect taxes, but some countries also resorted to real increases in the prices and rates charged for goods and services furnished by the public sector.

a) Fiscal balances

At the close of 1994, there were three countries –Chile, Colombia and Paraguay– whose fiscal accounts had been fairly well balanced for a number of years, but only Chile was successful in preserving its record in this area in 1995 (so much so, in fact, that it actually increased its surplus further). Colombia's fiscal position made an about-turn, although the resulting public-sector financial deficit did not even amount to one full point of GDP; for its part, Paraguay did manage to maintain its public-sector surplus, but the central government witnessed a deterioration in its accounts, as well as sustaining quasi-fiscal losses as a consequence of the assistance it provided to the banking system.

Three countries which had stepped up their fiscal adjustment efforts the year before turned in weaker performances in 1995. Peru had marked up a surplus of approximately 3% of GDP in 1994 as economic activity proceeded at a brisk pace, but in 1995 expenditure and income more or less evened out on the basis of a somewhat slower –yet still high– growth rate. The large sums spent by Ecuador in response to specific situations which arose (armed border clashes and the energy crisis) added considerably to its public-sector deficit, which thus climbed to nearly 2% of GDP. For its part, Brazil lost a great deal of ground, as its 1994 operating surplus (1% of GDP) gave way to a deficit amounting to 5% of GDP in 1995.

Almost all the countries whose fiscal adjustment programmes suffered setbacks in 1994 managed to improve their public-sector accounts in 1995. Mexico balanced its fiscal accounts with the help of a very strict domestic adjustment plan, but it also paid out large sums in the form of financial assistance to various banking institutions that were experiencing problems in terms of their liquidity positions or financial stability. After seeing its deficit grow over the preceding two years, the Dominican Republic managed to post a surplus in 1995. The harsh adjustment programme launched by Uruguay midway through the first half of the year enabled it to put a stop to the tendency to run up increasingly large deficits which the non-financial public sector had been exhibiting since the year before. Argentina was the exception to the rule, in that the slump in its level of economic activity had a direct effect on tax receipts, thereby adding to the deficit. While it is true that this financial imbalance amounted to a scant one-half point of GDP, it should be noted that towards the end of the year the gap was beginning to widen.

No substantive change was seen in the position of high-deficit countries whose shortfalls were covered with concessionary funding (Bolivia, El Salvador, Guatemala, Honduras and Nicaragua, among others).

Table II-1
LATIN AMERICA AND THE CARIBBEAN: DEFICIT(-) OR SURPLUS OF THE NON-FINANCIAL PUBLIC SECTOR AT CURRENT PRICES [a]
(Percentages of GDP)

Country	1980	1987	1988	1989	1990	1991	1992	1993	1994	1995[b]
Argentina	-4.8	-4.6	-6.2	-3.2	-3.8	-1.6	-0.1	1.4	-0.1	-0.5
Bolivia	-5.4	-6.8	-5.8	-4.8	-3.9	-2.6	-2.8	-6.5	-3.3	-1.9
Brazil	-2.0	-7.0	-7.4	-6.6	1.5	-0.2	-1.8	-0.8	1.1	-5.1
Chile [c]	6.5	1.9	1.0	1.4	0.8	1.5	2.2	1.9	1.7	2.6
Colombia	-2.6	-1.9	-2.2	-1.9	-0.5	0	-0.1	0.3	2.6	-0.3
Costa Rica	...	-0.2	0.1	-2.5	-2.5	-0.1	0.7	0.6	-6.6	-1.9
Ecuador	-7.4	-9.6	-5.3	-1.4	0.1	-1.0	-1.7	-0.4	-0.2	-1.9
El Salvador	...	...	...	-5.8	-2.8	-4.9	-6.5	-3.6	-2.0	-0.9
Guatemala [c]	-4.7	-2.4	-2.4	-3.8	-2.3	-0.1	-0.5	-1.5	-1.5	-0.5
Haiti [c]	...	...	...	...	-1.3	-0.5	-2.8	-3.8	-4.3	-4.5
Honduras [c]	-8.7	-8.1	-6.9	-7.4	-6.4	-3.3	-4.9	-9.3	-5.2	-2.9
Mexico	...	-15.5	-12.5	-5.6	-3.9	-0.4	1.6	0.7	-0.1	0.1
Nicaragua	...	...	...	...	-17.2	-7.9	-8.3	-8.6	-12.1	-9.7
Panama [c]	-9.3	-4.5	-5.3	-7.0	-0.7	-2.7	-1.4	-0.4	-0.8	0.8
Paraguay	...	...	...	...	5.2	2.9	0.1	1.2	2.4	2.8
Peru	...	...	...	...	...	-0.9	-1.5	-1.2	3.1	-0.1
Dominican Republic [c]	-2.8	-2.2	-1.6	-0.1	0.3	2.8	2.9	-0.4	-1.2	0.5
Uruguay	...	...	-2.5	-3.4	0.3	1.3	1.5	-0.8	-2.5	-1.5
Venezuela	...	-4.4	-8.5	-1.2	0.1	-2.2	-5.9	-1.3	-13.8	-5.9

Source: ECLAC, on the basis of official figures.
[a] Calculated on the basis of figures in the local currency at current prices. [b] Preliminary estimates. [c] Refers to the central government.

Nonetheless, in every case their deficits diminished, and much the same thing occurred in the three countries that had found themselves in serious fiscal difficulties in 1994 (Costa Rica, Haiti and Venezuela). All three managed to narrow their financial gap, although, even so, their deficits were still quite sizeable.

b) **Fiscal income**

i) ***Tax receipts***

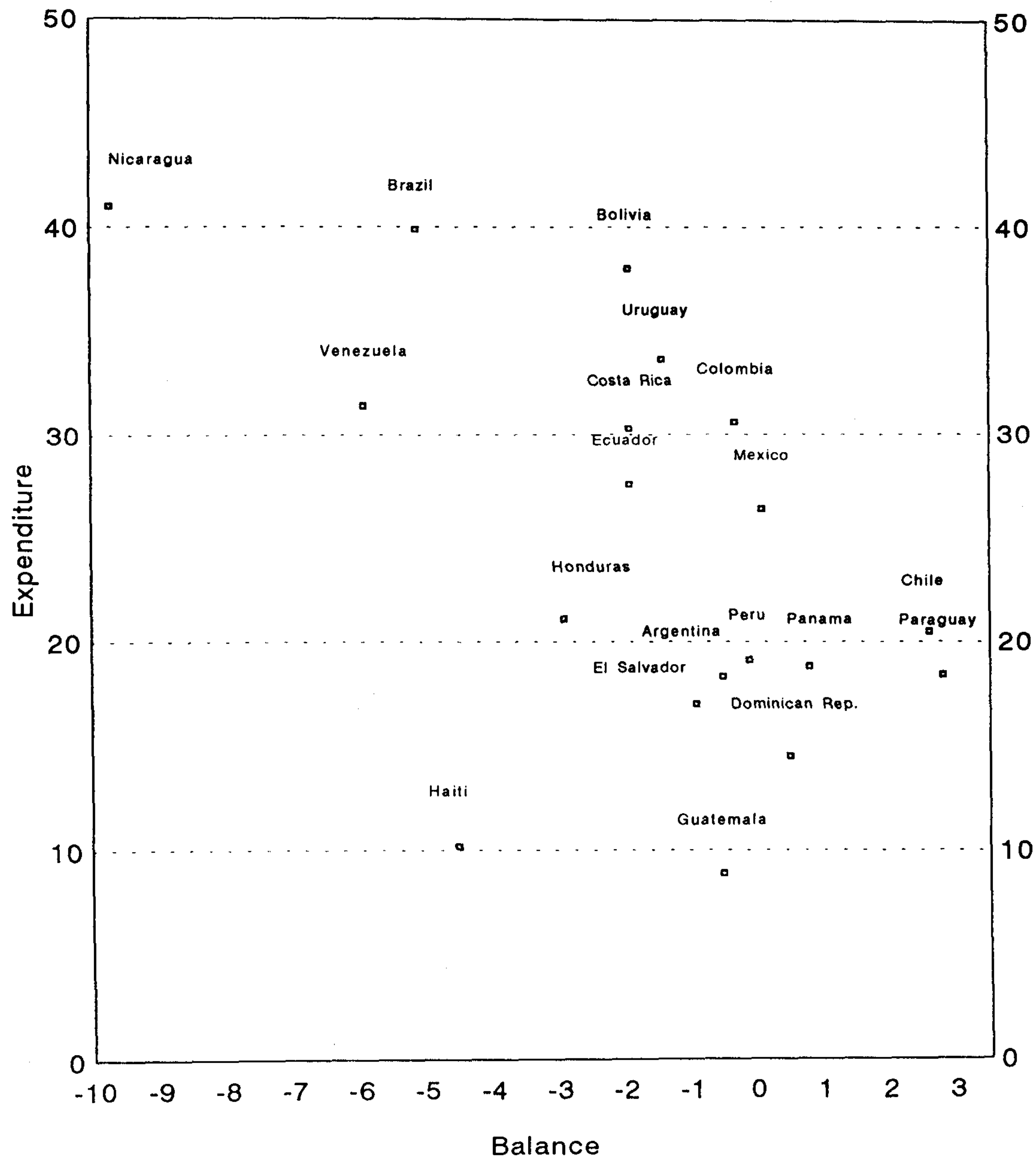
In the great majority of the countries (15 out of the 19 for which information is available), the non-financial public sector's current revenues rose in real terms, which indicates that their strategies for reducing the fiscal deficit were largely based on efforts to increase their income.

The tax burden –defined as the ratio between tax revenues and the gross domestic product– was in the 15%-20% range in more than half the countries of the region. The tax burden was under 10% of GDP in only three countries (Haiti, Guatemala and Venezuela).

Procedural improvements in the administration of the tax system were one of the main reasons for the increase in revenues in a number of countries, particularly Bolivia, Costa Rica, Haiti, Guatemala, Paraguay and Peru. Some countries (Argentina, Bolivia, Costa Rica, Ecuador, El Salvador and Honduras) added to the tax load by introducing new taxes and raising existing ones. In these cases, policy-makers focused their efforts on raising the rates of indirect taxes on domestic transactions, such as the value added tax and excise taxes. Costa Rica also temporarily increased its customs duties. Despite advances in the management of the tax system, however, tax evasion and avoidance are still rampant in virtually the entire region.

Pronounced slumps in economic activity drove down real revenues in Argentina, Mexico and Uruguay. Escalating inflation also eroded real receipts in Mexico due to the effect of collection lags. In Brazil, on the other hand, lower inflation helped to boost real income for the second year running.

Figure II-1
LATIN AMERICA AND THE CARIBBEAN: BALANCE AND EXPENDITURES OF THE NON-FINANCIAL PUBLIC SECTOR, 1995
(Coefficients expressed as percentages of GDP)



Source: ECLAC, on the basis of official figures.
Note: Data on the deficits and expenditures of Chile, Dominican Republic, Guatemala, Haiti, Honduras and Panama refer to the central government.

Table II-2
LATIN AMERICA AND THE CARIBBEAN: INCOME OF THE NON-FINANCIAL PUBLIC SECTOR

Country	Category	Percentage of GDP							Percentage variation[a]	
		1980	1990	1991	1992	1993	1994	1995 [b]	1994	1995
Argentina	Current income	16.1	13.2	15.0	17.4	19.9	17.9	17.4	-3.4	-7.1
	Tax revenue	15.0	12.4	14.2	16.6	17.4	17.0	16.5	4.9	-7.2
	Capital income	0.4	0.2	1.2	1.4	0.3	0.3	0.5	7.4	59.3
	Total income	16.5	13.5	16.3	18.8	20.2	18.2	17.9	-3.2	-6.0
Bolivia	Current income	33.1	25.7	26.2	26.1	31.5	33.7	34.2	12.4	5.1
	Tax revenue	5.0	6.2	6.9	8.6	11.0	11.3	12.4	7.8	14.3
	Capital income	0.4	0.2	1.5	2.3	1.6	2.7	1.9	71.1	-26.7
	Total income	33.5	25.9	27.7	28.4	33.2	36.4	36.1	15.3	2.7
Brazil	Gen. govt. income	20.6	30.2	26.2	25.4	27.0	29.0	31.2	13.7	11.8
	Operating income	3.8	1.5	4.1	3.8	2.5	3.2	2.4	35.2	-20.1
	Total income	24.4	31.7	30.3	29.2	29.4	32.2	33.7	15.5	8.6
Chile [c]	Current income	32.8	20.5	22.3	22.4	22.6	21.9	22.3	0.9	10.1
	Tax revenue	18.7	14.5	16.7	16.9	17.6	17.1	17.1	1.2	8.2
	Capital income	1.6	1.2	1.1	1.0	0.8	0.8	0.8	4.1	8.2
	Total income	34.5	21.7	23.4	23.4	23.4	22.7	23.1	1.0	10.1
Colombia	Current income	19.7	23.6	25.1	25.7	27.2	29.3	28.9	14.5	4.3
	Tax revenue	13.5	14.9	16.2	16.9	19.1	19.4	19.6	7.9	6.8
	Capital income	0.7	0.1	0.0	0.2	1.7	3.6	1.4	125.1	-58.9
	Total income	20.4	23.7	25.1	26.0	28.8	32.9	30.3	21.4	-2.6
Costa Rica	Current income	...	26.1	27.6	28.2	28.2	26.0	28.3	-3.8	11.6
	Capital income	...	0.0	0.1	0.1	0.1	0.0	0.1		
	Total income	...	26.1	27.7	28.3	28.3	26.0	28.4	-4.0	12.0
Ecuador	Current income	27.0	27.1	25.4	25.8	26.6	24.4	25.7	-3.7	8.1
	Oil revenue	7.3	11.6	8.8	9.6	8.7	7.2	7.6	-12.9	8.4
	Non-oil revenue	19.7	15.5	16.6	16.2	17.9	17.2	18.1	0.7	8.0
El Salvador	Current income	...	12.5	13.0	13.6	13.7	15.2	16.1	17.2	12.5
	Tax revenue	...	9.1	9.5	9.6	10.3	10.8	11.8	11.4	15.4
Guatemala [c]	Current income	9.5	7.9	9.0	10.1	9.0	7.6	8.4	-11.8	15.5
	Tax revenue	8.6	6.8	7.3	8.2	7.8	6.7	7.6	-10.6	19.1
Haiti [c]	Current income	...	7.7	7.8	5.8	5.7	3.4	5.7	-42.8	74.1
	Tax revenue	...	7.3	7.6	5.5	5.5	3.4	4.0	-41.7	24.0
Honduras [c]	Current income	16.5	16.4	17.4	17.4	16.8	16.8	18.1	-1.1	11.1
	Tax revenue	15.2	14.8	15.5	16.0	15.7	15.6	16.3	-1.7	7.5
	Capital income	0.0	0.0	0.0	0.6	0.6	0.4	0.1	-32.3	-76.4
	Total income	16.5	16.4	17.4	18.0	17.4	17.3	18.1	-2.3	8.3
Mexico [c]	Current income	16.5	17.1	17.0	17.7	17.3	17.3	17.7	3.6	-4.4
	Current income excluding PEMEX earnings	...	13.3	13.4	14.3	14.2	14.8	13.1	8.0	-17.3
	PEMEX earnings	...	3.8	3.6	3.4	3.1	2.5	4.6	-16.8	72.6
	Capital income	...	...	3.7	3.2	0.4	0.0	0.0		
	Total income	16.5	17.1	20.7	20.9	17.7	17.3	17.7	1.3	-4.4
Nicaragua	Current income	...	...	24.3	27.7	28.4	28.7	30.8	5.2	12.0
	Capital income	...	...	0.2	0.2	0.5	0.3	0.5	-37.5	74.0
	Total income	...	19.3	24.5	27.9	29.0	29.0	31.3	4.1	12.7
Panama [c]	Current income	19.1	18.5	19.6	21.0	20.1	19.7	19.6	1.6	1.7
	Tax revenue	13.9	12.5	13.3	13.8	13.1	13.1	13.2	3.9	2.5
Paraguay	Current income	...	16.1	16.0	16.2	16.4	18.2	21.1	14.7	20.2
	Capital income	...	0.5	0.2	0.3	0.1	0.3	0.1	120.5	-68.8
	Total income	...	16.6	16.2	16.4	16.5	18.5	21.1	15.6	18.8

Table II-2 (concl.)

Country	Category	Percentage of GDP							Percentage variation[a]	
		1980	1990	1991	1992	1993	1994	1995[b]	1994	1995
Peru[c]	Current income	17.0	7.8	9.2	11.0	10.8	13.0	13.8	37.1	14.3
	Tax revenue	15.8	7.5	8.6	9.5	9.3	11.1	11.6	35.9	12.6
	Capital income	0.0	...	0.1	0.2	0.4	4.7	1.6	1 238.1	-63.3
	Total income	17.0	7.8	9.3	11.2	11.2	17.7	15.3	80.0	-6.9
Dominican Republic[c]	Current income	13.5	10.3	13.1	15.4	16.1	15.0	15.0	-2.9	4.7
	Tax revenue	10.8	9.8	11.4	13.9	15.0	14.0	13.9	-2.3	3.9
Uruguay	Current income	...	28.9	31.1	31.8	31.7	31.9	32.1	7.5	-2.2
	Tax revenue	...	17.8	18.3	19.2	19.5	20.4	20.4	11.8	-2.8
	Total income	...	28.9	31.1	31.8	31.7	32.0	32.2	7.9	-2.2
Venezuela	Current income	...	32.7	29.4	24.0	25.6	27.3	25.2	3.8	-5.5
	PDVSA earnings	...	25.8	21.2	15.8	15.4	15.8	14.0	0.4	-9.5
	Non-oil revenue	...	6.9	8.2	8.3	10.2	11.4	11.2	9.0	0.0
	Capital income	...	0.2	1.7	0.2	0.2	0.6	0.3	203.4	-47.0
	Total income	...	32.9	31.1	24.3	25.8	27.8	25.5	5.2	-6.3

Source: ECLAC, on the basis of official figures.
Key: PEMEX = Petróleos de México, PDVSA = Petróleos de Venezuela.
[a] Calculated on the basis of figures in the local currency at current prices. [b] Preliminary figures. [c] Refers to the central government.

ii) ***Other public-sector income***

Increases in the prices and rates charged by State enterprises were used as an expedient for achieving rapid gains in government income in some cases. State-run firms' net contributions to the public sector's financial balance sheet were significant in Colombia, Haiti, Paraguay and Uruguay. A decrease in the number of government-owned companies in Bolivia as a consequence of that country's privatization programme reduced the financial input obtained from such enterprises.

High copper prices on the international market represented a major source of non-tax income for Chile; as in earlier years, a large portion of these increased profits were paid into a reserve fund. Panama's earnings from the operation of the Canal also continued to make an important contribution to its public finances. Oil revenues were down in Ecuador and Venezuela, but Mexico's decision to raise the fees charged for drilling rights averted a major downturn in the funds received by the federal government.

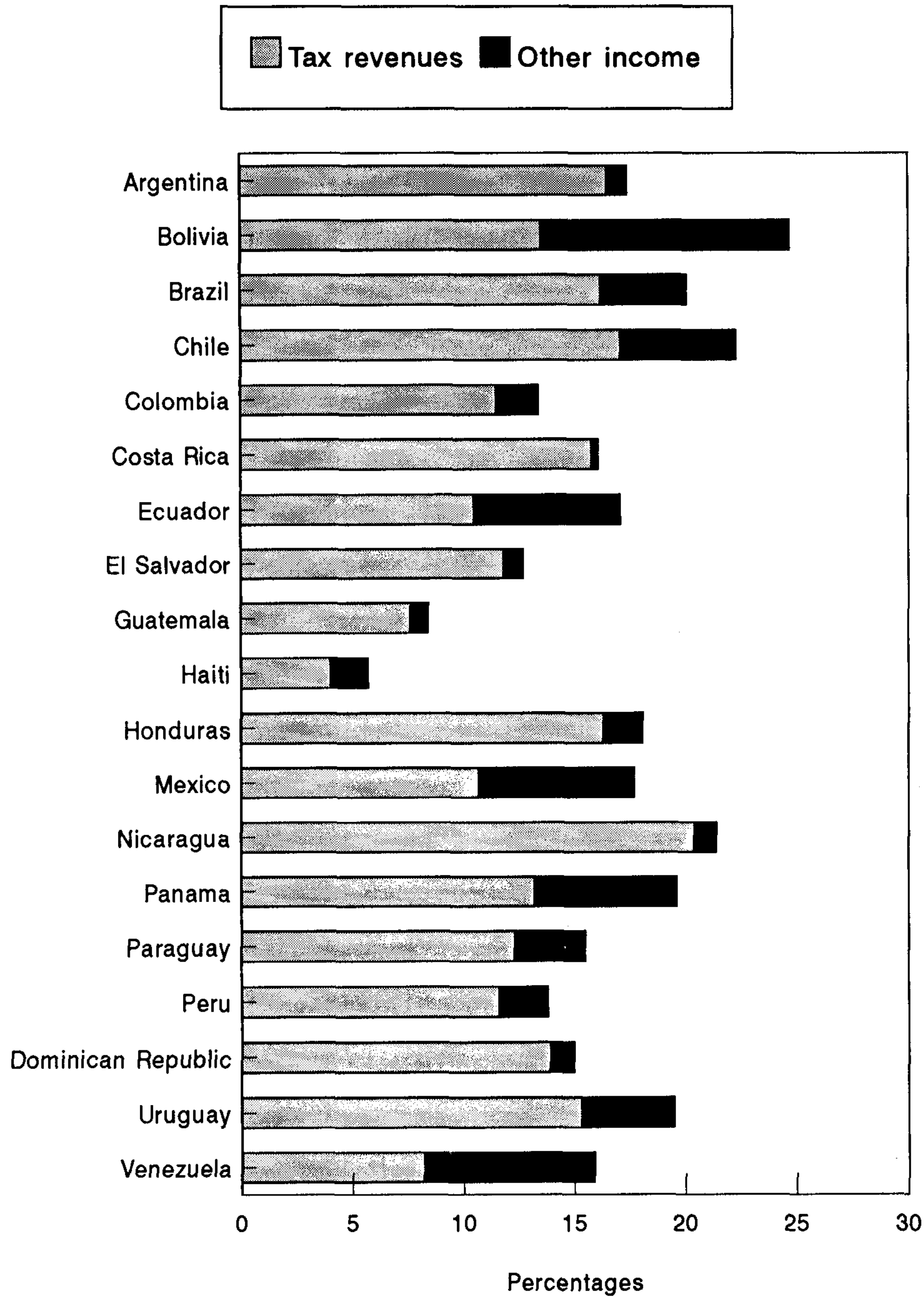
Income from the sale of government assets was lower than in the past, although it still amounted to nearly half a point of GDP in Argentina and to 1.6% of GDP in Peru.

c) **Public expenditure**

The management of government expenditure varied from country to country, in line with the differences in their fiscal and macroeconomic situations. Nine countries chose to cut total spending in order to strike a better financial balance. In Bolivia, Costa Rica and Honduras, reductions in expenditure were coupled with upswings in income; the Dominican Republic, Panama, Uruguay and Venezuela based their adjustments on a decrease in expenditure, while Argentina and Mexico geared their spending patterns to their lower levels of income. On the other hand, five countries (Brazil, Colombia, Ecuador, Paraguay and Peru) increased expenditure, thereby adding to their fiscal shortfalls. In Chile, El Salvador, Guatemala, Haiti and Paraguay, expenditure also rose, but less sharply than income, and these countries' fiscal positions therefore improved.

Eight of the nine countries that reduced total expenditure did so by holding down current

Figure II-2
LATIN AMERICA AND THE CARIBBEAN: CURRENT INCOME OF CENTRAL GOVERNMENT, 1995
(As a percentage of GDP)



Source: ECLAC, on the basis of official figures.

Table II-3

LATIN AMERICA AND THE CARIBBEAN: EXPENDITURE OF THE NON-FINANCIAL PUBLIC SECTOR

Country	Category	Percentage of GDP[a]							Percentage variation[b]	
		1980	1990	1991	1992	1993	1994	1995	1994	1995[c]
Argentina	Total expenditure	21.3	17.3	17.9	18.9	18.8	18.3	18.3	4.6	-4.4
	Current expenditure	15.2	15.4	16.2	16.8	17.3	16.9	17.2	4.9	-2.7
	Capital expenditure	5.0	1.9	1.7	2.1	1.5	1.4	1.1	0.3	-24.9
Bolivia	Total expenditure	38.9	29.8	30.3	31.2	39.7	39.7	38.0	5.1	-0.7
	Current expenditure	31.1	22.3	22.4	22.5	29.9	29.8	28.9	4.9	0.4
	Capital expenditure	7.8	7.5	7.9	8.7	9.8	9.8	9.1	5.7	-3.9
Brazil	Total expenditure	26.2	36.6	34.6	34.3	36.4	32.4	39.9	-6.0	27.9
	Current expenditure	17.2	29.5	27.9	28.0	30.0	28.1	34.3	-1.0	26.7
	Capital expenditure	9.0	7.1	6.7	6.4	6.4	4.3	5.6	-29.2	35.1
Chile [d]	Total expenditure	28.0	21.0	21.8	21.2	21.5	21.1	20.5	2.2	5.3
	Current expenditure	23.4	18.1	18.6	17.5	17.7	17.2	16.9	0.9	6.2
	Capital expenditure	4.6	2.9	3.2	3.7	3.7	3.9	3.6	8.6	1.2
Colombia	Total expenditure	23.0	24.3	25.1	26.2	28.5	30.3	30.6	13.0	6.8
	Current expenditure	15.9	16.8	18.2	18.7	18.8	20.7	22.4	17.0	14.4
	Capital expenditure	7.1	7.5	6.9	7.4	9.9	9.6	8.2	3.1	-9.7
Costa Rica	Total expenditure	...	28.6	27.8	27.6	27.6	32.6	30.3	23.1	-4.7
	Current expenditure	...	23.9	23.7	22.3	22.2	26.6	25.6	24.9	-1.4
	Capital expenditure	...	4.8	4.1	5.4	5.4	6.0	4.7	16.1	-19.2
Ecuador	Total expenditure	34.4	27.0	26.4	27.5	26.9	24.6	27.6	-4.3	15.2
	Current expenditure	20.3	19.5	18.5	19.6	19.4	17.3	21.0	-6.4	24.6
	Capital expenditure	14.1	7.5	7.9	7.9	7.6	6.5	6.4	-9.9	1.1
El Salvador	Total expenditure	...	15.3	17.9	20.1	17.5	17.5	17.0	5.7	3.6
	Current expenditure	...	12.8	13.8	13.4	13.0	13.2	12.9	8.0	3.7
	Capital expenditure	...	2.5	4.1	6.7	4.6	4.3	4.1	-1.0	3.1
Guatemala [d]	Total expenditure	14.2	10.2	9.1	10.7	10.6	9.2	8.9	-9.5	2.0
	Current expenditure	8.6	8.5	7.6	7.8	7.5	6.9	6.4	-4.6	-1.8
	Capital expenditure	5.6	1.7	1.5	2.9	3.1	2.3	2.5	-21.7	13.3
Haiti [d]	Total expenditure	...	9.1	8.3	8.6	9.6	7.8	10.2	-22.4	37.5
	Current expenditure	...	8.8	8.2	8.4	9.3	7.5	9.6	-23.0	34.5
	Capital expenditure	...	0.3	0.2	0.2	0.3	0.3	0.6	-4.4	109.6
Honduras [d]	Total expenditure	25.2	22.8	20.7	22.9	26.7	22.4	21.1	-17.2	-2.9
	Current expenditure	16.0	17.2	16.5	16.6	17.8	15.4	14.8	-14.6	-0.5
	Capital expenditure	9.3	5.6	4.3	6.3	8.9	7.0	6.2	-22.3	-8.3
Mexico [d]	Total expenditure	19.7	20.0	17.3	16.1	16.9	17.7	18.2	8.5	-4.3
	Current expenditure	14.7	17.3	15.0	13.7	15.0	15.3	16.2	5.9	-1.1
	Capital expenditure	5.0	2.7	2.3	2.4	2.0	2.4	2.0	27.7	-23.8
Nicaragua	Total expenditure	...	36.5	32.4	36.2	37.6	41.1	41.0	13.8	4.2
	Current expenditure	...	34.4	26.8	26.3	25.3	26.1	24.6	7.3	-1.4
	Capital expenditure	...	2.1	5.5	9.9	12.4	15.0	16.4	26.1	13.9
Panama [d]	Total expenditure	28.4	19.1	22.3	22.4	20.5	20.4	18.8	3.4	-6.1
	Current expenditure	21.1	18.7	16.9	19.7	17.9	17.9	16.2	3.7	-7.3
	Interest	5.1	3.3	2.6	4.4	3.0	3.7	3.0	28.8	-8.6
	Capital expenditure	7.4	0.5	5.4	2.7	2.6	2.6	2.6	1.5	1.7
Paraguay	Total expenditure	...	11.4	13.3	16.3	15.3	16.1	18.4	8.2	18.8
	Current expenditure	...	8.4	10.1	12.7	12.2	12.6	13.0	6.0	7.5
	Capital expenditure	...	3.0	3.2	3.6	3.1	3.5	5.3	16.7	59.6
Peru [d]	Total expenditure	19.4	10.3	10.7	12.6	12.7	14.8	15.9	32.1	16.0
	Current expenditure	15.0	9.1	9.2	10.0	9.8	11.1	12.3	29.2	18.8
	Capital expenditure	4.4	1.2	1.5	2.6	2.9	3.7	3.6	41.9	7.4

Table II-3 (concl.)

Country	Category	Percentage of GDP[a]							Percentage variation[b]	
		1980	1990	1991	1992	1993	1994	1995	1994	1995[c]
Dominican Republic[d]	Total expenditure	16.3	10.1	10.4	12.5	16.5	16.1	14.5	2.1	-6.2
	Current expenditure	11.3	5.4	5.3	6.0	8.3	7.6	7.9	-3.7	8.4
	Capital expenditure	5.0	4.6	5.1	6.5	8.2	8.5	6.6	7.9	-19.2
Uruguay	Total expenditure	...	28.6	29.9	30.3	32.5	34.5	33.6	13.4	-5.3
	Current expenditure	...	24.5	25.8	26.3	27.6	28.5	29.1	10.4	-0.7
	Capital expenditure	...	4.1	4.1	3.9	4.8	5.9	4.5	31.4	-25.8
Venezuela	Total expenditure	...	32.8	33.3	30.2	27.1	41.7	31.4	49.7	-22.9
	Current expenditure	...	20.4	19.4	18.1	17.2	19.4	18.7	10.2	-1.5
	Capital expenditure	...	11.7	12.8	11.6	9.7	9.5	11.2	-4.8	20.8

Source: ECLAC, on the basis of official figures.
[a] Calculated on the basis of figures in the local currency at current prices. [b] Calculated on the basis of figures in constant 1980 dollars. [c] Preliminary figures. [d] Refers to the central government.

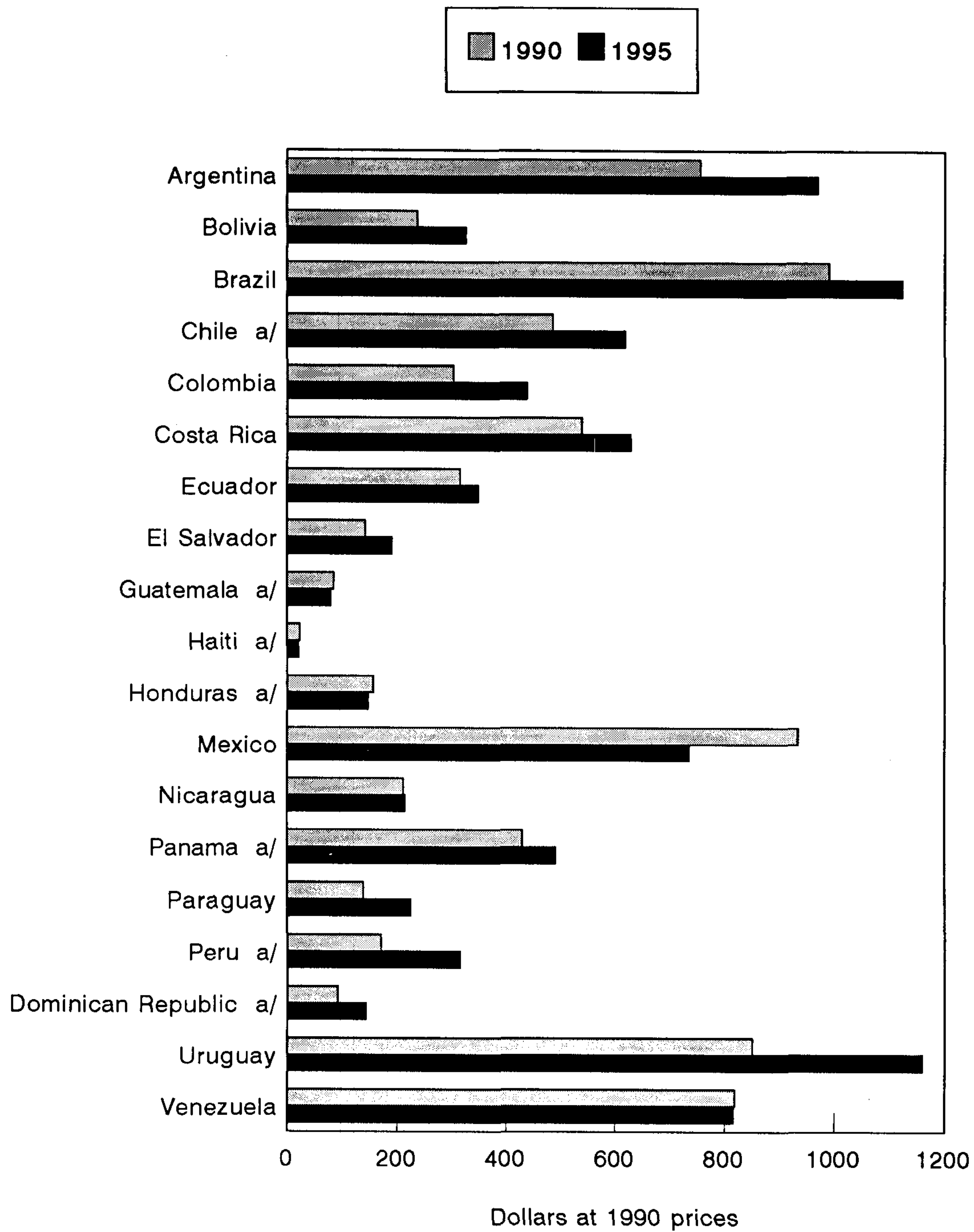
outlays. Argentina, Costa Rica, Honduras, Mexico and Uruguay also decreased investment, whereas Panama and Venezuela made their adjustments at the expense of current disbursements, since their capital expenditure actually increased. In contrast, the improvement in the Dominican Republic's fiscal balance sheet was achieved entirely through cuts in public investment.

These nine countries' fiscal policy environments varied in terms of the constraints they imposed. In Uruguay, an adjustment was unavoidable, since the downswing in economic activity and high inflation eroded income, thus making it essential to curb public spending. Fiscal policy had to be implemented under very difficult conditions in Venezuela –after the Government's bailout of distressed banks in 1994 had caused expenditure to swell by nearly 13% of GDP– as well as in Costa Rica, where the Government's adjustment programme only managed to bring down the fiscal deficit from 7% of GDP in 1994 to 4.4% in 1995. The recessions affecting Argentina and Mexico had a direct impact on their levels of real income, which declined. Both of these countries pared down their spending levels, but chose different methods of doing so, with Argentina cutting back on capital expenditure while Mexico made the bulk of its reductions in current expenditure.

Unlike the above-mentioned countries, Brazil, Colombia, Ecuador, Peru, Haiti and Paraguay adopted expansionary fiscal policies. In the first four of these cases the upturn in spending had an adverse effect on the public sector's balance sheet; in the last two, the increases in expenditure were more than offset by gains in income.

Fiscal policy-makers adopted a frankly expansionary approach in Brazil, with spending climbing by over 7% of GDP. This was primarily attributable to a substantial increase in current outlays (particularly under the headings of consumption expenditure and interest payments), although capital expenditure also rose. The higher level of transfers in Colombia played an important part in the fact that, far from repeating its performance of the year before, when it had posted a surplus, the non-financial public sector actually ran up a small deficit in 1995. In Ecuador, the expenses associated with the country's armed conflict with Peru, the fuel subsidies provided in order to alleviate the energy crisis and interest payments were the main causes of the increase in expenditure. Current spending also mounted in Peru. Total expenditure was up in Chile, El Salvador and Guatemala as well, but in these cases, the increase was moderate in size, since it was substantially less than GDP growth.

Figure II-3
LATIN AMERICA AND THE CARIBBEAN: PUBLIC-SECTOR EXPENDITURE PER CAPITA, 1995



Source: ECLAC, on the basis of official figures.
a/ Refers to central government expenditure.

2. Foreign exchange policy

In 1995, foreign exchange policy played a pivotal role in the economic strategy employed by policy-makers in four of the region's largest countries. The currency crisis in Mexico at the close of 1994, the turnaround in Brazil's trade balance, the steep drop in the real exchange rate in Venezuela and the adverse implications which the alteration of the system of convertibility in Argentina was likely to have for its stabilization process leant added importance to the ongoing debate regarding the role of the exchange rate in price stabilization or in strengthening external competitiveness. In some cases, priority was given to its function as an anchor for domestic prices and, in others, to its ability to enhance external competitiveness.

This debate was not of such crucial importance in the other countries of the region, although it did command a great deal of interest in countries that were receiving a large volume of external (and chiefly short-term) resources, in view of such inflows, repercussions on the real exchange rate.

The practice of placing restrictions on the entry of short-term capital in an effort to reduce the volatility of such inflows was confined to those countries which had employed this instrument the year before (i.e., Brazil, Chile and Colombia). For the region as a whole, the composition of external capital inflows has changed since the early 1990s in that the proportion of private short-term capital has been declining while that of long-term capital has been growing. Direct investment has continued to be an important source of funds.

An analysis of trends in the real effective exchange rate (calculated on the basis of a basket made up of the currencies of major trading partners) indicates that the currencies of 9 out of the 18 countries for which information is available appreciated during 1995. The annual average real exchange rate fell considerably in Brazil, as the country moved to consolidate its new stabilization programme, and in Venezuela, where the decrease was due to the adoption of a fixed exchange rate against the dollar which was then abandoned as the year drew to a close. Haiti's currency also rose in value, since political and economic conditions in the country were less turbulent than in years past. A slight appreciation was also registered in the currencies of Chile, Costa Rica, the Dominican Republic, El Salvador, Guatemala and Honduras.

In contrast, even though Argentina and Mexico used very different strategies, both countries' currencies depreciated in real terms against a basket of currencies representing their main trading partners. The currencies of Bolivia, Nicaragua, Peru, Paraguay and Uruguay also lost ground, although in the cases of Paraguay and Uruguay, as well as Argentina, the decline was largely due to the appreciation of the Brazilian real (Brazil is the most important trading partner of all three). The 1995 averages for Colombia's and Ecuador's real effective exchange rates were much the same as the year before, but the value of their currencies gradually weakened as the year progressed.

The two countries which changed their foreign exchange regimes during 1995 –Brazil and Ecuador– both chose to use a system of currency bands, as did Venezuela midway through 1996. Hence, by mid-1996, seven countries (Haiti, Mexico, Guatemala, Honduras, Paraguay, Peru and the Dominican Republic) were allowing their currencies to float, although in most cases the Central Bank was also exerting some control over the exchange rate. Another six (Brazil, Chile, Ecuador, Colombia, Uruguay and Venezuela) were using exchange rate bands that could be switched over to a managed parity system if the exchange rate neared the floor or ceiling of the band. Three countries (Bolivia, Costa Rica and Nicaragua) were using crawling pegs, while El Salvador joined the very small group of countries (Argentina and Panama) which were maintaining a fixed parity against the dollar.

a) Countries registering a real appreciation

In many cases, the exchange rate continued to be used as a tool for achieving the priority

Table II-4

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

(Based on consumer price indexes)

	1980	1985	1990	1991	1992	1993	1994	1995[b]
Argentina	58.7	94.7	100.0	83.3	77.5	74.0	78.4	87.0
Bolivia	72.8	50.4	100.0	108.3	116.3	117.6	125.1	126.6
Brazil	141.7	149.9	100.0	118.5	127.7	117.1	92.9	70.6
Chile	50.5	71.2	100.0	98.9	95.3	96.6	96.5	92.4
Colombia	52.2	59.6	100.0	101.0	90.0	87.0	74.8	74.9
Costa Rica	64.7	89.9	100.0	108.3	103.0	100.7	101.0	98.6
Ecuador	48.4	62.3	100.0	95.2	94.7	84.0	78.2	78.8
El Salvador	139.0	75.8	100.0	98.4	98.2	87.4	83.9	81.9
Guatemala	57.0	47.2	100.0	87.9	87.0	88.2	85.1	82.6
Haiti [c]	82.4	64.6	100.0	94.0	95.2	112.0	91.5	80.5
Honduras	66.4	53.4	100.0	107.9	102.2	112.6	125.3	112.3
Mexico [d]	76.2	95.2	100.0	91.1	84.1	79.8	81.9	121.1
Nicaragua	243.4	70.1	100.0	104.6	104.9	108.3	113.3	118.9
Paraguay [e]	50.4	80.8	100.0	86.9	90.6	92.2	97.4	106.8
Peru	220.2	232.6	100.0	82.1	80.9	83.3	84.6	85.6
Dominican Republic	86.0	112.4	100.0	100.6	101.3	96.8	95.4	93.5
Uruguay	59.5	77.9	100.0	88.1	84.1	74.2	76.6	79.4
Venezuela	45.9	52.2	100.0	93.9	88.5	88.9	92.5	70.6

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

[a] Corresponds to the average of the indexes of the (main official) real exchange rates between each country's currency and the currencies of its main trading partners, weighted by the share of that country's total exports represented by exports to each of the trading partners. The weightings are averages for the period 1989-1992. For further information on the methodology and sources used, see ECLAC, *Economic Survey of Latin America, 1981* (E/CEPAL/G.1248), Santiago, Chile, 1983. United Nations publication, Sales No. E.83.II.G.2. [b] Preliminary figures. [c] From 1987 on, the commercial exchange rate was used. [d] The exchange rates used were the following: To July 1982, the mean of the average buying and selling rates as reported to the Bank of Mexico by major commercial banks; August to November 1982, the preferential rate for essential imports; after November 1982, the mean of the buying and selling rates on the regulated market. [e] The unregulated or parallel exchange rate was used.

objective of reducing inflation. This policy yielded positive results in Brazil and Venezuela, whose currencies appreciated the most, in real terms, during 1995.

Brazil's foreign exchange regime was modified under the Real Plan. The prior system's aim had been to maintain a stable real exchange rate; the new system –which was adopted during a period of very heavy inflows of external capital, import liberalization and mounting domestic demand– gave rise to a sharp appreciation of Brazil's currency and a large trade deficit, thus making a change in the country's foreign exchange policy necessary. Accordingly, in March 1995 the Government announced the adoption of a system of currency bands. These bands were to be subject to ongoing adjustments in line with the differential between domestic and external prices and with productivity gains. The upper and lower limits of the band were modified a number of times with a view to enhancing the country's external competitiveness and preventing any further widening of the trade deficit. Despite these efforts, however, the authorities were unable to neutralize the initial appreciation of the real, and, in consequence, the annual average real effective exchange rate proved to be 25% lower in 1995 than it had been in 1994 and was just over 50% of its 1992 level.

In response to quite a different set of circumstances, throughout the year Venezuela maintained the capital controls it had introduced in June 1994 along with the official exchange rate of 170 bolívares to the dollar, with the result that the steep upturn in domestic prices led to a sharp appreciation of the currency in real terms. The outcome was that the annual average real effective exchange rate for 1995 was 25% lower

than it had been the year before. Midway through the year, the country's securities exchanges were authorized to begin trading dollar-denominated Brady bonds in bolívares, thereby setting up what was for all intents and purposes a de facto parallel exchange market. The implicit exchange rate for these transactions continued to rise until it was twice as a high as the official rate. In October, the parallel exchange rate began to be used for some service transactions, such as payments for airline tickets and overseas credit-card purchases by Venezuela residents. At year's end, the market was consolidated once again with the introduction of a single exchange rate of 290 bolívares to the dollar. Since demand pressure in the currency market failed to subside, however, in April 1996 the currency was allowed to float, whereupon the exchange rate climbed to around 470 bolívares to the dollar. Finally, in mid-1996 a currency band system was instituted.

The other countries whose currencies gained in value enjoyed a favourable external environment, either because the international prices of their raw material exports had risen sharply or because they received large inflows of external funds in the form of private transfers, tourism receipts and short-term capital.

Among this group of countries, the case of Chile is particularly striking. Chile exhibited very strong export growth while also witnessing a substantial increase in the international prices for its main export products and sustained inflows of external capital, which continued to play a part in the downward movement of the real exchange rate. The currency appreciated considerably during the first half of the year as the nominal value of the dollar fell sharply. In July, the combination of a number of steps taken by the Central Bank (particularly new measures regarding reserve requirements aimed at curbing the entry of short-term capital via the banking system), a stronger dollar on international markets and burgeoning imports contributed to an upsurge in the nominal rate. Near the end of the year, the Central Bank introduced a 2% annual discount into the corrections made in determining the value of the currency basket used as a point of reference, which is adjusted daily on the basis of the differential between external and domestic inflation; in so doing, the authorities have, in light of the country's changed external circumstances, incorporated a structural tendency towards a revaluation of the Chilean peso. As a result, the annual average real effective exchange rate slipped by 4% in 1995.

El Salvador set the rate for its currency against the dollar at the start of the year based on such factors as its abundant inflows of external resources in the form of remittances by non-residents and tourism receipts, the higher prices brought by its commodity exports on the international market, and the inflow of short-term capital that was attracted by the difference between domestic and external interest rates. As domestic prices continued to climb, the colón increased in value.

The Dominican Republic was in much the same sort of position; the supply of finance on the country's currency market was quite ample (owing, among other factors, to remittances from abroad and incoming short-term capital), while tourism and *maquila* sales flourished. All of this contributed to an appreciation of the dollar within a context of greater external openness. The increased value of the peso in real terms has given rise to an entire structure of subsidies and implicit taxes applying to specific export and import activities. One particularly noteworthy factor is that official trading operations put such traditional exports as sugar at a disadvantage while subsidizing the use of petroleum and petroleum products.

The currencies of Costa Rica, Guatemala and Honduras also appreciated as these countries, too, enjoyed favourable external conditions. The appreciation was slight in Costa Rica, where the real exchange rate has been quite stable over the past four years. In Guatemala, this situation coincided with a loss of international reserves, while in Honduras –following a year marked by a great deal of uncertainty that had put heavy pressure on the foreign exchange market– the real exchange rate rebounded to the level it had reached two years earlier.

The cases of Cuba and Haiti merit special mention. The downward trend in the real exchange rate seen in both of these countries reflected the fact that their currency markets were in a more balanced position than they had been in past years thanks to a more flexible supply of

foreign exchange and the improved operation of their financial and product markets.

b) Countries registering a real depreciation

These countries can be divided into two different groups. The first is made up of countries that trade heavily with Brazil, where the appreciation of the real pushed up its effective exchange rate against the currencies of its most active trading partners. The second group is made up of economies whose currencies were allowed to depreciate for balance-of-payments purposes or whose value was driven down by a strong demand for foreign exchange in the presence of economic or social conditions that heightened the level of uncertainty among economic agents.

Mexico was the country whose currency depreciated the most in 1995. Early in the year, uncertainty about the viability of the emergency programme and about the Government's compliance with the stated terms for its redemption of *tesobonos* triggered a steep downturn in the peso, which bottomed out in early March. Subsequent modifications in the emergency programme and the revision of the country's macroeconomic targets contributed to the recovery and stabilization of the peso, but the continuation of the recession and a number of events of a non-economic nature (chiefly in the political arena) destabilized the currency again in September. This state of affairs persisted until near the end of the year, when the dollar reached 7.7 pesos –a 120% increase in its price in nominal terms over its level just prior to the end-1994 devaluation of the peso.

The other cases of real depreciations within the region were limited in scope. In Bolivia, the monetary authority continued to intervene in the foreign exchange market with a view to achieving a gradual improvement in the country's external competitiveness, thereby carrying forward a policy it has pursued since 1989. In Peru, whose inflows of external capital thinned out somewhat in 1995, the real exchange rate climbed for the second year in a row following a number of years of steady declines. Nicaragua, which received a considerable flow of foreign aid and saw an improvement in its terms of trade, maintained its system of sliding parities for the gold córdoba and corrected the exchange rate for the dollar at a pace that outstripped the movement in domestic prices.

The MERCOSUR countries were in a quite different position. With the rapid increase in trade that has taken place within this subregional grouping in recent years, Brazil has become the main buyer of its trading partners' exports. Consequently, the steep appreciation of the Brazilian currency in real terms boosted the purchasing power of its MERCOSUR partners in that country and their real effective exchange rates therefore improved, even though the currencies of Paraguay and Uruguay strengthened against the dollar and the parity of the Argentine peso held steady.

The free convertibility of Argentina's currency, which has been maintained since 1991, came under heavy pressure as capital flows retreated in the wake of the events that overtook Mexico in late 1994. Nonetheless, the Government continued to uphold the system and placed top priority on the country's stabilization programme; as a result, productivity gains and the reduction of local-currency costs came to play a key role in the expansion of competitiveness. Stronger demand from Brazil, higher international prices for major export products and the incoming stream of long-term external capital contributed to the equilibrium of the balance of payments and thereby shored up the currency's parity with the dollar. Given these conditions, the annual average real effective exchange rate for 1995 climbed to a five-year high that put it 11% above where it had been the year before.

Paraguay continued to float its currency, subject to Central Bank intervention. In a departure from the situation during the preceding four years, in 1995 the Central Bank sold more foreign exchange than it bought, and the increase in the dollar exchange rate was therefore a scant 3%, which represented a 5% appreciation of the local currency in real terms. This factor was more than offset, however, by the guaraní's depreciation against the Brazilian real, and the real effective exchange rate consequently reached the highest level to be recorded in many years.

In Uruguay, the Central Bank continued to make monthly devaluations in the floor rate of its 7%-wide currency band. Although some degree of convergence was observed between domestic prices, on the one hand, and the price of the dollar together with the portion of external inflation relevant to the country, on the other, the annual average real exchange rate was higher in 1995 than it had been the year before owing to the sharp appreciation of the Brazilian real during the second half of 1994.

Two countries whose currencies had risen in value in past years saw their exchange rates change direction in 1995. Thus, even though the real average exchange rate for 1995 was similar to the preceding year's rate, at year's end it was much higher than it had been in late 1994.

In Colombia, the exchange rate went through two very different stages. Up to August, the currency stayed close to the central band rate, but for the rest of the year –partly as a result of greater political uncertainty– the dollar clung to the ceiling of the band, prompting the Bank of the Republic to offer hard currencies for sale on the open market on a number of occasions. This brought about a reversal in the trend of the real effective exchange rate, which thus climbed by around 6% during the year. Nevertheless, in terms of annual averages, the 1995 rate was virtually the same as the year before. In view of this situation, during the first few months of 1996 the Bank of the Republic relaxed the regulations governing short-term overseas borrowing which it had established previously in an effort to mitigate the effects of ongoing capital inflows on the real exchange rate.

In order to quell the steady appreciation of the sucre, Ecuador adopted a currency band which was adjusted in accordance with the projected inflation rate. The series of corrections made over the course of the year represented a real devaluation of the sucre on the order of 2%.

3. Monetary policy

The priority given to foreign exchange policy in a number of countries' stabilization programmes relegated monetary policy to a subordinate role. Other countries allowed their currencies to float and sought to check inflation through the use of moderate or tight monetary policies. In both cases, fiscal adjustment measures buttressed monetary policy by reducing the pressure for money creation. As a consequence of the difficulties experienced by some financial systems and the considerable volume of inbound external resources, however, a sizeable expansion was seen in the primary money supply in various countries. Faced with an undesired increase in liquidity, their central banks strengthened their sterilization mechanisms (chiefly open-market operations and higher reserve requirements). In response to these circumstances, real domestic interest rates tended to move upward, thereby dampening domestic demand and slowing the economy's growth.

The monetary policies pursued in the region can be grouped into two main categories: i) essentially passive policies, implemented under a system of managed exchange rates; and ii) policies of a more discretionary nature.

a) Passive monetary policies

In those countries that employed the exchange rate for the dollar as the main variable in domestic price formation, money creation was primarily endogenous. The situation was much the same in countries that devalued their currencies periodically (generally on the basis of changes in the spread between domestic and external prices) and in those whose currencies tended to hover near the outer limits of their currency bands. In the latter type of country, however, monetary policy provided some scope for action, since it was used to align the level of liquidity with policy-makers' objectives in respect of domestic prices.

As mentioned earlier, Argentina, El Salvador and Venezuela adopted a fixed exchange rate in 1995. Bolivia, Costa Rica and Nicaragua corrected their exchange rates through a regular series of small devaluations, while in Uruguay the exchange rate clung to the floor of the band. In almost all of these cases, the money creation generated by foreign-exchange transactions was not the only factor influencing the growth of the money supply. The increase in the money stock caused by the provision of central bank credit to help out troubled financial institutions, open-market operations aimed at sopping up what was regarded as excess liquidity, and the monetary effects of the public-sector's financial balance all helped either to create or absorb money and thus altered –in some cases, strikingly– the growth of the primary money supply caused by variations in international reserves.

The case of Argentina provides a good example of a passive monetary policy, given its system of free convertibility. After several years of remonetization, in 1995 the increase in the money supply was quite limited. The steep drop in demand for domestic assets –due to a smaller volume of transactions and greater uncertainty as to the soundness of the financial system– drove down the demand for money during the first half of the year, and particularly for interest-bearing deposits. In late February the authorities modified the Central Bank's charter and expanded the scope of its authority to assist the financial system through rediscounting operations, which had been extremely limited until that time. The laws governing financial institutions were also amended so as to empower the Central Bank to authorize the reorganization of such institutions prior to suspending their operations. The announcement of a package of foreign assistance tied to the IMF agreement signed by Argentina, in conjunction with the fiscal and financial measures unveiled in March, eased the tension in credit markets. Although this did not start off a swift recovery, the prospect of a run on deposits and of a credit squeeze gradually receded.

Conditions in financial markets began to return to normal, and the downward trend exhibited by the money supply in previous months was consequently reversed during the second half of the year. Late in the year, peso-denominated rates on term deposits and on loans to top-rated corporate clients were lower than they had been in mid-December 1994, while the dollar rates on the same instruments were only slightly higher.

Even though Costa Rica adopted a system of small, frequent devaluations, it implemented a tight monetary policy in order to lower both the fiscal deficit and inflation. The tools used by policy-makers to control money creation were reserve requirements (which they had raised in late 1994) and open-market operations. Sales of "stabilization bonds" were 65% higher than the year before and, in conjunction with increased placements of Treasury bonds, therefore exerted upward pressure on real interest rates. As a result, M1 shrank nearly 18% in real terms while local-currency liquidity contracted even more. This outcome was not entirely attributable to the country's monetary policy, however, but was instead also a reflection of the general public's preference for converting their savings from the local currency into foreign exchange.

In Bolivia, which also used a system based on numerous small devaluations, the main events affecting monetary policy were the banking crisis that broke out during the first half of 1995, which triggered a sizeable increase in the money supply due to the credit assistance provided to the system, and the Government's commitment to push ahead with its stabilization programme. In order to reconcile these two objectives, sales of certificates of deposit on the open market were stepped up (the volume of such transactions more than doubled the 1994 figure). The higher level of external financing which it received and the smaller size of the fiscal deficit enabled the public sector to build up its deposits with the Central Bank, thereby driving down the net level of domestic credit extended to that sector. Given these circumstances, domestic interest rates gradually rose as the year progressed, although their average level for the year was much the same as it had been in 1994.

El Salvador switched to a system of fixed exchange rates at the start of 1995. In response to a copious inflow of external resources, the authorities began to implement a sterilization

policy aimed at keeping the level of liquidity in line with the growth of the economy and with the targets they had set for inflation and net international reserves. The Central Bank's decision to raise interbank interest rates and reserve requirements held the expansion of monetary aggregates to much more moderate levels than the year before. Despite the downswing in credit to the public sector and in the financial system's net international reserves, liquidity expanded due to a significant increase in private-sector borrowing (30%), which was financed with the external resources that were flowing into the country.

Under its managed exchange-rate regime, Nicaragua's monetary policy, which had already been quite restrictive in previous years, was tightened even further. The net amount of credit extended by the Central Bank to the country's financial system continued to decline in 1995, which helped to curb the growth of liquidity. In April, the legal reserve requirement was raised, but this did not affect domestic interest rates. The Central Bank's move to float negotiable investment certificates marked the first time it had ever engaged in córdoba-denominated operations on the open market. Despite widespread indexation to the dollar, the public continued to perceive a certain measure of risk, and this was reflected in an increasing degree of dollarization; in fact, the ratio between deposits in dollars and in córdobas climbed to nearly 60%. What is more, the high default rate made the financial system reluctant to lend out the funds that it attracted.

In Venezuela, the strong increase in domestic credit conflicted with the Government's foreign exchange policy, under which a fixed exchange rate was maintained for almost the entire year. Indeed, the credit extended by the Central Bank to the public sector virtually doubled in 1995. The liquidity that this injected into the economy continued to fuel the demand for foreign exchange and helped to draw down international reserves. Uncertainty as to whether or not the authorities would maintain the fixed exchange rate against the dollar in the face of a hefty fiscal deficit, which was being covered through domestic borrowing, seriously weakened money demand. Thus, although inflation amounted to 52%, the money supply only expanded by 34% and the broadly defined money supply (M2) by 37%.

In Uruguay, where the dollar crept along or very near the floor of the currency band for most of the year, 70% of the growth in the monetary base corresponded to the acquisition of foreign currency within the banking system, while about one third was generated by the Central Bank's para-fiscal expenditures. In contrast, the financial system's deposits with the Central Bank had a contractionary effect. Public-sector borrowing, which showed an increase, was easily financed by issues of six-month, dollar-denominated "monetary regulation notes". Against this backdrop, trends in money creation and in nominal transactions were in step with one another.

b) **Active monetary policies**

The remaining countries in the region allowed their currencies to float and relied on monetary policy as the main tool for achieving their objectives. In the vast majority of cases, these countries' monetary policy-makers took a restrictive line in an effort to forestall any excessive increase in liquidity that could destabilize their product or currency markets.

Brazil's adoption of a currency band system reinforced the active control over domestic demand that it had begun to exercise in late 1994. In an effort to relieve the pressure that a high level of domestic expenditure might exert on the balance of payments, in October 1994 the Central Bank had established reserve requirements for deposits and even lending operations within the financial system. This policy was buttressed by the decision to float the real, and interest rates rose considerably; as a result, business enterprises that had access to the international market turned to borrowing overseas, while high rates of return within the country made financial investments in the Brazilian market highly attractive. Both of these factors contributed to the steep upturn in capital inflows observed during the second half of 1995.

In order to limit the monetary expansion caused by the increase in international reserves, the Central Bank of Brazil lowered reserve

Table II-5

LATIN AMERICA: REAL INTEREST RATES [a]

(Annualized percentages)

	1994				1995			
	I	II	III	IV	I	II	III	IV
Argentina								
Deposits	6.0	3.9	1.2	6.1	11.4	15.0	7.4	8.7
Loans	19.9	16.6	12.6	19.9	22.0	31.3	26.3	14.5
Bolivia								
Deposits	14.1	13.0	5.3	4.5	7.0	6.2	12.8	-3.8
Loans	52.6	44.2	38.1	39.1	34.3	35.3	51.3	26.0
Brazil								
Deposits	35.5	43.0	7.8	17.8	33.0	24.7	25.8	15.7
Loans	630.8	399.1	73.0	101.3	114.5	89.8	59.9	63.1
Chile								
Deposits	3.1	7.6	5.9	6.0	4.3	4.6	4.5	7.0
Loans	8.1	12.2	10.7	10.8	8.6	8.4	8.2	11.6
Colombia								
Deposits	-12.3	5.4	15.7	17.5	-2.6	9.0	18.1	17.2
Loans	-4.8	14.7	25.5	24.8	4.9	17.2	28.1	26.6
Costa Rica								
Deposits	3.4	0.6	-3.7	-7.1	-4.9	-0.8	6.0	3.4
Loans	16.0	13.6	9.5	5.2	6.2	9.7	15.3	13.4
Ecuador								
Deposits	-5.1	3.3	15.2	14.2	18.8	9.8	17.4	20.9
Loans	3.9	11.6	23.4	21.5	24.4	22.9	28.5	31.2
El Salvador								
Deposits	0.5	6.3	4.6	5.8	0.5	4.4	-4.4	10.9
Loans	4.7	10.9	9.9	11.8	5.9	8.4	-0.8	14.8
Guatemala								
Deposits	-2.2	1.5	-1.8	-4.3	6.0	-6.8	2.0	-4.4
Loans	8.5	13.4	11.5	7.5	19.2	5.2	14.9	7.1
Honduras								
Deposits	-9.8	-20.8	-9.4	-12.7	-22.3	-9.6	-7.3	-6.5
Loans	-0.5	-12.3	1.1	-0.5	-12.1	2.4	5.5	6.0
Mexico								
Deposits, 1 month	1.1	8.6	7.6	5.9	-21.2	-18.4	5.4	3.3
Deposits, 3 months	1.3	8.7	7.3	5.6	-22.1	-19.1	5.2	3.0
Panama [b]								
Deposits	...	...	...	6.2	...	...	...	7.8
Loans	...	...	...	9.6	...	...	...	10.0
Paraguay								
Deposits	-8.1	14.9	8.0	6.4	5.8	12.1	17.1	11.1
Loans	0.4	25.8	18.3	16.4	12.8	21.4	28.1	22.1
Peru								
Deposits	3.8	9.2	5.1	5.9	2.7	4.1	7.9	6.2
Loans	36.0	38.1	28.5	28.8	21.2	23.8	27.0	23.9
Uruguay								
Deposits	1.6	-5.6	-6.8	-8.6	0.7	-2.0	1.2	8.7
Loans	45.9	35.3	31.5	29.4	43.7	43.5	47.8	53.1
Venezuela								
Deposits	17.3	-19.0	-19.0	-23.3	-12.3	-21.4	-8.8	-28.5
Loans	32.8	-6.4	-7.8	-8.1	3.9	-10.4	4.6	-19.0

Source: ECLAC, on the basis of official figures.

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

requirements on deposits considerably and did away with the ones applying to bank lending activity altogether. In addition, early in October new mechanisms were created to lengthen the terms of incoming external resources; nevertheless, real domestic interest rates remained high, thereby encouraging further inflows of external capital and dampening the demand for credit. The country's strict monetary policy and its recently achieved price stability had a positive impact on public and private financial institutions, a number of which had been experiencing solvency and liquidity problems.

The interplay of foreign exchange and monetary policies was a crucial factor in Chile during 1995. On a number of occasions the monetary authorities tried to check the net inflow of short-term external capital by introducing regulations designed to increase the cost of accepting foreign capital and to diversify local institutional investors' portfolios on an international scale. In addition, within the framework created by the nominal revaluation of the dollar during the second quarter, in May the authorities took steps to give the market a broader role in determining the level and structure of domestic interest rates. In September, however, they adopted a more restrictive monetary policy stance as the Central Bank moved to hike interbank rates; later, in December, it increased its rediscount rates along with the rates offered on the securities it floated as a means of regulating liquidity, thereby reversing the downward trend in these rates which had been in evidence since May. This policy was tightened up even further in early 1996 in response to the sharp upswing in aggregate demand.

Colombia applied a tight monetary policy throughout the year in an effort to rein in the rapid growth of domestic demand. Ever since mid-1994 the country's monetary authorities had been striving to reduce the growth rate of private consumption while also implementing an expansionary fiscal policy. This policy remained in place during the first half of 1995, but policy-makers then decided to cut public spending and, at the same time, to lower interest rates. Interest rates started to bounce back towards the end of the year, however, as the level of uncertainty mounted in response to political events in the country.

In Honduras, the goal of reducing inflation, which had surged during 1994, was the linchpin of the country's monetary policy. In order to keep money creation within the limits called for by the targeted rate of price increases, the Government floated bonds on the open market and maintained high legal reserve requirements. Thanks to these measures, the increase in M1 was only half of what it had been in 1994.

Monetary policy was particularly strict in Mexico, in view of what had occurred in 1994, and M1 therefore shrank by nearly one third in real terms. The attraction of deposits by multi-purpose banks slipped 14%, while the private sector's credit balance dropped 17%, as compared to an increase of 36% in 1994. The pivotal elements of the country's adjustment programme –which from the very outset enjoyed the backing of the international community, as evidenced by the loan packages granted by the United States and the IMF– were harsh fiscal restrictions and a highly contractionary monetary policy. The recession and the high level of interest rates hurt the financial position of business firms and households alike, making it difficult for them to pay off their debts. This, in turn, undermined the banking system's financial standing, since the default rate on banks' loan portfolios skyrocketed. The Government set up various mechanisms to safeguard the savings of private citizens, help debtors to restructure their financial obligations and assist the commercial banks to put themselves back on a sound financial footing, all of which had an impact on the level of public expenditure. This machinery contributed to an improvement in the banks' capitalization indexes, but failed to check the increase in the default rate on bank loans.

The slowdown in the formerly swift growth rate of domestic demand in Peru was also based on a tight monetary policy, to which the decrease in the inflow of external resources (far below the preceding year's level) contributed as well. The policy tools used by the authorities to soak up excess money included the sale of securities by the Central Reserve Bank of Peru and deposits by the public sector and the Banco de la Nación in the Central Bank; these measures succeeded in

lowering the annual growth rate for primary money creation from 57% as of the end of March to 37% in December. The confidence inspired by the Government's policies continued to fuel money demand, and the share of total bank liabilities represented by foreign-currency deposits therefore diminished once again. Under these circumstances, local-currency interest rates on both deposits and loans sank in real terms.

In contrast to the above-mentioned cases, the Dominican Republic pursued a much looser monetary policy in 1995. The build-up of international reserves played a major role in boosting the money supply. At the same time, very attractive domestic interest rates (which stood, when measured in annual averages, more than 9% above international rates) contributed to the increase in deposits by the general public in the financial system and, hence, to the upturn in bank lending. Although public-sector borrowing climbed by a rather modest amount, given the policies being implemented in an effort to improve the outturn of the public sector's accounts, both of these increases generated a much higher level of money creation than had originally been anticipated.

In Guatemala, monetary policy continued to be expansionary during the first few months of 1995, but in the second quarter policy-makers took steps to siphon off excess liquidity and bring net international reserves, which had dropped sharply, back up to their former level. To this end, the Bank of Guatemala resumed its operations on the open market and kept bank reserve requirements at high levels. Nonetheless, its sterilization efforts were seriously hampered by the commercial banking system's use of deposit-attraction mechanisms that were not subject to reserve requirements, and secondary credit thus swelled by more than 24%, which injected more liquidity into the economy. In response to this situation, the Central Bank stepped up its open-market operations, offering hefty returns that translated into operating losses on the order of 1% of GDP. Meanwhile, the process of amending the laws governing financial activity moved forward in 1995, and, as part of that approach, legislation designed to strengthen the Superintendency of Banks and to increase the capitalization of banking institutions was passed during the year. Interest rates were also entirely decontrolled by legislative decree.

The monetary policies of Ecuador, Haiti and Paraguay had some distinctive features. In some instances, circumstances in these countries were such that the authorities enjoyed greater manoeuvering room and were able to take steps which led to the remonetization of the economy. In other cases, liquidity rose above the limits that had been set for it based on the targeted inflation rate, and the authorities therefore implemented sterilization measures which succeeded in bringing the rate of monetary expansion back down to moderate levels.

In Ecuador, the credit extended to the public sector, which found itself in a more difficult fiscal position than before, and the emergency assistance furnished to a number of banks and other financial institutions to help them cope with liquidity problems were major factors in the expansion of the money stock. Uncertainty in the financial market and political events in the country also drove down the demand for money and thereby led to a decrease in international reserves and a contraction of the money supply. As a result, in 1995 M1 increased by just 13%, which was only one third as much as the year before and far below annual inflation. High interest rates, in conjunction with the energy crisis and sluggish domestic demand, led to a build-up in loan arrears after they had already jumped to nearly twice their former level in 1994. In late 1995 and early 1996, a number of financial institutions were overtaken by a severe liquidity crisis, and some of them lapsed into bankruptcy. In a bid to stabilize the financial system, the Central Bank extended emergency financing, imposed a freeze on the chartering of new banks, created incentives for mergers among financial institutions, raised the minimum level of reserves required of such institutions and upgraded the supervisory machinery for the sector.

The gradual normalization of the political situation in Haiti opened the way for an influx of external financial aid. Under the agreement that the country signed with the IMF, the increase in its international reserves turned out to be the main factor in the expansion of the money stock. Public-sector borrowing –which had been the main cause of the growth of liquidity in 1994–

had just the opposite effect in 1995. Private-sector borrowing rose considerably and, when signs of excess liquidity began to appear, the authorities reacted by boosting reserve requirements sharply and removing the cap on interest rates. Monetary authorities also pledged to hold back one fifth of external inflows. In August, the Central Bank began to sell foreign exchange (thus helping to absorb monetary resources) and, as a result of all this, local-currency liquidity grew by only 15%, which was well within the limits set in the agreement with the IMF.

In Paraguay, price stabilization was the primary focus of the monetary programme which was launched in early 1995, as had also been the case in 1994. The crisis that broke out in numerous financial institutions in late April severely hindered this programme's implementation, however. The financial crisis hit major banking institutions accounting about for one sixth of the system's total deposits. In order to prevent this crisis from spreading to the rest of the system, the Central Bank took over the loans of distressed companies, a step which boosted monetary expansion sharply (by an amount equivalent to three fourths of money creation as of the end of 1994). The monetary authority then sopped up the excess money in circulation through the sale of Treasury bills. The slump in public-sector borrowing also helped to absorb surplus liquidity, thereby enabling the Central Bank to hold back the expansion of primary money to levels in line with the Government's price stabilization objectives against a backdrop of steadfast nominal exchange rates. The very appealing interest rates offered by the Central Bank in order to soak up excess liquidity pushed real interest rates far above the levels they had reached in the past.

III. STRUCTURAL REFORMS

During 1995, the structural reform process continued to gain ground in the region, although the pace of progress and the degree of consolidation in each country remained quite uneven.

One of the most important developments in 1995 was the fact that the privatization process at the national level not only was continued but was also embraced by a number of countries that had not previously divested themselves of public-sector enterprises. Equally important were the efforts made to improve existing regulatory systems in sectors where public utilities were being privatized and to introduce new regulatory mechanisms to tighten up the operation of the financial system. In the area of social security reform, a number of countries took steps during 1995 to set up social insurance systems funded by employee's contributions. In the area of foreign trade, on the other hand, the liberalization process suffered some setbacks as non-tariff barriers were reintroduced or strengthened and tariffs were raised in countries which had made substantial progress in liberalizing their trade regimes in the past.

Special mention should be made of the reform process that is taking place in Cuba. Different in many ways from the rest of Latin America and the Caribbean, Cuba is in effect making structural changes of varying scope under its existing socialist system. During 1995, for example, it continued opening up its economy to foreign capital and decentralizing its foreign trade, which will eventually lead to a separation between Central Bank operations and those to be carried out by the commercial banks that will be established in the future, thus paving the way for the reform of the financial system. The privatization of the agricultural sector also continued as the proportion of cooperatives and individual producers increased and the amount of land worked by the State sector was reduced to 30% of the country's total farmland.

1. **Public-sector reforms**

A major feature of public-sector reform in 1995 was the ongoing progress of the privatization process, particularly in the case of public utilities; this has, in turn made it necessary to move ahead with the restructuring of their regulatory systems. Some advances were also made in the reform of the region's social security systems.

a) **Privatizations**

Since the early 1990s, the privatization process has gradually taken hold in the region, thereby consolidating the State's new role, in which greater emphasis is placed on its function as a regulatory body and direct State participation in the production of goods and services is being sharply curtailed to make room for greater involvement in financing, policy design and the regulation of economic activities. From a more short-term perspective, there has been a tendency –reflected to some extent in developments in 1995– to gear the sale of public-sector firms and, more specifically, the whole pace of the privatization process, to budget requirements. Divestment of such assets is, thus, still considered an important source of funds for narrowing fiscal deficits and helping to finance shortfalls in the balance of payments.

Before 1988, Chile alone had made significant progress with sales of publicly-owned companies, but in 1989 both the sums involved and the number of countries engaged in the

process began to escalate. Then, after peaking in 1991, the sell-off rate slackened; this trend became more pronounced in 1995, when divestment of public assets in 14 countries of the region brought in some US$ 3.7 billion –considerably less than the US$ 8.5 billion realized in 1994– and the number of companies privatized fell from 120 to 63. Much of the explanation for this marked decline lies in the fact that certain stages of the process have now been completed in a number of countries, such as Argentina and Mexico, where in previous years revenue from privatizations had equalled some 8% of GDP. Nevertheless, the process also slowed in Brazil and Peru, while in Chile it has generated only modest revenues in recent years, after having produced spectacular gains during the second half of the 1980s.

An analysis of the sectoral distribution of privatizations reveals that, in those countries where this process is the farthest along, the companies sold have primarily been in subsectors such as electricity and telecommunications; this circumstance is accounted for by the large amount of capital such activities require and the extremely high returns on investment in these services due to the wide gap that exists between supply and demand. There have also been substantial divestments in Argentina's oil sector (30%) and in Mexico's financial sector (51%). In Bolivia, it is hoped that the capitalization of Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) will increase the share of the hydrocarbons sector.

The decline in privatizations observed in 1995 has led some experts to conclude that the process may be entering a new phase which is characterized by a more gradual approach, by more thorough preparations for such sales, and by attempts to find strategically better partners.

Despite the slowdown, however, prospects for 1996 and the following years are encouraging, since countries where the privatization process has only recently taken off –such as Brazil, Colombia, Ecuador, Panama, Paraguay and Venezuela– are making strenuous efforts to shift the process into high gear. Moreover, 1995 saw the removal of obstacles to greater domestic and foreign private-sector participation in the production of a number of goods and services that had formerly been the exclusive preserve of the public sector. There is evidence of this in Brazil, for example, where Constitutional reforms have put an end to State monopolies in telecommunications, natural gas distribution, shipping services and hydrocarbons. In Mexico, too, the Constitution has been amended to allow both Mexican and foreign private investors to enter the telecommunications, transport, natural gas and infrastructure sectors. In addition, there is an increasing tendency to use concession-based mechanisms to finance activities in areas where the State has traditionally held sway, such as infrastructure projects in Chile and natural resource (oil) development in Peru and Ecuador.

Private-sector participation in infrastructure projects is still only in the preparatory or initial stages, but there are high hopes as regards this sector's future role in the areas of road and rail systems, ports and airports, and it is thought likely that concession-based mechanisms will play a very important part in the process. Operations of this nature will, however, necessarily take longer to carry out because of their great technical complexity and their very high capital requirements.

Although privatization per se makes no contribution to capital formation, it has galvanized the process of accumulation. The reasons for this include the existence of unmet demand in areas of activity where the State used to exercise sole responsibility and of considerable technological backwardness, since both of these circumstances have obliged the new operators to expand their production capacity rapidly. Other processes have also been at work, however, including an increasing openness to market competition and the emergence of new opportunities for the private sector, such as those provided by the concession-based schemes currently being applied in the area of infrastructure.

In Peru, for example, the sales agreements for a number of public-sector enterprises (particularly the largest such companies and public utilities), have included clauses calling for around US$ 3.5 billion in investment over the next few years –a sum which almost matches the US$ 3.9 billion realized from the sales

Table III-1
LATIN AMERICA AND THE CARIBBEAN: VALUE OF PRIVATIZATIONS [a]
(Millions of dollars)

	1985 - 1989	1990	1991	1992	1993	1994	1995
Total	**2 446**	**5 875**	**16 702**	**14 886**	**10 179**	**8 529**	**3 774**
Argentina [b]	-	2 139	1 896	5 312	4 589	1 441	793
Bolivia	-	-	-	7	14	-	887 [c]
Brazil	-	-	1 564	2 451	2 621	1 972	910
Chile	1 146	29	117	21	-	203	3
Colombia	52	117	105	27	4	681	138
Costa Rica	15	-	3	-	-	27	-
Ecuador	-	-	-	-	-	74	73
Mexico	1 233	3 580	10 716	6 799	2 507	771	-
Nicaragua [d e]	-	0.4	20	14	74	7	...
Panama	-	0.6	2	17	21	100	-
Paraguay	-	-	-	-	-	22	-
Peru [b]	-	-	3	208	317	2 578	946
Venezuela	-	10	2 276	30	32	15	21
Other countries	-	-	-	-	-	638	2

Source: R. Cominetti, "La privatización y el marco regulatorio en Bolivia y Nicaragua: un análisis comparativo", Reformas de Políticas Públicas series No. 43 (LC/L.973 and Add. 1), Santiago, Chile, ECLAC, 1996.
[a] Cash income plus income in the form of external and domestic debt instruments, calculated on the basis of their secondary-market value; in the case of Brazil, domestic debt securities were computed at their face value. [b] Includes concessions. [c] Includes US$ 51 million from privatizations and US$ 836 million from the capitalization of four companies, including the State railway company (ENFE), which was capitalized at the beginning of 1996. [d] Includes assumption of liabilities; does not include capital contributions to illegally confiscated companies which were later returned to their owners. [e] Only US$ 33 million correspond to cash payments, a considerable portion of which were made in the form of bonds.

themselves. Bolivia has adopted a method of privatization –referred to as capitalization[1]– whose specific features make it possible to obtain financial inputs from strategic international partners equal to the net worth of the companies that are privatized (US$ 900 million in 1995). These resources may be used only for investment in the companies themselves and the deadline for their disbursement varies between six and seven years.

Another interesting example is the Chilean programme to privatize energy generation and distribution and telecommunications; despite the absence, as a rule, of specific capitalization clauses, investment in these areas has surged thanks, on the one hand, to the very characteristics of these two subsectors and, on the other, to Chile's anti-trust regulations and legislation (see box III-1).

b) **The regulatory system**

Since the late 1980s, the countries of the region have implemented major reforms in order to regulate and reinforce institutional and microeconomic aspects of various sectors of the economy. These reforms have sought to reduce risk in the banking system and capital market and to establish rules for competition and supervisory functions relating to the privatized public utilities.

i) ***Regulation of financial activity***

The majority of the countries of the region seem neither to have quite completed their

[1] Privatization in Bolivia takes the form of capitalization, whereby the State's share in a company diminishes as the capital inputs from a strategic private partner increases.

Box III-1
CHILE: THE EFFECTS OF PRIVATIZATION ON INVESTMENT IN THE ELECTRICITY AND TELECOMMUNICATIONS SUBSECTORS

Chile's electricity and telecommunications companies were privatized between 1986 and 1989. Before their sale, the Government had reorganized the companies by restructuring their internal management and setting up affiliates and subsidiaries which were later to be coordinated through holding companies. In addition, the tax system was modified to bring public and private corporate taxes into line with each other.

Opportunities for public-sector enterprises to invest and borrow had previously been very limited, since the need to improve public finances and balance the budget had obliged such companies to generate higher profits for transfer to the central government.

The privatization of the electricity subsector began with the sale of small blocks of shares in the holding company for the electricity distributor CHILECTRA Metropolitana, S.A. and concluded in 1989 with the privatization of the national electricity company, ENDESA. Substantial private investments were made in the subsector between 1985 and 1993, with a cumulative total approaching US$ 3.6 billion. This has allowed the supply of electrical power to expand at a rate similar to that of GDP during the last 10 years; installed capacity has increased by 68% in the case of ENDESA and by 31% in the case of its rival generating company, CHILGENER.

Between 1994 and 1995, ENDESA, which holds a 61% share of the country's installed power generation capacity, invested US$ 450 million, with part of this sum being spent on the new Pangue power plant; the company also plans to invest over US$ 1.5 billion between 1996 and 2000 in the installation of new power lines, substations and transformers.

Investment in the private electricity subsector
(Millions of dollars)

Year	Amount
1985	170
1986	227
1987	350
1988	322
1989	521
1990	611
1991	287
1992	348
1993	624
1985-1993	3 560

Source: Jaime Tohá (consultant), Estudio sobre la reforma del sector energético en Chile (LC/R.1493), Santiago, Chile, ECLAC, January 1995.

In 1982, Congress passed an omnibus act which opened the telecommunications sector up to competition by allowing private investment and defining the relevant regulatory agency's role. In 1987, a new schedule of local and long-distance rates was introduced, along with an arbitration procedure for settling disputes between companies and the regulatory authority. These reforms facilitated the privatization of the Compañía de Teléfonos de Chile (CTC), which operates the local telephone system, and the Empresa Nacional de Telecomunicaciones (ENTEL), which furnishes national and international long-distance services. The process was completed in 1988.

Once privatized, these companies embarked upon a swift development process (particularly CTC) and their rate of capital accumulation –which had in the past been constrained by the obligation to distribute all their profits– was impressive. Investment jumped from a pre-privatization rate of less than US$ 150 million per year to an average of US$ 500 million per year between 1990 and 1995. This enabled CTC to expand the number of lines it has in service from 592,000 in 1988 to nearly 1.8 million in 1995 (the projected number for the year 2000 is 3 million) as well as to digitize all its lines and double its volume of telephone traffic. Meanwhile, ENTEL has expanded the switching network, transmission capacity and digitization of the international telephone system; in addition, it has financed a national and international fibre-optic grid, an undersea interoceanic cable network and an international satellite system.

The inauguration in October 1994 of the multi-carrier system for long-distance calls that was made possible by recent legislation created a highly competitive situation which induced other telephone companies to enter the subsector and spurred existing companies to invest more. In 1995, local services were contracted out to existing and new operators, leading ENTEL to draw up plans to invest US$ 800 million in such projects as local networks and the mobile telephone system between 1997 and 2000, while CTC plans to invest at least US$ 2 billion in 1996-2000 in order to stand up to the new competition.

Investment in the telecommunications subsector
(Millions of dollars)

Year	CTC	ENTEL
1988	110	36
1989	347	35
1990	468	39
1991	357	43
1992	432	60
1993	549	82
1994	387	102
1995	560	...
1988-1995	3 210	...

Source: Empresa Nacional de Telecomunicaciones (ENTEL), *Memoria anual y estado financieros*, Santiago, Chile, various issues; Compañía de Teléfonos de Chile (CTC), *Memoria anual*, Santiago, Chile, various issues.

reforms of the regulatory system for the financial sector nor to have laid sufficiently solid foundations for those reforms –a situation which, in combination with the adverse macroeconomic climate, would account for the latest wave of banking crises (see chapter IV). The few exceptions include Chile, which made the necessary adjustments during the first half of the 1980s, Colombia and, to a lesser extent, Bolivia, Peru and El Salvador.

Despite the limited progress of such reforms, however, there have been a number of positive developments during the 1990s, notably in Argentina, Peru, Colombia, Ecuador, El Salvador, Mexico and, belatedly, Venezuela. Of particular interest is the design of new banking legislation which incorporates competition-promoting principles such as multipurpose banking facilities; capital ratios more closely geared to the Basle Agreement's capital adequacy standards; risk-diversification standards based on regulations regarding portfolio composition; restrictions on associated-party loans; and stricter accuracy standards with regard both to accounting principles and to market information. This new legislation also seeks to invest supervisory bodies with greater authority and powers and to furnish more precise definitions of the coverage of such mechanisms as government deposit insurance and Central Bank financial aid to institutions in difficulties; the aim of all these measures is to contain and correct the current problems of distortion of incentives and moral hazard. In addition, most regulatory agencies are making a determined effort to improve their computing capacity and steps are being taken virtually throughout the region –Brazil may well be the sole exception– to establish inspection procedures based on assessment of the quality of risk asset portfolios.

ii) ***Regulation of public services***

The privatization of public utilities –which in most cases have monopolistic market structures but nonetheless contain potentially competitive segments– has led many countries to revamp their regulatory frameworks. Approaches to market reorganization vary depending on whether the goods in question are tradable or non-tradable and what entry and exit barriers may exist. In the telecommunications field, Chile became the first country to lift market entry barriers when it introduced a multi-carrier long-distance telephone system, which entered into operation in 1994; in 1995, the system was extended to include local services, with the result that any one area may be served by more than one operator. The regulation of inter-carrier connections is one of the most important aspects of the new system, as every operator must be allowed unrestricted access to the lines in order to guarantee free competition in this field.

As regards electrical energy and natural gas, attempts have been made to step up competition at the production stage while regulating transmission and distribution, both of which are natural monopolies. In the petroleum sector, there is an observable trend towards encouraging competition in the domestic hydrocarbons market by promoting private participation and eliminating State monopolies. The aim is to stimulate competition at the exploration and production stages by ceasing to set up reserves on behalf of State companies and encouraging private companies to assume most of the risk.

The reform of regulatory mechanisms has not progressed at the same speed as privatization. Bolivia alone has made regulation a central element of its capitalization programme. The new integrated regulatory system established in Bolivia under the Sectoral Regulatory System (SIRESE) Act in late 1994 is administered by a group of autonomous, politically independent agencies made up of a General Superintendency and a number of sectoral superintendencies. What is noteworthy about this new regulatory framework is its integrated nature, which makes it possible not only to guarantee uniform standards for all the various sectoral regulatory bodies but also to achieve economies of scale, as each sector can benefit from the lessons learned by all the others.

Another interesting initiative in the field of regulation in 1995 was the reform of Brazil's Telecommunications Act, which had been in force since 1962. The new regulatory framework will make it possible to generate competition in the telecommunications subsector –hitherto a State monopoly– map out the structure of the industry for the future and regulate such services

Box III-2
THE REGULATORY SYSTEM IN BOLIVIA

The regulatory system currently in operation in Bolivia is based on an omnibus act known as the SIRESE (Sectoral Regulation System) Act and on a series of sectoral laws, not all of which have yet been passed.

The SIRESE Act stipulates that the purpose of the system is to regulate, control and supervise activities in the telecommunications, electricity, transport, water and hydrocarbons sectors and any other sectors that may subsequently be incorporated into the system by law.

SIRESE is part of the executive branch and is under the authority of the Ministry of Finance and Economic Development. It is run by the General Superintendency and the sectoral superintendencies, which are self-governing bodies with technical, administrative and financial autonomy.

The superintendents are appointed by the President of the Republic from a shortlist submitted after approval by two thirds of the members present in the Senate.

The appointment system has been designed to be independent of the political process. Accordingly, a seven-year term of office has been set for the Superintendent-General and a five-year term for the sectoral superintendents, and persons who have held these posts in the past cannot subsequently be appointed until a period of time equal to the length of that term has elapsed. In addition, there are a series of provisions intended to prevent candidates for these positions from facing a conflict of interest.

The Superintendent-General's responsibilities include overseeing the management of the sectoral superintendencies and settling any jurisdictional disputes arising among them.

The sectoral superintendents' responsibilities are:

- To promote competition and efficiency in the subsectors regulated by SIRESE.
- To award, amend, renew and cancel concessions, licences, authorizations and registrations.
- To ensure that services are provided in the agreed manner and that contractual obligations are fulfilled, including the investment plan to which the regulated enterprises have committed themselves.
- To approve and publish prices and rates.
- To examine and process complaints and grievances brought by users, regulated enterprises and the relevant State agencies.

Source: R. Cominetti, "La privatización y el marco regulatorio en Bolivia y Nicaragua: un análisis comparativo", Reformas de política pública series, No. 43 (LC/L.973 and Add.1), Santiago, Chile, ECLAC, 1996.

as the cellular telephone system, data transmission and satellite services; it will also pave the way for the reorganization of the holding company for the State tele-communications enterprise (TELEBRAS) and its subsequent sale to the private sector.

The privatization of road, port, railway and airport infrastructure has aroused a debate regarding the legal and contractual structures for public works concessions, the auction process, the construction and production phases and the relevant tax regime, and all of these issues figure on the Governments' agendas for 1996.

c) **Social security reforms**

During 1995 a number of countries moved towards the establishment of social insurance systems funded by individual wage-earners' contributions. Until recently, this kind of system existed only in Chile, but Argentina, Colombia and Peru introduced similar schemes a short time ago and have now been joined by Mexico and Uruguay as well.

Towards the end of 1995, the Mexican Congress passed a law modifying the pension system to allow workers to open individual retirement accounts. These accounts are to be administered by pension-fund management boards (AFORES), in which domestic and foreign financial institutions, as well as the Mexican Social Security Institute, will be able to participate.

In Uruguay, the pay-as-you-go system has been replaced by a mixed system composed of one component based on the pre-existing redistributive scheme and another in which pensions are funded by contributors' payments

into individual accounts. The new system divides pensionable remunerations into three brackets. For wages of up to around US$ 800, both employer and employee make compulsory contributions to the pay-as-you-go system. Between US$ 800 and approximately US$ 1,600, both contributions are still compulsory, but the employer pays into the public redistributive system while the employee pays into the privately-managed individually funded system. Above US$ 1,600, contributions are optional and are channelled entirely into the funded system. Participation in the new scheme is compulsory for workers under the age of 40 and optional for those over 40.

In July 1995, Peru amended its legislation to equalize the cost of public and private insurance (the latter was previously more expensive) as a way of encouraging contributors to join the private pension system. Under the new regulations, the contribution to be deposited in the individual's account was temporarily reduced from 10% to 8% and the 1% contribution to the redistributive system was discontinued, as was the value-added tax (VAT) previously levied on pension-fund management boards' (AFPs) commissions and insurance coverage. In addition, as of November, contributors were allowed to switch freely between AFPs.

In Chile, where an individually funded system has been in operation since 1982, accumulated funds up to the end of 1995 totalled nearly US$ 26.7 billion: 40% of this sum was invested in government securities, 32.5% in private-sector stocks and bonds, 16.3% in mortgage bonds and around 6% in time deposits (the last two being financial-system instruments). In view of the large amounts involved, and in order to increase the range and rate of return of the instruments held, in 1995 the limit set on investment in corporate stock was raised from 30% to 37% while the ceiling on foreign investments was raised from 6% to 9%; the allowable number of such instruments was also increased, as was the number of destination countries. Floating-rate investments are now also permitted, as is investment in convertible securities; this opens up the possibility of financing greenfield projects, including investments in infrastructure.

2. Trade reform

In 1995, the foreign trade liberalization process took a step backwards as tariffs rose and new non-tariff barriers were erected. This was particularly the case in countries which had made significant progress in trade reform during the 1990s.

Although the general set of conditions created by trade liberalization remained in place in nearly all the economies of Latin America and the Caribbean, the need to protect some sectors that were highly vulnerable to international competition –from Asian countries especially– led a number of countries to raise tariffs and erect new non-tariff barriers. The authorities in these countries asserted, however, that these measures did not represent a reversal of the liberalization process because they were of a purely temporary nature and were primarily designed to combat unfair competition.

The Government of Argentina, for example, raised tariffs during the first quarter of 1995. It also took a number of other steps, such as imposing import quotas, requiring advance authorization for automotive products, banning imports of clothing and spare parts for used motor vehicles; issuing new local-content regulations applying to finished goods produced by the automotive industry; and reducing drawbacks on exports. Some of these measures were intended to improve the Government's fiscal position, but others were of a more protectionist nature.

Brazil, too, interrupted the import liberalization process, which had made great strides in 1994, in response to the need for greater competitiveness in the domestic market to underpin the stabilization drive. A significant

Box III-3

MAIN INSTRUMENTS OF TRADE REFORM

1. ELIMINATION OF BANS, QUANTITATIVE RESTRICTIONS AND ADMINISTRATIVE BARRIERS.
2. REDUCTION OF TARIFFS AND TARIFF-RATE SPREADS.
3. REPLACEMENT OF GENERALIZED EXPORT-PROMOTION SCHEMES (SUBSIDIES) AND WITH SELECTIVE INSTRUMENTS.
4. STREAMLINING OF ADMINISTRATIVE EXPORT PROCEDURES.

reversal in the country's external accounts –the result of a more open economy and a sharp real appreciation of its currency– led Brazil, in its turn, to raise import tariffs on automotive products (to 32% in February and to 70% in April); import quotas and licence requirements followed later. These new barriers were removed towards the end of the year, however, in anticipation of an adverse ruling by the World Trade Organization (WTO); what is more, by that time the drop in imports had rendered them unnecessary in any case. Tariffs on household appliances were hiked as well, and import barriers were later extended to include other areas such as textiles, clothing and toys.

Argentina and Brazil adopted these restrictive measures in line with their commitments under MERCOSUR based on the safeguard clauses contained in that agreement. A certain amount of friction nevertheless arose owing to the effect these measures had on trade flows, even though the items concerned, such as automotive products, textiles and clothing, were as yet not covered by the automatic tariff rollback scheme.

Mexico also decided to increase its tariffs on 65 products to between 25% and 260% in the case of imports from non-NAFTA (North American Free Trade Agreement) countries. In Costa Rica, meanwhile, a surtax of 8% was added to existing tariffs at the end of March with the aim of giving an immediate boost to fiscal income while awaiting passage of the reform bill being considered at that time by the Legislative Assembly. After the law was passed in September, the surtax was dropped.

Panama, by contrast, made a certain amount of progress in trade liberalization. Once negotiations on entry to WTO had begun, Panama agreed to cut its maximum tariff level from 40% to 30% over a period of five years and to set a minimum tariff of 5% for all but agricultural products; the rates for these products would start out at a higher level but would then gradually be reduced.

Table III-2 compares the tariff rates in effect when trade reforms were begun with those in force at this writing, omitting temporary changes. As can be seen, average rates were in general still low –between 10% and 20%– and the number of steps remained quite limited.

3. Financial and capital-market reform

During 1995 a number of countries embarked upon financial liberalization programmes designed along much the same lines as other initiatives already under way in the region.

The law establishing a new charter for the Central Bank which was recently passed in Costa Rica laid the foundations for profound, though gradual, changes in the country's banking sector. This legislation gives the Central Bank greater

Table III-2
SELECTED LATIN AMERICAN COUNTRIES: SUMMARY OF THE TRADE LIBERALIZATION PROCESS

	Start of programme	Latest year of evaluation	Maximum tariff		Number of steps		Average tariff	
			Initial	Final	Initial	Final	Initial	Final
Argentina [a]	1989	1995	65	33	-	11[b]	39	13.4
Bolivia	1986	1995	150	10	-	2	12	9.7
Brazil	1987	1995	105	20 [b]	29	11[b]	51	12.0[c]
Chile [d]	1984	1995	35	11	-	-	35	11
Colombia	1990	1995	100	20	14	4	44	13.4
Costa Rica	1986	1995	100	20 [e]	-	4[e]	27	14.0[e]
Jamaica	1989	1991	-	-	-	-	50	20.3
Mexico	1985	1995	100	20 [f]	10	7[f]	24	12.0[g]
Peru	1990	1995	108	25	56	3	66	16.3
Venezuela	1989	1995	135	20	41	4	35	13.4

Source: ECLAC, on the basis of official figures.
[a] Tariffs include a 3% surtax. [b] No account is taken of the temporary increase (to 70%) of the tariffs on 109 items under the headings "passenger vehicles" and "electrical household appliances" which was instituted in March 1995. [c] If the temporary increase (see note [b]) is taken into account, then the average tariff was 12.7%. [d] Under Chile's first trade liberalization programme, which was completed in 1979, a uniform tariff of 10% came into effect and remained in place until 1982. In 1984, the tariff was raised to 35% and was then reduced to 20% in 1995 and to 15% in 1988 before being lowered to its current level of 11% in 1991. [e] Information relates to the Central American Common Market (CACM) tariff. 95% of all traded goods are duty free; on the remaining 5%, countries may apply higher or lower tariffs than those agreed upon. The highest tariffs tend to be applied to textiles, woven fabrics, clothing and footwear, while lower tariffs —as low as 1%— may be applied to essential items. In the case of Costa Rica, the reader should note that since March 1995 the country has been applying a temporary 8% surtax for fiscal purposes. This surcharge has not been figured into the maximum and average tariff rates shown in this table; if it were, each of those rates would be 8% higher than the figure given here. [f] No account is taken of the temporary increase, to between 25% and 260%, of the tariffs on 65 items which was implemented at the beginning of 1995. [g] If the temporary increase (see note [f]) were to be taken into account, the average tariff would be 13.5%.

autonomy and puts an end to State banks' monopoly on current accounts; in addition, it gives all financial institutions access to the Central Bank's discount window (see box III-4). The State-run commercial banks are to keep their monopoly on certain services, however, although steps have been taken to encourage them to compete with one another. An agreement was also signed by the Government, the Central Bank and State-run commercial banks with the aim of strengthening the competitiveness of the State's commercial banking system. The agreement stipulates, *inter alia*, that the Central Bank will help backstop this system by reducing reserve requirements and covering any losses such banks may incur on foreign-currency operations. The State's commercial banks, for their part, are to improve the range of services they offer on a competitive basis, cut their administrative and operating costs and reduce interest-rate spreads. In 1995 Costa Rica also established the Superintendency for Financial Institutions (SURGEF), which is to draw up and implement prudential regulations.

The modernization of El Salvador's financial system moved forward with the drafting of a number of bills that aim to increase financial institutions' solvency, expand their overseas operations and improve their information gathering and reporting procedures. Modernization of the system's legal framework will permit new banks and related institutions to be established and will allow foreign banks to participate in the domestic market.

Cuba has continued to promote a policy of openness to foreign capital as part of its ongoing

Box III-4

MAIN FEATURES OF FINANCIAL AND CAPITAL-MARKET REFORMS

1. LIBERALIZATION OF CAPITAL ACCOUNT OR REDUCTION OF RESTRICTIONS THEREON.
2. ELIMINATION OF BARRIERS TO FOREIGN INVESTMENT AND EQUAL TAX TREAT FOR FOREIGN AND DOMESTIC CAPITAL.
3. DEREGULATION OF INTEREST RATES AND BANK CREDIT; LIBERALIZATION OF CURRENCY MARKET.
4. DEVELOPMENT OF MULTI-PURPOSE BANKING FACILITIES.
5. SUPERVISION AND PRUDENTIAL REGULATION.
6. CENTRAL BANK AUTONOMY.

process of structural transformation. In September 1995, for example, a foreign investment act was passed which sets time-limits to ensure speedy processing of investment proposals and provides for the establishment of wholly foreign-owned companies. It also makes provision for the creation of free trade zones and industrial parks, and the relevant decree-law was drawn up during 1995 and was passed at the end of the first half of 1996.

IV. THE FRAGILITY OF LATIN AMERICA'S FINANCIAL SYSTEM

Loss of confidence in Mexico's economic stability led to a withdrawal of foreign capital in 1994, and the capital outflow was exacerbated by the devaluation of the peso in December of that year. The situation did considerable harm to Mexico's banking system and sent shock waves throughout the region, damaging financial institutions in a number of countries, especially Argentina, through effects on liquidity due to deposit volatility and through the high real interest rates characteristic of severe macroeconomic adjustment. To these factors were added the internal problems, dating from late 1993, plaguing Venezuela's economy and financial markets. The most severe banking crises occurred in Argentina, Mexico, Paraguay and Venezuela. To a lesser extent, Bolivia, Brazil, Costa Rica and Ecuador also ran into difficulties.

Since 1970 the world has witnessed a number of banking crises, particularly in the developing countries, and Latin America has not been immune. The events of the last two years bring to mind the severe difficulties experienced in the early 1980s, though the climate today is more favourable. The crises were not totally unexpected in Latin America, since in several countries weaknesses in the banking system –particularly in some microeconomic aspects– had not been fully corrected.

Nevertheless, it should be noted that the financial impact of the Mexican crisis on the economies and banking systems of the various countries differed widely. Some experienced an extraordinary boom, such as Chile, whose banking sector in 1995 recorded its eleventh consecutive year of growth, with deposits on the order of 60% of GDP, real returns on capital close to 20% per annum and an overdue loan ratio of under 0.7%. Others, such as Colombia, Peru, Uruguay and some Central American countries including El Salvador, did not suffer major turbulence, but merely natural, temporary declines in their stock exchanges.

1. Factors contributing to recent banking crises

The banking crises that have occurred since the late 1970s can be attributed primarily to the process of financial deregulation undertaken in the region, in a context of strong macroeconomic imbalances and insufficient domestic saving; however, other factors have also played a part, including inconsistencies between policies and reforms, microeconomic and institutional deficiencies and the critical situation of public-sector banks in several countries. The interaction between macroeconomic conditions and the state of Latin America's banking system has demonstrated that the risks of a banking crisis are great if macroeconomic equilibria are not fully achieved. Experience has also shown that when countries introduce a sweeping programme of liberalization and deregulation without first consolidating the necessary institutional reforms, such as more effective supervision mechanisms, the vulnerability of the financial system tends to increase. Moreover, political uncertainty and turmoil have also been a major cause of banking crises in the region.

The instability in Argentina, Brazil and Mexico, though partly attributable to microeconomic factors, was precipitated by severe macroeconomic adjustments. In contrast, in Ecuador and Venezuela –although both were beset by political crises, confidence problems and macroeconomic imbalances– the troubles of the banking system were due chiefly to poor standards of disclosure and, in Venezuela especially, to an inadequate regulatory and supervisory framework. The economies of Bolivia and Paraguay have enjoyed stability, but their banking systems –especially Paraguay's– have nevertheless faced crises, which in essence are attributable, notwithstanding the progress made in Bolivia since the late 1980s, to microeconomic and institutional factors.

There is general recognition of the widespread absence, until recently, of regulatory frameworks suited to dealing with the risks of a rapidly expanding banking market less subject to government control. Reforms would include stringent capitalization ratios, hedging mechanisms, reliable accounting rules and demanding standards of disclosure. Other problems, such as equipment obsolescence, insufficient human resources training and inadequate auditing methods, that have plagued watchdog agencies in the region for many decades have made prudential supervision in an environment of greater freedom in banking management simply unfeasible.

There has also been confusion concerning the scope of public deposit insurance, which must necessarily be limited, and specifically the inadvisability of having the State or central bank assume full responsibility for losses resulting from the liquidation of insolvent banks, a common practice in quite a few countries in the 1980s and in some during the 1990s.

Another problem is that Governments have tended to rely too much on the banking system to finance public-sector deficits, by setting high reserve requirements or mandating investments, thereby constraining lending in the market and consequently limiting the experience built up by the banks prior to expansion.

A striking feature is the low financial intensity of the region, whose banking sector manages assets that do not usually exceed 25% of GDP (see figure IV.1). Nonetheless, the stability of this market is crucial to the real sector of the economy, since banks handle more than 80% of formal financing to firms and individuals. It is therefore not surprising that instability in the banking sector represents a severe handicap for economies and that bank bailouts have in general carried a high price in fiscal terms or contributed to a rapid acceleration of the inflation rate.

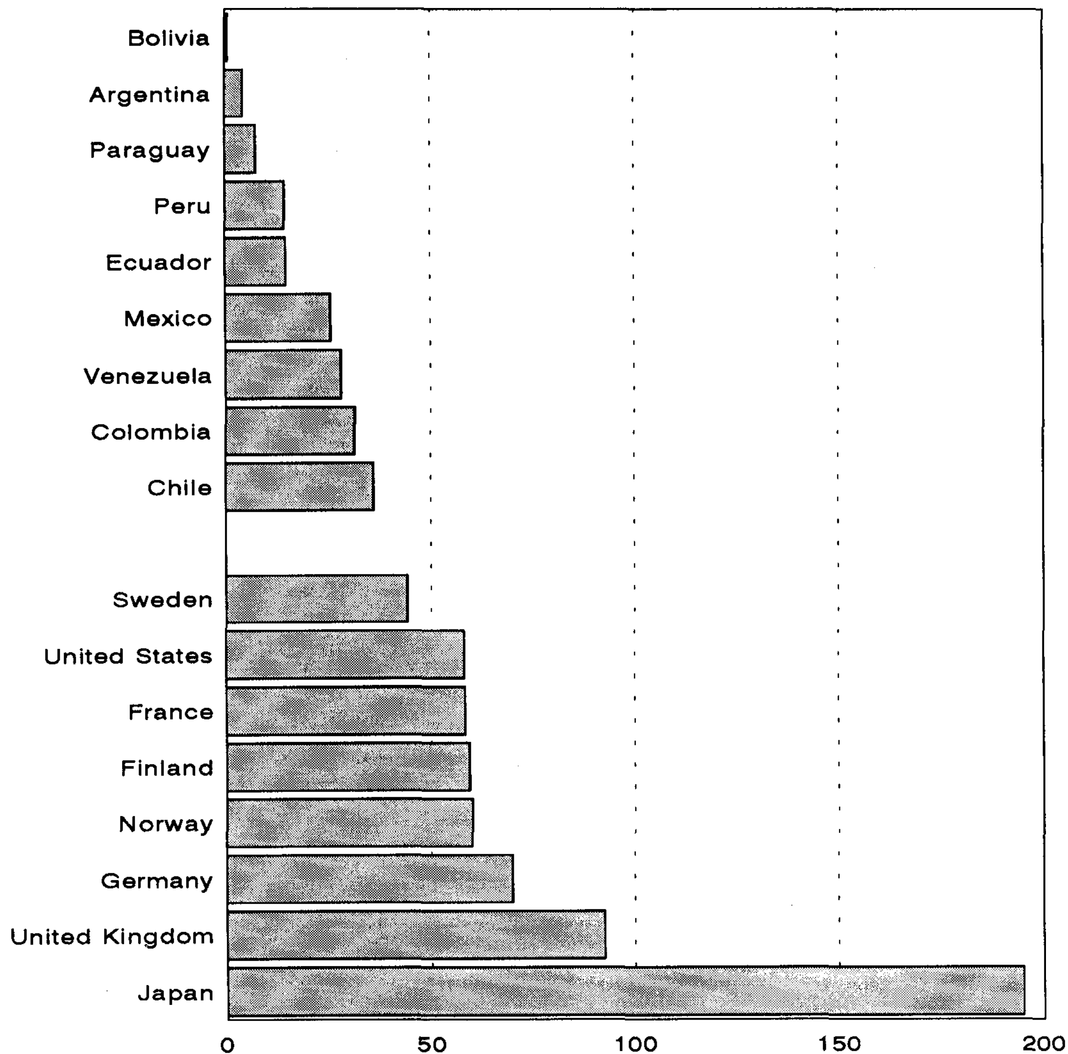
The countries of the region have implemented a series of reforms, particularly during the current decade, designed to strengthen institutional and microeconomic aspects of the banking system and capital markets in general. However, except in the case of Chile, Colombia, and to a lesser extent, Bolivia, El Salvador and Peru, these reforms appear to have been neither comprehensive nor sufficiently developed in most of the region; this situation, added to the macroeconomic factors, explains the resurgence of banking crises in the mid-1990s.

2. Measures taken to cope with the banking crisis

The Governments of the region responded in a variety of ways to the recent crises in the financial sector. Initially, all attempted to alleviate the problem by providing troubled institutions with financial assistance. Follow-up measures varied. Some Governments, for instance, encouraged bank mergers and takeovers and the participation of new shareholders, including foreign investors. As part of their economic reforms and efforts to resolve recent crises, some countries made it easier for foreign banks to set up operations or eliminated some of the obstacles foreign investors must overcome in order to acquire complete or partial ownership of local banks.

Despite these measures, a number of institutions had to be shut down or placed under control of the central bank, though some were able to resume operations, once former owners were removed from management. All the countries beset by banking crises took steps to deal with the situation, to avoid depositor losses

Figure IV-1
DEPOSITS IN THE BANKING SYSTEM
(Percentages of GDP)



Source: ECLAC, on the basis of official figures.

or to shore up the asset position of ailing institutions; measures ranged from the granting of financial assistance under certain conditions to tax incentives to promote restructuring of the banking industry.

The financial assistance accorded banks and depositors, plus the tax incentives, represented a high cost to central banks and Governments. The cost was highest in Venezuela, where it was equivalent to 13% of GDP, but was also significant –between 4% and 5%– in Bolivia, Brazil, Mexico and Paraguay. These percentages were comparable to those recorded during banking crises in some of the developed countries in the current decade (see table IV.1).

The banking crises were handled with varying success. In some countries, such as Argentina, Bolivia, Brazil and Mexico, the measures taken helped strengthen the banking system, while in others, such as Ecuador, Paraguay and Venezuela, no progress was made; indeed, such measures as were taken served only to exacerbate distortions. There have, however, been achievements in the region in recent years, in the

form of new banking legislation incorporating principles of greater competition through multi-purpose banking regimes, improved solvency rules more in keeping with the Basle accord on capital adequacy requirements, risk diversification standards, and more comprehensive disclosure rules. Efforts are being stepped up to confer greater status and powers on supervisory agencies and to set clear limits on the scope of public deposit insurance and on the financial assistance central banks will accord to troubled institutions. Initiatives are also focusing on upgrading the capabilities of regulatory agencies and developing inspection procedures that measure the quality of risk asset portfolios.

The most successful case of recovery is Argentina, where the non-inflationary rescue mechanisms employed have apparently proven far more effective than in the past in restoring confidence and ensuring that the correct incentives remain in place. Improvements have been noted in the microeconomic and institutional spheres, including greater emphasis on bank supervision, the disclosure of more information on the financial health of banks and improvements in almost all important aspects of prudential standards; these reforms are all very recent, however, and have yet to be fully consolidated.

The measures adopted by the Mexican Government to reinforce the capitalization and ownership structure of banks had the merit of avoiding distorted incentives and moral hazard. A government programme was created to provide short-term loans to service international obligations and temporarily capitalize banks, while another scheme sought to promote capital increases using shareholder resources. In addition, it was made easier for foreign investors to acquire equity in local banks, and assistance was provided in rescheduling some US$ 2 billion in bank debt.

Brazil introduced a series of confidence-boosting measures. Since August 1995, the Central Bank has had the power to permit foreign investors who buy into local banks to acquire a majority shareholding. In November 1995, a fund was created to increase the insurance on bank deposits, and a programme was launched to support bank restructuring and mergers.

Bolivia also took constructive steps to strengthen the banking system. A fund was established to improve liquidity and increase the capital base of the banking system. The fund mechanism was designed to enhance transparency in the banking system and reinforce market incentives.

In Venezuela, on the other hand, the policies adopted since 1994 to resolve the crisis have lacked focus and consistency, and apparently have not helped resolve the problems. Moreover, the restructuring of some banks, the winding-up of others and the introduction of deposit insurance have all posed substantial operational difficulties.

Paraguay passed a financial stabilization and recovery act in an attempt to refloat the banks under government supervision, though to little practical effect. Deposit insurance was increased, but at the same time accounting standards were relaxed, and this only served to aggravate the predicament of the banking system.

Ecuador, despite a number of measures introduced in 1993-1994 in an effort to improve the standard of supervision and put its financial system in order, was also faced with financial crises: the first involved a medium-sized institution, while more recently, in 1996, several brokerage firms closed down and the Government was forced to intervene in the country's third largest bank, an event that revealed the weakness of bank supervision. The Central Bank ultimately had to step in and assume full ownership of the failing bank.

3. The situation in Mexico

Mexico's banking sector has been under strong macroeconomic pressure during the 1990s as a result of stabilization plans that brought inflation down from 159% in 1987 to 8% in 1994. Against that backdrop, interest rates since 1990 have remained relatively high, and the Government has worked to reduce its budget deficit. At the same time, it has adopted reforms aimed at

Table IV-1

FINANCIAL CRISES: COST OF BANK BAILOUT, SIZE OF OVERDUE LOAN PORTFOLIO AND NUMBER OF INSOLVENT BANKS

Country	Year	Cost of bailout/GDP %	Overdue loans/total %	Insolvent banks (number)
Latin America				
Argentina	1995	...	28.00	47
Bolivia	1994-1995	4.20	...	3
Brazil	1995	5.00	...	17
Ecuador	1996	1.10	...	2
Mexico	1995	5.70	20.00	10
Paraguay	1995	4.11	...	8
Venezuela	1993-1994	13.00	9.30	19
Other countries				
Finland	1991-1993	8.20	9.30	...
Norway	1988-1992	4.50	...	...
Sweden	1991-1993	4.50	...	...
United States	1991	5.10	4.80	...

Source: Latin America: G. Ramírez Vilardell (cons.), *"Vulnerabilidad del Sistema Financiero de América Latina"*, Santiago, Chile, ECLAC, 1996.
Other countries: L. Rojas Suárez and S. Weisbrod, *"Banking crises in Latin America: experience and issues"*, document presented at the Conference on Banking Crises in Latin America, Inter-American Development Bank (IDB), Washington, D.C., 6-7 October 1995.

deregulating the major markets and privatizing enterprises. These developments for a time generated expectations of economic growth, enabling Mexico to attract sizeable flows of short-term foreign capital, on the order of US$ 25-30 billion a year, during 1992 and 1993. The prolonged overvaluation of the peso, stemming from the use of the exchange rate as a nominal anchor, led to a large balance-of-payments current account deficit, equivalent to 7-8% of GDP between 1992 and 1994, while consumption grew at a brisk pace and saving remained sluggish, representing no more than about 14% of GDP. These factors combined to create a highly vulnerable macroeconomic situation, particularly with regard to capital flows. The situation was aggravated by political developments from early 1994 onwards and resulted in a progressive slackening in capital flows to under US$ 10 billion in 1994 and the devaluation of the peso in December of that year. Over the course of 1995, inflation picked up sharply the level of economic activity dropped, and interest rates fluctuated between 50-80%; this had a severe impact on both borrowers and banks, especially because consumer and business debt were high, as reflected in the fact that bank lending had expanded by an average of 24% in real terms between 1991 and 1994.

A number of Mexican banks were at risk of insolvency in 1995, owing to an adjustment process that caused the proportion of overdue loans to climb to around 20% of total loans for the banking system as a whole. Another reason for the banks' troubles, apart from the difficult macroeconomic circumstances mentioned above and relatively poor supervision, was imprudent business management, combined with a lack of technical expertise in handling commercial risks in an expansionary economic climate, since prior to privatization, the Mexican banking sector had concentrated on public-sector financing. A further contributing factor would appear to be the financial conglomerates' desire for a quick return

Table IV-2
DEPOSITS IN COMMERCIAL BANKS AS A PERCENTAGE OF GDP IN COUNTRIES IN FINANCIAL CRISIS

	1994	1995
Argentina	4.66	4.37
Bolivia	0.47	0.72
Ecuador	13.45	14.80
Mexico	22.79	25.66
Paraguay	5.97	7.53
Venezuela	29.14	26.13

Source: ECLAC, on the basis of official figures.

on their big investments in bank acquisition. In 1991 and 1992, the Government sold 65% of the equity in 18 banks it controlled for approximately US$ 12 billion, with prices for the various banks averaging 3.65 times the book value of the stock and in some cases more than 5 times the book value.

The Government responded quickly to the banking crisis by instituting a series of measures, some designed to strengthen the capitalization and ownership structure of banks, which had the merit of avoiding distorted incentives and moral hazard. First, the Government enlisted the support of international financial agencies to set up a temporary capitalization programme (PROCAPTE), administered by the Bank Savings Protection Fund (FOBAPROA), an agency of the Bank of Mexico, for the purposes of granting short-term loans to service international obligations and temporarily capitalize banks that did not fulfil the normal capital adequacy requirements. To that end, PROCAPTE purchased subordinated bonds (with five-year maturities) considered as capital for accounting purposes and redeemable as stock in the event of non-payment. Five banks availed themselves temporarily of capitalization resources amounting to some US$ 900 million, while short-term loans worth US$ 3.8 billion were disbursed and were paid off when circumstances improved.

In addition, FOBAPROA introduced a scheme to promote capitalization with shareholder resources. For this purpose, FOBAPROA acquired the banks' high-risk loan portfolios in return for bond issues, on condition that for every peso of portfolio transferred shareholders must increase the bank's capital by half a peso. Although the mechanism has made financial statements less transparent, nevertheless, since it is designed so that the risk associated with the bond is equal to the risk of the ceded portfolio, it at least ensures that the stockholders still bear the burden of losses and has furthermore served to increase bank capital. The portfolios purchased from 10 banks account for roughly 10% of total loans in the banking system, and capital has increased by about US$ 4.8 billion, 80% of net worth at 31 December 1994. Undoubtedly, one factor contributing to this success was the Government's decision to make it easier for foreign investors, particularly financial institutions, to acquire equity in local banks. As a result of this decision, at the beginning of 1996 there were five banks in which foreign investors had acquired a portion of the share capital ranging from 16% to 70%. In addition, as happened in Chile during the 1980s, the Government has had to step in to help various sectors and consumers reschedule roughly US$ 2 billion in bank debt.

It is too early to evaluate the effectiveness and cost of the measures undertaken to revitalize the Mexican banking sector (some calculations put the cost in 1995 at 6% of GDP). Nevertheless, the steps taken appear to address fundamental problems and show a commitment to improving long-term microeconomic and institutional conditions.

4. The situation in Argentina

The devaluation of the Mexican peso in late 1994 raised serious doubts that the convertibility regime could be maintained and led to an interruption and reversal of capital flows. It also caused a crisis of confidence in the banking system, especially in the cooperative and provincial public-sector banks, many of which were known to be facing solvency problems. It is estimated that dollar deposits slumped by about 15%, or some US$ 3.5 billion, between December 1994 and March 1995, while deposits in pesos fell by some 13%, or about US$ 3.3 billion, between December 1994 and April 1995, triggering a serious liquidity crisis. The situation started to return to normal in the fourth quarter of 1995, but although the exchange rate held firm and prices remained stable, very high interest rates (exceeding 20% in real terms for deposits made in the second quarter of 1995) and the fierce liquidity squeeze inevitably provoked a sharp recessionary adjustment. GDP declined by some 4.3% in 1995 and the banking sector showed increasing signs of weakness.

Total losses by banks in 1995 are calculated at about US$ 700 million; these poor results extended into the first six months of 1996. On average, non-performing and underperforming loans hovered around 28% of the total in the second quarter of 1995, ranging from 35% and 50% for cooperative and provincial public-sector banks to 18% and 12% for private and foreign-owned banks, respectively. These latter two categories proved to have far more solid assets than the rest and to be much better at weathering the liquidity squeeze, which would indicate that the country has started to overcome traditional problems of lack of disclosure and that market discipline has to some extent been at work. By mid-1996, 43 banks out of a total of 177 disappeared, in most cases by merger with stronger banks with the aid of government rescue programmes; the tally included 29 cooperative banks, four provincial public-sector banks, nine locally-owned private banks and one foreign bank. In addition, nine non-bank financial institutions also closed their doors.

Although it is still too soon to know how much bank debtors will be able to repay, the position of Argentina's financial sector does appear to have improved since mid-1996, while domestic interest rates have dropped substantially and deposits have flowed back into banks. Of particular note in this process are the measures taken by the Government to alleviate the crisis; for example, the Government injected liquidity by releasing reserve funds held with the Central Bank (BCRA) and operating a "security network" headed by the Banco de la Nación –the Central Bank is subject to strict legal limitations as a lender of last resort– with the aim of shoring up interbank lending. The Government also set up a deposit insurance scheme, financed by the banks, with a premium of up to 0.06% per month on the daily average of deposits, which aims to accumulate a fund equal to 5% of the total insured. In order to avoid moral hazard, insured liabilities will be subject to the stipulation that interest rates offered may not exceed a reference rate.

Meanwhile, using resources collected by the Government and loans from international financial agencies, a fund has been set up to privatize provincial public-sector banks, and another created to capitalize private banks with insufficient equity. This second fund, similar in design to Mexico's programme, has US$ 2 billion with which to acquire subordinated bonds with a 3-year maturity that can be counted as capital and are convertible to share capital in the event of default.

5. The situation in Venezuela

Venezuela's financial system has achieved a certain depth, at least by Latin American standards, as shown by the fact that in 1993 deposits were equivalent to about 30% of GDP. Nonetheless, the loan portfolio has typically represented a small proportion of total bank assets. Moreover, just before the country's banking crisis erupted in January 1994, macroeconomic conditions were not altogether unfavourable, even though 1991 and 1992 were

marked by the reappearance of fiscal deficits and a slowly deteriorating political climate, which stalled the reform process. In any event, in late 1993, for reasons that are not altogether clear, the second-largest private bank in Venezuela was faced with a big run on deposits, so that the Government had to intervene in January 1994; the panic spread, causing major instability in financial markets and severe macroeconomic problems throughout the period 1994-1996, encompassing fiscal deficits, inflation, recession and currency depreciation.

Between January 1994 and August 1995, 19 banks –responsible for 55% of total deposits as of December 1993– came under government control; four of these banks were nationalized, and the others were liquidated, and their assets placed under control of the Deposit Insurance and Bank Protection Fund (FOGADE). This situation led to great turmoil in the capital markets and in many firms, because of the operation in Venezuela of de facto financial conglomerates with strong interlinkages between companies. By mid-1995, the Government had committed resources on the order of US$ 8 billion, just for financial assistance, injections of capital into nationalized banks and assumption of liabilities of other banks taken over by nationalized institutions, without counting the cost of deposit insurance.

Macroeconomic fluctuations and political conflicts were obviously important factors in Venezuela's financial crisis, but serious microeconomic and institutional deficiencies weighed far more heavily than in other countries. Although prudential regulations were overhauled and a new general banking act came into effect in January 1994, there are strong technical reasons for concluding that these steps were too little and too late. The crisis revealed that the Superintendency of Banks and Financial Institutions was ineffective and obsolete in its methods, and it also showed that the banking system was out of control and marked by business abuses, an absence of self-regulation and market discipline, undercapitalization and a nearly total lack of disclosure. There were revelations of a large volume of loans to owning conglomerates, along with significant unreported bank liabilities from trusts, brokerage of commercial paper and offshore transactions. A problem of moral hazard may also have arisen with respect to deposit insurance and the financial assistance FOGADE provided unconditionally to banks.

6. The situation in Brazil

Brazil's financial system is quite complex in terms of the number and diversity of institutions, which total about 3,500, including 250 commercial and multi-purpose banks. However, at the national level, private banking in particular is underdeveloped; this appears to be a reflection of the difficult macroeconomic conditions prevailing over the last decade and the dominance of federal- and state-government banks. In 1995, loans to the private sector totalled no more than 30% of GDP, and over 50% of financial activity was handled by the many public-sector institutions. As might be expected under those circumstances, public banks were severely weakened, because they continued to lend in times of extremely high real interest rates –in general well in excess of 100% per annum during the period 1991-1995– and because they were heavily involved in financing state governments and enterprises. Moreover, banks owned by the state governments in particular were very inefficient and greatly overstaffed. Private banks, meanwhile, earned their profits chiefly from the intermediation of public paper with buyback agreements, foreign exchange transactions and inflation gains on demand deposits.

Even though macroeconomic conditions improved during 1995 and 1996, since inflation was reduced to below 20% per annum, while GDP grew on average by 4.7% over the period 1993-1995, the banking system as a whole had to deal with strong pressures and a crisis of confidence, although there was no massive withdrawal of deposits. A number of factors, in addition to those already mentioned, appear to have contributed to this situation. First, the sharp drop in inflation in 1995-1996, to less than one hundredth of the levels recorded in the two previous years, heavily stressed the entire

commercial and multi-purpose banking system. Second, the stabilization initiatives contained in the *Real* Plan, combined with the uncertainty generated by the Mexican crisis, caused serious liquidity problems for a number of private and public banks –despite the high level of international reserves and a manageable current account deficit. In particular, the Central Bank of Brazil (BCB) strictly enforced reserve requirements, for state banks as a means of supporting the stabilization programme and putting the states' finances on a sounder footing. Those requirements revealed the serious lack of liquidity in the banks' loan portfolios, and this prompted the Central Bank to implement assistance plans, primarily through swaps of state-government paper for federal securities, and by virtually taking over the management of the banks. Third, real interest rates remained very high, which hurt loan portfolios and limited the growth of this activity as a replacement for inflation-related income.

Since late 1994, the Central Bank has liquidated or intervened in a total of 17 public and private banks. Most were small in size, but the Central Bank was compelled to intervene on an extraordinary basis in both the Banco do Estado de São Paulo (BANESPA), Brazil's second largest bank, and the Banco do Estado de Rio de Janeiro (BANERJ). It also conducted routine interventions in the second half of 1995 in two major private banks, the Banco Económico and the Banco Nacional, which apparently had been rife with irregularities for many years. This panorama was further compounded in 1996 by the discovery of serious problems in the management and supervision of the Banco do Brasil, which forced the Government to acknowledge the bank's losses and undertake to recapitalize it for US$ 5 billion.

The situation of the banking system led the Government to adopt a series of confidence-building measures. Since August 1995, the Central Bank has been empowered to allow foreign investors to acquire a majority shareholding in Brazilian banks. In November 1995, a loan guarantee fund was set up for the purpose of increasing insurance on deposits with public and private banks from 2,000 to 20,000 reais, to be financed by a premium of 0.3% per annum on deposits. Lastly, at the end of 1995 as an outgrowth of efforts to bolster the merger between the failed Banco Nacional and Unibanco, a Programme was launched to promote the restructuring and strengthening of the national financial system (PROER), as a vehicle for the Central Bank to support the numerous restructurings and mergers taking place in Brazil. The mechanisms include tax exemptions for mergers undertaken before 31 December 1996, lines of credit linked to various losses and costs associated with downsizing, release of reserve funds, relaxation of operating limits and authorization to defer expenses.

Lastly, it would be incorrect to speak of a widespread crisis among private banks, as on the contrary they appear to have minimized their exposure. Improvements have also been noted in prudential regulatory standards and especially in capital requirements. Moreover, in late 1995 the Central Bank was demonstrating good analytical and supervisory capacity, although its on-site inspections were deficient in some areas, particularly with respect to portfolios rating audits, an issue that will be particularly pertinent if Brazil's private banks expand lending in the future.

7. The situation in Paraguay

Paraguay's financial system had serious problems in 1995-1996, despite the fact that the economy continued to enjoy a high degree of stability. It should be pointed out that the development of the financial system has been out of proportion to the size of the economy; in 1995 Paraguay had 35 banks and 64 financial institutions for a total volume of deposits barely greater than US$ 1.8 billion. Prudential standards and supervision by the Central Bank of Paraguay (BCP) have not been sufficient to ensure effective monitoring of the financial system, which in addition operates within an inadequate legal framework. Financial institutions are undercapitalized and handicapped by poor management and above all by a serious lack of reliable information. A significant portion of transactions are not recorded on the banks'

books, and it is strongly suspected that a high percentage of loans have been made to associates.

Beginning in mid-1995, when the irregularities of some institutions became evident, the Central Bank was obliged to intervene in four banks, which were subsequently liquidated, and four other financial institutions. The deposits in the banks under central bank supervision represented about 15% of total deposits in the domestic banking system. There was a major loss of confidence in the local financial system, and this situation continued to worsen as the crisis developed; by mid-1995, 54% of bank deposits were held in foreign-owned institutions. Again in 1996, the Central Bank had to step in to shore up a number of institutions, accounting for a further 15% of deposits in domestic banks, and there were concerns for their solvency. By mid-1996, the Central Bank had committed some US$ 400 million to help troubled banks, quite a large figure in relation to deposits and one which generated considerable political controversy. During the second half of 1995, the Government approved –to little practical effect– a temporary financial stabilization and recovery act (Act No. 797), in order to refloat banks under government control, increase deposit insurance to approximately US$ 20,000 and streamline accounting procedures for banks that submitted restructuring plans. The third initiative, also ineffective, came in for severe criticism, complicating still further the banking system's predicament.

Thereafter, the Paraguayan authorities sought more effective means of strengthening the banking system and imposing greater market discipline. In mid-1996, a project was announced to set up a bank capitalization fund, modelled on similar programmes in Mexico, Argentina and Bolivia. During the second quarter of 1996, Congress passed a new general banking and lending institutions act (Act No. 861), which contains all the elements of modern prudential supervision.

8. The situation in Bolivia

Macroeconomic stability has characterized Bolivia's economy for nearly a decade, since hyperinflation was tamed. As a result, deposits have staged an impressive recovery, climbing from some US$ 600 million in late 1989 to some US$ 2.5 billion in late 1995. However, the entire post-inflationary period has been marked by high interest rates and a high degree of dollarization of deposits, suggesting that it has been hard to win back confidence.

Beginning in 1988, the Superintendency of Banks set about devising better prudential regulations, including portfolio rating mechanisms, establishment of risk provisions, controls on loans to associates, and proper disclosure by banking institutions. Lastly, in April 1993, a new banks and financial institutions act (Act No. 1488) was passed, containing all the provisions required to ensure adequate bank regulation and supervision.

Notwithstanding these developments, several financial institutions started running into liquidity and solvency problems in the fourth quarter of 1994. Banco de Cochabamba and Banco del Sur were both shut down, and by virtue of Executive Order No. 23,881, the Government assumed responsibility for payment of those banks' deposits. The situation deteriorated in 1995, leading to major public controversy aimed largely at Banco Boliviano Americano (BBA), Bolivia's sixth largest bank, but also involving the Central Bank's support and efforts to secure foreign investors. Available information indicates that a substantial proportion of the Bolivian banking system suffers from undercapitalization and imprudent management, despite the provisions of the 1993 law and the regulations promoted by the Superintendency of Banks.

As part of its efforts to strengthen the banking system, in September 1995 the Government issued Executive Order No. 24,410, establishing a fund for the development of the financial system and assistance to the productive sector; one of the purposes of the fund is to channel resources into shoring up liquidity and raising the capital base of the banking system, using the US$ 265 million contributed mainly by international

agencies. The fund boasts considerable resources, equivalent to more than the capital of all local banks combined. The fund is designed to increase transparency in the banking system and reinforce market incentives; a pre-condition for its use is that financial statements be immediately adjusted to meet strict accounting standards; contributions take the form of subordinated loans granted to banks and considered as capital for accounting purposes, but convertible into shares, with a resulting change of ownership, in the event of default (as in Mexico and Argentina).

9. The situation in Ecuador

Ecuador's banking system remained somewhat chaotic until early 1994, because the monetary authorities had authorized a large number and variety of institutions to take deposits from the public, including banks, finance companies, brokers of commercial paper, mutual associations, cooperatives, leasing firms and credit card companies. Furthermore, since the 1980s a number of banks had engaged in irregular practices; in order to avoid taxes and attract funds in foreign currencies, they would record many of their domestic loan and deposit transactions on the books of offshore subsidiaries and associated foreign firms. These practices, combined with very lax legislation, inadequate disclosure and an inefficient Superintendency of Banks, created a situation in which there was very little real control of the banking system.

In 1993 and 1994, the Government, with the support of the Inter-American Development Bank, took steps to improve bank supervision and restructure the financial system. To that end, a new general financial institutions act was passed in May 1994, embodying the principles of multi-purpose banking, the Basle capital standards, stringent accounting and disclosure rules and in general a more suitable legal framework in which to exercise prudential supervision. The Superintendency of Banks attempted to introduce some key rules, such as portfolio rating mechanisms. More recently, however, particularly in 1995, Ecuador's banking system has suffered from severe uncertainty, as a result of the deteriorating macroeconomic situation, a drop in capital inflows, the effects of armed conflict with Peru and domestic political tensions.

In August 1994, the authorities had to deal with rumours and liquidity problems involving Banco de los Andes, a medium-sized bank which accounted for 4% of deposits. Though the problem was resolved when the ailing institution merged with another bank, the episode nevertheless highlighted the difficulties alluded to, such as loans to associates and offshore transactions.

Over the last year and a half, liquidity shortages and high interest rates have been the order of the day. In spite of its intention to maintain the exchange rate, the Central Bank of Ecuador (BCE) has had to take steps to stem the liquidity crisis facing banks. In late 1995, new officials at the Superintendency of Banks, backed by legal amendments, decreed a three-year moratorium on the establishment of new banks and sharply increased minimum capital requirements, bringing to a halt the conversion of institutions to multi-purpose banks under the 1994 act. The Superintendency has also sought to bring about the merger of a number of financial institutions, and, in 1996, the National Financial Corporation (CFN), with international funding, has been working to restructure the obligations of bank debtors.

In 1996, as a result of the liquidity crisis, the Government had to deal with the closure of several stockbrokers and to intervene in the failed Banco Continental, the country's third largest bank, which held some 10% of assets in the financial system. The bank's image was badly hurt by the discovery of a capital pyramiding scheme involving associated firms, which apparently gave them access to tax benefits. The case also underlined the laxity of bank supervision, for the bank had been expanding strongly prior to the scandal. The Central Bank ultimately became de facto owner of the bank, when it granted the institution a subordinated loan counted as capital in the amount of some US$ 200 million.

V. LEVEL OF ACTIVITY AND INFLATION

1. GDP Growth

The gross domestic product (GDP) of Latin America and the Caribbean grew by 0.3% in 1995, thereby interrupting the recovery which had begun in 1991. Per capita GDP thus declined 1.5%, in contrast with the 3.3% increase noted in the preceding year. As a result, the region's GDP for 1995 was 16% higher than in 1990, but only 30% higher than in 1980, before the debt crisis struck, while per capita GDP was still 5% lower than the 1980 figure.

The picture is even gloomier if one looks at how the level of economic activity changed in the course of the year. The strong expansion observed in the latter half of 1994 continued into the first few months of 1995, but from the second quarter on, there was a dramatic turnabout which led to a contraction in regional output. In the fourth quarter, the recession bottomed out, but signs of an upturn were unconvincing. The recessionary situation persisted into the first half of 1996, although an improvement was expected in the second half. Thus, GDP growth in Latin America and the Caribbean should be between 2% and 3%.

This negative trend is attributable mainly to the sharp downturn in production in Mexico and Argentina (see table V-1). Excluding these two countries, regional output exhibited a very different trend, recording an increase of slightly over 4%, or just one percentage point less than in 1994, when it had reached its highest point of the past 15 years. The financial crisis that broke out in Mexico in December 1994, when capital inflows to that country had fallen off drastically, spread to the rest of the region, but Argentina was the most seriously affected; total demand contracted in these two countries, causing declines in consumption and investment, although this slump was partly offset, in both cases, by a surge in exports.

The repercussions of this decrease in external capital inflows had already been felt in the first quarter of 1995, but the situation worsened significantly from the second quarter on, leading to a contraction in GDP in both economies that dragged down the regional figure, which was also affected by the loss of momentum in other economies, in particular Brazil and Peru.

As a result of the crisis in Argentina, Uruguay –which has strong economic ties with that country– also suffered a decline in its GDP for 1995. In Jamaica, for its part, economic growth was again minimal owing to problems of economic instability and setbacks in the manufacturing and mining sectors.

In contrast with these poor performances, the rest of the countries in the region recorded positive trends, although substantial variations were to be seen among these economies in terms of both their actual growth rates and the duration of the upswing to date. In 10 countries of this group, indicators of economic activity in 1995 were either better or practically the same as in 1994; in 10 others, the increase was slightly lower. In both situations, growth in 1995 was due to the expansion of domestic and external demand. The reduction in financial inflows from abroad was noticeable only in the first quarter; later, there was an improvement in these inflows which played an important role in the growth of the economies concerned.

Five countries (Chile, Colombia, Guyana, El Salvador and Peru) recorded GDP growth rates of over 5%, thus maintaining the positive performance of preceding years. For Chile, which registered an increase of just over 8% –a substantially higher rate than the previous year's– 1995 was the twelfth year of

Table V-1
LATIN AMERICA AND THE CARIBBEAN: TOTAL GROSS DOMESTIC PRODUCT
(Annual growth rates)

	1990	1991	1992	1993	1994	1995[a]	1981-1990	1991-1995[a]
Latin America and the Caribbean	**-0.3**	**3.2**	**2.6**	**3.6**	**5.2**	**0.4**[b]	**0.9**	**3.0**[b]
Argentina	0.0	8.8	8.6	6.1	7.4	-4.4	-0.9	5.2
Bolivia	4.6	5.3	1.6	4.2	5.1	3.6	0.2	4.0
Brazil	-4.7	0.1	-1.1	4.4	5.7	3.8	1.3	2.6
Chile	3.3	7.1	10.5	6.0	4.1	8.2	3.0	7.2
Colombia	3.8	1.6	4.0	5.1	6.3	5.7	3.7	4.5
Costa Rica	3.5	2.1	7.3	6.0	4.4	2.5	2.2	4.5
Ecuador	3.2	5.4	3.7	2.5	4.8	2.7	1.7	3.8
El Salvador	4.8	3.6	7.5	7.4	6.0	6.1	-0.4	6.1
Guatemala	3.0	3.7	4.9	4.0	4.1	5.0	0.9	4.3
Haiti	-0.1	0.8	-8.4	-1.3	-4.4	4.8	-0.5	-1.8
Honduras	-0.8	2.0	6.3	7.0	-1.3	3.2	2.4	3.4
Mexico	4.5	3.7	3.0	0.8	3.6	-6.6	1.7	0.8
Nicaragua	-0.1	-0.1	0.8	-0.4	4.1	4.4	-1.8	1.8
Panama	8.0	8.1	7.5	3.8	3.8	1.9	1.6	5.0
Paraguay	3.0	2.4	1.6	4.1	2.9	4.1	3.0	3.0
Peru	-5.4	2.8	-0.9	5.8	13.9	7.7	-1.2	5.7
Dominican Republic	-4.9	0.8	6.7	2.2	4.3	4.7	2.4	3.7
Uruguay	0.6	3.2	7.8	3.3	6.9	-2.8	0.0	3.6
Venezuela	7.0	9.7	6.1	0.7	-2.5	2.3	-0.7	3.2
Other Caribbean countries								
Antigua and Barbuda[c]	3.5	4.3	1.7	3.4	5.5	-3.8	6.4	2.1
Barbados	-3.2	-4.0	-6.2	1.5	3.8	2.7	0.9	-0.5
Belize	10.3	3.1	9.5	4.3	1.5	3.8	4.5	4.4
Dominica	6.3	2.2	2.7	1.9	2.1	1.8	4.4	2.1
Grenada	5.2	3.6	1.1	-1.3	2.3	2.3	4.9	1.6
Guyana	-3.0	6.0	7.8	8.2	8.5	5.1	-2.7	7.1
Jamaica	5.5	0.7	1.5	1.4	0.8	0.5	2.5	1.0
Saint Kitts and Nevis	3.0	3.8	3.6	4.0	3.2	2.0	5.8	3.3
Saint Vincent and the Grenadines	7.0	3.1	6.5	1.3	0.4	3.0	6.5	2.9
Saint Lucia	4.4	2.3	7.1	2.3	2.8	3.8	6.8	3.6
Suriname	0.1	3.5	5.8	-4.5	-0.8	...	0.5	...
Trinidad and Tobago	1.5	2.7	-1.7	-1.6	4.2	3.5	-2.4	1.4

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures. [b] Does not include Suriname. [c] Based on figures at factor cost.

uninterrupted growth. Colombia showed an upturn of around 6% and El Salvador continued the dynamic recovery (6%) which had begun at the start of the decade when the civil war came to an end. Guyana recorded an increase (5%) for the fifth consecutive year –for a cumulative rise of 40%– but its growth rate was somewhat lower than the figure for the preceding year. Peru experienced 7% growth, although this was down from the previous year's level of 14%, thus completing three years of vigorous expansion; nevertheless, its performance changed considerably in the course of the year, with a marked slowdown in the second half. In the first few months of 1996, there were even signs of a recessionary situation, although this later started to correct itself.

In 10 other countries, GDP continued to grow at a moderate pace of between 3% and 5%, while in five others, the rise was between 1.5% and 3%.

The Brazilian economy grew by approximately 4% in 1995, almost two percentage points lower than the rate for 1994. As with Peru, there was an uneven pattern during the course of the year; in the first quarter, the economy continued to display the same remarkable vitality as in 1994, which, in itself, was sufficient to ensure a satisfactory performance for the entire year. There followed a marked decline in the second and third quarters, but in the fourth, it stabilized at a low level which carried over into the first half of 1996. The reasons for this sudden break in the trend are different from those noted for Argentina and Mexico, however. Although, initially, the consequences of the fall-off in foreign inflows were noticeable, the slowdown was actually due to the measures put into effect to stop the economy from overheating and to maintain the degree of stability already achieved.

Belize, the Dominican Republic, Guatemala and Paraguay, displayed more dynamism than in the preceding year. On the other hand, in addition to Brazil, as already discussed, another six countries –Barbados, Bolivia, Costa Rica, Ecuador, Panama and Trinidad and Tobago– suffered a slowdown.

Four other countries (Haiti, Honduras, Nicaragua and Venezuela) showed signs of an upturn, after the paltry results of the preceding years. In Venezuela, GDP was up by just over 2%, but this was on the strength of the oil sector's performance since the rest of the economy was sluggish. The exacerbation of the recession and the introduction of an adjustment plan also had an adverse effect on the growth of the economy, and a fall in the level of activity may therefore be expected in 1996, thus making a stronger recovery in regional output unlikely. Honduras, where the impact of the main obstacles to economic growth encountered in the preceding year started to subside, achieved an expansion of slightly over 3%. Nicaragua recorded satisfactory growth for the second consecutive year, but it was insufficient to compensate for a protracted period –over a decade– of severe economic recession. Haiti also showed signs of recovery, following the lifting of the international embargo, although this could scarcely make up for the huge losses incurred in the preceding years (see table V-1).

Economic activity in Cuba increased, but the country remained mired in the severe recession that has prevailed since the collapse of its relationship with what was formerly the socialist bloc; thus, GDP amounted to only slightly more than half of the level recorded in 1989. At the same time, the intensification of the economic embargo by the United States is making recovery difficult, especially by keeping away new investors.

The small countries of the Organization of Eastern Caribbean States (OECS) showed a modest increase (1.9%) that was somewhat lower than the previous year; nevertheless, there were wide disparities between the different member countries: Antigua and Barbuda recorded a decline of almost 4%, while Saint Vincent and the Grenadines had a growth rate of over 7%.

Although many countries of the region still had relatively high population growth rates, GDP per capita growth rates were mostly positive in 1995. In five countries –Chile, Colombia, El Salvador, Guyana and Peru– this indicator of well-being climbed by over 3%, and in eight others –Barbados, Belize, Bolivia, Brazil, the Dominican Republic, Guatemala, Haiti and Paraguay– the rates were between 1% and 3%. In another three economies –Ecuador, Nicaragua and Trinidad and Tobago– they were up slightly while in Costa Rica, Honduras, Panama and Venezuela, there was no variation. In the four remaining countries (Argentina, Jamaica, Mexico and Uruguay), per capita GDP decreased. In the OECS countries, a 1% rise was recorded, although with very pronounced differences within the group.

During the current decade, per capita GDP increased in most countries of the region; only in five were there decreases (Barbados, Haiti, Mexico, Nicaragua and Trinidad and Tobago). The strongest gains were made in Argentina, Chile, Colombia, El Salvador, Guyana, Panama, Peru and Uruguay. However, in view of the poor performance of the region's economies in the preceding decade, only a few countries recorded a significantly higher per capita GDP in 1995 than in 1980, namely Chile (49%), Jamaica (41%), Belize (36%), Colombia (36%) and the Dominican Republic, Panama and Uruguay, where it increased by about 10%. At the opposite

Table V-2

LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS DOMESTIC PRODUCT

(Annual growth rates)

	1990	1991	1992	1993	1994	1995[a]	1981-1990	1991-1995[a]
Latin America and the Caribbean	**-2.2**	**1.3**	**0.8**	**1.8**	**3.3**	**-1.4**[b]	**-1.1**	**1.1**[b]
Argentina	-1.3	7.4	7.3	4.8	6.2	-5.5	-2.3	3.9
Bolivia	2.3	2.8	-0.8	1.7	2.6	1.1	-1.9	1.5
Brazil	-6.4	-1.7	-2.8	2.7	3.9	2.1	-0.7	0.8
Chile	1.6	5.4	8.7	4.2	2.5	6.5	1.3	5.4
Colombia	2.0	-0.2	2.2	3.3	4.6	4.1	1.7	2.8
Costa Rica	0.8	-0.4	4.7	3.5	1.9	0.2	-0.6	2.0
Ecuador	0.8	3.0	1.4	0.3	2.5	0.5	-0.9	1.5
El Salvador	2.8	1.5	5.2	5.0	3.7	3.7	-1.7	3.8
Guatemala	0.1	0.8	1.9	1.1	1.1	2.0	-2.0	1.4
Haiti	-2.2	-1.2	-10.3	-3.3	-6.3	2.7	-2.4	-3.8
Honduras	-3.7	-1.0	3.2	3.9	-4.1	0.3	-0.8	0.4
Mexico	2.5	1.8	1.1	-1.1	1.8	-8.2	-0.4	-1.0
Nicaragua	-3.1	-3.6	-3.0	-4.2	0.2	0.7	-4.4	-2.0
Panama	5.9	6.0	5.5	1.9	1.9	0.1	-0.5	3.1
Paraguay	0.0	-0.5	-1.3	1.2	0.2	1.3	-0.2	0.2
Peru	-7.1	0.9	-2.6	4.0	12.0	5.9	-3.3	3.9
Dominican Republic	-6.9	-1.2	4.6	0.3	2.3	2.9	0.2	1.7
Uruguay	0.1	2.6	7.2	2.7	6.3	-3.3	-0.6	3.0
Venezuela	4.4	7.1	3.6	-1.6	-4.6	0.1	-3.2	0.8
Other Caribbean countries								
Antigua and Barbuda[c]	2.8	3.6	1.0	2.8	4.9	-7.2	5.9	0.9
Barbados	-3.2	-4.4	-6.6	1.1	3.4	2.3	0.6	-0.9
Belize	7.3	0.5	6.7	1.7	-1.1	1.2	1.9	1.8
Dominica	7.8	2.2	2.7	1.9	2.1	1.8	4.8	2.1
Grenada	5.7	3.4	0.9	-1.5	2.1	2.1	4.7	1.4
Guyana	-3.1	5.0	6.6	7.2	7.3	4.1	-3.2	6.0
Jamaica	5.0	0.1	0.8	0.7	0.1	-0.2	1.4	0.3
Saint Kitts and Nevis	3.5	3.8	3.6	6.5	3.2	2.0	7.0	3.8
Saint Vincent and the Grenadines	5.9	2.2	5.6	0.4	-0.5	2.1	5.5	1.9
Saint Lucia	2.9	1.0	5.7	0.9	1.5	2.4	5.3	2.3
Suriname	-1.2	2.3	4.6	-5.6	-1.9	...	-0.7	...
Trinidad and Tobago	0.2	1.6	-2.8	-2.7	3.0	2.4	-3.7	0.3

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures. [b] Does not include Suriname. [c] Based on figures at factor cost.

extreme, the sharpest reductions in per capita GDP were noted in Bolivia, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago and Venezuela (see table V-2).

Gross national income, like gross domestic product, scarcely increased since there were only minor variations in the terms of trade and external factor payments. There were significant differences between countries, however. Thus, in Chile, the rise in national income was almost 7% higher than the rise in GDP as a result of the improvement in the terms of trade caused by the increases in copper and pulp prices on the international market. There were also appreciable improvements, although not on the same scale, in Colombia, Costa Rica, the Dominican Republic, El Salvador and Guatemala. On the other hand, in Mexico, the fall in income was greater –by almost two percentage points– than the decline in GDP because of lower

prices in dollars for tourism and other services as a result of the devaluation. Lastly, in the case of Haiti, national income grew at an extraordinarily high rate (25% against 5% GDP growth) owing to the substantial volume of current transfers received from abroad.

2. Production sectors

The performance of the region's production sectors revealed considerable differences. On the one hand, agriculture, mining and basic services (electricity, gas and water, and transport and communications) expanded in most countries, regardless of the trend in their total* GDP*, since this was accounted for by factors unrelated to the economic situation of the moment. On the other hand, in the rest of the sectors (manufacturing, construction, commerce and financial services), there was a marked contrast: in the countries where there was an expansion in economic activity, all these other sectors recorded positive results whereas, in countries with overall declines, these sectors posted significantly lower production figures.

The agricultural sector expanded in all the countries of the region except Haiti, Mexico and Venezuela (see table V-3). Paraguay had the strongest increase (10%), thanks to the improved harvests of its two main crops, but substantial increases –of between 5% and 7%– were also recorded in nine other countries (Brazil, Chile, Colombia, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua and Peru).

Mining production was also up in all countries where this sector has a major role except in Mexico, where production figures declined slightly. In Argentina, mining output continued to climb, thanks to its increased fuel production. Colombia also made substantial gains based on an upswing in hydrocarbon production. In Venezuela, the petroleum industry was quite buoyant, in contrast to the other sectors of production, which recorded an overall decline. Utilities showed an overall expansion of 5%, again with the exception of Mexico, which suffered a slight decline.

Among the countries that marked up increases in manufacturing output, five (Chile, Colombia, El Salvador, Peru and Venezuela) recorded rises of between 4.5% and 7%, while Haiti posted a rise of 15%, although this represented no more than a partial recovery from the debacle of the preceding years. In the other countries of this sub-group, modest increases were noted; in Brazil, for example, where manufacturing bore the brunt of the economic slowdown, the expansion of this sector amounted to less than 2%. In Nicaragua and Peru, the construction industry recorded noteworthy increases on the order of 16%. Other services recorded gains in Peru (11%) and in Chile and Haiti (approximately 7%). In Brazil, the increase was below 3%, above all because of the contraction in banking services prompted by the decline in the rate of inflation.

In the three countries where there was a slowdown in activity (Argentina, Mexico and Uruguay), the performance of the manufacturing sector, construction and other services (in particular commerce) was poor. The fall in manufacturing production in Argentina was especially noticeable in the case of such items as motor vehicles and household appliances. In Mexico, the manufacturing sector suffered a significant contraction which affected almost all of its branches. In the automotive industry, the structure of demand, which shrank overall by 19%, was drastically different; domestic sales plummeted 73%, while the number of vehicles exported soared 38%. In Uruguay, manufacturing output intended for the Argentine market suffered the sharpest decrease, while construction was the most adversely affected activity with declines of between 11% and 22%. This sector also performed poorly in Venezuela, as a result of the crisis in that country, and in costa rica due to the adjustment policies that were being implemented.

Table V-3
LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT, BY BRANCHES OF ECONOMIC ACTIVITY, AT MARKET PRICES
(Annual growth rates)

	Agriculture		Mining and quarrying		Manufacturing		Construction		Subtotal: goods		Basic services		Other services	
	1994	1995[a]	1994	1995[a]	1994	1995[a]	1994	1995[a]	1994	1995[a]	1994	1995[a]	1994	1995[a]
Latin America and the Caribbean [b]	**5.5**	**2.9**	**5.4**	**4.2**	**5.7**	**-0.5**	**7.5**	**-4.6**	**5.9**	**0.1**	**6.2**	**2.9**	**3.9**	**-0.6**
Argentina	3.8	1.7	11.7	4.3	4.2	-6.5	15.7	-11.0	6.2	-5.2	7.3	-3.8	8.4	-3.6
Bolivia	8.1	1.6	3.6	3.5	4.5	4.1	3.2	5.0	5.4	3.2	9.5	5.0	5.2	3.0
Brazil	8.4	5.0	4.7	3.1	7.8	1.6	6.0	0.1	7.6	2.1	4.9	8.4	2.3	2.7
Chile	8.5	5.5	2.7	7.2	2.9	6.5	2.0	7.4	3.7	6.6	7.3	10.7	3.7	7.1
Colombia	2.3	5.2	4.5	17.8	1.4	1.0	21.5	3.8	4.4	5.4	7.5	5.3	6.6	5.7
Costa Rica	3.2	3.3	[a]	[a]	3.5	3.0	6.2	-12.0	3.6	1.9	7.6	5.2	4.4	2.5
Ecuador	3.9	3.2	7.6	0.6	6.9	6.9	5.3	-1.4	6.3	3.0	4.2	3.2	3.1	2.2
El Salvador	-2.7	5.1	12.0	7.2	7.9	7.0	10.1	6.0	4.1	6.2	5.2	5.6	6.1	6.2
Guatemala	2.4	2.9	3.8	12.3	2.9	3.3	-4.9	8.0	2.1	3.5	5.3	6.4	5.2	5.7
Haiti	-0.8	-11.3	-14.3	50.0	-11.2	23.6	-2.1	85.1	-3.2	5.8	-23.1	12.6	-3.1	3.4
Honduras	0.8	6.9	2.3	9.1	-1.8	2.6	-19.2	-2.2	-3.1	4.3	0.6	6.1	0.2	1.5
Mexico	2.0	-2.5	1.6	-3.4	3.6	-4.6	6.4	-23.3	3.5	-6.3	7.8	-3.6	3.1	-7.6
Nicaragua	10.8	5.0	-10.1	10.9	1.0	3.0	17.8	16.3	7.7	5.1	0.4	5.1	0.3	3.4
Panama	3.1	2.4	9.6	-5.5	4.3	0.2	2.2	1.3	3.5	1.1	3.5	7.0	5.8	1.5
Paraguay	-0.6	7.2	5.0	2.0	1.5	2.5	3.6	4.0	0.6	5.2	11.4	9.2	4.1	1.9
Peru	14.7	5.6	4.0	2.4	15.8	4.5	32.1	17.2	18.3	7.4	8.0	7.3	11.0	11.5
Dominican Republic	-1.8	6.0	88.2	9.4	2.9	-0.7	6.6	5.7	5.5	4.0	4.9	9.1	3.1	4.7
Uruguay	9.2	2.7	7.1	-14.6	4.0	-2.8	5.7	-14.7	5.8	-2.7	11.4	3.1	3.9	-3.2
Venezuela	1.9	-0.6	5.6	4.8	-3.5	7.2	-26.3	-11.4	-1.7	3.7	-2.2	3.8	-2.7	-1.6

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures. [b] Does not include Cuba.

3. Supply and demand

Total supply in Latin America and the Caribbean increased 1% in 1995, owing mainly to the expansion in the volume of imports (4%), since GDP growth was flat. This increase in supply was lower than in the four preceding years, when it had stood at an annual average rate of slightly over 5%. Domestic demand contracted 1% due to the fact that exports grew more than imports in terms of volume, which means that a larger portion of the increase in supply was transferred abroad, unlike previous years, when a high percentage of the increase in domestic demand had been met with goods and services brought in from abroad.

The volume of the region's imports increased less than in previous years because of the substantial decline in the amount imported by Argentina and Mexico, although this was offset by strong expansions in Bolivia, Brazil, Chile, Colombia, Ecuador, Peru and Venezuela (between 10% and 30%) and in Haiti, where imports quadrupled after the trade embargo was lifted (see table V-4).

The volume of exports expanded 12%, which was more than in 1994 and more than the historical average annual rate for the period 1981-1994. Significant increases were noted in Argentina, Colombia, El Salvador, Mexico and Nicaragua (between 10% and 28%); in Haiti, the indicator was two and a half times higher. In Brazil, there was scarcely any increase and in Uruguay, there was a 7% decline.

Table V-4

LATIN AMERICA AND THE CARIBBEAN: TOTAL SUPPLY, DOMESTIC DEMAND AND GROSS NATIONAL INCOME [a]

(Annual growth rates)

	1990	1991	1992	1993	1994	1995[b]	1981-1990	1990-1995[b]
1. Total supply (2 + 3)	0.9	5.0	5.1	4.4	6.4	1.0	8.6	23.9
2. Gross domestic product at market prices	-0.4	3.3	2.7	3.7	5.2	0.3	10.1	16.0
3. Imports of goods and services	12.1	17.6	20.8	8.6	12.6	4.6	-1.3	81.6
4. Exports of goods and services	6.5	4.9	7.2	7.5	8.8	12.5	68.9	47.9
5. Domestic availability of goods and services (2 + 3 - 4) = domestic demand (6 + 7)	0.1	5.0	4.8	3.9	6.0	-1.0	2.6	20.0
6. Final consumption expenditure [c]	1.3	5.4	4.3	3.1	4.7	0.2	12.5	18.9
7. Gross fixed capital formation	-4.4	3.4	6.7	7.3	10.9	-5.2	-24.4	24.4
8. Income	-14.9	-5.9	2.2	6.3	-0.1	-1.6	51.6	0.5
9. Real gross national income (2 - 8) [d]	0.8	3.5	3.0	3.2	5.9	0.3	6.3	17.0

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] 19 countries. [b] Preliminary figures. [c] Includes variation in stocks. [d] Includes current transfers and terms-of-trade effect.

The notable expansion in the volume of exports counterbalanced the adverse effects of the slump in domestic demand and the increase in imports, thus contributing to GDP growth of 0.3%. In some countries, a considerable portion of domestic demand was diverted to imports; this was the case in Brazil, where over half of the increase in domestic demand was siphoned off by foreign-made goods, which accounted for the phenomenal increase in the country's imports. Exports were also affected, since part of the potential outward flow of goods was channelled into the local market to help satisfy the sharp increase in domestic demand. In addition, there was a strong diversion of domestic demand towards external sources in Chile, Colombia, El Salvador, Haiti, Peru and Venezuela. Owing to this shift, GDP growth was lower than the expansion in domestic demand in these countries. On the other hand, in Argentina and Mexico just the opposite occurred as the increase in trade balances averted a sharper fall in GDP.

While total demand showed a slight increase at the regional level, wide differences existed from one country to another. On the one hand, this aggregate expanded in a large number of economies and did so particularly vigorously in seven of them, where it rose by over 5%. On the other hand, in another three countries, total demand fell: in Mexico by as much as 11%, in Argentina by 6% and in Uruguay by 4%. In almost all the countries where demand rose sharply, the increase was attributable to upturns both in domestic demand and in exports. In almost all cases where there was a significant contraction in total demand, it was due to a sharp fall in domestic demand since exports soared.

Domestic demand in the region as a whole contracted 1%, but there were considerable differences between countries. On the one hand, Chile, El Salvador and Peru recorded substantial increases (10% or more) and Haiti witnessed a 30% rise. These upswings stemmed mainly from strong growth in gross capital formation and, to a lesser degree, in consumption.[1] On the other hand, domestic demand was down in three countries –Argentina, Mexico and Uruguay– with a sharper fall being seen in investment than in consumption. Fixed investment continued the upturn begun in 1991, but the regional aggregate represented only 20.9% of GDP, compared with 28% in 1980 (for further details, see chapter VI).

[1] Includes the variation in stocks.

In 1995, Brazil, Chile, Colombia, El Salvador, Haiti, Peru and Venezuela recorded a substantial rise in per capita consumption (between 5% and 11%), while in Ecuador, Guatemala and Paraguay, the increase was slimmer. In four other countries (Bolivia, Costa Rica, the Dominican Republic, and Honduras), it remained relatively stable. On the other hand, in Argentina and Mexico, this indicator declined markedly (by 6% and 15%, respectively) and in the Dominican Republic, Nicaragua, Panama and Uruguay, it was down by between 2% and 4%.

Per capita consumption levels in general remained lower than they had been at the beginning of the previous decade, as the upturn observed between 1991 and 1995 only made up in part for the setbacks recorded between 1981 and 1990 (see figure V-1). Only in six countries (Brazil, Chile, Colombia, El Salvador, Paraguay and Uruguay) was per capita consumption higher in 1995 than in 1980. On the other hand, the sharpest decreases were noted in Bolivia, Haiti, Mexico, Nicaragua, Panama and Venezuela.

4. Inflation

In 1995, the regional rate of inflation again fell dramatically, dropping to 26%, after having reached 890% in 1993 and 340% in 1994; it has continued its downward movement in 1996, although at a slower pace. This sharp reduction was due to a considerable decrease in Brazil which marked the end of the last of all the quasi-hyperinflationary situations experienced in the region over the preceding 15 years.

This decrease in 1995 was, moreover, quite widespread, since in 17 out of the 22 countries analysed, the consumer price index declined or remained stable. Only four actually experienced a rise in inflation and only Mexico showed a marked increase, but without reaching the high rates recorded several years earlier; inflation reached 52% in 1995, after a low of 7% in 1994. In 1996, the 12 month rate of inflation started to fall, subsiding to 31% by June. In Costa Rica, which had experienced 20% inflation in 1994, the rate went up to 23% in 1995, while in Bolivia and El Salvador, it also advanced by three percentage points, reaching 13% and 12%, respectively.

Venezuela was the country with the highest rate of inflation in the region in 1995 (57%), although this was lower than the year before. However, in December the rate of inflation began to rise again, and this trend strengthened further in 1996; thus, by July, the 12-month increase was 112%, an unprecedented level for the country. The monthly variations spiralled upwards until May, but then started to abate.

Inflation was very low –an annual rate of less than 2% per year– in three countries (Argentina, Barbados and Panama) and in four others, was below 10% (Chile, the Dominican Republic, Guatemala and Trinidad and Tobago). In a large group of countries (Bolivia, El Salvador, Jamaica, Nicaragua, Paraguay and Peru), it varied between 11% and 16%. Six other countries (Brazil, Colombia, Costa Rica, Ecuador, Haiti and Honduras) had price increases of between 20% and 30%. Uruguay experienced a high rate of inflation (35%), although it was lower than in 1994. Brazil, which for many years had sustained the highest inflation in the region (up to four digits), recorded a rate of only 20% in 1995, down from 930% in 1994 and 2,500% in 1993. In 1996, inflation continued to decline, although more slowly, and the 12-month rate was 16% as of June (see table V-5).

Price rises were also down in other countries in 1995 –notably Ecuador and Uruguay– which had previously suffered high levels of inflation, although nowhere near as high as in the cases referred to above. In Ecuador, inflation continued to abate, although slowly –moving from 25% in 1994 to 22% in 1995. In Uruguay, as already indicated, it stood at 35%; this was the lowest figure to be recorded since 1983 and confirmed the downward trend of the four preceding years. In 1996, this decline persisted, and the 12-month rate as of June was 29%.

Table V-5
LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES
(December-to-December variations)

	1980-1989	1990	1991	1992	1993	1994	1995	1996[a]
Latin America and the Caribbean	**388.4**	**1 209.7**	**200.8**	**420.8**	**892.7**	**339.9**	**25.9**	**21.8**
Argentina	162.0	1 343.9	84.0	17.5	7.4	3.7	1.7	0.1
Barbados	2.0	3.4	8.1	3.4	-1.0	0.5	3.4	...
Bolivia	9.6	18.0	14.5	10.5	9.4	8.5	12.6	13.1
Brazil	740.5	1 584.6	475.8	1 149.1	2 489.1	929.3	22.0	14.9
Chile	10.6	27.3	18.7	12.7	12.2	8.9	8.2	7.7
Colombia	18.8	32.4	26.8	25.2	22.6	22.5	19.3	20.3
Costa Rica	14.0	27.3	25.3	17.0	9.0	19.9	22.6	19.4[b]
Ecuador	29.1	49.5	49.0	60.2	31.0	25.4	22.8	24.0
El Salvador	10.0	18.3	9.8	20.0	12.1	8.9	11.4	10.0
Guatemala	14.2	59.6	10.2	14.2	11.6	11.6	8.6	11.6
Haiti [c]	16.9	26.1	15.8	16.8	36.1	31.7	24.0	18.2[d]
Honduras	15.3	35.2	21.4	6.5	13.1	28.8	26.8	21.3[d]
Jamaica	25.8	29.7	80.2	40.2	30.1	26.9	25.5	...
Mexico	15.9	29.9	18.8	11.9	8.0	7.1	52.0	31.8[b]
Nicaragua	1 591.5	13 490.5	775.4	3.6	19.5	12.4	11.1	11.1
Panama	0.8	0.8	1.1	1.7	0.9	1.5	0.9	1.6[d]
Paraguay	13.2	44.1	11.8	17.8	20.3	18.3	10.5	9.6[b]
Peru	880.3	7 649.6	139.2	56.7	39.5	15.3	10.2	11.9
Dominican Republic	12.6	79.9	7.9	5.2	2.7	14.3	9.2	6.6[d]
Trinidad and Tobago	4.8	9.5	2.3	8.5	13.4	5.5	3.8	...
Uruguay	43.0	128.9	81.3	59.0	52.9	44.1	35.4	28.3[b]
Venezuela	42.8	36.5	31.0	31.9	45.9	70.8	56.6	112.6

Source: ECLAC, on the basis of official figures.
[a] Twelve-month variations to July 1996. [b] Twelve-month variations to June 1996. [c] In earlier publications, reference was made to the fiscal year, which in this country runs from September to the following August. [d] Twelve-month variations to May 1996.

Colombia, which for a number of years had recorded moderate inflation, maintained this pattern in 1995 and even achieved a slight reduction in comparison with the previous year's rate. In Paraguay, the inflation rate, which had hovered just under 20% in 1994, recorded an appreciable decline in 1995, falling to just over 11%; in the first months of 1996, it tended to accelerate somewhat, however. Jamaica, after recording 80% inflation in 1991, had shown a downturn since 1992 and managed to maintain this trend in 1995 with an annual rate of slightly under 16%.

The marked reduction in the regional rate of inflation and the improved performance of the vast majority of countries are attributable to the stabilization programmes implemented in previous years and to the programme initiated in Brazil –the region's largest economy– in the middle of 1994. The devaluation in Mexico had the opposite type of effect, although its impact was cushioned by the fall in the level of economic activity in that country.

The chief objective of the macroeconomic policies implemented in the region in the last several years has been to curb inflation, and the strategies used to achieve this goal have included fiscal austerity measures, prudent monetary policies and greater liberalization, especially through the conclusion of regional agreements with a view to eliminating tariffs between trading partners. Exchange rate variations have played an important role in consumer price movements in almost all the countries of the region by providing support for anti-inflationary measures in situations characterized by an abundant supply of foreign exchange (for further details on economic policy, see chapter II).

Notwithstanding the undeniable strides made over the last few years, efforts to lower inflation to the levels seen in developed countries have run up against great difficulties.

Bringing inflation down from its previous extremely high levels, either through orthodox programmes involving the use of exchange-rate anchors and harsh monetary policies or through de-indexation (as in the recent case in Brazil) has certainly been an impressive achievement. However, once rates of the order of 10% to 20% have been reached, inflation seems to put up some resistance to efforts to reduce it further. The only exception may be Argentina: after the initial success of its stabilization programme, it also had difficulties in putting an end to the inflationary process in spite of the exchange policy of strict convertibility that it applied. However, in 1995 and 1996, prices stabilized completely, if only as a direct result of the severe recession affecting the country. The intractability of inflation is perhaps attributable to the persistence of a certain element of inertia in price movements, which is only overcome when the economy in question undergoes a severe recession.

VI. INVESTMENT AND SAVING

1. General outlook

The drop in investment that occurred in 1995 in Latin America and the Caribbean in the wake of Mexico's financial crisis brought the recovery process that had begun in the early 1990s to a halt. This phenomenon was accompanied by a modest decline in national and domestic saving, while external saving experienced a sharp downturn.

The region's prospects for sustained growth over the long term are based on the countries' ability to increase their savings and investment rates. The crisis of the 1980s had precipitated a widespread slowdown in growth that led to a slump in domestic demand and, hence, to an underutilization of installed capacity; this, in its turn, contributed to a strong contraction in investment, which was also dampened by the abrupt drop in capital flows from abroad. The 1990s ushered in a recovery that continued until 1994, but in 1995, the stagnation of the region's GDP triggered a new downturn in investment in the wake of the Mexican financial crisis and its after-effects in other countries of the region.

In contrast, gross domestic saving has proved more stable, hovering around 22% of GDP during the last 15 years, though it did show a slight decline in 1995. National saving, for its part, displayed a definite downward trend in the 1980s, with the result that its level in the 1990s was five percentage points below that recorded in the 1980s. This trend reflected the worsening of the terms of trade during the 1980s, and, to a lesser extent, higher net external payments for factor services, which were only partially offset by the expansion in net unrequited private transfer payments. In 1995, there was a considerable drop in external saving flowing into the region, especially portfolio capital, and this had a negative impact on investment.

It is important to note that the levels of saving and investment in Latin America and the Caribbean are, in general, very low in comparison with high-growth regions, such as the countries of East Asia, which normally record investment and savings rates of over 30% of GDP. According to recent estimates prepared by ECLAC, in order for Latin America and the Caribbean to attain an average growth rate of 6%, the region would need to raise its fixed investment rate to over 26% of its GDP. In 1995, only seven countries met that standard: Chile, Colombia, the Dominican Republic, Honduras, Nicaragua, Panama and Peru. This group of countries, whose average investment rate was 27% of GDP, achieved a growth rate of 5.3%. For the region as a whole, on the other hand, average fixed investment amounted to 21% of GDP while the region's overall growth rate amounted to just 0.3%.

2. Investment[1]

The present investment rate of Latin America and the Caribbean is very low, whether viewed from an historical perspective or in comparison with other regions. In 1995, the situation worsened still further, given that gross fixed investment dropped by 5.2% to the equivalent of 21% of GDP, which was one point less than in 1994. This decline did not occur across the board, however, but is instead attributable to adverse circumstances in just a few countries, particularly Argentina and Mexico. The composition of investment continued to undergo major changes, with increases being noted in private investment and in machinery and equipment. A number of countries made significant progress as regards the institutional and legal framework for investment.

During the early 1990s, the region's economies recorded moderate growth and, as pre-existing external constraints came to an end, was approaching the production frontier. As a country nears that frontier, however, it must have higher levels of investment and productivity. One of the legacies of the crisis of the 1980s was that the region's level of investment in infrastructure, education and job training has been too low to meet the demands of economies undergoing significant reforms and major changes.

The region's domestic investment rate declined to 21.4% of GDP at constant 1990 prices, which was very close to the lowest level registered in the previous decade. Mexico and Argentina, which account for a large share of the region's aggregate investment, were especially hard hit. The downturn in fixed investment was less marked, but inventories recorded quite a significant slump, especially in Mexico[2] (see table VI-1).

There were mixed investment trends in the countries in question. Investment contracted in six and expanded in the other 13 countries for which information is available. Argentina and Mexico were among the countries showing declines, after having recorded significant rates of growth in previous years. Output dropped considerably in these two countries, but the downswing in investment –both private and public– was even sharper and was, moreover, evident in construction and in machinery and equipment as well. In Argentina, the upward trend in fixed investment as a percentage of GDP, which had been in evidence since 1990, came to an end. In Mexico, public investment fell by 19% and private investment by 34%. The drop in physical investment by the Government was especially abrupt, notwithstanding a higher level of investment by Petróleos Mexicanos (PEMEX) and the implementation of emergency programmes to combat unemployment. The huge drop in investment resulted in a significant reduction in imports of capital goods (35%), though it should be noted that export firms' imports of machinery and equipment by export firms recorded substantial growth. The investment slowdown was particularly evident in the construction industry.

Gross fixed investment also contracted in Costa Rica, Honduras, Uruguay and Venezuela. Investment was down sharply in Costa Rica for the second year in a row as a result of the severe stabilization policies implemented in order to reduce the country's hefty fiscal deficit. Investment in Uruguay slipped by around 6% in 1995, after having expanded by two thirds during the preceding four years. One contributing factor was the fiscal adjustment programme, which emphasized cutbacks in central-government capital expenditure. In Venezuela, investment continued to fall, thus reaching very low levels (14% of GDP), as a consequence of the grave crisis affecting the country in recent years, which

[1] This analysis refers mainly to fixed investment, since in the case of a number of countries, such as Argentina and Brazil, this is the only variable for which information is available. In addition, the figure given for the variation in stocks in Colombia –10% of GDP– is extremely high, probably as the result of an underestimation of consumption.

[2] Total investment in Mexico plunged by 42%, falling from 25.4% to 15.8% of GDP. Fixed investment decreased less (29.1%), slipping from 21.4% to 16.2% of GDP.

Table VI-1

LATIN AMERICA AND THE CARIBBEAN: COEFFICIENTS OF GROSS FIXED INVESTMENT

(Percentages of gross domestic product)

	1980	1985	1990	1991	1992	1993	1994	1995[a]
Latin America and the Caribbean	**28.3**	**20.1**	**19.5**	**19.5**	**20.2**	**21.0**	**22.1**	**20.9**
Argentina	26.1	16.0	13.9	16.0	19.3	20.7	22.9	20.1
Bolivia	12.8	11.1	12.6	14.2	15.7	15.7	14.2	16.0
Brazil	33.9	24.1	22.9	21.7	20.2	20.8	22.2	22.5
Chile	21.0	17.6	23.3	21.3	24.3	26.9	26.8	27.8
Colombia	20.5	19.1	16.6	15.4	16.6	21.5	24.0	25.2
Costa Rica	22.8	17.6	22.4	19.1	21.7	25.1	21.9	19.7
Ecuador	31.8	20.5	18.4	19.4	20.0	19.7	19.7	20.2
El Salvador	12.8	11.8	13.7	15.4	16.9	18.0	19.1	19.8
Guatemala	18.4	11.5	13.0	13.0	16.1	16.5	15.3	15.6
Haiti	16.3	18.8	15.1	15.9	12.1	11.4	11.4	28.8
Honduras	27.6	19.6	20.2	19.9	23.7	30.0	29.8	25.6
Mexico	24.7	17.8	18.6	19.4	20.9	20.5	21.4	16.2
Nicaragua	15.5	21.1	16.0	14.8	17.0	18.1	21.7	22.8
Panama	22.5	15.2	8.4	14.8	19.5	26.5	27.6	28.8
Paraguay	26.8	19.2	22.0	22.8	21.0	20.6	21.0	21.1
Peru	28.9	19.6	21.2	21.1	21.9	23.3	27.0	30.0
Dominican Republic	28.3	20.9	24.9	22.0	25.7	27.1	27.6	29.4
Uruguay	23.4	9.6	10.6	12.8	14.0	15.8	15.4	14.7
Venezuela	24.9	19.3	14.1	17.4	20.9	19.3	14.9	14.5

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures.

has led to high inflation, steep devaluations and a widespread banking crisis. Though Honduras showed some signs of recovery, the persistent economic crisis caused a sharp decline in private investment.

The countries showing the highest increases in investment were Bolivia, Chile, Colombia, the Dominican Republic, El Salvador and Peru, with rises of over 10%. Virtually all of these economies have been growing for a number of years now, some at quite high rates. Fixed investment in Chile continued to be very robust (12%), accelerating strongly in the second half to reach levels approaching 29% of GDP. Bolivia saw an upturn not only in investment as a whole but also in the private sector's share of that aggregate; this trend went hand in hand with a strong increase in foreign direct investment, which accounted for a third of gross fixed investment. It should be noted that the capitalization of public-sector enterprises was only partly responsible for this positive trend, since strategic partners' contributions, particularly in the electricity and telecommunications subsectors, did not materialize immediately, but were instead held outside the country in trust accounts.

Fixed investment in Colombia grew by 11% and was thus the most dynamic component of aggregate demand in 1995. Accordingly, its share of GDP rose to 25%. Unlike the previous year, public investment expanded more quickly than private investment. Investment in machinery and equipment also showed an appreciable increase due to the expansion of the petroleum subsector. In Peru, the upward trend in investment remained on course. The private sector accounted for most of the upswing, but public investment also grew robustly, increasing its share to around a fifth of total investment. Private investment in El Salvador once again recorded rapid growth, unlike public investment, which was so low (4% of GDP) that its contribution to production activity was quite limited. In Brazil, investment rose by about 5%, which was somewhat higher than GDP growth,

but down from the 13% recorded the previous year. This meant that the investment coefficient remained low in comparison with the levels of the early 1980s. Nevertheless, there was an important qualitative change, which took the form of a steep rise in the share of imported capital goods, which has surely produced a significant rise in the productivity of capital. A breakdown of fixed investment reveals that machinery and equipment represented a very large share of the total.

Investment in Guatemala developed into a dynamic component of aggregate demand; private investment increased in the areas of housing, manufacturing and commerce, while public investment grew at a faster pace than in recent years. In Nicaragua, gross domestic investment expanded vigorously for the second year running, bolstered by an upswing in construction and by more modest increases in spending on machinery and equipment. Public and private investment grew at similar rates, with more than half of the former being channelled into economic infrastructure projects. In Haiti, investment staged a significant recovery, thanks largely to greater public spending on labour-intensive infrastructure repair and maintenance projects for which generous financial backing was forthcoming in the form of foreign aid.

In Jamaica, the decline in external debt payments paved the way for an increase in gross investment, especially in machinery and equipment. In Trinidad and Tobago, capital expenditure rose by 30% and was channelled primarily towards the upgrading of physical infrastructure. In Barbados, in contrast, capital expenditure fell by 13%, thus putting the end to the upward trend observed in the two preceding years. The downturn in public investment was particularly striking. In Saint Kitts and Nevis, capital expenditure jumped by 70%, chiefly as a result of infrastructure development.

There are two widely used criteria for breaking down investment; one is based on the sector of origin, and thus makes a distinction between public investment and private investment, while the other disaggregates investment in terms of the type of product involved (investment in machinery and equipment, on the one hand, and investment in construction, on the other). Generally speaking, there are two theoretical approaches to the relationship between public and private investment. In the opinion of some experts, the two types of investment are complementary, since the productivity of private investment rises as public investment (especially in infrastructure) increases. However, other experts contend that the two types of investment work against one another because public investment crowds out private investment, notably by pushing up interest rates. The empirical results available for Latin America suggest that the productivity-related effect is the more pronounced of the two in the region.

This point may be especially relevant in the light of current circumstances in the region. From both historical and comparative viewpoints, public investment's share of the total has remained fairly high in Latin America. However, one of the effects of the crisis of the 1980s has been a downward trend in public investment, whether because of external constraints or as a consequence of structural reforms. The privatizations implemented as part of this reform process have reduced State participation in production and, hence, in investment. Both factors also explain why the reduction has been particularly sharp in the case of infrastructure, especially road building and maintenance, the energy and water subsectors and port facilities.

During 1995, the vast majority of countries for which data are available recorded an increase in the share of private investment. This trend had already been in evidence in 1990-1994, given that in five countries (Bolivia, Chile, Ecuador, Guatemala and Uruguay) private investment had grown more quickly than public investment, while the opposite had occurred in three others (Peru, Venezuela and Nicaragua) (see table VI-2).

It is also important to distinguish between investment in machinery and equipment and investment in construction. According to a number of studies on developed countries, the first of these investment categories has a greater impact on economic growth than the other. However, the data for Latin America for 1990-1995 do not back up that assertion.

Table VI-2
LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): COMPOSITION OF GROSS FIXED INVESMENT, BY SECTOR

	Percentage of GDP				Growth rates, 1995/1994		
	Public		Private		Public	Private	Total
	1990	1995	1990	1995			
Bolivia [a]	7.6	7.5	5.0	8.5	-6.5	41.5	14.0
Colombia	6.1	8.6	10.5	16.6	15.7	9.5	11.0
Chile [a]	5.9	5.8	17.4	22.0	6.0	14.5	12.1
Ecuador	4.0	3.0	14.4	17.1	-2.9	6.9	5.3
El Salvador	2.5	3.3	11.2	16.5	0.4	12.4	10.2
Guatemala	2.7	2.8	10.3	12.9	4.7	8.3	7.6
Honduras	6.6	8.9	13.6	16.7	-3.9	-14.9	-11.4
Mexico [b]	...	...	...	...	-34.0	-19.0	-29.1
Nicaragua	9.3	16.7	6.7	6.0	9.3	9.7	9.4
Peru [a]	2.4	5.1	18.8	24.9	14.7	20.7	19.8
Uruguay	3.0	3.5	7.6	11.1	-29.9	2.8	-7.6
Venezuela	9.2	10.1	4.9	4.4	-6.9	-15.1	-0.9

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] The percentage breakdown by sector is based on information from official sources. [b] Official figure.

Moreover, when external resources are in short supply, the composition of investment is directly affected, in particular as regards machinery and equipment, since many of these products are imported.

In the case of Latin America, empirical analyses also point towards some sort of connection between these two disaggregations. The increase in private investment may be concentrated in machinery and equipment, especially imports thereof. Furthermore, the relative drop in investment in construction goes along with the downswing in public investment. As regards the composition of investment, in 1990-1995 there was a relative increase in private investment and in investment in machinery and equipment. In 1995, both these categories experienced similar positive trends, despite a slump in investment for the region as a whole.

During 1995, there was a markedly higher increase in investment in machinery and equipment in 10 of the 12 countries for which information is available, while in the other two, construction predominated; this appears to consolidate the upward trend in machinery and equipment's share in total investment which has been taking shape in Latin America since 1990 (see table VI-3).

In a number of Latin American countries, major changes were made in the institutional and legal framework for investment. As part of this process, privatization programmes were launched or carried forward which, while not generating new investments themselves, certainly created the conditions necessary for an acceleration of the accumulation process. In 1995, this was especially the case in Peru and Brazil (see chapter III). There were also, however, substantive changes to the regulations governing the investment process, as in the case of the reforms implemented in Bolivia and Chile. In Bolivia, these changes were made within the framework of what is referred to there as the capitalization of public-sector enterprises, the most fundamental structural reform to be carried out in that country in recent memory. This capitalization process works in the following way: the public sector contributes the existing assets as initial share capital, while private investors (considered strategic partners) provide fresh capital in exchange for a 50% stake in the enterprise and control of its management. In Chile, the main reforms have concerned the financial sector. Of particular importance were legal changes designed to streamline regulations on institutional investment in infrastructure

Table VI-3

LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): COMPOSITION OF GROSS FIXED INVESMENT, BY DESTINATION

	Percentage of GDP				Growth rates, 1995/1994		
	Construction		Machinery and equipment		Construction	Machinery and equipment	Total
	1990	1995	1990	1995			
Bolivia [a]	7.0	7.3	5.6	8.7	7.6	20.0	14.0
Colombia	15.3	13.4	7.6	9.1	0.0	13.2	4.9
Chile [a]	8.2	9.9	8.4	15.3	4.0	16.1	11.0
Ecuador	10.3	10.5	12.9	17.3	7.0	15.5	12.1
El Salvador	8.7	7.8	13.7	11.8	-10.0	-6.6	-8.0
Guatemala	7.0	8.4	6.7	11.4	5.9	13.7	10.2
Honduras	9.3	8.1	9.3	8.1	-25.0	-32.8	-29.1
Mexico [b]	6.6	8.6	9.4	14.2	18.6	4.5	9.4
Nicaragua	3.3	16.1	5.1	12.7	3.0	10.8	6.2
Peru [a]	14.1	20.0	7.1	10.0	18.4	22.8	19.8
Uruguay	6.5	7.9	4.2	6.7	-15.1	3.1	-7.6
Venezuela	7.8	7.3	6.3	7.1	-10.3	11.0	-0.9

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] The percentage breakdown by sector is based on information from official sources. [b] Official figure.

projects, which is expected to amount to US$ 2.4 billion during 1995-1997; given this situation, the regulations governing the pension fund system, insurance schemes and investment funds were modified with a view to gearing the diversification and attraction of resources to the special characteristics of infrastructure projects. In addition, insurance companies and mutual funds were authorized to make investments abroad and, in June, foreign investment margins and alternatives open to institutional investors were broadened with the inclusion of fixed- and floating-rate options, these steps were designed to facilitate the international diversification of portfolios.

3. Saving[3]

For a number of years now, domestic saving in the region has been relatively stable, but in 1995 it edged downward by just over half a percentage point of GDP. This result reflected, in particular, the marked decline in domestic saving in Brazil and Paraguay, although this was partly offset by an increase in external saving. In contrast, Argentina and Mexico witnessed a drop in external saving, due to reduced capital inflows from abroad.

a) Domestic saving and national saving

In 1995, gross domestic savings amounted to 20.5% of GDP. Net external payments for factor services came to about 3% of GDP, while unrequited private transfer payments stood at 1%. The terms-of-trade effect has remained relatively stable in the 1990s, although it was

[3] It is important to point out that the change in the base year from 1980 to 1990 has an impact on the figures for gross national savings. The terms-of-trade effect in 1990 was, according to the old base (1980), equal to -5% of GDP. Consequently, the new series (base year = 1990) records an average increase in gross national savings of 5 percentage points of GDP. This, in turn, is reflected in an increase in gross capital formation of about 4 points of GDP.

Table VI-4
LATIN AMERICA AND THE CARIBBEAN: FINANCING OF GROSS CAPITAL FORMATION [a]
(Expressed as percentages of gross domestic product)

	1980	1985	1990	1991	1992	1993	1994	1995[b]
1. Gross domestic savings	24.7	24.6	22.6	21.2	20.5	20.6	21.0	20.4
2. Factor income	-2.4	-4.1	-3.4	-3.1	-3.1	-3.1	-3.0	-2.9
3. Current transfers	0.3	0.5	0.9	1.0	1.2	1.0	1.0	1.1
4. Terms-of-trade effect	3.2	0.1	0.0	-0.1	0.1	-0.1	0.4	0.2
5. Gross national savings (1 + 2 + 3 + 4)	25.8	21.0	20.1	19.0	18.7	18.3	19.4	18.8
6. External savings	3.9	0.3	0.2	1.6	3.2	3.9	4.0	2.7
7. Gross capital formation (5 + 6)	29.6	21.3	20.3	20.6	21.9	22.2	23.4	21.4

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] 19 countries. [b] Preliminary figures.

somewhat lower in 1992-1993 than in 1994. Thus, national saving was two points lower than domestic saving as well as showing a decrease with respect to the preceding year (see table VI-4).

The fact that domestic saving exceeded gross national saving was due primarily to the marked differences between the two variables in Venezuela and Mexico. In Venezuela, this divergence was caused by the terms-of-trade effect, while, in Mexico, a combination of this effect and increased external payments for factor services was responsible. On the other hand, Chile, Colombia, Costa Rica, El Salvador and Haiti –along with, to a lesser extent, Bolivia, Guatemala and the Dominican Republic– all recorded higher levels of national savings than of domestic savings. In almost all of these countries, this was attributable to the fact that the terms of trade were more favourable than in 1990 (the base year) and more than compensated for net outflows in the form of factor payments. In El Salvador and Haiti, a major contributing factor in the stronger increase in national saving was the sizeable net transfers received from abroad, equivalent to 19% and 35% of GDP, respectively.

National savings was greater than 20% of GDP in Brazil, Chile, Colombia, Ecuador, Honduras, Panama, Peru and Venezuela. In the region's "success stories", such as Chile, the main factor was the increase in domestic saving by business enterprises. Nevertheless, in 1995, the combined effect of the terms of trade, factor income and current transfers was negative in Brazil, Ecuador, Panama and especially Venezuela (see table VI-5).

In Brazil, there was a continuation of the downward trend in domestic saving, but on this occasion it was offset by a significant rise in external saving. Domestic savings in Chile once again hovered around 29% of GDP, with a public-sector savings rate of 5.1%. In addition, the favourable external conditions helped pave the way for an unprecedented national saving rate of 32% of GDP. This feat was partly attributable to the 1984 tax reform, which encouraged firms to save by setting the marginal tax rate on undistributed profits lower than the rate levied on distributed profits.

b) **External saving**

External saving fell steeply in 1995, after having expanded significantly in 1990-1994; portfolio flows showed a particularly sharp decrease owing to the loss of confidence prompted by Mexico's financial crisis in late 1994. The largest drops in external savings were recorded in Mexico (10% of GDP and US$ 26 billion) and Argentina (4% and US$ 8 billion) (see table IV-6).

Table VI-5
LATIN AMERICA AND THE CARIBBEAN: NATIONAL SAVING
(As a percentage of gross domestic product)

	1980	1985	1990	1991	1992	1993	1994	1995[a]
Latin America and the Caribbean	**25.8**	**21.0**	**20.1**	**19.0**	**18.7**	**18.3**	**19.4**	**18.8**
Argentina	22.7	15.2	17.1	15.6	15.3	16.7	18.1	18.9
Bolivia	13.1	9.2	8.7	11.1	7.9	7.7	12.1	11.3
Brazil	30.8	27.0	22.0	21.3	21.9	20.8	21.9	18.5
Chile	16.7	10.3	24.5	25.3	26.4	24.3	27.6	32.5
Colombia	22.5	14.3	19.9	23.0	25.4	22.7	26.0	26.1
Costa Rica	11.7	12.1	16.3	19.4	21.3	20.0	20.4	21.7
Ecuador	28.3	23.7	14.4	16.2	18.9	14.4	15.3	16.0
El Salvador	13.4	6.5	8.4	11.2	14.9	16.7	19.1	17.0
Guatemala	16.6	9.6	10.6	13.5	11.9	10.3	10.6	12.5
Haiti	9.6	14.8	13.8	12.5	12.7	10.2	11.7	23.6
Honduras	14.9	10.1	16.2	18.6	18.0	23.5	26.2	25.1
Mexico	20.1	18.6	18.8	16.8	15.9	16.0	15.6	15.5
Nicaragua	-3.8	-7.4	0.8	17.0	-19.3	-12.0	-8.1	-3.3
Panama	7.7	10.7	12.2	4.5	11.0	15.7	10.7	20.2
Paraguay	20.2	14.8	19.6	18.3	11.3	7.8	1.9	4.1
Peru	33.5	19.3	19.5	20.8	18.5	19.9	22.7	23.6
Dominican Republic	10.5	18.9	20.8	20.2	15.5	21.3	26.0	32.5
Uruguay	21.1	10.5	12.8	13.9	13.9	13.1	12.2	13.9
Venezuela	33.8	24.7	27.2	20.1	15.0	14.0	16.3	16.7

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures.

External saving also declined in Costa Rica, Guatemala, Honduras, Nicaragua, Panama and Uruguay. External saving was negative in Chile, the Dominican Republic and Venezuela, although in Chile's case, this was due to the prepayments it made on its external debt, as the country took advantage of its extremely favourable balance-of-payments position. In contrast, the share of the total saving accounted for by external sources rose markedly in Bolivia, Brazil, El Salvador, Haiti, Paraguay and Peru.

In Brazil, external saving climbed by US$ 17 billion, which was equivalent to almost 4% of GDP. The first months of 1995 were marked by an outflow of capital, but this turned into a significant inflow in the second half. Lines of credit for external trade operations not only recovered, but actually expanded; in addition, overseas sales of privately-issued bonds and securities resumed.

Of all the components of external saving, the one most directly related to investment is foreign direct investment (FDI). In a global context, FDI has gradually become the primary instrument of international economic integration. This trend is also evident in Latin America, though it differs from one country to another, since FDI is concentrated in a handful of countries (mainly Argentina, Brazil, Chile, Colombia and Mexico). This group of countries has recently been joined by Bolivia and Peru (see chapter VIII).

In 1995, in a continuation of the dynamic trend initiated in 1990, direct investment topped the US$ 21 billion mark. As in previous years, it was mainly directed towards the mining and petroleum sectors, except in Mexico, where it was channelled primarily into manufacturing. Direct investment showed a decline in Chile, Peru and Mexico, but this merely represented a lull in a firm upward trend which has brought it up to around 3% of GDP.

In Argentina and Brazil, FDI expanded markedly, though in the case of Brazil, it still represents a fairly small proportion of GDP

Table VI-6
LATIN AMERICA AND THE CARIBBEAN: EXTERNAL SAVING
(As a percentage of gross domestic product)

	1980	1985	1990	1991	1992	1993	1994	1995
Latin America and the Caribbean	**3.9**	**0.3**	**0.2**	**1.6**	**3.2**	**3.9**	**4.0**	**2.7**
Argentina	3.4	0.8	-3.2	0.4	4.0	4.0	4.8	1.2
Bolivia	0.1	7.7	3.8	4.3	7.8	8.1	2.0	4.7
Brazil	3.8	0.1	1.0	0.4	-1.7	0.0	0.3	4.0
Chile	9.9	7.0	1.8	-0.3	2.0	5.8	1.7	-0.3
Colombia	0.8	5.9	-1.3	-6.3	-2.5	5.8	7.7	8.9
Costa Rica	13.6	6.4	8.7	1.7	6.0	9.1	6.3	1.7
Ecuador	6.8	-0.7	3.0	5.3	1.6	4.8	4.2	4.7
El Salvador	-0.8	4.1	5.4	4.5	3.8	2.3	0.3	3.8
Guatemala	2.7	4.0	3.0	2.6	8.0	7.7	6.7	4.9
Haiti	7.7	6.1	1.3	3.5	-0.6	1.3	-0.3	5.2
Honduras	12.9	9.8	6.8	7.9	10.1	9.1	9.0	5.2
Mexico	6.9	-0.4	3.1	5.9	9.3	8.4	9.8	0.2
Nicaragua	21.6	31.3	14.3	0.2	36.5	28.4	30.3	26.7
Panama	17.9	4.4	4.4	12.4	10.8	8.3	16.2	7.3
Paraguay	8.2	5.8	3.3	5.9	11.0	14.2	20.3	18.3
Peru	0.3	-0.3	1.9	2.3	4.6	4.3	4.6	7.1
Dominican Republic	19.2	2.4	4.3	2.6	11.0	6.5	2.3	-2.3
Uruguay	6.5	1.2	-2.0	-0.4	0.1	2.3	3.7	2.9
Venezuela	-10.0	-8.9	-17.0	-3.3	6.8	3.6	-4.5	-2.5

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures.

(0.5%). In Colombia, FDI continued to rise, reaching the equivalent of 2.5% of GDP. The level of FDI was extraordinarily high in Bolivia, where it amounted to 5.5% of GDP; new investments and the privatization of State-owned enterprises in the energy and telecommunications subsectors were two of the factors that helped produce this result. Costa Rica, too, experienced abundant inflows of FDI (4% of GDP).

VII. EMPLOYMENT AND WAGES

1. The overall situation

Two major trends were to be observed in the regional employment situation in 1995: a sharp increase in open unemployment, much of which was due to cyclical factors, and a very low rate of productive job creation, which reflected a problem of a more structural nature.

The regional unemployment rate rose steeply, climbing from 6.3% of the workforce in 1994 to 7.1% in 1995; this 0.8-point change translates into an increase of around 16% in the number of unemployed persons. Not since the crisis of the early 1980s has the annual unemployment rate climbed so fast or so high. Real wages also declined in a number of countries –quite significantly in some cases– after three years of more or less regionwide increases.

Unlike the pattern observed in the early 1980s, the deterioration of the employment situation in 1995 was not an across-the-board phenomenon. In 1982, and again in 1983, the unemployment rate went up in 12 of the 16 countries for which series are available, whereas in 1995 nine countries reported an upswing in unemployment, in another three the rate remained practically unchanged and in five, unemployment fell. Arguably, the regional unemployment rate was strongly affected by events in Argentina and Mexico, where unemployment indexes climbed quite sharply: indeed, if these two countries are left out of the calculation of the regional rate (which is based on national population-weighted rates) then the results show a slight drop between 1994 and 1995 (from 6.5% to 6.2%). Thus, an improvement in the open unemployment rates of these countries (as was in fact observable in Argentina towards the end of 1995 and in Mexico at the beginning of 1996) is likely to have a favourable effect on the regional rate.

Be that as it may, longer-term series on labour-market trends indicate that, beyond the immediate causes of fluctuations in the unemployment rate, there are structural problems that are affecting job creation and are diminishing its impact in the area of social equity: this is exemplified, particularly, by the fact that productive employment in high-productivity sectors has been growing very slowly while jobs have increasingly been concentrated in such low-productivity sectors as the informal sector, which includes most small-scale and micro-enterprises, and own-account workers. As a result, a high percentage of new jobs are not very productive. This trend continued in 1995, even in many countries where open unemployment did not increase very much.

2. A sharp rise in the regional unemployment rate

The countries' performances in terms of unemployment were uneven, largely due to differences in growth. In those countries where unemployment was a particularly serious problem, an increase in the labour supply could be seen to coincide with a marked drop in demand as a consequence of adverse economic conditions. The fact remains, however, that the relationship between output and unemployment appears to have undergone a change in the early 1990s, which points to the presence of an additional structural problem.

BOX VII-1
ECONOMIC CONTRACTION AND UNEMPLOYMENT IN ARGENTINA AND MEXICO

In 1995, output in both Argentina and Mexico dropped drastically and open unemployment increased. Despite the fact that the contraction in economic activity was more pronounced in Mexico, however, the increase in unemployment was greater in Argentina, for a number of reasons.

On the demand side, the loss of wage-based jobs was actually more marked in Mexico than in Argentina, but in Mexico there was also an increase in the number of jobs in micro-enterprises, own-account work and unpaid labour. Consequently, since a significant portion of the unemployed were absorbed into low-quality occupations, the overall level of employment remained practically constant. In Argentina, on the other hand, employment fell in all categories, and a considerable drop was therefore observed in total employment. In addition, the increase in the labour supply, which in both countries was the result of the entry of a larger proportion of women into the workforce, was much greater in Argentina.

The crisis that rocked Mexico, and its fallout in Argentina, had very serious repercussions on the labour markets of these two countries. In Mexico, urban unemployment reached an annual average of 6.3% and peaked in the third quarter of the year at 7.4%, thereby exceeding the high recorded in the early 1980s (7.2% in the third quarter of 1983). Meanwhile, the annual average in Argentina was 17.5% –an all-time record. Before these increases, the unemployment rate had behaved differently in each of these countries. In Mexico, prior to 1995, open unemployment had remained below 4%, while in Argentina, despite high GDP growth rates, unemployment had been mounting quite rapidly ever since 1992 and had reached 11.5% in 1994 (see table VII-1).

Other countries where significant increases in urban unemployment were observed –in each case in a context of limited or negative growth– were Costa Rica, Uruguay and Venezuela, while in Bolivia, Honduras, Panama and Paraguay, unemployment rates rose less (see figure I-3). In Cuba, too, where economic reforms were under way, open unemployment began to emerge as a major problem. On the other hand, in Chile, Guatemala, Nicaragua and Peru, where high GDP growth was achieved in 1995, unemployment fell sharply. This was also the case during the first half of the year in Brazil and Colombia, but the slowdown in economic activity in these countries pushed unemployment up during the second half, with the result that the annual average improved only moderately in Brazil and remained unchanged in Colombia.

In a number of countries (Argentina, Costa Rica, Mexico, Uruguay and Venezuela), the factors that drove unemployment rates up had as much to do with supply as with demand. Thus, in all of these countries, the participation rate, too, went up, and did so quite sharply in some cases, such as Uruguay and Venezuela and, also, during the first half of the year, in Argentina. In part, this is a reflection of the tendency of households to add to the labour supply when labour market conditions deteriorate –particularly when they do so very abruptly– in order to make up for the loss of income that occurs when the main breadwinners are thrown out of work or when their earnings fall.

At the same time, long-term trends in the participation rate show that the labour supply has been expanding. At the regional level, this indicator (unweighted) has risen steadily since 1990, although in some individual countries –Brazil, for instance– the reverse has happened (see figure VII-1).[1] The main reason for this has been the long-term increase seen in women's participation as urbanization has proceeded and levels of education have improved, a trend that should not be confused with short-term fluctuations. The need for

[1] The regional activity rate, weighted by the working-age population, remained relatively stable owing to the drop in Brazil's participation rate, and as of the end of 1995, was just slightly higher than it was in 1990.

Table VII-1
LATIN AMERICA AND THE CARIBBEAN: OPEN URBAN UNEMPLOYMENT
(Average annual rates)

	1980	1990	1991	1992	1993	1994	1995[a]
Latin America	**6.2**	**5.8**	**5.8**	**6.2**	**6.2**	**6.3**	**7.1**
Argentina	2.6	7.5	6.5	7.0	9.6	11.5	17.5
Bolivia [b]	...	7.3	5.8	5.4	5.8	3.1	3.6
Brazil [c]	6.3	4.3	4.8	5.8	5.4	5.1	4.6
Chile [d]	11.7	6.5	7.3	4.9	4.1	6.3	5.3
Colombia [e]	10.0	10.5	10.2	10.2	8.6	8.9	8.9
Costa Rica	6.0	5.4	6.0	4.3	4.0	4.3	5.7
Ecuador [f]	...	6.1	8.5	8.9	8.9	7.8	7.7
El Salvador	...	10.0	7.9	8.2	8.1	7.0	7.0
Guatemala [g]	2.2	6.5	6.4	5.7	5.5	5.2	4.3
Honduras	...	7.8	7.4	6.0	7.1	4.0	4.6
Mexico	4.5	2.7	2.7	2.8	3.4	3.7	6.3
Nicaragua [h]	...	11.1	14.2	17.8	21.8	20.7	18.2
Panama [i]	9.9	20.0	19.3	17.5	15.6	16.0	16.2
Paraguay [j]	4.1	6.6	5.1	5.3	5.1	4.4	5.2
Peru [k]	7.1	8.3	5.9	9.4	9.9	8.8	7.1
Uruguay [l]	7.4	8.5	8.9	9.0	8.3	9.2	10.3
Venezuela	6.6	11.0	10.1	8.1	6.8	8.9	10.9

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Capital cities. [c] Metropolitan areas of Rio de Janeiro, São Paulo, Belo Horizonte, Porto Alegre, Salvador and Recife. [d] Santiago metropolitan area. [e] Seven metropolitan areas. [f] Includes hidden unemployment. [g] Nationwide total, official estimates. [h] Nationwide total, official estimates: from 1993 onward, nationwide urban rate, based on household surveys. [g] Metropolitan area. Includes hidden unemployment. [j] Asunción metropolitan area: from 1994 onward, nationwide urban rate. [k] Lima metropolitan area. [l] 1980, Montevideo.

productive job creation has therefore increased as well.

On the demand side, job creation in countries with high unemployment rates was constrained by a decline in economic activity. Where the recession hit hardest –Argentina and Mexico– the demand for labour weakened, which meant that the number of employed persons as a percentage of the working-age population also dropped in those countries. It is this trend, together with the increase in the participation rate, that explains the surge in unemployment in both countries (although the increase was far greater in Argentina than in Mexico) (see table VII-2). Elsewhere, a portion of the additional workforce found employment, although it was often in low-productivity, low-paid jobs. It was for this reason that in Costa Rica, Uruguay and Venezuela, both the unemployment index and the ratio of employed persons to the total working-age population rose at the same time. In these countries, the rise in the unemployment rate can be attributed to the fact that the rate of job creation was lower than the rate of expansion of the labour supply.

An analysis of the structure of unemployment provides a means of determining how an economic crisis reduces the demand for labour in different branches of activity. In cases where a crisis imposes severe constraints on domestic demand, the production of non-tradable goods and services is usually the hardest hit. Indeed in Argentina, Uruguay and Venezuela, for example, unemployment in the construction sector rose significantly, with Greater Buenos Aires recording an annual average of 34.9%. Argentina also experienced a rapid climb in unemployment in commerce (the result of lower household

BOX VII-2
THE INCREASE IN UNEMPLOYMENT IN ARGENTINA

Despite a high rate of GDP growth, unemployment in Argentina increased substantially between 1992 and 1994 as a result of the relentless expansion of the labour supply and insufficient job creation. On the one hand, with increasing numbers of women entering the labour market, the participation rate climbed steadily from the mid-1980s until May 1993, after which it fell back slightly and then levelled out at a quite high figure during the period between the second half of 1993 and the end of 1994. On the other hand, structural reforms (changes in relative prices, technological and organizational innovations, public-sector downsizing) slowed the demand for labour. Even so, the powerful economic momentum of the early 1990s continued to drive the employment rate up until 1993; thus, employment and unemployment climbed in tandem during this period. In 1994, however, the generation of new jobs faltered, the employment rate dropped and, despite a lower participation rate, unemployment continued to increase.

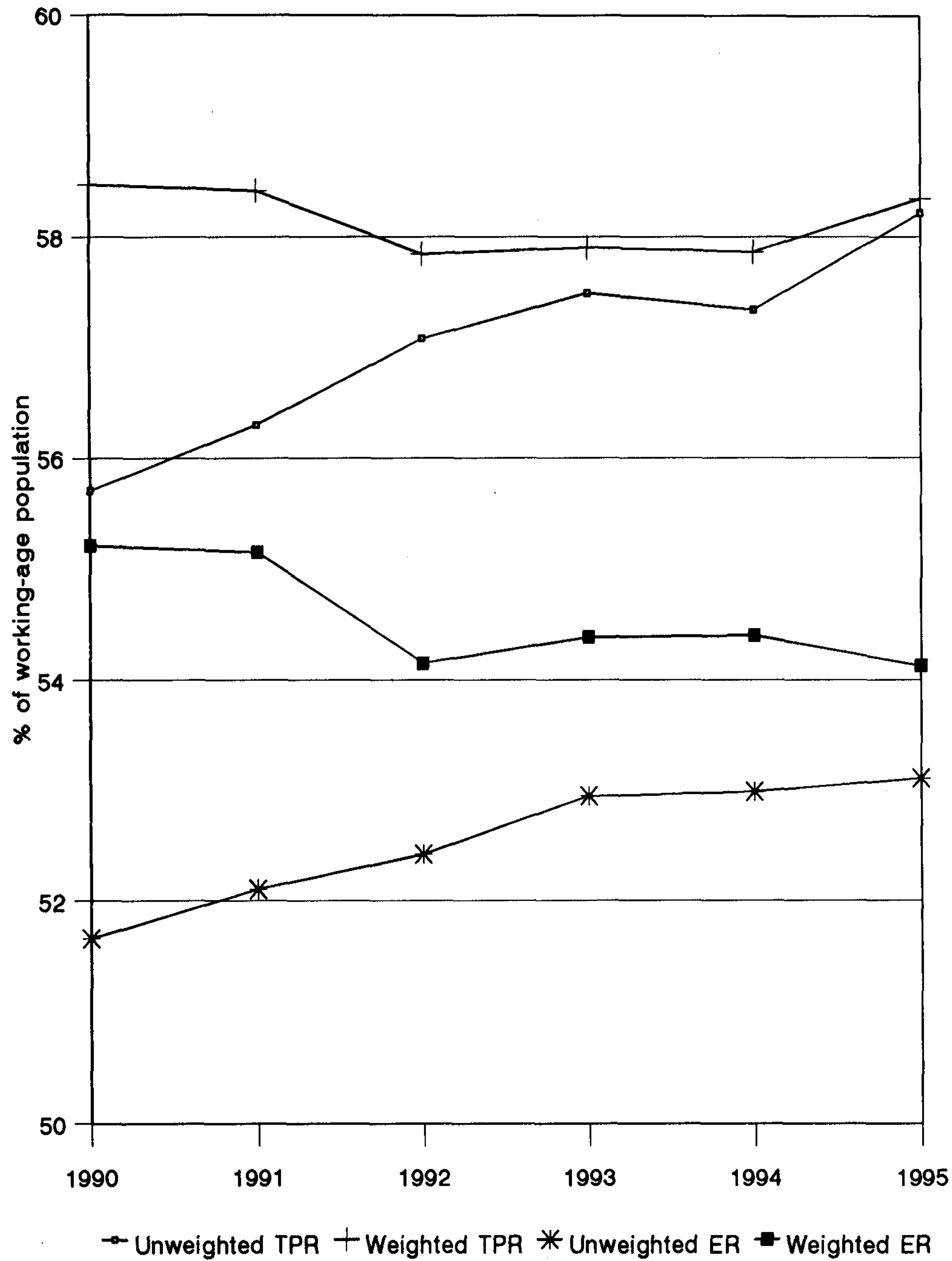
The sharp economic contraction of 1995 caused the demand for labour to decline. Simultaneously, supply (the participation rate) suddenly built up. One of the most important reasons for this was that, in the face of growing unemployment among heads of household (which rose from 8.9% in October 1994 to 12.9% in May 1995), the secondary labour force (mainly women) stepped up its rate of entry into the labour market. Accordingly, the female participation rate went up from 31.2% to 35.1% during the same period. At times when the pace of economic activity is slow, the search for work on the part of these new or sporadic entrants into the labour force often proves unsuccessful, with the result that they swell the ranks of the unemployed; thus, the female unemployment rate in Greater Buenos Aires stood at 24.5% in May 1995 (compared with 15.7% in October 1994) while total unemployment was 20.2%. With prospects in the labour market looking less than promising, some people opted out again, however, and as of October 1995, the rate of female participation had taken back once more (to 33.2%), as had unemployment (to 20.1% for women and 17.4% overall). The upshot of this was an increase in the percentage of women in the working population as the female employment rate (i.e., the number of employed women as a percentage of the female population) climbed from 26.3% to 26.6% between October 1994 and October 1995, whereas the male rate went down from 49.7% to 47.3%.

Apart from the drop in the participation rate, a further factor which helped to push the unemployment rate down towards the end of the year was the fact that a certain number of jobs were actually created, although some of these were mere stopgaps, as shown by the higher rate of underemployment. Even so, the yearly average shows that employment slumped again, slipping to 36.6% of the total population –the lowest level since 1983. In May 1996, the situation deteriorated once more and, although the participation rate dropped again, a net loss of jobs caused unemployment to climb.

consumption), domestic service (reflecting the tight economic situation of middle-income groups) and government service (due to restructuring and policies designed to restrain public spending). By contrast, the rise in unemployment in manufacturing was less pronounced and was more a reflection of a longer-term trend towards retooling than a result of the immediate crisis –although the crisis did hit this sector, too, provoking a variety of responses including, apart from lay-offs, a reduction of working hours and the suspension of overtime. The increase in the amount of jobs that were involuntarily converted into part-time positions showed up in the figures for visible underemployment, which rose from 10.3% to 12% in Argentina, while in Mexico the number of employed persons working fewer than 35 hours per week went up from 18.4% to 19.6% of the economically active population.

The interpretation of developments in 1995 should not, however, be confined to the short term. During the early 1990s, a change had been observed in the relationship between GDP growth and unemployment (see figure VII-2); thus during the period in question, the attainment of a given level of growth did not contribute, as it had in the past, to a reduction in unemployment, and the region's unemployment rate rose during the first half of the decade even though its economic growth rate was far higher than it had been during the 1980s. While this does not mean that there is no longer a connection between output growth and job creation, it does indicate that this relationship is changing. It may be inferred from the data on regional employment and

Figure VII-1
LATIN AMERICA AND THE CARIBBEAN (12 COUNTRIES): TOTAL PARTICIPATION RATE (TPR) AND EMPLOYMENT RATE (ER)



Source: ECLAC, on the basis of official figures.

Table VII-2

LATIN AMERICA AND THE CARIBBEAN: INDUSTRIAL EMPLOYMENT INDICATORS

(Average annual indexes: 1990=100)

	1980	1990	1991	1992	1993	1994	1995[a]
Formal industrial employment[b]							
Brazil	108.9	100.0	93.4	88.4	87.7	87.8	87.7
Colombia[c]	111.6	100.0	101.2	102.4	103.8	101.2	98.2
Costa Rica[d]	...	100.0	98.6	102.0	102.7	103.5	103.2
Ecuador[e]	...	100.0	101.1	97.6	96.2	89.7	84.8
Guatemala[f]	81.5	100.0	114.2	125.7	130.6	138.7	...
Mexico[g]	93.4	100.0	99.2	97.2	93.2	91.4	88.5
Non-maquila industry	105.7	100.0	98.6	95.0	88.9	85.2	79.5
Maquila industry	26.0	100.0	102.8	110.5	118.7	128.1	141.5
Peru[h]	122.9	100.0	94.9	85.2	78.3	77.3	75.4
Uruguay[i]	94.5	100.0	94.6	85.8	74.6	61.3	54.8
Venezuela[j]	91.8	100.0	103.7	107.2	105.7	95.3	79.4
Total industrial employment[b]							
Argentina[k]	140.9	100.0	102.7	102.6	96.4	90.8	85.3
Bolivia[l]	...	100.0	121.8	135.7	136.1	148.2	157.6
Chile[m]	74.6	100.0	103.0	108.9	118.7	114.8	114.3
Colombia[n]	...	100.0	106.4	113.9	113.0	113.5	116.8
Costa Rica	93.7	100.0	103.1	107.7	107.5	111.2	105.3
Nicaragua	...	100.0	99.7	90.6	87.1	82.7	87.4
Panama[o]	79.4	100.0	101.3	117.3	125.5	133.1	134.9
Venezuela	69.6	100.0	110.8	116.2	113.7	113.3	117.1

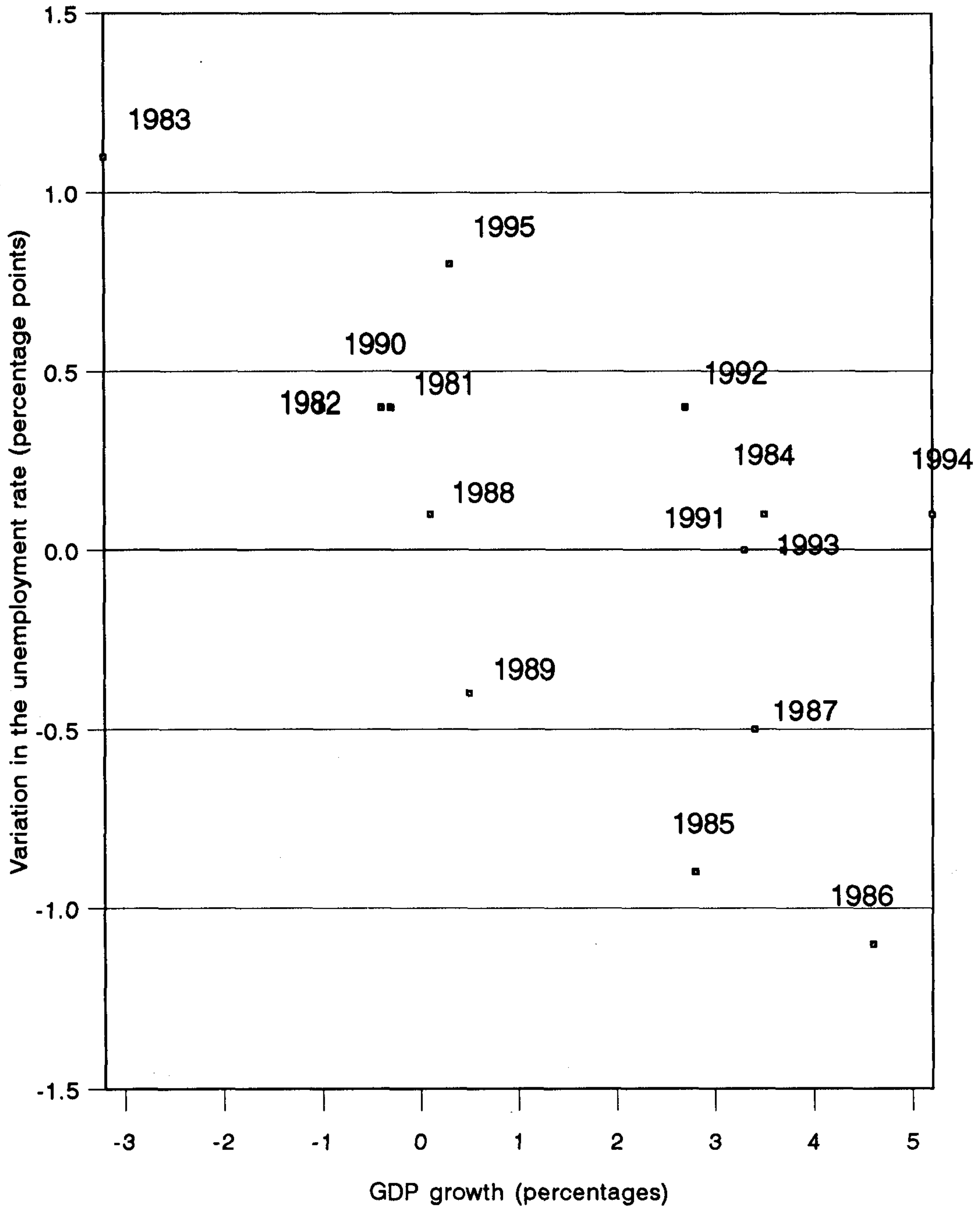
Source: ECLAC, on the basis of official figures and figures supplied by the Institute of Economics, University of Costa Rica.
[a] Preliminary figures. [b] The indexes of formal industrial employment reflect the situation in large- and medium-scale enterprises, while those referring to total industrial employment include small-scale and micro-enterprises, as well as own-account workers. [c] Manufacturing, excluding coffee processing. [d] Industrial enterprises with 20 or more workers. [e] Industrial enterprises with 10 or more workers. [f] Persons paying into the social security system; includes mining. [g] Total formal industrial employment. [h] Industrial enterprises in metropolitan Lima with 100 or more workers. [i] The figure shown for 1980 actually refers to 1982. [j] Industrial enterprises with five or more workers. [k] Up to 1990, refers to formal employment in manufacturing; from 1991 onward, refers to the total number of persons employed in manufacturing in Greater Buenos Aires as of October of each year. [l] Capital cities. [m] Metropolitan region. [n] Seven metropolitan areas, fourth-quarter figures. [o] The figure shown for 1980 actually refers to 1982.

unemployment that will be analysed below that this change has to do with the economic restructuring processes currently under way in a large number of countries in the region, which has proved to be of only limited effectiveness in generating productive employment.

3. Insufficient job creation

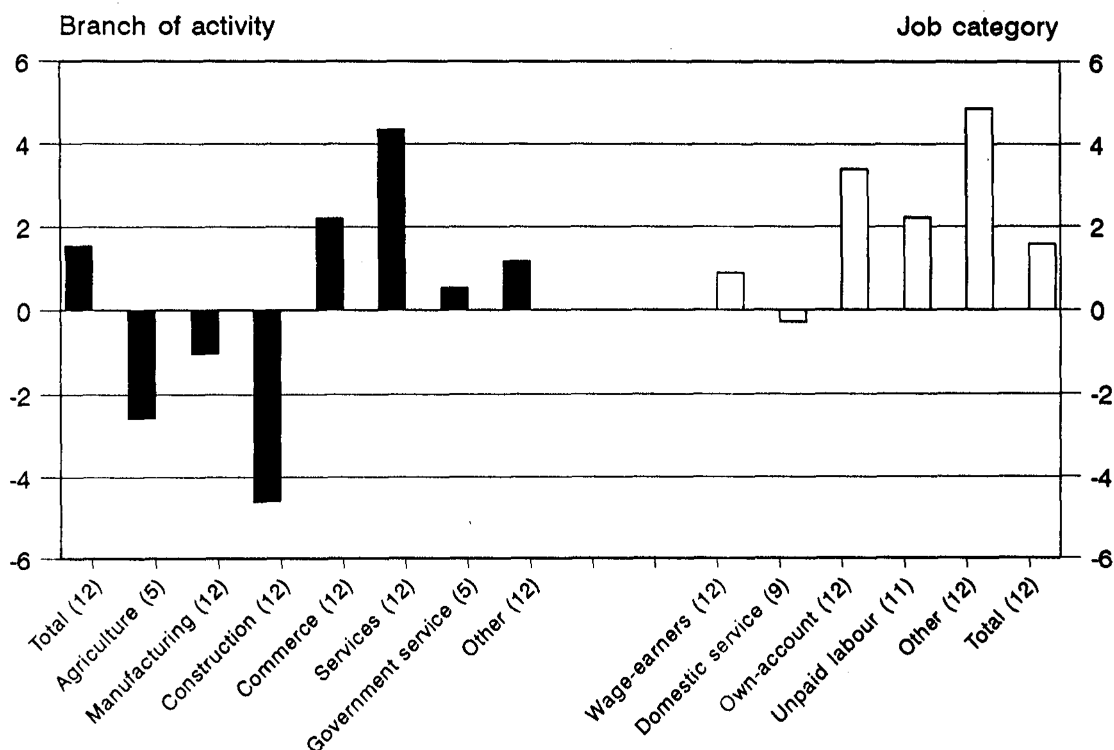
Few jobs were created in 1995, and these few were concentrated in less productive activities and low-level occupational categories. The shortfall in productive job creation has thus become the most serious problem facing the labour market in the medium term.

Figure VII-2
LATIN AMERICA AND THE CARIBBEAN (17 COUNTRIES): GROWTH AND UNEMPLOYMENT, 1981-1995



Source: ECLAC, on the basis of official figures.

Figure VII-3
LATIN AMERICA AND THE CARIBBEAN: NET VARIATION IN EMPLOYMENT BY BRANCH OF ACTIVITY AND OCCUPATIONAL CATEGORY
(Percentages)



Source: ECLAC, on the basis of official figures.
Note: Variations refer to nationwide rates weighted by the working-age population. Figures in brackets indicate the number of countries for which information was available.

In 1995, the average number of employed persons in 12 countries of the region (see figure VII-3), weighted by their working-age populations, went up by 1.6%. This means that, in a large number of countries, not enough jobs were created, since the annual growth of the working-age population at the regional level is reckoned to be 2.1% and the expansion of the economically active population is put at 2.7%. As in previous years, net job creation was concentrated in the tertiary sector.

Industrial employment declined even in absolute terms. Of particular concern was the disappearance of many jobs in industry in Argentina and Mexico due to a contraction of domestic demand for manufactures which could not be offset by increasing exports. Industrial employment expanded in only a few countries, such as Bolivia and Colombia; in Brazil, too, it increased slightly in annual average terms, but the rate dropped substantially towards the end of the year.

In all countries for which information is available, medium-sized and large industrial concerns (i.e., formal activities) shed jobs (see table VII-2). In this sector, only the *maquila* industry held its ground as a net job creator in Mexico and a number of Central American and Caribbean countries, although

the North American Free Trade Agreement (NAFTA) appears to be causing *maquila* activities in the subregion to lose some momentum.

According to the information from countries such as Brazil, Chile and Colombia, technological and organizational innovations in other major branches of industry helped boost labour productivity significantly, and the immediate effect of this was to inhibit job creation.[2] This trend was observed in a number of countries throughout the first half of the 1990s, although it was occasionally reversed by favourable economic situations that led to a significant upswing in hirings. At the beginning of 1996, information on manufacturing in Argentina and Brazil pointed to a continuing decline in formal industrial employment.

Employment in the construction sector also declined sharply at the regional level, largely as a result of the contraction in the Argentine and Mexican economies; however, employment in this sector was also down in countries such as Bolivia, Brazil, Costa Rica and Uruguay, while in others –such as Chile and Panama– it improved only slightly.

According to the information provided by the small group of countries that maintain annual records on rural employment, agricultural employment also contracted in absolute terms, thus indicating that the long-term downward trend in this sector has not abated. Nevertheless, as the existence of land disputes in countries such as Brazil, El Salvador, Guatemala, Honduras, Mexico and Paraguay demonstrates, in many parts of the region agricultural work continues to play a key role in helping a large number of rural families to survive and in acting as a bulwark against poverty in rural areas.

In tertiary activities, on the other hand, employment rose sharply. In commerce, hotels and restaurants, for example, employment was up by between 2% and 3%, with very high rates in Bolivia, Colombia, Ecuador and Venezuela. It was service activities, however, that recorded the biggest increases. Employment in community, social and personal services –the sector that already employs the greatest percentage of the workforce in a large number of countries– expanded considerably once more, with a 4% increase for the region as a whole and particularly sharp upturns in Bolivia, Brazil, Chile, Costa Rica, Mexico and Panama.

Given the disparate nature of employment in this subsector, this increase may reflect the generation of formal –and generally highly productive– employment, as well as low-paid jobs. In Chile, for example, wage-earners accounted for approximately 50% of the increase in employment in this branch, while the remaining 50% comprised own-account workers and service staff. In a number of Central American countries and in Cuba and the Dominican Republic, the expansion of tourism continued, as in previous years, to generate formal tertiary-sector employment in commerce, hotels and restaurants and in social and personal services. In many countries, however, the growth of employment in community, social and personal services and in commerce has mainly been a reflection of growth in informal activities; this was the case in Ecuador, for example, where nearly 80% of the increase in service employment was the result of the expansion of the informal sector (including domestic service).

The steep climb in employment in finance, real estate and business services noted in a large number of countries was due partly to the brisk activity to be seen in these sectors as the modernization of the structure of production proceeded and partly to the spreading practice among business enterprises of subcontracting services from specialized companies. This trend was also, on the other hand, a factor in the decline in industrial employment.

The countries' government services were not caught up in the momentum of tertiary-sector employment, however. According to the information available from countries where separate records are kept for this subsector, civil-service employment levels showed practically no change in absolute terms. Indeed, a number of countries, including Bolivia, Brazil, Colombia and Costa Rica, recorded a decline in employment either in the civil service itself or in the government sector as a whole.

[2] It should be remembered, however, that productivity gains play an important part in growth and in indirect and induced job creation.

Table VII-3
LATIN AMERICA AND THE CARIBBEAN (12 COUNTRIES): CONTRIBUTION TO NET JOB CREATION, 1995
(Percentages)

Contribution of each branch of activity to non-agricultural employment		Contribution of each job category to total employment	
Total	**1.7**	**Total**	**1.6**
Manufacturing	-0.2	Wage-earners (including domestic service)	0.6
Construction	-0.3	Own-account workers	0.7
Commerce, hotels and restaurants	0.5	Unpaid workers	0.1
Community, social and personal services (including finance, real estate and business services)	1.6	Other	0.2
Government service	0.0		
Other	0.1		

Source: ECLAC, on the basis of official figures.

Clearly, the real contribution of each branch of activity to net job creation depends not only on its relative growth but also on its relative weight in the structure of employment. As can be seen from table VII-3, it was the expansion of services, which exhibited a high growth rate in the region and had a considerable share in the composition of employment, that accounted for much of the net employment generated in 1995.

Since the 1980s, the indications have been that formal activities have only a limited job-creation capacity.[3] In 1995, this assessment seems to have been confirmed at the regional level by a further increase in the share of the informal sector (micro-enterprises and own-account work) in total employment. Although information on recent changes in the relative size of the informal sector is available for only a few countries, data on the generation of employment that are broken down by occupational category show that this trend persists in, *inter alia*, Bolivia, Brazil, Costa Rica, Ecuador, Mexico and Panama. In the region as a whole, the number of jobs created for wage-earners was negligible –around 0.9%– although this figure was heavily influenced by Mexico's enormous job losses in this category (see figure VII-3). However, even a simple average for 12 countries of the region shows only 2% growth in wage-based employment, with rates of 2% or more being recorded by Brazil, Colombia, El Salvador and Panama, among others. By contrast, own-account work expanded at an average rate of more than 3%, with highs of over 5% in Bolivia, Costa Rica and Mexico; meanwhile, in another typical informal-sector category –unpaid family labour– employment rose by a weighted rate of more than 2% and an unweighted rate of over 6%, which testifies to the

[3] Between 1990 and 1994, the share of the formal sector (medium-sized and large enterprises, the public sector, administrative personnel, and own-account professional and technical workers) in non-agricultural employment at the regional level shrank from 47.9% to 44.3% (ILO, *Panorama laboral '95*, No. 2, Lima, ILO Regional Office for Latin America and the Caribbean, 1995).

BOX VII-3
RELATIVE INCOMES IN THE INFORMAL SECTOR

The incomes of persons employed in micro-enterprises and of own-account workers are generally far below average. The average earnings of own-account workers, who are a very diverse group, are higher than those of wage-earners employed in micro-enterprises.

AVERAGE INCOMES OF THE EMPLOYED ECONOMICALLY ACTIVE POPULATION, BY JOB CATEGORY
early 1990s (figures given in multiples of the relevant per capita poverty line), urban areas

	Total employed	Non-professional, non-technical wage-earners in establishments employing up to 5 persons	Non-professional, non-technical own-account workers
BOLIVIA, 1992	4.3	2.8	3.2
BRAZIL, 1990	4.4	2.8	3.3
CHILE, 1992	4.7	2.8	4.5
COSTA RICA, 1992	5.1	3.1	3.9
HONDURAS, 1992	3.5	1.4	1.6
MEXICO, 1992	4.7	2.4	3.3
PANAMA, 1991	5.0	3.0	2.3
PARAGUAY, 1992 (Asunción)	3.6	2.1	3.1
URUGUAY, 1992	4.6	2.8	3.3
VENEZUELA, 1992	4.8	2.5	5.1

Source: ECLAC, *Social Panorama of Latin America, 1995* (LC/G.1886-P), table 4, Santiago, Chile.
Note: This source also provides detailed information on other occupational categories.

relatively rapid advance of this sector in a number of smaller countries.[4]

An analysis of the relative weight of the different occupational categories shows that the expansion of own-account work contributed 0.7% to the increase in overall employment, while waged-based employment (including domestic service) contributed 0.6%, and the remaining two categories together contributed 0.3% (see table VII-3).

In addition, in 1995 the trend in many countries still seemed to be for waged-based employment to become more and more concentrated in small businesses and micro-enterprises as well as to become less and less secure. In Brazil, for example, the number of wage-earners not covered by employment contracts, measured as a proportion of total wage-earners, continued to rise, climbing from 34.3% in 1994 to 34.7% in 1995 (five points higher than it was in 1991). In Mexico, the share of total employment accounted for by establishments employing fewer than five workers (excluding own-account and unpaid workers) grew from 20.5% to 20.9%. This means that the categories of lower average productivity

[4] The rapid expansion of the category "Other occupational categories" on the weighted scale reflects the growth in the number of employers in Brazil and Mexico, most of whom, in all likelihood were micro-entrepreneurs.

–wage-earners employed in small businesses and micro-enterprises, and own-account and unpaid workers– are expanding.

Owing to this increase in informal-sector employment, the employment rate continued to rise in many cases, as can be seen from its non-weighted levels in 12 countries (see figure VII-2). However, with a number of the biggest countries in the region exhibiting a low job-creation capacity, the weighted rate has been falling, with the result that in 1995 it was well below its 1990 level.

4. **Mixed wage trends**

After three years of rising wages in nearly all the countries of the region, trends in 1995 were less favourable. Like unemployment rates, however, real wage indexes behaved in widely differing ways.

In the five countries that recorded rather sharp rises in unemployment, real wages were down in absolute terms, which underlined the difficult conditions existing in their labour markets (see table VII-4). In Mexico, where wages in manufacturing had risen steadily since the end of the 1980s, real wage levels dropped particularly steeply –by 14%– in 1995, thus slipping below the levels achieved in 1992 and in the early 1980s. In Venezuela, real wages fell considerably for the third year in a row. Wage erosion was not as great in Argentina, Costa Rica or Uruguay, although in many cases workers' real earnings fell by more than their wages did owing to measures such as the suspension of overtime and temporary lay-offs. Moreover, in Argentina's case, there was an even steeper reduction in pay for many high-level employees in both the public and private sectors. In Peru, despite strong GDP growth and a fall in unemployment, real wages also declined, after having increased significantly increase in 1994.

By contrast, wages moved upward in absolute terms in Brazil, Chile, Ecuador and Paraguay; indeed they rose so rapidly that in some cases they regained lost ground. In Brazil, wages in the less formal categories (non-contract wage-earners, own-account workers) which had fallen considerably at the beginning of the 1990s, also rose markedly.

The real minimum wage also fell in a number of countries, and once again the decline was most pronounced in some of the countries whose labour markets had performed poorly in general; thus, in Mexico, Uruguay and Venezuela, for example, the decrease was very steep (see table VII-5). In the majority of countries for which information is available, real minimum wages were lower than they had been in 1980. In fact, only in Chile, Colombia, Costa Rica, Panama and Paraguay were they higher. In six countries, the minimum wage went up in real terms in 1995, with the highest rises occurring in Ecuador, Brazil and Chile; in others, wage policy was aimed at holding minimum wages steady at existing levels.

Generally speaking, the wages of large segments of the working population in the region are not high enough to guarantee households an income above the poverty line. In addition to unemployment, then, low wages continue to be an important cause of poverty. The situation is extremely serious, particularly in the rural areas of many countries,[5] and it is safe to say that in 1995 the combination of higher unemployment rates and declining real wages that was seen in 1995 has probably had a deleterious effect on levels of well-being in a large number of households in the region. By contrast, the recovery of wages that took place in Brazil, particularly in the lowest-paid occupational categories, contributed to an improvement in income distribution, thus confirming that, just as high inflation inhibits the achievement of greater social equity, so quelling inflation encourages it.

[5] See, for example, ECLAC, *Social panorama of Latin America, 1995* (LC/G.1886-P), Santiago, Chile.

Table VII-4

LATIN AMERICA AND THE CARIBBEAN: REAL AVERAGE WAGES

(Average annual indexes: 1990 = 100)

	1980	1990	1991	1992	1993	1994	1995 [a]
Argentina [b]	130.0	100.0	101.3	102.7	101.0	102.0	100.8
Bolivia [c]	...	100.0	93.4	97.1	103.6	111.8	112.6
Brazil [d]							
Rio de Janeiro	94.0	100.0	79.3	79.5	85.7	87.1	91.8
São Paulo	88.6	100.0	88.3	85.3	94.6	98.0	102.0
Chile [e]	95.4	100.0	104.9	109.6	113.5	118.8	123.6
Colombia [f]	85.0	100.0	97.4	98.6	103.2	104.1	105.5
Costa Rica [g]	115.8	100.0	95.4	99.3	109.5	113.6	111.4
Ecuador [h]	...	100.0	104.6	113.5	127.8	139.2	153.0
Guatemala [g]	142.5	100.0	93.6	107.6	115.2	122.9	...
Mexico [i]	128.3	100.0	106.5	114.3	124.5	129.1	111.5
Nicaragua [j]	477.6	100.0	103.2	103.2	118.8	128.6	133.4
Panama [k]	96.2	100.0	103.8	106.2	106.1	...	...
Paraguay [l]	102.1	100.0	104.7	103.6	104.5	106.1	114.2
Peru [m]	309.3	100.0	115.2	111.1	110.2	127.4	116.7
Uruguay	108.5	100.0	103.8	106.1	111.2	112.2	109.0
Venezuela [n]	...	100.0	94.2	98.8	90.1	75.9	65.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Manufacturing. [c] Private sector in La Paz. [d] Workers covered by social and labour legislation. [e] Up to April 1993, wage-earners in sectors other than agriculture. From May 1993 onward, general index of hourly pay. [f] Manual workers in manufacturing. [g] Average earnings reported by persons enrolled in the social security system. [h] Enterprises with 10 workers or more in mining, manufacturing, commerce and services activities. [i] Manufacturing. [j] Average wages, not counting payment in kind and other benefits. [k] Manufacturing in Panama City, estimated figures. [l] Asunción. [m] Private-sector manual workers in metropolitan Lima. [n] Urban non-manual and manual workers, as of the second half of each year.

5. Employment trends in 1996

During 1996, the regional unemployment rate has tended downwards slightly, but in a large number of countries, the rate of productive job creation is still too low.

Based on data from the end of 1995 for Argentina and the beginning of 1996 for Mexico, the annual average rate of open unemployment for 1996 is expected to go down in those countries where it rose most sharply during 1995. Against a background of moderate growth and given the severely limited capacity of high-productivity sectors to generate productive employment, however, such improvement as there is will probably be due mainly to a contraction of the labour supply and the creation of "subsistence-level work" in the informal sector, although a more intensive use of installed capacity may also play some role in helping to reduce unemployment.

For other big countries in the region, such as Brazil and Colombia, initial data for 1996 point to a continuation of the rise in unemployment that overshadowed the second half of 1995. Thus the regional outlook once again includes mixed trends in unemployment, with a high average rate and shortfalls in terms of productive job creation throughout much of the region.

Table VII-5

LATIN AMERICA AND THE CARIBBEAN: REAL URBAN MINIMUM WAGE

(Average annual indexes: 1990 = 100)

	1980	1990	1991	1992	1993	1994	1995[a]
Argentina	465.9	100.0	259.1	203.7	263.7	363.9	352.0
Bolivia	...	100.0	165.6	164.8	181.2	199.9	196.3
Brazil	138.4	100.0	112.8	102.5	113.0	108.0	113.9
Chile	114.4	100.0	109.3	114.3	120.0	124.4	130.0
Colombia	93.1	100.0	96.7	95.0	97.6	96.0	95.6
Costa Rica	82.7	100.0	92.8	92.5	92.7	93.6	91.0
Ecuador [b]	288.3	100.0	87.0	87.1	100.0	115.9	137.4
El Salvador	287.2	100.0	103.1	104.6	104.6	102.7	103.1
Guatemala	207.5	100.0	80.7	72.5	62.8	55.5	50.7
Haiti	136.2	100.0	84.6	74.2	60.0	43.3	81.8
Honduras	117.6	100.0	96.6	108.7	110.2	94.8	89.6
Mexico [c]	252.9	100.0	95.8	90.9	89.4	89.6	76.9
Panama	100.8	100.0	98.9	97.4	108.8	107.3	106.6
Paraguay [d]	76.4	100.0	95.6	87.1	83.8	86.0	87.4
Peru [e]	428.0	100.0	68.0	68.0	47.8	61.9	63.3
Dominican Republic	131.7	100.0	97.0	118.0	112.1	119.1	120.2
Uruguay	145.0	100.0	89.6	87.4	75.8	67.3	62.0
Venezuela [f]	209.1	100.0	86.5	123.3	108.0	121.0	113.3

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. [b] Minimum living wage, including supplementary allowances. [c] Minimum wage, deflated by the consumer price index for Mexico City. [d] Minimum wage in Asunción. [e] Minimum wage in the Lima metropolitan area for non-agricultural activities. [f] Nationwide minimum wage for non-agricultural activities; from 1992 onward, includes meal and transport allowances.

VIII. THE EXTERNAL SECTOR

1. Foreign trade in Latin America

The trade deficit in goods and services in Latin America and the Caribbean narrowed by US$ 16 billion in 1995. The merchandise trade balance, in particular, changed direction, moving from a deficit of nearly US$ 14 billion to a surplus approaching US$ 2 billion. This was due primarily to a dramatic expansion in exports from the region (21%) –the biggest increase since 1980, and one which took exports to a total of US$ 222 billion– and to a slowdown in the rate of increase in the value of imports, which had risen quite rapidly since the beginning of the 1990s.

Four main factors played a part in this result, although their effects were counteracting. The decisive factor was the contraction of voluntary external financing caused by the financial crisis in Mexico, which, while it created problems in both Mexico and Argentina and triggered a massive cutback in imports, also made it possible for both countries to expand their exports appreciably. Secondly, trends in international commodity prices, which rose more than import prices, also made an important contribution to the improvement of the region's external accounts. Thirdly, intraregional trade continued to expand briskly, as it has done since the beginning of the decade. Lastly, counteracting the other trends, Brazil's export volume shrank, while its level of imports soared in response to the explosion of domestic demand set off by the successful implementation of the *Real* Plan.

a) The volume of foreign trade

In 1995, the volume of the region's foreign trade in goods and services again grew much faster than its gross domestic product (GDP), a sign that the regional economy is indeed opening up and that Latin America and the Caribbean are playing their part in the increasing globalization of the world economy.

In recent years, the growth of foreign trade has rested chiefly on the dynamism of imports, but in 1995 imports slowed throughout the region and lost their leading role. The total volume of imports of goods and services in the region increased by little more than 4%, as against nearly 13% in 1994. Consequently, the ratio of imports to regional GDP (21%) rose more slowly than it had since the late 1980s (in 1990 it was only 14%). Export performance, on the other hand, improved; exports grew by 12%, further enhancing their steadily expanding share in GDP, which hitherto this decade had lagged behind the ratio of imports to GDP. In 1995, exports accounted for 20% of GDP, compared with 16% in 1990 and 10% in 1980.

Because of the preponderance of merchandise trade within total trade, the pattern observed in both was similar: imports increased by 5% and exports by 10% (see table VIII-1). These aggregate results were heavily influenced by the sudden drop in external capital flows that affected Mexico and Argentina and, indirectly, Uruguay. The extraordinary readjustment that these countries were forced to make caused a marked rise in exports and a sharp cutback in imports. The situation in Argentina in turn adversely effected economic activity in Uruguay, and imports faltered there as well.

Aside from these three countries, trends in most of the remainder were the same as they had been throughout the 1990s, that is, imports expanded faster than exports. Brazil, one of the two biggest economies in the region –the other being Mexico– provided an extreme example.

Table VIII-1
LATIN AMERICA AND THE CARIBBEAN : VARIATION IN EXPORTS AND IMPORTS OF GOODS [a]
(Growth rates)

	Exports			Imports		
	Value	Volume	Unit value	Value	Volume	Unit value
1985	-5.3	2.4	-7.5	0.9	1.6	-0.7
1986	-14.2	0.4	-14.5	2.6	5.6	-2.9
1987	14.9	7.1	7.2	13.5	8.5	4.6
1988	16.1	7.6	7.9	16.3	9.6	6.2
1989	11.0	4.5	6.1	8.6	4.9	3.4
1990	10.1	5.1	4.8	12.9	9.4	3.3
1991	0.6	4.7	-3.9	17.8	20.8	-2.5
1992	6.6	6.3	0.3	22.2	22.4	-0.3
1993	7.9	8.6	-0.7	9.7	8.8	0.9
1994	16.1	8.9	6.6	18.8	14.6	3.6
1995 [b]	21.3	10.4	9.9	11.8	4.3	7.2

Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF) and national sources.
[a] Covers 17 Spanish-speaking countries plus Brazil and Haiti. [b] Preliminary figures.

The success of its *Real* Plan induced an abrupt expansion of domestic demand, which drove imports up and depressed exports.

i) ***Merchandise exports***

Differing trends in the volume of merchandise exports were observable in the countries of the region. Two groups, in particular, stand out for their very dissimilar performances. Argentina, Mexico, Chile, Costa Rica, El Salvador, Haiti and Nicaragua recorded double-digit growth rates in exports of goods, whereas for Brazil, Paraguay, Uruguay, Panama and the Dominican Republic, growth was negative or close to zero (see table VIII-2).

These disparities can be explained by different combinations of the factors of domestic and external supply and demand for goods in each country. Domestic demand was the major factor, for example, in Argentina, Mexico and Brazil, all of which are large exporters of manufactures. In the case of Argentina and Mexico, the recession due to the abrupt drop in capital inflows pushed exports up (and in Mexico this expansion was further fuelled by the sharp currency depreciation); while in Brazil domestic demand crowded exports out as the exchange rate appreciated. External demand affected the countries of the region in different ways, depending on where their principal markets lay.

The countries with double-digit growth in export volume were those that were able to take advantage of the opportunities created by the more dynamic economies in Latin America and other regions and favourable trends in international commodity markets. Analysis of the performance of selected countries shows that Argentina, for example, benefited from the strong demand for manufactures in Brazil, whose economic situation in some ways complemented Argentina's own. Meanwhile, the main boost to Mexico's export trade, thanks to the devaluation of the peso and the new opportunities opened up by the North American Free Trade Agreement (NAFTA), came from an increase in sales to the United States large enough to reverse its traditional trade deficit with its neighbour. El Salvador reaped the benefit of the sizeable expansion of intraregional trade within the Central American Common Market (CACM). By contrast, Paraguay and Uruguay were affected by the contraction in demand in Argentina, while Panamanian exports from the Colón Free Zone were hit by the drop in demand in Mexico and other Latin American markets.

Generally speaking, countries with fast-expanding export sectors sold in increasing proportions to other Latin American countries, and the most vigorous markets for intraregional

Table VIII-2
LATIN AMERICA AND THE CARIBBEAN: EXPORTS OF GOODS FOB
(Growth rates)

	Value			Unit value			Volume		
	1993	1994	1995[a]	1993	1994	1995[a]	1993	1994	1995[a]
Latin America and the Caribbean	**7.9**	**16.1**	**21.3**	**-0.7**	**6.6**	**9.9**	**8.6**	**8.9**	**10.4**
Argentina	7.2	20.8	32.4	1.9	1.9	10.1	5.2	18.5	20.3
Bolivia [b]	11.3	38.8	5.7	6.6	15.6	0.5	4.4	20.1	5.2
Brazil	10.7	11.3	5.5	-2.7	6.5	7.9	13.8	4.5	-2.3[b]
Chile	-8.1	26.1	38.2	-8.9	12.6	23.9	0.9	12.0	11.5
Colombia	2.3	17.9	18.7	-4.5	15.1	16.0	7.1	2.4	2.4
Costa Rica	7.3	12.6	30.8	1.2	8.0	14.0	6.1	4.3	14.7
Ecuador	1.8	25.5	13.4	-3.0	13.5	5.9	4.9	10.6	7.0
El Salvador [b]	22.3	71.2	32.6	-9.2	29.7	15.1	34.7	32.0	15.3[b]
Guatemala	6.2	13.7	28.3	-6.0	8.0	16.5	13.0	5.3	10.2
Haiti	7.9	-29.7	166.6	0.3	6.0	10.0	7.6	-33.6	142.2
Honduras [b]	1.6	7.6	26.6	3.6	21.6	10.1	-1.9	-11.5	15.0
Mexico	12.3	17.3	30.6	6.2	4.9	5.0	5.8	11.8	24.4
Nicaragua	19.7	31.5	50.6	14.9	18.1	17.0	4.2	11.4	28.7
Panama	6.1	10.8	0.9	0.0	1.1	2.1	6.1	9.6	-1.1
Paraguay	42.3	18.7	12.1	-6.6	8.3	7.0	52.3	9.6	4.8
Peru	-0.6	29.6	22.3	-4.0	10.1	12.7	3.6	17.7	8.6
Dominican Republic	-9.2	26.0	15.4	-3.0	8.0	14.5	-6.3	16.6	0.8
Uruguay	-3.9	10.5	10.6	-3.5	7.4	10.8	-0.4	2.9	-0.2
Venezuela	4.1	7.5	16.3	-7.2	1.5	10.5	12.1	5.9	5.2

Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF) and national sources.
[a] Preliminary figures. [b] The indexes and rates given for unit value and volume are derived from national accounts.

exports were to be found in Brazil, Peru, Chile and Venezuela. Chile and Venezuela also figure, along with Argentina and Mexico, among those whose own exports within the region expanded most. Being above all a commodity exporter, however, Latin America as a whole was not able to take full advantage of the substantial growth in imports by the Asian region, and it was manufactures that made the biggest contribution to the surge in exports.

ii) ***Merchandise imports***

Except in Argentina, Mexico and Uruguay, imports expanded to a greater or lesser extent in almost all the countries of the region in response to the growth of domestic demand, which was itself usually dependent on activity levels (see table VIII-3). The expansion of imports was particularly striking in Brazil, Peru, El Salvador, Ecuador, Guatemala and Chile, and also Haiti, while the extraordinary import drive observed in Colombia in recent years drew to an end. Significant in these developments were changes in real exchange rates, which appeared to exert more influence on import trends than on export trends. In nearly all the countries it was noticeable that imports expanded when the local currency appreciated and contracted when it depreciated (see figure VIII-2). The former situation was more common, showing how important the fight against inflation has been; countries where this occurred included Brazil, Chile, Guatemala and Venezuela. Currency depreciation and import contraction occurred in Nicaragua and Paraguay, in addition to Argentina, Mexico and Uruguay.

Table VIII-3
LATIN AMERICA AND THE CARIBBEAN : IMPORTS OF GOODS FOB
(Growth rates)

	Value			Unit value			Volume		
	1993	1994	1995[a]	1993	1994	1995[a]	1993	1994	1995[a]
Latin America and the Caribbean	**9.7**	**18.8**	**11.8**	**0.9**	**3.6**	**7.2**	**8.8**	**14.6**	**4.3**
Argentina	13.6	29.2	-6.7	1.5	3.0	8.9	11.9	25.4	-14.4
Bolivia [b]	10.8	-0.4	14.1	9.1	-1.1	0.8	1.5	0.7	13.2[b]
Brazil	23.1	31.4	49.4	-3.6	3.3	13.7	27.7	27.2	31.4
Chile	10.2	6.9	34.7	-2.2	3.5	9.4	12.7	3.2	23.1
Colombia	50.7	21.5	17.0	-1.2	0.5	9.6	52.6	20.9	6.8
Costa Rica	18.8	6.2	5.9	2.4	3.7	9.0	16.1	2.4	-2.8
Ecuador	18.8	32.7	24.8	3.9	6.0	9.0	14.3	25.1	14.5
El Salvador [b]	13.2	36.3	31.5	-7.7	17.2	8.1	22.7	16.3	21.6[b]
Guatemala	2.4	6.8	19.1	-0.1	-1.1	7.6	2.5	8.0	10.7
Haiti	24.5	-47.0	339.1	-0.8	2.9	6.5	25.5	-48.5	312.1
Honduras [b]	-4.7	12.3	12.3	-9.2	8.8	15.3	4.9	3.2	-2.6
Mexico	5.2	21.4	-8.7	5.8	5.0	6.0	-0.6	15.7	-13.8
Nicaragua	-14.5	19.0	8.6	-0.7	2.1	7.1	-13.8	16.6	1.4
Panama	4.8	9.7	6.8	0.6	3.4	5.6	4.2	6.0	1.1
Paraguay	40.8	29.0	4.8	1.0	-0.4	6.0	39.4	29.6	-1.1
Peru	-1.0	37.7	37.9	-1.0	8.1	8.7	0.0	27.4	26.9
Dominican Republic	-2.6	7.4	4.4	-1.2	2.5	3.0	-1.4	4.8	1.3
Uruguay	10.1	22.7	3.2	1.7	1.0	9.0	8.3	21.5	-5.3
Venezuela	-10.7	-28.7	41.9	-0.5	0.5	9.0	-10.2	-29.1	30.1

Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF) and national sources.
[a] Preliminary figures. [b] The indexes and rates given for unit value and volume are derived from national accounts.

b) Foreign trade and foreign exchange earnings

Higher growth in export volume than in import volume was accompanied by a generalized improvement in the terms of trade, as export prices also rose more than import prices (see table VIII-5). As a result, there was a significant change in the regional merchandise trade balance, which swung from a deficit in excess of US$ 13.5 billion in 1994 to a modest surplus of US$ 1.6 billion in 1995 (see table VIII-17). At the same time, the trade deficit in goods and services narrowed dramatically from around US$ 25.7 billion to US$ 9.35 billion.

i) ***International prices***

Higher commodity prices were a decisive factor in the improvement in the real terms of trade, for commodities form the bulk of exports from most Latin American countries, with the exception of Mexico and Brazil. This favourable trend was mainly due to the steady pace of worldwide economic activity (which had begun to grow again and expanded at a rate of 2.4%, after a period of virtually no growth between 1991 and 1993) (United Nations, 1996), and to the depreciation of the United States dollar against a number of the major currencies (it lost between 8% and 9% of its value against the yen and the European ECU).

The combination of strong demand, more vigorous activity and –most notably in Japan– appreciating exchange rates, led to an expansion of world trade that far outstripped output growth, and to a substantial rise in most primary commodity prices due to inelasticity of demand. Commodity prices, which had begun to rise in the second half of 1993, peaked in the first quarter of 1995, after which they began to fall back once more as a result of the restrictive

Table VIII-4

LATIN AMERICA AND THE CARIBBEAN: PRICES OF MAIN EXPORT PRODUCTS

(Annual average prices)

	1980	1990	1991	1992	1993	1994	1995[a]
Soya bean oil [b]	598.3	447.3	453.8	429.0	480.4	615.6	625.2
Sugar [c]	28.7	12.6	9.0	9.1	10.0	12.0	13.3
Bananas [c]	17.0	23.6	25.6	21.5	20.0	19.9	19.9
Cocoa [c]	118.1	57.7	54.2	49.8	50.7	63.3	65.0
Coffee 1 [c]	178.8	96.5	89.9	68.2	75.8	157.3	158.3
Coffee 2 [c]	208.8	82.8	72.9	56.5	66.7	143.2	145.9
Beef [c]	125.9	115.4	120.8	111.4	118.7	105.8	86.5
Bovine leather [c]	104.6	108.3	65.6	63.5	81.2	106.8	111.0
Fishmeal [b]	504.4	412.5	477.8	481.5	364.7	376.3	495.0
Shrimp [c]	4.6	4.9	5.3	4.9	5.2	5.9	6.1
Maize [b]	210.3	127.1	126.3	120.0	120.4	125.2	144.6
Soybeans [b]	296.3	246.9	239.6	235.5	255.1	251.8	259.3
Wheat [b]	175.9	136.8	129.0	150.5	141.9	150.9	178.8
Cotton [c]	94.2	81.1	77.1	61.8	62.2	82.2	98.3
Wool [c]	194.5	167.3	119.0	123.2	115.8	144.7	172.4
Tobacco [c]	142.6	178.4	186.5	185.0	183.4	122.9	119.9
Aluminium [c]	78.4	74.4	59.1	56.9	51.7	67.0	81.9
Copper [c]	98.6	120.7	106.1	103.5	86.7	104.6	133.1
Tin [c]	761.4	281.1	253.7	276.6	234.0	247.7	281.8
Iron ore [b]	27.2	30.8	33.3	31.6	28.1	25.5	27.0
Lead [c]	41.1	36.8	25.3	24.6	18.5	24.8	28.6
Zinc [c]	34.6	68.9	50.7	56.3	43.7	45.3	46.8
Crude oil [d]	27.6	20.0	17.1	16.6	14.7	14.6	15.8

Source: ECLAC, on the basis of figures from the United Nations Conference on Trade and Development (UNCTAD) and the International Monetary Fund (IMF).

Note: **Soya bean oil**, all sources, f.o.b. Rotterdam. **Unrefined sugar**, f.o.b. Caribbean ports, for export to the open market. **Central American and Ecuadorian bananas**, f.o.b. United States ports. **Cocoa beans**, average of daily prices (futures), New York and London. **Coffee 1**, Colombia, mild arabica, ex-dock New York. **Coffee 2**, Brazil and other arabicas, ex-dock New York. **Beef**, frozen and de-boned, all sources, United States ports. **Bovine leather**, United Kingdom, average import prices. **Fishmeal**, all sources, 64%-65% protein, c.i.f. Hamburg. **Shrimp**, price in United States. **Maize**, United States, No. 3, yellow, c.i.f. Rotterdam. **Soybeans**, United States, No. 2, yellow, in bulk, c.i.f. Rotterdam. **Wheat**, f.o.b. United States, No. 2, Hard Red Winter. **Cotton**, United States M 1-3/32", c.i.f. Northern Europe. **Wool**, clean, combed, 48"s quality, United Kingdom. **Tobacco**, United States, all markets. **Aluminium, copper, tin, lead and zinc**, spot prices on the London Metal Exchange. **Iron ore**, Brazil to Europe, C. 64.5% Fe, f.o.b. **Oil**, Venezuela, Tía Juana, light.

[a] Preliminary figures. [b] Dollars per metric ton. [c] US cents per pound. [d] Dollars per barrel.

monetary policies that developed countries were implementing to deal with the threat of inflation.

Even so, average dollar prices for most goods were higher in 1995 than in 1994. The strength of demand was of most benefit to industrial raw materials, such as cotton and minerals and metals, prices for which improved by an average of 20%. Copper and nickel prices went up by around 30%, while, among other products of regional importance, sugar prices rose by 10% and wheat by nearly 20%. Oil price rises were smaller (8%).

There were a number of important exceptions to the upward trend; international beef prices slumped by 18%, and the annual average prices of soybeans, bananas, coffee and precious metals remained virtually unchanged. Coffee prices tumbled in the second half of 1995, after having more than doubled the year before. With a view to halting the price slide, the major Latin American, Asian and African coffee-exporting countries reached a new agreement to hold back coffee from the market.

Meanwhile, the fact that developed countries had prioritized the control of inflation in their economic policies meant that their recovery during 1994 and 1995 was accompanied by the

Table VIII-5

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

(Indexes: 1990 = 100)

	1980	1990	1991	1992	1993	1994[a]	1995[a]
Latin America and the Caribbean	**129**	**100**	**99**	**99**	**98**	**100**	**103**
Argentina	154	100	102	109	109	108	109
Bolivia [b]	134	100	98	81	79	93	93
Brazil	120	100	105	104	105	108	102
Chile	124	100	102	101	94	103	116
Colombia	116	100	107	109	105	120	127
Costa Rica	104	100	104	106	105	109	114
Ecuador	166	100	90	88	83	88	86
El Salvador [b]	108	100	99	99	97	107	114
Guatemala	113	100	104	104	98	107	116
Haiti	170	100	84	80	81	83	86
Honduras [b]	107	100	105	99	113	126	121
Mexico	150	100	101	106	106	106	105
Nicaragua	145	100	93	68	79	91	99
Panama	107	100	98	98	98	95	92
Paraguay	91	100	99	99	91	99	100
Peru	139	100	96	95	92	94	97
Dominican Republic	183	100	109	102	100	106	118
Uruguay	84	100	100	103	98	104	106
Venezuela	165	100	83	79	74	75	76

Source: ECLAC.

[a] Preliminary figures. [b] Indexes derived from national accounts.

lowest inflation rates since the 1960s. This had the effect of tempering price rises in the region's imports from these countries –largely manufactures. Average inflation in developed countries, which had fallen during the early 1990s and stood at 2.3% in 1994, remained low (2.4%) in 1995.

The unit values in the merchandise trade of the Latin American and Caribbean countries reflected international price trends in line with each country's specific product mix and terms of sale, the two factors that determine the correlation between unit values and spot-market prices. In export terms the country that benefited most was Chile, where the average unit value of exports went up by nearly one quarter, boosted primarily by the surge in copper, cellulose and fishmeal prices. Elsewhere in South America, unit values in Colombia, Peru, Uruguay and Venezuela went up by more than 10%, while increases in Central America varied between 10% and 17%, since coffee sales, in particular, had been contracted at prices prevailing before the shift in trend. Generally speaking, the rise in the unit values of imports, more similar in kind, was somewhere between 7% and 10%. As a result, the terms of trade improved in all the countries with the exception of Brazil, Bolivia, Ecuador, Paraguay, Honduras, Mexico and Panama, where they remained unchanged or deteriorated slightly.

ii) ***The value of trade***

The favourable trend in international prices was thus the determining factor in increasing the region's earnings from exports of goods. The most notable of the few exceptions to this rule were Argentina and Mexico, which experienced not only favourable trends but also a strong

growth in export volumes. The value of exports thus rose in all the countries, and in most cases the rise was substantial (see table VIII-3). Only in Panama was growth less than 1%, while in Bolivia, Brazil and Paraguay it approached 6%. In the majority of the remaining countries, the value of exports went up by between 10% and 30%; and the increase was even greater in Argentina, Chile, El Salvador, Mexico and Nicaragua, for example –and indeed in Haiti, where trade made an exceptional recovery after several years of political upheaval, a trade embargo and economic chaos.

Thus in 1995 the region's overall earnings from merchandise exports were US$ 222 billion, 21% more than in 1994 (see table VIII-6). This outcome marked a new stage on the upward path that export earnings have followed since the beginning of the decade. It was the biggest increase since 1980 and, in terms of recent decades, it was second only to the surge in income occasioned by soaring oil prices in the 1970s. Just as those episodes were the product of events in the oil-producing countries, so the trigger in 1995 was the crisis that engulfed Mexico and Argentina, the two countries that were ultimately responsible for 60% of this increase in earnings.

At the same time, the only countries whose import spending went down despite price rises of nearly 10%, were Argentina and Mexico. The other countries' import bills grew, although in nearly half the cases more of the increase was spent on covering price rises than on purchasing larger volumes, when greater quantities were in fact purchased (see table VIII-4). Apart from Haiti, the biggest spender was Brazil, whose imports increased in value by 50%. The value of imports to Chile, Ecuador, Peru, El Salvador and Venezuela rose by between 25% to 40%, an increase shared, except in Ecuador, among all categories of goods (consumer, intermediate and capital). A further five countries recorded rises in excess of 10%.

iii) ***Foreign trade markets***

According to preliminary estimates by the Latin American Integration Association (LAIA), intraregional trade continued to grow, as it has since the beginning of the 1990s. Between 1990 and 1994, the value of intraregional exports nearly tripled and their share in total Latin American exports increased from 11% to 17%. In 1995, exports to other LAIA countries grew by 24%, further expanding their share of total. Exports between countries in the Andean Group increased by 26%, in MERCOSUR by 20% and in the Central American Common Market (CACM) by 25%: these rates were higher than the rate of growth in trade between each of these groups and the rest of the world (see table VIII-6).

iv) ***The balance of trade in goods and services***

The above trends were reflected in various ways in the merchandise trade balance in each of the Latin American and Caribbean countries. Those that had been hardest hit by the abrupt drop in voluntary external financing showed improvements that were a direct result of the process of adjusting to the new shortage of finance. One of the most significant turnabouts occurred in Argentina where, thanks to an increase of US$ 6.5 billion, a large deficit turned into a substantial surplus. Developments in Mexico were similar, but the amounts involved were even greater: the preceding year's deficit of nearly US$ 18.5 billion swung to a surplus of more than US$ 7 billion. Equally dramatic was the radical improvement in Chile's merchandise trade balance, although in this case the reasons were very different.

Argentina, Mexico and Chile were also the only countries in the region, apart from two oil-exporting countries, Ecuador and Venezuela, to run up a merchandise trade surplus with the rest of the world in 1995 (see table VIII-6). The other countries not only posted a deficit, but in most a wider deficit than before. In no case was the change as great as in Brazil, however, there the traditional surplus, which in 1994 had been well above US$ 10 billion, shifted to a deficit of more than US$ 3 billion.

It was basically the merchandise trade balance that shaped the regional balance of trade in goods and services, for trade in services accounted for no more than a small fraction of total trade (15% of exports and 18% of imports). Only in a few countries do services have a large share in foreign trade, but in a number of those, such as the Dominican Republic, Costa Rica, Guatemala, Uruguay and Paraguay, the sector is a major source of

Table VIII-6
LATIN AMERICA AND THE CARIBBEAN: INTRAREGIONAL AND TOTAL EXPORTS
(Billions of dollars)

	1992	1993	1994	1995[a]
Mercosur				
Intrasubregional	7.2	10	12	14.4
World	50.5	54.2	62.1	70.3
Mercosur/World (in %)	14.3	18.5	19.3	20.5
Andean Group				
Intrasubregional	2.2	2.9	3.8	4.8
World	28.3	29.8	35.2	40.2
Andean Group/World (in %)	7.8	9.7	10.8	11.9
LAIA				
Intrazonal	19.4	23.7	28.6	35.5
World	134.9	145.2	169.3	206.3
LAIA/World (in %)	14.4	16.3	16.9	17.2
CACM				
Intrazonal	0.9	1.1	1.2	1.5
World	4.7	4.9	6.2	7.8
CACM/World (in %)	19.1	22.4	19.4	19.2
CARICOM[b]				
Intrazonal	0.2	0.3	0.4	...
World	3.7	3.7	3.8	...
CARICOM/World (in %)	5.4	8.1	10.5	...
Region[c]				
Intraregional	24.5	29.3	34.7	...
World	146.1	156.4	180.6	...
Region/World (in %)	16.8	18.7	19.2	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary estimates. [b] Includes only Barbados, Guyana, Jamaica and Trinidad and Tobago. [c] Includes LAIA, CACM, Barbados, Guyana, Jamaica, Trinidad and Tobago, Bahamas, Belize, Haiti, Panama, Dominican Republic and Suriname.

foreign exchange; the same is true of Panama, whose earnings come from banking and transport services. These countries and, exceptionally, Mexico, were the only ones to record a surplus in their trade in services.

Taken as a whole, regional revenue from exports of services rose from over US$ 34 billion to around US$ 38 billion, of which Mexico accounted for over one fourth. Payments for services also increased, albeit by somewhat less (US$ 2 billion), to nearly US$ 47.6 billion, half of that spent by Brazil and Mexico. As a result, the regional deficit narrowed to less than US$ 11 billion (see table VIII-6).

2. Economic integration in the region

During 1995, progress continued to be made with the integration process in Latin America and the Caribbean. Trade policy in nearly all the countries of the region is now tied to subregional integration agreements. All four of the existing agreements of this type –MERCOSUR, the Andean Group, the Central American Common Market (CACM) and the Caribbean Community (CARICOM)– have recently become customs unions with varying levels of integration.

MERCOSUR became a customs union on 1 January 1995, and the Andean Group followed

suit barely a month later, each group putting into effect a common external tariff (CET) to supplement the free trade regime that its members had agreed on. At the beginning of 1995 the MERCOSUR CET had 11 tariff brackets ranging from 0% to 20% with a simple average of 11%. The Andean Group's CET varied from 5% to 20% over just four brackets, with an average of 14%. Both Bolivia and Peru continued to apply their own national tariffs, however, and Peru did not join the Group's free trade regime but continued to trade with the other member countries under bilateral agreements.

In mid-1993, CACM members agreed on a common external tariff with a minimum of 5% and a maximum of 20%. Since then, they have been moving to perfect their customs union, although there are still major exceptions to the intraregional free trade regime and to application of the common external tariff under the new Central American Tariff System. Honduras having resumed its place as a full member of CACM, the free trade regime was further strengthened in 1995 by Costa Rica's agreement to reduce its surcharges on the other four members and by Nicaragua's approval of a reduction in its temporary import tariffs. The tariff system has three components. The first covers roughly 95% of all dutiable items and is common to all the parties (except for the safeguards and temporary surcharges each party is permitted); the second comprises the 3% of tariffs that are to progressively converge by 1999; and the third consists of the other 2%, which will remain unchanged.

By mid-1995, CARICOM countries had made significant progress in pursuit of their goal of reciprocal free trade, and work continued on the implementation of the agreed common external tariff. As regards free trade, 10 out of the 13 member countries[1] dropped their requirement for prior import licences. The CET structure is now set as far as 1998, and a gradual reduction of the common tariffs on non-agricultural goods is planned, to bring them down to between 5% and 20%.

Of the four integration schemes, it is without doubt MERCOSUR that has made the most progress, as can be seen from the high degree of trade liberalization among all its members; it is also moving forward with its CET according to a schedule to be completed by 2006.

There are four basic reasons for the remaining limitations of these customs unions. In the first place, the free trade regimes still permit lists of exceptions, and these will only gradually be phased out. Secondly, the common external tariffs do not yet apply to the whole range of dutiable goods, and countries have drawn up lists of products for which the tariffs are only gradually to be brought into line with CETs. Thirdly, some countries have not yet applied their own group's CET. Lastly, a number of countries of the region have recently adopted unilateral trade policy measures in order to cope with adverse economic situations. In some groups such measures have created great internal tensions, although so far it has been possible to resolve these tensions through direct negotiations between the parties involved.

It is important to bear in mind the fact that since 1 January 1994, Mexico has also been a member of the North American Free Trade Agreement (NAFTA), along with Canada and the United States. A year after Mexico joined NAFTA, the treaty of the Group of Three came into force, creating a free trade area between Colombia, Mexico and Venezuela. An additional element of the integration picture is the proliferation of bilateral agreements that, despite their obvious similarities, nevertheless differ so significantly in their specific details that it would be difficult to harmonize them by simply making them multilateral.

A variety of efforts have been made to devise a broader framework encompassing all the different integration processes, but as yet no definitive approach appears to have been adopted. The possibility of the countries of the region joining NAFTA in the near future seemed to offer good prospects, but these evaporated when the United States suspended the fast track authority provisions. After the Summit of the Americas in Miami in December 1994, a new path towards integration at the hemisphere level began to emerge with the Free Trade Area of the

[1] In February 1996, Suriname was admitted as the fourteenth member of CARICOM.

Americas (FTAA) initiative. The ministers of foreign trade of the 34 countries participating in the FTAA project have since met on two occasions (in Denver, Colorado, in July 1995 and in Cartagena, Colombia, in March 1996) and 11 working groups have been set up; these groups are currently compiling comprehensive information on the national and subregional levels that may be relevant to future negotiations. According to the Declaration of Principles of the Summit, the process of covergence should take account of all the integration agreements that are already in place in the region. This position was subsequently reaffirmed at the two later meetings, where it was also acknowledged that there was a range of possible approaches to such harmonization.

The formation of a customs union by the MERCOSUR countries also appears to have created a new focus of convergence in the south of the continent. In June 1996, MERCOSUR and Chile completed negotiations on the establishment of a free trade zone within the next 18 years. Also in June, Bolivia signed a framework agreement on negotiations to create a free trade zone with MERCOSUR, and it is expected that the other Andean countries will reach similar agreements with the group. If these initiatives, and the economic complementarity agreements between Chile and the Andean countries, bear fruit, they will bring about a South American free trade area of a sort, although significant gaps and limitations will still exist.

3. The current account balance and the income balance

The balance-of-payments current account deficit in Latin America and the Caribbean was just over US$ 32 billion in 1995, marking a halt in the upward trend that began in 1991. From 1992 to 1994 the region's deficit had averaged US$ 43 billion. This narrowing of the deficit was mainly a reflection of the improvement in the external accounts of Mexico, Argentina and Chile, somewhat tempered by a deterioration in those of Brazil, Peru and Colombia.

The most important contribution to the improvement in the regional current account was made by Mexico, where the huge deficit posted in 1994 –the equivalent of 7.5% of GDP– has brought close to a balance in 1995. Argentina's deficit also shrank considerably, narrowing to the equivalent of 2.5% of output. The trade balance was the decisive factor in both these cases. Other countries of the region where trends in the balance-of-payments current account took a positive turn included Chile, the Dominican Republic and Costa Rica.

By contrast, the poor showing of the external accounts of Brazil, Peru and Colombia had an adverse effect on the region's overall current account (see table VIII-17). Brazil's deficit was US$ 18 billion, chiefly owing to the first large trade deficit the country had run up in many years; even so, as a percentage of output the current account deficit was moderate (2.2%). In Peru, too, the deterioration in the current account was attributable to the trade deficit, which doubled owing to the strong expansion of imports. Colombia's wider deficit, however, was due both to a further deterioration in the balance of trade and to the increase in factor service payments.

The region's income balance, which basically reflects net payments of profits and interest, showed a modest increase on the 1994 figure and amounted to US$ 37.6 billion; this means that it was not a significant factor in the variation in the current account balance (see table VIII-17). Net profit remittances for the region (US$ 11.5 billion) continued to be concentrated in five countries: Argentina, Brazil, Colombia, Mexico and Chile. Net interest payments totalled US$ 25 billion. In 1995, as in 1994, there was a regionwide increase in gross interest payments. One of the contributory factors was the rise in interest rates (LIBOR); although these gradually declined during the course of the year, the annual average was one percentage point higher than in 1994. A further reason for the rise in interest payments was the increase in external debt, chiefly in Mexico, Brazil, Argentina and Colombia.

4. Capital flows and international reserves

In 1995, the balance on the region's capital and financial account was nearly US$ 27 billion, a much lower figure than the annual average of US$ 49 billion recorded in 1992, 1993 and 1994.[2] This figure included US$ 21 billion in direct investment, US$ 14 billion in net portfolio investment in bonds and US$ 7 billion in other long-term capital; these inflows were offset, however, by outflows of US$ 15 billion in short-term capital and portfolio investment (see table VIII-7). The region's international reserves shrank by US$ 5.6 billion, as it increased its reserve assets (foreign exchange) by US$ 24.4 billion, while drawing on US$ 30 billion in exceptional financing.

a) General trends

In the wake of the events in Mexico in 1994, two distinct phases could be observed in the flow of capital to Latin America and the Caribbean. The first phase, which lasted from January to April 1995, was characterized by financial turbulence that affected the region's major economies in varying degrees. Its chief manifestations were a flight of short-term capital from a number of Latin American countries and a virtual cut-off of flows of private financing to the region. Multilateral agencies filled the gap in this situation by providing compensatory financing that enabled Mexico to meet its huge short-term commitments and Mexico and Argentina to regain access to international financial markets. In the second phase, which began in May 1995, Latin America once more became fully active in the international financial markets, particularly the bond market. It is also important to note that direct investment flows to the majority of countries in the region had a momentum of their own and remained unaffected by the Mexican financial crisis during 1995.

Capital flows to Latin America and the Caribbean over the course of the year largely reflected the pattern of private capital flows to developing countries in general. The main features of such flows were: i) a continuation of the upward trend in direct investment that began in 1991, partly as a consequence of the active privatization programmes being pursued in emerging economies; ii) a sharp drop in portfolio investment in stocks –chiefly as a result of the heightened volatility of the financial markets in the wake of the Mexican crisis (especially in the first few months of 1995), combined with the strong performance of the United States stock market in 1995; and iii) a recovery in portfolio investment in bonds, although not yet to the level recorded in 1993 (see figure VIII-1).

The region's financial account balance[3] was the outcome of opposite trends (see table VIII-17). On the one hand, capital in Brazil expanded by US$ 31 billion, an extraordinarily high proportion of which consisted of short-term capital and portfolio investment (see box VIII-1). Colombia's net inflows of US$ 4.4 billion, half of which represented direct investment, set a new record for the country. Capital flows to Peru totalled US$ 3.85 billion, an amount which despite its size did not match the preceding year's exceptional figure; the chief components were direct and portfolio investment and short-term capital.

Meanwhile, other Latin American countries recorded net outflows of capital. Mexico experienced net outflows of US$ 14.6 billion in voluntary capital, owing mainly to the fact that, the year's total net outflows of portfolio investment and other capital amounted to

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[2] Changes in the methodology used for the capital and financial account in the fifth edition of the IMF *Balance of Payments Manual* include the following: i) the financial account does not include official transfers; ii) the scope of portfolio investment has been widened to include money-market debt instruments and negotiable financial instruments (chiefly bonds), which under the fourth edition were reported as other capital; and iii) direct investment and portfolio investment are no longer broken down into long- and short-term, although "other investment" is. For full details see International Monetary Fund, *Balance of Payments Manual*, fifth edition, Washington, D.C., 1993.

[3] Capital inflows figured as the balance on the capital and financial account plus errors and omissions in the balance of payments.

Table VIII-7

LATIN AMERICA AND THE CARIBBEAN: SOME SOURCES OF EXTERNAL FINANCING

(Millions of dollars)

	1990	1991	1992	1993	1994	1995[a]
A. **Debt**						
Bonds [b]	2 760	7 242	12 577	28 794	18 241	23 395
Banks [c]	8 559	6 800	10 942	1 581	5 027	5 117
Commercial paper	-	1 212	840	315	400	...
Certificates of deposit	-	670	1 100	65	...	...
B. **Investment**						
Direct [d]	6 599	11 101	13 676	13 734	21 887	21 288
ADR/GDR [e]	98	3 891	3 964	6 022	4 704	962
External funds [f]	575	727	293	10	565	...

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

[a] Preliminary figures. [b] Gross value. [c] Net short- and medium-term borrowing. [d] Net figures. Includes reinvestment of profits. [e] ADRs = American Depository Receipts; GDRs = Global Depository Receipts. [f] Close-ended funds only; initial capital.

US$ 21.6 billion. On the other hand, reserve assets increased, boosted by the compensatory capital provided by the multilateral agencies and the extraordinary loans granted by the United States Treasury Department, which together totalled US$ 26 billion.

Venezuela continued to experience net capital outflows in 1995, as in 1994, although these shrank to US$ 3.4 billion. Inflows of non-compensatory capital to Argentina amounted to only US$ 400 million, a sum that did not stand comparison with the US$ 10 billion in external financing received annually in the three-year period 1992-1994.

In Chile, which took steps to discourage the influx of short-term capital and in October made an exceptional prepayment of US$ 1.8 billion to multilateral agencies, net inflows diminished from US$ 3.8 billion in 1994 to US$ 900 million in 1995. Among the remaining South American countries, capital inflows to Bolivia totalled US$ 260 million, a sum which exceeded the preceding year's total, while the balance on Uruguay's capital account was positive, although lower than it had been in 1994.

Inflows of capital to Central America and the Caribbean totalled only US$ 1.7 billion in 1995[4], and the largest sums went to El Salvador and Panama.

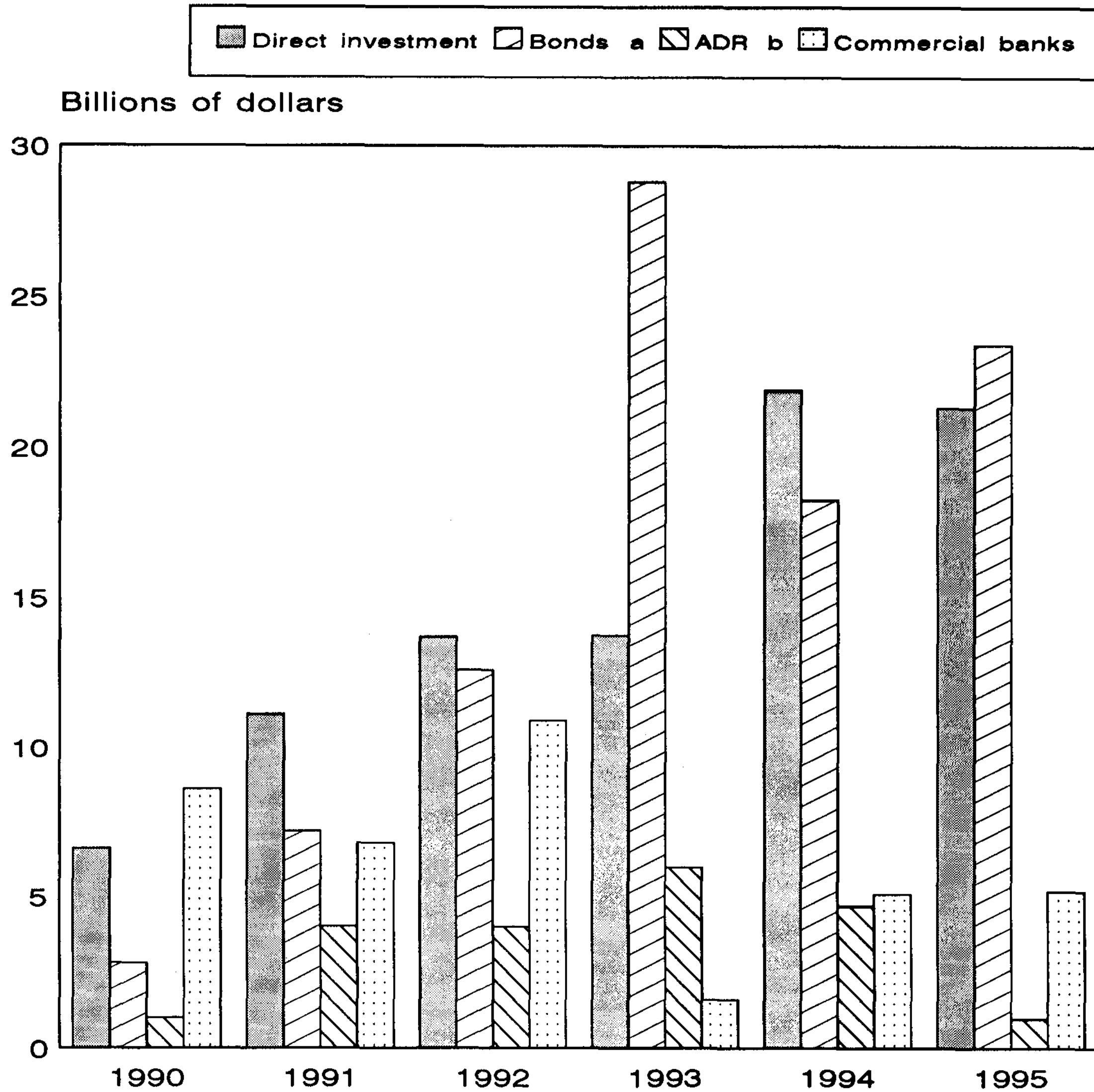
b) The composition of capital flows

In 1995, the upward trend in direct investment that began in 1990 continued. As in previous years, such investment was concentrated primarily in the mining and oil sectors and was associated with high-yield projects. The exception was Mexico, where an appreciable share of direct investment went into manufacturing. The financial crisis in Mexico and the political upheavals in other countries of the region during 1995 did not detract from the strength of these flows.

With the benefit of a regulatory framework much more favourable than in previous years, direct investment continued to increase in 1995, rising to more than US$ 21 billion (see

[4] Under the new methodology used for the balance of payments, some official transfers that used to be reflected in the capital account balance, are now reported on the current account, mainly as current transfers. Since the majority of Central American countries receive sizeable sums in financing of this kind, their financial account balance appears rather small when figured according to the new version of the balance of payments.

Figure VIII-1
LATIN AMERICA AND THE CARIBBEAN: SOURCES OF EXTERNAL FINANCING



Source: ECLAC, on the basis of official figures.
[a] Gross values. [b] Primary issues.

table VIII-8). For the first time since 1990, such investment was not mobilized primarily by privatization programmes. In 1995, the value of companies sold off was only US$ 4.3 billion, as compared with an annual average of US$ 11 billion between 1991 and 1994.

Although direct investment declined in Chile, Peru and Mexico, these dips were mere interruptions in a clear upward progression, and the ratio of direct investment to output remained at around 3%. Flows into Colombia continued to

Box VIII-1
BRAZIL: INFLOWS OF CAPITAL

In 1995, net capital inflows to Brazil totalled US$ 31 billion, an unprecedented figure equal to half the value of the year's exports of goods and services.

During the early months of the year, the Mexican crisis caused a shrinkage in capital inflows to Brazil. As a result, the amount of new Brazilian securities issued (bonds, euronotes and certificates of deposit) dropped from US$ 3.2 billion in the last quarter of 1994 to a mere US$ 500 million in the first quarter of 1995. During the same period, the stock market recorded net outflows of US$ 3.6 billion, in contrast to 1994, when a total of US$ 7.3 billion was accumulated. In view of this unstable situation, the Central Bank announced in March the introduction of a currency band--initially set at between 0.84 and 0.93 reais per dollar--thus formalizing a mechanism which had already been operating de facto for some months.

External events and domestic adjustment policies prompted speculative activity and caused a reduction of US$ 6.5 billion in international reserves between December 1994 and April 1995. This situation forced a new adjustment of the exchange rate band, whose floor was raised to 0.88 reais, an effective devaluation of 5%. However, from midway through the second quarter there was a gradual but steady increase in participation in international private financial markets. The exchange rate band was adjusted once more in June, this time without turbulence in the foreign exchange market, and the value of the dollar gradually rose to slightly over 0.96 reais per dollar by mid-December.

The recovery of capital flows, which accelerated in the second half of 1995, was evident from the following: i) sales of private bonds and securities, which had amounted to US$ 4.3 billion during the first quarter, rose to US$ 7.5 billion in the second quarter; ii) the Brazilian Government once again floated international bond issues, in Germany and Japan, to the value of US$ 1.8 billion; iii) net direct investment reached US$ 3.5 billion, nearly double the amount for the same period in 1994; iv) commercial lines of credit to finance foreign trade increased as a result of the substantial expansion (50%) of imports of goods and services; and v) inflows of equity and financial capital expanded greatly.

BRAZIL: BALANCE ON THE CAPITAL AND FINANCIAL ACCOUNT[a]
(Billions of dollars)

	1994	1995
Total	7.7	31.1
Long-term capital	3.0	10.3
Direct investment	2.0	3.5
Other long-term capital	1.0	6.8
Portfolio investment and short-term capital	4.4	19.4
Errors and omissions	0.3	1.4

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

The increase in long-term capital and, in particular, the growing percentage of direct investment are significant. The changes in legislation on foreign investment and the end of the State monopoly in petroleum and communications, together with the privatizations announced in the electricity sector, should stimulate such flows still further in 1996. Short-term capital and portfolio investment, however, soared to an extraordinary US$ 19 billion, despite the measures adopted in October 1994 by the Central Bank to discourage speculative flows of very short-term capital. Although some of these measures were relaxed during the first quarter of 1995, the Central Bank raised the tax rates once again with a view to reducing the influx of short-term capital.

expand, reaching a total of US$ 2 billion, or the equivalent of 2.5% of GDP.

Direct investment flows to Argentina and Brazil were nearly US$ 4 billion, substantially more than in previous years, although in Brazil's case the level was still low as a proportion of GDP (0.5%). Of particular note was direct investment in Bolivia, which equalled 5.5% of output, partly as a result of new investments and partly owing to the privatization of companies in the energy and telecommunications subsectors under the capitalization programme. Direct investment flows into Costa Rica were also significant (4% of GDP).

The level of direct investment abroad by the countries of the region were again appreciable, notably in Brazil (US$ 1.4 billion), Chile (US$ 900 million), Colombia (US$ 300 million)

Table VIII-8
LATIN AMERICA AND THE CARIBBEAN: NET FOREIGN DIRECT INVESTMENT[a] [b]
(Millions of dollars)

	1980	1990	1991	1992	1993	1994	1995[c]
Latin America and the Caribbean	**5 538**	**6 599**	**11 101**	**13 676**	**13 734**	**21 887**	**21 288**
Argentina	678	1 836	2 439	4 179	6 305	1 200 [d]	3 900[d]
Bolivia	47	10	94	120	122	128	372
Brazil	1 544	324	89	1 924	801	2 035	3 475
Chile	213	582	400	321	410	796	1 008
Colombia	51	484	433	740	710	1 515	1 977[e]
Costa Rica	48	160	173	222	244	298 [e]	350[e]
Ecuador	70	126	160	178	469	531	470
El Salvador	6	2	25	15	16	-	...
Guatemala	111	48	91	94	143	65	75
Haiti	13	8	14	-	-	-	-
Honduras	6	44	52	48	35	35	50
Jamaica	28	138	133	142	78	117	...
Mexico	2 090	2 549	4 742	4 393	4 389	10 973	6 963
Nicaragua	-	-	-	15	39	40	70
Panama	-47	-147	138	173	-658	549	...
Paraguay	32	76	84	137	111	180	207
Peru	27	41	-7	145	371	2 326	1 691
Dominican Republic	93	133	145	180	183	190	199
Trinidad and Tobago	185	109	169	178	379	516	...
Uruguay	290	0	0	0	102	155	124
Venezuela	55	76	1 728	473	-514	239	357

Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF).
[a] Refers to direct investment in the reporting economy minus direct investment abroad by residents. Includes reinvested earnings. [b] In accordance with the fifth edition of the IMF *Balance of Payments Manual*, all transactions between non-financial direct-investment enterprises and their parent companies and affiliates are included in direct investment. [c] Preliminary figures. [d] Source: World Bank, World Debt Tables 1995-1996. [e] Official figures.

and Venezuela (US$ 200 million); the majority of such investment was in neighbouring countries.

Gross portfolio investment in bonds, which in 1995 reached US$ 23.4 billion, was 30% higher than in 1994, although it was still lower than 1993's record figure of US$ 29 billion (see table VIII-9). Net debt in the form of bonds, however, increased by only US$ 15 billion, since around US$ 8.5 billion of debt principal was paid off. Mexico, Brazil and Argentina were responsible for 90% of total bond sales.

In the wake of the Mexican devaluation at the end of 1994, bond issues declined sharply in the countries of the region in the early part of 1995; in the first four months of the year issues amounted to barely US$ 1 billion, and the great majority of these were private issues. In the following months, however, foreign investors showed more interest in providing financing to Latin American countries and were further encouraged by declining international interest rates as the year wore on.

Terms for bond issues deteriorated: average maturities shortened from four and a half years in 1993 to four years in 1994 to only three and a half years in the first nine months of 1995, although the trend reversed itself in the fourth quarter of 1995 and the first quarter of 1996. In addition, the spread above the reference rate at which lenders were able to place their bonds widened. The private sector's share in such placements, which had been nearly 60% in 1993-1994, fell to slightly over 35% in 1995, mainly owing to greater public-sector activity in Argentina and Mexico. There was thus a preponderance of government bond issues, except in Brazil, where private bond issues

Table VIII-9
LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES [a]
(Millions of dollars)

	1990	1991	1992	1993	1994	1995	1995	
							1st sem.	2nd sem.
Total	**2 760**	**7 242**	**12 577**	**28 794**	**18 241**	**23 395**	**6 829**	**16 566**
Argentina	21	795	1 570	6 308	5 319	6 354	1 594	4 760
Barbados	-	-	-	-	50	-	-	-
Bolivia	-	-	-	-	10	-	-	-
Brazil	-	1 837	3 655	6 465	3 998	7 040	3 471	3 569
Chile	-	200	120	322	155	300	-	300
Colombia	-	-	-	567	955	1 083	410	673
Costa Rica	-	-	-	-	50	-	-	-
Ecuador	-	-	-	-	-	10	-	10
Guatemala	-	-	-	60	-	-	-	-
Jamaica	-	-	-	-	55	-	-	-
Mexico	2 477	3 782	6 100	11 339	6 949	7 646	1 129	6 517
Panama	-	50	-	-	250	324	225	99
Peru	-	-	-	30	100	-	-	-
Trinidad y Tobago	-	-	100	125	150	71	-	71
Uruguay	-	-	100	140	200	211	-	211
Venezuela	262	578	932	3 438	-	356	-	356

Source: International Monetary Fund (IMF), information provided to ECLAC.
[a] Gross financing.

predominated, and in Chile, where the public sector did not issue bonds at all. The proportion of bond issues denominated in deutsche mark and yen also increased gradually, owing to the low interest rates in those currencies.

During the first quarter of 1996, appreciable quantities of bonds continued to be issued, under the stimulus of the recent drop in international interest rates, and these, too, continued to be concentrated in Argentina, Brazil and Mexico (see table VIII-10).

Portfolio investment in stocks, both on local stock exchanges and abroad, chiefly in the United States, was badly affected by the Mexican financial crisis and by political and economic disturbances in other countries of the region (see table VIII-11). Primary issues of depositary receipts in the United States market (ADRs) declined sharply from US$ 4.7 billion in 1994 to only US$ 960 million in 1995. During the first quarter a number of Latin American companies tried in vain to place ADRs, and from the second quarter on, there were corporate issues only from Brazil, Chile, Colombia and Panama. Since the beginning of 1996, however, there has been a strong recovery.

Stock prices at the end of 1995, as compared with the end of 1994, were down by 20% to 30% in Brazil, Colombia, Mexico and Venezuela and by 3% in Chile, while in Argentina and Peru they rallied. Although the Mexican financial crisis affected nearly all the stock exchanges during the first few months of 1995, they recovered later, especially in early 1996 (see figure VIII-2).

According to figures from the Bank for International Settlements, the region's debt with the international commercial banking system increased by 3% and stood at US$ 230 billion by

Table VIII-10
INTEREST RATES IN INDUSTRIALIZED COUNTRIES
(Average values)

	1990	1991	1992	1993	1994	1995
	Short-term financial market rates					
Germany	7.9	8.8	9.4	7.5	5.3	4.5
Canada	11.6	7.4	6.8	3.8	5.5	5.7
United States	8.1	5.7	3.5	3.0	4.2	5.8
France	9.9	9.5	10.4	8.8	5.7	6.4
Italy	12.4	12.2	14.0	10.2	8.5	10.5
Japan	7.2	7.5	4.6	3.1	2.2	1.2
Netherlands	8.3	9.0	9.3	7.1	5.1	4.2
United Kingdom	14.7	11.8	9.6	5.5	4.8	6.0
	Long-term financial market rates					
Germany	8.9	8.6	8.0	6.3	6.7	6.5
Canada	10.9	9.8	8.8	7.9	8.6	8.3
United States	8.6	7.9	7.0	5.8	7.1	6.6
France	10.0	9.1	8.6	6.9	7.4	7.6
Italy	11.5	13.2	13.3	11.3	10.6	12.2
Japan	7.4	6.5	4.9	3.7	3.7	3.7
Netherlands	8.9	8.7	8.1	6.5	7.2	7.2
United Kingdom	11.1	9.9	9.2	7.9	8.1	8.3

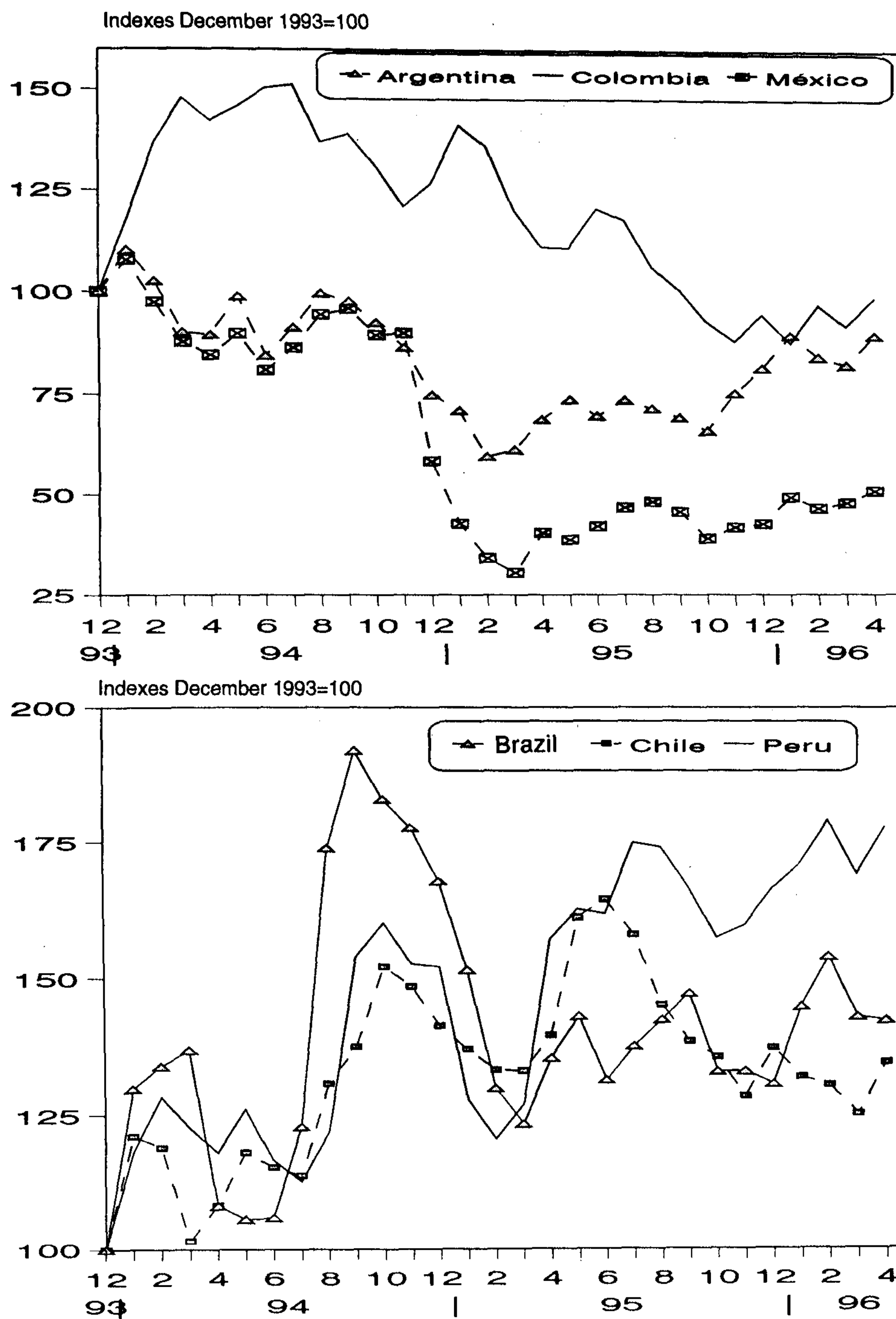
Source: International Monetary Fund (IMF), *International Financial Statistics*, Washington, D.C., various issues.

Table VIII-11
LATIN AMERICA AND THE CARIBBEAN : INTERNATIONAL STOCK ISSUES [a]
(Millions of dollars)

	1990	1991	1992	1993	1994	1995
Total	**98**	**3 891**	**3 964**	**6 022**	**4 704**	**962**
Argentina	-	360	392	2 655	735	-
Brazil	-	-	133	-	1 028	296
Chile	98	-	129	288	799	224
Colombia	-	-	-	98	207	71
Mexico	-	3 531	3 077	2 913	1 679	-
Panama	-	-	88	-	100	371
Peru	-	-	-	26	133	-
Uruguay	-	-	-	-	23	-
Venezuela	-	-	146	42	-	-

Source: International Monetary Fund (IMF), information provided to ECLAC.
[a] Refers to American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) for widening of new capital (primary issues).

Figure VIII-2
STOCK MARKET PRICE INDEXES IN DOLLARS



Source: ECLAC, on the basis of figures from the International Finance Corporation.

the end of the year. Contributing factors were increased borrowing in Colombia and Uruguay (20%), Chile (17%), Peru (12%), Brazil (11%) and Argentina (8%) and reductions in the remaining countries, of which the biggest in percentage terms occurred in Nicaragua (-17%) and Ecuador and Mexico (-8%); the reductions in Nicaragua's and Ecuador's debts resulted from the rescheduling of commercial debt. The growth of the debt owed to commercial banks was due to the appreciation of the main European currencies, but this situation was offset in part by the devaluation of the yen against the United States dollar.

Syndicated loans, which a number of companies preferred, continued to be granted with increasing frequency in 1995, especially in Argentina, Brazil, Chile and Colombia. In early 1996 the interest rates on such loans compared very favourably even with the most advantageous bond terms. The reasons for preferring this type of financing were the greater speed at which credit be approved more quickly, particularly when a small number of banks are involved, and the slackness of bond markets at certain periods.

The restrictions on the movement of short-term capital were tightened in 1995. The existing regulations in Colombia and Chile were augmented by a number of measures adopted in Brazil to discourage inflows of this type of more volatile capital, which is attracted by exchange-rate expectations and high domestic interest rates.

c) **International reserves and transfers**

In 1995 the region's reserves and related items shrank by US$ 5.6 billion because, while reserve assets (foreign exchange) expanded by US$ 24.4 billion, US$ 30 billion of exceptional financing was used (see table VIII-17). This was largely a result of events in Mexico and Brazil. Mexico was able to meet its enormous short-term commitments thanks to compensatory capital provided by the IMF and the United States Treasury Department, resources that actually swelled Mexico's gross reserves by US$ 10.6 billion. A US$ 13 billion increase in Brazil's reserves was made possible primarily by a massive influx of short-term capital.

The figure for net transfers of financial resources (defined as net inflows of voluntary and compulsory capital minus net profits and interest) to Latin America and the Caribbean in 1995 was positive and larger than in 1994. Net transfers amounted to US$ 19.5 billion, owing to the extraordinarily large transfer of capital to Brazil (nearly US$ 20 billion), which was only partly offset by the negative transfers to Argentina, Chile, Ecuador, Mexico and Venezuela (see table VIII-12). It is interesting to note that, excluding non-voluntary capital from the financial account, the net transfer of resources to the region was negative for the first time since 1991 (US$ 10 billion), whereas in 1994 a positive transfer of US$ 4.7 billion was recorded and only a year before that, the figure was US$ 24 billion.

5. External debt

In 1995 the region's external debt amounted to US$ 587 billion, mainly as a consequence of the greater liabilities of Argentina, Brazil, Colombia and Mexico. In most of the remaining countries there was only moderate growth in external indebtedness and in some there was even a reduction. Despite the higher growth rate of the region's external debt, the ratio of debt to exports of goods and services declined once more owing to the strong expansion of exports. Total interest paid as a proportion of the value of exports also declined, to only 15%, less than half the rate recorded 10 years before. Nevertheless, there are still a few Latin American countries whose debt-export ratio is over 200%.

a) **General trends**

The external debt of Latin America and the Caribbean grew by 10%, the highest rate since

Table VIII-12
LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFERS [a]
(Millions of dollars)

	1980	1990	1991	1992	1993	1994	1995[b]
Latin America and the Caribbean	**9 409**	**-16 595**	**3 465**	**28 183**	**30 733**	**8 960**	**19 755**
Argentina	358	-5 830	-1 573	7 367	8 433	7 336	-584
Bolivia	-685	-45	7	218	393	45	196
Brazil	2 093	-7 310	-8 570	584	-1 633	-723	19 951
Chile	2 286	841	-872	1 185	763	1 813	-850
Colombia	880	-2 237	-2 604	-1 816	440	1 392	2 247
Costa Rica	-42	64	341	355	334	191	86
Ecuador	342	-792	-515	-897	-74	-81	-598
El Salvador	-388	294	-22	190	118	36	325
Guatemala	-221	-5	638	507	685	500	211
Haiti	31	-34	58	-8	25	-28	247
Honduras	44	11	79	161	-47	89	99
Mexico	4 621	2 396	14 777	16 406	18 427	-1 809	-1 270
Nicaragua	-154	49	-272	339	136	344	351
Paraguay	375	377	617	151	802	1450	1 177
Peru	-543	-164	905	1 224	1 382	4 077	3 530
Dominican Republic	319	-19	322	450	184	-545	-394
Uruguay	728	-468	-162	11	231	439	337
Venezuela	-636	-4 659	311	1 756	134	-5 566	-5 233

Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF) and national sources.
[a] The net transfer of resources is equal to the net capital inflow (including non-voluntary inflows) minus net payments of profits and interest. In this table, negative figures indicate outward transfers of resources. [b] Preliminary figures.

1982 (see table VIII-1). Thanks to the unusual expansion of exports of goods and services, however, debt burden indicators continued to lighten in most of the countries of the region. Nevertheless, it is important to note that during the last two years, this improvement was due partly to exceptionally favourable trends in the terms of trade, and that public-sector borrowing increased sharply.

In 1995, Mexico's external debt grew by 18%, chiefly because the Government had taken on larger commitments with international institutions in order to finance the redemption of TESOBONOS. In Brazil, debt increased by 11%, partly because private firms preferred to borrow on the international market in order to avoid the high cost of domestic borrowing. In Argentina and Colombia, foreign liabilities –particularly of the public sector– increased by more than 10%.

By contrast, debt in a number of Latin American countries went down in nominal terms in 1995, the most significant reductions occurring in Nicaragua (-12%) and Ecuador (-4.5%), and, to a lesser extent, in Guatemala and Costa Rica. Nicaraguan debt was reduced through the buy-back of its commercial debt at 8% of its nominal value and through forgiveness of bilateral debt by some European Governments, while the reduction of Ecuador's debt was chiefly the result of the debt- restructuring and debt-reduction schemes arranged with the commercial banks under the Brady Plan. Meanwhile, Chile's external debt remained virtually unchanged because of the exceptional prepayment made by the Government and the Central Bank to multilateral institutions, which offset the increase in private- sector liabilities.

The secondary market reacted negatively to the Mexican devaluation at the end of 1994. The price of debt paper in most of the countries (except Chile and Colombia) dropped in the first quarter of 1995, falling most sharply in Panama

Table VIII-13
LATIN AMERICA AND THE CARIBBEAN: TOTAL DISBURSED EXTERNAL DEBT [a]
(Millions of dollars)

	1980	1990	1991	1992	1993	1994	1995[b]
Latin America and the Caribbean	**220 439**	**443 049**	**446 523**	**462 653**	**501 946**	**532 484**	**586 985**
Argentina [c]	27 157	62 233	58 413	59 123	67 802	79 345	89 679
Bolivia [d]	2 340	3 768	3 582	3 784	3 777	4 216	4 528
Brazil	64 000	123 439	123 910	135 949	145 726	148 295	164 836
Chile	11 207	18 576	17 319	18 964	19 665	21 768	21 825
Colombia	6 805	17 848	17 312	16 862	18 370	21 280	23 431
Costa Rica	2 209	3 924	3 992	3 992	3 827	3 818	3 794
Ecuador	4 167	12 222	12 802	12 795	13 631	14 589	13 934
El Salvador [d]	1 176	2 076	2 102	2 338	1 988	2 069	2 243
Guatemala [d]	1 053	2 487	2 403	2 252	2 086	2 160	2 107
Guyana	449	1 812	1 873	2 054	2 062	2 000	2 058
Haiti [d]	290	841	809	873	866	875	901
Honduras	1 388	3 588	3 441	3 539	3 904	4 152	4 372
Jamaica	1 734	4 152	3 874	3 678	3 687	3 652	3 452
Mexico [f]	50 700	101 900	114 900	114 000	127 500	136 500	161 100
Nicaragua [d]	1 825	10 616	10 312	10 806	10 987	11 624	10 242
Panama [d]	2 271	3 795	3 699	3 548	3 494	3 663	3 710
Paraguay	861	1 670	1 637	1 249	1 218	1 240	1 328
Peru	9 595	19 996	20 787	21 409	23 998	25 460	27 487
Dominican Republic	2 173	4 499	4 614	4 413	4 559	3 924	4 001
Trinidad and Tobago	911	2 520	2 438	2 215	2 102	2 064	1 905
Uruguay [d]	1 165	4 472	4 141	4 136	4 293	4 605	4 852
Venezuela [e]	26 963	36 615	32 163	34 674	36 404	35 185	35 200

Source: ECLAC, on the basis of official figures.
[a] Includes debt owed to the International Monetary Fund (IMF). [b] Preliminary figures. [c] New estimates prepared by the Ministry of Economic Affairs and Public Works and Services for 1991-1995. Debt corresponds only to the stock of gross public-sector debt and the debt of some parts of the private sector. It does not include short-term private-sector financial debt nor, since it is gross debt, cumulative private-sector assets abroad. Figures for 1980 and 1990 (regional aggregates only) are taken from the series in the World Bank's World Debt Tables 1995-1996. Note that these two series are not comparable since they are based on different methodologies. As an illustration, the World Bank's figure for 1991 is US$ 7 billion higher than the new official estimate. [d] Public external debt. [e] The public debt does not include investment by non-residents in government securities. The figures on private debt between 1991 and 1993 have been adjusted to account for the privatization process and the elimination of the system of foreign-exchange controls. [f] Total debt according to official figures and data from international financial agencies.

(-31%), Mexico (-28%), Peru (-23%), Costa Rica (-21%) and Argentina (-17%). Later there was a gradual but systematic recovery, and by the end of the year the price of debt paper in nearly all the countries where it was bought and sold had exceeded the levels prevailing at the end of the previous year (see table VIII-14).

b) **The debt burden**

The region's debt burden dropped yet again, as it had since 1987. The ratio of total interest payments to exports of goods and services was 15%, less than half the ratio 10 years ago. This favourable trend was the result of a vigorous expansion of exports, since interest payments increased because of both the higher level of indebtedness and the steady rise in international interest rates (LIBOR rose by one percentage point between mid-1994 and mid-1995). The debt burden in the majority of the countries, although not in Bolivia, Brazil, Uruguay and the Dominican Republic, which recorded moderate increases (see table VIII-15). In 1995 the ratio in seven countries (Chile, Costa Rica, Dominican Republic, El Salvador, Guatemala, Paraguay and Venezuela) was under 10%. In another five countries (Colombia, Ecuador, Honduras, Mexico and

Table VIII-14

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

(As a percentage of face value)

	1994				1995			
	March	June	September	December	March	June	September	December
Argentina	58	53	51	45	37	48	48	54
Brazil	...	41	44	42	36	45	47	51
Chile	95	95	95	95	95	-	-	-
Colombia	90	90	90	90	-	-	-	-
Costa Rica	80	67	63	63	50	50	52	52
Ecuador	44	41	41	30	26	31	32	35
Honduras	34	35	36	36	-	-	-	-
Jamaica	85	83	83	83	-	-	-	-
Mexico	72	66	66	62	44	57	61	61
Nicaragua	12	9	8	6	-	-	-	-
Panama	65	55	58	55	38	51	57	42
Peru	60	50	59	58	44	58	65	70
Dominican Republic	-	-	-	-	-	-	-	-
Uruguay	-	-	-	-	-	-	-	-
Venezuela	57	53	49	48	42	49	51	54

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

[a] Weighted by the amount of bank debt.

- Indicates that no transactions took place.

Table VIII-15

LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL INTEREST TO EXPORTS OF GOODS AND SERVICES [a]

(Percentages)

	1980	1990	1991	1992	1993	1994	1995[b]
Latin America and the Caribbean	**21.4**	**23.5**	**20.4**	**18.1**	**16.7**	**15.5**	**15.1**
Argentina	22.0	37.9	36.1	28.3	20.7	22.9	22.7
Bolivia	25.0	25.0	24.4	25.0	23.2	16.6	19.0
Brazil	34.1	30.9	27.2	20.8	18.0	16.6	20.2
Chile	19.3	17.8	14.7	11.3	10.2	8.2	7.0
Colombia	11.8	19.0	16.4	14.4	13.3	12.9	12.3
Costa Rica	18.1	15.4	10.1	8.7	8.1	6.6	5.6
Ecuador	18.1	34.1	29.8	23.3	21.6	19.0	15.8
El Salvador	5.9	13.1	12.6	10.5	10.3	6.3	5.0
Guatemala	5.3	11.2	8.9	8.9	6.1	5.6	5.2
Haiti	2.1	7.9	7.7	11.3	10.7	17.5	10.1
Honduras	10.6	18.0	21.1	25.9	23.7	22.3	15.7
Mexico	27.7	19.0	18.0	17.5	18.3	16.7	15.1
Nicaragua	24.3	58.3	110.3	158.5	115.6	102.2	54.2
Paraguay	13.5	5.3	4.7	8.2	3.6	3.0	2.6
Peru	20.8	29.6	23.4	25.8	26.3	22.9	22.2
Dominican Republic	19.9	13.4	8.6	9.1	10.5	5.9	6.3
Uruguay	11.0	26.9	21.2	15.7	14.3	13.7	14.7
Venezuela	8.1	16.3	7.1	10.4	10.1	9.3	8.4

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

[a] Includes interest payments actually made and interest due but not paid. [b] Preliminary figures.

Table VIII-16
LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL DISBURSED EXTERNAL DEBT TO EXPORTS OF GOODS AND SERVICES
(Percentages)

	1980	1990	1991	1992	1993	1994	1995[a]
Latin America and the Caribbean	**209**	**276**	**276**	**267**	**271**	**249**	**228**
Argentina	274	420	406	400	434	429	376
Bolivia	227	386	380	468	425	358	364
Brazil	293	351	355	376	334	303	313
Chile	188	181	156	152	167	151	114
Colombia	128	206	191	182	200	198	170
Costa Rica	185	200	182	155	132	116	91
Ecuador	144	376	376	352	367	318	267
El Salvador	97	213	234	240	175	126	102
Guatemala	61	159	142	120	103	95	75
Haiti	95	264	312	765	738	1 365	326
Honduras	147	348	339	340	366	356	307
Mexico	224	209	223	206	208	192	179
Nicaragua	369	2 707	3 048	3 494	2 992	2 568	1 581
Paraguay	153	89	81	63	47	41	38
Peru	233	480	488	486	544	448	403
Dominican Republic	171	246	248	231	206	154	132
Uruguay	76	207	188	157	156	142	148
Venezuela	135	195	193	224	226	205	178

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

Uruguay) the ratio was between 12% and 16%, while in Bolivia it fell to 19% and in Argentina and Peru to 22%. The reduction in Argentina's debt burden was especially noteworthy; over the last six years it has fallen by half. Although Nicaragua reduced its debt burden, the ratio remained very high (54%).

The ratio of external debt to exports of goods and services declined once more, owing particularly to the robust expansion of exports, even though the rate of external borrowing increased. For the first time since the beginning of the debt crisis in 1982, the external debt ratio was similar to the 1979-1980 ratio of 228%. In 1995 the ratio fell practically across the board in all the countries of Latin America and the Caribbean, with the exception of Bolivia, Brazil and Uruguay (see table VIII-16).

c) Renegotiation of external debt

During 1995, important advances were made in renegotiating the external debt in most of the heavily-indebted Latin American countries. Panama signed a definitive agreement and Peru a preliminary agreement under the Brady Plan. Nicaragua bought back its debt with commercial banks and restructured its debts with the Paris Club, as did Bolivia and Haiti.

In October 1995, Panama signed a definitive external debt restructuring agreement under the Brady Plan, covering US$ 2 billion in principal and US$ 1.5 billion in arrears. The "menu" of principal options included: a par bond with a 30-year term and grace period, at an interest rate rising gradually from 3% to 5%, and a discount bond with a 30-year term and grace period at a 45% discount and an interest rate equal to the six-month LIBOR plus 0.81%. The greater part of the interest was to be paid over 20 years, with a grace period of 10 years, at interest rates of 0.81% over LIBOR.

Peru announced at the end of 1995 that, after a year of negotiations, it had reached a preliminary agreement with commercial banks to restructure its debts under the terms of the Brady

Table VIII-17

LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS

(Millions of dollars)

	Exports of goods f.o.b.			Imports of goods f.o.b.			Merchandise trade balance			Balance of trade in services[a]		
	1993	1994	1995	1993	1994	1995	1993	1994	1995	1993	1994	1995
Latin America and the Caribbean	**157 661**	**183 037**	**222 081**	**166 056**	**197 264**	**220 484**	**-8 395**	**-14 227**	**1 597**	**-12 440**	**-11 878**	**-10 795**
Argentina	13 117	15 839	20 969	15 543	20 078	18 728	-2 426	-4 239	2 241	-2 660	-2 856	-2 158
Bolivia	710	985	1 042	1 068	1 064	1 215	-358	-79	-173	-129	-112	-126
Brazil	39 630	44 102	46 506	25 301	33 241	49 663	14 329	10 861	-3 157	-5 590	-5 346	-7 495
Chile	9 199	11 604	16 039	10 181	10 879	14 655	-982	725	1 384	4	22	-149
Colombia	7 429	8 756	10 396	9 087	11 040	12 921	-1 658	-2 284	-2 525	97	181	-66
Costa Rica	1 867	2 102	2 750	2 627	2 788	2 954	-760	-686	-204	223	288	149
Ecuador	3 062	3 844	4 358	2 474	3 282	4 095	588	562	263	-145	-177	-129
El Salvador	732	1 252	1 661	1 766	2 407	3 165	-1 034	-1 155	-1 504	24	-57	-65
Guatemala	1 363	1 550	1 989	2 384	2 547	3 033	-1 021	-997	-1 044	83	46	122
Haiti	82	57	153	267	141	620	-185	-84	-467	6	-57	-85
Honduras	853	918	1 162	944	1 060	1 190	-91	-142	-28	-43	-12	-32
Mexico	51 885	60 882	79 542	65 366	79 346	72 453	-13 481	-18 464	7 089	-2 529	-2 604	871
Nicaragua	267	351	529	659	784	852	-392	-433	-323	-57	-71	-99
Panama	5 428	6 013	6 070	5 889	6 458	6 897	-461	-445	-827	234	165	467
Paraguay	1 500	1 780	1 996	2 711	3 498	3 667	-1 211	-1 718	-1 671	394	565	499
Peru	3 515	4 555	5 572	4 049	5 576	7 688	-534	-1 021	-2 116	-584	-520	-889
Dominican Republic	511	644	743	2 118	2 276	2 375	-1 607	-1 632	-1 632	1 135	1 299	1609
Uruguay	1 732	1 913	2 117	2 118	2 600	2 682	-386	-687	-565	282	450	358
Venezuela	14 779	15 890	18 487	11 504	8 199	11 631	3 275	7 691	6 856	-3 185	-3 082	-3 577

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

[a] Does not include factor income.

Table VIII-17 (cont.)

	Trade balance			Current transfers			Balance on income accounts			Balance on current account		
	1993	1994	1995	1993	1994	1995	1993	1994	1995	1993	1994	1995
Latin America and the Caribbean	**-20 835**	**-26 105**	**-9 198**	**10 516**	**11 819**	**13 610**	**-33 598**	**-34 955**	**-36 775**	**-43 917**	**-49 241**	**-32 363**
Argentina	-5 086	-7 095	83	411	320	432	-2 372	-2 590	-2 914	-7 047	-9 365	-2 399
Bolivia	-487	-191	-299	228	267	234	-221	-202	-237	-480	-126	-302
Brazil	8 739	5 515	-10 652	1 603	2 423	3 621	-10 323	-9 091	-11 105	19	-1 153	-18 136
Chile	-978	747	1 235	386	358	355	-1 504	-1 743	-1 430	-2 096	-638	160
Colombia	-1 561	-2 103	-2 591	1 138	863	694	-1 707	-1 793	-2 157	-2 130	-3 033	-4 054
Costa Rica	-537	-398	-55	143	142	154	-225	-207	-236	-619	-463	-137
Ecuador	443	385	134	130	145	231	-1 255	-1 210	-1 191	-682	-680	-826
El Salvador	-1 010	-1 212	-1 569	1 004	1 289	1 389	-112	-95	-96	-118	-18	-276
Guatemala	-938	-951	-922	363	449	553	-127	-136	-156	-702	-638	-525
Haiti	-179	-141	-552	173	156	505	-11	-11	-28	-17	4	-75
Honduras	-134	-154	-60	81	82	96	-256	-255	-260	-309	-327	-224
Mexico	-16 010	-21 068	7 960	3 640	4 011	3 965	-11 030	-12 363	-12 579	-23 400	-29 420	-654
Nicaragua	-449	-504	-422	234	241	75	-429	-466	-359	-644	-729	-706
Panama	-227	-280	-360	271	221	227	-620	-1 150	-454	-576	-1 209	-587
Paraguay	-817	-1 153	-1 172	100	32	42	-95	-74	-67	-812	-1 195	-1 197
Peru	-1 118	-1 541	-3 005	484	502	422	-1 009	-1 064	-1 164	-1 643	-2 103	-3 747
Dominican Republic	-472	-333	-23	442	493	530	-395	-319	-344	-425	-159	163
Uruguay	-104	-237	-207	53	41	32	-192	-243	-173	-243	-439	-348
Venezuela	90	4 609	3 279	-368	-216	53	-1 715	-1 943	-1 825	-1 993	2 450	1 507

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

Table VIII-17 (concl.)

	Balance on capital and financial account [a]			Global balance			Reserve assets			IMF loans, Use of IMF credit and Exceptional financing		
	1993	1994	1995	1993	1994	1995	1993	1994	1995	1993	1994	1995
Latin America and the Caribbean	**56 935**	**40 218**	**26 777**	**13 018**	**-9 023**	**-5 586**	**-20 464**	**5 161**	**-24 376**	**7 446**	**3 862**	**29 962**
Argentina	7 079	9 466	414	32	101	-1 985	-3 758	-561	69	3 726	460	1 916
Bolivia	378	76	258	-102	-50	-44	-134	-121	-131	236	171	175
Brazil	6 871	7 696	31 109	6 890	6 543	12 973	-8 709	-7 215	-12 920	1 819	672	-53
Chile	2 681	3 855	921	585	3 217	1 081	-171	-2 918	-740	-414	-299	-341
Colombia	2 132	3 197	4 404	2	164	350	-17	-152	-350	15	-12	0
Costa Rica	436	376	322	-183	-87	185	60	65	-185	123	22	0
Ecuador	100	-81	324	-582	-761	-502	-499	-449	233	1 081	1 210	269
El Salvador	177	131	423	59	113	147	-112	-113	-72	53	0	-75
Guatemala	864	595	321	162	-43	-204	-110	2	158	-52	41	46
Haiti	-6	-25	275	-23	-21	200	-19	13	-200	42	8	0
Honduras	126	307	250	-183	-20	26	100	-17	-135	83	37	109
Mexico	30 632	11 754	-14 652	7 232	-17 666	-15 306	-6 057	18 865	-10 654	-1 175	-1 199	25 960
Nicaragua	-375	-55	-496	-1 019	-784	-1 202	79	-81	-4	940	865	1 206
Panama	299	806	681	-277	-403	94	-93	-106	-77	370	509	-17
Paraguay	895	1 521	1 244	83	326	47	-86	-328	-47	3	2	0
Peru	2 291	4 083	3 850	648	1 980	103	-748	-3 038	-947	100	1 058	844
Dominican Republic	459	-227	-20	34	-386	143	-154	385	-113	120	1	-30
Uruguay	433	677	557	190	238	209	-180	-243	-162	-10	5	-47
Venezuela	1 463	-3 934	-3 408	-530	-1 484	-1 901	144	1 173	1 901	386	311	0

Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF) and national sources.
[a] Includes errors and omissions.

Plan. The amounts include principal of US$ 4.4 billion and interest arrears of US$ 5 billion. There are four principal options: i) a par bond, guaranteed by the United States Treasury Department, with a 30-year term and grace period and with interest rates rising gradually from 3% to 5%; ii) a discount bond, also guaranteed by the United States Treasury Department, with a 30-year term and grace period, at a 45% discount and an interest rate equal to six-month LIBOR plus 0.81%; iii) an interest-reduction bond with a 20-year term and an eight-year grace period at an interest rate of 3.25% during the first two years, rising to 4.5% in the ninth and tenth years and to LIBOR plus 0.81% in the eleventh to the twentieth years; and iv) a direct debt buyback option, part of which the Government of Peru used in 1995 to buy back an amount not officially disclosed. The greater part of the interest was to be paid over 20 years with a grace period of 5 years, at interest rates equal to the three-month LIBOR plus 0.81%, and the rate of interest on unpaid interest would be 2.5% per year.

In November 1995, Nicaragua, whose external debt was equivalent to six times its output in 1994, bought back 81% of its debt of US$ 1,727 million owed to commercial banks at 8% of its face value. This operation was financed with a loan of US$ 40 million from the Inter-American Development Bank, grant of a US$ 40 million from the World Bank and US$ 25 million in assistance from the Governments of the Netherlands, Sweden and Switzerland. In March 1995, Nicaragua signed an agreement restructuring its bilateral debt with countries members of the Paris Club; Bolivia followed suit in March and December, as did Haiti in May and Honduras in February 1996. All these countries availed themselves of the Naples terms, which aim to allow the poorest and most severely indebted nations to reduce their bilateral debt by 50% or 67%. To qualify for these terms, countries must either have a per capita output under US$ 500 or a debt/export ratio of over 350%. They must also have complied satisfactorily with the adjustment programmes agreed with the IMF.

SECOND PART

COUNTRIES

ARGENTINA

1. General trends

Argentina's economy contracted by more than 4% in 1995, bringing to an end the expansionary phase of the preceding four-year period, during which gross domestic product (GDP) had increased by nearly 35%. The downturn in the economy was associated with an abrupt change in the trends in capital flows and foreign trade. The influx of financial resources slackened considerably, while a trade surplus was recorded for the first time since 1991. A surge in exports mitigated the impact on the level of economic activity of the slowdown in domestic demand. The decline in output exacerbated unemployment. Inflation continued to fall: for the year as a whole, the consumer price index (CPI) rose less than 2%.

During the first few months of 1995, there was considerable turbulence in the financial markets, and demand for assets plummeted. The government economic team managed to dispel doubts about whether the exchange-rate regime would endure and to prevent the problems in the financial system from worsening. Nevertheless, there was a credit squeeze, which clearly affected domestic demand and the level of economic activity. The markets for financial assets began to return to normal in the second half of the year, although conditions continued to fluctuate. Deposits began to flow back into the banks, and this, along with greater demand for securities, led to a gradual relaxation of the supply of credit, thus easing the financial constraints on real activity. However, the economy continued to suffer the after-effects of the crisis that broke out in early 1995, and output declined in the second half.

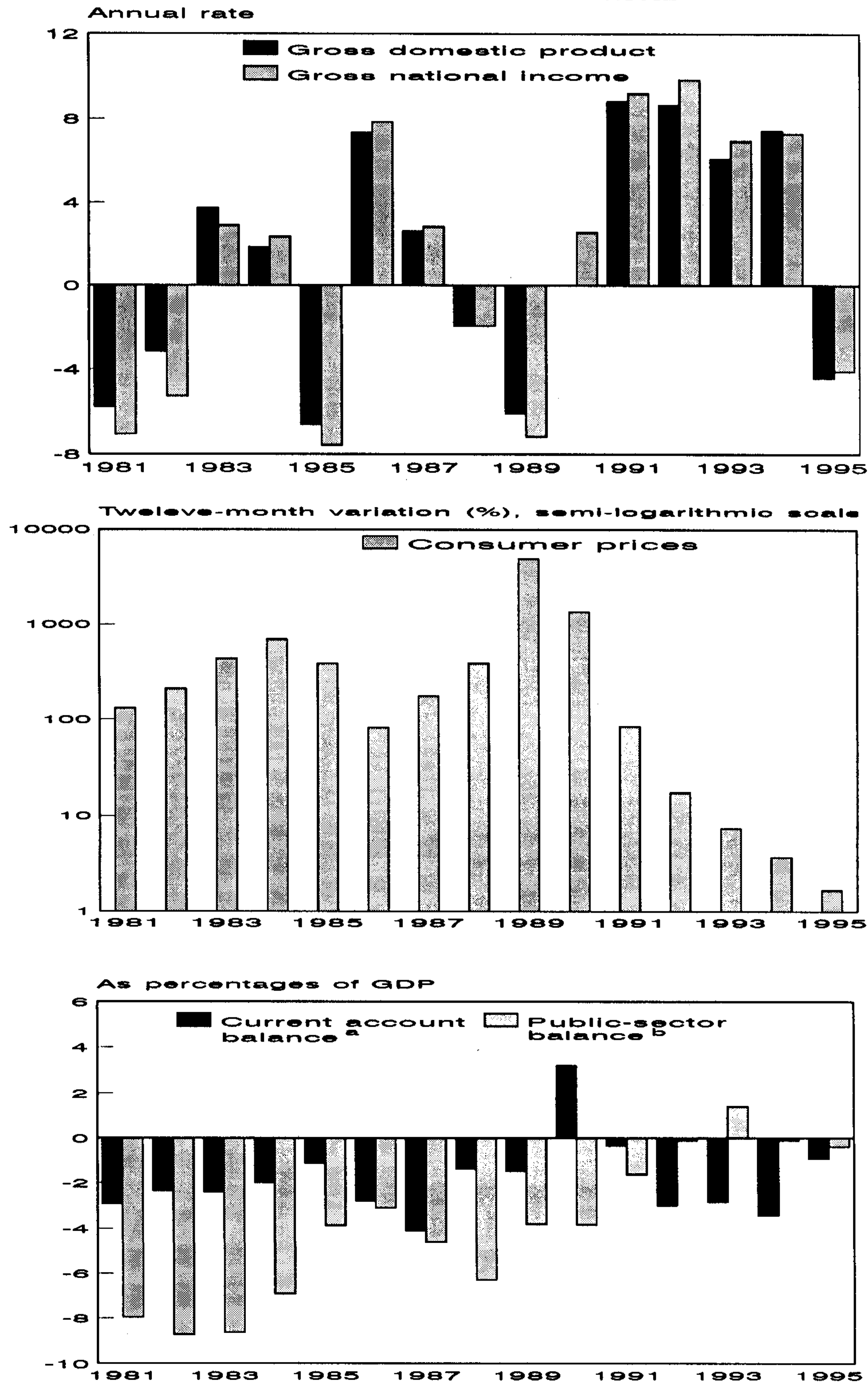
Towards the end of the year, there were signs of a turnaround in both demand for industrial goods and output, boosted by favourable trends in financial markets and exports. These developments were reflected in the first quarter of 1996 in a recovery (adjusted for seasonal factors) in activity, although it still remained below pre-recession levels. The employment ratio, on the other hand, further deteriorated; the unemployment rate in May was 17%, though the actual number of unemployed declined, as a result of lower labour force participation. Tax receipts were eroded by the already depressed volume of aggregate expenditure and cuts in social security contributions. In the first quarter of 1996, the national public sector posted a primary deficit in terms of its cash performance, though the Government managed without too much difficulty to raise sufficient finances through placement of securities. At the same time, the lack of inflationary pressures became evident; the consumer price index for the first six months of 1996 was actually negative.

2. Economic policy

The upheaval in financial markets after the Mexican peso was devalued had an adverse effect on domestic activity, causing a shift in Argentina's economic outlook in 1995.

Monetary authorities faced the challenge of dealing with liquidity problems in the financial system, while simultaneously keeping operative the convertibility system, which served as the frame of reference for price formation and asset-holding decisions. In other words, they were forced to deal with a critical situation within an institutional framework that imposed

Figure 1
ARGENTINA: MAIN ECONOMIC INDICATORS



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

tight constraints on the Central Bank of Argentina.

In early 1995, the main focus of economic policy was on reinforcing expectations concerning the maintenance of the convertibility regime, while at the same time implementing a variety of measures to shore up the financial system. The authorities sent clear signals that they would adhere to the current monetary regime, and thereby managed to ensure that the uncertainty then prevailing in asset markets did not affect expectations concerning the parity of the peso.

The renewal of the extended fund facility with the International Monetary Fund (IMF), which had been suspended in 1994, was a signal designed to ease pressures on financial markets. The targets set in this instance called for strict fiscal restraint in the second half.

In March 1996, the authorities announced a series of measures aimed at bolstering public revenues. The agreement reached with the IMF also entailed extensive financing for the public sector, to be provided both by the agency itself and by other international lending institutions. In addition, the Government undertook a special bond issue, which was absorbed by large domestic firms and foreign banks.

Beginning in the second quarter, severe credit rationing had a major impact on demand and the level of activity and also affected tax revenues. The increased budget constraints hit some provinces especially hard, causing at times lengthy delays in payments, including wages.

The palpable need for economic stability was probably the major factor behind the re-election in May of President Carlos Menem, who made no changes to his cabinet.

In the second half of 1995, demand for financial assets revived. The change in the economic climate was probably a reflection of foreign investors' greater willingness to channel funds into the Latin American region, as well as the perception that the local market had overcome the crisis. Interest rates continued on their downward path, and, starting in May, the volume of bank deposits staged a gradual recovery, though the upswing in credit was slow and marked by cautious behaviour on the part of both borrowers and providers of funds. International reserves increasedsubstantially.

In early 1995, the customs union between the Southern Common Market (MERCOSUR) countries took effect. Exhaustive negotiations were conducted throughout the year concerning aspects of the area's trade regime. They focused particularly on the standards applicable to the motor vehicle industry and on the products that countries would include in their lists of exceptions to the general arrangements for the customs union. MERCOSUR also entered into negotiations with Chile and Bolivia, with a view to setting up trade integration mechanisms, which came to fruition in 1996 with the signing of association agreements.

a) **Fiscal policy**

In 1995, the national public sector experienced a reduction in primary income and expenditure. The downswing in the level of activity and the pension reform introduced in mid-1994 resulted in a decline in government revenues. A variety of economic adjustment measures were implemented in an effort to close the fiscal gap. The ratio of the national public sector financial deficit to GDP remained low, although somewhat higher than the preceding year. The overall deficit in 1995 was equivalent to 0.5% of GDP (excluding privatizations), while the financial result showed a surplus on the order of 1% of GDP (0.6% excluding privatizations).

The national public sector's current income declined in nominal terms, because value added tax (VAT), which accounts for an appreciable share of tax revenues, applies primarily to consumption, which contracted sharply during the recession. Furthermore, the full impact of social security reform was felt in 1995, since a proportion of social security contributions shifted to private pension funds, and the number of contributors to the retirement scheme declined. The entry into effect of the MERCOSUR customs union also brought about a decline in fiscal revenues by reducing tariffs on foreign trade. Lastly, it is likely that a combination of lower income and liquidity constraints faced by a significant number of taxpayers affected tax compliance.

Table 1
ARGENTINA: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment[b]								
Gross domestic product	-1.9	-6.1	0.0	8.8	8.6	6.1	7.4	-4.4
Per capita gross domestic product	-3.3	-7.4	-1.3	7.4	7.3	4.8	6.2	-5.5
Gross national income	-1.9	-7.2	2.6	9.2	9.8	6.9	7.3	-4.1
Gross domestic product, by sector								
Goods	-1.6	-9.5	1.7	10.2	7.7	4.5	6.2	-5.2
Basic services	-2.2	1.0	-1.1	3.8	9.7	7.9	7.3	...
Other services	-2.0	-3.7	-0.1	7.2	7.3	7.2	8.4	-3.6
	Percentages							
Contribution to growth of GDP[c]								
Consumption[d]	-3.4	-2.5	-0.1	9.1	8.6	4.5	4.5	-4.1
Gross domestic investment	-0.4	-4.7	-1.5	3.5	4.9	2.6	3.9	-3.6
Exports	1.4	0.2	1.8	-0.6	-0.1	0.2	1.3	1.6
Imports	0.5	0.8	-0.1	-3.2	-4.8	-1.3	-2.3	1.7
	Percentages of GDP[b]							
Gross domestic investment	19.2	15.4	13.9	16.0	19.3	20.7	22.9	20.1
National saving	18.1	14.5	17.1	15.6	15.3	16.7	18.1	18.9
External saving	1.1	0.9	-3.2	0.4	4.0	4.0	4.8	1.2
	Percentages							
Employment and wages								
Activity rate[e]	39.1	39.8	39.1	39.5	40.0	41.3	41.0	42.0
Open unemployment rate[f]	6.3	7.6	7.4	6.5	7.0	9.6	11.5	17.4
Real minimum wage (Index: 1990=100)	442.2	323.5	100.0	259.1	203.7	263.7	363.9	352.0
	Growth rates							
Prices (December-December)								
Retail prices	387.7	4 923.8	1 343.9	84.0	17.5	7.4	3.9	1.6
Wholesale prices	431.6	5 386.4	798.4	56.7	3.2	0.1	5.8	6.0
External sector								
Terms of trade (Index: 1990=100)[b]	97.9	96.6	100.0	101.6	109.5	111.6	109.7	111.6
Nominal exchange rate (pesos per dollar)[g]	0.0009	0.0290	0.4150	0.9171	1.00	1.04	1.04	1.03
Real effective exchange rate (Index: 1990=100)	129.7	143.1	100.0	83.3	77.5	74.0	78.4	86.4
	Millions of dollars							
Balance of payments								
Current account	-1 572	-1 305	4 552	-647	-6 546	-7 047	-9 365	-2 399
Trade balance (goods and services)	3 555	5 106	7 954	2 820	-3 639	-5 086	-7 095	83
Exports	11 149	11 766	14 800	14 386	14 795	15 624	18 509	23 859
Imports	7 594	6 660	6 846	11 566	18 434	20 710	25 604	23 776
Capital and financial account[h]	431	-8 008	-5 850	160	8 838	7 397	6 557[h]	9 521[h]
Overall balance	-1 306	-9 562	-583	-828	2 429	32	101	-1 985
International reserves (variation)	1 888	-1 826	3 121	2 040	4 477	3 758	561	-69
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	...	...	...	31.2	26.9	27.1	29.1	34.2
Net interest (as a percentage of exports)[i]	40.1	48.9	25.4	24.0	19.0	7.1	7.1	5.4

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
			Percentages of GDP					
Non-financial national public sector								
Current income[j]	12.8	12.7	13.2	15.0	17.4	19.9	17.9	17.4
Current expenditure	15.2	13.9	15.4	16.2	16.8	17.3	16.9	17.2
Savings	-2.4	-1.2	-2.1	-1.2	0.6	2.6	1.0	0.2
Capital expenditure (net)	3.9	2.6	1.7	0.5	0.7	1.2	1.1	0.6
Financial balance	-6.3	-3.8	-3.8	-1.6	-0.1	1.4	-0.1	-0.4
			Growth rates					
Currency and credit								
Money balances of banking system								
Net domestic credit	273.8	8 013.1	230.5	151.9	15.0	32.0	...	...
To public sector	293.1	14 888.4	220.1	55.9	-21.6	14.2	...	...
To private sector	354.3	5 607.7	734.5	112.0	53.5	23.7	...	...
Money (M1)	337.6	4 102.8	1 070.8	146.2	50.4	34.8	12.6	2.5
Local currency savings and time deposits	483.7	213.7	4 718.7	65.5	73.8	47.1	11.1	-8.2
M2	442.2	1 105.0	1 802.9	105.2	59.9	40.3	12.0	-2.5
Dollar deposits	...	...	473.1	268.5	64.7	60.7	25.9	2.5
			Annual rates					
Real interest rates (annualized)								
On deposits	...	...	-25.2	-10.4	-3.8	3.4	4.3	10.6
On loans	...	...	81.9	43.6	12.5	14.3	17.2	23.5
Equivalent interest rate in foreign currency[k]	...	...	138.0	-8.8	13.1	10.1	8.2	12.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Includes variation in inventories. [e] Percentages of the total population. [f] Percentages of the economically active population (EAP). [g] Corresponds to the exchange rate for exports. [h] Capital pending classification according to the methodology used in the fifth edition of the Balance of Payments Manual. Includes the banking sector and the non-financial public and private sectors. [i] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [j] Includes the national administration, the national social security system and public-sector enterprises. Relates to final budget figures. [k] Interest rates on deposits, deflated by the variation in the exchange rate.

Table 2
ARGENTINA: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	12.1	12.3	8.9	7.4	5.1	3.0	3.7	3.7	4.3	3.6	2.2	1.6
Real effective exchange rate (Index: 1990=100)[b]	75.0	74.4	73.3	73.2	73.5	75.6	80.8	83.5	83.9	87.1	87.5	87.1
Real interest rate (annualized, %)												
On deposits	4.5	-2.0	5.3	5.7	6.0	3.9	1.2	6.1	11.4	15.0	7.4	8.7
On loans	14.9	8.7	15.8	17.7	19.9	16.6	12.6	19.9	22.0	31.3	26.3	14.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Refers to the exchange rate for exports.

In order to bolster government revenues, the authorities increased the VAT rate, suspended cuts on employer social security contributions, raised import duties and reduced drawbacks on exports; in addition, they approved facilities for settling tax liabilities and imposed severe penalties on tax evaders.

By far the largest increase in the national public sector's cash expenditure was for interest payments; if this category is excluded, total cash expenditure recorded a slight drop. In particular, outlays for wages and salaries fell by around 5%. Social security spending rose yet again (2.5%) though much less than in previous years (20% in 1994). National government transfers to the provinces declined by around 1%. Capital expenditure contracted by the equivalent of 1.1% of GDP.

Privatization operations involving electricity distribution enterprises, a hydroelectric power plant, a gas distribution firm and petrochemical companies generated resources equivalent to 0.4% of GDP, well in excess of privatization receipts in 1994.

Public-sector financial debt rose by some 6.8 billion pesos to exceed the 87 billion peso level. Part of the increase was due to consolidation of previously contracted debt, compounding of interest and exchange losses. Throughout 1995, the Government was active in issuing and redeeming obligations. Among the debt issues were major loans granted by international agencies, under the terms of the financial package agreed to early in the year. The first half of 1995 saw a marked decline in demand for government paper, but open market operations resumed in August once demand picked up. The bill and bond offerings by the Government included issues denominated in yen and deutsche marks.

Public finances continued to be a subject of concern in the early part of 1996. In an effort to raise tax revenues, the Government secured the approval of the legislature to keep the VAT rate at 21% and to widen the base of both this tax and the tax on profits. In addition, reforms to the public administration were proposed, including the elimination of some agencies and staff cutbacks.

b) **Monetary policy and the credit markets**

During 1995, the money stock, which by virtue of the convertibility system is in practice determined by demand, rose by a bare 3.5%. The cumulative increase was due to an upturn during the second half of the year, since there was a decline in the first half. The contraction in the demand for money in the first half was linked to a marked drop in the demand for domestic assets, stemming from the lower volume of transactions and the uncertainty surrounding the stability of the financial system. Hence, the liquidity ratio comparing M2 with output fell for the first time since the early part of the decade.

The financial crisis necessitated intensive monetary management, within the limits set by the convertibility system. The authorities could count on a significant external financing package in a period of heavy turbulence in the credit markets. To cope with the emergency, the authorities expanded the scope of action allowed by the monetary system, while leaving the main features of the system unaltered, and resorted to external financing. By so doing, they succeeded in limiting the effects of the turbulence on the banking system. Over the period in question, the financial markets gradually returned to normal.

Immediately following the devaluation of the Mexican peso, there was a sharp drop in demand for bonds, and serious doubts arose as to the sustainability of the exchange-rate system in view of the anticipated contraction in external credit. The public increased its precautionary demand for foreign exchange, as reflected in a shift from assets denominated in the local currency to assets in dollars.

Foreign exchange reserves held by the Central Bank (US$ 2.6 billion) declined considerably in the first two months of 1995, as did bank deposits in pesos. Until late February, however, deposits in dollars were only slightly affected by withdrawals, although trends in total deposits varied widely from one institution to another. Heightened uncertainty about the exchange rate put upward pressure on interest rates, but the differential between the rates for transactions in pesos and in dollars widened. In late February, the gap between peso and dollar rates on bank loans to blue-chip companies exceeded nine

points per annum, in contrast to the difference of just over two points in early December 1994.

The Central Bank employed a variety of instruments to reassure markets about the continuity of the exchange-rate system and to shore up financial institutions' liquidity. The conversion into dollars of the reserves banks held with the Central Bank served as a signal that policy was directed towards maintaining the close link between the peso and the dollar. Reserve requirements were relaxed, and minimum cash requirements for peso and dollar accounts were made uniform. The Central Bank also lowered penalties for reserve shortfalls and injected liquidity into the banking system. In addition, a safety net was set up to assist institutions with liquidity problems.

In late February, the authorities amended the Central Bank charter to expand its scope of action in aiding the financial system by means of rediscount operations, which had been severely restricted. The Central Bank was also authorized to transfer any loan portfolios it had acquired. The law governing financial institutions was amended, empowering the Central Bank to restructure institutions before suspending their operations.

Financial turbulence intensified in March, because of the perception that the crisis far from ending, threatened to deepen. Though there was no run on the banks, there was widespread doubt as to the soundness of the financial system as a whole. The decline in deposits spread to dollar deposits and to all categories of banks, some of which could not meet their obligations at maturity. The banks' ability to lend fell sharply. Interest rates, meanwhile, sky-rocketed; by mid-March, the prime rate was 27% for dollar-denominated loans and in excess of 40% for peso-denominated loans.

In March, tension in the credit markets eased with the announcement of the external aid package linked to the IMF agreement and with the implementation of fiscal and financial measures. Although there was no quick recovery, the specter of accumulating deposit withdrawals faded.

Beginning in May, signs of recovery in the financial markets strengthened –though not without fluctuations– as doubts about the health of the banking system dissipated. Thus, in December, the stock index was almost 50% above the low recorded in March, though it was still somewhat below the level in December 1994. Moreover, there were signs of an increase in deposits, especially in the dollar segment, which offset a good part of the decline in the first months of the year. The increase in deposit holdings led to an overall decline in interest rates. By late 1995, rates in pesos were below the levels in mid-December 1994, while the analogous rates in dollars were a little higher.

Just as the previous decline in loans had been less abrupt, so the recovery in bank lending to the private sector was less marked than the recovery in deposits. Contributing factors were the repayment of rediscounts, encouraged by the Central Bank, and of foreign lines of credit together with a shift in the emphasis of lending towards the public sector.

The recovery of the financial markets continued into the early months of 1996. The prices of assets showed signs of recovery, in a climate sensitive to fluctuations in international financial centres and short-term movements in the domestic economy.

One of the consequences of the events of 1995 was that the number of financial institutions dropped from over 200 to around 150. This development was largely the result of mergers and acquisitions, involving roughly 10% of the sector's total assets. In addition, four state-owned provincial banks were privatized. A relatively small group of institutions, representing about 2.5% of the banking system's assets as of late 1994, had their licence to operate revoked or suspended. The larger banks were less affected by a loss of deposits in the first half and experienced most of the benefit from the subsequent recovery, and this increased the concentration of intermediated funds. The composition of which loans and deposits with respect to currency changed, with an increase in dollar-denominated transactions.

In September 1995 the Central Bank decided to replace the reserve requirements for banks with liquidity requirements that they could meet by holding a variety of assets. This measure was intended to help banks build back their liquidity and to encourage a reduction in the spread between lending and borrowing rates.

3. The main variables

a) Economic activity

The decline in output in 1995 of around 4.5% was not as drastic as in previous recessions, but the turnaround was abrupt. The change in aggregate output from one year to the next was nearly 12%. The recession was associated with a significant slump in domestic demand, which, as had occurred in the expansionary phase, fluctuated more than GDP.

The substantial increase in export volumes reduced the impact of the contraction in demand. On the supply side, activity in the goods-producing sectors declined somewhat more than average, after expanding less than GDP in the previous phase of the cycle. Manufacturing and construction both witnessed major downturns, which were mitigated by the output increases in natural resource-based sectors (agriculture and mining). The slump in domestic demand also affected the service sector, which had experienced robust growth in previous years.

The financial upheaval that marked the early months of 1995 produced, though with something of a lag, a break in the trend in real activity. During the first quarter GDP remained at high levels, but showed a marked deterioration in the second quarter. The recessionary trend continued throughout the rest of 1995, and it was only in the final months of the year that signs emerged of an upturn in the demand for industrial goods. This positive trend became clearer in the first six months of 1996, coinciding with the recovery of the credit markets. Estimated industrial output figures for April and May 1996 were higher than they had been a year earlier. Figures for GDP in the first quarter showed a decline with respect to the same period of the preceding year, but a comparison with late 1995, after adjustment for seasonal factors, reveals a more positive picture.

Domestic demand fell by more than 7% in 1995. Aggregate consumption slipped by over 5%, with very substantial declines in purchases of durable goods and slackening demand for services.

As usual in fluctuations in economic activity, fixed investment varied much more than output. A decline of some 16% in capital formation entailed a drop of around three points in the rate of investment, which at 20% was nevertheless higher than the average for 1991-1994. The downturn in investment affected both construction and purchases of machinery and equipment.

The general decline in demand for assets in the first half of 1995 also affected real estate. This was reflected in a decrease in the volume of sales of completed units (and to some extent in prices) and a postponement of new project starts. The second half saw an increase in the supply of mortgage credit, which had played a major role in the expansion of the sector in previous periods.

The decline in spending on machinery and equipment marked the end of several years of vigorous growth. Reduced demand for capital goods in 1995 occurred across the board, affecting both transport equipment and machinery, of local and imported origin.

In this context, a sustained increase in export quantities helped considerably to offset the slump in aggregate demand. Though the increase in external sales was influenced in some sectors by reduced local absorption, other contributing factors were the generally positive trends in international markets and improved capacity to supply those markets. The growth observed in 1995 extended to all major categories of goods, both primary goods and manufactures; a breakdown of exports by destination reveals an increase in sales to Brazil. Import volumes fell after several years of rapid growth. The downturn recorded in 1995 reflected a significant decline in the demand for final imported goods, while imports of intermediate goods held up and even showed a small increase.

In terms of the output of the different sectors, 1995 was characterized by considerable setbacks in construction and manufacturing. In fact, of all the major groups of activities, manufacturing was the only one in which output fell below the level recorded in 1993 (though trends in the various branches were quite mixed).

Agricultural production rose, boosted by improved international prices. The grain harvest for 1994-1995 was well in excess of 44 million tons, the largest on record in recent decades, and

9% larger than the previous harvest, while production in the livestock sector was comparable to that of the preceding year. During 1995, there was a continuation of the downward trend in domestic meat consumption, presumably as a result of changes in eating habits. Because of lower domestic demand, a higher proportion of the cattle slaughtered went to export, and hence export volumes increased significantly. At the same time, slaughtering was affected by the drought in the pampas region. On a more positive note, the elimination of foot-and-mouth disease should open up prospects for access to new foreign markets.

The brisk activity which characterized the mining sector in 1994 continued in 1995, with further increases in the production of oil (8%) and natural gas (9%). The prospects for metals also improved, as sizeable investments were planned for the sector.

Domestic sales of industrial goods declined markedly in 1995, but external demand proved relatively stable. However, the various sectors differed quite noticeably in their ability to channel supply towards foreign markets. The desire to export acted as an incentive to firms to strengthen their competitiveness through organizational changes, and in some subsectors, such as food and consumer chemical products, through merger with foreign firms. Overall manufacturing output contracted by almost 6%.

The food industries again managed to increase exports. This heterogeneous group comprises one of the sectors that have made major changes in recent years, introducing new technologies in a variety of activities and gaining a growing share in external markets. Thus, despite the slump in domestic demand, their production of a number of exportable goods increased, including vegetable oils and dairy products. In contrast, there were declines in categories, such as beverages, that are more sensitive to local consumption trends.

The chemicals industry also exhibited mixed trends. Production of many commodities increased, but consumer products, pharmaceuticals and petroleum products all suffered setbacks.

The iron and steel industry continued to expand, despite declining domestic sales. There was also growth in refining of non-ferrous metals, such as aluminium and zinc. On the other hand, metalworking industries experienced a sharp contraction.

The motor vehicle industry also experienced a major slump. Production of finished vehicles plunged by 30%, to under 300,000 units, in spite of increased sales to Brazil. The slowdown in domestic demand also affected vehicle imports.

Output of basic services did not repeat its dynamic growth of previous years, but was not severely affected by the recession. One of the outstanding features of the expansionary phase of 1991-1994 had been the rapid growth in "other services" reflecting the strong rise in spending. The recession of 1995 had a reverse effect on these sectors, although their output declined somewhat less than the average. Weak domestic demand caused a sharp drop in commercial activity, while the financial sector was affected by the decrease in intermediated funds.

b) **Prices, wages and employment**

The rise in the consumer price index (CPI) amounted to 1.6% in 1995, less than half that recorded in 1994, with the bulk of the increase occurring in January (1.2%). Notwithstanding the VAT rate hike in April, the cumulative variation for the rest of the year was very slight, with declines in some months. For the first time since the start of the decade, the relative price of private services rose less than the overall level.

In marked contrast to earlier periods, in 1995 the wholesale price index (WPI) rose more than the consumer price index. The 6% increase in WPI was primarily attributable to higher international prices, especially for agro-based products.

The labour market had been in upheaval in recent years, as a result of fluctuations in the labour supply and weak job creation during the period of economic expansion. The unemployment rate, which had risen above the 12% mark in October 1994, hit 18.4% in May 1995.

The jump in unemployment was largely the result of the increase in the labour force participation rate. The supply of labour, which had dropped off during 1994, rebounded in May 1995 to surpass the all-time highs of recent

decades. The decline in wages is believed to have obliged a large number of the economically inactive, especially women and young people, to seek employment.

The October survey noted a small increase in the number of employed compared with the figures for May. At the same time, the survey revealed a drop in the labour force participation rate; in this situation, the decrease in the labour supply was reflected in the unemployment rate, which fell by 2% for all urban areas, although there was a simultaneous increase in the incidence of underemployment.

Nominal wages in manufacturing changed very little in 1995, which meant a slight drop in real terms. It is likely that the erosion in average pay per person was more dramatic, due to a reduction in the average number of hours worked. Moreover, it would appear that renegotiation of lower pay levels was a widespread occurrence, particularly in the higher wage brackets. Another development with regard to labour costs was the reintroduction in early 1996 of reductions in employer social security contributions, after the cuts had been suspended the year before for fiscal reasons.

c) **The external sector**

In the early 1990s, Argentina enjoyed an abundant supply of external credit, while residents showed a marked propensity to increase their expenditure; these two phenomena combined between 1992 and 1994 to expand the balance-of-payments current account deficit. In late 1994, there was a break in the trend in capital inflows, and the overall picture changed abruptly.

In 1995, the current account deficit (-US$ 2.4 billion) was one quarter of the figure recorded the year before (-US$ 9.4 billion); this was attributable to the fact that the merchandise trade gap (US$ 4.2 billion) turned into a surplus of US$ 2.24 billion. The real services deficit also narrowed, largely due to a decline in spending on overseas travel. The financial services deficit widened by about US$ 300 million, owing to an increase in profits and dividends earned by foreign investors. At the same time, it is estimated that higher interest payments on financial debt were offset by improved returns on Argentine residents' investments abroad, with the result that the net deficit under the "interest" category decreased slightly.

The first quarter witnessed a sudden outflow of private capital, leading to a sharp drop in international reserves. In the second quarter, the current account swung from a deficit to a surplus. During the same quarter, the public sector obtained a sizeable volume of resources through loans from international agencies and a bond issue placed with foreign banks. In this manner, Argentina partially added to its reserves, despite another net outflow of foreign exchange owing to private-sector portfolio activity. The recovery was weak in the third quarter, but gathered steam in the final months of the year.

Despite a reduced flow of credit to the country for most of the year, there seems to have been a consolidation of foreign direct investments, apparently based on decisions influenced by factors other than cyclical fluctuations in the economy. In contrast, portfolio transactions of the non-financial private sector showed a sizeable deficit. Net placements of debt instruments by private-sector firms were negative in the first quarter, but over the course of the year reached a volume somewhat in excess of the figure for 1994. In the aggregate, however, the various financial transactions by firms and individuals gave rise to a net outflow of capital on the order of US$ 9 billion. The outflow was partially offset by borrowing by banks, especially during the first quarter, when the need to maintain their liquidity levels led them to draw on foreign lines of credit.

The public sector undertook numerous external financing operations. A significant proportion of these transactions involved loans from international agencies, which represented a net inflow of funds of some US$ 4.2 billion.

Privatizations were concentrated in the second half and were responsible for a capital inflow of US$ 960 million. National government bond issues generated a net inflow of somewhere over US$ 3 billion; most bond sales took place towards the end of the year, when demand for Argentine paper had picked up.

Total external financial transactions by government entities resulted in an increase in

public-sector external debt by US$ 5.7 billion (from US$ 61.3 billion to US$ 67 billion). Gross private financial debt owed to non-residents increased, in spite of net private capital outflows. In consequence, total external debt expanded to some US$ 89 billion, roughly US$ 10 billion more than at the end of 1994, though the debt-to-exports ratio improved (5 times in 1994 to 4.4 times in 1995).

Exports expanded by 32% in 1995, bringing their cumulative growth over a three-year period to 70%. In 1995, all major export categories recorded growth, including agricultural products (26%), fuels (over 30%), and non-agro-based manufactures (44%).

A geographical breakdown of trade flows by destination shows that the percentage of trade with MERCOSUR rose once again in 1995. Argentine exports to MERCOSUR countries increased by more than 40% in value and accounted for about one third of total exports, more than double the level five years earlier.

In 1995 there was a sharp decline in imports of finished goods, in a partial reversal of the strong growth of the preceding years. Imports of capital goods, for example, fell by almost a fifth, though their level was still 20% higher than in 1993. Imports of consumer goods slumped by over 25%, returning to 1992 levels. Despite the slowdown in domestic activity, particularly industrial output, imports of fuels and intermediate goods expanded. This was due primarily to the performance of categories such as chemical products and paper, prices of which rose strongly in international markets; furthermore, these goods were in many cases purchased as inputs for industries that were not particularly affected by the recession.

BOLIVIA

1. General trends

In 1995 the growth rate of the Bolivian economy slowed, and inflation rose from 8% to 13%; on a more positive note, the current account deficit remained within a sustainable range, the fiscal gap declined, and international reserves increased; this set of circumstances enabled the country to stave off a crisis in the banking system.

From a longer-term perspective, the most important development was the implementation of structural reforms formulated by the Government that took office in 1993, including its programme of "capitalizing" public-sector enterprises.

Output growth roughly equalled the average since 1987; trends in prices were also in line with the moderate inflation rates prevailing since then, following bouts of hyperinflation in the first half of the 1980s. Prices rose more rapidly in the first half of 1996, but actually decreased in the two months that followed.

The current account deficit widened to just over US$ 300 million, reflecting the fact that import growth more than doubled that of exports. The gap was financed by increased capital flows, particularly foreign direct investment.

Macroeconomic management was facilitated by the reduction of the weight of the consolidated public-sector deficit to less than 2% of GDP, the lowest level in many years, due primarily to cutbacks in government spending and improved domestic and customs revenues.

2. Economic policy

Maintaining macroeconomic stability continued to be a high priority of economic policy; despite this emphasis, monetary aggregates tended to expand. The trend was the result of the special financial assistance provided by the Central Bank of Bolivia to the financial system following the failure of two banks and the liquidity shortages facing other institutions owing to an abrupt decline in inflows of external resources triggered by the Mexican crisis. The reduction of the fiscal deficit, resulting in a substantial decrease in net credit to the public sector, allowed more room for manoeuvre in monetary management.

The long-drawn-out negotiations for Bolivia's entry into the Southern Common Market (MERCOSUR) culminated in June 1996 with the signing of a trade integration agreement, which is set to take effect in early 1997 and provides for progressive automatic tariff reductions.

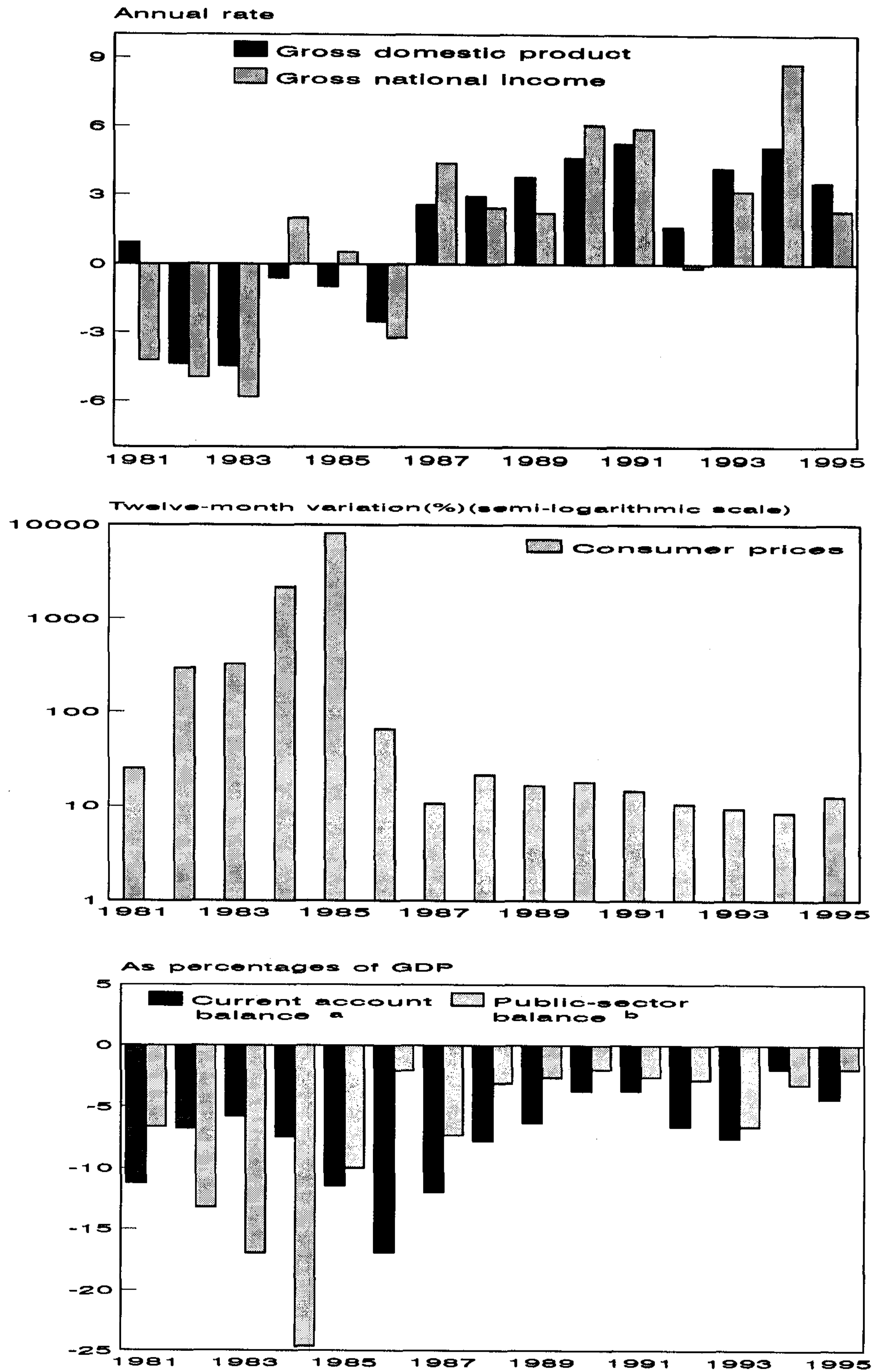
Around 5,000 hectares –or about one tenth of the area devoted to coca plantations in the Chapare region in the centre of the country– were destroyed as part of the anti-drug programme conducted by the Bolivian Government with the support of the United States. The eradication of plantations by farmers, offered US$ 2,500 for every hectare destroyed, is the chief strategy in the campaign against drug-trafficking. United States financial aid was cut from US$ 125 million to about US$ 90 million.

a) Fiscal policy

Since the tax burden in bolivia is below average for Latin America, the key to reducing the public-sector deficit is to increase revenues.

Domestic taxation rose by the equivalent of more than 1% of GDP in 1995, thanks to the increase in the transaction tax rate from 2% to

Figure 1
BOLIVIA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments. b Non-financial.

3%, improved revenues from specific consumption taxes and enhanced efficiency in administration reflected in the fact that the number of taxpayers was increased by more than 20%.

Current expenditure declined by a similar percentage as a result of a decline in personnel costs due to the elimination of fictitious posts and the fact that wage hikes (7.5%) lagged behind inflation. Education and health were the only sectors in which pay raises kept pace with the rise in consumer prices.

Accordingly, the relative size of the fiscal deficit, equal to just over 3% of GDP in 1994, fell below the 2% mark in 1995.

Efforts to cut back on spending should be facilitated by the process of capitalizing public-sector enterprises, as outlays in the form of subsidies to cover deficits and contributions to finance investment programmes are eliminated. One of the immediate effects of the capitalization programme, however, was the almost 1% drop in the level of income from public-sector enterprises to 3.5% of GDP. A portion of both domestic and foreign sales began to be shared with strategic partners, who now own half the stock of the capitalized firms.

b) **Monetary policy**

The banking crisis that loomed in the first half of 1995 obliged the Central Bank to authorize major credit assistance to institutions in difficulty to prevent a liquidity crunch. That necessity complicated the task of achieving the stipulated targets for net domestic credit and international reserves and impeded the progress of the stabilization programme.

In order to meet these financing requirements, and at the same time halt a major outflow of resources abroad, open market operations were stepped up. Purchases and sales by the Central Bank of its own certificates of deposit and Treasury bills were the most common operations used to control the money supply.

In the first half of 1995, the banking system suffered the turbulence caused by the intervention in and liquidation of the Sur and Cochabamba banks in late 1994. In addition, one of Bolivia's main banks, the Banco Boliviano Americano (BBA), was faced with a substantial loss of deposits amid rumors of possible insolvency, a problem that was resolved in mid-1995 when ownership and management were transferred to new investors.

The greater supply of external financing and the reduction of the fiscal deficit enabled the public sector to accumulate deposits in the Central Bank of Bolivia, with the result that net domestic credit loaned to the public sector registered a considerable decline.

Annual average interest rates have not varied to any great extent. However, analysis of quarterly figures reveals, beginning in May 1995, a rise in both loan rates and rates on fixed-term deposits, together with a slight rise in the rate on deposits in savings banks.

For the year as a whole, the money supply expanded by 24% and M2 by 20%, while the monetary base increased by just 13%, the slowest growth rate in recent years. International reserves expanded by US$ 130 million. Private-sector credit increased by 13%, while public-sector credit declined substantially.

The enactment of the new Central Bank Act established the autonomy of the institution, with the aim of promoting the development of the financial system and long-term macroeconomic stability. Its first independent Board of Directors was to be appointed in 1996.

The volume of transactions on the stock exchange languished at the US$ 1 billion level recorded the preceding year, marking an end to the dynamism observable since 1992.

c) **Foreign exchange policy**

The Central Bank persisted for the second year in a row in its efforts to maintain a stable real exchange rate, in order to preserve the competitiveness of the Bolivian economy vis-à-vis its main trading partners. The Central Bank continued to use a central reference exchange rate based on a basket of four currencies –the dollar, the pound sterling, the yen and the deutsche mark– weighted according to their relative importance in the balance of payments. The official exchange rate applied by the Central Bank took into account not only the real effective reference rate but also current conditions in the foreign exchange market.

Table 1
BOLIVIA: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	3.0	3.8	4.6	5.3	1.6	4.2	5.1	3.6
Per capita gross domestic product	0.7	1.5	2.3	2.8	-0.8	1.7	2.6	1.1
Gross national income	2.5	2.2	6.1	5.9	-0.2	3.2	8.8	2.3
Gross domestic product, by sector								
Goods	7.5	4.6	6.3	6.0	-0.4	4.5	5.4	3.2
Basic services	1.2	7.5	5.4	6.6	4.6	6.2	9.5	5.0
Other services	-1.2	2.8	2.5	3.8	4.0	4.5	5.2	3.0
	Percentages							
Contribution to growth of GDP [c]								
Consumption	2.9	2.3	2.7	2.9	2.9	3.0	3.5	2.8
Government	-0.5	0.1	0.0	0.4	0.4	0.4	0.3	0.1
Private	3.4	2.2	2.7	2.5	2.5	2.6	3.2	2.6
Gross domestic investment	-4.5	-2.1	2.0	3.7	0.6	0.7	-1.0	2.4
Exports	0.9	3.6	2.0	1.4	0.3	0.6	2.8	1.1
Imports	3.7	-0.1	-2.0	-2.6	-2.2	-0.1	-0.1	-2.7
	Percentages of GDP [b]							
Gross domestic investment	13.6	11.1	12.5	15.4	15.8	15.8	14.1	15.9
National saving	6.3	6.0	8.7	11.1	7.9	7.7	12.1	11.3
External saving	7.3	5.2	3.8	4.3	7.8	8.1	2.0	4.7
	Percentages							
Employment and wages								
Activity rate [d]	...	51.9	51.3	51.7	50.7	52.5	53.7	55.1
Open unemployment rate [e]	11.6	9.8	7.3	5.8	5.4	5.8	3.1	3.6
Real minimum wage (Index: 1990=100)	129.3	117.4	100.0	165.6	164.8	181.2	199.9	196.3
	Growth rates							
Prices (December-December)								
Retail prices	21.5	16.6	18.0	14.5	10.4	9.3	8.5	12.6
Wholesale prices	21.5	21.7	19.8	13.8	13.6	7.5	...	...
External sector								
Terms of trade (Index: 1990=100) [b]	110.5	94.5	100.0	97.9	81.3	79.4	92.8	92.5
Nominal exchange rate (bolivianos per dollar)	2.35	2.69	3.17	3.58	3.90	4.27	4.63	4.80
Real effective exchange rate Index: 1990=100)	74.1	71.9	100.0	108.3	116.3	117.6	125.1	126.6
	Millions of dollars							
Balance of payments								
Current account	-304	-270	-199	-217	-409	-480	-125	-303
Trade balance (goods and services)	-175	-161	-110	-181	-447	-488	-191	-300
Exports	671	867	977	944	809	888	1 177	1 246
Imports	846	1 028	1 087	1 125	1 255	1 375	1 367	1 545
Capital and financial account	-48	-118	78	172	414	405	394	534
Overall balance	-281	-400	-117	-121	-140	-102	-50	-44
International reserves (variation)	-13	-57	5	18	17	134	121	131
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	108.6	86.5	70.6	61.1	61.1	59.6	64.9	65.2
Net interest (as a percentage of exports)[f]	38.6	27.7	23.2	22.0	23.1	21.8	15.3	17.0

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Non-financial public sector								
Current income	26.2	25.0	25.7	26.2	26.1	31.5	33.7	34.2
Current expenditure	22.2	21.7	22.3	22.4	22.5	29.9	29.8	28.9
Savings	4.0	3.3	3.4	3.8	3.6	1.6	3.9	5.3
Capital expenditure (net)	7.1	5.9	5.4	6.4	6.4	8.2	7.1	7.2
Financial balance	-3.1	-2.6	-2.0	-2.6	-2.8	-6.6	-3.2	-1.9
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	1.9	-51.0	197.9	48.1	6.9	8.8	24.4	50.0
Net domestic credit to the public sector	...	...	54.5	6.5	184.2	29.9	6.0	-75.2
Domestic credit to the private sector	34.6	42.0	41.1	47.8	45.7	39.2	24.0	12.6
Money (M1)	34.7	3.1	17.6	25.2	19.0	14.6	33.5	23.5
Local-currency savings and time deposits	49.8	54.1	-90.5	8.9	-19.5	8	62.9	-27.3
M2	43.2	33.3	-56.5	22.7	13.9	14.0	37.1	18.2
Dollar deposits	64.2	30.6	106.7	68.1	44.2	41.8	7.1	19.1
	Annual rates							
Real interest rates (annualized)								
On deposits	...	6.7	5.3	8.4	11.9	11.9	9.3	5.6
On loans	...	18.4	20.7	23.5	32.7	40.8	43.5	36.7
Equivalent interest rate in foreign currency [g]	...	2.8	8.4	12.2	12.4	12.1	12.1	13.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [g] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
BOLIVIA: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	7.6	7.7	9.5	9.3	7.9	7.7	7.0	8.5	9.7	10.9	9.4	12.6
Real effective exchange rate (Index: 1990=100)	114.8	118.6	117.9	119.2	121.4	124.6	126.8	127.7	127.7	127.2	127.6	123.7
Real interest rate (annualized, %)												
On deposits	12.5	14.1	5.9	14.9	14.1	13.0	5.3	4.5	7.0	6.2	12.8	-3.8
On loans	40.5	37.9	37.2	47.8	52.6	44.2	38.1	39.1	34.3	35.3	51.3	26.0

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

The exchange rate to the dollar rose by 4%, less than a third of the increase in the consumer price index. Consequently, the export-weighted real effective exchange rate remained stable in 1995. If exports to Argentina are excluded from the calculation, the rate goes up, but only by 4%.

d) **Structural reforms**

The structural reforms on which Bolivia embarked in the mid-1980s have made a significant contribution to economic stabilization, but have failed to produce accelerated growth. Over the last 10 years, per capita GDP has expanded by barely 1% per year.

In an effort to break out of this pattern, the Government that took office in 1993 set about implementing a fresh round of structural reforms, including in particular capitalization of public-sector enterprises, popular participation, educational reform and administrative decentralization.

Under the Popular Participation Programme, designed to promote decentralization, investment by municipalities more than doubled, leading to a substantial reallocation of resources towards rural areas and provinces.

Educational reforms included a proposal for a new curriculum and the restructuring of the administration of the national education system. Nevertheless, in its attempts to implement these programmes, the Government has met with some resistance, particularly from universities and professors.

In 1995, the private sector committed resources of some US$ 1 billion in return for participation in the ownership and management of a number of large public-sector enterprises, the so-called capitalization programme, the most far-reaching of the structural reforms introduced in Bolivia in recent years. In an enterprise undergoing capitalization, the public sector contributes the existing assets as initial share capital, while private investors, referred to as "strategic partners", contribute fresh capital, to be invested in the enterprise over a specified number of years, in exchange for a 50% stake in the company and management control.

In June 1995, three generating plants owned by the Empresa Nacional de Electricidad (ENDE) were capitalized, in a deal that brought in some US$ 140 million. September and October saw the capitalization of the Empresa Nacional de Telecomunicaciones (ENTEL) for US$ 610 million and the national airline for US$ 50 million. In December, the eastern and western networks of the Empresa Nacional de Ferrocarriles (ENFE) were capitalized for some US$ 40 million. In addition, the Cochabamba electricity distribution utility was put up for bid, raising roughly US$ 50 million. In contrast, the implementation of pension system reform, entailing capitalization, was delayed owing to a number of setbacks.

The sale of Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) and the Vinto smelting company in 1996 was to complete the capitalization programme. The terms for submission of bids for the oil company were changed after intense political negotiation and provided for the capitalization of YPFB exploitation and exploration activities; the refining division, employing the most workers, would remain entirely in government hands. The first phase of the capitalization of the Empresa de Fundiciones Vinto ended with the pre-qualification of four interested firms, which must now submit their bids. The foreign direct investment package included, besides the smelter, two large mines, Huanuni and Colquiri, and the concession for these was to be awarded on the basis of joint venture contracts.

The passage of the Telecommunications Act paves the way for opening up this sector to market competition. In addition, a system of sectoral regulation (SIRESE) was set up, comprising a general superintendency and sectoral superintendencies (covering water, electricity, oil and gas, telecommunications and transport).

3. The main variables

a) **Economic activity**

The slowdown in exports of goods and services from 15% to 5% was responsible for the slackening of economic activity in 1995. Growth in output, however, was similar to the annual average recorded since 1987. Per capita GDP rose once again, but remained far below (-12%) its 1980 level.

Domestic demand strengthened in 1995, with a notable increase in gross capital formation. Private consumption expanded at a rate similar to that of output, while general government spending rose by barely 1%.

The upsurge in investment was marked by an increased percentage of private investment. The trend was closely linked to the strong increase in foreign direct investment (FDI), which financed a third of gross fixed investment. It should be noted that the capitalization of public-sector enterprises was only partly responsible for the positive trend in FDI, because the resources contributed by strategic partners, particularly in the electricity and telecommunications sectors, did not materialize immediately, being held outside the country in trust accounts.

The fastest-growing sectors in 1995 were communications (10%), electricity, gas and water (9%) and construction and commerce (5%). The agricultural sector lagged behind, with growth of just 2%, barely one quarter of the figure for 1994, as a result of poor winter harvests and lagging production of traditional crops. In contrast, production of industrial crops, concentrated in the Department of Santa Cruz and including soya, cotton, and sugar, rose by 14%.

Mining production increased by a little over 3%, with a rise of close to 5% in the case of oil and gas. The minerals that contributed most to the increased value of mining output were zinc, tungsten and silver. Zinc replaced gold as the leading foreign-exchange earner. The growth in oil and gas production was due to increased sales of refined fuels. In August 1995, the final agreement for the sale of gas to Brazil was signed, involving export volumes of up to 30 million cubic feet per day over a period of 20 years. The cost of building the Bolivian portion of the requisite gas pipeline amounts to roughly US$ 420 million, which will be provided entirely by private investors. The pipeline is due to come on stream in 1997 and will bring additional export earnings of about US$ 75 million a year.

Growth in manufacturing output was again at about the 4% level recorded in the two preceding years. Construction increased at a somewhat faster pace, with the boost in activity in the public sector more than compensating for the contraction in the private sector.

b) **Prices, wages and employment**

The rise in the consumer price level (12.6%) was almost two times the target set by the Government for 1995.

Weather factors were behind the rise in prices of non-industrial crops, for the most part non-tradable staples. Additional negative factors were the increase in international wheat prices and reduced donations of this product. This led to a 50% increase in the price of bread.

The inflation rate also had an import component, attributable to the real appreciation of neighbouring countries' currencies, which made tradable goods from these countries more expensive. Meat and potatoes were among the products most affected.

Monetary factors, such as the financial problems associated with the liquidation and intervention of banks, tended to reinforce price hikes deriving from these supply problems. Beginning in the second half, there was also an increase in government current expenditure on retroactive pay, bonuses and incentive payments, with the result that between November 1994 and August 1995 the average increase in money creation was over 20% per annum. This monetary trend was accompanied by a rise in interest rates, which increased the financial costs incurred by the productive sector. On the other hand, the slow pace of devaluation curbed inflationary pressures, due to the Bolivian economy's high degree of dollarization.

Some 60,000 jobs involving over 20 hours of work a week were created in 1995, chiefly in commerce, services and manufacturing. The unemployment rate was somewhat higher than in 1994. The legal minimum wage was raised by 8%, which represented a decline in real terms. In the private sector, real wages rose in mining, construction, financial institutions and services, but fell in manufacturing, commerce, restaurants and hotels. Wages in the public sector held their ground in real terms.

c) **The external sector**

The external sector was notable for the rise in imports (13%), in particular capital goods (38%), coinciding with an increase in total fixed

investment and foreign direct investment. Exports of mining products and oil and gas continued to expand at a satisfactory pace, but non-traditional exports contracted, since increase exports of soya, chestnuts, cotton and oils failed to make up for declining sales of jewellery, sugar and wood. The export surge of the previous year showed unmistakable signs of slowing down.

Accordingly, the weight of the balance-of-payments current account deficit, which had been 1% of GDP in 1994, tripled in 1995. However, sizeable inflows of external capital, especially of foreign direct investment, covered this considerable deficit.

In fact, the surplus on the financial account widened from close to US$ 400 million in 1994 to US$ 530 million in 1995, a trend entirely attributable to foreign direct investment. FDI amounted to US$ 370 million, almost three times the figure for the previous year, and this made it one of the major sources of investment financing in Bolivia. Analysis of the development plans of the capitalized enterprises, including those in the telecommunications and energy sectors, suggests that in the near future they will account for a high percentage of fixed investment, to be financed entirely with external resources.

The overall balance-of-payments account showed a small deficit, which was covered by special financing obtained after renegotiation of the public external debt with the Paris Club. Consequently, reserve assets rose by US$ 130 million.

By late 1995, the public external debt balance had reached the US$ 4.5 billion level, 7% higher than the previous year. One quarter of the increase was attributable to movements in the exchange rates of various currencies, with the rest almost exclusively due to an increase in multilateral debt.

In 1995, Bolivia received more than US$ 200 million in foreign loans from the Inter-American Development Bank (IDB), together with somewhat smaller loans from the World Bank and the Andean Development Corporation (ADC). This meant that most of the US$ 700 million in foreign loans were from multilateral sources. Among the main bilateral lenders were Germany (US$ 50 million) and Spain (US$ 20 million). External debt service amounted to some US$ 300 million, divided evenly between repayments of principal and interest and commission payments. Disbursements were earmarked mainly for multisectoral and infrastructure projects, especially in energy and transport.

At the fifth and sixth meetings of the Paris Club, held in March and December 1995, Bolivia was able to reschedule some US$ 1 billion of its debt and obtain a 67% reduction in its debt service, thus improving debt indicators in future years.

BRAZIL

1. General trends

In 1995 the Brazilian authorities continued to implement the Real Plan, which they had introduced in mid-1994. Within the framework of this plan, Brazil succeeded in making the transition from an economy beset by chronic inflation to one that enjoyed greater stability and was carrying forward a series of structural reforms in the areas of trade liberalization and the downsizing of the State's role in the economy. This was an unprecedented and still delicate situation, in which economic agents were just beginning to learn to function. A significant decline in inflation was accompanied by a rise in real wages and a build-up of international reserves.

Once the bulk of the inertial component of inflation had been eliminated, it became possible to achieve greater stability through the use of an exchange-rate anchor and the application of a tight monetary policy, although the cost of this approach in terms of reduced competitiveness and runaway real interest rates slowed the economy.

In situations such as this, any modification of foreign exchange policy carries the threat of renewed inflation. Unless the fiscal deficit is reduced quickly, the authorities will be obliged to make greater use of monetary instruments. A copious inflow of overseas capital will be required to keep the country's external accounts balanced, and this presupposes very high domestic interest rates. In such a context, relaxing monetary policy in order to stimulate a recovery in economic activity may well be problematic, yet any further slowdown in the economy may jeopardize the solvency of the financial system, thereby exacerbating unemployment and making it even harder to balance the country's fiscal accounts.

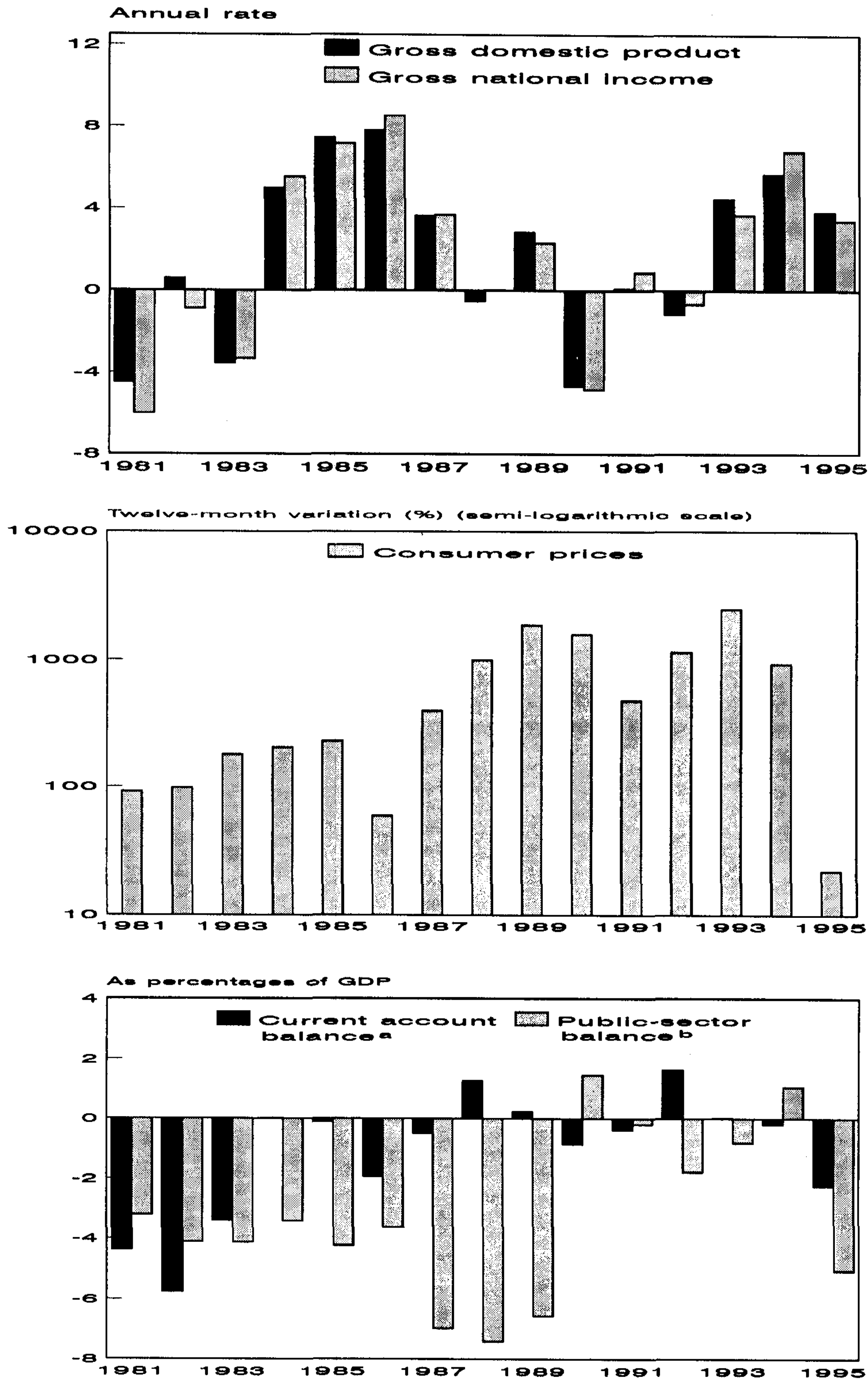
The authorities' hopes of breaking this vicious circle lie primarily in the momentum generated by the privatization process and in significant gains in productivity within the tradables sector.

In the midst of various domestic and external difficulties and disturbances, the stabilization programme remained the Government's top priority. The Mexican crisis of December 1994 led to a reduction in the supply of external resources for the countries of the region, and in Brazil's case, this resulted in a sharp drop in reserves. At the same time, however, domestic demand expanded vigorously as the stabilization programme began to bear fruit. In order to stem the momentum created by the surge in activity, domestic interest rates were raised to over 30% in annualized terms and foreign exchange policy was modified through the introduction of a system of currency bands; this system delimited the parameters for intervention by the Central Bank, which began to play an active role in the foreign exchange market on a regular basis. This approach thus led to the creation of a *de facto* exchange-rate anchor.

Once fears that the Mexican crisis would set off an uncontrollable chain reaction had subsided, capital flows rebounded so strongly that international reserves actually rose above their pre-crisis levels. Given the widening fiscal deficit and the substantial influx of capital, monetary policy had to be tightened, and this had a delayed effect on trends in output. Inflation also began to abate further, after having levelled off for a time.

In 1995, after 15 years of three- to four-digit annual inflation figures, the country recorded a rate of around 22%, the lowest since 1973. The downward trend continued into 1996, with a variation of a mere 16% for the 12 months up to June. On this showing, the current stabilization

Figure 1
BRAZIL: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments. b Estimated on the basis of consolidated public-sector borrowing requirements.

plan has been far more successful than any other initiative mounted during the last 10 years.

After the vigorous expansion associated with the introduction of the Real Plan, the level of activity fell off sharply from the second quarter onwards, and GDP growth, which had been around 6% in 1994, consequently dropped to 4% in 1995. Investment exhibited a similar trend and thus remained low in comparison to its levels during the early 1980s. An important qualitative change was to be observed, however, in that the share of imported capital goods increased considerably as the productivity of capital climbed significantly. Domestic saving weakened as external saving took its place.

A spectacular surge in imports and moderate growth in exports resulted in a trade deficit on the order of US$ 3.2 billion for 1995, in stark contrast to the ample surpluses Brazil had been achieving ever since 1982. The current account posted a deficit of US$ 18.1 billion, or more than 2% of the gross domestic product (GDP). These imbalances were more than offset by abundant inflows of capital from abroad, although the bulk of this capital was highly volatile. This about-turn in the country's external accounts eased the pressure that external capital flows had been exerting on monetary policy while simultaneously expanding the supply of goods, which helped to balance Brazil's product markets.

The slowdown in growth and the high level of interest rates had an adverse effect on the financial sector, which was already reeling from the loss of its former inflation-generated earnings. The ratio of debt arrears to total credit rose from slightly less than 8% in 1994 to 12% in 1995. The Central Bank was obliged to intervene in a number of major state and private banks and to set up a special programme to restructure the financial system and provide deposit insurance.

In 1995, the consolidated public sector slipped from an operational surplus equivalent to 1.1% of GDP to a deficit of 5%. After adjustment for inflation, interest payments –measured as a proportion of output– rose from 3.8% to 5.5% owing partly to higher real interest rates and partly to an increase in public debt. Higher outlays on public-sector wages and retirement pensions cut the primary surplus from 5.2% of GDP to a mere 0.5%.

2. Economic policy

When the Administration that had been elected the previous October, with a show of widespread support from the electorate, took office at the start of 1995, it set its seal of approval on the thrust of Brazil's economic policy, for the new President had played a key role in crafting the Real Plan. Fernando Henrique Cardoso took office at a time when external financing constraints were mounting as a consequence of the Mexican crisis and when the country's external accounts had recently taken a turn for the worse. From November 1994 on, Brazil's monthly trade figures began to show increasingly large deficits, and by June the negative balance had reached US$ 5.5 billion. Inflation, on the other hand, had levelled off at around 2% per month after having taken a spectacular dive at the beginning of the second half of 1994. Its resistance to any further descent was attributable to the buoyancy of domestic demand and the persistence of some remnants of inertial inflation.

Since any further increase in the scope of the fiscal adjustment was out of the question, the Government tightened up its monetary policy. In March, foreign exchange policy was modified to formalize the system of currency bands that had already, in actual fact, been in use for the past few months. In addition, tariffs on some products were raised in response to the soaring level of imports. Finally, most of the remaining indexation measures were dismantled, including the annual adjustment of wages on the basis of past inflation and the indexation of lending operations in the financial system.

a) Fiscal policy

As implementation of the Real Plan has proceeded, fiscal accounts have undergone a marked deterioration, thereby jeopardizing the achievement of a sustainable equilibrium in this area. The cost-reduction phase of the Plan has all

Table 1
BRAZIL: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment[b]								
Gross domestic product	-0.5	2.8	-4.7	0.1	-1.1	4.4	5.7	3.8
Per capita gross domestic product	-2.4	1.0	-6.4	-1.7	-2.8	2.7	3.9	2.1
Gross national income	0.0	2.3	-4.9	0.9	-0.6	3.7	6.8	3.4
Gross domestic product, by sector								
Goods	-2.5	3.0	-8.1	-1.5	-2.4	5.4	7.6	2.1
Basic services	6.1	6.1	2.2	6.3	2.6	3.5	4.9	8.4
Other services	0.9	2.3	-2.1	-1.1	-1.2	2.4	2.3	2.7
	Percentages							
Contribution to growth of GDP[c]								
Consumption[d]	-0.2	2.9	-0.9	1.6	-1.0	3.8	4.3	6.1
Gross fixed investment	-1.3	0.3	-2.7	-1.3	-1.7	1.5	2.7	1.1
Exports	0.9	0.4	-0.4	0.3	1.7	1.3	0.8	0.1
Imports	0.1	-0.7	-0.7	-0.5	-0.1	-2.1	-2.0	-3.5
	Percentages of GDP[b]							
Gross fixed investment	25.0	24.6	22.9	21.7	20.2	20.8	22.2	22.5
National saving	26.1	24.8	22.0	21.3	21.9	20.8	21.9	18.7
External saving	-1.1	-0.2	1.0	0.4	-1.7	-	0.3	3.8
	Percentages							
Employment and wages								
Activity rate[e]	...	...	63.8	62.4	60.0	59.0	59.5	59.4
Open unemployment rate[f]	4.2	3.7	4.5	4.8	4.8	5.4	5.1	4.6
Real minimum wage (Index: 1990=100)	129.9	133.1	100.0	112.8	102.5	113.0	108.0	113.9
	Growth rates							
Prices (December-December)								
Retail prices	993.3	1 863.6	1 585.4	475.8	1 172.0	2 497.6	929.3	22.0
Wholesale prices	1 050.1	1 748.8	1 449.5	471.7	1 154.3	2 639.5	920.6	6.4
External sector								
Terms of trade (Index: 1990=100)[b]	114.8	106.1	100.0	102.7	101.5	101.8	103.3	97.4
Nominal exchange rate (reais per dollar)[g h]	0.0953	1.0305	0.00003	0.00015	0.00164	0.03215	0.64250	0.918
Real effective exchange rate (Index: 1990=100)	143.2	108.4	100.0	118.5	127.7	117.1	92.9	70.6
	Millions of dollars							
Balance of payments								
Current account	4 156	1 002	-3 823	-1 450	6 089	19	-1 153	-18 136
Trade balance (goods and services)	16 145	13 327	6 986	6 687	11 897	8 739	5 515	-10 652
Exports	36 052	37 507	35 170	34 938	39 881	43 595	49 010	52 641
Imports	19 907	24 180	28 184	28 251	27 984	34 856	43 495	63 293
Capital and financial account	-9 207	-12 502	-5 532	-4 087	6 570	7 685	8 138	29 662
Overall balance	-5 878	-12 319	-9 651	-4 685	11 266	6 890	6 543	12 973
International reserves (variation)	1 250	893	474	-369	14 670	8 709	7 215	12 920
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	34.3	25.2	27.9	32.2	36.2	33.3	26.1	20.4
Net interest (as a percentage of exports)[i]	27.3	25.7	27.7	24.7	18.2	15.6	13.1	20.2

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Public sector								
Total income	24.0	25.9	31.7	30.3	29.2	29.4	32.2	33.7
Total expenditure	31.2	...	36.6	34.6	34.3	36.4	32.4	39.9
Operating balance[j]	-7.4	-6.6	1.2	-0.2	-1.8	-0.7	1.1	-5.1
	Growth rates							
Currency and credit								
Net international reserves	15.0	3.0	-5.7	-6.0	152.5	35.6	20.5	...
Money (M1)	570.3	1 384.2	2 335.7	330.7	912.7	2 184.6	324.6	26.0
	Annual rates							
Real interest rates (annualized)								
On deposits	-11.0	57.1	3.3	34.7	31.9	23.0	26.0	24.8
On loans	...	...	405.8	89.6	196.8	229.1	301.0	81.8
Equivalent interest rate in foreign currency[k]	-7.6	108.1	6.4	30.2	40.8	27.0	54.6	33.9

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Includes variations in stocks. [e] Percentages of the working-age population. [f] Percentages of the economically active population (EAP). [g] This rate is expressed in reais per US$ 1 million for the years up to 1989 and in reais per dollar from 1990 onward. [h] One real —Brazil's new currency— is equivalent to 2,750 cruzeiros reais. [i] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [j] Does not include the effects of inflation on the interest rate. [k] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

BRAZIL: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product (Index: 1990=100)[b]	113.0	127.9	124.8	119.9	118.1	131.6	133.2	131.6	129.8	139.0	134.8	130.3
Consumer prices (12-month variation, %)	1 243.3	1 467.1	1 905.7	2 497.6	3 490.7	5 015.3	2 301.8	929.3	277.1	33.4	25.5	22.0
Real effective exchange rate (Index: 1990=100)	121.8	119.9	114.5	112.0	107.9	104.8	84.0	74.9	71.5	72.7	69.4	68.7
Real interest rate (annualized, %)												
On deposits	6.8	35.3	22.2	27.8	35.5	43.0	7.8	17.8	33.0	24.7	25.9	15.7
On loans	131.8	203.1	92.0	489.4	630.8	399.1	73.0	101.3	114.5	89.9	59.9	63.1
Money (M1) (12-month variation)	1 073.7	1 199.1	1 452.8	2 082.1	3 166.1	5 872.8	5 790.0	2 621.8	202.0	145.0	22.3	26.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] On the basis of figures calculated at constant domestic prices. [c] On the basis of figures expressed in reais. One real —the new Brazilian currency— is equivalent to 2,750 cruzeiros reais.

but run its course, for any further cutbacks would threaten the interests of highly organized groups, and yet approval of a tax reform that would send out the right signals and thus augment fiscal revenues is still not on the horizon. Municipal and state government finances are in disarray and state banks are facing enormous losses on loans they had granted to their governments.

The imbalance in public-sector accounts is not a direct result of the stabilization programme, but rather the consequence of policies that date much further back. Paradoxically, the Brazilian economy's attainment of greater stability has brought to light imbalances that had previously gone unnoticed.

The consolidated public sector posted an operating deficit (the operating balance excludes the effects of inflation on interest payments) of somewhat more than 5% of GDP, by contrast with the preceding year's surplus of slightly more than one percentage point of GDP. Of the total 1995 deficit, nearly half was generated by the states and municipalities, about one third by the central government (including the Central Bank), and the remainder by State-owned enterprises.

Expenditures also exerted considerable pressure on the primary balance in 1995. The overall surplus fell from 5% to 0.4% of GDP, while the central government surplus (1.5%) turned into a 1.7% deficit; the deficit in the states and municipalities widened from 0.8% to 2.4%; and State-owned companies slipped from a surplus of 0.4% to a deficit of 0.9%. These downturns add up to more than six points of GDP, which indicates that the rise in interest rates from 4% to 5.4% of GDP was not the decisive factor in this turnaround.

The slowdown in economic activity was reflected in public-sector revenues. Although income was higher in 1995 than in 1994, the proceeds from both federal and state taxes started to dwindle in real terms in May, while expenditure continued to rise. This was as much a result of higher financial outlays as it was of the difficulty of curbing non-financial disbursements. Treasury revenues (not including social security) expanded by 10%, expenditure by 17%, and legally- and constitutionally-mandated transfers by 21%. Consequently, the central government's net income (after deducting the above transfers) climbed by barely 7%.

Wages were up by 16%, financial expenditure by 26% and other expenditure by 8%. At the same time, social security spending expanded by 32% in real terms. The states and municipalities faced even greater problems, since, given the sharp rise in wages, their payrolls were taking up more than 80% of their revenue.

The increase in public employees' wage levels was an outcome of the policy of awarding real wage increases which had been applied during the design phase and initial stage of the Real Plan. The Government subsequently adopted a more cautious policy and became even more circumspect in this regard in 1996. The drop in the inflation rate seen during the second half of 1995, however, contributed to an improvement in real wages, despite the fact that, in nominal terms, wage adjustments were smaller.

Although only a small portion of the increase in the deficit was attributable to the sharp rise in interest payments --particularly on domestic debt– the authorities' tight monetary policy had a perverse effect on public-sector finances. Interest payments were driven up by 26% in real terms by the expansion of the debt and higher interest rates, especially on domestic liabilities. This measure should therefore be seen as no more than an interim mechanism for controlling demand within the framework of the stabilization plan until such time as the full effects of the fiscal adjustment make themselves felt.

Reserves were allowed to build up despite the fact that the interest they accrued was considerably lower than what the Government was offering on its debt paper, and this accounted for a sizeable portion of the increase in the central government's public debt. The apparent incongruity of this policy stems from the fact that these reserves act, in effect, as a form of "insurance" for the stabilization plan since, without a high level of reserves, the plan's viability would be in jeopardy in the event of any speculation-generated foreign exchange crisis.

In response to the growing deficit, the Government urged Congress to pass constitutional reforms, made cuts in its wage bill and took steps to improve the management of

public-sector enterprises. It also attempted to tie the financial support it provided to state governments with cost-control measures and plans for raising revenue collection at these administrative levels. Thus, the fiscal adjustment was inarguably Brazil's major economic policy challenge for 1996.

b) **Monetary policy**

Monetary policy was the main instrument used to restrain domestic demand and relieve pressure on the balance of payments. Starting in October 1994, the Central Bank introduced a series of reserve requirements applying to deposits and even to loan operations within the financial system, and this policy generated a sizeable spread between borrowing and lending rates. Strong growth in domestic demand and in credit operations, combined with foreign exchange pressures, induced the Central Bank to keep interest rates high, and indeed in real terms they reached record levels. The aim of these measures was to discourage and penalize the build-up of inventories. Persistent monetary constraints made the use of lines of credit unfeasible, however, and, as a result, both consumers and business firms began to find it difficult to meet their payment obligations. Defaults increased, which was a disincentive to the granting of new loans. Thus, the costs associated with this policy are clearly connected with the imperative of financing a deficit on current transactions of approximately US$ 18 billion.

Companies enjoying access to international markets sought out new sources of finance in order to circumvent the excessive cost of domestic financing. At the same time, international investors were working through the banks with a view to conducting operations in the Brazilian market. Both of these factors contributed to a vigorous upsurge in capital inflows in the second half of 1995.

When inflation plummeted in mid-1994, the financial system sharply increased its credit operations in an effort to offset the drop in its inflation-related gains. It soon felt the effects of the Government's stringent monetary policy, however, and a number of public and private institutions lapsed into insolvency.

There were also other, more specific causes of this situation. The state banks faced the prospect of not being able to collect on a large portion of the loans they had made to state governments (e.g. BANESPA, the Banco del Estado de São Paulo S.A.) or of holding a large number of state securities (as in the cases of Río de Janeiro and Río Grande do Sul) in their loan portfolios. In the case of the Banco do Brasil, problems arose because loans had been extended to troubled sectors, such as agriculture. The financial imbalances faced by private institutions were due to a combination of high default rates on retail credit operations and poor management.

In early 1995, the Central Bank found it necessary to take over the management of a number of institutions and, in August, it had to do much the same with the Banco Economico. This bank, which is the eighth largest private bank in the country and the largest of all in the north-east, had already been granted more than US$ 1.5 billion in financing in order to help it maintain its liquidity ratio.

As part of its efforts to promote a restructuring programme, the Central Bank created financing mechanisms and strengthened its intervention capabilities by establishing deposit insurance providing coverage for up to 20,000 reais. In November, a merger was authorized between the Banco Nacional, which was suffering from liquidity and solvency problems, and UNIBANCO; and in 1996, the merger of two private regional banks (Banco Bandeirantes de Comercio S.A., in the south-east and Banorte, in the north-east) was announced. In 1996, the Banco Economico, whose operations had been suspended ever since the Central Bank had intervened, was acquired by another private national bank, EXCEL.

The Central Bank was obliged to retain part of the portfolios of the distressed banks and grant hefty loans to the other institutions involved in these operations, at a cost equal to three percentage points of GDP. The Government had to pump more than US$ 5 billion into the Banco do Brasil, which is the State's chief banking institution.

During the second half of 1995, however, the Central Bank lowered reserve requirements substantially and eliminated the reserve requirement applying to bank lending operations.

Early in October, new mechanisms for attracting funds were introduced with a view to engaging in longer-term operations. The Central Bank has also been cutting its base rate.

Owing to the prevailing level of uncertainty, however, loan interest rates exhibited a good deal of recalcitrance in the face of downward pressures despite these measures. As a result of the increased risk associated with the rising default rate –as a consequence, in particular, of the careless actions of commercial banks in the early days of the Real Plan– lending operations were slow to get off the ground, however.

Measures aimed at stimulating domestic demand also fell short of their objective, as the constraints affecting the terms of consumer loans persisted during 1995. It was not until May 1996 that the National Monetary Council extended the term for such operations from three to six months; later on, the restrictions on these transactions were lifted entirely.

c) **Foreign exchange policy**

The Real Plan brought with it a new foreign exchange regime. The Central Bank withdrew its commitment to hold the real exchange rate steady, and this resulted in a nominal revaluation in the first few months of the Plan. The combination of a new foreign exchange regime and lower customs tariffs fuelled a rapid expansion in the supply of imported products, which was essential to meet the surge in demand triggered by the abrupt deceleration in prices.

At the beginning of 1995, however, the worsening external situation obliged the Brazilian Government to clarify its exchange-rate policy. In March, the authorities announced the introduction of a currency band system, with the band's upper and lower limits initially being set at 0.84 and 0.93 reais. No specific indexation rules were defined, and the movement of the band was to be based on the differential between domestic and international prices and productivity gains. This mechanism had, in practice, already been in operation for a number of months, but its announcement marked the official demise of the pre-existing currency float, which had led to a sharp revaluation of the real, even in nominal terms.

The implementation of this new mechanism was hampered by speculative movements that siphoned off US$ 4 billion in international reserves. The Central Bank adjusted the band to between 0.88 and 0.93 reais, which was tantamount to a nominal devaluation of nearly 5%. In May, the ceiling was raised to 0.98 reais, and at the end of June the band was shifted once again, to between 0.91 and 0.99 reais. This adjustment, unlike the change made in March, was greeted with equanimity by economic agents and produced no turbulence in the foreign exchange market. The Central Bank has taken action on a regular basis, even within the band, to avert sharp fluctuations. This form of intervention has not been clearly delineated and gives the impression that the authorities are following –albeit erratically– trends in domestic industrial prices.

During the remainder of the year, minor variations were seen in the nominal exchange rate, chiefly as a result of action taken by the Central Bank. At the end of January 1996, the establishment of new band limits (0.97 and 1.06 reais) ushered in what was, in effect, a mechanism for pre-setting the exchange rate.

The momentum of the nominal exchange rate slackened off considerably as its 14% rise for 1995 was followed by an increase of only 4% during the first half of 1996. Thus, the real exchange rate, computed on the basis of consumer price indexes, continued to slide, although more slowly than in the recent past. The 1995 index of the average real exchange rate was 40% lower than its average value for 1978-1994, although the difference is less (-23%) if calculations are based on wholesale prices.

d) **Structural reforms**

In 1995, the structural reforms being carried out in the Brazilian economy were consolidated. The Constitution was amended in order to eliminate monopolies or relax restrictions on the participation of private or foreign capital in public services, most notably in the telecommunications and oil sectors.

Draft amendments to the Constitution dealing with the social security system, the civil service and the tax system were also submitted to

Congress. While these modifications had not yet taken on their final form –the corresponding regulations had yet to be drawn up– they provided a clear indication of the Government's intention to downsize the State, as well as a foretaste of major changes of a nature likely to put Brazil's economic growth on a more solid footing.

Although only one company –in the electricity sector– was actually auctioned off in 1995, the privatization process gathered speed as the operation of the western branch lines of the railway network was contracted out and the Government divested itself of the Río de Janeiro electricity distribution company (this last operation brought in nearly US$ 2.3 billion and was the largest sale to be carried out since the privatization process was launched). In addition, preparations were being made for the sale of Vale do Río Doce, S.A. one of the largest companies in the world in its field. The operation of two major, heavily-travelled 600-kilometre highways, both in poor condition, was also turned over to contractors who undertook to repair and widen these roads in exchange for the toll fees. In May 1996, a law was passed allowing private-sector and foreign participation in the cellular telephone business, which had previously been the exclusive preserve of the State-owned telecommunications company (TELEBRAS).

A number of states also embarked on privatization programmes in the hope of pulling themselves out of bankruptcy. What is more, the federal government has been making its loans to the state governments and any debt-restructuring arrangements it may offer them contingent upon the progress of their privatization schemes.

Import policy was modified in 1995 in view of the high levels of imports recorded for some product categories since the introduction of the Real Plan. One particularly worrisome development was that the monthly average for motor vehicle imports during the first two months of 1995 amounted to US$ 300 million, which was six times higher than the figure for the same period in 1994. Although the Government raised tariffs on motor vehicles and electrical and electronic products from 20% to 32% at the end of February 1995, the level of such imports remained high throughout the first half-year owing to expectations of a further tariff increase to 70%, which was, in fact, introduced in June along with a system of import quotas. After an adverse ruling by the World Trade Organization (WTO), however, Brazil did away with these quotas, which were proving redundant in any case because of a sharp decline in local demand. In addition, negotiations with Brazil's MERCOSUR partners resulted in a plan calling for a phased reduction of tariffs on motor vehicles from 70% to 35% by 1999.

3. The main variables

a) Economic activity

The sharp drop in inflation from July 1994 onward strengthened domestic demand, thereby driving up the level of economic activity. GDP had climbed by 6.5% in the third quarter of 1994 and by 9.4% in the fourth, and its momentum continued to accelerate in the first quarter of 1995, when GDP growth amounting to nearly 10% was spearheaded by the manufacturing and construction sectors, which recorded increases of 16% and 11%, respectively, compared with the same period of the year before.

The restrictive monetary policy that had been in place since the previous October brought about a reversal of this trend, however. The high default rate on commercial credit obligations hurt industry, whose inventories started to build up to considerably high levels. In the second half of the year, a number of sectors (including the automotive industry) began to sell off their inventories at a very rapid pace, triggering a sharp downturn in activity, and seasonally adjusted indicators pointed to a steady month-to-month contraction in manufacturing output. As a result, growth in 1995 was below 2%, less than a quarter of the annual rate recorded in the previous biennium. During the early months of 1996, this unfavourable trend persisted, but in April signs of a recovery began to be discernible.

The initial surge in industrial activity was made possible by a fuller use of installed capacity (with use rates reaching the unprecedented level of nearly 83%), increases in productivity and, most importantly, ready access to imported inputs. The use of installed capacity later fell back to around 75%, with marked differences being observed from one branch of industry to another. Capital and intermediate goods production flattened out, while the output of consumer products continued to rise, particularly in the case of durable goods (12%).

b) **Prices, wages and employment**

Consumer prices climbed by 22% in 1995, with the rate of increase slowing as the year went on. This trend continued into the first few months of 1996, although inflation flared up again in May. Wholesale prices rose a modest 6% in 1995, chiefly because agricultural prices fell by 13%.

An important factor in this encouraging result was the way in which the stabilization policy was implemented, both as regards the exchange rate and in terms of the management of interest rates. Brazil's introduction of the real in July 1994 drastically reduced the inertial component of inflation. After this remarkable start, stabilization policy concentrated on doing away with the remnants of this type of inflation along with the last vestiges of indexation mechanisms, but it also had to cope with what appears to have been an unexpectedly strong upturn in domestic demand which was itself directly attributable to the slowdown in inflation.

The price trends observed in the second half of 1995 were a reflection of a number of factors, including the very gradual rise of the exchange rate, the slowdown of the economy, strong competition from imports, the changes made in wage-adjustment mechanisms, a bumper harvest and the fact that the authorities held fast to their policy of holding down increases in utility rates and charges to moderate levels. There was also some degree of convergence between the prices of tradables and non-tradables, as price increases among the latter slowed noticeably; this was particularly true of rents and a number of services which, in the second half of 1994, had posted greatly above-average price rises that posed serious problems for the stabilization process.

The higher level of employment registered during the early months of the stabilization plan's implementation was short-lived. The rate of industrial employment in São Paulo, which had advanced by 2.5% between September 1994 and April 1995, fell back by 8% during the remainder of the year and then continued to slacken in the first few months of 1996, dropping to a level nearly 25% below the 1978 rate. This development was mirrored by trends in the unemployment rate, which descended between October 1994 and August 1995 but then began to rise rapidly. In spite of this, the average annual unemployment rate in the country's major metropolitan areas fell to 4.6% (from 5.1% in 1994).

Price stabilization contributed to an improvement in real wages in 1995. In May, the legal minimum wage was set at 100 reais per month, for a rise of 42% which pushed its purchasing power for the year as a whole up to 22% above the average for 1994. In May 1996, it was raised again, to 112 reais. In São Paulo, average real wages in manufacturing went up by nearly 9% in 1995.

There was virtually zero growth in the average level of formal employment in 1995. In the informal sector, however, an increase of nearly 5% was seen, while wages rose more than three times as fast (15%) as in the formal sector. This suggests that the main beneficiaries of the stabilization process have been lower-income groups. According to preliminary figures, the income of the poorest half of the population swelled by around 7.3 billion reais, while that of the richest quintile shrank by 12 billion reais (both figures have been adjusted for inflation), making this one of the most far-reaching instances of income redistribution in Brazil's history.

c) **The external sector**

In the first quarter of 1995, Brazil's trade deficit widened to US$ 2.3 billion, thus confirming the shift in direction observed in the last two months of the preceding year. The upset in the balance of trade, which until October 1994

had shown a monthly surplus of nearly US$ 1 billion, was chiefly due to the jump in imports, whose average monthly value shot up from just under US$ 2.5 billion to slightly over US$ 4 billion; this upsurge was attributable, in its turn, to the revaluation of the Brazilian real against the United States dollar in both real and nominal terms, to the acceleration of the MERCOSUR tariff-reduction programme and to the robust growth of domestic demand. In the second half of 1995, the downward slide of the real exchange rate eased, domestic demand cooled down as the economy slowed, and tighter import restrictions were introduced, and, as a result, the deficit not only evaporated but, by the end of the year, had given way to a modest surplus. In the first half of 1996, the trade balance once again showed a deficit, but it was considerably smaller than it had been during the corresponding period of 1994.

The value of merchandise exports totalled US$ 46.5 billion in 1995, which represented a rise of 5%. The most dynamic sector was semi-manufactures (33%), which benefited from higher international prices. Primary commodities slipped back by 1% owing to the poor performance of coffee and soybeans, which was, however, partially offset by improvements in iron ore and sugar sales. Exports of manufactures expanded by a scant 2%, almost certainly as a result of the low level of the real exchange rate. In the first half of 1996, exports did better, particularly in the case of manufactures.

Merchandise imports continued their headlong ascent, thus drawing close to the US$ 50 billion mark, which was 50% more than the preceding year's level. As the year progressed their rate of increase slowed, however, as the breakneck speed of their climb during the first six months was gradually checked by restrictive policy measures and the cooling of the economy.

The increase in exports to MERCOSUR countries in 1995 was very small, mainly due to the poor performance of exports to Argentina as a result of the harsh recession that gripped that country and the slide in its currency's real exchange rate against the real. Exports to Asian countries, on the other hand, expanded considerably thanks to a strong upturn in sales of iron ore and iron and steel semi-manufactures to those markets.

It is not surprising that external supply should have been used to meet the country's rapidly expanding domestic demand, in view of its considerable reserves: some US$ 40 billion, or 15 months' worth of imports. It was also assumed that the flow of external resources, in the form of either loans or direct investment, would continue. The Mexican crisis of December 1994 cast doubt on the validity of these assumptions, however. In the first quarter of 1995, new overseas issues of Brazilian securities, which had totalled more than US$ 3 billion in October-December 1994, tumbled to less than half that amount while, at the same time, the stock exchange recorded a net outflow of more than US$ 2 billion, in contrast to 1994, when the stock market had brought in over US$ 5 billion in external resources.

During the second half of 1995, a significant amount of foreign capital returned to the country. Commercial lines of credit for foreign trade operations not only regained the ground they had lost, but actually registered an increase as a result of the considerably larger volume of resource flows. In addition, foreign sales of stocks and bonds issued by privately-owned Brazilian companies picked up, swelling from US$ 3.7 billion in the first half of the year to US$ 5.9 million in the second half. Brazil also moved back into international bond markets (Japan and Germany), where it floated approximately US$ 1.8 billion in Treasury bonds. Finally, direct investment (not including portfolio investments) doubled to nearly US$ 3.9 billion, up from US$ 1.9 billion in the same period of 1994.

More than half the capital entering the country in the second half of 1995 –over US$ 16 billion– was short-term capital, however, despite the fact that Central Bank measures aimed at discouraging speculative inflows had been in place since October 1994. During the first quarter of 1995, a number of these measures were relaxed, but some months later the Central Bank again raised tax rates in an effort to reduce short-term inflows and extended the applicability of the relevant taxes to include foreign exchange operations in the open market. Portfolio investment inflows also expanded significantly. The end result of all this was that total net capital inflows amounted to US$ 30.7 billion in 1995, which was equivalent to more than 60% of the country's merchandise exports.

This large intake of capital boosted Brazil's international reserves so sharply that they actually surpassed the levels registered before the outbreak of the Mexican crisis. Thus, after having shrunk by US$ 9.6 billion between November 1994 and April 1995, reserves expanded by US$ 20.5 billion during the remainder of the year, totalling US$ 50.5 billion by the end of December. This trend held firm during the early part of 1996 and, by May, reserves stood at some US$ 56 billion.

The copious flow of incoming capital made it necessary to discontinue the reductions that were being made in the financial tax levied on capital entering the country and to raise these tax rates back up to the levels in effect prior to the Mexican crisis.

Brazil's external debt climbed to US$ 159 billion, or 7% more than the preceding year, mainly as a result of an increase in short-term borrowing.

CHILE

1. General trends

The Chilean economy's robust expansion (8.2%) in 1995 rounded out 12 consecutive years of growth at an average annual rate of 6.4%, making it the longest growth spell of the post-war period. Inflation continued to subside, falling to a 35-year low (8.2%). The economy's performance was buoyed by the positive showing turned in by the external sector, where the terms of trade improved by over 5 points of GDP. Total demand was up by 12% and national income by almost 15%. Chile's trade surplus climbed to US$ 1.4 billion, while the US$ 640 million deficit registered on the 1994 balance-of-payments current account gave way to a surplus of US$ 160 million and international reserves rose by approximately US$ 1.1 billion.

The strong position of the external sector helped to boost national saving to a record 32% of GDP, with fixed capital investment amounting to 28% of GDP. The public sector marked up a saving rate equivalent to 5% of GDP and, for the eighth year running, posted surpluses in its current and overall financial accounts. In 1995 and 1996, the public sector also made a total of US$ 3.4 billion in prepayments to multilateral and commercial banks.

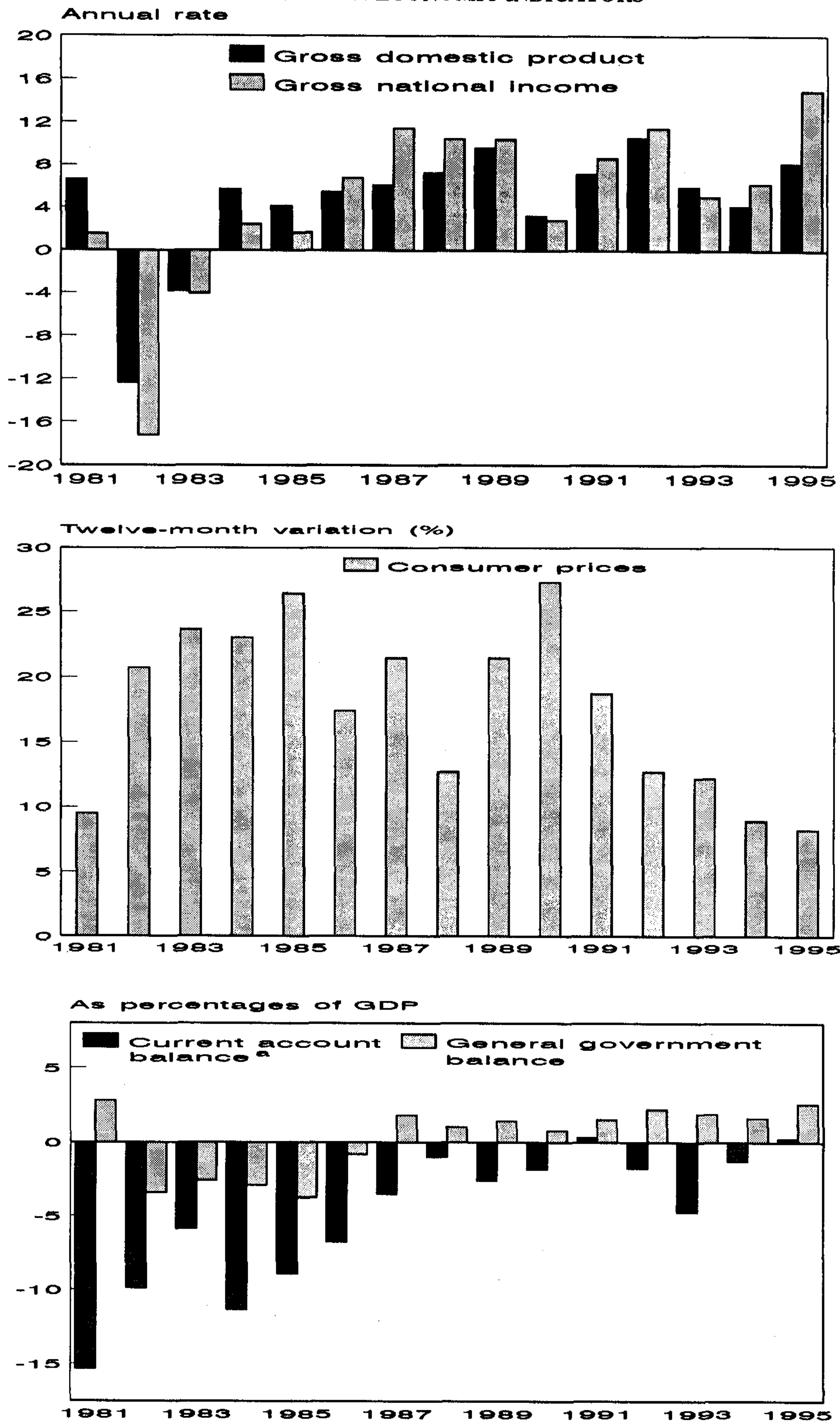
The growth of the economy, in which external conditions were a major contributing factor, enabled the country to complete the adjustment process it had begun in 1993-1994, an achievement that launched domestic demand on a steep upward path. Actual results were higher than the projected figures for growth, the balance-of-payments trade and current accounts, saving, investment and productivity, and were lower than the projections for employment and capital flows. The country just barely managed to reach its targeted level of inflation, perhaps because it failed to take full advantage of the abundant supply of external resources existing in the economy, thereby sparking a debate regarding the possible lack of economic policy tools to deal with an upward trend in private expenditure. Interest-rate volatility –caused by premature reductions that made larger rate hikes necessary later on– was a corollary of this phenomenon.

Owing to the considerable lag in the employment level's reaction to the upturn in economic activity following the completion of the economy's monetary adjustment at the start of the year, the average annual employment rate edged up by a scant 1%. The mean annual unemployment level of 5.4% was lower than the average figure for 1994 (6.0%), and the 4.1% increase in real wages fell far short of the average gain in labour productivity of over 7%.

The gap between the growth rates for expenditure and output widened to 4.4 points and was particularly striking in the third quarter, when it reached 6.2 points, with GDP expanding at 8.9% and domestic spending at 15.1%. In the final quarter, this gap narrowed back down to 5.4 points as GDP growth picked up (9.6%), but it was clear that expenditure and output were at unsustainable levels which were hindering the achievement of macroeconomic objectives.

The steep rise in spending seen during 1995 was in large part a transitory phenomenon caused by an improvement in the terms of trade which made it necessary to adjust domestic expenditure and output in order to align them with their trend values. After quickly shaking off –in the first quarter– the effects of the Mexican crisis on interest rates, the exchange rate and the stock market, the Chilean economy resumed its rapid growth. Owing to the impacts of the crisis, foreign portfolio investment was negative during the first nine months of the year, as was the flow of short-term resources in the first quarter, but

Figure 1
CHILE: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

both of these developments were more than offset by the improvement in the country's current account.

Growth outpaced potential income in 1995, and the economy was free of inflationary and balance-of-payments pressures thanks to the surplus generated by the increase in national income, which made it possible to channel the excess expenditure into more imports. In 1996, the growth rate remained strong, but within a context of declining national income –due to a deterioration in the terms of trade– and high interest rates. Nonetheless, a widespread increase in economic activity was observed in the first quarter (9%), and double-digit growth rates were recorded for mining (16%), construction (14%) and commerce (13%); the only exception to this upswing was the agricultural/forestry sector, where growth came to a standstill.

Indicators for the second half of 1995 pointed to a sizeable increase in domestic spending (15%) which was led by fixed capital investment, with gains of nearly 16% in the third quarter and 24% in the fourth. This required an upward revision of 1996 growth estimates and sparked concerns about the size of the expenditure-output differential which the country would start out with in 1996 and how this might affect its chances of achieving its inflation target.

The Central Bank felt that existing spending and output levels had overshot the Chilean economy's medium-term growth potential, and in April 1996 it therefore proceeded to adopt stricter monetary adjustment measures. This decision was based on the fact that both the global and underlying inflation rates were steepening alarmingly during the first quarter, thereby jeopardizing the achievement of the target inflation rate, and that the gap between expenditure and output had remained at untenable levels and showed no clear signs of narrowing.

In addition to its overall buoyancy, the production sector also exhibited a number of major changes in ownership that heightened its economic concentration in major markets such as the banking and financial system, telecommunications, the airlines and the electricity sector.

2. Economic policy

Economic policy continued to adapt to a downward trend in the exchange rate which was associated with strengthening exports, productivity and external investment flows. The monetary authority took further steps to regulate short-term capital inflows by expanding the coverage of reserve requirements and providing for the stricter enforcement of existing laws and regulations on the subject.

The authorities sought to bring their monetary and exchange policies into line with the relative abundance of hard currency existing in the Chilean economy by boosting the demand for foreign exchange and cutting back on the supply. During the first half of the year, the focus was on reconciling reductions in the interest rate with additional measures for opening up the capital account and curbing the inflow of short-term funds. During the second half, priority began to be shifted to controlling the growth of expenditure.

A change for the better was seen in the expenditure-output gap, as it narrowed from 3.3 points in the first quarter to 2.3 in the second, while inflation remained below 8%. Since the monetary authority expected the increase in the terms of trade to slow considerably in the second half of the year, once it had altered the course of monetary policy by adopting the daily rate as the key rate for the system, it relaxed its policy somewhat in May and June. As a result, the signals sent out by these lower rates added to the effect of the sharp upturn in the terms of trade.

a) Monetary policy

In May, the overnight interbank rate became the chief monetary instrument, thus supplanting the rate for 90-day Central Bank notes –which then came to be set by the market– as the principal monetary signal. This gave the market a larger role in determining the levels and structure of interest rates and gave the authorities more control over liquidity by allowing them to increase the frequency of marginal movements in short-term rates without significantly

Table 1
CHILE: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment[b]								
Gross domestic product	7.3	9.6	3.3	7.1	10.5	6.0	4.1	8.2
Per capita gross domestic product	5.5	7.7	1.6	5.4	8.7	4.2	2.5	6.5
Gross national income	10.5	10.4	2.9	8.6	11.4	5.0	6.2	14.9
Gross domestic product by sector								
Goods	9.0	10.3	3.6	5.0	8.0	4.5	3.7	6.6
Basic services	7.7	7.5	3.4	14.9	15.9	6.7	7.3	10.7
Other services	5.0	7.8	3.2	7.2	10.2	6.2	3.7	7.1
	Percentages							
Contribution to growth of GDP [c]								
Consumption	4.7	6.4	1.1	5.6	7.1	5.5	1.6	7.0
Government	0.4	0.4	0.1	0.4	0.5	0.3	0.2	0.2
Private	4.3	6.0	1.0	5.2	6.6	5.2	1.3	6.8
Gross domestic investment	2.6	5.2	1.0	0.4	6.5	3.5	0.3	5.6
Exports	3.8	4.6	2.6	3.1	4.2	0.6	3.6	3.3
Imports	-3.9	-6.6	-1.5	-2.1	-7.2	-3.7	-1.4	-7.7
	Percentages of GDP[b]							
Gross domestic investment	23.4	26.1	26.3	24.9	28.4	30.2	29.3	32.2
National saving	22.4	23.6	24.5	25.3	26.4	24.3	27.6	32.5
External saving	0.9	2.4	1.8	-0.3	2.0	5.8	1.7	-0.3
	Percentages							
Employment and wages								
Activity rate [d]	52.0	52.6	52.5	52.3	52.8	54.5	54.7	54.0
Open unemployment rate [e]	8.1	6.2	6.0	6.5	4.9	4.7	6.0	5.4
Real minimum wage (Index: 1990=100)	84.5	91.3	100.0	109.3	114.3	120.0	124.4	130.0
	Growth rates							
Prices (December-December)								
Retail prices	12.7	21.4	27.3	18.7	12.7	12.2	8.9	8.2
Wholesale prices	3.3	22.8	25.7	16.5	8.9	6.7	7.8	8.2
External sector								
Terms of trade (Index: 1990=100) [b]	103.8	103.3	100.0	102.0	102.7	97.3	104.1	117.7
Nominal exchange rate (pesos per dollar)	245	267	305	349	363	404	420	396
Real effective exchange rate Index: (1990=100)	102.0	96.4	100.0	98.9	95.3	97.5	96.5	92.4
	Millions of dollars							
Balance of payments								
Current account	-234	-705	-536	109	-703	-2 096	-639	160
Trade balance (goods and services)	1 517	1 022	1 081	1 579	727	-978	747	1 234
Exports	8 142	9 575	10 285	11 110	12 439	11 800	14 451	19 194
Imports	6 625	8 553	9 204	9 531	11 712	12 778	13 704	17 959
Capital and financial account	-773	1 211	3 051	823	2 884	2 778	4 573	1 168
Overall balance	-1 124	387	2 371	1 234	2 500	585	3 217	1 081
International reserves (variation)	-756	-549	-2 122	-1 049	-2 344	-171	-2 919	-741
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	79.3	64.0	62.4	52.3	47.1	44.4	43.1	35.3
Net interest (as a percentage of exports)[f]	19.8	16.1	14.4	10.5	7.8	6.0	4.8	2.8

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
General government								
Current income	22.3	21.2	20.5	22.3	22.4	22.6	21.9	22.3
Current expenditure	20.0	18.2	18.1	18.6	17.5	17.7	17.2	16.9
Savings	2.3	3.0	2.5	3.7	4.9	4.8	4.8	5.5
Capital expenditure (net)	1.2	1.6	1.7	2.1	2.7	2.9	3.1	2.9
Financial balance	1.0	1.4	0.8	1.5	2.2	1.9	1.7	2.6
	Growth rates							
Currency and credit								
Money balances of monetary system								
Net international reserves	-26.0	25.2	124.6	34.8	62.8	17.8	22.5	...
Net domestic credit	108.8	27.2	-10.8	36.2	-19.4	39.7	-3.9	...
To public sector	3.5	-8.3	18.6	14.3	-2.9	11.8	-10.0	...
To private sector	24.9	37.3	16.1	22.4	37.0	30.2	13.0	...
Money (M1)	53.5	5.5	27.0	39.7	21.2	29.2	-2.9	...
Local-currency savings and time deposits	24.5	30.8	32.0	36.9	32.4	22.5	22.6	...
M2	31.5	23.7	30.8	37.6	39.7	24.0	16.7	...
Dollar deposits	50.2	46.8	28.7	23.2	-17.2	31.3	-20.8	...
	Annual rates							
Real interest rates (annualized)								
On deposits	2.1	7.6	10.4	3.1	5.0	5.3	5.7	5.1
On loans	5.1	11.9	17.1	8.4	10.0	10.8	10.4	9.2
Equivalent interest rate in foreign currency [g]	11.1	16.9	24.0	10.2	16.5	5.9	22.2	14.9

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Refers to net interest as shown on the balance of payments, divided by exports of goods and services.
[g] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
CHILE: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product (Index: 1990=100)	124.3	125.9	128.2	128.0	129.3	131.8	133.0	133.9				
Consumer prices (12-month variation, %),	12.7	13.0	12.3	12.2	13.7	12.7	10.5	8.9	8.2	7.7	8.6	8.2
Real effective exchange rate (Index: 1990=100)	96.2	100.1	97.8	95.8	97.0	96.0	97.4	95.5	96.2	93.5	89.5	90.4
Real interest rate (annualized, %)												
On deposits	4.0	5.7	3.2	8.4	3.1	7.6	5.9	6.0	4.3	4.6	4.5	7
On loans	9.5	10.2	8.6	14.7	8.1	12.2	10.7	10.8	8.6	8.4	8.2	11.6
Money (M1A) [b] (12-month variation, %)	6.9	17.2	14.7	22.2	13.9	15.7	19.9	22.5				

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] In the private sector.

impacting the market. It also heightened the volatility of 90-day rates and provided less room for international interest-rate arbitrage. In addition, the real discount rate was lowered by 0.6 points to 5.2% and then, in June, to 5%.

In September, monetary policy was tightened. First, the Central Bank hiked interbank rates; next, a larger adjustment was made in long-term rates. Then, in December, it raised its discount rates and the rate on overnight funds to 6% in real terms, thereby reversing the interest-rate trend that had begun to take shape in May.

Late in April 1996, the Central Bank again raised interest rates, boosting daily rates to real annual levels of 7%-7.5% in an effort to speed up the convergence of the growth rates for output and expenditure at levels more in line with the growth trend of production capacity.

At the close of the first half of 1996, monetary policy remained tight, with the interbank rate standing at 7.5% in real terms. At around 7.4%, short-term rates were closer to where the Central Bank wanted them to be; the same could not be said of long-term rates, however, which had undergone a series of downturns and were hovering around 6.5%.

b) **Exchange policy**

In the first half of 1995, the provision requiring exporters to change 50% of their earnings in the formal exchange market was eliminated and all such restrictions on these funds were lifted. Insurance companies and mutual funds were allowed to invest abroad and, in June, fixed- and variable-rate foreign investment options and margins for institutional investors were broadened, thereby facilitating the diversification of foreign portfolio investments.

In an effort to gain greater influence over the structure and volume of capital flows, the authorities reduced the percentage of foreign-currency deposits available for use by banking institutions in the formal exchange market and hiked the reserve requirement for financial investments, secondary ADRs and foreign deposits to 30%. In addition, they broadened the range of overseas financial investments which banks would be allowed to undertake. Late in August, chapters XVIII and XIX of the Compendium of Rules on International Exchange (covering investments made by Chileans and foreigners using external debt paper purchased abroad at a discount) were eliminated after the increase in the price of such paper on the international market had made these provisions irrelevant.

The trend of the exchange rate, and specifically the peso's appreciation against the dollar, continued to be a highly controversial subject. The nominal exchange rate climbed from 402 pesos to the dollar in mid-December 1994 to a peak of 419 early in March as a consequence of the financial crisis that swept over the region. It thereupon began to fall steadily until bottoming out at 368 pesos to the dollar in mid-June due to the steep depreciation of the dollar against the yen and the deutsche mark during the first half of the year. This trend was reflected in the weightings used for the currency basket, the country's hefty trade balance, the steady incoming stream of foreign investment and the gradual resumption of short-term capital inflows. Starting in July, the combined effect of the actions taken by the Central Bank at the national level, the dollar's revaluation on the international market and the upsurge in imports helped the dollar to rebound to 420 pesos as of the end of November.

In the first half of December, the Central Bank altered its method of adjusting the basket of currencies on which the currency band is based by deducting an additional 2% (in annual terms) for international inflation (0.2% at a monthly rate); this calculation is adjusted daily based on the level of domestic inflation minus international inflation. Prior to the adoption of this measure, the basket was adjusted on the basis of the country's domestic rate of inflation minus 2.4 percentage points; since 13 December, however, 4.4 points are deducted, which translates into a 2% revaluation, in real terms, of the currency band's central rate.

The previous practice of deducting 2.4% for international inflation was intended to maintain a real constant exchange rate. The use of the new figure acknowledges the existence of a structural trend towards revaluation and eliminates the lag in the currency band.

During the second quarter of 1996, the movement of the exchange rate was influenced by an upswing in the dollar on international markets, on the one hand, and by an increase in the supply of foreign exchange brought about by commercial and financial circumstances, on the other. One of the effects of the former trend was to drive up the benchmark dollar rate and, hence, the currency band; and this, in conjunction with, the larger supply of foreign exchange, widened the gap between the benchmark dollar rate and the going rate on the market. As a result, the market rate dropped down to the floor of the band and, on a few occasions, even lower, thus obliging the Central Bank to buy up dollars. A further adjustment of interest rates in April 1996 opened up greater opportunities for arbitrage, however, and these operations appear to have been on the rise during the last few months.

This was probably why the Central Bank moved to tighten up its control over speculative inflows in mid-May by strengthening the enforcement of reserve requirements; to this end it ruled that external credits entering the country under chapters XIV and VI of the Compendium of Rules on International Exchange could not be extended more than once. This measure closes off one means of evading existing reserve requirements, since previously many credits were extended repeatedly without any reserve deposit being made.

c) **Fiscal policy**

The public sector posted an overall surplus of 2.4% of GDP (1.7% in 1994) and current savings amounting to 5.1% of GDP (4.8% in 1994), making this the eighth year in a row that public finances yielded current and general surpluses. Total savings covered the cost of public investments, with enough left over for external debt payments and even prepayments. The gain in current income was due to the increase in tax receipts made possible by the faster pace of economic activity and to the windfall profits occasioned by the high price of copper on international markets.

The public sector made US$ 1.3 billion in prepayments on the Treasury's and the Central Bank's middle- and long-term external debt obligations with international agencies. This prepayment represented a structural adaptation to the changing status of the country's external accounts, and its aim was to mitigate the effects of the temporary terms-of-trade bonanza on the build-up of reserves. Over the next three years, such prepayments are expected to save the country US$ 280 million per year on its interest and amortization payments.

Early in August, Congress agreed to raise direct taxes on cigarettes and fuel by nearly 10% in order to help finance a 10% increase in pensions under 100,000 pesos per month (US$ 245) and a 5% increase in educational subsidies. It also passed a number of amendments to the tax code in order to close up loopholes that had permitted both companies and individuals to evade their tax obligations.

Despite the growth of current expenditure, fiscal policy held the expansion of public-sector spending in line with the economy's long-term trends, thereby strengthening public-sector saving and helping to reduce inflation. The reduction of public debt and international interest rates contributed to this accomplishment. The public sector continued to pare down its total external debt, with the level of such debt tumbling from US$ 16,380,000,000 in 1987 to US$ 11,792,000,000 in 1990 and to US$ 5,874,000,000 as of March 1996.

d) **Structural reforms**

The main reforms undertaken in 1995 focused on the financial sector and included legal changes that relaxed some of the regulations governing institutional investments in infrastructure projects. Such investments are expected to total US$ 2.4 billion for 1995-1997, and steps were therefore taken to modify the rules and regulations concerning the operation of pensions funds, the insurance industry and investment funds so that the diversification and attraction of financial resources could be tailored to fit these kinds of projects.

In the case of pension-fund management boards (AFPs), the limit on equity investment was raised from 30% to 37% and the ceiling on external investment outlets was hiked from 6%

to 9%; the allowable number of such instruments and of destination countries was increased as well, and AFPs were authorized to invest in foreign equities.

Negotiations concerning the possibility of Chile becoming a party to the North American Free Trade Agreement (NAFTA) were once again delayed by the debate taking place within the United States Congress, but the Government of Chile continued to make headway in talks with Canada regarding the possibility of concluding a free trade agreement with that country by the close of 1996. The signature of such a document would mean that Chile would have free trade agreements with two of the three parties to NAFTA (Canada and Mexico). Talks with the European Union also moved ahead, and in June 1996 a framework agreement on investment and trade integration was concluded.

The most notable advances to be made in the area of trade agreements, however, took place within the framework of Chile's negotiations with the Southern Common Market (MERCOSUR), which sparked a heated controversy within the country regarding what implications such an agreement might have for traditional farmers. In mid-June 1996, Chile signed a protocol regarding membership in MERCOSUR in a special category that would not make it subject to the common external tariff.

3. The main variables

a) Economic activity

Unlike the situation the year before, the expansion of production was primarily based on domestic demand (13%). The fastest-growing component of expenditure was imports (22%), while the gains registered for gross fixed capital formation (12%) and exports (9%) once again outstripped GDP growth. Private consumption (11%) remained closely in step with national income, showing an increase that was attributable both to higher wages and to a strong upturn in consumer credit. In contrast, public-sector consumption rose by the moderate figure of slightly more than 2%.

Transport and communications (12%), commerce (11%) and fisheries (10%) exhibited the highest growth rates, followed by financial services (8%), construction and mining (7%) and manufacturing (6.5%).

In the first quarter of 1996, economic activity maintained its exceptional buoyancy thanks to domestic demand; the expansion of this segment of demand (13%), which outdistanced the growth of GDP (9%) by an ample margin, was led by the rise in investment (15%) and, secondarily, in consumption (12%). The value of exports climbed by a mere 6% due to a downswing in the prices of major export products (copper and wood pulp).

The deterioration in the terms of trade and the monetary restrictions that entered into effect at the close of December 1995 and in April 1966 were expected to have a stronger effect on the economy during the second half of the year.

b) Prices, wages and employment

The fact that expenditure grew faster than GDP drove up imports sharply and put pressure on the prices of non-tradable goods and services. From the start of the second quarter on, tradable goods exhibited an increase of between 5% and 6% over the corresponding period of 1994, but the prices of non-tradables shot up by between 9% and 10%. This trend remained in place for the rest of 1995 and the first quarter of 1996.

Taxes on fuel and cigarettes added three tenths of a point to the increase in the consumer price index, but even so it rose by only 8.2% for the year. The trend value for inflation was somewhat lower, however, and the authorities therefore set the next inflation target at no more than 6.5%.

This trend indicator began to deteriorate in January 1996, however, and by May had reached 8.6%. Nevertheless, from that point on, inflation was expected to abate as a result of the low and stable rate for the dollar on the domestic market, a partial reversal of the rise in oil prices, and the impact that the deterioration in the terms of trade and the country's successive monetary adjustments were expected to have on spending levels.

Nominal wages closed out the year with a mean 12-month rise of 12.7%, which was less than the sum of expected inflation and productivity; thus, the 4.1% average gain in real wages was achieved without generating inflationary pressures. In the first quarter of 1996, however, the rate of increase in nominal wages accelerated to an annual level of 15%, which was well in excess of expected inflation plus productivity.

Despite the rapid pace of growth, net job creation was sluggish, and slightly less than three fourths of new jobs were in the generally low-productivity area of community, social and personal services. Employment levels were down in agriculture and unchanged in manufacturing.

The latest measurement of the unemployment rate indicated that it had surged from 4.7% in the final quarter of 1995 to 6.6% in the first quarter of 1996; the two samples underlying these figures were not, however, comparable.

c) **The external sector**

The balance of payments registered a substantial improvement in the trade account and a slackening of net capital flows; in fact, these inflows were negative during the first quarter, but then embarked upon a rapid recovery starting in the second quarter. As of the end of December 1995, net international reserves amounted to US$ 14.8 billion, which was equivalent to 11 months worth of imports and practically two thirds of the country's total external debt.

The improvement in Chile's trade balance was accounted for chiefly by the strong upswing in the terms of trade which had begun in the second half of 1994 and, to a lesser extent, by the expansion of export volumes. Merchandise exports were up 38% with a 12% gain in volume and a 24% rise in prices. Imports climbed by 35% based on increases of 25% in volume and 8% in prices.

The value of copper exports jumped by 53%, with prices standing 35% above the preceding year's level. Exports of traditional products other than copper (bleached pulp, fishmeal, fresh fruit and sawn lumber) swelled by 39% (with prices rising 25% and volume up by 11%) while non-traditional exports showed an advance of 22% (with an increase of 10% in volume and of 11% in prices). Within this last category, exceptionally strong advances were seen in exports of processed marine products (an expansion of 24% for tinned fish and salmon) and processed agricultural goods (a 29% increase in dehydrated products, frozen tomatoes and fruit, bottled wine and malt barley).

The upturn in imports was accounted for by increases of 44% in consumer goods, 37% in intermediate products other than fuel, and 29% in capital goods.

The balance-of-payments financial account yielded a surplus of US$ 1.2 billion, as compared to US$ 4.6 billion the year before. This change was due to the steep drop in net medium- and long-term capital inflows caused by the country's prepayments on its external debt, a reduction in the use of lines of short-term credit, a negative balance for short-term trade flows and a sizeable decrease in portfolio investment, which was actually negative in the second and third quarters. Portfolio investment was hurt by the region's instability, the impact of this situation on international markets, and the decision of foreign investment fund managers to repatriate capital and profits.

Foreign direct investment slipped by slightly over 1% but, at almost double its 1993 rate, was still high. The decrease recorded in 1995 was due to a considerable increase in the capital remittances entering the country in connection with external debt swaps, since this increase was only partially offset by the 2% gain in direct investments made under Decree-Law No. 600 on foreign investment. Chilean overseas investments were down sharply (-26%) but were nonetheless very substantial and still significantly above their 1993 level.

COLOMBIA

1. General trends

Although the Colombian economy recorded an upturn on the order of 5% in 1995 while inflation fell below 20%, the country also became mired in a serious and protracted political crisis which created a climate of instability and uncertainty.

Despite a more restrictive form of monetary control, total private consumption continued to rise significantly (7%). External demand, gross investment and public spending also expanded considerably.

The balance-of-payments deficit on current account continued to widen, amounting to 4.5% of gross domestic product (GDP), and was financed by a strong inflow of foreign capital. Nevertheless, the peso lost value in real terms throughout 1995, thus reversing the trend of previous years. This boosted exports of goods, which outpaced merchandise imports. None-theless, the trade deficit in services was higher than in the preceding year.

The fiscal situation deteriorated somewhat, with the non- financial public sector recording a small deficit of 0.3% of GDP, in contrast to a 2.6% surplus in 1994. Expenditure rose again in real terms and, hence, so did the non-financial public sector's contribution to GDP, thereby reflecting the Government's intention to expand social programmes under the National Development Plan for 1994-1998. A tax reform package designed to increase government revenues was passed by the Congress in late 1995.

Monetary policy maintained its restrictive profile as policy-makers strove to curb consumption and pursue the fight against inflation. The differences that arose between the monetary authorities and the central government were settled by the temporary imposition of controls on interest rates.

The monetary crunch coincided with the end of the construction boom, which affected a number of related industries. The slowdown in consumption, which had enjoyed a strong expansion in preceding years (especially in the case of vehicles and consumer durables) put a damper on activity in manufacturing, transport and commerce. High interest rates only served to exacerbate the financial situation created by the high level of debt run up by economic agents in the previous period.

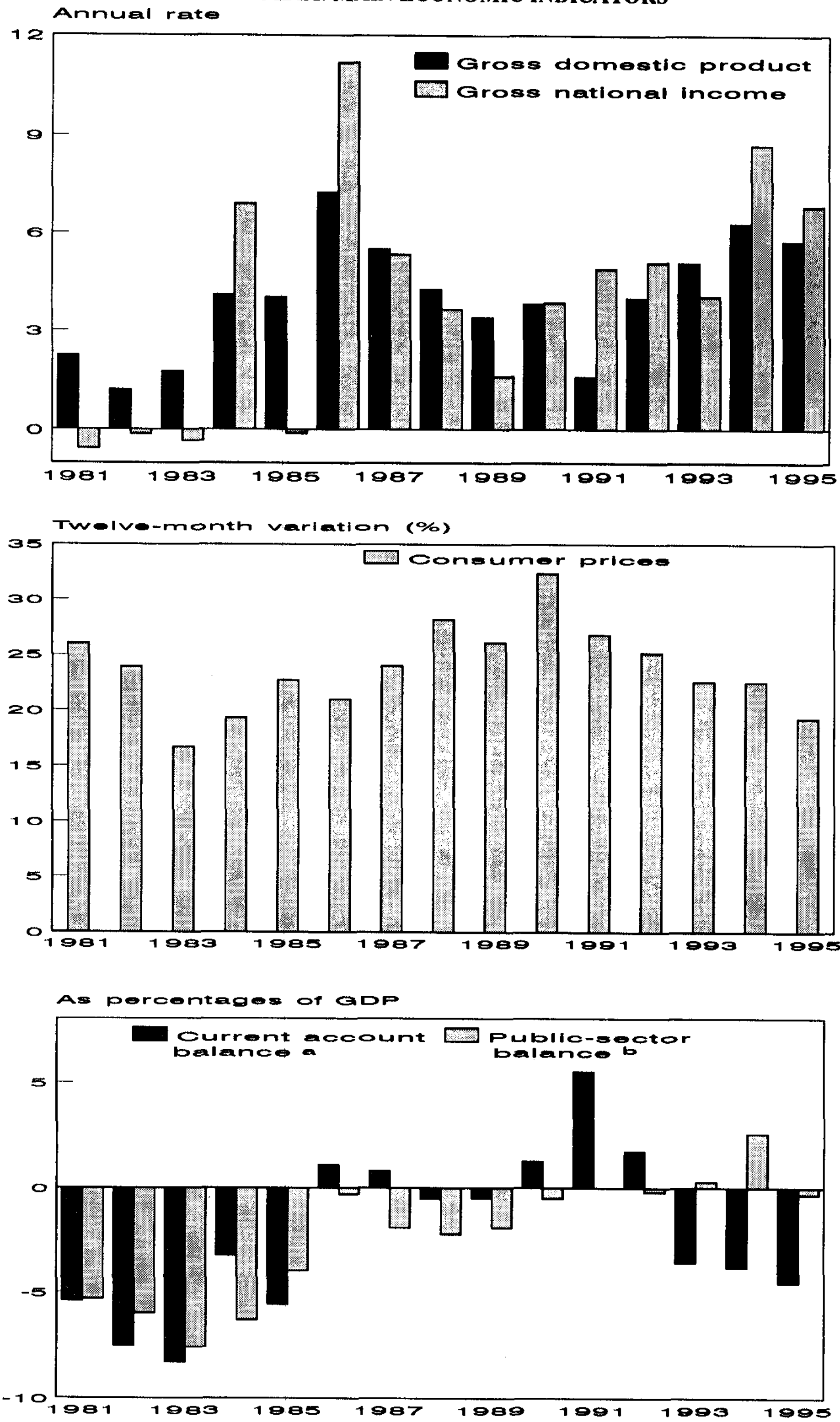
Structural reforms undertaken by the previous Administration were not pursued in 1995. The Government announced a privatization programme for 1996 which included plans to sell off a number of mines and banks which are expected to bring in over US$ 800 million.

2. Economic policy

Economic policy in 1995 was geared to resolving some of the problems that had mounted up during the preceding three-year period. The dynamism of previous years had been based on a rapid increase in public spending and private consumption, with the latter being financed through private borrowing on the domestic and foreign markets. The gap between domestic savings and total investment was widening at the same time as the peso was gaining in value and the deficit on the balance-of-payments current account was expanding. This growth pattern was not sustainable in the medium term, and a change in macroeconomic management was therefore necessary in order to achieve more balanced growth.

The first policy change to be made for this purpose was introduced in the second half of

Figure 1
COLOMBIA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments. b Non-financial public sector.

1994, when the Bank of the Republic started to implement a restrictive monetary policy even while fiscal policy continued to be growth-oriented. As inflation had remained unchanged in 1994 and the peso continued its upward trend, during the first part of 1995, the monetary authorities maintained their tight control over the money supply. With the high interest rates prevailing in the second quarter of the year, demand started to cool off and domestic activity began to slacken. This exacerbated the conflict between the objective of maintaining vigorous growth in output and the effort to check inflation. The conflict was partially resolved in June, when the Bank of the Republic agreed to control interest rates temporarily, while the Government decided to cut public spending to ease the pressure on the money market.

In the second half-year, interest rates declined slightly. However, by the end of 1995 they were on the rise again. In response to the growing political uncertainty in the country, the exchange rate shot up to the ceiling of the exchange rate band and at some points even went above it. The Bank of the Republic then stepped in to stabilize and support the Colombian peso.

a) **Fiscal policy**

In 1995, the non-financial public sector incurred a deficit of nearly 1% of GDP, whereas the previous year it had recorded a surplus. The deficit run up by the central government was even larger, but was partly offset by the financial surpluses recorded by the rest of the non-financial public sector. However, this deterioration was not attributable to a greater increase in current expenditure than in current income but rather to the fact that there were no revenues from privatizations in 1995. Without these entries in the 1994 accounts, there would have been no surplus for that year either. Consequently, the fiscal downturn registered in 1995 was not as significant as it appears to be at first glance.

The non-financial public sector's total income fell approximately 3% in real terms, while expenditure increased by 9%. For the first time in years, the central government's current expenditure was not lower than its current income, that is, central government savings were zero. The growth rate for tax receipts had been 10% the previous year but was only 0.7% in 1995, while total central government disbursements swelled by almost 11%, which explains the size of the central government deficit. However, the breakdown in expenditure was different. Increases in operating expenditure and transfers were smaller than in 1994 whereas capital investment, which had been at a standstill, expanded 12%.

Under Colombia's new constitutional provisions, transfers to decentralized bodies increased further; as a result, regional and local government finances, which had shown a deficit of 0.6% of GDP in 1994, balanced out in 1995.

In the rest of the non-financial public sector, surpluses recorded by the country's electricity companies, the Empresa Colombiana de Petróleos (ECOPETROL) and the social security system helped to offset part of the central government's deficit in 1995. On the other hand, the Empresa Nacional de Telecomunicaciones (TELECOM), the Metro de Medellín and the National Coffee Fund were all in the red.

To alleviate the pressure on the money market, in June the central government, acting in consultation with the Bank of the Republic, cut back its current disbursements by 530 billion pesos (a sum equivalent to slightly less than 1% of GDP). In December, the Congress passed a tax reform package that extended the value-added tax (VAT) and raised the rate from 14% to 16%, cancelled certain taxes on foreign investment and strengthened mechanisms for reducing tax evasion. The central government expects this reform to generate additional income in 1996 equivalent to 1% of GDP.

b) **Monetary policy**

In order to curb domestic demand, promote saving and check the upward movement of the exchange rate, the Bank of the Republic maintained its restrictive monetary policy in 1995, setting itself the goal of holding inflation to 18%. The actual rate turned out to be somewhat higher than this target figure, however.

In the course of the year, there was a contraction in the demand for money (M1), especially on current account; in turn, both the monetary base and M1 expanded less than expected. M1

Table 1
COLOMBIA: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	4.2	3.4	3.8	1.6	4.0	5.1	6.3	5.7
Per capita gross domestic product	2.4	1.6	2.0	-0.2	2.2	3.3	4.6	4.1
Gross national income	3.7	1.6	3.8	4.9	5.1	4.0	8.7	6.8
Gross domestic product, by sector								
Goods	4.0	4.4	3.0	1.6	1.2	1.3	4.4	5.4
Basic services	3.8	3.7	3.7	3.4	2.9	5.0	7.5	5.3
Other services	5.9	2.4	3.8	2.0	4.8	6.6	6.6	5.7
	Percentages							
Contribution to growth of GDP [c]								
Consumption	3.6	3.1	2.0	1.3	1.6	5.6	3.8	5.4
Government	0.9	0.6	0.3	0.3	1.1	0.8	1.5	0.7
Private	2.6	2.6	1.7	1.0	0.5	4.8	2.3	4.7
Gross domestic investment	1.7	-1.6	-0.2	-1.6	7.2	7.0	7.3	3.3
Exports	0.6	1.4	3.6	2.1	1.5	0.6	0.8	2.4
Imports	-1.6	0.4	-1.6	-0.2	-6.2	-8.2	-5.6	-5.3
	Percentages of GDP [b]							
Gross domestic investment	21.7	19.5	18.5	16.7	22.9	28.5	33.7	35.0
National saving	21.1	18.9	19.9	23.0	25.4	22.7	26.0	26.1
External saving	0.6	0.5	-1.3	-6.3	-2.5	5.8	7.7	8.9
	Percentages							
Employment and wages								
Activity rate[d]	57.9	57.6	58.4	59.5	60.8	60.1	60.0	59.8
Open unemployment rate [e]	11.3	9.9	10.5	10.2	10.2	8.6	8.9	8.9
Real minimum wage (Index: 1990=100)	101.9	102.7	100.0	96.7	95.0	97.6	96.0	95.6
	Growth rates							
Prices (December-December)								
Retail prices	28.1	26.1	32.4	26.8	25.1	22.6	22.5	19.3
Wholesale prices	29.5	25.6	29.9	23.1	17.9	13.2	20.7	15.4
External sector								
Terms of trade (Index: 1990=100) [b]	103.6	102.6	100.0	104.4	107.4	106.8	120.7	127.9
Nominal exchange rate (pesos per dollar)	299	383	503	604	681	787	827	915
Real effective exchange rate (Index: 1990=100)	86.5	88.8	100.0	101.0	90.0	85.6	74.8	74.9
	Millions of dollars							
Balance of payments								
Current account	-216	-201	542	2 349	912	-2 130	-3 033	-4 055
Trade balance (goods and services)	565	1 200	1 821	2 741	1 174	-1 561	-2 103	-2 592
Exports	6 751	7 322	8 679	9 101	9 241	9 174	10 761	13 773
Imports	6 186	6 122	6 858	6 360	8 067	10 735	12 864	16 365
Capital and financial account	940	407	26	-785	283	2 609	3 023	4 579
Overall balance	194	363	638	1 834	1 209	2	164	350
International reserves (variation)	193	434	610	1 836	1 092	17	152	...
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	43.4	43.4	42.4	40.7	32.4	30.7	26.7	26.1
Net interest (as a percentage of exports)[f]	17.3	18.1	15.3	12.4	9.8	8.0	7.5	6.1

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Non-financial public sector								
Current income	21.6	21.6	23.6	25.1	25.7	27.2	29.3	28.9
Current expenditure	16.6	16.7	16.8	18.2	18.7	18.8	20.7	22.4
Savings	5.0	4.9	6.8	6.9	7.0	8.4	8.6	6.5
Capital expenditure (net)	0.5	0.1	0.4	-	-0.2	-1.7	-3.6	-1.4
Financial balance	-2.2	-1.9	-0.5	-	-0.2	0.3	2.6	-0.3
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	...	...	...	94.1	29.9	-2.1	-7.2	16.2
Net domestic credit	...	...	...	-0.4	39.1	84.2	25.8	30.1
To public sector	...	...	...	40.9	-12.9	27.2	-15.0	-24.0
To private sector	...	...	...	17.1	37.6	57.8	36.0	35.7
Money (M1) [g]	...	...	...	28.1	39.1	32.8	22.3	20.2
Local-currency savings and time deposits	...	...	...	30.7	27.4	45.8	50.0	29.8
M2	...	...	...	29.9	30.9	41.7	41.8	27.4
	Annual rates							
Real interest rates (annualized)								
On deposits	-0.1	6.3	3.2	8.2	1.4	2.7	6.6	10.4
On loans	-	13.7	9.9	16.6	9.0	11.2	15.1	19.2
Equivalent interest rate in foreign currency [h]	...	3.7	4.0	9.8	-1.4	14.8	26.0	11.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1980 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients are obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [g] In the private sector. [h] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
COLOMBIA: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (nationwide) (12-month variation, %)	24.1	21.4	21.4	22.6	23.4	23.0	22.3	22.5	21.2	21.5	20.6	19.3
Real effective exchange rate (Index: 1990=100)	86.6	86.2	85.5	83.6	78.0	74.6	73.2	73.4	72.6	72.2	75.1	79.6
Real interest rate (annualized, %)												
On deposits	-9.5	3.0	7.9	9.4	-12.3	5.4	15.7	17.5	-2.6	9.0	18.1	17.2
On loans	-2.8	11.4	17.4	18.7	-4.8	14.7	25.5	24.8	4.9	17.2	28.1	26.6

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

increased by just over 20% and the monetary base by slightly over 11% (versus 25% and 28% in 1994). On the other hand, for much of 1995, the growth rate for the broadly-defined money supply (M3)[1] was higher than projected. Its overall increase for the year –26%– was within the projected range, however. With respect to quasi-money, the items showing the largest increase were savings deposits at commercial banks (46%) and deposits in savings and loan associations (38%). This indicates a change in the structure of monetary aggregates, which hampered the Bank of the Republic's efforts to control inflation.

The restrictive monetary policy caused the upward path of interest rates to steepen. Thus, by mid-1995, the rate for deposits varied between 32% and 35% and the lending rate was between 43% and 47%. In June, the Bank of the Republic imposed a temporary restraint on interest rates; this brought them down five percentage points, and they then remained at that level for the rest of the year. The monetary authorities also took steps to reduce the spread and average level of reserve requirements for the different types of deposits.

The rate of expansion of total credit in the financial system (37%) continued to show signs of cooling off (it had stood at 44% the preceding year).

c) **Foreign exchange policy**

In 1995, there were two distinct phases in the movement of the exchange rate. Until the beginning of August, it was at the mid-point of the band. For the remainder of the year, it stayed near the top of the band and even went through the ceiling at times, thus reflecting the political uncertainty that overwhelmed Colombia and forcing the Bank of the Republic to intervene in support of the peso. One of the measures taken consisted in modifying the regulations governing its own foreign currency position,[2] the minimum amount was reduced from 40% to 0% and a maximum limit of 30% was imposed (previously, there had been no ceiling). The net result of this moment of the exchange rate was a real 6% depreciation of the currency in December 1995, as compared with its level 12 months earlier, but the average annual rate was the same as for the previous year.

In the first months of 1996, political disturbances again forced the exchange rate up to the ceiling of the currency band. To ease the pressure on the foreign exchange market, the Bank of the Republic made use of its international reserves, drawing them down by around US$ 300 million.

In the first quarter of 1996, the Bank of the Republic also relaxed some of the restrictions on foreign borrowing. It reduced from five to three years the minimum period during which foreign lenders must maintain special deposits with the Bank of the Republic as a prerequisite for loan disbursement (after which time they may qualify for an exemption); it also reduced the mandatory reserve requirement for loans to less than three years.

3. The main variables

a) **Economic activity**

In 1995 the Colombian economy completed three years with an average annual growth rate of over 5% (per capita GDP went up 4% while national income rose almost 7%).

Unlike the situation in previous years, the sectors that produce non-tradables suffered a decline as their growth rate slowed from just over 8% in 1994 to slightly more than 5% in 1995; on the other hand, growth in the tradables sectors strengthened, exceeding 5%. Final consumption continued to be the driving force behind domestic demand, with a growth rate of slightly over 7% (two percentage points above the level of the previous year), but investment also maintained its pace and exports gained momentum. Aggregate supply again showed a larger increase than output, since imports again climbed significantly, albeit at a somewhat slower pace than in 1994.

Total investment, which grew 10%, was the most dynamic component of aggregate demand

[1] Currency outside banks plus all deposits in the financial system subject to reserve requirements.
[2] This system constitutes a type of foreign currency reserve requirement.

in 1995. Unlike the previous year, public investment exhibited a much faster increase than private investment did.

The most vigorous sectors in 1995 were mining and services. The agricultural sector also recorded strong growth, while manufacturing and private construction experienced a slowdown.

The sector that displayed the most dynamism in 1995 was mining, which, in a departure from the downward trend observed since 1991, posted an increase of 17%. Within the sector, there were very dissimilar patterns, however. Oil, gas, coal and nickel production grew strongly while the output of iron ore, gold, silver and platinum was considerably lower. Oil production soared by 30% with the intensive development of the Cusiana deposits, which yielded over 170,000 barrels per day in December 1995, more than quadruple the figure recorded 12 months earlier. Total oil production in Colombia thus totalled 580,000 barrels per day in 1995.

Services, as a whole, grew more than GDP, despite what was actually a slowdown in the sector. Communications, government services and personal services –which expanded by 12%, 8% and 7%, respectively– were the engine of this overall increase. The sharpest decrease was in the financial sector, which recorded a decline in its growth rate from 9% to just over 4% in 1995.

Agricultural production was up 5%, thus turning in a more dynamic performance than in previous years, thanks to good weather conditions and a favourable international market situation. Coffee production rebounded by almost 10% after a downturn that had lasted three years. Permanent crops and the livestock subsector also showed satisfactory growth (6% and 7%, respectively), in contrast with the sluggishness of annual crops.

Coffee processing was down by 17%, for the third consecutive year of double-digit declines. The slowdown in the rest of the manufacturing sector meant that its overall growth for 1995 did not even reach the 2% mark. The best results were posted by professional and scientific equipment, beverages, paper and paper products, and food items. Leather and leather goods, rubber products, milled wood, footwear, and electrical equipment and appliances declined substantially. Other areas of manufacturing turned in a lacklustre performance. This growth pattern was the result of a series of factors. The liberalization of the economy and contraband trade hurt textiles, leather and leather goods, and paper and paper products. The end of the boom in the construction and automotive industries had an adverse effect on the industries that provide them with inputs. The downswing in domestic demand affected all sectors, although in varying degrees.

The growth rate in construction (around 4%) was less than one-fifth of the previous year's rate. The decline in private construction (-3%), following a phase of vigorous expansion, was offset by the increase in civil engineering projects (14%).

b) **Prices, wages and employment**

Price movements were the most favourable to be seen since the beginning of the 1990s. Consumer prices went up almost 20%, three percentage points below the level recorded a year earlier.

This trend was attributable to the authorities' tight control of monetary variables, which slowed down final consumption, and to the Social Pact on Productivity, Prices and Wages signed in December 1994, which set limits on increases in public utility rates and wages. With the exception of health and other expenses, all items reflected smaller increases in 1995 than in 1994. The category of the consumer price index (CPI) that showed the most moderate rise was food (16%, compared with 23% in 1994). In the first five months of 1996, the cumulative variation was close to 13%, which was only slightly higher than the figure for the corresponding period in 1995.

The movement in the producer price index (PPI) was 15%, compared with almost 21% in 1994. The only exceptions to this general trend were the prices for imports and exports other than coffee, which went up 20% and 24%, respectively.

The employment situation which had not shown any major changes in the first half of 1995, worsened in the second as a result of the slowdown in economic activity, especially in labour-intensive sectors such as construction and commerce, thereby reversing the positive trend observed since the beginning of the decade.

Unemployment in the country's seven metropolitan areas rose to 9.5% in December 1995 (compared with 7.9% in December 1994), even though the labour participation rate was somewhat higher (61.2% in the final quarter of 1995) than it had been one year earlier. In March 1996, unemployment in the seven metropolitan areas exceeded 10%.

Due to the worsening labour situation, together with the effects of the Social Pact, wages remained flat in real terms in 1995.

c) **The external sector**

In 1995, expenditure again outpaced income in Colombia. The current account deficit widened to more than US$ 4 billion, rising from 4.4% to 5.2% of GDP. This gap was covered by the surplus of almost US$ 4.6 billion, or 5.6% of output, obtained on the financial account. At the end of 1995, the Bank of the Republic's net reserves stood at US$ 8.3 billion, reflecting an increase of US$ 300 million.

The merchandise trade deficit deepened by 10% to US$ 2.5 billion. Stimulated by the real depreciation of the peso and buoyant international prices (except for coffee), exports of goods totalled US$ 10.4 billion, thus attaining, for the first time since 1992, a higher growth rate (19%) than merchandise imports, which went up 17% to around US$ 12.9 billion.

This favourable export trend was based on the momentum generated by sales of oil and petroleum products, ferronickel and non-traditional exports. The value of sales of oil and petroleum products improved by almost 70% as a result of the upturn in international prices and the increased volume of exports, which allowed the oil industry to reclaim its position as the leading export sector in Colombia. Non-traditional exports also made significant gains, climbing by over 16% to US$ 4.7 billion. This was particularly the case for manufactures, especially chemicals, food, and paper and paper products. After recording strong growth in 1994, coffee exports suffered a setback, due to the marked downturn in international prices and a glut on the world market.

Merchandise imports grew at a slower pace than in 1994. Intermediate goods showed the most dynamic growth, expanding by approximately 30%. Purchases of capital goods from abroad increased by a mere 6%.

Whereas the merchandise trade deficit increased by 10%, the current account deficit widened by 34%. The main causes of this sharper deterioration were the dramatic rise (114%) in interest paid out by the private sector, as a consequence of the upward trend in foreign borrowing, and a 30% increase in remittances of profits and dividends.

Despite the Mexican crisis, capital inflows expanded by 50% to a record level of almost US$ 4.6 billion. For the second consecutive year, long-term capital inflows were greater than short-term inflows. Foreign direct investment amounted to US$ 2.6 billion, while portfolio investments fell US$ 420 million. It is estimated that two-fifths of foreign direct investment went to the petroleum sector. In 1995, portfolio investment and long-term external debt increased by just US$ 67 million and US$ 72 million, respectively.

Net short-term capital inflows amounted to US$ 1.8 billion, compared with a net outflow of almost US$ 500 million the previous year. Net short-term borrowing totalled US$ 1.2 billion and the net variation in external assets was close to US$ 600 million. This latter figure corresponded to public-sector income from privatizations concluded in previous years.

The total external debt amounted to US$ 23.4 billion; this was a 10% increase, which was a lower rate than in 1994. One third of the total was incurred by the private sector while 80% was long-term debt. The total debt in 1995 was equivalent to 26% of GDP and net interest equalled 6% of exports; both these percentages reflect a downward trend and suggest that short-term foreign debt does not pose a problem for the Colombian economy.

COSTA RICA

1. General trends

In 1995 the growth rate of the Costa Rican economy dropped to just slightly more than half the preceding year's rate of 4.4%. The public-sector deficit, including losses sustained by the Central Bank of Costa Rica, shrank to below 4% and the balance-of-payments current account deficit was slashed by 70%. In addition, foreign exchange reserves rallied so strongly that they exceeded the level agreed upon with the International Monetary Fund (IMF). Even so, inflation rose once again, climbing to nearly 23%.

A combination of factors undermined economic growth and led to a marked drop in investment for the second year running. The fiscal deficit having widened the year before, the authorities introduced strict policies designed to balance public finances in accordance with the agreement signed with the IMF in October 1994. A package of fiscal measures was not approved by the Legislative Assembly until the following September and, in the interim, a tight monetary policy had to be applied which led to a contraction in the supply of credit. Moreover, the volatility of international financial markets in the wake of the devaluation of the Mexican peso helped create a climate of uncertainty which caused a number of external loans to be put on hold and made investors wary.

Real activity was affected in different ways depending on the sector. Construction was hit the hardest, whereas agriculture and manufacturing grew faster than gross domestic product (GDP), as did a number of service sectors.

The dramatic narrowing of the deficit on the balance-of-payments current account was the result of a surge in exports of goods and services. Meanwhile, gross investment contracted while the domestic savings rate rose, so the need for external savings was cut by almost half. The balance-of-payments current account deficit was financed out of inflows of private long-term capital.

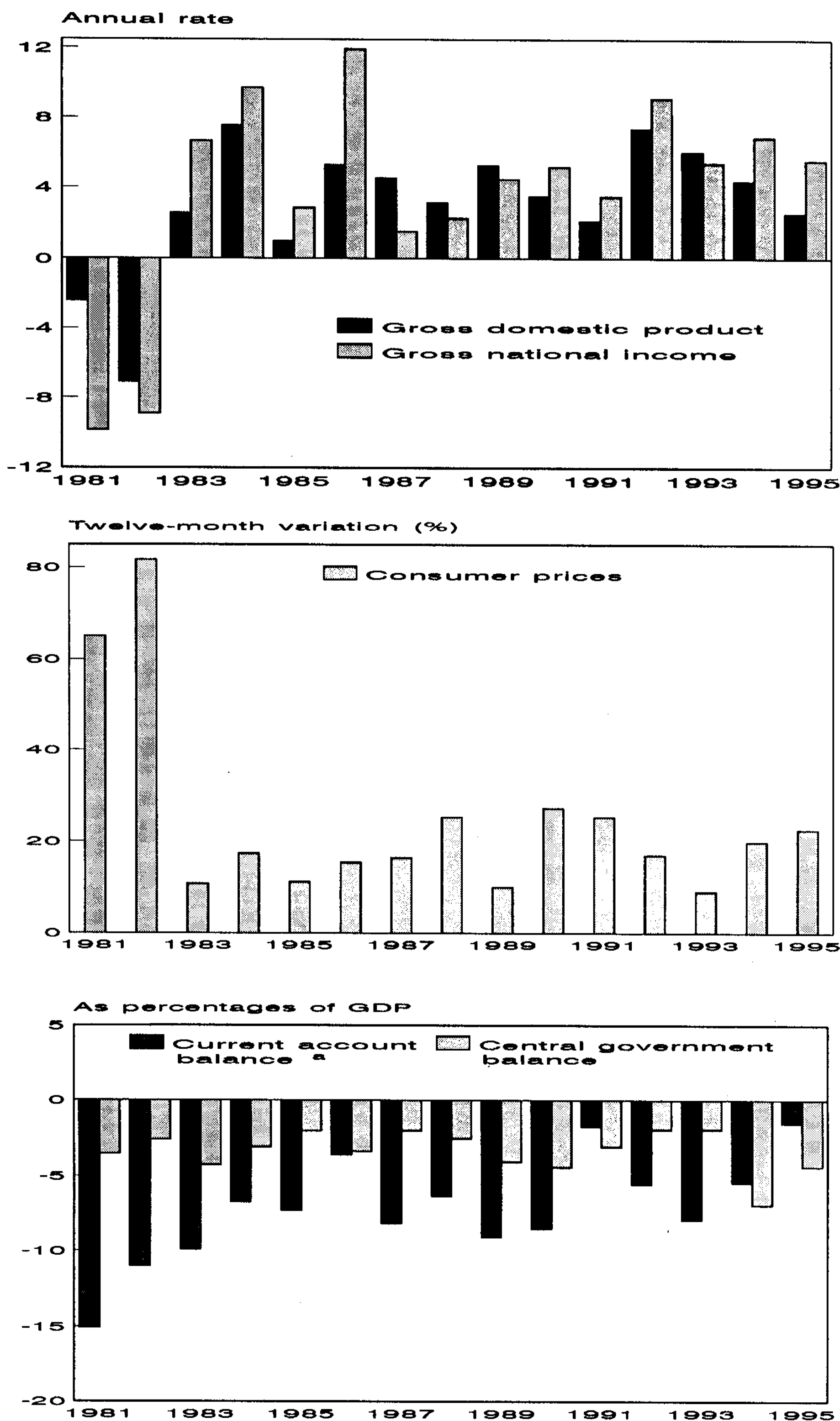
2. Economic policy

Economic policy during 1995 was shaped largely by efforts to reduce the public-sector deficit. The authorities had intended to bring about a sustained increase in tax revenues by reforming the tax system, but the delays involved in passing the relevant bills meant that contingency measures had to be adopted in order to restrict spending and generate more revenue, most notably through the use of import duties. The approval of a tax package in August made it possible to dispense with some of these provisions and contributed to the attainment of the public-sector deficit target. Nevertheless, because of the slow pace of progress towards a solution of the fiscal problem, the Government once again had to resort to expensive domestic borrowing, thereby pushing up interest payments as a proportion of public expenditure once again.

Monetary policy was geared towards curbing liquidity. High reserve requirements and substantial open-market operations kept the rate of expansion of monetary aggregates below the rate of inflation. At the same time, regulations for liberalizing the financial sector were drawn up which were expected to lead to major changes in the sector's operation from 1996 onwards.

Foreign exchange policy continued to call for small, frequent devaluations of the currency. In nominal terms, the colón was devalued against

Figure 1
COSTA RICA: MAIN ECONOMIC INDICATORS



the dollar at a faster pace than the year before in order to maintain the real exchange rate.

The authorities' price liberalization policy remained in effect, while wage policy was modified with a view to making pay levels more flexible.

Notwithstanding the short-term tariff increases that were introduced to channel more revenue into fiscal coffers, trade policy continued to focus on opening up the economy and diversifying exports.

a) **Fiscal policy**

Fiscal policy sought to narrow the deficit and, in the longer term, bring about a sustained increase in tax revenues, decrease the rigidity of expenditure and boost public-sector saving in order to cut down on the use of costly forms of domestic and external financing. At the same time, the authorities set themselves the task of improving the allocation of social spending.

The draft tax legislation that was submitted to the Legislative Assembly was designed to increase public-sector revenues, but the slowness with which these bills moved through the Assembly obliged the Government to adopt a variety of emergency measures, including under-spending on the public-sector budget; the application of a tax on coffee exports which allowed the Treasury to share in the industry's windfall profits from high international coffee prices; a temporary rise of eight percentage points in import duties between March and September; and the introduction of an excise tax on certain goods.

Upon passage of the tax reforms, most of these measures were discontinued. The modifications to the fiscal regime took the form of the Fair Taxation Act, the Tax Adjustment Act and the Customs Act. Tax evasion was made a criminal offence; the sales tax was raised temporarily from 10% to 15% but was eventually to be lowered to 13%; and a 1% tax on gross assets was introduced for companies with capital exceeding the equivalent of US$ 160,000. Stricter conditions were also stipulated for the teachers' pension scheme (a higher minimum qualifying age, a longer period of contribution and ceilings on pension levels).

Tax revenues went up by 10% in real terms and total public spending dropped by 5%, owing in part to a substantial reduction in capital expenditure. A slight decrease in overall current spending was the net result of the differing trends exhibited by its various components. Interest payments as a proportion of total central government outlays were up from 17% to 26%, which limited the manoeuvering room available to fiscal policy-makers. The authorities planned a significant cut in the public-sector deficit so that they would be able to limit bond issues and gradually ease the burden of financial liabilities. Priority was also given to changing the way in which Treasury bonds were sold through the introduction of open bidding arrangements and variable interest rates.

Pension payments continued to rise as a result of the large backlog of pending applications and the inevitable delay in implementing the new provisions. The wage bill for the consolidated public sector remained constant in real terms despite plans to trim back administrative staff and to step up the implementation of the labour mobility scheme. Civil service wages were subject to a variety of automatic adjustment mechanisms.

The overall public-sector deficit (including Central Bank losses) shrank to less than half its former level, which left it at around 3.5% of GDP. The central government deficit lessened somewhat, but was still over 4% of GDP, whereas decentralized public-sector companies posted a handsome surplus. Central Bank losses equalled 1.5% of GDP. During 1995, both the central government and the non-financial public sector as a whole managed a net amortization of external credits; as a result, net domestic financing was substantial, although it fell short of the preceding year's figure.

b) **Monetary policy**

Despite the build-up of international reserves, the growth rate of claims on the financial system slowed considerably. Both total domestic credit in the system and Central Bank credit, shrank in nominal terms. Although net credit to the public sector expanded by nearly 20% –owing particularly to the demand for funding for the

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	3.1	5.2	3.5	2.1	7.3	6.0	4.4	2.5
Per capita gross domestic product	0.3	2.4	0.8	-0.4	4.7	3.5	1.9	0.2
Gross national income	2.3	4.5	5.2	3.5	9.1	5.4	6.9	5.6
Gross domestic product, by sector								
Goods	3.0	5.8	2.1	3.0	7.1	5.5	3.6	1.9
Basic services	6.0	7.7	6.6	3.5	11.0	8.8	7.6	5.2
Other services	2.9	4.5	4.0	1.3	7.0	6.0	4.4	2.5
	Percentages							
Contribution to growth of GDP [c]								
Consumption	2.3	5.2	3.9	-0.2	5.7	5.6	5.6	1.2
Government	0.6	0.7	0.4	-0.2	0.5	1.0	0.5	0.1
Private	1.7	4.5	3.5	0.0	5.1	4.6	5.1	3.8
Gross domestic investment	-1.8	2.4	1.1	-3.3	8.2	3.5	-1.2	-2.7
Exports	3.0	3.6	2.5	4.0	4.6	4.3	1.9	4.8
Imports	-0.3	-5.9	-4.0	1.6	-11.1	-7.3	-1.9	-3.4
	Percentages of GDP [b]							
Gross domestic investment	23.5	24.6	24.9	21.1	27.3	29.1	26.7	23.4
National saving	17.4	15.7	16.3	19.4	21.3	20.0	20.4	21.7
External saving	6.2	8.9	8.7	1.7	6.0	9.1	6.3	1.7
	Percentages							
Employment and wages								
Activity rate [d]	94.5	96.2	95.4	94.5	96.0	95.9	95.8	94.8
Open unemployment rate [e]	5.5	3.8	4.6	5.5	4.1	4.1	4.2	5.2
Real minimum wage (lowest level) (Index: 1990 = 100)	95.1	99.1	100.0	92.8	92.5	92.7	93.6	91.0
	Growth rates							
Prices (December-December)								
Domestic retail prices	25.3	10.0	27.3	25.3	17.0	9.0	19.9	22.6
Wholesale prices [f]	19.7	10.7	27.9	22.3	12.7	6.6	...	...
Industrial producer prices	...	...	...	...	10.4	6.2	19.9	21.9
External sector								
Terms of trade (Index: 1990 = 100) [b]	104.8	103.1	100.0	100.9	104.2	104.0	107.1	113.2
Nominal exchange rate (colones per dollar)	75.8	81.5	91.6	122.4	134.5	142.3	157.3	179.3
Real effective exchange rate (Index: 1990 = 100)	104.0	98.0	100.1	108.3	103.0	100.4	101.0	98.6
	Millions of dollars							
Balance of payments								
Current account	-304	-480	-494	-99	-380	-619	-463	-137
Trade balance (goods and services)	-91	-237	-383	-43	-341	-537	-399	-55
Exports	1 611	1 831	1 963	2 190	2 580	2 906	3 281	4 147
Imports	1 702	2 068	2 346	2 232	2 922	3 443	3 680	4 202
Capital and financial account	-272	-183	-84	155	199	138	-122	197
Overall balance	-351	-454	-535	156	21	-183	-87	185
International reserves (variation)	188	112	-197	416	177	-60	-65	...
	Percentages							
External debt								
Total external debt (as a percentage of GDP)	93.9	85.0	67.9	69.8	58.5	49.3	45.1	41.8
Net interest (as a percentage of exports)[g]	19.8	17.9	9.6	5.7	5.0	5.0	3.7	2.5

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Consolidated non-financial public sector								
Current income	26.7	26.7	26.1	27.6	28.2	28.2	26.1	27.7
Current expenditure	21.8	23.6	23.9	23.7	22.3	22.2	26.6	25.1
Savings	4.9	3.2	2.2	3.8	5.9	6.0	-0.6	2.6
Net capital expenditure	4.9	5.6	4.8	3.9	5.3	5.4	6.1	4.5
Financial balance	0.1	-2.5	-2.5	-0.1	0.7	0.6	-6.6	-1.9
Domestic financing	0.1	2.0	2.2	-1.6	-1.3	0.2	5.7	2.9
External financing	-0.2	0.4	0.3	1.7	0.6	-0.9	0.9	-1.0
	Growth rates							
Currency and credit								
Money balances of monetary system								
Net international reserves	83.4	29.2	-19.8	156.5	23.0	4.9	4.6	41.6
Net domestic credit	16.7	4.0	30.4	4.7	24.3	31.5	27.6	-10.7
To public sector	17.3	-2.4	30.7	4.9	-4.3	2.7	28.6	19.6
To private sector	16.2	10.1	30.2	8.9	48.0	36.1	15.7	9.5
Money (M1)	21.6	18.2	7.5	29.0	36.0	7.8	31.1	1.1
Local-currency savings and time deposits	20.1	21.6	44.4	22.2	40.9	40.1	10.6	-7.9
M2	20.9	19.8	24.9	25.3	38.6	25.2	18.7	-4.0
Dollar deposits	47.2	30.9	39.5	67.1	0.2	10.3	20.9	29.7
	Annual rates							
Real interest rates (annualized)								
On deposits	-7.7	5.2	-4.9	1.5	-1.0	7.3	-1.7	0.9
On loans	3.2	17.6	4.0	10.8	9.8	19.3	11.0	11.1
Equivalent interest rate in foreign currency[h]	-0.3	9.2	-0.4	-2.8	15.1	6.4	7.9	5.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] In 1993 the wholesale price index was replaced by an industrial producer price index. [g] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [h] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	10.2	9.3	8.9	9.0	11.3	12.0	16.3	19.9	23.6	22.3	22.0	22.6
Real effective exchange rate (Index: 1990 = 100)	100.3	99.3	99.8	102.1	102.3	101.3	100.6	99.6	96.8	99.7	99.4	98.4
Real interest rate (annualized, %)												
On deposits[b]	10.3	-0.7	12.9	6.8	3.4	0.6	-3.7	-7.1	-4.9	-0.8	6.0	3.4
On loans[c]	21.2	11.0	25.7	19.5	16.0	13.6	9.5	5.2	6.2	9.7	15.3	13.4
Money (M1) (12-month variation, %)	31.4	17.1	6.0	7.8	5.4	13.3	30.7	31.1	16.6	11.6	-0.1	1.1

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] 180-day deposits. [c] Short-term.

liquidation of the Banco Anglo-Costarricense–credit to the private sector rose by only 9.5%, which was less than inflation; meanwhile the behaviour of other accounts as a whole (including, for example, bond sales designed to regulate the money supply) was contractionary.

M1 expanded very little (1%) during 1995 (compared with 31% the year before), which considerably eroded the real value of the money supply. Sharper still was the decrease in interest-bearing local-currency deposits, which were down even in nominal terms. Local-currency liquidity (M2) thus contracted by around 4% over the period as a whole (expressed as a proportion of GDP, this aggregate fell from 29% in 1994 to 22%). At the same time, foreign-currency deposits swelled by nearly 30% during the course of the year. This was appreciably higher than the rate of inflation, and such deposits thus came to account for over 35% of the broadly-defined money supply (M3).

This shift towards foreign-currency holdings occurred largely in the first half of the year and was sparked by the uncertainty engendered by the depreciation of the Mexican peso, the delay in moving the tax package through Congress and the local currency's faster rate of devaluation. Towards the end of the year, as uncertainty lessened, a stronger preference for deposits in colones made itself felt.

The main instruments used to control money creation were the high reserve requirements in effect since the end of 1994 and open-market operations. Central Bank sales of monetary stabilization bonds increased by more than 60%, which, in conjunction with the issuance of Treasury bonds, tended to push up the cost of money. The nominal interest rate on loans varied between 34% and 52%, while the rate for deposits ranged between 24% and 33%, depending on the banking group and the type of operation concerned.

c) Foreign exchange policy

The exchange rate continued to be subject to a controlled float as part of a system under which the authorities influenced the rate by means of market operations and mini-devaluations. Foreign exchange policy sought to bolster the real exchange rate, which had weakened the year before, by increasing the pace of these mini-devaluations, especially during the second quarter. The real exchange rate was thus maintained for a large part of the year, although in its final months the rate of depreciation fell below the domestic inflation rate. For 1995 as a whole, the cumulative rise in the exchange rate amounted to 18%, which represented a slight appreciation in real terms.

The law setting forth a new charter for the Central Bank established the convertibility of the currency and gave exporters the right to dispose freely of their foreign exchange earnings.

d) Reform policies

In an effort to rationalize government expenditure, a programme to reform the public sector was set in motion under which a number of agencies were closed down or dismantled and various ministries and institutions were merged. Six public-sector bodies involved in promoting agricultural production and exports were privatized. The ceiling on private-sector participation in the generation of electricity was also raised from 15% to 30%, and the allowed maximum proportion of foreign ownership in the sector was increased from 35% to 50%. The Costa Rican Electricity Institute (ICE) also set up a number of mechanisms to promote private investment. In addition, under the terms of the Public Works Concession Act of 1994, the private sector began to play a part in infrastructure activities; as part of this trend, two companies started up stowage operations in Puerto Limón.

The law establishing a new charter for the Central Bank, which was passed in September 1995 and came into force in 1996, gives the Central Bank greater autonomy and is intended to improve the efficiency of the banking system as a whole, and that of the Central Bank and the public-sector commercial banking system in particular. It puts an end to State banks' monopoly on current accounts and gives all financial institutions access to the Central Bank's discount window.

In October, the Government, the monetary authority and State commercial banks signed an agreement to strengthen the competitiveness of

the State's commercial banking system. Under this agreement, the Central Bank is to help support this system by applying lower reserve requirements and covering its foreign exchange losses on foreign-currency operations, while State commercial banks are to improve the range of services they provide, reduce their administrative and operating costs and cut interest rate spreads. It was expected that the Inter-American Development Bank (IDB) would assist in the recapitalization of State banks.

With the establishment of the Superintendency for Financial Institutions (SURGEF), supervisory coverage was extended to include all of the country's financial institutions, and the system for drawing up and implementing prudential regulations was reinforced. The new law included provisions intended to reduce the costs of the State's commercial banking system, consolidate its financial standing and, on this basis, bring about a decline in interest rates. As part of this approach, a phased reduction in the legal reserve requirements for all financial intermediaries was planned which is to lower such requirements to a uniform level of 15% by 1998.

3. The main variables

a) Economic activity

The country's level of economic activity was undermined by tight fiscal and monetary policies, the uncertainty that reigned until the third quarter regarding the attainment of macroeconomic targets, and protracted delays in the disbursement of external loans. Annual GDP growth, which had averaged 6% during the preceding three years, slumped to less than half that rate in 1995.

Gross domestic investment fell once more, this time by 10%, owing to the credit squeeze and cuts in public investment. The rate of increase in consumption was 4% –2 points lower than in 1994– but the growth of exports of goods and services accelerated (8%) and the volume of imports expanded by 3%.

The behaviour of individual sectors was quite uneven. Construction slumped (-12%) as both public- and private-sector building declined. Construction of tourism infrastructure, which had expanded vigorously in previous years and helped to maintain the levels of activity in the sector, began to flatten out as the market for hotel capacity became glutted.

Despite financing problems, agriculture and manufacturing grew by more than 3%. Trends in the production of traditional export goods were favourable. The banana harvest yielded 112 million crates, and great strides were made in raising plantation productivity, while better prospects in the international market boosted sugar-cane production. The coffee harvest increased only slightly, however, as a result of an agreement with other coffee-exporting countries to hold back coffee from the market in order to keep prices up. Meanwhile, a drop was seen in the production of staples such as rice, maize and beans.

Although manufacturing companies turned to external sources of financing, which relieved the financial constraints on industrial activity, the sector faced cost pressures from such sources as the seven-month-long application of higher import tariffs and the increase, as of August, in the value-added tax (VAT).

An expansion in export-oriented manufacturing activities was observed. The exception to this rule was the textile sector, which had to contend with foreign competition (particularly from Mexico) both locally and in the United States market, where the tariff preferences established under the North American Free Trade Agreement (NAFTA) were also a factor.

Maquila activity was very brisk, showing a growth rate of nearly 30%. This trend was buttressed by the establishment of new companies in the country's export processing zones.

In order to promote the development of industry as the economy opens up to foreign trade, the National Competitiveness Council and the Coordinated Industrial Policy Implementation System were set up.

In the services sector, transport fared well, mainly thanks to the increasing number of tourism air routes. Although the electricity, gas and water sector expanded by 4%, cuts in public expenditure had an adverse effect on

maintenance and, hence, on the electricity supply, which meant that energy had to be imported.

b) Prices, wages and employment

Inflation climbed to nearly 23%, which was considerably more than the target rate, under the influence of the temporary hike in tariffs, the increase in the sales tax, higher utility charges (the price of electricity jumped by 25%) and the excise tax on fuel.

Although the Government stepped up the implementation of its price liberalization policy in 1995, a list of 700 exemptions to the sales tax was drawn up in order to offset rises in the prices of products included in the basic shopping basket.

The economic slowdown was accompanied by a 1% increase in unemployment which pushed the rate above the 5% mark. In February public-sector posts were frozen and, between July 1994 and July 1995, the number of public-sector jobs was slashed by around 1,800 under the Labour Mobility and State Reform Programme.

Average real wages fell by 2%, while the minimum wage dropped somewhat more sharply. In the private sector, real wages went down by just over 2%, but in the public sector they rose slightly. Civil service wage adjustments were higher for staff in the lower grades.

Income policy was directed towards introducing more flexibility into the wage-setting process in order to avoid automatically incorporating inflation into wages, allow the different public bodies to adjust wages independently and link wages to worker productivity.

c) The external sector

In 1995, significant shifts were to be observed in external transactions. The current account deficit narrowed to US$ 140 million, which was 70% below its 1994 level and a mere one fourth of what it had been during the preceding biennium. This was well within the target agreed upon with the IMF, which was that the current account deficit should not exceed 3.6% of output. The economy's performance in this regard was a consequence of the narrowing of the trade gap and particularly of the expansion in exports of goods and services, whose value leapt by 26%. Reserves swelled by US$ 185 million, which was more than double the target figure set by agreement with the IMF.

Exports were spurred by rebounding international prices, the reactivation of the economies of Costa Rica's main trading partners, the limited nature of the variation in the real exchange rate and the lifting of restrictions on the use of foreign exchange earnings. Exports to the Central American countries soared by 46%, while the value of Costa Rica's sales to the rest of the world went up by somewhat more than 13%.

High coffee prices were an influential factor in the growth of exports of goods. Although coffee prices started to slide in June, foreign sales had already been arranged in advance on the futures market. Thus, in spite of the fact that the volume of physical sales fell as a result of Costa Rica's retention agreement with other exporting countries, the value of exports was actually 38% higher. A portion of the country's banana exports, which posted a 14% increase, went to non-traditional markets and fetched favourable international prices. Sugar exports shot up (62%) owing not only to better prices on the international market but also to the opening up of a new market in China.

Non-traditional exports also gained momentum, expanding by 15%. Nearly half of these sales were of non-traditional agricultural products, while the remainder were of manufactures. The former included pineapples, melons, foliage and ornamental plants, flowers, cassava and squash. Some of the main exports of manufactures were medicines, gold jewellery and chemicals. Exports of textiles and clothing contracted by 18% due to the effects of a United States quota on imports from Costa Rica and by competition from Mexico in the markets of its partners in NAFTA. *Maquila* exports grew by 29%, and tourism earnings were up by 6%.

The value of imports of goods and services rose by 14%, despite the more sluggish pace of domestic activity. The increase of nearly 6% shown by imports of goods was attributable to higher international prices and the large imported

component of non-traditional exports. Within this category, imports of intermediate goods climbed by 14%, while there was a contraction in the value of imports of capital goods and construction materials.

The deficit on the factor services account widened by some US$ 30 million as a result of increased profit remittances and interest payments. Outlays in connection with the foreign debt were substantial, since nearly US$ 50 million in arrears with the Paris Club were paid off and advance payments were made on bonds to be purchased under the terms of the renegotiation of Costa Rica's external debt. As a result of these amortizations, the public external debt lessened slightly. In addition, a number of credits from international organizations were withheld until the final quarter because of the delay in signing an agreement with the IMF.

Thus, it was private inflows of capital –principally foreign direct investment, which totalled US$ 350 million, and, to a lesser extent, external corporate loans– that provided most of the financing for the current account and helped build up reserves. The economic uncertainty that prevailed during the first part of the year did not translate into capital flight, by contrast with 1994, and, in net terms, short-term private flows over 1995 as a whole yielded a small positive balance.

CUBA

1. General trends

In 1995, the Cuban economy managed to halt the strong downward trend in economic activity which had begun in the early 1990s, thereby bearing out a number of signs observed in 1994. Gross domestic product (GDP) rose by 2.5%, after having fallen by 34% during the first four years of the decade, thus ending a six-year-long slide in per capita GDP.

This outcome was attributable to the reform process set in motion in the early 1990s and to the increased availability of foreign exchange; nonetheless, the scarcity of foreign exchange continued to be one of the main constraints affecting the level of activity in the Cuban economy, which is highly dependent on imports. The steps being taken to open up the economy to foreign capital also contributed to the country's favourable economic performance.

In an effort to deal with the serious distortions in Cuba's economy and society generated by the economic crisis and these distortions' negative impact in terms of efficient resource allocation, the authorities proceeded with structural reform initiatives designed to provide greater scope for private enterprise and gave macroeconomic policy a greater role in reducing the economy's severe fiscal and monetary imbalances within the framework of its monetary reform programme. The progress made in these areas in 1995 had positive effects in terms of inflation and the defence of the Cuban peso, whose dollar parity improved significantly on the parallel market, although the differential between this rate and the official rate remained quite large.

These factors were of major importance because they had a strong bearing on the living conditions of the population, most of whom depend for their livelihood on peso-denominated wages which, as in previous years, remained virtually unchanged in 1995. Although steps were taken to help narrow the wide gap that had opened up between this sector of the population and those segments whose members work in the free markets that have appeared in recent years or have some other form of access to dollars, people who receive their pay in pesos continued to be affected by the low purchasing power of their earnings and by shortages in official markets. This gap has called into question the equitable distribution of income which had been regarded as one of the successes of Cuba's economic system.

Import capacity expanded thanks to increases in export earnings –despite a sharp slump in sugar production, which amounted to only 3.3 million tons– and in tourist arrivals and remittances from family members residing abroad. Foreign investment also continued on its upward trend, and by mid-1995 had surpassed the US$ 2.1 billion mark, with half of this sum having already been disbursed. These investments mitigated the steep downward trend in total gross investment but did little to halt the prolonged deterioration of infrastructure and installed capacity, including dwellings, except in isolated sectors such as tourism.

The economic climate prevailing in 1995 carried over into early 1996; in fact, according to official estimates, the economy grew at a rate of almost 7% in the first quarter, owing to the performance of agriculture, mining and manufacturing. One particularly noteworthy development was that the sugar-cane harvest appeared to be heading towards its target level of 4.5 million tons. On the external front, the economic embargo imposed by the United States was reinforced by the passage of a law in March which, among other things, provides for sanctions against foreign firms whose activities in Cuba involve property confiscated from American citizens after 1959.

2. Economic policy

As in previous years, the basic parameters of Cuba's economic policy continued to be dictated by the need to improve the economy's functional capacity and to ensure the availability of products vital to its operation and to the satisfaction of the population's basic needs while, at the same time, preserving the main features of the economic system and its achievements in the social sphere.

In this context, the authorities carried forward the implementation of structural reform measures designed to alleviate the shortage of foreign exchange, which is one of the most pressing problems facing Cuba's economy, and to stimulate production activity in the country. These reforms have led to the creation of a new sphere of primarily domestic, market-based economic activity which is positioned midway between the traditional State sector and the internationalized sector of the economy. In a further bid to close this rift in the economy, Cuba continued to pursue its severe macroeconomic adjustment programme. This programme's objective is to reduce the fiscal deficit and the amount of pesos in circulation as a means of diminishing the distortions affecting the foreign-exchange market and dampening inflationary pressures.

Thanks to the close interaction existing between the two major spheres of economic policy –i.e., structural reform and the macroeconomy– the advances made in each of these spheres reinforced those achieved in the other. Just as the alleviation of sharp macro-economic imbalances was a precondition for the effectiveness of structural reforms, so the implementation of these reforms contributed to the success of fiscal and monetary initiatives. At the same time, economic decision-making continued to be dominated by the trade-offs between social considerations of distributive equity, external openness and the search for mechanisms to boost production.

a) **Structural reforms**

The steps taken to further the processes of liberalization, deregulation, downsizing and decentralization of the State in 1995 made it possible for enterprises to operate with greater autonomy within the framework established by the economic plan. In the agricultural sector, some 4,150 cooperatives and 86,000 private producers existed alongside the country's extensive network of State-run enterprises. Thus, in 1995 only about 30% of Cuba's farmland remained in government hands, down from over 75% at the beginning of the 1990s.

The number of self-employed workers in the private sector rose to over 200,000 following a decision in June to increase the number of permitted activities, lift the ban on self-employment for professionals working in areas other than their specialty, and permit restaurants to operate in private homes, provided they meet a series of strict requirements. In addition, there are an undetermined number of unregistered self-employed workers. There are also some 70 self-financing arrangements in operation which allow State firms to manage their own accounts in foreign currency.

As part of the authorities' policy of opening up the economy to foreign capital, new legislation governing foreign investment was enacted in September, in accordance with the constitutional reforms of 1992, which allows the transfer of State property, either in whole or in part. The new law provides for the more rapid processing of investment proposals and permits the establishment of wholly foreign-owned enterprises. (Previously, foreign investors had been allowed to participate only as partners in joint ventures.) By the end of 1995, approximately 230 such enterprises had been set up, and the establishment of another 160 was being negotiated. The new law also provides for the creation of free trade zones and industrial parks; the relevant provisions, which were drafted during 1995, appear in the decree-law that was promulgated in June 1996.

As part of the country's economic decentralization process and with a view to giving the National Bank of Cuba (BNC) greater autonomy in implementing monetary policy, a start was made on differentiating the functions of the BNC from those of the commercial banks which are to enter into operation in the future. In addition,

Table 1
CUBA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995[a]
		Growth rates					
Growth [b]							
Gross domestic product	0.7	-3.0	-10.7	-11.6	-14.9	0.7	2.5
Per capita gross domestic product	-0.4	-4.0	-11.6	-12.3	-15.4	0.3	1.4
Gross domestic product, by sector [c]							
Goods	...	-3.5	-16.2	-19.2	-16.7	4.2	...
Basic services	...	-8.2	-10.4	-13.2	-17.2	-0.9	...
Other services	...	-1.5	-6.1	-5.5	-13.4	-1.2	...
		Millions of dollars					
Balance of payments							
Current account	-4 595	-3 624	-1 933	-403	-372	-81	-146
Trade balance	-4 609	-3 666	-2 021	-585	-374	-190	-316
Exports of goods and services	5 562	5 605	3 270	2 309	1 989	2 246	2 944
Imports of goods and services	10 171	9 271	5 291	2 894	2 363	2 436	3 260
Capital account	5 700	3 700	1 900	402	388	79	143
		Percentages of GDP					
External sector [d]							
Current account	-23.6	-18.4	-11.9	-2.7	-2.5	-0.4	-0.7
Trade balance	-23.7	-18.7	-12.4	-3.9	-2.5	-1.0	-1.5
Gross debt	...	...	...	...	58.3	47.3	44.0
Government income and expenditure							
Total income	64.3	62.4	67.3	62.2	63.1	66.4	55.1
Total expenditure	71.4	72.3	90.4	94.9	96.6	73.8	58.9
Financial balance	-7.2	-10.0	-23.1	-32.7	-33.5	-7.4	-3.7
		Growth rates					
Currency							
Liquidity	...	19.8	33.6	25.5	32.1	-10.0	-7.0
Currency outside banks	...	11.4	41.7	23.0	11.6	-20.9	-1.5
Regular savings deposits	...	28.4	26.5	27.9	51.6	-2.3	-10.1

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Calculated on the basis of series in constant 1981 dollars at the official exchange rate of 1 peso to the dollar. [c] Calculated on the basis of series in constant 1981 pesos. [d] Calculated at the official exchange rate of 1 peso to the dollar.

there are to be at least two other multi-purpose banks: a new bank, to be called the Banco Agroindustrial y de Comercio, and the Banco Popular de Ahorro, which is already in existence. The work involved in setting up a network of currency-exchange offices was also begun in September 1995, and the creation of another new bank, the Banco de Inversiones, is planned; this process is slated for completion in 1997. The reforms being implemented in the financial system should make it possible to channel the foreign exchange that is on hand in the country into domestic lending. Another of these measures authorizes Cubans over the age of 18, regardless of their residency status, to open foreign-currency term accounts at an annual interest rate of 4%.

Financial transactions involving other countries continued to be entrusted primarily to the Banco Internacional de Comercio and the Banco Financiero Internacional. As a consequence of the decentralization of foreign trade, by mid-1995 more than 230 enterprises were conducting their own purchase and sale operations with business concerns in the rest of the world on a direct basis; six years earlier, only

50 enterprises had been active in the international marketplace.

b) **Fiscal policy**

Cutbacks in public-sector spending made it possible to halve the fiscal deficit, which thus fell to under 4% of GDP (versus more than 7% in 1994 and a hefty 33% only two years earlier), even though government revenue was down from the preceding year's level, which was the highest on record for the 1990s. The structural reforms being undertaken in the Cuban economy had an impact on both the level and the composition of public-sector income and expenditure.

Government revenue, measured in pesos at current prices, contracted by some 10%, chiefly as a consequence of smaller inputs from State enterprises in the form of profits and asset depreciation. Receipts under these two headings were particularly lean in the first half of 1995 because many enterprises were behind in their payments, and it therefore became necessary to take steps to remedy this situation to some extent in the second six months of the year. Even so, a large part of these revenues were not made available to the Treasury until January 1996. Furthermore, as a result of the decision to refrain from depreciating idle production facilities, amortization payments dropped by some 40 million pesos, or 10% of the budget estimate for this item.

This decrease was partially offset by higher revenues from other sources; an important contributing factor in this regard was the institutional overhaul undertaken in 1994, one of whose main results was the reinforcement of the tax system. The increases made in mid-1994 in the prices and rates charged for selected public-sector goods and services were reflected in higher receipts from indirect taxes in 1995, despite the unfavourable impact of lower sales of such important sources of indirect tax revenues as cigarettes and beer (tax receipts from these products were 116 million pesos below the budgeted figure).

The greater autonomy accorded to private enterprise led to an increase in direct income tax receipts from self-employed workers, farmers and cooperatives. In addition, the rising cumulative level of foreign investment was reflected in higher foreign-exchange receipts from the taxes levied on the profits of joint ventures and workers' earnings, tariffs and other customs duties, property and motor vehicle taxes, and documentation fees. In particular, the new customs provisions that came into force in July brought about a substantial upturn in revenues from duties on non-commercial goods imported by passengers entering the country by air or sea. The fees collected for airport services provided to airline passengers exhibited an increase as well.

Spending fell more sharply than income, with investment recording a steeper drop than current expenditure. The shift seen in the composition of current expenditure was a reflection of the reforms that have been implemented as well as of government priorities.

Reform measures resulted in savings in a number of areas. Economic downsizing and steps to boost production efficiency made it possible to cut subsidies to loss-making public-sector enterprises by almost half. This situation was especially noticeable in the agricultural sector, where a large number of State-owned farms that had previously recorded losses were turned into financially self-sustaining cooperative production units (UBPCs). Subsidies to many of these units were halted since, except in the sugar-cane industry, agricultural losses plummeted from 700 million pesos in the first half of 1993 to 57 million pesos in the same period in 1995. This made it possible to reallocate some assistance to strategic sectors, primarily other units in the sugar-cane industry whose financial performance was still unsatisfactory.

The reorganization of the central government which was carried out in April 1994 led to a drop in expenditure on wages and salaries and on goods and services. Spending in the areas of sports, the arts and culture also declined.

The reduction of expenditure made it particularly necessary to set priorities. Spending on defence and law enforcement dropped, while outlays for housing and community facilities rose for the third year in a row. There was also an increase in spending on education, health and social security (these items accounted for almost one third of the budget in 1995), as well as on science and technology and social welfare. The

social security and welfare systems have had to serve an ever increasing number of people, with over 1.3 million persons (12% of the population) drawing pensions and more than 116,000 families receiving welfare payments in 1995.

The high level of social welfare spending was a reflection of the economic crisis, and the transfer payments made to about 10,000 workers who were laid off owing to adjustment measures constituted a further burden. In addition, as part of the family assistance programme, price subsidies were raised for some goods, particularly for such products as milk, beef and veal, coffee and fuels for household use.

c) **Monetary and foreign exchange policies**

As of early 1995, the monetary situation in Cuba continued to be quite complex owing to the use of both a non-convertible local currency (the Cuban peso) and the United States dollar, which came to be employed more and more as the internationalized sector of the economy gained ground. In view of the distortions which this situation was generating within the economic system, the authorities took steps to put the money market on a more normal footing by strengthening the Cuban peso.

With this aim in mind, the authorities carried forward their policy of reducing local-currency liquidity, which had reached the unprecedented level of 11 billion pesos in late 1993 and had stood at 9.9 billion in December 1994, before slipping to 9.2 billion in December 1995. The amount of pesos in circulation dropped by the same proportion as liquidity did, since the percentage of liquid funds deposited in regular savings accounts, which were paying a nominal return of 2% per annum, held steady at around 60%.

Since the fiscal deficit was driving up the local-currency money supply, the authorities resorted to measures that targeted the private sector in an effort to reduce liquidity. In the wake of the increases made in selected public-sector prices and rates in 1994, the mechanisms used to soak up part of the local-currency money supply were expanded to include other spheres. In August 1995, approval was given for a prepayment scheme under which discounts were offered on mortgages held by the Banco Popular de Ahorro, which totalled 1 billion pesos as of mid-1995. People who repaid the entire amount of their debt were entitled to a 25% discount, while those who paid back over 60% of the mortgage were eligible for a 20% discount.

Pesos were not the only component of the money supply, however. The scrip issued to workers for the purchase of goods was also a factor, but no information was available as to how much was in circulation. Moreover, since 1993 United States dollars have been circulating in the Cuban economy in apparently ever-increasing quantities. In the light of the changes in the relative level of liquidity in these two currencies, the exchange rate staged a striking recovery on the parallel market, moving from 130 pesos to the dollar in mid-1994 to 25 pesos by late 1995. Thus, the enormous spread existing between the rate on the parallel market and the official rate (which remained at par) narrowed markedly.

Finally, there were also "convertible" pesos in circulation which had been introduced in December 1994 with a view to the eventual consolidation of the exchange market. These notes are backed by the National Bank of Cuba and can be used in the country's dollar stores; according to existing plans, at some point in the future these stores will begin to deal entirely in convertible pesos.

The currency exchange offices which opened their doors in September 1995 set the selling rate for convertible Cuban pesos at 30 pesos to the dollar and the buying rate for dollars at 25 pesos; hence, the existence of two exchange rates that were applicable to different types of transactions and sectors of the economy became virtually official.

d) **Trade policy**

In addition to the aforementioned trend towards the decentralization of foreign trade transactions, which continued into 1995, and the drafting of a decree-law regarding the creation of export processing zones, a number of changes were made in the relevant legislation based on World Trade Organization guidelines. As part of the work done in this area, regulations were

established regarding customs valuation procedures, rules of origin, the payment of customs duties and refunds of overpayments.

In line with the priority placed on increasing and diversifying Cuba's exports, 1995 saw the signing of new partial- scope agreements providing for reductions in tariffs and specific duties with a number of countries in Latin America, which is Cuba's largest regional market. Talks were also held with the European Union concerning the signature of a trade and economic agreement, and a protocol was signed with the Russian Federation to strengthen economic ties with that country. This agreement provided for an exchange of 1.5 million tons of sugar for 4.5 million tons of oil in 1996 and the granting of a loan to purchase equipment for the Cienfuegos nuclear power station.

3. The main variables

a) Economic activity

Aggregate supply increased once again in 1995 owing to the expansion of import volumes and an increase in output (up 2.5% of GDP); this paved the way for growth in household consumption and gross capital formation, but even so these variables barely exceeded the extremely low levels that had been reached after a five-year downturn which cut output by more than a third.

The slight rise in gross investment fell far short of the country's enormous needs in terms of the replacement of existing capital goods; this demand has been building up since the early 1990s due to the sharp contraction seen in investment in the past. No specific data are available on such investments, but the level of imports of machinery and equipment, which serves as an indirect indicator, declined from over US$ 2.7 billion in 1990 to less than US$ 120 million in 1994, while the deterioration of the country's infrastructure (including dwellings and production equipment) has clearly been very considerable.

The structural reform process was a defining feature of the economy in 1995, in spite of the slump in the 1994-1995 sugar-cane harvest, which amounted to only 3.3 million tons (17% down on the preceding year). In response to this situation, the Government decided to seek external loans for the purchase of inputs which, together with a policy of providing incentives for the industry's workers, were expected to boost sugar production to 4.5 million tons in the 1995-1996 season. The incentive programme covered not only workers in the State sugar industry, but also those employed in cooperative production units, as well as private producers.

Sugar production aside, output climbed once again (7% in the first six months), and almost all sectors showed signs of recovering from their previous low production levels. The increased output of intermediate goods, including fertilizers (140%), steel (46%) and cement (27%), contributed to an upswing in other activities. This expansion did not, however, occur across the board. Decreases in production were recorded for lubricating oils and greases, paper and paperboard, multilayer bags, and plastic boxes and cases, and there was a shortage of such household fuels as kerosene (the supply of kerosene was 65% lower in 1995 than in 1990) and liquified gas.

The agricultural sector expanded by about 4% thanks to the incentives created in the course of the economic liberalization process; for example, in 1995, 30,000 families were granted government-owned land in usufruct. Distribution problems hampered efforts to get the food supply to the population, however. The fishing industry, which had adopted new administrative methods designed to make it financially self-reliant by drawing on its foreign-exchange earnings, saw gross catches rise by roughly 13%.

Mining and quarrying received a boost from the move to open up the economy to foreign capital. Oil and gas production increased by about 15% to 1.5 million tons, which covered 30% of the energy demand of Cuba's thermal power plants as well as the energy needs of such important sectors as the cement and asphalt industries. As of mid-1995, oil exploration and drilling activities were being conducted offshore and at 12 onshore locations with the participation of foreign investors. Nickel production was up by 59% thanks to a combination of increased

investment by Canadian firms and the new foreign-currency self-financing schemes available to public-sector firms, which helped expand the supply of inputs.

The construction industry suffered from organizational difficulties and, as in other traditional sectors, from labour supply problems which prevented it from achieving its production goals. Nevertheless, the sector experienced a significant upturn as a result of growth in tourism, agriculture, residential construction and other foreign-investment-related areas.

The energy sector grew for the second consecutive year, in part due to the greater supply of both locally-produced and imported petroleum; petroleum imports, which accounted for four fifths of the total supply, recorded a slight increase (2%). This made it possible to boost electricity generation by 5% and to extend residential coverage to 92% of all households and thus increase per capita consumption. Power failures continued to occur, however, owing to the deterioration of installed capacity and inefficient fuel use. In an effort to deal with this situation, the authorities stepped up the pace of negotiations regarding external financing for the completion of the Juraguá nuclear power plant in Cienfuegos.

Public transport witnessed a downturn, but communications services benefited from a greater volume of long-distance calls, especially to the United States. The tourism sector continued to show impressive growth. The number of foreign visitors, especially from Canada, Italy, Mexico and Spain, rose from 617,000 in 1994 to 720,000 in 1995; this showing was associated with both a 13% jump in the number of available hotel rooms and the increase in occupancy rates.

b) **Prices, wages and employment**

Following the price and rate hikes which were introduced for some goods and services in mid-1994, inflationary pressures eased in 1995 thanks to the shrinking fiscal deficit, a tight monetary policy and the competition in the marketplace prompted by economic liberalization measures. Prices continued to vary enormously due to the coexistence of some markets where price levels were set by the authorities and others where prices were determined by supply and demand.

In markets subject to price controls, essential goods continued to be subsidized and did not increase significantly in price, but shortages forced the Government to ration these products. Moreover, the steep upward trend in prices of products such as cigars, cigarettes and alcoholic beverages, which had begun in 1994, continued unabated.

In the informal sector, prices fell by an estimated 50% as a consequence of the liberalization process and the establishment of agricultural produce markets where prices were determined by supply and demand. Prices in these markets, which had begun to operate in October 1994 under State supervision, fell by some 30% on average (prices were down by about 37% for meat and 26% for fruits and vegetables) owing to the Cuban-peso liquidity squeeze and, to a lesser degree, an increase in supply. Nonetheless, prices in these markets continued to be far higher than those prevailing in the official market. The reasons for this were the strong demand resulting from the difficulties faced by the State sector and cooperatives in increasing the supply they made available to the official market and the rudimentary level of organization in agricultural markets, where, for example, the volume of produce was not yet sufficient to permit economies of scale in transport. The situation with respect to rice and pork, both staples of the Cuban population's diet, was indicative of the drop in prices and of price levels in the country's deregulated agricultural markets; the price of rice plummeted from 90 to 10 pesos per pound, while pork prices tumbled from 150 to 60 pesos per pound.

These examples also serve to underscore the insufficient purchasing power of government wages, which crept up from an average of 186 to 193 pesos per month. This was enough to purchase rationed staples in the formal market (at much lower prices than in the parallel market) but the individual quota remained inadequate. Nevertheless, in keeping with the policy of reducing the amount of pesos in circulation, which made it possible for prices in unregulated markets to fall, wages were left unchanged

except in rare cases of sharp productivity increases. People who sold their products or services on the free market and those who had access to dollars enjoyed higher incomes. A survey conducted in Cuba in October showed that such people were in the minority, however.

The policy of providing subsidies in convertible pesos and in kind, as well as scrip for use in stores in which transactions are conducted in pesos, was continued in order to ease the plight of government workers whose wages are paid in pesos and to offset, to some degree, the excessive incentives provided for the internationalized and market-based sectors of the economy, which were drawing human resources away from the public sector. In 1995, inducements of this sort were approved for 765,000 workers, compared with 115,000 in 1994. Most of the recipients were engaged in priority activities that generated hard currency (including around 400,000 workers employed in the sugar industry, 80,000 in the cultivation and harvesting of the coffee crop and 50,000 in tourism) and in the energy sector.

The open unemployment rate surpassed 7%. In keeping with the social objectives of the economic policy applied in recent decades, 1995 saw a continuation of the gradual realignment of staffing levels and relocation of surplus public-sector workers as part of a process designed to avoid mass layoffs. Many of these workers were relocated in faster-growing sectors of the economy (e.g., agriculture and tourism) while others became self-employed. As the use of installed capacity was very low, under-employment remained high, affecting half a million jobs according to official estimates.

c) **The external sector**

The sustained drop in Cuba's import capacity which had begun in 1989 came to an end in 1995, thanks to an increase in the supply of hard currency which was itself due to growth in capital inflows and higher earnings from exports of goods and services. In spite of this fledgling recovery, however, the value of the country's imports of goods and services at current prices was still not even one third as much as it had been in 1989. The more favourable capital account balance was offset by a widening current account deficit, which was attributable to deficits in the trade and factor-income accounts.

The dollar value of exports rose by 17%; this development was the outcome of a combination of favourable international prices for export commodities and positive trends in traditional goods such as mining products (especially nickel), fish, tobacco and some light manufactures. Similar trends were also seen in exports of cement and other building materials and of goods produced by the iron and steel industry (especially steel products). External sales of nickel and shellfish, which were the country's second and third most important export items, recorded significant growth as well.

Sugar, which continued to be Cuba's leading export, also benefited from a rise in prices, although export volumes fell markedly owing to the poor harvest. In fact, sugar accounted for less than half of total exports in 1995, compared with almost three quarters of the total just six years earlier.

Much of the rise in the value of imports was due to the higher prices charged for such products as fuels and foodstuffs, which made up two thirds of the import bill. The value of oil imports, for example, rose from almost US$ 750 million in 1994 to US$ 870 million in 1995, even though, at six million tons, the volume of imports was only slightly higher than in 1994 and was less than half as much as was purchased in 1989.

Cuba's foreign trade activity, which remained subject to an economic embargo by the United States, continued to diversify. The Latin American and Caribbean region became Cuba's leading market in 1995, absorbing 35% of its exports. The region also took on great importance as a supplier for Cuba due, in large measure, to significant growth in imports from Mexico, which become one of Cuba's main trading partners. Cuba's other major partners were Canada, China and the Russian Federation (despite, in the latter case, the huge decrease in trade with European countries that had formerly been part of the socialist bloc, which accounted for 80% of Cuba's foreign trade in 1989 but barely 15% in 1994).

As regards non-factor services, tourism showed the best results, with gross earnings of US$ 1.1 billion (although this sector also

consumed a large volume of imported inputs), which represented an increase of almost 30% over the preceding year. Of particular note was the growth in private-sector foreign exchange earnings from room rentals, restaurants and taxi services. Telecommunications services also played a larger role in generating foreign exchange as a consequence of the upswing in the volume of long-distance calls. Net factor payments continued to expand owing to the repatriation of profits and interest payments on the external debt. Thanks to remittances from abroad, unrequited private transfer payments continued to expand –as they have been since the early 1990s– and thus reached a level of US$ 600 million.

Foreign investment in Cuba rose for the third year in a row, surpassing the US$ 800 million mark. The upsurge in domestic activity was based on the supply of foreign credit; nevertheless, given Cuba's lack of access to sources of medium- and long-term finance, the funds it obtained were in the form of short-term loans at interest rates of from 12% to 20%. These borrowings financed a number of production activities, including the 1995-1996 sugar-cane harvest, for which a loan of US$ 300 million was secured at an interest rate of 15%.

Access to longer-term loans was made conditional upon a resumption of debt servicing, which had been interrupted in 1986. Informal talks with the international financial community regarding the possibility of rescheduling Cuba's external debt of over US$ 9 billion got under way in August 1995. Cuba's leading creditors are Japan (25% of the total), Spain (13%), France (12%), Argentina (9%), the United Kingdom (8%) and Italy (5%).

ECUADOR

1. General trends

The performance of Ecuador's economy in 1995 was adversely affected by a series of unexpected events. A number of key variables in the economic programme being implemented since late 1992 suffered unanticipated impacts –pressure on the exchange rate, high interest rates and a fiscal deficit– from the armed conflict with Peru, a long period of energy shortages and a political crisis which culminated in the resignation and departure from the country of the Vice-President of the Republic. As a result, the targets set for 1995 could not be met, and the country therefore witnessed a partial reversal of the favourable trends of previous years.

The course taken by Ecuador's economy in 1995 should be seen against the background of the economic programme which was launched towards the end of 1992, whose central elements have been the stabilization of the exchange rate, fiscal austerity and structural reforms. During the first two years the programme was in operation (particularly 1994), many of its results were promising: inflation fell, international reserves rose, growth resumed and unemployment was reduced. Nevertheless, the authorities themselves admitted that the strategy presented a number of problems, namely high and volatile interest rates, a tendency for the exchange rate to appreciate in real terms and an increase in the current account deficit. It also became clear during 1995 that the programme was highly susceptible to rapid changes in economic agents' expectations, particularly with regard to exchange rate policy; as a result, in the course of the year the authorities were twice obliged to adjust their economic instruments and reformulate their targets.

Against this background, gross domestic product (GDP) grew by 2.7%, largely owing to the strength of exports and private investment, and per capita GDP was thus virtually unchanged. Meanwhile, inflation continued on its downward path, albeit at a somewhat more moderate pace, reaching 23% in December. The non-financial public sector ended the year with a deficit equivalent to 1.9% of GDP, the balance-of-payments current account deficit rose to 4.6% of GDP and international reserves shrank by US$ 230 million. By the end of the year, the financial sector, which in preceding years had expanded strongly, was showing signs of weakness and the authorities were forced to step in and apply a variety of instruments to bolster it.

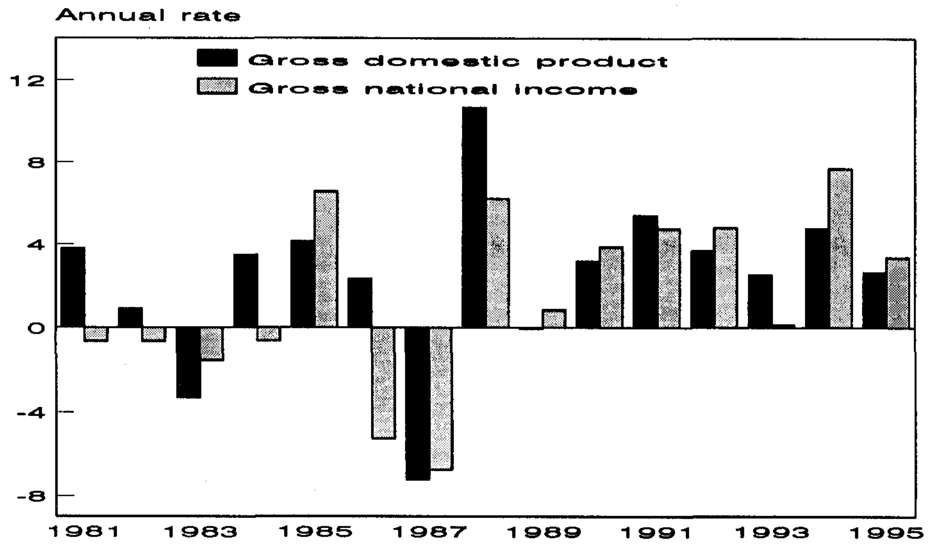
The trends to be observed towards the end of 1995 –i.e., the critical state of public finances, high interest rates, pressure on the exchange-rate band and signs of weakness in the financial sector– continued into early 1996. The uncertainties inherent in an election year, which culminated in a change of Administration in August 1996, in an atmosphere devoid of basic consensus on economic or social policy, also had a negative impact on economic agents' decisions.

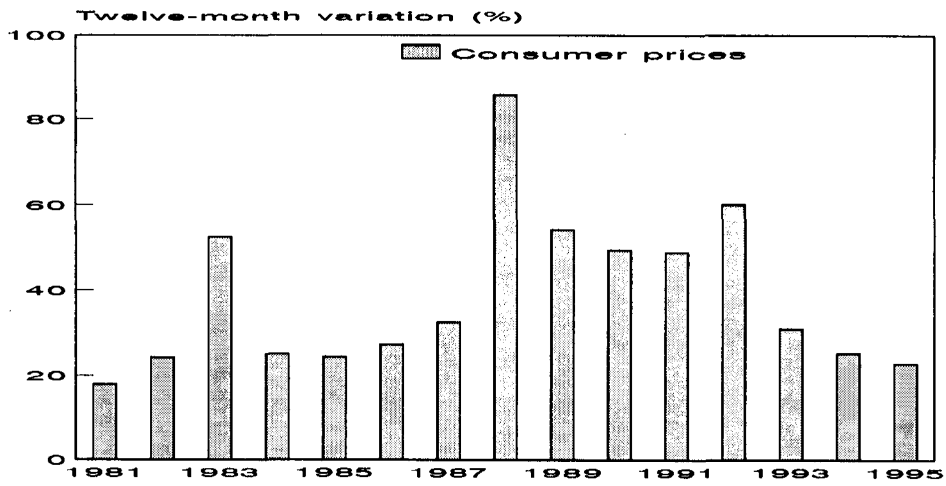
2. Economic policy

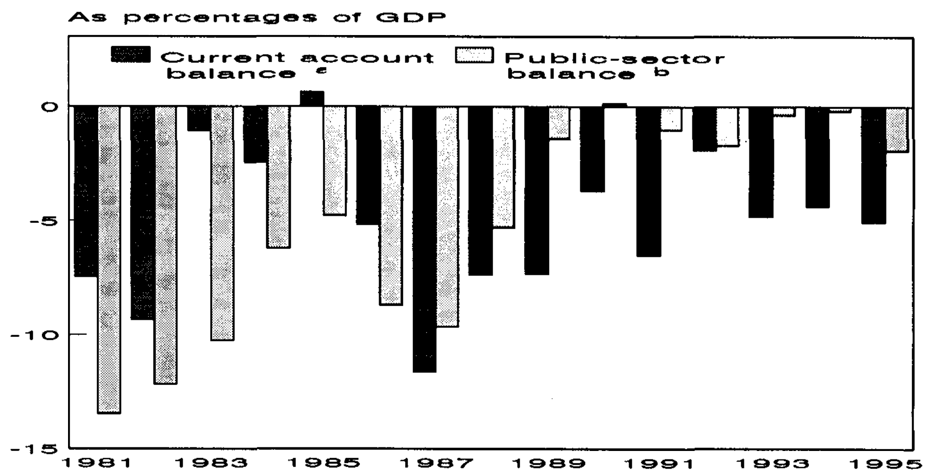
In 1995 the Ecuadorian authorities followed an economic policy consistent with the programme which had been in place since the end of 1992. The only change from 1994 was the introduction of a currency band whose gradient was determined on the basis of the expected rate of internal and external inflation in an effort to avoid any further appreciation of the sucre and

Figure 1

ECUADOR: MAIN ECONOMIC INDICATORS







Source: ECLAC, on the basis of official figures.
a Of the balance of payments. b Non-financial.

thus maintain the real exchange rate. At the same time, a tight fiscal policy continued to be applied, along with a monetary policy which aimed to bring down inflation and reduce interest-rate volatility by controlling liquidity.

However, political and economic factors had effects on a number of different variables –expectations regarding the exchange rate and inflation, external capital flows, high interest rates, unforeseen expenditures and others– which led the authorities to take several measures, including two adjustments to the currency band and the introduction of a more expansive fiscal policy. At the same time, although some reforms were implemented, the political situation hindered any significant progress in the country's strategic modernization process –another pillar of the economic programme.

a) **Fiscal policy**

Fiscal austerity was an important element of the stabilization programme implemented since the end of 1992, and indeed, the non-financial public sector's deficit, which had stood at 1.7% in 1992, had been reduced to 0.2% by 1994.

The armed conflict with Peru at the beginning of 1995, occasioned a high level of unplanned expenditure, however. Part of this was covered by revenues from special-purpose taxes (a 2% motor vehicle tax and a contribution equivalent to two days' pay from public- and private-sector workers) but the year ended with a non-financial public sector deficit of 1.9% of GDP. Current expenditure, in particular, was up from 17.3% to 21% of GDP, largely as a result of expenses relating to the hostilities with Peru and the cost of subsidies on diesel fuel (which rose considerably due to the shortage of hydroelectric power) and, to a lesser extent, of increased in interest payments. On the other hand, capital expenditure continued at the same level in real terms, so its share of GDP remained at around 6.5%. Transfer payments in connection with the public sector's staff-reduction scheme dropped from 0.8% to 0.2% of GDP.

While total expenditure went up from 24.6% to 27.6% of GDP against a background of slower growth than predicted, revenues only increased from 24.4% to 25.7% of GDP. In a departure from previous years' practice, this higher deficit was financed exclusively with domestic resources.

The public-sector imbalance continued into the early months of 1996, and by the end of April the authorities were therefore predicting a deficit of 2.3% of GDP for the year. A number of factors contributed to this situation: various groups of public-sector employees received pay rises; several cases of fraud led to Treasury losses; extra capital was injected into the State-owned development bank, Banco Nacional de Fomento (BNF), whose portfolio was also cleaned up; and low levels of growth in production and imports made it difficult to increase fiscal revenues. The outgoing Administration announced its intention to reduce the deficit by 1.4% through current and capital expenditure cuts, however, which would mean the Administration taking office in August would inherit a shortfall of just 0.9%.

b) **Monetary policy**

Between the end of 1992, when the current macroeconomic programme was implemented, and 1994, money creation was fuelled by an increase in international reserves; this was offset through sterilization operations consisting mainly of a build-up of deposits by the non-financial public sector in the Central Bank. In 1995, however, these deposits shrank owing to the increasingly difficult fiscal situation. In addition, towards the end of the year the Central Bank granted emergency loans to a number of banks and financial institutions which were experiencing liquidity problems. Even so, despite these two highly expansionary factors, the money supply (M1) grew by only 13%, far below the 1994 increase of 36%. The smallness of this rise, which was also below the inflation rate, was a result of the contraction caused by the drop in international reserves. By early 1996, the authorities were having to resort ever more frequently to sales of monetary stabilization bonds in order to control money creation and offset the increase in financial-sector borrowing.

Several factors –including the official policy of propping up the currency band, the financial system's efforts to attract deposits in order to ease its acute liquidity crunch, the perception that country risk was higher as a result of political

Table 1
ECUADOR: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	10.7	-0.1	3.2	5.4	3.7	2.5	4.8	2.7
Per capita gross domestic product	8.0	-2.4	0.8	3.0	1.4	0.3	2.5	0.5
Gross national income	6.2	0.8	3.9	4.8	4.8	0.1	7.7	3.4
Gross domestic product, by sector								
Goods	18.4	-3.8	-0.5	5.1	3.7	3.5	6.3	3.0
Basic services	6.2	8.0	4.7	6.1	5.8	4.5	4.2	3.2
Other services	3.2	-1.6	3.0	3.8	2.6	2.4	3.1	2.2
	Percentages							
Contribution to growth of GDP [c]								
Consumption	2.3	0.4	3.5	1.6	0.9	4.2	5.2	1.9
Government	0.1	-0.2	0.2	-0.2	-0.3	-0.1	0.0	0.1
Private	2.1	0.6	3.3	1.8	1.2	4.3	5.2	1.8
Gross domestic investment	-0.9	0.6	-3.2	5.2	-0.3	-0.9	1.3	1.7
Exports	5.7	-0.1	2.6	2.0	3.2	1.2	3.0	2.2
Imports	3.6	-1.0	0.4	-3.4	-0.1	-2.1	-4.7	-3.1
	Percentages of GDP [b]							
Gross domestic investment	20.7	21.3	17.5	21.6	20.5	19.2	19.5	20.6
National saving	14.6	14.9	14.4	16.2	18.9	14.4	15.3	16.0
External saving	6.1	6.4	3.0	5.3	1.6	4.8	4.2	4.7
	Percentages							
Employment and wages								
Activity rate [d]	55.3	56.3	48.8	56.8	58.9	58.0	55.6	55.2
Unemployment rate [e]	7.0	7.9	6.1	8.5	8.9	8.9	7.8	7.7
Real minimum wage (Index: 1990= 00)	140.5	110.2	100.0	87.0	87.1	100.0	115.9	137.6
	Growth rates							
Prices (December-December)								
Retail prices	85.7	54.2	49.5	49.0	60.2	31.0	25.4	22.8
Wholesale prices	66.8	80.1	45.5	48.0	54.7	39.2	18.2	...
External sector								
Terms of trade (Index: 1990=100) [b]	93.4	100.8	100.0	92.9	92.3	86.1	90.7	89.1
Nominal exchange rate (sucres per dollar) [f]	302	526	768	1 046	1 534	1 919	2 199	2 566
Real effective exchange rate (Index: 1990=100)	92.3	94.6	100.0	95.2	94.7	83.5	78.2	78.8
	Millions of dollars							
Balance of payments								
Current account	-683	-716	-366	-707	-215	-682	-680	-826
Trade balance (goods and services)	440	539	880	483	800	443	385	134
Exports	2 644	2 871	3 253	3 408	3 631	3 716	4 589	5 212
Imports	2 204	2 332	2 373	2 925	2 831	3 273	4 204	5 078
Capital and financial account	-588	-511	-806	-481	-633	156	-60	1 578
Overall balance	-1 243	-1 112	-956	-1 025	-947	-582	-761	-502
International reserves (variation)	-26	118	195	78	22	499	449	-233
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	114.8	118.1	123.0	117.9	111.1	96.0	93.6	85.1
Net interest (as a percentage of exports)[g]	34.7	37.3	33.3	29.0	22.5	20.9	17.9	14.3

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Non-financial public sector								
Current income	21.5	26.3	27.1	25.4	25.8	26.6	24.4	25.7
Current expenditure[h]	21.4	20.2	19.5	18.5	19.6	19.4	18.1	21.2
Savings	0.1	6.1	7.6	6.9	6.2	7.2	6.8	4.1
Capital expenditure	5.4	7.5	7.5	7.9	7.9	7.6	6.5	6.4
Financial balance	-5.3	-1.4	0.1	-1.0	-1.7	-0.4	-0.2	-1.9
Domestic financing	1.8	-5.1	-3.3	-1.9	0.3	-2.3	-1.3	2.2
External financing	3.5	6.5	3.2	2.9	1.4	2.6	1.5	-0.3
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	...	...	336.2	109.6	65.0	50.9	34.9	10.4
Net domestic credit	...	10.5	21.9	35.7	47.6	56.9	81.3	67.7
To private sector	...	38.4	42.3	66.5	61.2	77.8	77.4	49.1
Money (M1)	...	38.1	52.2	46.5	44.5	49.4	35.7	15.0
Local-currency savings and time deposits	...	52.0	77.4	71.4	60.7	52.2	64.6	38.8
M2	...	44.2	63.8	59.0	53.3	51.0	52.0	28.8
Dollar deposits	...	...	...	806.1	1 385.0	239.9	202.7	135.8
	Annual rates							
Real interest rates (annualized)								
On deposits	33.7	-13.7	-7.8	-4.7	-7.9	1.0	6.9	16.7
On loans	-27.8	-7.4	-3.7	-1.2	-1.7	13.2	15.1	26.8
Equivalent interest rate in foreign currency[i]	-25.3	-11.6	0.2	-1.9	4.1	17.6	11.6	13.6

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Up to 1992, refers to the exchange rate on the regulated market. From 1993 on, refers to the exchange rate on the open market. [g] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [h] In 1994 and 1995, includes expenditures relating to staff reductions. [i] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
ECUADOR: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product (Index: 1990=100)	110.1	110.3	111.9	111.6	113.0	113.7	117.7	118.6	117.4	119.0	118.9	118.5
Consumer prices (12-month variation)	56.1	52.2	35.5	31.0	31.6	26.5	26.2	25.4	22.7	22.5	22.9	22.8
Real effective exchange rate (Index: 1990=100)	89.6	84.1	82.2	78.5	79.0	77.4	78.5	77.8	76.9	77.2	78.1	83.0
Real interest rate (annualized)												
On deposits	-5.3	-6.9	15.0	1.3	-5.1	3.3	15.2	14.2	18.8	9.8	17.4	20.9
On loans	10.1	1.9	28.0	12.7	3.9	11.6	23.4	21.5	24.4	22.9	28.5	34.2
Money (M1) (12-month variation)	48.7	46.8	51.2	49.4	52.0	44.1	62.3	35.7	23.0	29.3	14.9	15.0

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

events, and the expansion of domestic borrowing by the public sector– contributed to the marked volatility and very high level of real interest rates, which far exceeded those of the previous year. The combination of high interest rates –the reference interest rate on deposits averaged 16.7% in real terms, while the loan rate was 26.8%– with an energy crisis and the scant expansion in domestic demand, which were affecting production, led to an increase of nearly 90% in the delinquency rate, which had already gone up considerably in 1994.

In late 1995 and early 1996, a number of financial institutions were overtaken by a severe liquidity crisis, and some of these investment and securities firms collapsed. In order to stabilize the financial system, the Central Bank granted around US$ 150 million in emergency credits to a number of investment houses and banks, froze the issuance of licences for the establishment of new banks, provided incentives to encourage financial institutions to merge, raised capital reserve requirements, and took steps to improve supervision of the sector.

In March 1996, the Central Bank intervened in the Conticorp financial group and its subsidiary, the Banco Continental (one of the largest banks in the country), authorizing a loan of around US$ 160 million in order to avert its collapse and temporarily taking over its management. In addition, in order to clean up these financial institutions' portfolios and revive the production sector, a credit package was put together consisting of a US$ 200 million loan from the Andean Development Corporation and supplementary funds from the National Finance Corporation (CFN).

High domestic interest rates stimulated a 39% rise in local-currency savings and time deposits, although this was markedly lower than the increase recorded in 1994. Owing to the prevailing level of exchange-rate uncertainty, foreign-currency deposits grew far more –by 138%– and accounted for 24% of total quasi-money in both local and foreign currency. Nevertheless, the broad money aggregate (M2) (excluding foreign-currency deposits) expanded by only 29%, compared with 52% in 1994, as the growth of quasi-money was offset by a smaller increase in M1. As a result, the monetization process observed during previous years, which had been reflected in an increase in M2 (excluding foreign-currency deposits) in relation to the monetary base, ground to a halt in 1995. During the first half of 1996, however, this process picked up once more.

c) **Foreign exchange policy**

With a view to halting the continual appreciation of the sucre, at the end of 1994 the authorities announced that they would replace the controlled float of the currency with an exchange-rate band whose crawl rate was set at 12% at the beginning of 1995 based on the expected rate of internal and external inflation. The main instrument used to keep the exchange rate within its pre-set limits was Central Bank intervention in the foreign exchange market. The authorities found it difficult, however, to hold the rate within the band and on two occasions during 1995 were obliged to adjust the band owing to changes in the expected rate of inflation and pressures on the foreign exchange market. In February the band was raised 4%, while at the end of October the rate of crawl was increased from 12% to 16.5% and the band was widened to 10% of its central rate.

Expectations of a substantial nominal devaluation persisted, however, and the exchange rate hovered stubbornly near the ceiling of the band. The exchange rate increase was thus greater than expected, and the year ended with a slight devaluation of the sucre in real terms (around 2% of its annual average rate against a basket of the currencies of Ecuador's main trading partners), thereby reversing the tendency to appreciate which the currency had exhibited in previous years.

With a view to defending their gains in terms of stabilization and guiding expectations, the authorities announced that the currency band would remain in place until August, when the outgoing Administration's term of office would end. In addition, in order to curb currency speculation, in January 1996 they gradually began to lower the maximum percentage of net assets which financial institutions were allowed to hold in reserve currencies. During the first few months of 1996, the price of the dollar continued

to hover near the ceiling of the band, but the increase in domestic inflation did cause the local currency to appreciate somewhat compared with its level at the end of 1995.

d) **Trade policy**

At the beginning of 1995 the Andean Group's Common External Tariff came into effect for Colombia, Ecuador and Venezuela at levels ranging between 5% and 20%, depending on the type of product; an exemptions schedule was also established for each country which would then be phased out over a four-year period.

Negotiations on Ecuador's entry into the World Trade Organization (WTO) were also completed in 1995. The Ecuadorian Congress having ratified the agreement in December 1995, the country joined WTO on 21 January 1996. In addition, an economic complementarity agreement with Chile came into effect on 1 January 1995, and an agreement was concluded with Cuba providing for preferential tariff treatment for certain products.

e) **Structural reforms**

In 1992 the incoming Administration made structural reform one of the pillars of its programme. Over the next few years, anxious to increase the private sector's participation and the public sector's efficiency, the Government revamped the regulatory mechanisms for the financial, agricultural and hydrocarbon sectors, privatized a number of State-owned enterprises, granted concessions to private companies to provide public services and restructured several public agencies.

In order to be able to introduce political, social and economic reforms (e.g., the authority to dissolve Congress, social security reform, a ban on strikes by public utilities), the Government conducted another referendum in November 1995. However, in the context of the profound political crisis which culminated in the resignation and departure from the country of the Vice-President of the Republic, the Government's proposals were rejected. As a result, progress could be made only in those areas where a legislative majority was obtained. In one such instance, a bill was passed permitting the partial privatization of Ecuador's telecommunications company, EMETEL, through the sale of 35% of the corporation's stock to an international operator which would also assume the responsibility for managing and running the company and of up to 10% of its stock to EMETEL employees.

In August 1995, a block of 50.1% of the stock of the national airline, Ecuatoriana, was sold, and the sale of a further 24.9%, divided up into small blocks of shares, was envisaged. At the beginning of 1996 Congress passed a bill permitting the partial privatization of the Ecuadorian Electrification Institute (INECEL) in three years' time. This bill was vetoed by the Administration, however, and as of mid-1996 no consensus had been reached on the matter.

By the beginning of 1995 fuel distribution was being handled by private companies. During the course of the year progress was also made in the process involved in putting concessions for port services out to tender. In addition, the customs system was updated, the postal-service monopoly was eliminated and the national postal company was modernized.

3. The main variables

a) **Economic activity**

In 1995 GDP grew by barely 2.7%, and per capita GDP therefore remained virtually constant. Factors such as the energy crisis, high interest rates and the uncertainty caused by the political crisis had an adverse effect on growth. As a result, in each quarter except the second, GDP was down on the corresponding period of the preceding year.

Overall demand increased by 4.6%, thanks mainly to the robust performance of exports and private investment. Public-sector investment contracted, however, and growth in final consumption was also lower than the year before. This drop was due to the fall in household consumption of final goods, public consumption having increased for the first time since 1990 as a result of expenditures in connection with the armed conflict with Peru.

Gross domestic investment went up from 19.5% to 20.6% of GDP, a rise that was attributable solely to private investment, since public-sector investment declined in real terms. This increase in investment was chiefly financed out of higher gross national savings, which rose from 15.3% to 16%.

Agriculture and the finance and real estate sector turned in some of the best performances of 1995. With the exception of coffee, the main export crops expanded, but the harvests of a number of domestic-market crops fell. Crude oil production was somewhat higher, with the pipeline operating at full capacity. High interest rates and lower public-sector investment contributed to a decline in construction. In contrast to previous years, community, social and personal services expanded –albeit only by 1%– primarily as a result of the growth in government services. After contracting for two consecutive quarters, GDP grew 0.7% in the first quarter of 1996, a rise of 1.7% over the first quarter of 1995.

b) **Prices, wages and employment**

In 1995, the Government's macroeconomic programme was aimed at continuing to reduce inflation, which had amounted to 25% at the end of 1994, by maintaining a stable real exchange rate, pursuing a tight fiscal policy and controlling liquidity. Owing largely to unexpectedly sharp adjustments of the exchange rate and an increase in the fiscal deficit, however, the downward trend in inflation levelled off, and from March onward the 12-month inflation rate held at between 22% and 23%, closing out the year at 23%. A maximum inflation target of 19% was set for 1996, but the first half of the year once ended with an annual rate of 23% again.

In 1995 the Government continued its policy of boosting real minimum wages, which had fallen 70% between 1980 and 1991. In 1991 the country saw the beginning of an upturn and in 1995 minimum wages, including supplementary allowances, rose by 19% in real terms; thus, between 1991 and 1995 minimum wages won back a quarter of the ground they had formerly lost. This policy had a positive effect on real wages in medium-sized and large companies and, as a result, the annual average wage for 1995 was up 10% on the previous year.

Owing to the slower growth of production, the labour market suffered a drop in demand, with the number of vacancies advertised falling 5% in comparison with 1994; this trend was even more pronounced at the beginning of 1996. The unemployment rate rose substantially in August, but dropped once more at the end of the year; consequently, the annual average was similar to that of the preceding year (7.7% of the labour force). As to the composition of employment, there was a slight increase in the share of the informal sector.

c) **The external sector**

Having surged strongly in 1994, exports expanded yet again in 1995, albeit at the lower rate of 13%. It was a favourable year for all the major exports –commodities as well as manufactures. The only exception was coffee, where falling prices and export volumes cut the value of exports to half the preceding year's level. Many of the country's other main export commodities, such as crude oil, shrimp and cocoa, made gains in terms of both volume and price. There was also substantial growth in banana exports thanks to an increase in volume and practically constant prices. Exports of manufactures fared even better than those of commodities and thus increased their share in total exports from 18% in 1994 to 19% in 1995.

Exports to Ecuador's principal markets (the United States and the European Union) grew at about the same pace, while those to the Andean Group were down as a result of the hostilities with Peru and a slowdown in exports to Colombia.

Imports, including purchases of arms, rose by 25%; if this category is excluded, then the increase was 16%. After four years of notable growth, imports of consumer goods, particularly consumer durables, suffered a reverse in 1995. On the other hand, capital goods imports were up slightly, while a considerable increase was seen in imports of raw materials and intermediate goods; this was particularly true in the case of fuel and lubricants, as a result of the energy crisis.

Consequently, in 1995 the merchandise trade surplus fell by nearly half, to US$ 260 million. Since arms purchases figured prominently in this result, some improvement was expected in 1996. Meanwhile, the deficit on trade in services fell slightly. Thus, the overall current account deficit increased from 4% to 4.6% of GDP. During the first few months of 1996, however, the trade balance improved considerably owing to a drop in imports.

The financial account posted a large surplus. Thanks to the external debt restructuring agreement which Ecuador signed in late 1994, net disbursements to the general government showed considerable growth after several years of high negative figures. At the same time, private borrowing in dollars soared (by more than US$ 700 million) due to the high cost of loans in sucres. Foreign direct investment was somewhat lower, however, as a consequence of declining investment in the petroleum sector and a slowdown in privatizations, although it was still high in historical terms.

The year's economic and political problems contributed to an estimated US$ 600 million in other –primarily short-term– capital losses which were entered under the heading of errors and omissions.[1]

As a result, the overall balance at the end of the year showed a deficit of US$ 500 million (part of which was covered by special financing), and losses of reserves in 1995 amounted to US$ 230 million. In the first quarter of 1996, however, reserves remained relatively stable.

[1] This item also includes amortization and interest payments for previous years made as part of the rescheduling of Ecuador's external commercial debt. This process came to a conclusion in February 1995, when the existing bonds were swapped for new ones.

EL SALVADOR

1. General trends

In 1995, the economy of El Salvador continued growing in a stable environment, even though the targets set out in the monetary and financial programme were not fully met. In a fourth year of significant expansion, gross domestic product (GDP) grew by 6%. Large inflows of remittances from Salvadorans resident abroad stimulated domestic demand and activities catering to the local market. Increased domestic spending continued to erode the real exchange rate, which encouraged imports. The trade deficit widened to nearly 16% of GDP, exacerbating the balance-of-payments current account deficit. Nevertheless, merchandise exports rose by 33% at current values, while volume expanded by 17%.

Although the non-financial public-sector deficit narrowed to less than 1% of GDP, the rise in consumer prices (11%) was greater than in 1994. Mid-year adjustments to a number of utility charges, minimum wages and the rate of the value-added tax (VAT) affected both costs and expectations, as did the increase in liquidity during the first half of the year due to external borrowing by commercial banks and large private companies.

Financing by means of external short-term credits was encouraged by the spread between local and international interest rates produced by a fixed-rate system of currency convertibility, one of a series of measures designed to promote greater commercial and financial openness in the economy. External funds taken in by banking institutions fuelled a rapid expansion of private-sector credit, which in the first half of 1995 reached a level 40% above that for the same period the preceding year. In order to control the increase in spending, monetary policy was tightened during the latter part of the year. The higher cost of credit restrained demand for goods and services.

2. Economic policy

At the beginning of 1995, the Government announced a strategy of gradual dollarization of the economy, based on a fixed exchange-rate system. The programme included accelerated tariff reductions, fiscal reform and privatization of State assets, as well as further financial reforms and the establishment of a pension scheme based on individual capitalization.

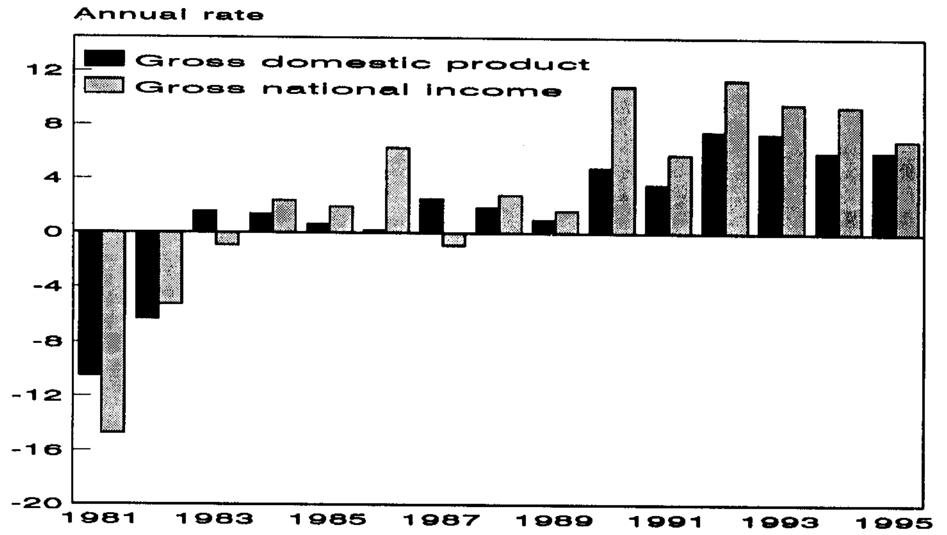
Uncertainty as to how these measures would be implemented and what their effects would be led to some speculative behaviour that complicated the application of policy, particularly in the areas of finance and foreign exchange.

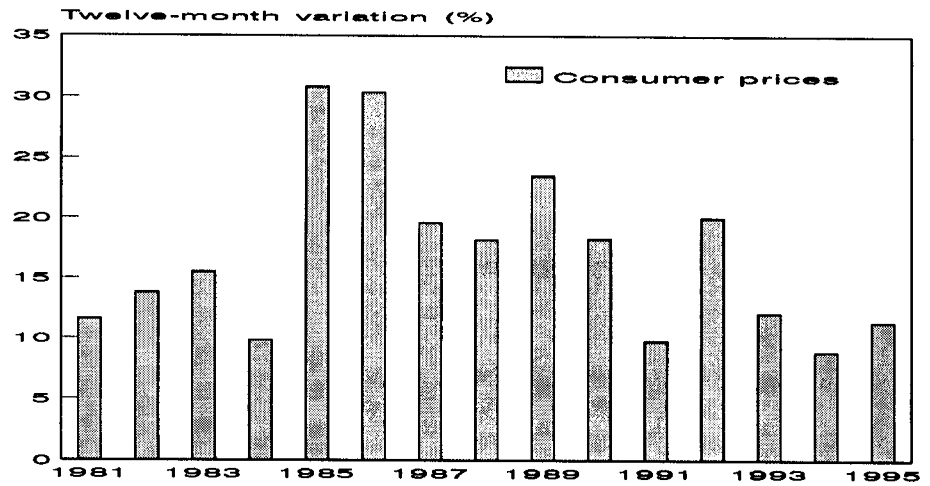
a) Fiscal policy

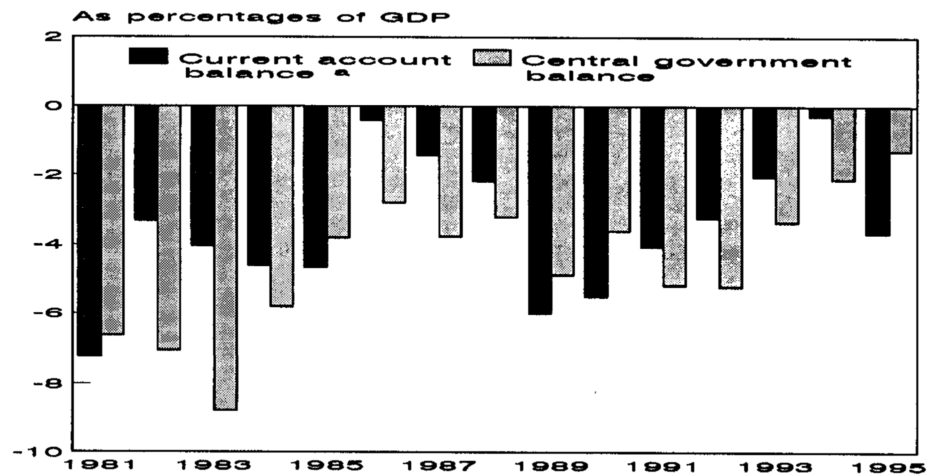
Government revenues swelled as a result of stricter supervision, the imposition of harsher penalties for tax evasion, and increases in a number of tax and utility rates. The non-financial public-sector deficit, excluding grants, narrowed considerably, reducing the public-sector financing requirement (2% of GDP in 1994) to less than half.

The growth in public-sector current income was due chiefly to a significant increase in tax revenues. The tax ratio increased to nearly 12% of GDP, one point higher than it had been in 1994, although still far short of the levels of the mid-1980s. The biggest increases were in revenues from income tax, VAT and import duties. The tax reform adopted during the first half of 1995 raised the VAT rate (from 10% to 13%) and also increased taxes on cigarettes and on alcoholic and carbonated beverages. Since its

Figure 1
EL SALVADOR: MAIN ECONOMIC INDICATORS







Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

introduction in 1992, VAT has become the most important single tax, generating over two fifths of total tax revenue.

The wage rise (8%) awarded to public-sector employees in July and the commitments made in the peace agreements, especially concerning compensation payments to demobilized members of the armed forces, were factors in the expansion of current spending. On the other hand, better management kept the increase in public-sector current expenditure below target. In October, the Legislative Assembly passed the Transitional Financial Compensation Act, otherwise known as the Compulsory Retirement Act, which would eliminate 15,000 of the 110,000 public-sector jobs, starting in January 1996.

Real public-sector investment kept pace with prices. Central government investment expenditure was significantly higher, while State-enterprise investment projects were limited.

The fact that revenues were higher and spending lower than planned meant that current saving improved from 2% to 3.2% of GDP and covered more than 75% of capital expenditure. Thus public-sector investments could be made without recourse to inflationary financing or significantly higher external borrowing.

The public-sector deficit was financed solely with external resources, since the Government, as planned, paid off its domestic debt. Grants and donations, though less in amount than the preceding year, accounted for over 60% of net external credit to the public sector and 85% of the deficit.

b) **Monetary policy**

The Central Reserve Bank's monetary policy was geared towards maintaining liquidity levels that were consistent with growth in the economy and with the achievement of the targets for inflation and net international reserves.

The measures that were adopted resulted in only moderate growth in the monetary aggregates compared with the year before. The rate of expansion of local-currency liquidity (M2) slowed from 21% to 8%. Both the money supply and time deposits increased markedly less than in 1994. Growth in dollar deposits also slowed, although at 18% it still exceeded the growth of assets in local currency. While both public-sector credit and net international reserves in the financial system contracted, the expansion of liquidity was fuelled by a significant increase in loans to the private sector (30%).

Domestic credit expanded as a result of various policy moves. During the early months of the year, it was decided that the legal reserve requirement for dollar deposits should be the same as for local-currency deposits, which remained at 20% for time deposits and 30% for demand deposits. In addition, the banking system was authorized to pay interest on dollar demand deposits with average daily balances exceeding US$ 5,000. These measures reduced the monetization of dollar deposits, while the spread between domestic and international interest rates led banks to look for short-term credit abroad. During the first half of 1995, total credit to the private sector was 40% higher than in the same period the year before. This situation generated a surge in liquidity and raised inflationary expectations (particularly once the VAT increase was announced), putting pressure on prices as a result. The expansion of credit was accompanied by a growing current-account deficit due to the widening of the trade gap.

Under the circumstances, the Central Reserve Bank decided to curb aggregate spending in order to help stabilize prices and check the demand for foreign exchange. During the second half of the year, the authorities took several steps to curb liquidity and in particular the expansion of private-sector credit. They raised the rate of interest on credit granted to banks through the Central Reserve Bank's automatic liquidity window and set a maximum term of five days for such credit. In addition, the reserve requirements for both local-currency and dollar deposits made by the State and autonomous State-owned institutions and enterprises were increased, by 15% for savings and time deposits and by 5% for demand deposits. The 10% reserve requirement was also reintroduced for foreign-currency loans and guarantees with terms of less than five years obtained abroad by financial institutions.

The effect of these measures was to push interest rates up and to widen the spread between lending and deposit rates over the course of the year to nearly five percentage points.

Table 1
EL SALVADOR: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	1.9	1.0	4.8	3.6	7.5	7.4	6.0	6.1
Per capita gross domestic product	0.1	-0.9	2.8	1.5	5.2	5.0	3.7	3.7
National income	2.8	1.6	10.9	5.8	11.4	9.7	9.5	6.9
Gross domestic product, by sector								
Goods	2.0	1.5	3.8	3.8	8.8	-1.4	4.1	6.2
Basic services	2.0	1.2	6.2	-2.9	9.1	6.8	5.2	5.6
Other services	1.7	0.5	5.2	3.7	5.8	3.9	6.1	6.2
	Percentages							
Contribution to growth of GDP [c]								
Consumption	1.6	1.5	13.9	3.2	7.7	8.0	7.5	9.5
Government	0.5	-0.2	-6.4	0.3	0.1	0.1	0.3	0.3
Private	1.2	1.7	20.3	2.9	7.7	7.9	7.3	9.1
Investment	2.2	3.6	-2.8	2.4	4.4	1.8	1.5	2.7
Exports	-2.1	-2.7	4.1	-0.1	1.3	5.5	2.6	4.1
Imports	0.1	-1.4	-10.4	-1.9	-5.9	-7.9	-5.6	-10.2
	Percentages of GDP [b]							
Gross domestic investment	13.9	17.3	13.9	15.7	18.7	19.1	19.4	20.8
National saving	11.5	11.6	8.4	11.2	14.9	16.7	19.1	17.0
External saving	2.4	5.7	5.4	4.5	3.8	2.3	0.3	3.8
	Percentages							
Employment and wages								
Activity rate [d]	...	...	...	51.6	52.2	...	...	...
Open unemployment rate [e]	...	...	...	8.7	9.9	...	7.7	7.7
Real minimum wage (Index: 1990=100) [f]	125.2	106.3	100.0	97.8	101.0	97.9	99.9	98.6
	Growth rates							
Prices (December-December)								
Retail prices	18.2	23.5	18.3	9.9	19.9	12.3	8.9	11.4
Wholesale prices	4.6	11.6	22.5	-1.2	9.6	2.6	11.9	...
External sector								
Terms of trade (Index: 1990=100) [b]	85.5	82.3	100.0	98.5	98.6	97.1	107.4	114.4
Nominal exchange rate (colones per dollar)	5.00	5.48	7.69	8.08	8.44	8.70	8.74	8.76
Real effective exchange rate (Index: 1990=100)	86.9	82.8	100.1	98.4	98.2	88.0	83.9	80.9
	Millions of dollars							
Balance of payments								
Current account	-129	-370	-261	-212	-195	-118	-18	-276
Trade balance (goods and services)	-369	-704	-651	-717	-950	-1 011	-1 212	-1 569
Exports	939	909	973	898	975	1 138	1 639	2 209
Imports	1 308	1 612	1 624	1 614	1 925	2 149	2 851	3 778
Capital and financial account	52	118	-11	-61	-4	87	84	423
Overall balance	-184	-111	27	-148	-134	59	113	147
International reserves (variation)	-30	110	165	-70	92	112	113	72
	Percentages							
External debt								
Public debt (as a percentage of GDP)	29.7	32.8	43.8	40.1	38.6	34.1	31.2	29.9
Net interest (as a percentage of exports)[g]	8.7	7.1	10.9	10.1	8.0	8.0	4.4	3.2

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Non-financial public sector								
Current income	...	10.3	12.5	13.0	13.6	13.7	15.2	16.1
Current expenditure	...	11.8	12.8	13.8	13.4	13.0	13.3	12.9
Savings	...	-1.5	-0.3	-0.8	0.2	0.8	2.0	3.2
Net capital expenditure	...	4.3	2.5	4.1	6.7	-4.5	4.0	4.1
Financial balance	...	-5.9	-2.9	-4.9	-6.5	-3.6	-2.0	-0.9
Domestic financing	...	2.6	-1.1	0.8	0.6	-0.3	-1.6	-1.2
External financing	...	3.2	3.9	4.1	5.9	4.0	3.6	2.1
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	-21.2	69.6	92.6	1.7	26.1	13.7	10.3	-4.5
Net domestic credit	9.6	-32.6	10.4	22.7	37.5	45.5	26.2	15.0
To public sector	4.0	-28.1	37.5	23.2	14.3	3.8	-27.5	-15.8
To private sector	12.5	12.3	6.2	12.8	31.0	37.5	27.1	30.4
Money (M1)	8.3	12.8	22.1	6.1	31.8	12.4	10.2	4.4
Local-currency savings and time deposits	14.0	-19.5	32.0	29.1	31.2	48.6	25.3	9.1
M2	12.0	-8.7	27.9	20.0	31.4	35.9	21.0	7.9
Dollar deposits	...	...	5.6	-34.1	99.0	1.7	58.3	18.4
	Annual rates							
Real interest rates (annualized)								
On deposits	-2.3	-5.8	-0.5	5.9	-6.2	2.7	4.3	2.8
On loans	-0.6	-3.9	2.2	4.2	-2.5	6.4	9.3	7.1
Equivalent interest rate in foreign currency[h]	15.0	16.3	-11.4	15.5	-0.8	22.4	12.5	14.3

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Real minimum wage in the manufacturing and services sectors in San Salvador. [g] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [h] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
EL SALVADOR: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	21.2	23.4	15.0	12.3	13.0	9.9	9.7	8.9	8.7	9.4	12.2	11.4
Real effective exchange rate (Index: 1990=100)	92.3	90.1	85.1	84.5	83.3	83.8	84.4	84.1	83.0	82.8	79.8	77.9
Real interest rate (annualized, %)												
On deposits	5.0	-2.8	4.6	4.2	0.5	6.3	4.6	5.8	0.5	4.4	-4.4	10.9
On loans	7.8	0.6	8.8	8.5	4.7	10.9	9.9	11.8	5.9	8.4	-0.8	14.8

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

c) **Trade policy**

The authorities had intended to reduce tariffs to zero during the Administration's term of office. However, the demands of a number of groups in the private sector and El Salvador's commitments as a member of the Central American Common Market (CACM) forced the adoption of a more gradual approach. The first step was taken in April, when tariffs on imports of capital goods were cut from 5% to 1%. The plan called for reductions in 1996 in the tariff on inputs and basic commodities of non-local manufacture to 1% and in the tariff ceiling from 20% to 15%. The tariff ceiling would then be lowered by a further three percentage points per year, to 6% in 1999.

1995 saw the ratification of El Salvador's full membership in the World Trade Organization (WTO), and in that context negotiations took place on free trade agreements between Mexico and what is known as the Northern Triangle of Central America (El Salvador, Guatemala and Honduras), and between Colombia, Venezuela and Central America. Trade and investment agreements were also negotiated with the Dominican Republic and Panama. In addition, bilateral talks on reciprocal promotion and protection of investments were opened with Ecuador, Switzerland, Spain, Chile, the Netherlands, the People's Republic of China, the Russian Federation, Colombia and the United States of America.

d) **Reform policies**

In November 1995, the sale of the last of the banks under State supervision (Banco Hipotecario) was announced. This concluded the process of financial sector privatization which began in 1990. Progress was also made during the course of the year in drafting laws designed to reinforce the solvency of financial institutions, extend their foreign operations and promote improvements to their information systems. The amendments to the legal framework of the financial system would allow for the establishment of new banks and financial institutions and the participation of foreign banks in the domestic market. In addition, new proposals were drawn up for tightening prudential bank supervision rules and strengthening the Superintendency of Banking. Legislation on insurance companies, investment funds and pension systems, is also being drafted to promote the development of institutional investors.

In the interests of ensuring the soundness of financial institutions and improving their efficiency and competitiveness, a bill to amend the Banks and Financial Institutions Act was submitted to the Legislative Assembly. The amendments would entail a substantial increase in the minimum capital required to set up banks and financial institutions, and such companies would have to list their shares on the Stock Exchange. The reforms would also increase the ratio between equity and total weighted assets and alter the liabilities-to-equity ratio. A common reference interest rate would be introduced, to be set by the banks and financial institutions and varied according to the type of credit transaction, in local or foreign currency; all loans would then earn a rate based on this common reference rate.

3. The main variables

a) **Economic activity**

With growth of 17%, exports of goods and services provided the impetus for a significant expansion (11%) of aggregate demand. Private investment also forged ahead (12%), which boosted gross fixed investment by 10%. Growth in consumption speeded up (9%), eroding still further the already meagre rate of domestic saving. This is an indication of the extent to which economic activity in El Salvador depends on inflows of resources from abroad, including private and official unrequited transfers. It is estimated that remittances from family members alone are equivalent to 12% of GDP. Within aggregate supply, the rate of expansion of the imported component was nearly four times the rate of growth in output.

There were gains of nearly 6% in goods-producing activities as a result of the upturn (5%) in the agricultural sector due to good harvests of coffee and basic grains.

Despite vigorous growth in the output of *maquila* companies, the industrial sector lost momentum owing to the more intense competition from imports that accompanied the increase in domestic demand and to labour unrest. Within manufacturing, the most active subsectors were machinery and metal products, and textiles and clothing.

Difficulties in selling upper-middle-income housing and the glut of shopping malls and office buildings slowed the expansion of the construction sector to 6%.

Hydroelectricity generation in 1995 was affected by technical failures and by the low levels of the power station reservoirs during the first few months of the year, so that thermal energy generation, whose direct production costs are higher, had to be stepped up. The rate of growth of electricity and drinking-water services fell to 5%.

The growth of the communications subsector was driven by the expansion of local telephone services. Transport was also boosted by the increased demand for haulage of merchandise, particularly for export or import.

The greater purchasing power of the population as a result of family remittances, combined with the price effect of tariff reductions and the real exchange-rate appreciation, helped commerce to maintain a strong growth trend.

b) **Prices, wages and employment**

Until the end of the first half of 1995, the 12-month variation in the consumer price index (CPI) tended downwards, but this trend was reversed in July with the announcement of increases in VAT, public utility rates (water, electricity and telephone) and minimum wages. In September, severe weather conditions hurt the vegetable and fruit harvests, driving food prices up. The monetary and fiscal measures that were taken slowed the pace of inflation by the end of the year, and the cumulative variation to December was slightly over 11%, compared with the target of 6%-8% set by the authorities.

In July, public-sector employees received a pay rise of 8%, while in August the minimum wage for private-sector workers and employees went up by 10%. These increases were barely enough to regain the purchasing power that had been lost to inflation.

Despite the favourable trend in GDP, job creation was insufficient to reduce unemployment, which stood at around 7.7% nationally (7% in urban areas and 8.7% in rural areas).

c) **The external sector**

In 1995, the merchandise trade deficit widened by US$ 350 million, with exports expanding by 33% and imports by 31%. The trade deficit in goods and services, which also grew (US$ 1.57 billion), was the equivalent of nearly one sixth of output.

Merchandise exports rose to a level of US$ 1,660 million. The value of sales of traditional exports rose by 31%, largely owing to an increase in coffee exports. The volume of coffee exported was actually 12% lower than the year before, but since the price of beans rose substantially, the value of sales increased by more than 33%. Non-traditional exports, which accounted for nearly three fifths of total exports, expanded by 17%. By contrast with 1994, sales to the Central American region jumped (up 25%). More than 70% of non-traditional exports found their way to CACM, notably medicines, paper and cardboard containers, perfume and cosmetic products, aluminium products and refrigerators and freezers. Even so, the interregional trade balance was again negative; the ample surplus El Salvador ran up with Honduras and Nicaragua only partly offset the yawning gap in its trade with Guatemala and Costa Rica. *Maquila* exports (especially clothing) totalled US$ 660 million, an increase of 50% over the 1994 level.

The impetus of economic activity, the appreciation of the currency and stockpiling by companies in anticipation of a VAT hike pushed up the rate of imports of merchandise, which swelled by 31%. Under a more open economic policy, goods imports as a proportion of GDP rose

from 28% to 30%. In contrast to 1994, this expansion was spearheaded by consumer goods (33%), particularly durables, followed by capital goods (27%) and raw materials and intermediate goods (23%). The greater availability of resources due to the growth of family remittances, along with the first half-year's surge in private-sector credit, helped to fortify the demand for consumer goods. Imports of intermediate and capital goods were also boosted by the cut in the tariffs on capital goods from 5% to 1%.

Net current transfers, including family remittances and grants, were around US$ 1.4 billion, which exceeded the value of merchandise exports and financed the bulk of the trade deficit. Grants –the fruit of bilateral agreements, chiefly with the United States, Japan, Canada and Germany– totalled more than US$ 130 million. While the volume of grants and donations was thus lower, there was an increase in (mainly soft) loans for development projects.

As a result, the deficit on current account, which in 1994 had been negligible, soared to US$ 280 million, the equivalent of nearly three percentage points of GDP. Nevertheless, inflows of foreign exchange through the capital account were enough to swell the net international reserves in the Central Reserve Bank by the end of the year (US$ 935 million, or nearly three months' worth of imports) by around US$ 150 million more than 12 months previously.

In 1995, a new stand-by agreement was signed with the International Monetary Fund (IMF) for US$ 58 million. In addition to providing support for the Government's reform programme, the agreement allowed El Salvador continued access to financing on concessional terms from the international community, which helped to underpin the country's macroeconomic stability.

Loans, of which (70%) came from the Inter-American Development Bank (IDB) and the World Bank, rose to some US$ 930 million. Resources obtained through external cooperation agreements were allocated to the priority areas of education, health, water supply improvements, public security, justice, housing and the environment.

The external public debt increased by more than US$ 170 million, although as a percentage of GDP it fell from 26% to 23%. The ratio of interest payments to exports was close to 6% and the debt service/exports ratio was slightly over 17%, in both cases a marked improvement.

GUATEMALA

1. General trends

In 1995 the Guatemalan economy expanded by 5%, which was, faster than in the preceding two years, thanks to good export prices and brisk domestic spending induced by a significant increase in private-sector bank credit. The growth in exports reduced the balance-of-payments current account deficit, but even so, it was still quite high. Inflation also slowed to below 9%, but this may have been partly attributable to the delay in adjusting electricity prices.

The country's economic performance was matched by positive developments on the political front. In 1995 presidential, congressional and municipal elections were held. A number of political groupings participated in these elections, and the new President took office early in 1996. Although negotiations to end the internal armed conflict proceeded slowly throughout 1995 with no sign of significant progress being made, an agreement on social and economic issues and the agrarian situation, which had taken eight months to hammer out, was signed in May 1996.

The prevailing conditions in international markets, which were reflected in an increase of nearly 20% in the terms of trade, had a positive influence on Guatemala's macroeconomic performance. Early in 1995 the prices of its main export products –coffee and sugar– rose substantially, although they moved downward again in the second half of the year.

The foreign exchange market, however, was affected by both the expansion of liquidity which had occurred in the last quarter of 1994 and the uncertainty characteristic of a pre-election period. Furthermore, traditional means of regulating the money supply were rendered less effective by the new types of instruments which the country's banks began to use to attract funds. Although the Bank of Guatemala sold foreign currency on several occasions in order to meet increased demand, as a result of which international reserves fell, the exchange rate continued to depreciate slowly. While significant progress was made towards achieving the monetary programme's targets for net credit to the central government, they were not fully met.

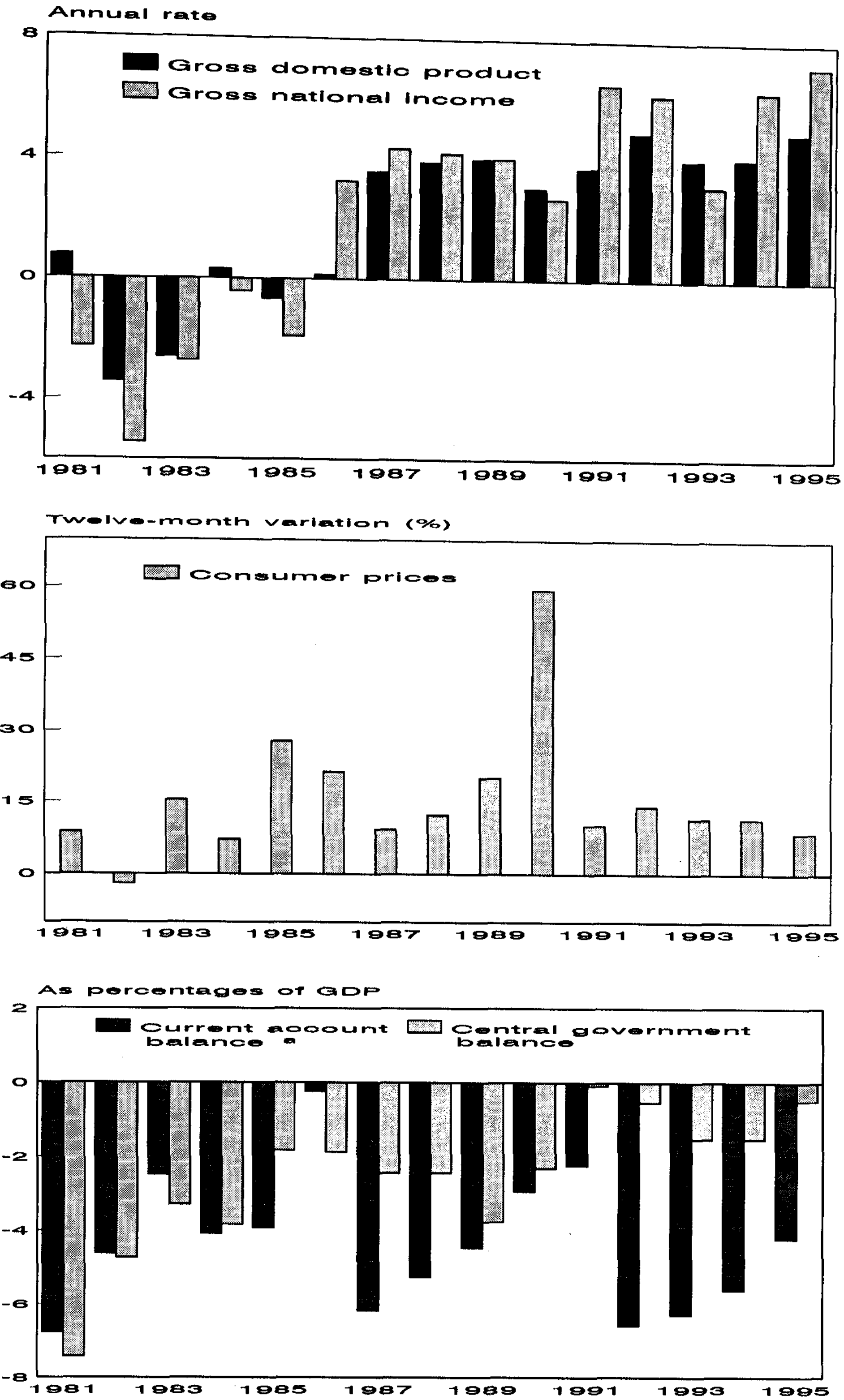
The fiscal deficit was markedly lower, at 0.5% of gross domestic product (GDP), thanks to a significant increase in current government saving. This, in turn, was due to a contraction in expenditure and, in particular, to improved tax revenues. The tax ratio, however, remained below the levels recorded for some other years during the 1990s and was low in comparison with other countries of the region. In addition, the Bank of Guatemala's losses were on a par with those of the preceding year.

The balance-of-payments current account deficit fell to 4% from the 1994 figure of 5.6%. Although the trade deficit also shrank, it again exceeded 6% of GDP. Unrequited private transfers rose considerably to just under 3% of GDP, but although this helped alleviate the need for external financing, the drop in capital inflows was reflected in a decrease in international reserves.

2. Economic policy

In May 1995 the Government signed an agreement with the International Monetary Fund (IMF), an earlier arrangement having been suspended in late 1994 because that year's fiscal

Figure 1
GUATEMALA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

targets had not been met. Broadly speaking, economic policy in 1995 focused on stabilization objectives. In fiscal terms, the authorities' aim was to boost tax revenues and bring down the public-sector deficit, including its quasi-fiscal components. Monetary targets centred on a moderate expansion of liquidity so as to protect international reserves.

No major changes were seen in external trade policy. Tariffs were kept between a maximum of 20% and a minimum of 5%, although in the course of the year the members of the Central American Common Market agreed to adjust their tariff range to 0%-15%. This measure was not implemented during 1995, however, and Guatemala remained at liberty to decide when it would begin applying the new tariffs. Meanwhile, the country continued its efforts to obtain terms comparable to those granted to Mexican exports in the United States market.

Wages continued to be set through company-specific negotiations, although the Government did enact an across-the-board increase in the minimum wage towards the end of the year.

a) **Fiscal policy**

The main objectives of fiscal policy were to reduce the public sector's overall deficit to no more than 1.3% of GDP, to increase tax revenues and to cut net credit to the central government.

The central government's deficit was below its target level, at roughly 0.5% of GDP, while the positive trend in tax revenues brought about a partial reversal of the sharp downturn in the tax ratio. On the other hand, the target for net credit to the central government was not fully met, for although the central government paid off a large part of its considerable loans from the banking system, it was also forced to draw on its deposits in order to deal with liquidity problems.

One important feature of public finances was the rise in tax revenues from the equivalent of 6.7% of GDP in 1994 to 7.6% in 1995. This, together with only moderately higher current spending, led to a marked upswing in savings and enabled the Government to finance part of its capital expenditure with its own resources.

Tax revenues increased by nearly 30%. Income from the value-added tax (VAT) was up 26%, owing to higher receipts from imports and non-personal services, as well as from customs duties, which rose significantly (34%). After having fallen in 1994, revenues from direct taxes were considerably higher; income tax receipts, in particular, jumped by 60%.

A large number of administrative measures were implemented by the internal revenue service during 1995. First, quarterly income-tax payments were re-instituted after correction of the technicalities that had resulted in their being declared unconstitutional. Moreover, early in the year the Constitutional Court upheld the legality of the concept of tax offences, thereby paving the way for the penalization of tax evasion. In addition, the administration of VAT was refined and stricter criteria for tax credits were introduced. The fiscal authorities also took a number of steps to improve procedural aspects of the tax system, including the recruitment of auditors to investigate charges of tax evasion, the establishment of a customs audit section and the modernization of the service's information systems.

The central government's current expenditures went up by less than 8% in nominal terms, which was somewhat more than in 1994, but was less than the inflation rate. This was the result of a slight increase in its expenditure on wages and of a nominal decrease in outlays on goods and services. Interest payments climbed significantly, however, and the Government's capital expenditure, which had fallen in nominal terms in 1994, accelerated by 24.4%.

Growth in revenue notwithstanding, fiscal management was conducted under difficult circumstances; in particular, the provision of several important government services continued to exhibit a number of shortcomings. Furthermore, the illiquidity of public finances made it impossible to pay off a floating debt of 345 million quetzals from fiscal 1994, and the Government was obliged to incur further debts of the same type amounting to 1.27 billion quetzals in 1995. In addition, the central government was up to two quarters in arrears on its transfer payments to the country's municipal governments.

Nevertheless, the Government's financing needs were substantially lower. In 1995, external credit to the public sector contracted sharply and,

Table 1
GUATEMALA: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	3.9	4.0	3.0	3.7	4.9	4.0	4.1	5.0
Per capita gross domestic product	0.9	1.1	0.1	0.8	1.9	1.1	1.1	2.0
Gross national income	4.2	4.0	2.7	6.6	6.2	3.1	6.4	7.2
Gross domestic product, by sector								
Goods	4.3	3.1	2.6	2.8	4.7	2.2	2.1	3.5
Basic services	4.9	10.0	6.1	5.7	8.3	5.5	5.3	6.4
Other services	3.4	3.6	2.8	4.0	4.4	5.1	5.2	5.7
	Percentages							
Contribution to growth of GDP [c]								
Consumption	3.7	3.3	1.2	3.1	7.5	4.4	5.9	5.1
Government	0.3	0.3	0.2	0.1	0.4	0.5	0.3	0.3
Private	3.3	3.0	0.9	3.0	7.1	3.9	5.6	4.8
Gross domestic investment	-0.2	0.1	-0.2	3.1	4.8	-1.1	-0.1	1.0
Exports	1.4	2.2	1.8	-0.8	1.8	2.7	0.8	1.8
Imports	-1.0	-1.5	0.3	-1.7	-9.1	-2.0	-2.5	-3.0
	Percentages of GDP [b]							
Gross domestic investment	14.7	14.2	13.6	16.1	19.9	18.0	17.2	17.4
National saving	11.5	11.6	8.4	11.2	14.9	16.7	19.1	17.0
External saving	5.8	4.9	3.0	2.6	8.0	7.7	6.7	4.9
	Percentages							
Employment and wages								
Activity rate [d]	52.5	52.3	52.1	52.1	52.1	52.1	52.1	52.1
Open unemployment rate [e]	8.8	6.1	6.5	6.4	5.7	5.5	5.2	4.3
Real minimum wage (Index: 1990=100)	157.5	141.3	100.0	80.7	72.5	62.8	...	...
	Growth rates							
Prices (December-December)								
Domestic retail prices	11.0	20.2	59.8	10.0	14.2	11.6	11.6	8.6
External sector								
Terms of trade (Index: 1990=100) [b]	98.8	97.6	100.0	107.2	106.7	103.0	110.5	118.3
Nominal banking exchange rate (quetzals per dollar)	2.62	2.82	4.49	5.03	5.17	5.64	5.75	5.82
Real effective exchange rate (Index: 1990=100)	85.0	85.4	100.0	87.9	87.0	88.9	85.1	82.6
	Millions of dollars							
Balance of payments								
Current account	-414	-367	-233	-214	-713	-702	-638	-525
Trade balance (goods and services)	-462	-438	-244	-340	-962	-938	-951	-922
Exports	1 269	1 424	1 568	1 688	1 883	2 033	2 271	2 800
Imports	1 731	1 861	1 812	2 028	2 845	2 971	3 222	3 721
Capital and financial account	81	225	-46	688	571	688	644	448
Overall balance	-336	-87	-243	639	-27	162	-43	-204
International reserves (variation)	-111	59	-42	558	-65	110	-2	-158
	Percentages							
External debt								
Public debt (as a percentage of GDP)	29.7	29.9	31.3	25.1	20.8	18.7	19.1	17.0
Net interest (as a percentage of exports)[f]	11.7	10.3	10.7	7.6	7.6	4.9	4.2	3.8

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Central government sector								
Current income	10.1	9.4	7.9	9.0	10.1	9.0	7.6	8.4
Current expenditure	10.1	10.1	8.5	7.6	7.8	7.5	6.9	6.4
Savings	-	-0.6	-0.6	1.5	2.4	1.5	0.8	2.0
Capital expenditure	2.4	3.1	1.7	1.5	2.9	3.1	2.3	2.5
Financial balance	-2.4	-3.8	-2.3	-0.1	-0.5	-1.5	-1.5	-0.5
	Growth rates							
Currency and credit								
Money balances of banking system								
International reserves	19.4	-57.7	-11.3	-1 015.9	57.6	19.2	-15.8	-8.6
Net domestic credit	11.9	9.8	20.5	15.1	11.2	5.8	39.6	15.7
To public sector	-11.7	23.5	-1.1	94.7	-31.0	-34.4	-47.4	-36.5
To private sector	15.0	9.6	16.6	18.4	35.1	15.3	14.2	24.4
Money (M1)	14.3	20.7	33.9	18.3	5.4	21.1	34.9	8.2
Local-currency savings and time deposits	9.2	14.8	13.7	64.1	27.4	3.4	20.1	13.5
M2	11.1	17.1	21.7	44.1	19.5	9.0	25.3	11.5
	Annual rates							
Real interest rates (annualized)								
On deposits	-	-5.2	-23.9	13.1	-3.4	1.0	-1.7	-0.8
On loans	2.7	-2.7	-20.6	22.0	4.6	11.8	10.2	11.6
Equivalent interest rate in foreign currency [g]	4.3	-5.4	-1.7	22.7	6.2	1.9	12.8	2.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [g] Nominal interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
GUATEMALA: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	13.2	13.2	14.4	12.6	14.0	13.3	10.8	12.1	8.4	8.2	8.4	8.6
Real effective exchange rate (Index: 1990=100)	86.4	87.3	90.7	91.0	88.1	85.1	84.6	82.7	82.1	82.8	82.9	82.6
Real interest rate (annualized, %)												
On deposits	5.6	-5.2	3.5	-	-2.2	1.5	-1.8	-4.3	6.0	-9.8	2.0	-4.4
On loans	16.3	4.9	15.0	11.1	8.5	13.4	11.5	7.5	19.2	5.2	14.9	7.1

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

as a result, domestic credit increased as a percentage of total financing (from 35.5% to 80%) even though it decreased in volume. Since the Government is barred from borrowing from the Bank of Guatemala by the Constitution and maintains a policy of settling up its debts with the financial system, the Government launched public bond offerings several times during the course of the year at market rates for short terms (around three months, on average) in what is still an emerging market.

b) **Monetary policy**

The multiplicity of monetary policy objectives occasioned conflicts in its implementation, since macroeconomic stabilization was the first priority, but the authorities were also trying to help bring down interest rates as a means of encouraging the expansion of the economy.

During the first few months of the year, the thrust of monetary policy continued to be expansionary, with net international reserves dropping from around US$ 800 million at the end of 1994 to US$ 630 million by mid-February 1995. Beginning in the second quarter, steps were taken to soak up excess liquidity and restore the level of international reserves. Accordingly, the Bank of Guatemala began to engage in open-market operations again and kept bank reserve requirements high.

These attempts to restrict the money supply were hampered, however, by the commercial banks' efforts to attract funds using instruments that were not subject to reserve requirements, since this led to a sharp increase in credit and helped create secondary liquidity. As this undermined the effectiveness of the reserve requirement as an instrument of monetary control, the Bank of Guatemala relied heavily on open-market operations in which it offered quite high rates of return, with the result that it incurred operating losses of around 1% of GDP.

The growth of monetary aggregates slowed in 1995. Among the factors of liquidity, the net effect of the financial system's foreign exchange operations was contractionary, and domestic credit expanded less than the year before. Net credit to the public sector fell once more, although there was an increase in private-sector loans, and bond sales undertaken as a means of controlling the money supply had a contractionary effect as well. This resulted in an 11% variation in currency liabilities, as against 25% in 1994. The rate of growth of the money stock plummeted from nearly 20% to 8%, and the expansion of interest-bearing deposits was also down on the preceding year, from 20% to 13.5%, although it did outpace inflation.

Interest rates were affected by the borrowing operations of both the Government and the Bank of Guatemala. Annual average rates, for deposits as well as loans, were below those of 1994 in nominal terms. However, since inflation slowed, real average rates were higher, and indeed interest rates tended upwards over the course of the year, especially the rates for 63- and 182-day bonds. The spread between loan and deposit rates also widened, even though the new instruments which the banks were using to attract funds cut the effective reserve requirement by nearly five percentage points; thus, interest rate spreads increased in spite of the fact that reserve-related costs were lower.

During 1995, the reform of the legislative framework for financial activity proceeded; these measures included the enactment of laws to strengthen superintendency of banks and the capital structure of financial institutions. A directive was also issued giving the go-ahead for a complete liberalization of interest rates.

c) **Foreign exchange policy**

During the course of the year, demand for foreign exchange became stronger, which prompted the Bank of Guatemala to step in. The Bank sold around US$ 80 million in all (US$ 27 million in April, US$ 13 million in October and US$ 41 million in November). These interventions, along with the monetary and fiscal policies that were being pursued, acted to contain the exchange rate. The currency depreciated against the dollar by around 5%, which translated into a slight drop in the real exchange rate.

d) **Public external debt policy**

The resumption of Guatemala's agreement with the IMF restored its access to external

financing. In June, the Inter-American Development Bank (IDB) made the final disbursement of US$ 35 million on a financial modernization loan. None the less, public debt service (including both amortization and interest payments) was far higher than loan disbursements, which exacerbated the Government's financial problems. Public external debt declined somewhat in 1995 (-3%), while outlays in the form of amortization and interest payments fell by 23%.

3. The main variables

a) Economic activity

In 1995 the Guatemalan economy grew by 5%, thus exceeding the population growth rate (2.9%) for the ninth year in a row. Owing to the rather slow increase in production and the relatively high demographic growth rate, however, per capita income remained below the level achieved at the beginning of the 1980s.

Exports of goods and services gave a fillip to overall demand, swelling by nearly 9%. This performance was a result of the favourable conditions that prevailed in the markets for Guatemala's main export products. In addition, investment expanded significantly, by contrast with 1994. Private investment, having fallen by nearly 4% in 1994, recorded a rise of 8%, with the bulk of this increase being accounted for by housing, manufacturing and commerce. Public-sector investment, for its part, was up by 5% –after having declined in the preceding two years– owing to an increase in the resources allocated to the telephone system and other types of infrastructure. Consumption rose by 5%, boosted as much by Government as by the private sector. Contributory factors included the increase in remittances from abroad and the expansion of credit.

In 1995, growth was widespread in the principal sectors of the economy. Of particular note was the performance of the construction sector, which, after two years of contraction, surged ahead by 8% thanks to the rise in public-sector investment and a boom in hotel-building and other tourism-related projects (the stock of hotel rooms climbed by around 10% in 1995). The fact that credit was more readily available was a further positive factor, since bank loans to this sector soared by 52%, thereby pushing up the construction sector's share in the total bank portfolio's by two percentage points.

Mining moved up appreciably (12%) thanks to a vigorous expansion in oil production (29%), which was stimulated by the sustained momentum of investment and production operations, by virtue of which output has tripled in the last seven years.

Basic services rose by 6.5% –once more exceeding the growth rate recorded for the production of goods– as a result of the extension of the telephone system and an increase in electric power generating capacity. Other services grew by more than 5%, with tourism and finance services both continuing to expand rapidly. By contrast, the pace of growth in government and municipal services slowed as a result of the Government's policy of curbing current spending and the delay in making transfers from the central government to the municipalities.

Goods production was more buoyant than in the preceding two years (3.5%) owing to the acceleration in agricultural and industrial growth and the strength of the construction and hydrocarbons sectors, as mentioned earlier.

Agriculture was hurt by excessive rainfall, but not all subsectors were equally affected. Trends in export products were favourable, thanks to improvements in farming techniques and infrastructure. A further important factor in this good performance, particularly as regards coffee, was the fact that the rains did not fall during the harvest. The extremely heavy rainfall was expected to take its toll on the 1996 harvest, however.

The growing mechanization of the sugar-cane sector and the consolidation of new cane-producing areas produced a record harvest. This sector has also benefited for many years from government policies designed to boost its profitability. By contrast, crops destined for the domestic market, which are more vulnerable to the vagaries of the weather, were damaged by the

excessive rains, and the maize, rice and bean harvests were therefore thinner.

The rate of growth in the manufacturing sector rose marginally compared with the preceding year, from 2.9% to 3.3%, owing mainly to the expansion of exports. The increase in output was similar in the various subsectors of industry. Exports of manufactures expanded more rapidly than in 1994, especially in the case of plastic articles, foodstuffs and chemicals. Garment exports produced in *maquila* industries also expanded, but at a more moderate pace.

b) **Prices, wages and employment**

The inflation rate in Guatemala was 8.6%, which was within the target range of 8%-10% set at the beginning of the year. This achievement was chiefly due to the fiscal, monetary and foreign exchange policies that were pursued, but was attributable in part to the delay in adjusting electricity rates, an issue that was not resolved in 1995 because of legal problems. The greatest price increase was again in education, while the prices of clothing and of transport and communications services rose less than the aggregated price index.

The acceleration in the activity rate was due to a rise of nearly 4% in employment, which drove down the open unemployment rate to 4.3%. The level of underemployment also fell slightly. Even so, the under-utilization of the labour supply continued to affect a substantial percentage of the active population.

Real wages remained stable and at the end of the year an across-the-board increase of 10% in minimum wages was enacted.

c) **The external sector**

Better prices for Guatemala's main export products, combined with an upswing in volume, pushed exports up faster than imports (23% as against 15%). This brought the trade deficit in goods and services down, although it remained high as a proportion of GDP (6%). Thanks to the bountiful stream of private transfers, including remittances from Guatemalans living abroad (which account for around 3% of GDP), the country pared down its current account deficit from 5% of GDP in 1994 to around 4% in 1995. Capital inflows were lower than the current account deficit, and consequently international reserves shrank by US$ 158 million.

The value of merchandise exports recorded its highest rise in the last six years. Although sales to the rest of the world showed the most significant increase (28%), exports to Central America accelerated faster than in previous years (19%). The value of traditional exports went up by a little over 20%, as increased sales of coffee, bananas and sugar more than offset the drop in meat exports. Non-traditional exports jumped by a sizeable amount (36%), the most notable performances being in oil sales (48%) and clothing exports to the United States (27%). The latter amounted to US$ 175 million, which put the sector in fourth place, following coffee, sugar and tourism, as a source of foreign exchange earnings.

In the category of trade in real services, tourism posted a surplus, after having run up a deficit in 1994. This sector generated US$ 210 million in foreign exchange, while outlays were cut to US$ 140 million. Meanwhile, current transfers brought in just over US$ 550 million (23% more than in 1994), which was similar to the combined total for coffee and sugar exports.

Merchandise imports expanded by 19%, chiefly as a result of the increase in purchases of intermediate goods (22%) and capital goods (20%), which outstripped the growth of consumer goods (12%) for the first time in some years.

Capital inflows came from private-sector operations, as public-sector debt payments exceeded the credits received. There was a drop in incoming short-term capital, but flows of long-term funds to the private sector increased, mainly as a result of investments in oil production and in the expansion of electric power generating capacity.

HAITI

1. General trends

The restoration of a constitutional civilian government in October 1994 was an extremely significant political development which changed the course of the Haitian economy in fiscal 1994-1995.[1] The trade embargo imposed on the country following the military coup of September 1991 was lifted, and the foundations were laid for the implementation of an emergency programme with financial support from the international community. The inflow of foreign capital led to a spectacular rebound in imports, which was reflected in a substantial current account deficit –equivalent to 9% of the country's already diminished gross domestic product (GDP)– and in an increase in the public sector's level of expenditure and deficit. This marked the end of a crisis which had caused a 10% reduction in national income since 1990, and the beginning of a partial recovery that was reflected in a rise in GDP of almost 5%.

Despite this partial reactivation, it is estimated that the rate of unemployment remained above 50%, and the informal sector continued to be the principal source of employment. Although the higher level of economic activity and the inflow of foreign capital brought about an increase in per capita income, there has nevertheless been a sharp deterioration in the standard of living, and social indicators for a wide sector of the population continue to be alarming.

Faced with this situation, the Government formulated an emergency economic revival plan geared to satisfying the most pressing needs of the people and devised a structural adjustment scheme. On this basis, an economic and financial programme was developed with backing from the international community, which pledged to contribute US$ 1.7 billion over a three-year period. The programme was defined in conjunction with multilateral financial organizations so as to fit in with the macroeconomic framework established under the standby agreement signed in March with the International Monetary Fund (IMF).

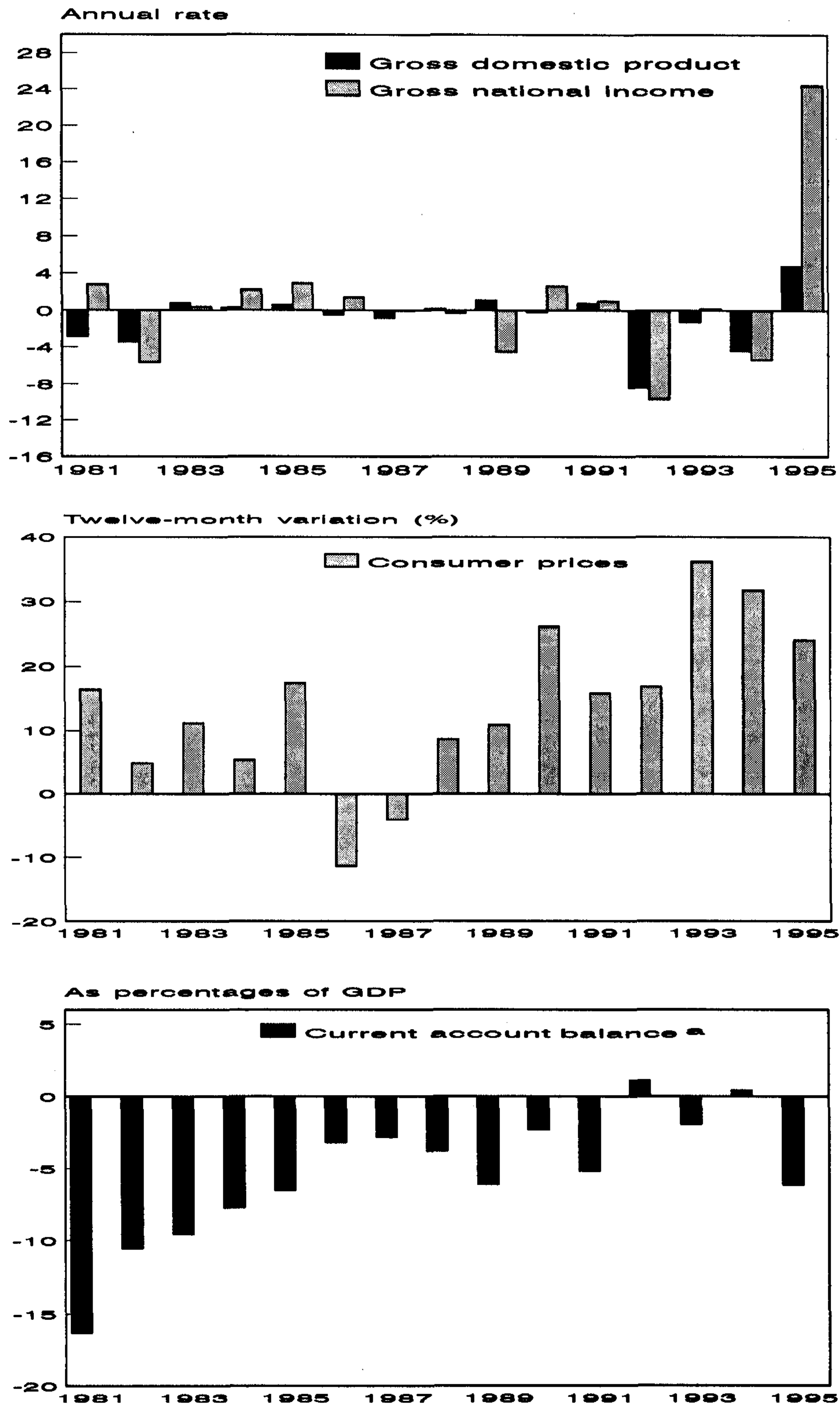
The availability of financing and the resultant increase in the supply of imports, in addition to the adoption of a moderate monetary policy, made it possible to bring the rate of inflation down to 24% and to stabilize the exchange rate at around 15 gourdes to the dollar, notwithstanding the accumulation of US$ 200 million in international reserves.

2. Economic policy

The main objectives of the economic authorities during the period under review was to overcome the critical situation created by the virtual collapse of the national economy following three years of military rule and the subsequent trade embargo and, during a second phase, to correct the structural and institutional defects which were hindering the country's development. Accordingly, the Government adopted a macroeconomic adjustment programme and a structural reform plan which provided for the reinforcement of public finances, private-sector development, public-sector reforms, the privatization of State enterprises and the implementation of sectoral programmes.

[1] As is usual in the case of Haiti, the years referred to are fiscal years, which run from 1 October to the following 30 September.

Figure 1
HAITI: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

The direction of economic policy and the economic programme's goals were defined in concert with international finance institutions; to assist with its application, standby funds were allocated by the IMF, while the World Bank and the Inter-American Development Bank (IDB) granted structural adjustment and technical assistance loans. In addition to the agreements signed with these organizations, various sectoral programmes were financed by bilateral and multilateral agencies with the objective of contributing to the revitalization of the economy and attenuating the social costs of the crisis. As an initial step in facilitating the procurement of fresh capital from abroad, in December 1994 Haiti made a commitment with the IMF, the World Bank and IDB to use US$ 65 million in grants from 10 donor countries and US$ 18 million from the Government itself to pay off its arrears on its debts with these multilateral sources.

Most of these fiscal and monetary measures were implemented in the first half of the year and proved to be successful: inflation went down and there was an improvement in the exchange rate. From July onwards, however, efforts to curb public spending suffered a number of setbacks, prices climbed, and the exchange rate took a turn for the worse. Furthermore, opposition to the privatization of public corporations mounted in the second half of the year and prompted the resignation of the Prime Minister in November, thereby interrupting this process and creating a climate of uncertainty on the eve of the presidential elections. Moreover, some bilateral and multilateral financial organizations suspended the disbursement of funds that had already been approved in the expectation that new measures to reinforce fiscal discipline would be adopted.

a) **Fiscal policy**

When the constitutionally-elected President took office in October 1994, the tax performance ratio had suffered a drastic decline that had brought it to barely more than 3% of GDP. Faced with this situation, the authorities took steps to increase current income; the measures included updating the reference exchange rate used for customs valuations, increasing taxes on petroleum products and collecting service charges amounting to 3% of the value of imports. At the same time, initial steps were taken to strengthen budget performance, reduce tax and customs duty evasion, and allow the sector to recover the estimated 80 million gourdes in arrears built up over the preceding years. To this end, approval was given for the establishment of an office to monitor the country's 200 largest taxpayers, update company listings and automate customs operations. The principal fiscal measures of this sort were incorporated into a law that was enacted at the beginning of March 1995, under which foreign trade was also liberalized.

Tax revenues were nearly three times higher than in 1994 and represented over 5% of GDP. Total income (excluding grants and donations) was slightly below 6% of GDP and thus came very close to the target figure established under the economic programme.

Although income taxes showed an increase, their contribution to total revenue was less than the sum of indirect corporate taxes (turnover taxes) plus taxes on foreign trade. The latter increased despite the decrease in tariffs, as a result of measures adopted and the higher volume of imports. Public corporations recorded an operating surplus that far exceeded its 1994 level. Furthermore, approximately 400 million gourdes were recovered which had been held in commercial bank accounts that had been frozen during the embargo.

Current expenditure was 25% higher than expected, amounting to more than double the figure for the preceding year and about 10% of GDP. Not only did staffing costs increase, but the other operating expenses of the civil service climbed much more steeply, in particular during the second half-year, due to the reactivation of the public sector. Some of these funds were used to defray the cost of replacing the armed forces with a civilian police force (which is still in the process of being formed) and of retraining demobilized staff for other jobs. Interest payments on the domestic and external public debts represented 6% of current expenditure. Public investment in labour-intensive infrastructural repair and maintenance projects

Table 1

HAITI: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	0.2	1.1	-0.1	0.8	-8.4	-1.3	-4.4	4.8
Per capita gross domestic product	-1.8	-0.9	-2.2	-1.2	-10.3	-3.3	-6.3	2.7
Gross national income	-0.3	-4.5	2.6	1.0	-9.7	0.2	-5.3	24.5
Gross domestic product, by sector								
Goods	1.3	0.5	-1.1	-2.5	-10.5	-6.5	-3.2	5.8
Basic services	6.8	3.4	3.0	-7.6	-12.2	-2.2	-23.1	12.6
Other services	-0.8	0.9	1.2	4.5	-2.5	4.1	-3.1	3.4
	Percentages							
Contribution to growth of GDP [c]								
Consumption	1.0	-2.7	0.6	2.4	-9.9	2.8	-7.0	13.9
Gross domestic investment	-0.7	-1.0	-0.6	1.0	-4.9	-0.8	-0.5	18.8
Exports	-3.2	1.6	0.9	-0.6	-9.6	0.5	-4.7	16.8
Imports	3.1	3.2	-1.0	-2.0	15.9	-3.8	7.8	-44.7
	Percentages of GDP [b]							
Gross domestic investment	16.8	15.7	15.1	15.9	12.1	11.4	11.4	28.8
National saving	14.0	11.5	13.8	12.5	12.7	10.2	11.7	23.6
External saving	2.8	4.2	1.3	3.5	-0.6	1.3	-0.3	5.2
	Percentages							
Employment and wages								
Real minimum wage (Index: 1990=100)	129.3	120.4	100.0	84.6	74.2	60.0	43.3	81.8
	Growth rates							
Prices (December-December)								
Retail prices	...	...	26.1	10.8	16.8	36.1	31.7	24.0
External sector								
Terms of trade (Index: 1990=100) [b]	113.5	86.8	100.0	86.5	86.9	86.4	81.7	88.3
Nominal exchange rate (gourdes per dollar)	5.9	6.3	7.4	7.7	9.1	12.4	14.2	15.3
Real effective exchange rate (Index: 1990=100)	93.1	96.4	100.0	94.0	95.2	112.0	91.5	80.5
	Millions of dollars							
Balance of payments								
Current account	-40	-63	-22	-56	8	-17	4	-75
Trade balance (goods and services)	-206	-211	-197	-272	-135	-179	-141	-552
Exports	275	237	318	260	114	117	64	276
Imports	481	448	515	532	249	297	205	828
Capital and financial account	26	60	33	26	-21	-44	-16	120
Overall balance	-2	-16	-34	11	-6	-23	-21	200
International reserves (variation)		-	-5	-38	20	11	19	-13.
	Percentages							
External debt								
Public debt (as a percentage of GDP)	73.1	78.0	53.9	48.2	50.2	55.8	60.1	...
Net interest (as a percentage of exports)[d]	8.3	9.5	7.9	7.7	11.3	10.7	17.5	10.1

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Central government								
Current income	9.4	11.0	8.7	8.7	6.6	5.1	3.3	5.7
Current expenditure	9.7	13.6	11.4	10.4	10.1	7.5	7.2	9.6
Savings	-0.3	-2.7	-2.7	-1.7	-3.5	-2.3	-3.9	-3.9
Capital expenditure	3.9	2.0	1.4	1.0	0.6	0.5	0.3	0.6
Financial balance	-4.2	-4.7	-4.2	-2.7	-4.1	-2.9	-4.2	-4.6
	Growth rates							
Currency and credit								
Money balances of banking system								
Net domestic credit	6.7	17.3	6.9	3.0	27.2	26.4	27.9	-2.4
To central government	8.0	12.2	9.4	-3.2	24.5	30.8	25.2	-15.8
To private sector	8.4	30.6	3.5	6.7	4.5	40.0	8.7	56.6
Money (M1)	17.7	10.5	1.2	5.1	24.8	26.7	21.1	25.7
Local-currency savings and time deposits	5.3	18.3	13.8	14.0	28.5	35.1	25.8	7.5
M2	11.5	14.2	7.4	9.7	26.8	31.3	23.8	15.3
	Annual rates							
Real interest rates (at end of period)								
On deposits[e]	...	-7.9	-5.5	-19.1	-22.0	-18.7	-3.2	-9.1
On loans[e]	...	1.1	-4.1	-17.8	-13.6	-9.5	1.9	2.1
Equivalent interest rate in foreign currency[f]	...	...	-8.4	3.1	-11.6	-25.7	-11.7	7.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP [d] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [e] Figures up to September of each year. [f] Interest rate on deposits, deflated by the variation in the exchange rate.

amounted to less than 1% of GDP, but was much higher than in previous years; these funds were over and above the external aid received by the country, which also grew.

The overall deficit was equivalent to slightly under 5% of GDP, and over 80% of this was covered by external funds (grants and concessional loans); in addition, there were the domestic funds that had been in accounts frozen during the embargo. In contrast, in the previous three years, it had been financed almost entirely through issues by the Central Bank.

The situation of the rest of the non-financial public sector was more variable. This sector's overall surplus, which enabled it to transfer funds to the Government and pay off a sizeable portion of its debt with the Bank of the Republic of Haiti, came primarily from the country's telecommunications company. Nevertheless, other companies which remained out of commission, such as Haiti's cement factory and wheat flour mills, had a negative impact on public finances, as did the electricity sector, since they continued to receive government support. No capital income was recorded, as the privatization of State enterprises was postponed.

For the 1996 fiscal year, a 25% rise in expenditure and income is expected. Just as in fiscal 1995, the financing of the deficit will depend on the timely disbursement of foreign assistance and concessional loans, given that current income would only cover around 75% of expenditure under the headings of civil service wages and operating expenses.

b) **Monetary and exchange rate policies**

After three years of unchecked expansion, monetary policy resumed a moderate course; to achieve this, the authorities resorted to two instruments: bank reserve requirements and intervention in the foreign exchange market. The monetary base, together with local-currency, expanded by approximately 15%; this growth rate was lower than the increase in the value of transactions and was within the limits agreed upon with the IMF.

Unlike previous years, when the expansion of the money supply was caused by the need to finance the fiscal deficit, net credit granted to the public sector diminished in 1995, due in part to the amortization of advances granted in 1994 against funds held in accounts frozen in connection with the international embargo. In addition, the guidelines of the Bank of the Republic regarding restrictions on credits to the public sector were adhered to more strictly. The changes noted in this area were in keeping with the arrangements made for financing the public deficit, which relied chiefly on foreign capital for that purpose. Net inflows of foreign assets increased substantially (by US$ 200 million).

Credit to the private sector also rose (by over 50%) as the situation in the banking system returned to normal. Consequently, the money supply's (M1) 25% expansion exceeded the growth of the monetary base, mainly as a result of an increase in demand deposits. Quasi-money grew by only 7.5% because of the low returns offered on term deposits and the fact that many savers preferred to keep their liquid assets in dollar accounts, which more than doubled in value. Thus, the broadly defined money supply (M3), which includes such accounts, increased by 25%, compared with a 15% expansion of local-currency liquidity (M2).

In order to limit money growth, the monetary authorities, who had raised the reserve requirement for demand deposits to 73% for commercial banks in March while the minimum reserve on term deposits was maintained at 20%, set the reserve requirement for all types of deposits at a standard 48% in May and then raised it to 53.5% in September. These measures did not apply to dollar deposits, which recorded the greatest increase. The reduction of liquidity towards the end of the year made it possible to lower the minimum reserve requirement by two percentage points.

When money growth accelerated in July partly as a result of the increase in fiscal outlays and the above-mentioned uncertainty regarding the authorities' future economic policy stance, the foreign exchange market started to show signs of agitation. The gourde lost 4% of its value between July and August and the rate of exchange rose to over 15 gourdes to the dollar. This pressure was attenuated by the intervention of the Bank of the Republic starting in August. Thus the currency fluctuated between 13 and 15 gourdes to the dollar throughout the year, reflecting a 12% recovery compared with the period during which the embargo was in effect.

A presidential decree was signed removing the ceiling on interest rates, which were exhibiting an upward trend, and the interest rate spread widened in response to the rise in the minimum reserve requirement. Depending on the size of a loan and its purpose, the lending rate of commercial banks moved from a range of 11%-20% at the beginning of the fiscal year to 12%-25% by its end. The average rate offered on term deposits (12 months) climbed from 5.5% to 8.5%, but this was still equivalent to a negative return in real terms.

c) **Trade policy**

Trade policy tended towards a greater liberalization of the trade regime. In December 1994, the Government suspended import license requirements for a period of three months and reduced import duties on rice, sugar and cement. In March 1995, trade reforms were strengthened, the import restrictions which still applied to seven agricultural products were removed and the range of tariff rates was reduced by 50% on average to a band of 0%-15%, with the exception of the 25% rate applying to petroleum products. Furthermore, the obligation to repatriate 40% of export earnings was removed. As already indicated, customs valuations for taxation purposes were increased and the market exchange rate began to be applied in these calculations.

d) Structural reforms

The Government proposed a series of measures designed to open up the economy, foster private enterprise, demilitarize public life and privatize State enterprises. For these purposes, a presidential committee was established, composed of prominent figures from the public and private sector, to put forward measures to stimulate investment, modernize the economy and the legal and regulatory provisions governing investment activity, and promote privatization. A tripartite commission was also established to update and revise controversial provisions in the labour code.

In order to contribute to the modernization of government services, various international finance agencies granted Haiti technical assistance loans to supplement its structural adjustment financing. However, one of the principal aspects of its reforms, the privatization process, gave rise to political tensions and was therefore discontinued. With the support of the international community, various funds were also set up to mobilize private investment; one of these funds was oriented towards the implementation of labour-intensive projects, while another was designed to attract foreign investment for infrastructure projects.

3. The main variables

a)Economic activity

Expectations created by the country's return to democracy and the support forthcoming from external sources contributed to an economic recovery from the stagnation caused by the embargo, as a result of which output rose by almost 5%. External funding fueled a 110% rise in domestic demand, which was concentrated in the first half of the year; from July onward, a slow down was to be observed due to the contraction of available credit for small businesses and the uncertainty caused by the political situation.

Private consumption, which was boosted both by pent-up demand among the Haitian population and by the presence of a sizeable United Nations contingent, was the factor which contributed the most to the growth of demand. Second in terms of magnitude was government consumption, which rebounded considerably (70%). The increase in public capital expenditure led to an upswing in total investment of 164% in 1995. On the other hand, private investors maintained a generally cautious attitude as they awaited signs of greater stability. Exports also grew significantly (280%), thereby regaining the admittedly low pre-embargo level.

The expansion in demand was reflected mainly in imports, which grew more than threefold and thus came to represent a much higher percentage of domestic output (58%). In fact, the level of output was somewhat lower than the volume of private consumption; this situation underscores the importance of foreign capital to Haiti, since external resources financed not only investment but also part of consumption. Consequently, there was an internal dissaving equivalent to 7% of GDP.

The country's vital agricultural sector, which accounted for 30% of GDP, and government services were the only areas that did not display any dynamism. Unlike the rest of the economy, agricultural activity contracted sharply (-11%), adding to the downward slide recorded since 1992. Practically all agricultural products, whether intended for domestic or export markets, reflected a decrease. Tropical storm Gordon, which battered the country in late 1994, and the undercapitalization of Haiti's rural areas led to a fall in the sugar-cane, banana, rice and coffee harvests. Staple food crops were also down, although to a lesser extent, as was meat output, for which the demand has been dwindling for a number of years. Production was stepped up in the case of only a few items, especially mangoes.

Almost all other sectors managed to show some degree of recovery, following a generalized slump. As part of this trend, the construction industry experienced a boom (85%) as a result of infrastructure and housing projects. Manufacturing grew 24%, following a cumulative recession of 60% during the previous four years. The most dynamic branches of industry were consumer goods for the domestic market and inbond assembly *(maquila)* activities. The latter

showed promising signs of recovery, with 75 firms in operation out of the 145 companies that had been in place at the beginning of the decade; the production of garments and sports goods continued, but electronics lost ground.

Basic services were fully restored, but the expansion of electricity generation, gas distribution and water supply capacities (40%) was insufficient to meet demand. Prolonged interruptions in these services had an adverse effect on the economy. The telephone network was expanded somewhat and, once foreign trade had been resumed, the level of activity in cargo handling services increased. Activity in commerce, restaurants and hotel services benefited from the increased availability of imported items and from the demand generated by members of international missions. Financial, insurance and real estate services showed slight gains and institutions devoted to mobilizing private funds and processing foreign transfers experienced a strong upturn.

b) **Prices, wages and employment**

Increased supply and the moderate increase in liquidity slowed the rise in consumer prices, which was 24% in 1995 (down from 32% in 1994). Food prices recorded the highest inflation rate.

Wages increased in 1995 after being at a standstill for several years. The minimum wage moved from 15 to 36 gourdes in May and some public-sector employees were also granted a raise. The real minimum wage rose significantly (89%), which allowed it to recover its 1991 level; nevertheless, its purchasing power was still lower than it had been 10 years before.

Although no precise unemployment data were available, it is estimated that half of the economically active population was out of work, while the informal sector provided employment and income to a large segment of society. The *maquila* industry which had provided almost 50,000 jobs in the late 1980s, was hit by a crisis that virtually paralysed it in 1994, but by September 1995 it was employing almost 13,000 persons. Construction also contributed significantly to job creation.

The Office for Occupational Health and Maternity Insurance, which had been closed down, resumed its activities, providing coverage to nearly 43,000 workers, which was 7,000 less than in 1991.

c) **The external sector**

With the extraordinary surge in imports following the lifting of the embargo, the economic upturn allowed no more than a partial recovery in export capacity and a slight increase in external sales, which, as a result, amounted to only slightly more than half as much as they had just before the *coup d'état*. Increased shipments, together with the improvement in the terms of trade, raised the purchasing power of exports. The value of the merchandise purchased during the year (US$ 620 million) more than quadrupled in comparison with the preceding year, while exports were over US$ 150 million; consequently, an unprecedented merchandise trade deficit of close to US$ 470 million was recorded.

The bulk of imports (80%) originated in the United States. One third of these purchases were food products, in particular grains, soybean oil, sugar and beans. Purchases of intermediate goods –including materials for the *maquila* industry, building materials and fuels– were also high.

With respect to the export mix, the greater part of external sales was accounted for by the *maquila* industry, which has been staging a somewhat slow recovery; next in importance were coffee and coffee products, essential oils and mangoes.

In addition to the negative merchandise trade balance, expenditure for real services in connection with Haiti's increased merchandise imports exceeded income under this heading, thus resulting in a trade deficit of some US$ 550 million. The increase in interest payments on the foreign debt had an adverse effect on the factor income account, but was more than offset by the larger inflow of private capital (US$ 108 million). The current account deficit stood at US$ 75 million, which was not only higher than the pre-coup figure but also represented 9% of GDP.

Thanks to the change in the political situation, both official grants and donations and the loans

made available to the country were far higher than in previous years; in fact, they not only provided more than enough to cover the current account deficit but also boosted international reserves by US$ 200 million, or the equivalent of four months' worth of imports.

The external public debt amounted to US$ 900 million dollars –US$ 26 million more than in the preceding fiscal year– in spite of the fact that lending institutions paid out over US$ 100 million in loans that had been granted beforehand. This was achieved through a radical debt-rescheduling exercise. In December 1994, Haiti had paid off its accumulated arrears (US$ 82 million), thus fulfilling the requirement laid down by international financial agencies for the provision of fresh funds. Furthermore, in May, Haiti availed itself of the Naples Terms, for which the world's poorest countries are eligible, and obtained the cancellation of US$ 75 million that it owed to members of the Paris Club together with a rescheduling of bilateral debts. In addition, it has made a commitment to accept only concessional loans.

HONDURAS

1. General trends

In 1995 the Honduran economy grew by 3.2% thanks to the removal of a number of obstacles which were hampering economic activity and which had caused output to decline the preceding year. Conditions in external markets, in particular, were more favourable, and this had a very positive effect on the terms of trade. This improvement also influenced the trade balance and helped bring down the balance-of-payments current account deficit. The public sector's financial deficit also narrowed, mainly as a result of the tax changes that had come into effect during the preceding fiscal year. Nevertheless, the inflation rate remained quite high, which affected the purchasing power of large groups of the population.

Economic policy was subject to the terms agreed upon with international credit institutions. The problems involved in meeting those conditions, on the one hand, and a lack of matching funds at the local level, on the other, made it difficult to obtain long-term loans, however. For example, the second tranche of the country's structural adjustment loan from the International Monetary Fund (IMF) did not become available until late in the year, once IMF targets and structural performance criteria had been met. Even so, despite the reduced inflows of external capital, international reserves rose –albeit only slightly– as a result of the increase in exports.

The process of privatizing public-sector enterprises continued during 1995. The Government temporarily took over the management of the Empresa Hondureña de Telecomunicaciones (HONDUTEL) for the purpose of reorganizing its finances as a preliminary step to prepare for the sale of shares. According to the legislation governing the sale of the company, 51% of the shares are to remain in the hands of the public sector.

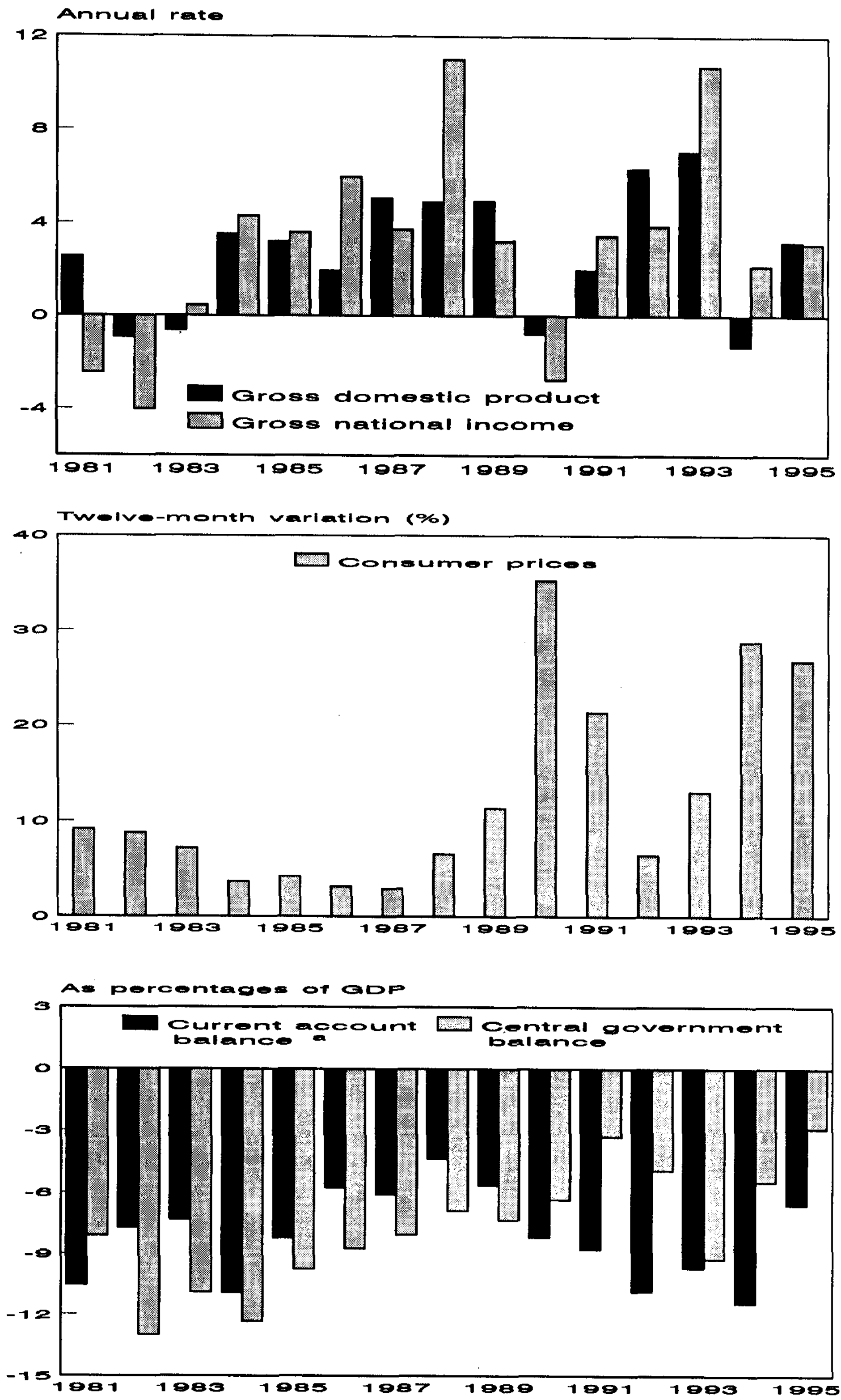
2. Economic policy

Economic policy was geared toward a series of objectives, including cutting inflation, reviving the economy and correcting price lags in inputs and basic services, as part of a general policy scheme in which the interplay of market forces figured prominently. Throughout 1995, however, the authorities encountered difficulties in reconciling these diverse objectives, particularly in the case of inflation. At the beginning of the year, for example, inflation spurted in response to a rise in commodity prices, which had not kept pace owing to the application of price controls during the last few months of 1994; later in the year, inflation rose due to adjustments in the price of a number of widely-used inputs and services and to the depreciation of the currency on the foreign-exchange market.

Monetary policy aimed to contain the expansion of liquidity, and the rates of growth of the monetary aggregates did in fact slow down, although they were still significant.

Important tasks for fiscal policy were to regulate the changes resulting from the tax reforms that were introduced in late 1994 and to continue with the policy of rationalizing public spending. Central government revenues increased in real terms, while expenditure contracted; this brought about a striking reduction in the fiscal deficit, which shrank from

Figure 1
HONDURAS: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

the equivalent of 5.5% of gross domestic product (GDP) in 1994 to below 3% in 1995. As a result of this performance, Honduras met the fiscal targets set in the IMF agreement. This improvement in the equilibrium of public-sector finances was in fact mainly due to cutbacks in real investment by the Government, however.

The management of foreign-exchange policy continued to be based on an auction system under which the Central Bank sets the upper and lower limits for fluctuations in the exchange rate. During the first half of the year, the supply of foreign exchange tended to outweigh demand. In October, however, in response to a surge in demand prompted by an unexpectedly small supply of foreign currency, the authorities allowed the rate of crawl for the reference exchange rate to steepen.

a) **Fiscal policy**

The mainstay of fiscal policy was the reforms implemented at the end of 1994, the results of which began to make themselves felt in 1995. Under the provisions of these reforms, a 1% tax on net corporate assets was introduced; the base for the sales tax was broadened by including services and eliminating a number of exemptions; interest income other than earnings on savings deposits became subject to income tax (at a flat rate of 10%); and the tax on private motor vehicles was raised. A special taxation scheme was also devised for coffee growers, and the method for computing the tax base for foreign trade duties was changed.

In 1995, the central government's current income went up by 14% in real terms, or by around two percentage points of GDP. Expenditure, meanwhile, went down (-3.1%), although by considerably less than the preceding year (-14%). Consequently, the fiscal deficit narrowed substantially.

The surge in tax revenues, after the preceding year's sluggishness, was primarily a result of the broader application of the income tax, higher receipts from the general sales tax, and taxes on sales of petroleum. Income tax receipts went up by 35% in real terms, thanks to the new tax on net assets, which, while it did not bring in significant revenues on its own, did help to curtail tax evasion. A further factor in the rise in government income was the decision to withhold 10% of coffee growers' windfall profits as an advance payment on their income taxes. Sales tax receipts were up 9% as a consequence of the broader tax base and, to a lesser extent, the elimination of a number of exemptions. Revenues from the various taxes on sales of petroleum products jumped sharply, boosting their share of current tax receipts to 16%. The amount brought in by taxes on foreign trade dropped in real terms, however, as import duties levelled off due to the abolition of the 10% import surcharge and the reduction of the customs service charge from 5% to 3%.

The central government's current expenditure held steady in real terms, after a 12% fall in 1994. Nominal pay rises were granted to teachers and health-sector workers, and a bonus equivalent to one month's wages was awarded to public-sector employees, but the increase in this item of expenditure was no more than the rise in prices. Interest payments, which account for over a quarter of current spending, remained stable.

Capital expenditure continued to contract in constant terms, albeit more slowly than during the preceding year. In particular, a decline was seen in financial investment, which includes credit to decentralized agencies; as in 1994, such loans were largely directed towards servicing the external debt of the Empresa Nacional de Energía Eléctrica (ENEE). Real investment by the central government was lower as a percentage of GDP. Some of the largest investments made in 1995 were in the communications, transport and energy sectors.

The amount of external financing received by the Government exceeded its deficit; this took off some of the pressure to use domestic credit, which had been a common practice in previous years.

b) **Monetary policy**

The line followed by Honduran monetary policy was dictated by its aim of curbing inflation, and in order to achieve this the authorities floated bond issues on the market. Meanwhile, the Central Bank had planned to cut the 1994 reserve requirement of 40% to 34% by

Table 1
HONDURAS: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	4.9	4.9	-0.8	2.0	6.3	7.0	-1.3	3.2
Per capita gross domestic product	1.7	1.8	-3.7	-1.0	3.2	3.9	-4.1	0.3
Gross national income	11.0	3.2	-2.7	3.5	3.9	10.7	2.2	3.1
Gross domestic product, by sector								
Goods	4.2	8.4	-0.8	3.5	8.0	4.8	-3.1	4.3
Basic services	8.6	5.9	6.8	2.2	3.1	4.8	0.6	6.1
Other services	4.9	1.5	-2.3	0.4	5.3	9.9	0.2	1.5
	Percentages							
Contribution to growth of GDP [c]								
Consumption	2.3	4.7	-2.6	0.5	3.2	3.1	-0.2	3.5
Government	1.3	0.4	-2.0	-1.3	1.5	0.2	-0.3	-1.2
Private	1.0	4.3	-0.6	1.8	1.8	2.9	0.1	4.7
Gross domestic investment	5.5	-0.9	0.7	4.1	3.3	6.8	2.1	-4.0
Exports	-0.3	1.5	0.2	-0.6	2.4	-0.3	-2.8	2.8
Imports	-2.6	-0.4	1.0	-2.0	-2.6	-2.5	-0.4	0.9
	Percentages of GDP [b]							
Gross domestic investment	24.1	22.1	23.0	26.6	28.1	32.6	35.2	30.2
National saving	18.4	16.1	16.2	18.6	18.0	23.5	26.2	25.1
External saving	5.7	6.0	6.8	7.9	10.1	9.1	9.0	5.2
	Percentages							
Employment and wages								
Open unemployment rate [d]	8.4	8.0	7.1	8.0	6.4	7.5	5.0	6.0
Real minimum wage (Index: 1990 = 100)	94.1	85.4	100.0	96.6	108.7	110.2	94.8	89.6
	Growth rates							
Prices (December-December)								
Retail prices	6.7	11.4	36.4	21.4	6.5	13.0	28.9	26.8
Wholesale prices	10.7	20.4	41.3	20.4	9.6	14.0	35.1	21.1
External sector								
Terms of trade (Index: 1990=100) [b]	105.3	101.0	100.0	105.2	99.2	113.1	126.3	120.6
Nominal exchange rate (lempiras per dollar)	2.00	2.00	4.10	5.32	5.51	6.59	8.63	9.49
Real effective exchange rate (Index: 1990 = 100)	60.4	56.1	100.0	107.9	102.4	112.5	125.3	112.3
	Millions of dollars							
Balance of payments								
Current account	-181	-206	-228	-258	-351	-309	-327	-224
Trade balance (goods and services)	-115	-125	-94	-124	-192	-134	-154	-60
Exports	1 026	1 061	1 033	1 016	1 041	1 067	1 166	1 425
Imports	1 141	1 186	1 127	1 139	1 233	1 201	1 320	1 485
Capital and financial account	76	-39	37	-52	75	207	201	271
Overall balance	-198	-384	-299	-158	-247	-183	-20	26
International reserves (variation)	-22	-29	20	67	92	-100	17	135
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	92.1	92.2	129.3	117.0	109.4	122.6	145.1	129.2
Net interest (as a percentage of exports) [e]	16.6	16.6	17.2	20.2	25.0	22.8	22.3	19.3

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Central government								
Current income	15.0	14.7	16.4	17.4	17.4	16.6	16.0	18.1
Current expenditure	17.4	17.9	17.2	16.5	16.6	17.6	15.0	14.8
Savings	-2.4	-3.1	-0.8	1.0	0.8	-1.0	1.0	3.2
Capital expenditure (net)	4.5	4.2	5.6	4.3	5.7	8.2	6.5	6.1
Financial balance	-6.9	-7.4	-6.4	-3.3	-4.9	-9.2	-5.5	-2.9
Domestic financing	2.6	4.1	-1.2	-3.3	-2.9	-0.4	0.7	-0.9
External financing	4.3	3.2	7.5	6.6	7.8	9.6	4.8	3.8
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	-16.8	-21.1	5.0	-	-	-67.2	38.3	217.5
Domestic credit	9.0	12.5	16.2	5.1	14.1	56.2	26.7	6.5
To public sector	14.9	19.7	8.4	-56.8	-23.6	-38.6	65.6	-
To private sector	5.3	8.6	6.6	16.5	24.8	14.9	24.7	21.1
Money (M1)	12.5	20.3	25.2	16.8	14.2	13.0	37.0	18.3
Local-currency savings and time deposits	11.2	11.2	9.8	23.0	34.2	5.3	10.1	21.7
M2	11.8	15.2	16.9	20.0	24.7	8.7	22.3	20.0
	Annual rates							
Real interest rates								
On deposits	1.9	-2.6	-20.0	-7.6	5.5	-1.1	-13.2	...
On loans	8.2	3.5	-13.9	1.1	14.3	8.1	-3.1	...
Equivalent interest rate in foreign currency[f]	8.6	8.6	-50.1	8.6	4.9	-9.6	-12.8	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Open unemployment rate in Tegucigalpa. [e] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [f] Interest rate deflated by the variation in the average bank exchange rate for sales of banknotes.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	7.3	10.3	13.2	13.0	16.5	21.7	24.1	28.8	33.8	29.3	28.3	26.8
Real effective exchange rate (Index: 1990=100)	105.1	110.7	115.0	119.3	120.4	129.2	127.3	124.2	114.9	112.9	111.0	110.4
Real interest rate (annualized, %)												
On deposits	1.9	-5.6	-2.8	1.9	-9.8	-20.8	-9.4	-12.7	-22.3	-9.6	-7.3	...
On loans	10.3	2.1	7.2	12.9	-0.5	-12.3	1.1	-0.5	-12.1	2.4	5.5	...

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

mid-1995, then to 27% and ultimately to 15%. To avoid fuelling inflation, however, the first of these reductions was not made until June.

Growth in liquidity was triggered initially by the influx of foreign-exchange earnings from coffee exports and, later, by the lowering of reserve requirements. To offset this, the Government stepped up its open-market sales of bonds and of a new kind of Central Bank paper called "monetary absorption certificates" (authorization was given in January 1995 for an offering equivalent to up to 2% of GDP).

The expansion of the money supply slowed throughout 1995, with M1 growing by 18%, i.e., only half as fast as the preceding year. Nevertheless, the various components of the money supply differed widely in their behaviour, as sight deposits rose by more than 30%, while currency outside banks increased by only 6%. Local-currency liquidity and broad money (including foreign-currency deposits) moved up at similar rates (20%). Demand for dollar deposits was influenced by the Central Bank's decision midway through the year to authorize the use of foreign-currency accounts for investment and working capital. Until that time, the use of such accounts had been restricted to exports.

The expansion of domestic credit within the financial system (6.5%) was far below the rate of growth in its deposits and thus there was a significant drop in credit in real terms. This was primarily a result of trends in public-sector operations, since, while the nominal volume of net loans to the Government diminished, other public-sector institutions' level of indebtedness with banks rose in net terms. By contrast, credit to the private sector expanded (by somewhat more than 21%), albeit more slowly than inflation.

On average, annual interest rates were slightly below those of 1994 in real terms. In the second half of the year, however, interest rates on loans moved upward. At the same time, the spread between annual interest rates on loans and deposits continued to widen (to nearly 17 points); in recent years the width of this spread has been a cause of financial disintermediation.

In order to improve the supervision of the financial system and promote its modernization, in late 1995 a number of laws were passed governing the operation of the system and the National Banking and Insurance Commission. This legislation was designed to regulate the operation of the informal financial sector (which was not subject to the legal reserve requirement regime) and to encourage competition.

c) Foreign-exchange policy

Foreign-exchange policy was based on the measures adopted in mid-1994 in connection with the establishment of a system of foreign exchange auctions under which the Central Bank sets the upper and lower limits for fluctuations in the exchange rate. Under this system, the Central Bank buys hard currency from its exchange agents at the market's reference rate and auctions it off to buyers whose bids have to be within 1% of the benchmark exchange rate, which is set on the basis of the reference rate.

During the first few months of the year, as foreign exchange was readily available, the lempira appreciated slightly in nominal terms. Later in the year, however, the demand for foreign exchange climbed at the same time as the supply was squeezed by delays in the disbursement of a number of external loans. Consequently, the exchange rate began to rise slowly during May and June, but its pace slackened during the second half of the year. Thus, during the first half of the year the dollar remained below its December 1994 price, but from June onward it was higher, reaching 10.36 lempiras in December. Even so, the nominal depreciation of the currency was noticeably slower than in the preceding year, and below the domestic rate of inflation.

For some years now, foreign-exchange policy has paid particular attention to ensuring that local production remains competitive in foreign markets. In 1995, the Central Bank added momentum to the movement of the reference exchange rate by shortening the intervals between adjustments in the bid exchange rate; this was done, starting in October, by reducing (from 15 to five) the number of consecutive auctions after which the bid price could be altered if the reference exchange rate diverged from the benchmark rate.

3. The main variables

a) Economic activity

The Honduran economy revived in 1995, after the preceding year's drop in GDP. The growth rate of 3.2% produced a slight increase in per capita output, while national income rose at a rate similar to GDP.

The contraction in the volume of imports (-2.4%), however, hampered the expansion of overall supply, which was a modest 1.7%. At the same time, export volume swelled considerably (11%), while domestic spending was slightly lower (-1%); this was due to a sharp drop in investment, since consumption was up 4%.

The removal of the main obstructions in the Honduran economy cleared the way for rebuilding its levels of activity. In particular, favourable weather conditions not only helped to boost agricultural output but also contributed to an increase in the supply of electric power (an energy shortage had had an adverse effect on industry in the year before).

The improvement in output was based on positive trends in primary sectors and, particularly, agricultural activity. Growth in manufacturing returned to positive levels, but was rather lacklustre, while the output of the construction industry declined once again (albeit by far less than in 1994) because of the cutback in public investment and the scarcity of cement and other inputs.

The agricultural sector expanded by nearly 7%. Output both for export and for the domestic market was significantly higher, resulting in an 11% rise in crop-farming production. Livestock production made some headway, although there was little real momentum, owing mainly to the downturn in the slaughtering of cattle for the foreign market.

Crop production for the domestic market did well thanks to timely rains. The harvests of the chief crops in this subsector were higher, in particular maize, whose yield expanded by 33%. Increases were also recorded in beans (10%), rice (17%) and bananas (9%).

Agricultural production for export was also higher. Notwithstanding the restrictions imposed on imports of bananas from Latin America by the European Union, production was aided by improved conditions in foreign markets. Thus, after a two-year slump, yields increased by 12%. Coffee production also recovered and was further assisted by good international prices.

As to the remaining components of the agricultural sector, forestry continued at a standstill as a result of the partial ban imposed to avoid overcutting, and fishery output declined yet again. Shrimp farming, which had flourished during the past decade, continued to suffer from the ravages of a disease that has proved very difficult to eradicate.

The manufacturing sector showed a modest recovery (2.6%). From the standpoint of supply, the increase in the availability of electricity was an important development, while trends in some industries were affected by an expansion in domestic demand for manufactures. The expansion recorded in 1995 was based on production in the categories of food, beverages and tobacco; textiles and clothing; chemicals and petroleum products; and basic metals. It should be borne in mind that the categories of textiles and clothing includes the *maquila* industry, which in recent years has shown signs of great vitality.

During 1995, the total supply of electricity (2,526 kWh), including imports, was sufficient to satisfy domestic demand without the need for rationing. Midway through the year, electricity charges were raised substantially in order to cover the distributor's operating costs and to create appropriate conditions for investments which would help ensure a regular supply on an ongoing basis.

b) Prices, wages and employment

The increase in consumer prices slowed somewhat in 1995, with cumulative inflation over the year amounting to 27% (as against 29% in 1994). During the first few months of the year, inflation accelerated, mainly as a consequence of the jump in food prices that occurred when, in December 1994, the authorities lifted the temporary price controls which had been imposed on 40 staple foods a short time earlier

Just as the impact of this phenomenon began to fade, price adjustments in other areas, such as electricity, fuel and transport, started to make themselves felt. The broadening of the tax base for the sales tax and, in recent months, the depreciation of the lempira on the foreign-exchange market were further contributory factors. Nevertheless, the second half of the year saw a slowdown in the growth rate of the aggregate level of prices.

Minimum wages rose by 22.3%, having last gone up in mid-1993. Real wages, fell by nearly 6%, however, thus compounding the wage erosion observed in 1994. This situation occasioned a variety of protests and, as a result, some groups of workers won concessions designed to boost their wages. Midway through 1995, wage-earners were awarded a bonus equivalent to an additional (fourteenth) month's pay as an emergency measure to alleviate the slump in real wages.

c) **The external sector**

Honduras' balance-of-payments current account deficit dropped to slightly more than US$ 220 million, or the equivalent of around 15% of the value of its exports of goods and services. This performance was a reflection of the reduction in the merchandise trade deficit made possible by a significant increase in the value of exports of goods.

From the beginning of the decade until 1993, fluctuations in exports of merchandise had displayed no definite trend, but the momentum noted in 1994 took a firm hold in 1995, and the value of exports climbed by nearly 27%. International price variations played a major part in this trend. With the exception of meat and silver, whose prices fell, Honduras' main export products (traditional as well as non-traditional) brought higher prices; this was especially true of coffee, which registered a price hike of more than 65%, and, to a lesser extent, of bananas (17%).

Coffee exports swelled to around US$ 350 million, mainly owing to these higher prices. The amount exported during 1995 was 5% up on 1994; the modest size of this increase was attributable to the implementation of an agreement among the Central American countries to withhold 20% of their production from the market.

The recovery of international banana markets prompted increases in both the prices and volume (in similar proportions) of banana exports. Nevertheless, while their value rose by nearly 40%, after dropping sharply in 1994, this still did not restore them to 1993 levels.

The volume of shrimp exports contracted by 10%, due to the lower level of supply. Prices rose, but not enough to offset their reduction in volume.

In recent years there has been a rapid expansion of the *maquila* industry in Honduras. Although in 1995 it displayed less forward momentum, the value added by this activity still accounted for a large share (around 15%) of exports of goods and services.

The value of merchandise imports rose by 12.5% (approximately the same as the preceding year's rise), to nearly US$ 1.2 billion. This buoyancy was shared in more or less equal measure by all the main product categories, with consumer goods, intermediate goods and capital goods all increasing at similar rates. A somewhat above-average rise was observed in petroleum and fuels, as both prices and imported volumes were higher.

In 1995 the surplus in real services widened. At the same time, however, rises in interest rates and profit remittances pushed up the deficit in factor services slightly, from US$ 190 million to US$ 200 million. There was also a moderate rise in unrequited private and official transfers.

Capital inflows covered external borrowing requirements, so reserves expanded slightly. Long-term capital flows were down, however, with the exception of direct investment, which jumped from US$ 35 million to US$ 50 million. In 1995 there was a significant reduction in the inflow of long-term funds to the official sector. Disbursements from the IMF and the receipt of World Bank and Inter-American Development Bank (IDB) loans were held up by the country's delay in meeting a number of the conditions set by the IMF, but this situation was ameliorated somewhat by the use of short-term credit. Late in the year, when the majority of the IMF targets and performance criteria were deemed to have been

met, the second tranche of the structural adjustment loan was disbursed.

The external debt recorded a moderate increase (5%) which brought it to around US$ 4.4 billion. With the rise in exports, the debt-exports ratio dropped to 3.2, which, while still high, was the lowest figure to be recorded since the start of the decade. The increase in the debt in 1995 was a result of higher public-sector borrowing, since private-sector indebtedness was virtually unchanged. Most of Honduras' foreign debt is with international agencies (nearly 60%) and multilateral lenders (37%). In order to ease the debt service burden, a proposal has been made for the cancellation of debts owed to the Paris Club and other creditors.

MEXICO

1. General trends

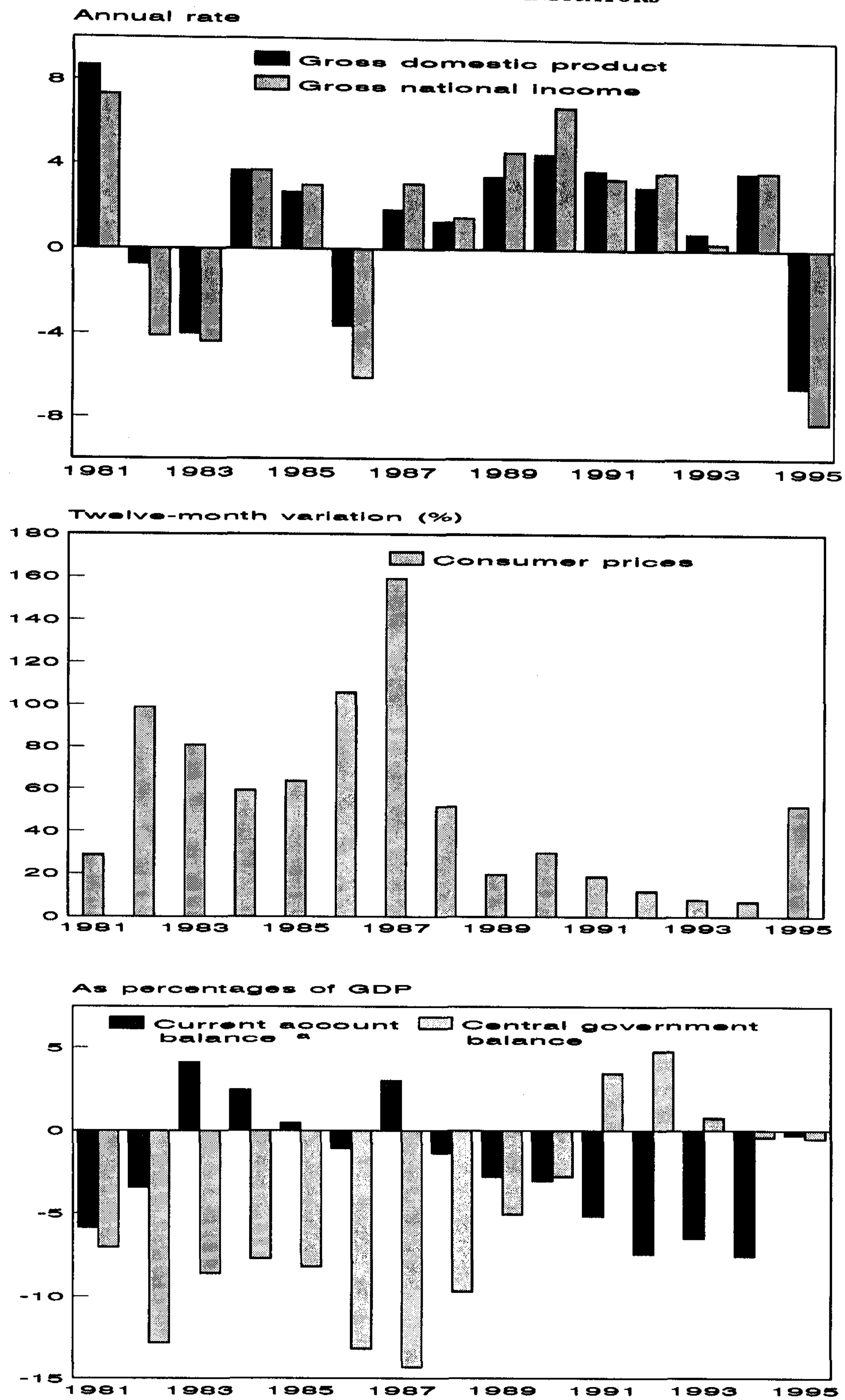
In the wake of the steep devaluation of the peso in late 1994, in 1995 the Mexican economy was engulfed by what proved to be the worst crisis to hit the country in modern times. The Government launched an emergency programme whose main objective was to bring about a swiftly paced, in-depth adjustment of the external sector in order to cope with the sudden interruption of external capital inflows. Hemmed in by a severe crisis in the banking system, an extremely unstable currency and the threat of a surge in inflation, the economy shrank by nearly 7% in 1995 and might well have contracted even further had it not been for the export sector's rapid response to the adjustment of the exchange rate. Nevertheless, with the help of a generous amount of international assistance, the authorities continued to pursue the development strategy whose implementation had begun in 1987 with the downsizing of the State, and no major changes were made in their approach.

The year 1994 had been a time of great uncertainty in Mexico due primarily to political events in the country, even though trends in the main economic variables were more promising than they had been at any other time since the introduction of the stabilization and structural reform programme. Economic activity had picked up, inflation had continued to subside until reaching a mere 7% per year, and the non-financial public sector's deficit was less than 1% of gross domestic product (GDP). Nonetheless, there were also some worrisome factors, such as the sizeable deficit on the current account of the balance of payments and a notable downturn in the inflow of external financial resources, which made it necessary to draw heavily upon the country's international reserves. In addition, since the assumption was that both the outflow of foreign exchange and the increasing level of uncertainty were temporary phenomena which would come to an end once the elections were over, monetary policy-makers had reverted to an expansionary approach. These factors, together with the pessimistic expectations generated by the political situation, set off the massive crisis that swept over the country in the final 10 days of December 1994.

The adjustment programme implemented in 1995 was based on strict fiscal restraints and a highly contractionary monetary policy. From the very outset, it was backed by a credit package of over US$ 50 billion –made up chiefly of special loans from the United States Department of the Treasury and the International Monetary Fund (IMF)– of which only US$ 27 billion had been used by year's end. Under an agreement signed with the IMF which included very strict macroeconomic targets, these external funds were of crucial importance to the adjustment programme's viability. More specifically, they made it possible to ensure the amortization of US$ 29 billion in foreign portfolio investment in short-term dollar-convertible government securities (*tesobonos*) which were to mature in 1995. The inevitable outcome of this bailout operation was an increase of more than US$ 24 billion in Mexico's external debt.

The downturn in economic activity went through a number of different stages in the course of the year. During the first quarter, the decline in GDP was not very sharp, thanks to the strong forward momentum of the last three months of 1994 and to the lag in the devaluation's effect on domestic prices. The second and third quarters brought a production slump of unprecedented proportions, however, after which the recessionary trend began to ease, although haltingly.

Figur 1
MEXICO: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

The collapse of domestic demand was particularly striking in construction, commerce and many manufacturing industries, all of which are major employers and include a large percentage of small businesses. Employment fell off sharply, with open unemployment rising by nearly 1 million persons. Despite three wage adjustments, the highest rate of inflation in eight years (52%) drove down the population's real income levels (by 14% in the case of people earning the minimum wage and by slightly more than that in the manufacturing sector).

As the economic recession deepened and financial markets remained volatile, the authorities began to implement new economic policy measures which helped to dispel the country's financial turbulence, although production was still slack. Towards the end of the year, however, the peso was buffeted by a series of speculative assaults which drove the Bank of Mexico to intervene in the exchange market. Even so, the depreciation of the peso amounted to 47% in nominal terms and 31% in real terms in 1995.

The recession and the high level of interest rates weakened the financial position of both businesses and households. This made it more difficult for them to service their debts and thus undermined the financial stability of the banking system, whose default rate shot up so sharply that the Government was obliged to devise a number of mechanisms to safeguard the public's savings, help debtors restructure their loans and pave the way for the financial reorganization of the commercial banking system. These programmes did help to improve the banks' capital positions, but they were also costly and were not successful in slowing the growth of the banks' portfolio of overdue loans.

The adjustment of the external sector was dramatic. The current account of the balance of payments went from a deficit equivalent to around 8 points of GDP to a virtually balanced position. Moreover, primarily as a result of the interruption of foreign capital inflows, the country posted a trade surplus for the first time in seven years. On the other hand, a large-scale withdrawal of external funds from the money market (mainly as a consequence of the redemption of *tesobonos*), a 13% drop in direct investment and a massive pull-out of investors from the stock market caused the capital account to show a deficit after having posted increasingly large surpluses over the preceding seven years.

During the early months of 1996, signs of the recession persisted, but the downward trend was not as steep as before, with GDP slipping by just 1% in the first quarter; nevertheless, unemployment was still high and real wages were still low. Inflation, too, remained high and financial markets swung back and forth, but their general direction of movement was a positive one. As of the beginning of May, the prime interest rate had fallen by nearly 15 points, the stock market had moved up 16% (20% in dollars) and the real exchange rate had registered an appreciation of nearly 13%.

2. Economic policy

The adjustment programme was launched in early 1995; its objectives were to reduce the deficit on the current account of the balance of payments, to quell the inflationary spiral and to create the necessary conditions for a reactivation of the economy as quickly as possible. The main policy measures adopted under this programme were the establishment of fiscal, monetary and wage restrictions and the adoption of a system of floating exchange rates to take the place of the currency bands which the authorities had been using as an anti-inflationary anchor since 1988.

To back up this emergency programme, the country was granted a special US$ 27 billion loan package from the United States Department of the Treasury and the IMF to help ease the pressure on the peso that had begun to build up early in the year when the swift erosion of reserves prompted investors to regard the planned conversion of the US$ 29 billion in *tesobonos* that were to mature in 1995 as a high-risk operation.

Since the recession continued to deepen as the year progressed, the emergency programme was modified several times. In March

Table 1
MEXICO: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	1.3	3.4	4.5	3.7	3.0	0.8	3.6	-6.6
Per capita gross domestic product	-0.7	1.5	2.5	1.8	1.1	-1.1	1.8	-8.2
Gross national income	1.5	4.6	6.7	3.3	3.6	0.3	3.7	-8.3
Gross domestic product, by sector								
Goods	0.9	3.9	5.9	3.0	2.3	0.4	3.5	-6.3
Basic services	2.8	4.6	6.1	5.4	7.0	3.4	7.8	-3.6
Other services	1.3	2.9	3.3	4.0	2.7	0.7	3.1	-7.6
	Percentages							
Contribution to growth of GDP [c]								
Consumption	2.4	4.9	4.9	4.7	4.0	0.1	3.4	-7.1
Government	0.0	0.0	0.2	0.3	0.2	0.2	0.2	-0.5
Private	2.4	4.9	4.7	4.3	3.8	-0.1	3.2	-6.5
Gross domestic investment	2.2	1.0	2.2	1.6	3.3	-0.7	1.9	-10.7
Exports	0.8	1.2	1.2	1.0	0.8	1.2	2.3	6.3
Imports	-4.1	-3.7	-3.8	-3.6	-5.2	0.1	-4.0	4.9
	Percentages of GDP [b]							
Gross domestic investment	20.4	20.7	21.9	22.7	25.3	24.4	25.4	15.8
National saving	19.3	18.1	18.8	16.8	15.9	16.0	15.6	15.5
External saving	1.1	2.5	3.1	5.9	9.3	8.4	9.8	0.2
	Percentages							
Employment and wages								
Activity rate [d]	51.6	51.8	51.8	53.3	53.8	55.2	54.7	55.0
Open unemployment rate [e]	3.6	3.0	2.8	2.6	2.8	3.4	3.7	6.3
Real minimum wage (Index: 1990=100)	124.4	114.6	100.0	94.4	91.2	90.3	90.0	77.3
	Growth rates							
Prices (December-December)								
Retail prices (nationwide)	51.7	19.7	29.9	18.8	11.9	8.0	7.1	52.0
Wholesale prices (Mexico City)	42.6	18.1	27.4	15.7	10.7	7.4	7.8	58.1
External sector								
Terms of trade (Index: 1990=100) [b]	85.6	92.7	100.0	100.2	103.6	103.2	103.8	97.4
Nominal exchange rate (new pesos per dollar)	2.27	2.46	2.81	3.02	3.09	3.12	3.38	6.50
Real effective exchange rate (Index: 1990=100)	110.0	103.2	100.0	91.1	84.1	79.7	81.9	121.1
	Millions of dollars							
Balance of payments								
Current account	-2 374	-5 825	-7 451	-14 888	-24 442	-23 400	-29 420	-654
Trade balance (goods and services)	2 414	-267	-3 110	-9 369	-18 618	-16 010	-21 067	7 960
Exports	36 776	42 379	48 805	51 556	55 471	61 402	71 203	89 825
Imports	34 362	42 646	51 915	60 925	74 089	77 412	92 271	81 866
Capital and financial account	-4 495	1 110	8 441	25 139	27 039	33 760	15 787	-11 781
Overall balance	-10 062	-211	2 218	7 973	1 745	7 232	-17 666	-15 306
International reserves (variation)	-6 721	542	3 261	8 154	1 173	6 057	-18 865	10 654
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	58.3	46.3	41.9	40.0	34.6	35.3	35.2	65.0
Net interest (as a percentage of exports)[f]	16.8	15.9	13.6	12.4	13.6	14.9	12.9	11.7

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Federal government								
Current income	16.8	17.8	17.2	17.0	17.7	17.3	17.2	17.9
Current expenditure	25.3	21.2	17.3	14.6	13.6	14.4	15.2	16.4
Savings	-8.5	-3.4	-0.1	2.5	4.1	2.8	2.0	1.5
Capital expenditure (net)	1.9	2.0	2.7	2.3	2.4	2.0	2.4	2.0
Adjustments	0.7	0.4	-	-	-0.1	-0.4	-0.4	-0.2
Financial balance	-9.7	-5.0	-2.8	0.2	1.6	0.4	-0.8	-0.7
	Growth rates							
Currency and credit								
Money balances								
International reserves held by Bank of Mexico	...	...	71.3	79.9	7.3	31.9	-57.0	267.5
Net domestic credit	66.9	45.6	41.7	35.6	21.4	11.5	29.2	5.8
To central government (net)	70.1	13.5	17.7	-2.5	-51.9	...	1 131.8	...
To private sector	82.9	97.6	73.5	61.5	47.7	24.3	40.3	-4.2
Money (M1)	65.8	38.6	64.7	124.8	14.7	17.9	1.1	2.3
Local-currency savings and time deposits	37.5	43.7	41.4	20.1	23.9	10.5	33.2	55.5
M2 [g]	42.2	43.0	46.2	47.1	20.4	13.4	21.3	38.6
Dollar deposits	-4.2	69.8	10.6	9.8	28.6	12.3	89.9	86.0
	Annual rates							
Real interest rates (annualized)								
On deposits (30 days)	7.3	13.8	1.0	-1.3	3.4	6.9	5.8	-7.7
Equivalent interest rate in foreign currency (30 days) [h]	42.6	18.2	17.2	12.2	14.0	15.9	-8.5	1.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [g] Includes dollar-denominated deposits. [h] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
MEXICO: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product [b] (Index: 1990=100)	105.8	108.6	102.6	111.9	106.5	113.9	107.3	116.4	105.4	102.7	98.6	109.6
Consumer prices (12-month variation, %)	10.9	10.0	9.6	8.6	7.3	6.9	6.8	6.9	15.0	33.8	41.7	48.7
Real effective exchange rate (Index: 1990=100)	79.7	80.3	79.7	78.9	77.1	81.1	82.8	86.4	132.5	118.3	110.8	122.7
Real interest rate (annualized, %) On deposits[c]	7.0	8.6	6.1	5.8	1.1	8.6	7.6	5.9	-21.2	-18.4	5.4	3.3
Money (M1) (12-month variation, %)	19.1	18.4	22.0	17.9	20.0	9.8	8.4	1.1	-17.6	-15.2	-10.5	2.6

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on non-seasonally-adjusted series at constant prices in pesos. [c] For 30-day terms.

macroeconomic goals were revised to fit in with an economic environment marked by higher inflation and slower growth, the prices and rates charged for public-sector goods and services were increased once more, and the value added tax (VAT) rate was raised from 10% to 15%. In November, on the occasion of the signature of the Alliance for Economic Recovery, the country's macroeconomic targets were revised yet again, the prices and charges for goods and services provided by the public sector were increased further and a wage adjustment was slated to take effect in December.

Meanwhile, in a effort to restore the profitability of investment in rural sectors, boost production, combat poverty, remedy the shortfall in the agricultural sector's food output and offer food products at competitive prices, the Government and trade union organizations in the sector signed the Rural Alliance, which was expected to begin making its effects felt in 1996. In order to shield the low-income population from the impacts of the adjustment, the Government adopted a number of compensatory social measures but, even so, public expenditure for social development shrank by 11% in real terms in 1995.

Midway through the year, the Government unveiled the National Development Plan for 1995-2000, in which it reaffirmed its commitment to keeping public finances on a sound footing and to promoting deregulation, liberalization and a reduction in inflation, as well as to placing priority on the resumption of sustained growth and increased employment. In view of the serious problems triggered by the crisis, the Plan assigns top priority to the reactivation of domestic saving; this source of savings is seen as providing the main means of financing development in Mexico, while external savings are considered to play no more than a supplementary role in this respect.

The adjustment programme's objectives were achieved for the most part, since the deficit on the balance-of-payments current account was reduced considerably and the economy staved off any impending bouts of hyperinflation. Nonetheless, 15 months after the adjustment programme entered into effect, the chances of a resumption of growth were still far off on the horizon. There are three primary objectives of fundamental importance in this regard: i) finding a thorough-going solution for the problems faced by the banking system and its debtors; ii) ensuring the continuity of Mexico's inflows of external resources with a view to stabilizing the exchange market; and iii) buttressing the tenuous reactivation of production so as to foster greater confidence on the part of the public and pave the way for a return to previous real wage levels.

a) **Fiscal policy and public finance**

The fiscal policy applied during this period was extraordinarily harsh because of the need to generate a large enough primary surplus to relieve the pressure on the exchange rate, cope with the sudden increase in debt service caused by the devaluation and the upturn in domestic and external interest rates, and free up funds to pay for emergency programmes to assist those sectors of the population that were harmed the most by the crisis. Moreover, the Government had taken on major financial obligations in an effort to firm up the banking system's financial standing and help out the country's debtors. The cost of doing so is estimated, at current values, at the equivalent of 5.7% of GDP. In addition, in 1996 approval was given for a new programme to aid mortgage holders at a cost of another 1.7% of GDP. The total cost of this programme in 1995 had amounted to 1.6% of GDP, mainly because it also included the cost for that year of one of the programmes set up to restructure loan payments.

The public sector was, for all intents and purposes, in a balanced financial position, while its primary balance sheet (which does not include finance charges) yielded a surplus equivalent to 5.4% of GDP. The fact that this was more than double the preceding year's figure attests to the scope of the adjustment.

The public sector's current revenues were 3.8% lower in real terms due to a 13% drop in non-oil receipts which was partly offset by a 21% jump in oil earnings, while the federal government's budgetary receipts slipped 2.6% as the net result of a downturn of almost 21% in tax revenues and a jump of over 50% in non-tax income owing to a steep rise in oil royalties.

The decrease in tax revenues was a consequence of the slackening of economic activity, the fiscal measures adopted to help out taxpayers, and a corporate liquidity squeeze. The erosion (also in real terms) of income tax receipts was the outcome of the capital losses sustained by businesses with debts denominated in foreign currencies, the measures taken to increase workers' disposable income and the reduction in the tax rate on corporate assets, among other factors.

On the other hand, receipts from the value added tax (VAT) edged down by a mere 1.4%, despite the contraction of GDP and imports, thanks to the decision to raise the general rate from 10% to 15% in April.

In real terms, public-sector expenditure shrank by nearly 5%; interest and other current payments on the debt virtually doubled, whereas outlays having a direct influence on effective demand plunged by 15.6% in real terms. The pronounced decrease in government investment in physical assets was particularly striking, but the level of investment in Petróleos Mexicanos (PEMEX) was higher and the implementation of emergency employment programmes continued.

The total public debt had declined from 45.8% of GDP in December 1994 to 43.4% by December 1995, while the domestic debt shrank from 13.1 to 6.9 points of GDP, mainly as a result of the redemption of *tesobonos*; the net external public debt rose from 32.7% to 36.5% of GDP, however.

The gross external public debt (excluding Bank of Mexico debt) swelled by more than US$ 15 billion as a consequence of the international loans received by Mexico to help it deal with the economic emergency (and, especially, to pay off *tesobonos*), disbursements of IDB and World Bank loans, and the sale of debt paper on international markets. Servicing the external debt absorbed an enormous amount of foreign exchange –the equivalent of 35% of total 1995 export earnings– and the country's debt service is expected to remain high in coming years, which probably means that it will need to reschedule or negotiate a change in financial instruments in 1996 or thereafter.

Unlike what had occurred in other crises, in 1995 the country soon re-entered voluntary credit markets. Placements of securities issued by the federal government and the countries' development banks totalled more than US$ 6 billion in 1995, and another US$ 5 billion was floated during the early months of 1996. Most of these issues have been of short- or medium-term securities and have yields far above international benchmark rates.

b) Monetary policy and monetary and financial considerations

As a result of the authorities' tight monetary policy and the slump in economic activity, monetary aggregates showed an across-the-board decrease. The balances for the monetary base and the money supply (M1) were down by 23% and 30% in real terms, respectively. The intake of funds by all banking institutions as a group was 14% lower, while net credit to the private sector –which had risen 36% in 1994– fell by 17%. Since this variable includes the effect of loan restructurings, the downturn in the amount of fresh credit flowing into the private sector was actually even sharper. The trends exhibited by these monetary aggregates, as well as by the interest rate on deposits, indicate that monetary policy was, in fact, highly restrictive.

Nominal interest rates displayed an upward trend as a consequence of the monetary squeeze caused by the adjustment programme and the need to maintain a high rate of return on financial investments because of the pressure exerted on the peso throughout 1995. For example, the average yield on 28-day treasury bills (*cetes*) was 48%, which was more than three times what it had been in 1994 (14%). During the first few months of 1995, however, real rates on deposits were negative due to the lag in the adjustment of nominal rates that usually arises following a steep devaluation; thereafter, real rates exhibited a decidedly positive trend (although they were also quite volatile), averaging 15% for the period from May to December.

The uncertainty overshadowing the economy in 1995 and the increasing severity of the banking crisis played a part in widening the spread between lending and borrowing rates. Interest rates on deposits peaked in March, when the rates on 28-day *cetes* in the primary market topped 80%, whereas the rates on loans were over 100%.

The amount of government debt paper in circulation fell by over 45% between the end of 1994 and the end of 1995; this was mainly attributable to the redemption of *tesobonos*, which went from representing 66% of all such securities to a mere 1.5% during this period. This reduction counterbalanced the increase in *cetes* and other public securities, one of whose hallmarks was the growing percentage of foreign stakeholders (probably former holders of *tesobonos*); this was especially true in the case of *cetes*, where foreign ownership amounted to 45% by the end of the year.

The stock market was extremely volatile, but its overall direction of movement, in real terms, was downward. Early in the year the descent that had begun in late 1994 steepened, plunging the Index of Prices and Quotations (IPYC) to its lowest point for the year in March. Subsequently, the confidence instilled by the adjustment programme helped to buoy prices, but this strengthening trend was interrupted in late September when the currency market began to show signs of instability and pessimistic expectations began to form regarding the balance sheets of issuers; these factors were then reflected in the instability of the IPYC in the final quarter.

In the closing weeks of the year, the IPYC rose considerably and, in early 1996, went on to break through the 3,000-point barrier for the first time ever. This rebound –in which both external financial factors and the undervaluation of many stocks played a part– helped the IPYC to reclaim some of the ground it had lost during its headlong slide in 1995. As a result, this indicator posted a 17% nominal increase between December 1994 and December 1995, although when calculated in dollars, it actually fell by 27%.

c) Foreign exchange policy and markets

In 1995 a system of floating exchange rates was adopted to take the place of the currency bands which the authorities had been using as an anti-inflationary anchor for the last seven years. In early 1995, uncertainty as to the emergency programme's chances of fulfilling the terms and conditions established for the redemption of *tesobonos* contributed to the sharp depreciation of the new peso, which reached its height in early March. Later on, the Government's modification of the emergency programme and adjustment of its macroeconomic targets bolstered the recovery and stability of the currency, but in September the persistent recession and a number of non-economic (primarily political) events combined to put an end to the stability of the currency, which then remained unstable almost up until the end of the year. As a result, the peso depreciated nearly 50% in nominal terms and 31% in real terms in 1995. As the year drew to a close, the Bank of Mexico had to inject funds (US$ 505 million) into the currency market on a number of occasions to counteract the speculative pressure bearing down on the peso during the last quarter of the year.

d) Structural reforms

In response to the crisis and the pressing need for foreign exchange, early in 1995 the Government announced further deregulation measures, concessionary arrangements and privatizations that are expected to bring in around US$ 14 billion over a period of several years. The most notable examples include PEMEX petrochemical subsidiaries (US$ 2 billion), electrical power supply (US$ 6 billion), satellites (US$ 1.5 billion), telecommunications, ports and airports; natural gas distribution and the railroad. Arrangements for the privatization of a number of port terminals have already been made, work on the development of long-distance telephone services is moving forward and some concessions for the provision of electrical power have been awarded. Concessions for radio tracking services and for cable television and closed-circuit television services have also been granted. Plans to privatize PEMEX petrochemical subsidiaries sparked opposition from various groups, however, so even though the bidding conditions were announced in October and the deadlines set for the acceptance of bids had already passed, the sale of the first group of such firms was still pending.

Late in 1995, Congress passed a new Mexican Social Security Institute Act. This legislation, which was to remain in effect until 1 January 1997, provided for reforms in all five branches

of insurance coverage: health and maternity; disability and life insurance; unemployment insurance for older workers and retirement and old-age pensions; occupational hazards; and custodial care and social benefits. As a means of boosting domestic saving, the new law alters the pension system and, in a departure from the preceding legislation on the subject, authorizes the opening of individual retirement accounts into which the retirement fund contributions from employers, the Government and workers themselves will be deposited. These accounts are to be managed by the country's recently created pension fund administrative boards, which are governed by regulations that were approved by Congress in March 1996.

3. The main variables

a) Economic activity

The economy was hit by the worse recession to occur in more than 60 years. The ensuing adjustment programme caused domestic demand to plummet and this, in combination with the reduction of external capital inflows, drove down output (-6.6%) and per capita GDP (-8.2%). The largest decreases were seen in the second and third quarters (10.5% and 9.6%, respectively); the contraction of the economy during the first quarter was very slight, thanks to the forward momentum generated by the economic buoyancy of the closing months of 1994. The downturn was still considerable in the last quarter of 1995 (-6.6%), but the overall trend appeared to be less recessionary than before.

All the components of aggregate demand except exports suffered considerable setbacks: total domestic demand fell 17% in real terms, public-sector consumption was down by 6% and private consumption by 9%, and public investment dropped 19% while private investment was 34% lower. Exports were the only component to post an increase (28%); had it not been for their strength, output would have decreased even more sharply than it did.

The recession's effects were felt in all branches of the economy, but the most seriously affected activities were the ones that cater to the domestic market (which are also the most important sources of employment) –such as construction, commerce and some services– and, in general, the vast majority of small businesses. The agricultural sector registered a 2.5% decline, manufacturing was down by 4.6%, and services fell back 7.6%.

The agricultural sector was hit by a serious crisis in 1995. On the one hand, the slump in domestic demand was too severe to be offset by the expansion of exports; moreover, the supply of agricultural products was lower because production was hurt by a number of factors: a 25% reduction in credit in real terms and the high rate of loan defaults; the sharply escalating prices of inputs; and droughts in the northern part of the country early in the year which primarily hurt livestock production and spring/summer crops.

Manufacturing output shrank by 4.6%, thus recording a decrease of a magnitude not seen since 1983. Businesses serving the home market lost a great deal of ground, whereas the country's small number of direct and indirect exporters managed to sustain their forward momentum thanks, above all, to the effect of the devaluation. This was not enough to halt the downswing in domestic consumption however, and as a result only two of the nine branches of the manufacturing sector (paper and basic metals) recorded higher levels of output.

This split in the market was also reflected in the automotive industry, where the production of motor vehicles slipped 15% as the net result of a 71% drop in output for the domestic market and a 35% jump in exports, which thus came to claim an 84% share of this branch of industry's total output.

The two main causes of the 23% slump in construction were high interest rates, which dampened the demand for credit, and cuts in public-sector expenditure on infrastructure and housing programmes. In real terms, the value of this sector's output was 15% lower than it had been 15 years earlier.

Activity in the services sector was sluggish, with a striking 14% downturn in commerce. In retail sales, motor vehicle distributors, furniture stores, department stores, stationery stores,

bookstores, hardware stores, and clothing and shoe stores were hurt the most, with all of these categories registering downturns of more than 20%.

Economic trends remained unfavourable in the first months of 1996. In a prolongation of the trend observed throughout 1995, GDP receded 1% in the first quarter of 1996. Nonetheless, there were already some signs that the situation would start to improve from that point on.

b) **Prices, wages and employment**

Inflation, which had tended to subside during the past few years, surged upward in 1995, for the sharpest increase in consumer prices (52%) since 1987. Plunging domestic demand and wage constraints offset the increase in costs brought on by the devaluation and kept inflation from spiraling out of control. The most critical point was reached in April, when inflation was pushed up to 8% by the appreciation of the dollar early in the year, the VAT rate hike and the emergency wage adjustment that was announced during that month. Inflation then began to abate and continued to do so until August, at which point it leveled off at around 2% before closing out the year with a 3.3% upturn in December that was partially a seasonal phenomenon.

The depreciation of the peso pushed up the prices of tradable goods by 17% more than those of non-tradables. The price of the basic shopping basket jumped 61%, which had an especially serious impact on the real income levels of the working class. Producer prices climbed 59%, with particularly steep increases in the cases of the public sector (70%) and raw materials (73%), chiefly because of such products' external origin or their linkage with international prices.

Minimum wages were raised three times in 1995: in January (7%), April (12%) and December (10%). These wage hikes were not large enough to make up for the loss of purchasing power caused by inflation, however, and the real minimum wage therefore deteriorated by 14.2%. Real wages in the manufacturing sector also weakened (-15.3%). With these decreases, the real minimum wage fell to a scant one third of what it had been in 1980 while wages in manufacturing activities were equivalent to 83% of what they had been in that year. The population's real income is expected to decrease further in 1996, although less sharply than in 1995.

The open unemployment rate advanced from 4.5% in January to a high of 7.6% in August, whereupon it receded to 5.5% in December, primarily due to seasonal factors and the implementation of temporary employment programmes. This last figure is much higher than the end-1994 rate (3.2%) and indicates that over 900,000 persons joined the ranks of the unemployed in 1995, bringing the total number of openly unemployed workers to around two million.

These unemployment levels resulted in a record 5.4% drop in the number of persons covered by the Mexican Social Security Institute (IMSS). The largest reduction was among casual workers, mainly in the construction industry. Manufacturing activities continued to lay off workers, and the labour force employed in this sector therefore shrank by 7.5% in 1995. In contrast, the *maquila* industry created over 80,000 new jobs and was employing more than 680,000 workers by the end of 1995, which was equivalent to about 30% of total employment in the manufacturing sector.

Many workers who were laid off from jobs in formal activities sought refuge in the informal sector, which thus continued to help cushion the economy from the effects of the crisis and social pressures. This phenomenon was also associated with a number of adverse features, however, such as low productivity, an absence of social security coverage, and wage levels below those of the formal sector.

c) **The external sector**

Mexico's external accounts did an about-face in 1995. In a departure from the trend seen in recent years, when a copious inflow of external resources had covered the country's growing deficit on current account, in 1995 the capital account registered an outflow of US$ 8.5 billion. The outflow of portfolio investment was particularly notable (-US$ 10 billion), especially since there had been a net inflow of over US$ 8 billion under this heading in 1994. This

turnaround was in large part responsible for the fact that the capital account showed a deficit for the first time since 1990. In contrast, even though the flow of direct investment slackened somewhat, it was still considerable and was substantially above the levels recorded prior to 1994. A sizeable net outflow –over US$ 5 billion– was also registered under the heading of errors and omissions.

The small deficit entered on the current account (US$ 650 million) was in stark contrast to the 1994 deficit of over US$ 29 billion. This change –equivalent to 8% of GDP– was mainly attributable to Mexico's trade surplus.

During this second year under NAFTA, trade with the United States yielded a record US$ 13 billion surplus, making Mexico the country with the fourth largest trade surplus with the United States in the world. Merchandise sales to the United States were 28% higher than before and accounted for 84% of Mexico's total exports. Imports from the United States were down 5%, but still represented 74% of total purchases from abroad. Trade between Mexico and its largest trading partner amounted to over US$ 120 billion.

The US$ 2.6 billion trade deficit on the services account in 1994 gave way to a surplus of US$ 900 million in 1995 thanks, in particular, to a much larger surplus in international tourism services. Given the high level of interest payments on the external debt, however, the deficit recorded for factor services was not only large (US$ 13 billion) but was also 14% higher than the 1994 figure.

The price competitiveness generated by the devaluation of the peso and the sharp contraction of domestic demand played a decisive role in the achievement of a surplus in merchandise trade (over US$ 7 billion) for the first time since 1989; it also constituted a major change from the situation in 1994, when a deficit of over US$ 18 billion had been posted. The fastest growth rate to be recorded since 1980 drove exports up to a total of US$ 79.5 billion, and external sales of products other than petroleum exhibited the largest increase to be seen in 21 years. Exports of manufactures were up by 32% and accounted for 84% of the total, industrial exports expanded 47% and external sales by the *maquila* sector rose 19%. The 41% increase in the motor vehicle industry's overseas sales was particularly significant because of the size of its share in total exports (17%), but it is important to note that the export boom in 1995 was an across-the-board phenomenon. Exports of primary products were bolstered by an improvement in the terms of trade and thus expanded considerably.

Merchandise imports were 8.7% lower, while imports of intermediate goods maintained a modest growth rate owing to the heavy dependence on imported inputs exhibited by export and non-export firms alike. The sharp downswing in domestic investment and consumption led to a notable decrease in imports of capital and consumer goods (35% and 44%, respectively) despite a strong upturn in export firms' imports of machinery and equipment.

The end result was a US$ 15 billion deficit on the overall balance of payments. Nonetheless, in order to build up reserves the authorities drew on a portion of the emergency external assistance provided to the country, with the result that the year-end level of reserves was US$ 11 billion higher in 1995 than in 1994.

NICARAGUA

1. General trends

The Nicaraguan economy grew by more than 4% in 1995, pushing up the per capita gross domestic product (GDP) for the second time in ten years, a sign that the first steps have been taken towards the stabilization and normalization of daily life and economic activity now that the country has recovered from the ravages of war.

The growth of GDP was fuelled by greater domestic and external demand. Improvements in relative prices led to an upturn in exports, while the resurgence of investment and, to a lesser extent, private consumption, gathered pace. The supply of goods and services was boosted in a variety of ways: higher international coffee and banana prices, for example, and legislation that had been passed at the beginning of the 1990s to encourage the *maquila* industry, constituted major incentives to the production of tradable goods. Among activities oriented towards the domestic market, commerce expanded significantly under the stimulus of a relatively high level of liquidity among urban upper-income groups and of extra-economic factors such as a lessening in the activity of armed bands in the northern areas of the country.

During 1995, Nicaragua made progress in consolidating its macroeconomic adjustments, keeping inflation under control (11%) and moderating its serious external imbalances through successful renegotiation of its overwhelming foreign debt. Even so, little progress was made in reducing the consolidated fiscal deficit, which remained around 10% of GDP, in spite of the marked increase in current saving by the public sector.

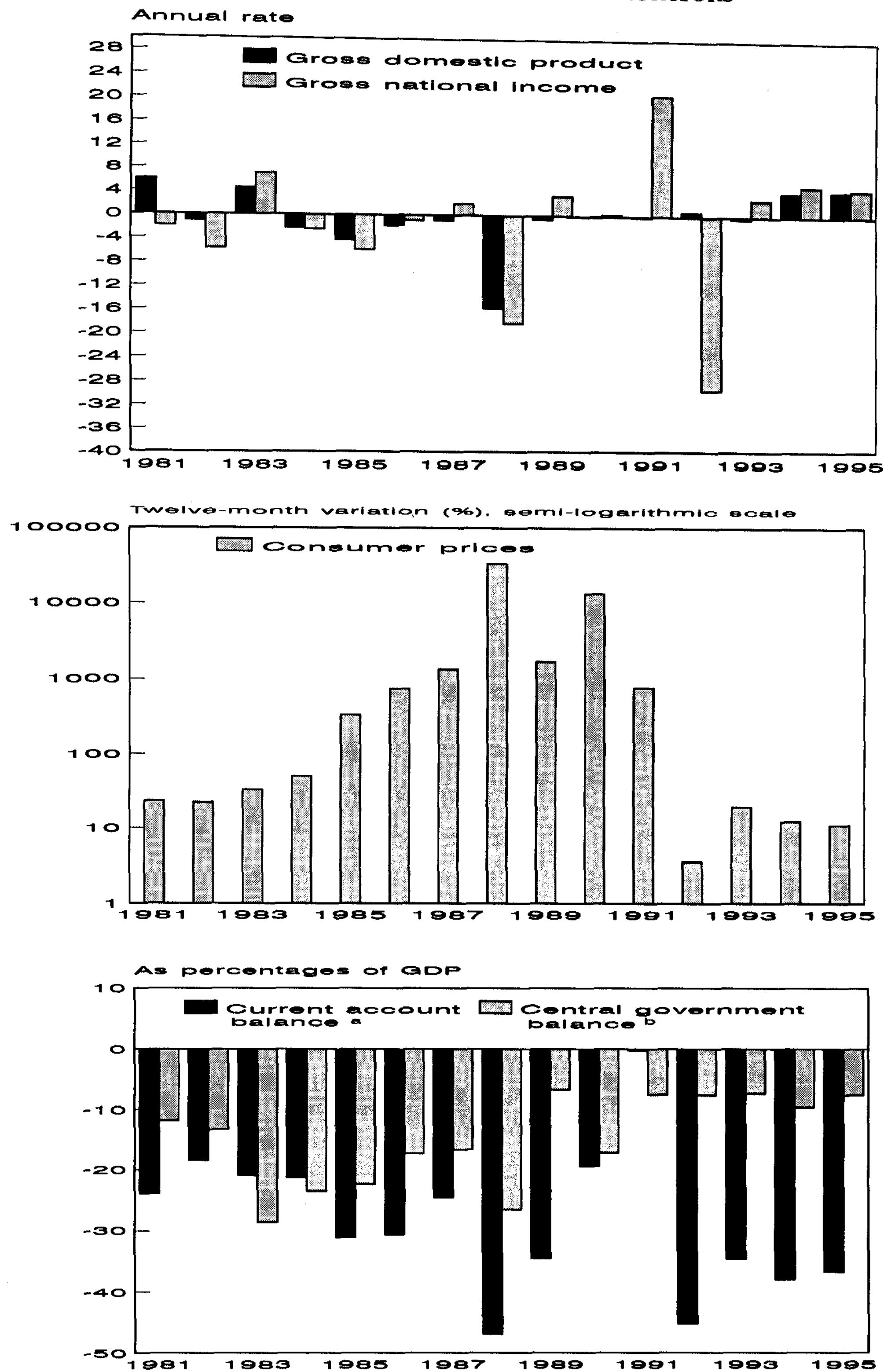
2. Economic policy

Economic management in Nicaragua is severely constrained by the country's extreme dependence on external resources, as evidenced by its inordinate level of indebtedness and the persistence of its trade deficit. Domestic saving is in fact negative: consumption exceeded national income by the equivalent of 4% of GDP in 1995, and that figure has been considerably higher in other years. The country has thus required continual transfers of funds from abroad.

In 1995, economic policy continued to develop in a context of extreme austerity, in accordance with the adjustment programme, but not all the targets agreed with the International Monetary Fund (IMF) were met. The central objective, to reduce the fiscal deficit by increasing the primary surplus, was only partially achieved, which meant that the macroeconomic programme had to be renegotiated. It was replaced by an interim programme, which took account of structural and political constraints. Meanwhile, international negotiations made it possible, for the first time in many years, to reduce Nicaragua's huge external debt.

The easing of tensions in the external sector, in combination with tight monetary and fiscal policies, helped to keep the exchange rate and prices in check. There remained, however, the very important question of the extent of use of factors of production. This issue lent critical significance to the steps that were taken to temper the often institutionalized rigidity of the economic structure, which projected a high risk profile to potential investors, and two promising developments in this respect were the National

Figure 1
NICARAGUA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

Assembly's passing of the act privatizing the public telecommunications company (TELCOR) and the all-party agreement to respect the agricultural smallholdings that had been created under the reforms of the 1980s.

a) **Fiscal policy**

The central objective of fiscal policy in 1995 was to increase the non-financial public sector's rate of current saving. As a result of the increase in revenue and restrained current spending, public saving as a proportion of GDP went up from 2.7% to 6.2%. The improved fiscal performance was not, however, enough to meet the targets set in the adjustment programme.

Both tax and non-tax revenue rose. No important changes were made in the structure of taxation, but ground was won in the fight against tax evasion and late payment, and in eliminating exemptions. The "tax machine" (alcoholic beverages and cigarettes) and income from tariffs were helped by the increases in private consumption and imports. Income from public utilities was boosted by higher charges. On the expenditure side, the labour mobility plan designed to cut administrative staff remained in operation, although the results fell short of the target. The Government made efforts to maintain the level of infrastructure investment.

The increase in current saving, although tempered by the rise in capital expenditure, brought the consolidated deficit down from 12% to 10% of GDP. A number of donor countries, seeing that the adjustment programme's targets were not being met, began withholding external funding. Fresh talks with the IMF resulted in the interim plan mentioned above, but although the revised objectives were in large part attained during the latter part of the year, the Government was obliged to go to the Central Bank of Nicaragua for net financing of around 3% of GDP in order to cope with its short-term liquidity problems.

b) **Monetary policy**

Monetary policy in 1995 was an intensification of the restrictive approach adopted in previous years. The Central Bank of Nicaragua strengthened its institutional autonomy by preparing annual and quarterly monetary programmes, although it was unable to avoid granting credits to the central government in the second half of the year.

The separation between the Central Bank and the credit market became more pronounced. Net Central Bank credit to the national financial system, which had been static as of 1993 and negative in 1994, contracted still further, helping to slow the expansion of liquidity. The Central Bank tried to intervene only in emergencies, as a lender of last resort, with rapid-recovery instruments such as overnight loans or loans with a term of a few days.

In April 1995, the use of the legal reserve requirement as an economic instrument was extended, partly as a monetary control measure, but also with a view to forestalling the effects of excess liquidity in private banks, whose cautious policy on loans contrasted strongly with the upsurge in deposits.

Yields on financial assets, along with utility charges and other key prices, are adjusted regularly in line with exchange-rate variations, which implies a tight indexation of the Nicaraguan economy as a whole. Nevertheless, despite the greater stability of the monetary and financial situation and high yields on córdoba deposits, which were adjusted by the exchange rate by means of a "value-maintenance" clause, the spread of dollarization revealed a lingering perception of risk among the general public.

In 1995, the Central Bank of Nicaragua began using local-currency open-market operations, selling Negotiable Investment Certificates (CENI) as a further stringency measure designed to control liquidity and protect foreign reserves. The first auction, in July, was restricted to financial institutions but subsequent auctions were open to the general public. Since these were not large-scale operations, however, they did not push interest rates up appreciably.

The fragility of the Nicaraguan financial system stems from a number of market imperfections. Although stabilization allowed deposits to recover and strengthened confidence in the financial system, the perception of productive activities, particularly agricultural activities, as a high-risk area continued to prevail. The risk was exacerbated by the failure to clear up the State banking system's

Table 1
NICARAGUA: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	-15.7	-0.6	-0.1	-0.1	0.8	-0.4	4.1	4.4
Per capita gross domestic product	-17.7	-3.2	-3.1	-3.6	-3.0	-4.2	0.2	0.7
National income	-18.2	3.4	0.3	20.8	-29.5	2.9	5.3	4.7
Gross domestic product, by sector								
Goods	-17.5	3.9	-1.0	-0.7	0.6	1.2	7.7	5.1
Basic services	-13.6	-1.4	2.0	3.9	1.8	-2.8	0.4	5.1
Other services	-13.9	-5.4	0.7	0.1	1.0	-1.9	0.3	3.4
	Percentages							
Contribution to growth of GDP [c]								
Consumption	-8.7	-11.7	-0.9	4.4	1.1	-4.9	1.0	-0.6
Government	-16.3	-6.4	8.2	-11.1	-2.3	-0.6	-0.6	-0.9
Private	7.6	-5.3	-9.1	15.5	3.4	-4.3	1.5	0.4
Investment	-7.2	-3.0	-2.5	2.1	0.0	-0.8	6.7	2.3
Exports	-0.9	4.1	2.1	-1.3	2.9	1.0	1.8	5.2
Imports	1.0	10.0	1.2	-5.4	-3.2	4.4	-5.4	-2.5
	Percentages of GDP [b]							
Gross domestic investment	20.5	17.6	15.1	17.3	17.2	16.4	22.2	23.4
National saving	-15.3	-0.4	0.8	17.0	-19.3	-12.0	-8.1	-3.3
External saving	35.8	17.9	14.3	0.2	36.5	28.4	30.3	26.7
	Percentages							
Employment and wages								
Activity rate [d]	67.5	60.6	55.7	47.7	49.7	49.9	46.4	46.8
Open unemployment rate [e]	6.0	8.4	11.1	14.2	17.8	21.8	20.7	18.2
Average real wage (Index: 1990=100)	37.3	61.9	100.0	103.2	103.2	118.8	128.5	133.3
	Growth rates							
Prices (December-December)								
Retail prices	33 547.6	1 689.1	13 490.3	865.6	3.5	19.5	12.4	11.1
External sector								
Terms of trade index (Index: 1990=100) [b]	113.4	103.8	100.0	89.8	68.3	77.5	86.0	94.6
Nominal exchange rate [f]	0.27	15.66	689.96	4.27	5.00	6.12	6.72	7.53
Real effective exchange rate (Index: 1990=100) [g]	125.4	150.0	100.0	104.6	104.9	108.3	113.3	118.9
	Millions of dollars							
Balance of payments								
Current account	-715	-362	-305	-5	-834	-644	-729	-706
Trade balance (goods and services)	-583	-326	-290	-486	-610	-449	-504	-422
Exports	273	341	392	338	309	367	453	648
Imports	856	667	682	824	919	816	957	1 070
Capital and financial account	304	-89	-161	-544	-538	-503	-209	-561
Overall balance	-360	-520	-648	-464	-1 312	-1 019	-784	-1 202
International reserves (variation)	44	64	-39	109	1	-79	81	4
	Percentages							
External debt								
Public debt (as a percentage of GDP)	474.0	929.5	675.1	646.6	585.8	589.3	605.5	532.5
Net interest (as a percentage of exports) [h]	96.0	60.1	55.3	107.4	156.1	114.1	100.6	53.1

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Central Government								
Current income	21.1	23.4	14.9	19.3	20.4	19.5	20.1	21.4
Current expenditure	41.3	26.7	30.7	23.5	22.1	20.6	21.0	18.9
Current savings	-20.2	-3.3	-15.8	-4.2	-1.7	-1.1	-0.9	2.5
Net capital expenditure	6.4	3.4	1.3	3.3	5.9	6.3	8.7	10.2
Financial balance	-26.6	-6.7	-17.1	-7.5	-7.6	-7.3	-9.6	-7.6
Domestic financing	24.6	3.4	-5.2	-4.6	-6.1	-	-1.5	1.1
External financing	2.0	3.3	22.3	12.1	13.8	7.3	11.2	6.5
	26.6	6.7	17.1	7.5	7.7	7.3	9.7	7.6
	Real growth rates							
Currency and credit								
Money balances								
Net international reserves	...	...	...	449.2	4.1	-51.6	132.7	-7.5
Domestic credit	...	98.6	184.9	494.1	461.2	10.5	9.7	1.1
To public sector	...	98.1	191.9	295.5	794.4	6.4	6.2	-3.2
To private sector	...	100.9	150.0	1 659.4	21.7	50.0	33.6	24.4
Money (M1)	...	-2.9	-2.6	850.8	16.4	-4.4	36.3	13.4
Local-currency savings and time deposits	...	195.7	67.5	808.0	39.9	48.7	96.9	26.1
M2	...	...	6.8	841.8	21.1	7.9	55.8	18.6
Dollar deposits	...	307.6	41.4	770.5	55.3	70.8	77.4	60.0
	Annual rates							
Real interest rates (year end)[i j]								
On deposits (savings accounts)	...	...	...	...	8.5	8.9	8.8	...
On loans (short-term)	...	...	...	...	19.7	20.1	20.3	...
Equivalent interest rate in foreign currency[k]	...	...	...	...	8.5	8.9	8.8	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Open unemployment rate in Managua. [f] This rate is expressed in córdobas per US$ 1,000 for the years up to 1987, in thousands of córdobas per dollar for the years 1988-1990, and in gold córdobas per dollar for 1991-1994, at the official exchange rate. [g] Based on the official exchange rate. [h] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [i] Interest rates are covered by a clause requiring the maintenance of dollar values; therefore, once the nominal interest rate has been adjusted on the basis of the real effective exchange rate, it is equal to the real interest rate. For these purposes, the December-December variation in this index should be used. [j] These figures represent a simple average of the floor and ceiling rates in the State and private banking systems. [k] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
NICARAGUA: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation)	21.1	18.9	23.9	19.5	4.0	8.2	8.9	12.4	12.1	12.2	8.6	11.1
Real effective exchange rate (Index: 1990=100)	106.6	109.0	108.2	109.3	110.2	112.7	115.6	114.5	114.0	121.0	122.4	118.0

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

overdue debt. Despite the latent over-supply of resources in the financial system, the banks preferred to adopt a conservative strategy, even at the cost of immobilizing some of their funds.

c) **Foreign exchange policy**

Foreign-exchange policy continued to develop in line with the plan devised two years before, which provided for the córdoba to depreciate in nominal terms by an amount roughly equal to its inflation against the dollar. This policy not only kept the relative exchange rate more or less stable, with a slight depreciation during 1995, but also further closed the already narrow gap between rates in the official and unofficial markets.

Despite the slight increase in the real exchange rate, the argument as to whether the currency was overvalued did not abate. It was certainly no simple matter to pin down just where the misalignment might lie, given the very real changes that the economy was undergoing and the degree to which it was influenced by such phenomena as the constraints on the supply of tradable goods and the widespread practice of adjusting prices and contracts in line with exchange-rate fluctuations.

d) **Trade policy**

During 1995, Nicaragua made progress towards full institutionalization and normalization of its relations with its main trading partner, the United States, and with the international community as a whole. However, the investment protection agreement that was concluded with the United States includes no specific mechanisms for resolving property-related issues, which in a number of cases involve Nicaraguans who have taken United States citizenship. Nicaragua also ratified the World Trade Organization (WTO) agreements.

Trade relations with the other members of the Central American Common Market (CACM) continued to develop within the framework of integration and liberalization established in the Guatemala Protocol. As regards the process of tariff elimination, Nicaragua, like Guatemala and El Salvador, cut its tariff on capital goods to 1%, and continued to follow the specific liberalization timetable agreed with its partners in the region.

e) **Reform policies**

In November, after a long debate, the National Assembly passed an act partially privatizing the public telecommunications company (TELCOR). This decision brought to an end the initial process of privatization of productive companies and services, which was one of the cornerstones of the Government's economic strategy.

There are several aspects of the TELCOR privatization that have a bearing on the general question of property rights and the extension of the private sector's role in economic activity. The privatization was, however, a sign that the legal rights involved are gradually being consolidated.

At the end of the year, the Privatization Act was passed, establishing a legal framework for the issuance of definitive titles to property and for the programme of compensation to former owners of expropriated property. It also provided for a huge issue of new compensation bonds (US$ 650 million) which could be swapped for earlier issues and which were backed by United States Treasury zero-coupon bonds. The privatization of TELCOR was also an instrument to raise funds to back these new bonds, so as to provide better guarantees and boost their value on the secondary market.

3. **The main variables**

a) **Economic activity**

Overall supply expanded by nearly 5%, reflecting the 4.4% rise in GDP and the 6% increase in imports (although this was less than the 1994 figure). Exports, which swelled by 24%, were the fastest-growing component of demand during 1995. Investment also expanded for the second year in a row, boosted by construction (19%) and, to a lesser extent, by expenditure on machinery and equipment, which rose by 5%.

Despite Nicaragua's tight fiscal policy, public-sector investment expanded by around 10%, which was similar to the growth in private investment and the equivalent of one-sixth of output. More than half of public-sector investment in 1995 went towards infrastructure projects. Nearly 70% of private investment consisted of purchases of machinery and equipment, while the remainder went into construction. Foreign direct investment, 60% of which took advantage of the favourable conditions granted by the law, amounted to some US$ 70 million.

Aggregate consumption remained practically static, since the slight increase in private spending (0.4%) was offset in part by a contraction of more than 5% in government spending.

By contrast with the preceding year, the higher level of activity was spread throughout nearly all sectors. The recovery of in manufacturing did not really take off, however, and there were great disparities within the agricultural sector. Medium- and small-scale farmers and peasant agriculture, in particular, continued to experience grave difficulties, while larger units, with greater capital resources and business capacity, went from strength to strength, increasing their output by 5%.

Also observable in 1995 was a continuation of the gradual trend away from the use of land for crops for the domestic market towards the production of export crops, as a result of the movement of relative prices and the segmentation of the supply of credit.

Output from the 1994-1995 and the 1995-1996 harvests was very different. In 1994-1995, the yields of a number of products, both for the domestic market and for export, fell: the main exceptions in each group were beans and sugar cane respectively. There were sharp drops in the yields of maize, rice, sorghum, banana, tobacco and cotton; the coffee harvest also declined, although not greatly. Exports of the two most important traditional products expanded, however, as higher international prices prompted sales of coffee stocks and tempted banana-growers to divert a larger proportion of their supply to external markets. By contrast, preliminary data for the 1995-1996 agricultural year indicate an increase in export crops and maize but a decline in rice, beans and sorghum. Beef production contracted for the second year running, owing mainly to low international meat prices and the lack of a solution to the debt arrears that affect a large number of producers.

Of the remaining primary activities, the most vigorous was fishing, where the output and export of crustaceans expanded greatly. There was only a slight increase in forestry but the sector performed well inasmuch as exports nearly doubled. Mining output was up 11% owing to increased production of all the most important minerals but silver.

Within manufacturing, there was a significant increase in agroindustrial production for export, thanks to large earnings from coffee, sugar refineries and marine-product factories. However, although manufacturing output as a whole was assisted by a greater injection of bank credit, it expanded by barely 3%, as it was still undergoing a difficult process of restructuring, diversification and consolidation. On the other hand, there was rapid growth in 1995 among the *maquila* industries operating in the "Las Mercedes" industrial free zone, where there are 17 factories and around 8,000 workers, producing mainly clothing.

Electricity generation was up by 6%, with supply roughly balancing demand. The main increases came in commercial and industrial consumption, for the use of electricity in irrigation dropped for the third year in a row, an indication of the recalcitrance of the problems being experienced in many agricultural activities. There was slight growth in the remaining private services (transport, commerce, finance), but government services continued to contract.

b) Prices, wages and employment

Consumer prices in Nicaragua rose by 11%, somewhat less than in 1994, but more than planned by the Government. Nevertheless, the more moderate rate of inflation made it easier to conduct foreign-exchange policy in an organized fashion. As in previous years, upward pressure on prices was mainly due to exchange-rate

adjustments being transmitted through the indexation mechanisms used in setting a number of prices (though not wages); meanwhile, monetary policy was geared towards curbing the pressures of demand.

Although the open unemployment rate fell, it remained above 18%. Moreover, the rate of underemployment rose, which meant that more than half the labour force (55%) was underutilized. At the same time, however, household surveys revealed a slight increase in the rate of informal employment in the main cities.

c) **The external sector**

The rise in the value of exports and the slowdown in the expansion of imports narrowed the trade and current-account deficits, although the latter still exceeded total exports of goods and services. Negotiations conducted during the course of the year resulted in a reduction in the external debt, which was also restructured to provide more favourable terms for the country. Nevertheless, the economy continued to suffer from serious external imbalances, with debt still at an extremely high level and the international trade deficit persisting.

Trends in the terms of trade were favourable for the third year in a row, although they did not reach pre-1989 levels. There was only a moderate increase in the average price of imports, while that of exports rose by more than 20%. Thanks above all to higher coffee and banana prices and to the positive showing in exports of seafood and non-traditional products, the value of exports of merchandise rose by 50%. There was also a marked expansion in exports of manufactures and those from the free zone, most of which went to the United States, more than doubled, to US$ 80 million.

There was significant growth in imports of services (27%) and merchandise (9%). Imports of consumer goods slowed, unlike those of commodities and intermediate goods for the manufacturing industry, which expanded by 25%, and of capital goods for the same sector, which grew by 6%. The agricultural sector, on the other hand, made fewer purchases of equipment from abroad, while its imports of inputs increased only slightly.

The momentum gained by exports helped narrow the trade deficit in goods and services from US$ 434 million in 1994 to US$ 323 million in 1995. This, and the reduction of debt service payments, brought the deficit on current account down from US$ 730 million to US$ 706 million: this was covered by the increase in debt arrears and by positive inflows of official capital, chiefly in the form of grants and donations.

Intensive renegotiations during the year enabled Nicaragua to reduce its external debt for the first time in many years and restructure it in such a way as to wipe out nearly all its obligations to private creditors.

In March 1995, Nicaragua once again opened negotiations with the Paris Club and reached agreement with the United States and the majority of European countries on debt due and falling due up to June 1997. The Netherlands forgave Nicaragua's bilateral debt in its entirety, while France and Germany agreed to forgive 77% of Nicaragua's debt with them. Under the agreement with Italy, Nicaragua's debt with two Italian financial institutions, the export insurance agency and a bank specializing in medium-term operations, was kept active. An agreement with Finland, which had also shown a willingness to forgive Nicaragua's debts, was yet to be signed. Despite this progress, however, a large amount of bilateral debt remained to be renegotiated, most of it with the Russian Federation and Latin American countries.

Nicaragua bought back a large part of its debt with private creditors. The bulk of this debt, more than US$ 1.3 billion dollars, had been contracted with commercial banks and dated back to before 1979. The Government offered to buy back all these obligations, but US$ 250 million in bank debt and US$ 20 million in debt to suppliers remained outstanding. The price negotiated with the creditors (8 cents per dollar of nominal value) was similar to, or even less than, the secondary market price.

These operations were financed with a loan of US$ 24 million from the Inter-American Development Bank (IDB) and contributions from the World Bank (US$ 40 million) and from a

number of European countries, notably Sweden and Switzerland.

The success of the renegotiation process made it possible to make debt service payments in a more orderly fashion, and the sum effectively paid (US$ 230 million) was in part financed through new official loans from a number of sources (notably the IDB and the Government of Japan), designed to help adjust the balance of payments.

PANAMA

1. General trends

In 1995 the economy of Panama grew by less than 2%, continuing the sustained decline that replaced the momentum observable at the beginning of the decade and signalled the end of the cycle of recovery from the crisis of the late 1980s. Consequently, the increase in per capita output halted and job creation remained sluggish. These trends were the result of adverse conditions that affected two of the three pillars of the Panamanian economy: the international banking centre and the Colón Free Zone.

The process of revitalizing the infrastructure and management of the Panama Canal, to be completed by 1999, was tied up with a number of important economic reforms carried out with financial support from international agencies, such as the restructuring of the State sector, including modernization of the tax system and a programme of privatization of public-sector enterprises and utilities; amendment of the labour code; and the implementation of legislation regulating economic activity. These policy measures, in particular those which addressed tax and labour issues, met with resistance both from workers and in some business circles, leading to a climate of social tension that affected production and may have been a factor in the slowdown in private investment.

Not only was private investment lower, but consumption declined, owing to the scant increase in jobs and real wages, and the external sector did not perform as well because of a decline in demand for exports from the Colón Free Zone, slower growth in the international banking centre and problems for Panamanian banana exports in gaining access to the European Union market, among other factors.

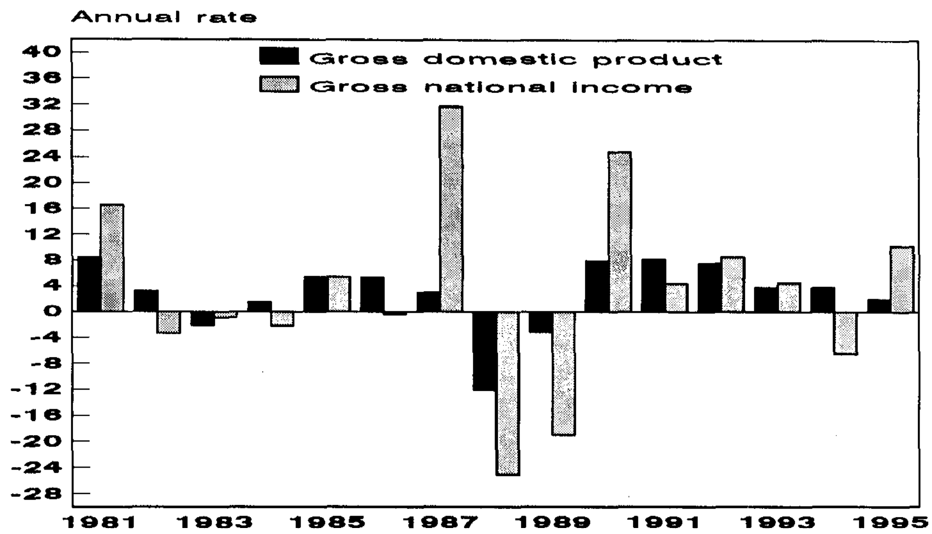
Even against this background, there were a number of achievements during the year, the most important being that prices maintained their traditional stability, the public-sector account posted a surplus, progress was made towards regularizing the payments situation for both the external and domestic public debt, and structural reforms were carried out to open up the economy to foreign trade and investment.

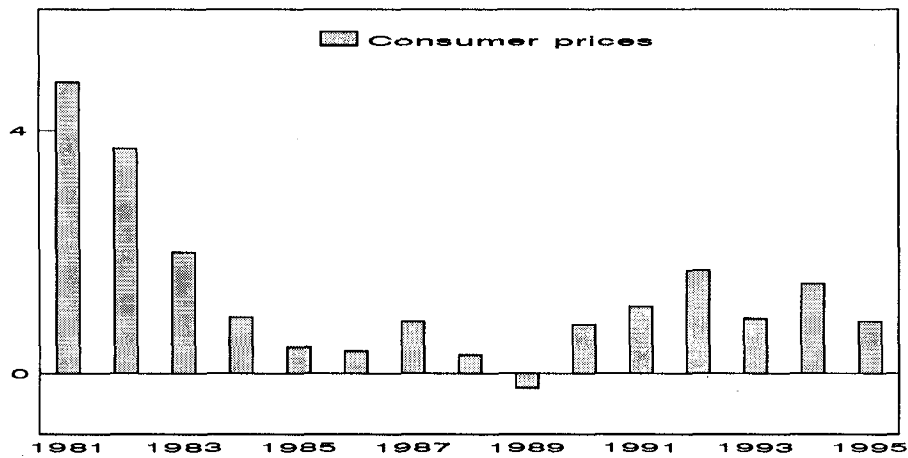
2. Economic policy

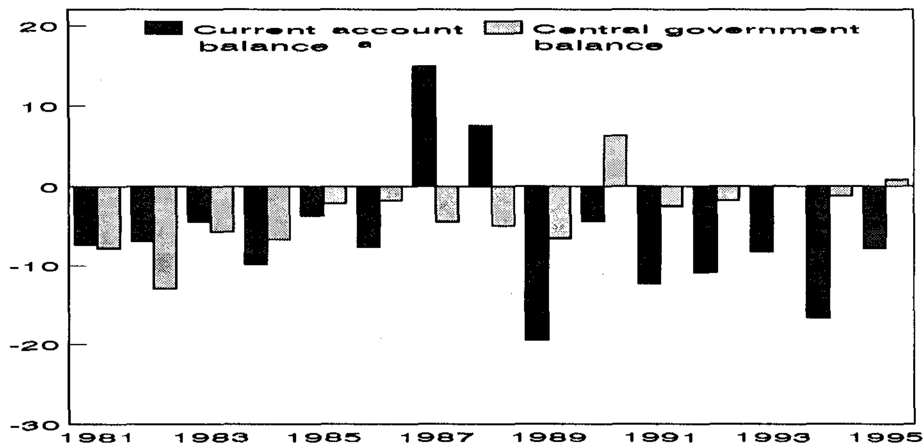
Within Panama's peculiar economic and financial structure, characterized by the lack of any official monetary sector, economic policy focused on reorganizing public finances, an effort that entailed renegotiating the external debt and continuing the process of privatizing public-sector enterprises and utilities. The Government also implemented a number of credit policy measures to provide a stimulus to specific activities.

Of particular importance were the introduction of a set of economic reforms and the consolidation of a number of policies already in place under the economic modernization programme instituted by the Government that took office in mid-1994. Central to those initiatives were reform of the State and revision of the regulatory framework for economic activity. The basic aim was to create conditions which would give fresh impetus to productive activity, enhance the country's economic efficiency and international competitiveness and attract foreign direct investment.

Figure 1
PANAMA: MAIN ECONOMIC INDICATORS







Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

a) **Structural and trade reforms**

In June 1995, the Universalization of Fiscal Incentives to Production Act was passed modifying the regime of tariffs on manufacturing companies' imports of inputs and the incentive scheme for non-traditional exports and introducing a temporary import and export system. Temporary fiscal incentives were also provided to encourage investment in several productive activities and areas of infrastructure.

The programme of privatization of State-owned companies remained in place, and although no privatizations were carried out during 1995, the Instituto Nacional de Telecomunicaciones (INTEL) was made a corporation, as a first step towards the eventual sale of 49% of its stock, which would raise nearly US$ 500 million for the State. During the first quarter, the concession for cellular telephone services was awarded, for nearly US$ 73 million, and concessions were also awarded for one copper mine and one gold mine. Plans for 1996 included concessions on the ports of Cristóbal and Balboa and the privatization of the electricity-generating company and a racecourse. The intention was to use the revenue from these operations to set up a fund for public-sector investment in social projects.

In one very important development, the labour code was reformed with the intention of making the labour market more flexible; the amendments included measures designed to liberalize the conditions governing hiring and dismissal. To balance this, provisions were introduced making it easier to form a union and establishing a severance fund to guarantee payments to workers for long service, unfair dismissal and mutually-agreed termination of contract.

In 1995 a number of measures were adopted modifying the regulatory framework of economic activity. One such measure was a law protecting free competition, which led to the establishment of a supervisory board. A consumer protection law was also passed, and regulations were introduced to discourage unfair trade practices. Bills on copyright and industrial property rights were at the regulatory stage or under consideration by the Legislative Assembly.

During the year, negotiations on trade or investment agreements took place with a number of countries. Talks were held with the government of the Chinese Province of Taiwan with a view to setting up an industrial park on a strip of land recently recovered from the Panama Canal Zone; and agreements were signed with Korea to encourage Korean investment in Panama. Within the Latin American region, Panama joined the Andean Group, with observer status.

Negotiations concerning membership in the World Trade Organization (WTO) also gathered speed; Panama's application was expected to be approved by mid-1996. The move would involve a number of commitments on Panama's part, including the elimination of tariff barriers. It was agreed that the maximum tariff should be reduced from 40% to 30% over a five-year period and that a minimum of 5% should apply to practically the whole range of activities. Only for the agricultural sector were higher rates set, but these would be cut over time. Also envisaged were measures to liberalize the service sector, in which Panama, with a very liberal regime on services, already had a competitive position.

b) **Fiscal policy**

The tax reform boosted government revenues, despite the slowdown of growth in economic activity. Combined with restrained expenditure, this meant that central government posted a surplus equal to 0.8% of GDP.

The increase in revenue of nearly 10% in real terms was a result of greater receipts from both tax and non-tax sources. Tax revenues were affected by the income-tax reform, which set a uniform rate of 30% for corporations and raised the rate for companies operating in the Colón Free Zone from 8.5% to 15%. A system of quarterly advance payments was also instituted. Indirect taxes showed moderate growth, as the modest revenue yield from export, production, sales and excise taxes was added to the relatively better performance of the transfer tax and import duties.

Non-tax revenue, which made up nearly one third of current income, also recorded a significant increase. Profits from State-owned

Table 1
PANAMA: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	-12.1	-3.1	8.0	8.1	7.5	3.8	3.8	1.9
Per capita gross domestic product	-13.8	-5.1	5.9	6.0	5.5	1.9	1.9	0.1
Gross national income	-25.1	-19.0	24.8	4.4	8.5	4.6	-6.5	10.2
Gross domestic product, by sector								
Goods	-20.4	-0.3	7.9	12.8	10.5	8.6	3.5	1.1
Basic services	-5.6	-2.2	2.6	0.9	1.8	0.3	3.5	7.0
Other services	-9.4	-12.5	11.2	5.6	10.0	2.2	5.8	1.5
	Percentages							
Contribution to growth of GDP [c]								
Consumption	-9.6	7.8	-5.7	11.5	0.4	-1.1	-1.4	-1.4
Government	-4.0	-1.4	0.2	1.5	-1.4	0.4	-0.1	0.3
Private	-5.6	9.2	-5.9	9.9	1.9	-1.5	-1.4	-1.7
Gross domestic investment	-9.4	-1.8	12.9	1.7	6.6	3.0	3.9	1.2
Exports	-12.7	-5.4	15.2	19.8	9.3	5.9	7.7	3.0
Imports	19.6	-3.7	-14.5	-25.0	-8.8	-4.1	-6.4	-0.9
	Percentages of GDP [b]							
Gross domestic investment	6.6	5.0	16.6	17.0	21.9	24.0	26.9	27.6
National saving	-7.3	17.8	4.4	12.4	10.8	8.3	16.2	7.3
External saving	13.9	-12.8	12.2	4.5	11.0	15.7	10.7	20.2
	Percentages							
Employment and wages								
Activity rate [d]	56.9	58.0	58.0	57.5	60.2	60.4	60.7	61.6
Open unemployment rate [e]	16.3	16.3	16.8	16.0	14.7	13.3	14.0	13.7
Real minimum wage (Index: 1990=100) [f]	100.0	99.9	100.0	99.0	98.6	103.2	108.3	108.2
	Growth rates							
Prices (December-December)								
Retail prices	0.7	0.5	0.8	1.1	1.6	0.9	1.3	0.8
External sector								
Terms of trade (Index: 1990=100) [b]	101.1	100.5	100.0	98.8	98.3	97.9	96.3	93.5
	Millions of dollars							
Balance of payments								
Current account	-210	256	-172	-324	-600	-834	-749	-1 197
Trade balance (goods and services)	-164	256	-214	-390	-585	-832	-757	-1 172
Exports	1 167	1 575	1 880	2 024	1 907	2 487	3 138	3 451
Imports	1 331	1 319	2 093	2 415	2 493	3 320	3 895	4 623
Capital and financial account	-199	-174	-76	215	192	323	457	411
Overall balance	-211	-9	114	363	50	189	394	48
International reserves (variation)	-168	145	219	299	-347	86	338	48
	Percentages							
External debt								
Public debt (as a percentage of GDP) [g]	77.3	76.7	70.4	62.5	53.1	49.2	49.4	49.5
Net interest (as a percentage of exports) [h]	9.0	4.0	1.4	1.4	4.9	2.1	1.3	0.8

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Central government								
Current income	12.4	11.4	24.1	18.2	18.4	19.0	18.0	19.6
Current expenditure	16.8	17.1	17.4	15.7	17.7	16.5	16.7	16.3
Savings	-4.5	-5.8	6.7	2.5	0.7	2.5	1.2	3.3
Capital expenditure	0.5	0.9	0.4	5.1	2.5	2.4	2.4	2.6
Financial balance	-5.0	-6.6	6.3	-2.5	-1.8	0.1	-1.2	0.8
Domestic financing	5.4	6.6	-2.9	0.1	2.1	0.4	1.2	-1.1
External financing	-0.4	-	-3.4	2.4	-0.3	-0.4	0.1	0.3
	Annual rates							
Real interest rates (annualized)								
On deposits	9.0	10.8	9.1	7.1	4.4	5.5	6.2	7.8
On loans	12.7	...	12.1	11.5	9.1	10.5	9.6	10.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1980 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Refers to the industrial minimum wage. [g] Refers to the contractual public-sector external debt and does not include adjustments for currency fluctuation. [h] Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

enterprises went up by 5% in real terms, even though two such companies had been privatized in 1994. In particular, the national lottery, the National Port Authority and the Colón Free Zone made larger contributions to revenues. Fiscal income from non-tax sources included revenue from the operation of the Panama Canal, which increased by more than 10%.

Total central government expenditure fell by nearly 2% in real terms, after rising in 1994. This outcome was chiefly attributable to reductions in public debt service payments, which had been renegotiated and were 15% lower than in 1994. A tight public spending policy was reflected in cuts in purchases of equipment and supplies, other personal services and current transfers. Under current spending, only salaries rose in real terms.

Capital spending, on the other hand, recorded a real increase of nearly 7% as a result of greater investment in education and health. In the course of the year, contracts for port and highway infrastructure projects were awarded to private contractors, thus boosting private-sector investment.

One of the Government's main concerns was to regularize its public debt payments situation. With regard to domestic debt, the Government therefore continued to redeem bonds maturing in 1995 and extended to mid-1996 the deadline for exchanging expired bonds from the period 1988-1992. Treasury paper maturing in 1995 was redeemed on schedule and new issues were floated.

With regard to external debt, 1995 saw a renewed effort to deal with the country's arrears. Under the Brady Plan, debts of around US$ 3.5 billion with the commercial banking sector, including nearly US$ 2 billion in accumulated interest, were renegotiated. By the end of the year, the majority of Panama's creditors had opted for restructuring, chiefly through bonds with a reduction of interest. It is estimated that as a result of the agreement, reductions of 45% in the principal and 33% in the agreed interest will be achieved. The Government also renegotiated US$ 145 million of its oil debt with Mexico at the beginning of 1996. In November, the International Monetary Fund (IMF) approved a drawing-rights agreement for US$ 104 million.

c) **Credit policy and the international banking centre**

In 1995, minor modifications were made to the policies of selective support for productive activities. The conditions for preferential credit granted by banks to agricultural activities and backed by the Government were changed. Midway through the year, the discount on the local market reference interest rate was cut, which pushed up the maximum rate for agricultural-sector borrowers from 7% to 8.75%. In addition, in order to encourage construction of low-income housing, the interest-rate subsidy was redefined under the Universalization of Incentives Act to provide discounts which would vary according to the cost of the dwelling. In other activities, the current market interest rates rose marginally, to between 10% for industrial credit and somewhat less than 13% for consumer credit.

The legal reserve requirement and other banking regulations did not change during 1995. For the first time since the 1987-1989 crisis, three-month Treasury certificates were issued, for a total of 50 million balboas. The arrears that had accrued as a result of the suspension of payments on the 1988 issue of certificates were also paid off.

The international banking centre's deposit and loan operations turned in a modest performance compared with their vigourous growth since 1990. Credit from the national banking system to the private sector, for example, expanded by 13%, a significant change of pace compared with the average annual increase of 22% recorded between 1991 and 1993. Loans to the commercial sector, which accounted for two thirds of total credit and included loans to companies in the Colón Free Zone, together with loans to the next most important subsector, housing, grew at a slightly lower rate than total credit; credit to industry, on the other hand, increased by 28%, while credit to agriculture and fishing declined drastically. For the second year in a row, there was only a moderate increase in consumer loans (13%), which had recorded growth of over 50% during the three-year period 1991-1993. Credits to foreign borrowers increased by 14%, appreciably less than in 1994.

By contrast with the expansion in credit to the private sector, there was a contraction in credit to the public sector, thanks to the latter's improved finances, and this held down the rate of growth of total credit to 6%. This trend was part of an overall levelling-off of total assets within the national banking system, following average growth rates of 20% over the period 1990-1994. The trend was also reflected in a decline in other assets, including liquid assets. This downturn was accompanied by a halt in the upward momentum in deposits sustained in previous years: demand deposits grew moderately (6%), while savings and time deposits declined sharply (by 8%). It was foreign banks, however, that accounted for this turn about, while domestic deposits in fact increased.

Banks operating under international license also recorded more moderate rates of increase than in the recent past, even though both total assets and foreign deposits expanded by between 13% and 15%.

3. The main variables

a) **Economic activity**

There was a drop in the growth rate of all components of demand. Private investment lost impetus, particularly in construction, as a boom in luxury hotels and apartments and modern shopping malls came to an end. There was a slight upturn in fiscal investment, especially in public infrastructure projects. With job creation at a standstill and real wages moving only sluggishly, consumer spending declined for the third year in a row. External demand also grew more slowly than the preceding year.

The meagre expansion in supply has reflected GDP and imports about equally. Slow growth in services and in goods production overall meant that Panama's GDP rose by only 1.9%, half the 1994 figure.

Despite this overall result, basic services did well (7% growth) particularly transport

services, boosted by heavy traffic through the Panama Canal. In fact, the Canal thanks to an expansion of world trade, handled a record level of tonnage.

Commerce was one of the categories hardest hit by the economic situation in 1995. Domestic trade, both wholesale and retail, languished as a result of reduced consumption and less construction, while a sharp drop in the level of re-exports was reflected in downturn in activity in the Colón Free Zone. Only in the hotels and restaurants category were results better, as increased tourism contributed to 6% growth.

The activities of banks and other financial establishments also expanded by 6%. Other private services –real estate, business and rental services– were static, however, tracking the performance of trade in goods and goods production in general. On the other hand, an increase in public-sector provision of health, education and social security services led to a significant rise in the level of government services.

With respect to goods production, the poor performance of some export categories was reflected in a drop in the rate of growth in agriculture. Banana production was down by 7% as a result of frequent bad weather and a strike by banana workers protesting the labour code reforms, in addition to the effects of the European Union's imposition of quotas on banana imports. Sugar-cane production was also lower (-6%), sugar cane having been replaced by other crops in some areas. Produce for chiefly domestic consumption, however, fared relatively better. Rice and maize output was slightly higher, as was livestock production, which benefited from good prices for beef and pork and improved dairy production. Fishing turned in a very good performance (28%), owing to a large catch of shrimp for the foreign market.

Manufacturing achieved virtually no growth in 1995, despite better showings by the textile, clothing and footwear, chemical products and petroleum derivatives categories, all of which expanded by more than 3%. In food, beverages and tobacco production, the preceding year's levels were not maintained, while non-metallic minerals lost considerable ground (9%) because of scant demand from the construction industry. Construction itself hardly grew at all during 1995, in an intensification of the slump that had begun in 1994, following a period of growth averaging 70% during 1991-1993. Government incentives (such as preferential interest rates) to encourage the building of dwellings for lower-middle income families did not offset the depressive effect of the end of the growth cycle that followed the 1987-1989 crisis. Construction activity was also hampered by striking workers opposed to the Government's reforms, particularly labour code reforms.

b) **Prices, wages and employment**

Panama's economy continued to enjoy one of the region's lowest inflation rates. The consumer price index (CPI) for the capital went up by 0.9%, slightly less than in 1994.

That average conceals significant disparities among the prices in different categories, however. Some prices actually fell: there was a slight drop in the prices of clothing and footwear and of fish a somewhat bigger drop in the case of fresh fruit and a fall of nearly 5% in meat prices. Meanwhile, other categories recorded appreciable price rises, as happened with coffee (34%), legumes and vegetables (9%) and oils and fats (7%), and there were less marked rises in categories such as bread and cereals, rents, medical care, leisure activities and education.

Imports contributed more than domestic products to the increase in consumer prices. This was shown by the behaviour of the different components of the wholesale price index, which went up by 2.9%, a figure exceeding both the 1994 rise in the wholesale price index and the 1995 rise in the CPI. Wholesale prices of imports rose by nearly 4%, and this movement was even more marked in agricultural products and crude oil (nearly 10%), basic metals (8%) and food, beverages and tobacco (7%).

Nominal wage increases of varying size were granted in a number of sectors. Public-sector employees received an adjustment equal on average to the rate of inflation; pay within the national banking system went up by more than 2%; and there was a 5% pay rise (up to September) in manufacturing and commerce. An increase of nearly 6% in the minimum wage,

which had not changed for three years, was announced at the end of the year.

In general terms, the slackness in economic activity prevented the creation of sufficient jobs to absorb the increase in the economically active population. The ranks of the open unemployed swelled by 3,000, although the national unemployment rate actually fell slightly from the 1994 figure of 14%. Unemployment tended to be concentrated in urban areas, particularly the Panama City metropolitan area. An important factor in this situation has the gradual closing of military bases in the Canal Zone, which eliminated many directly- and indirectly-created jobs.

According to partial indicators, however, employment was up in some sectors. The number of Panamanian nationals employed in the international banking centre, for example, increased by nearly 8% and in wholesale trade by just under 6%. There was a negligible increase in employment, however, in the public sector, no increase at all in some areas (hotels, restaurants and retail trade) and a decline in employment in other sectors, such as manufacturing, where it declined by 3.5% during the first nine months of the year, notably in beverages, tobacco, miscellaneous foodstuffs, yarn and textiles and non-metallic mineral products.

c) **The external sector**

The deficit on current account was reduced by more than half, to somewhat under US$ 600 million. This result was helped by a larger surplus in non-factor services and by an appreciable narrowing of the deficit in factor services, and it more than made up for the near-doubling of Panama's merchandise trade deficit. Lower payments for factor services were due to a 31% reduction in interest on the external debt as a result of renegotiation.

During 1995, trade in goods expanded more slowly than the preceding year, and this was reflected in a small increase in exports (1%) and a somewhat larger increase in imports (7%). A key factor in this result was the stagnation of re-exports from the Colón Free Zone, due to a number of causes. On the one hand, the main re-export markets were slacker, some as a result of economic problems (Mexico, Argentina and Venezuela) others as a result of armed conflict (Peru and Ecuador). On the other hand, currency revaluations in Japan and Korea, two of the chief countries of origin of imported merchandise, pushed up prices considerably.

Domestically-produced exports fared better. Merchandise exports increased by 6%, totalling US$ 565 million, although the performance of the different categories was far from even. The value of coffee sales during the first half of the year, for example, was pushed up by high prices on the international market. Shrimp exports, too, grew by 17% owing to a bigger catch and higher prices. Earnings from petroleum derivatives rose substantially as a result of the recovery of the refining industry from a fire the year before.

By contrast, the value of sales of Panama's most important export product, bananas, dropped by 8%. The decline was even greater for beef (-29%), owing to flagging demand in Mexico, its main market. Lobster and fish oils also slumped badly (-27% and -24%). Non-traditional exports as a whole declined slightly too, as a result of the drop in exports of products such as cured cattle hides, leaf tobacco and cosmetics.

Imports of goods for the local market rose by 8%. The growth rate of imports of intermediate goods fell to 9%, which can be explained by the slowdown of the economy in general and the lack of movement in manufacturing in particular. Imports of consumer goods expanded faster (11%), however, as did capital goods (14%), largely owing to the purchase of urban transport equipment and of heavy machinery and equipment for roadworks.

The public sector's external debt rose slightly, to more than US$ 3.7 billion. In particular, central government borrowing from official sources increased. Disbursements totalled US$ 168 million, and a large proportion of these were from the Inter-American Development Bank (IDB); half of this sum went towards health and rural infrastructure projects.

PARAGUAY

1. General trends

The upturn in the farming sector, especially in the cases of cotton and soybeans –two of Paraguay's main export crops– was a key factor in the 3%-4% increase in the growth rate that was recorded for the gross domestic product (GDP) in 1995. Moreover, against a background of fiscal equilibrium and exchange-rate stability, inflation fell to an annual rate of around 10%, the lowest figure in 14 years.

The management of monetary policy was conducted within a highly adverse environment due to a financial crisis which overtook a number of private banks midway through the year. The authorities were able to prevent the crisis from spreading to the rest of the financial system, however, by providing deposit insurance for members of the public and furnishing financial assistance to institutions in distress.

A portion of the monetary expansion generated by the provision of credit assistance to the banking system was absorbed through open-market operations; a nominal contraction in credit to the public sector, due to a surplus in the latter's financial accounts and an increase in external borrowing, also helped bring the growth of the money supply under control.

The external sector once again posted a sizeable deficit on current account, although the shortfall was more than covered by capital inflows, with enough left over to produce a small increase in international reserves. As in previous years, Paraguay's massive external trade deficit was coupled with a large surplus under the heading of net errors and omissions, which suggests that the country continues to experience difficulties with regard to the registration of external transactions.

This financial instability led to a credit squeeze that affected a number of activities in 1995, particularly commerce. In addition, during the first half of 1996, adverse weather conditions reduced the cotton harvest. Foreseeing a drop in fiscal revenue, the Government raised public utility rates and fuel prices. Even so, over the 12 months ending in July, prices rose by around 9%.

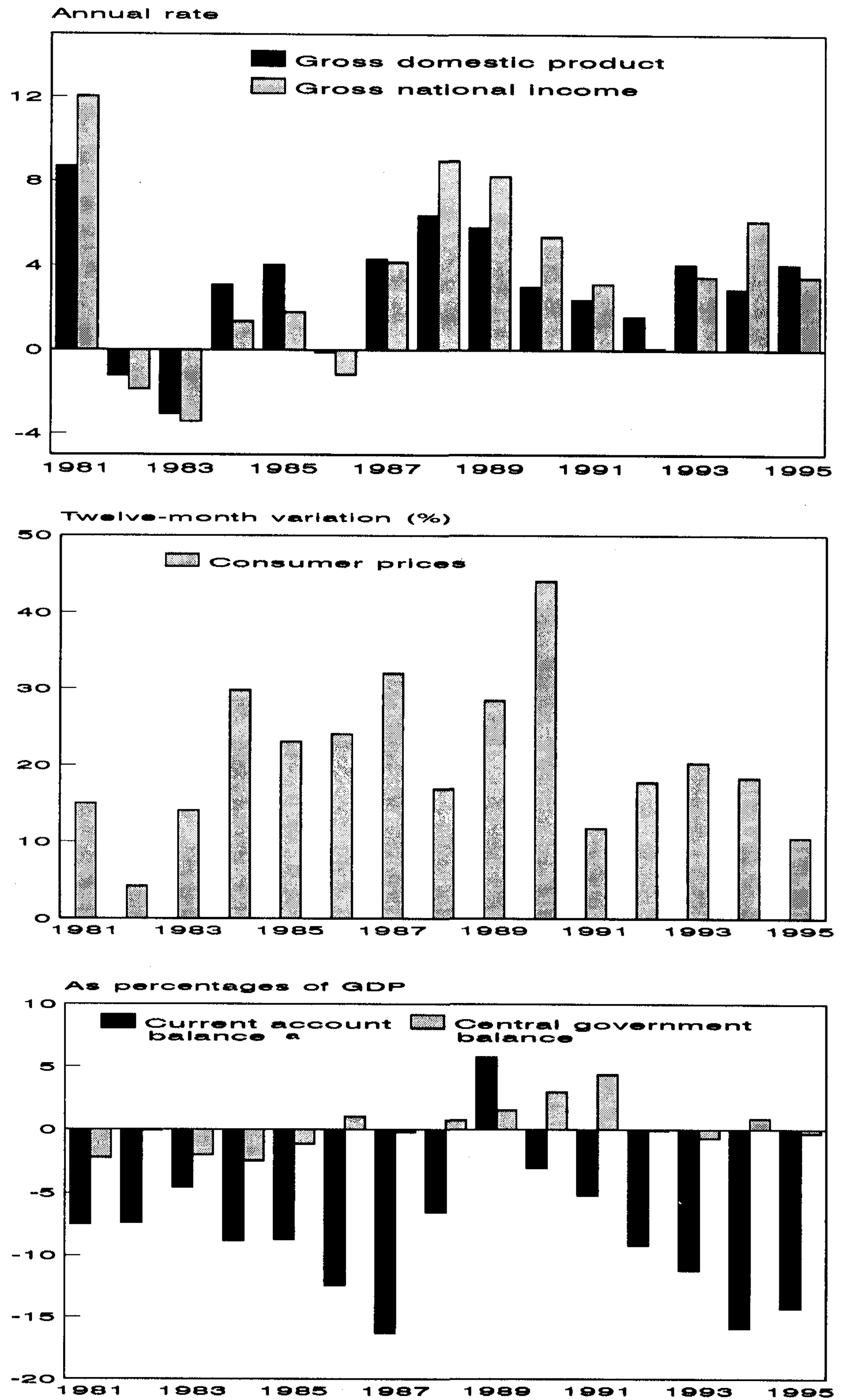
2. Economic policy

Price stability was once again the main economic policy objective in 1995. The original programme's linchpin had been the maintenance of a robust fiscal position, while the Government's policy of exchange rate stabilization was seen as a means of helping to curb cost-push inflationary pressures.

The implementation of this strategy was disrupted, however, when a number of financial institutions, which between them accounted for around one sixth of the system's total assets, were overtaken by crises of liquidity and, later, insolvency. The Central Bank intervened by taking over the management of the troubled banks and granting them credit to cover their operating costs, meeting their commitments with foreign correspondent banks and financing the withdrawal of deposits. In addition, steps were taken to create a safety net for the financial system.

As a result, Central Bank credit to the private financial system increased considerably, thereby leading to a degree of monetary expansion which was incompatible with the objective of bringing down inflation. Although the public sector had continued to perform as planned, policy-makers

Figure 1
PARAGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

decided to continue taking an active part in the open market by issuing "monetary regulation bonds" to soak up as much liquidity as possible. To this end, the real interest rate paid on these bonds, most of which had a maximum term of 45 days, was also raised to around 10%.

An ample supply of foreign exchange made it possible to achieve the objective of exchange-rate stability; indeed, the authorities were so successful in this regard that the price of the dollar rose only slightly during the year. In the area of trade policy, the strategy of establishing global linkages was consolidated through subregional and international integration agreements.

a) **Fiscal policy**

Under the tax regime that came into force in 1991, the improvement of collection procedures was the top priority for fiscal management. A special effort was made to modernize the collection of customs duties, bearing in mind the fact that a considerable number of transactions generally fail to appear in fiscal records.

Improved tax-administration mechanisms boosted 1995 tax revenues by 18% in terms, or one and one half percentage points of GDP. The bulk of this came from taxes on foreign trade, which grew by nearly half in real terms.

The upturn in spending, which amounted to two percentage points of GDP, exceeded the increase in income, mainly because capital expenditure surged as a result of a doubling of real public investment.

These trends in income and expenditure caused the central government's balance sheet to show a small deficit. However, the net balance recorded for the remainder of general government and the higher surplus run up by public-sector companies helped to raise the non-financial public sector's surplus to the equivalent of 2.8% of GDP. As a consequence of the public sector's external borrowing, its financial management had a contractionary effect.

The increase in expenditure was particularly steep in the last quarter, when half of the amount spent on physical investment for the entire year was disbursed. Since, during the same period, spending on personal services also went up, fiscal management clearly deteriorated towards the end of the year. In February 1996, with a view to restoring financial equilibrium, the prices and rates charged for goods and services furnished by the public sector (water, electricity and petrol-based fuels) were raised considerably, and the gasoline tax was increased as well. Concern over the 1996 fiscal outcome was nevertheless aroused by cuts in the taxes on trade in goods and services in the first few months of the year and declining receipts from taxes on foreign trade.

b) **Foreign exchange policy**

During 1995, the system of a floating exchange rate combined with Central Bank intervention remained in place. By contrast with the preceding four years, when the monetary authority was a net purchaser of foreign exchange, the Central Bank sold US$ 21 million more in dollars than it bought.

Nevertheless, the price of the dollar rose by barely 3% during the year, and consequently the guaraní appreciated by 5% against the dollar. The annual average real effective exchange rate, on the other hand, rose by nearly 7% against a basket of the currencies of Paraguay's main trading partners, mainly as a result of a sharp increase in the rate against the Brazilian real. The real effective rate held relatively steady throughout 1995, after having recorded significant increases during the second half of the preceding year.

c) **Monetary policy**

As was also true under the preceding year's programme, price stabilization was the main objective of the monetary programme devised at the beginning of 1995. The financial crisis that erupted at the end of April seriously interfered with the original plan, however.

Given the severe illiquidity that beset a number of institutions in late May as a result of a run on deposits, the monetary authority took over the reins of four banks, one building society and two pension funds. Since, taken together, these institutions controlled around one sixth of total deposits, the authority's move threatened to unleash a systemic crisis. Nevertheless, by

Table 1
PARAGUAY: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	6.4	5.8	3.0	2.4	1.6	4.1	2.9	4.1
Per capita gross domestic product	3.1	2.6	0.0	-0.5	-1.3	1.2	0.2	1.3
Gross national income	9.0	8.3	5.4	3.2	0.1	3.5	6.1	3.5
Gross domestic product, by sector								
Goods	8.7	6.5	2.0	0.4	0.8	4.0	0.6	5.2
Basic services	7.1	5.2	7.4	6.7	5.8	7.9	11.4	9.2
Other services	3.6	5.0	3.6	4.1	1.9	3.6	4.1	1.9
	Percentages							
Contribution to growth of GDP [c]								
Consumption	0.5	-4.4	11.7	4.0	7.4	6.2	11.9	1.2
Government	0.2	0.3	0.2	1.2	0.6	0.4	0.3	0.4
Private	0.3	-4.7	11.5	2.8	6.8	5.8	11.6	0.8
Gross domestic investment	0.8	2.1	2.0	2.0	-1.6	0.5	1.0	1.1
Exports	8.4	4.6	4.3	2.1	-1.1	12.7	3.8	4.0
Imports	-3.4	3.4	-15.0	-5.7	-3.1	-15.3	-13.7	-2.3
	Percentages of GDP [b]							
Gross domestic investment	20.7	21.6	22.9	24.3	22.3	21.9	22.3	22.4
National saving	15.8	26.6	19.6	18.3	11.3	7.4	9.8	4.9
External saving	4.9	-5.0	3.3	5.9	11.0	14.5	12.5	17.5
	Percentages							
Employment and wages								
Activity rate [d]	63.1	64.2	61.0	59.4	...	...	60.8	66.3
Open unemployment rate [e]	4.7	6.1	6.6	5.1	5.3	5.1	4.4	5.2
Real minimum wage (Index: 1990=100)	102.9	104.2	100.0	95.4	87.1	83.7	86.0	87.4
	Growth rates							
Prices (December-December)								
Retail prices	16.9	28.7	44.0	11.8	17.8	20.4	18.3	10.5
Wholesale prices	33.7	26.1	67.2	12.4	...	14.8	15.1	13.9
External sector								
Terms of trade (Index: 1990=100)	91.1	95.5	100.0	100.9	102.7	98.2	106.8	101.3
Nominal exchange rate (guaraníes per dollar)	928	1 145	1 230	1 326	1 500	1 744	1 912	1 971
Real effective exchange rate (Index: 1990=100)	96.5	101.9	100.0	86.9	90.6	93.9	97.4	106.8
	Millions of dollars							
Balance of payments								
Current account	-210	256	-172	-324	-626	-811	-1 196	-1 197
Trade balance (goods and services)	-164	256	-214	-390	-570	-816	-1 153	-1 172
Exports	1 167	1 575	1 880	2 024	1 978	2 604	3 045	3 451
Imports	-1 331	-1 319	-2 093	-2 415	-2 548	-3 420	-4 199	-4 623
Capital and financial account	-199	-174	-76	215	111	176	397	411
Overall balance	-211	-9	114	363	-24	83	326	48
International reserves (variation)	-168	145	219	299	-347	86	328	48
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	62.3	45.9	30.0	26.6	18.7	17.3	16.9	16.3
Net interest (as a percentage of exports)[f]	9.0	4.0	1.4	1.4	8.2	3.6	3.0	0.8

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Central government								
Current income	7.9	11.4	12.4	11.9	12.6	12.3	14.5	15.5
Current expenditure	5.9	8.9	7.8	8.5	11.5	11.1	11.4	11.8
Savings	2.0	2.5	4.6	3.3	1.1	1.1	3.1	3.7
Net capital expenditure	1.3	1.0	1.5	2.5	2.4	1.8	2.1	4.0
Financial balance	0.7	1.5	3.0	0.8	-1.4	-0.7	1.0	-0.3
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	...	...	...	46.3	-11.4	28.3	41.3	18.3
Net domestic credit	...	...	...	70.7	288.4	34.5	8.2	22.5
To public sector	...	...	...			21.6	...	...
To private sector	...	...	...	59.6	39.2	35.7	36.7	9.9
Money (M1)	25.7	46.1	27.7	27.5	30.5	17.7	32.4	19.7
Local-currency savings and time deposits	17.1	30.8	-9.1	5.2	25.0	4.1	59.2	43.0
M2	20.6	37.3	20.0	35.3	35.1	18.9	38.4	31.2
Dollar deposits	8.3	892.2	63.1	56.0	66.5	53.0	15.3	1.0
	Annual rates							
Real interest rates (annualized)[g]								
On deposits	...	...	13.4	23.9	16.7	3.2	5.3	11.5
On loans	...	...	30.0	35.6	28.2	11.9	15.2	21.1
Equivalent interest rate in foreign currency[h]	...	...	-18.3	-9.1	5.0	9.1	17.9	19.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1980 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population in Asunción. [e] Percentages of the economically active population (EAP). Up to 1993, this figure refers to the Asunción metropolitan area. Figures for 1994 and 1995 refer to urban areas nationwide. [f] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [g] Figures for 1990-1992 are December-December rates; figures for 1993-1994 are annual averages. [h] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
PARAGUAY: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (nationwide) (12-month variation, %)	18.0	18.6	16.6	20.4	22.4	20.9	20.9	18.3	14.3	14.9	12.2	10.5
Real effective exchange rate (Index: 1990=100)	92.7	95.4	94.7	92.9	91.1	92.6	101.1	104.7	106.4	107.9	106.7	106.1
Real interest rate (annualized, %)												
On deposits	-2.9	8.3	8.8	-1.3	-8.1	14.9	8.0	6.4	5.8	12.1	17.1	11.1
On loans	4.9	16.9	17.8	7.9	0.4	25.8	18.3	16.4	12.8	21.4	28.1	22.1

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

providing coverage for depositors in financial institutions, foreign correspondent banks and other creditors, the Central Bank succeeded in restoring confidence in the system. The monetary authority also took over the management of these banks, whose doors remained open.

The outcome of all this was an enormous expansion of the money supply that had not been foreseen when the stabilization programme was being designed. Thus, during 1995, the credit which the Central Bank granted to the banking system for the purposes of furnishing financial support and providing the system with a safety net increased by an amount equivalent to three quarters of the entire addition to the money supply in 1994. Since this expansion was not compatible with the 10% target for annual inflation, the monetary authority proceeded to soak up excess liquidity through the sale of monetary regulation bonds for terms of between seven and 45 days at an annual interest rate of around 20%. Practically one third of the increase in Central Bank credit to the banking system was sterilized by this means, and another third was absorbed through the contraction in bank credit to the public sector. Thus, with the help of a slight drop in international reserves, the Central Bank managed to limit the expansion of primary money to 19% of the level recorded at the end of the preceding year.

The interest rates offered on these monetary regulation bonds during the first half of 1995 exerted upward pressure on bank deposit interest rates. These rates later began to give ground, in line with the trend of inflation, but as inflation fell more slowly, the real average interest rate was considerably higher than it had been in 1994.

Given the slow movement of the price of the dollar, interest rates on local-currency deposits were actually far more attractive in terms of their foreign-currency equivalent. Consequently, local-currency deposits made by the general public swelled by more than 40%, thus driving up broad money (M2) by more than 30%, while dollar deposits (which in previous years had grown rapidly) held steady. This indicates a return of public confidence in the banking system and a minimal level of uncertainty concerning trends in the exchange rate.

d) **Trade policy**

On 1 January 1995, the Common External Tariff (CET) entered into force within the framework of the Southern Common Market (MERCOSUR), a limited customs union in which Paraguay is associated with Argentina, Brazil and Uruguay. In the early 1990s, these countries had agreed upon automatic reductions in tariffs and tariff exemptions. During the first half of 1995, the member countries decided to devise a programme of action for the remainder of the century with a view to the establishment of a fully-fledged union by the year 2006. MERCOSUR was also accorded recognition by the World Trade Organization (WTO).

The entry into force of the CET, the progress made in establishing MERCOSUR and recent steps taken by neighbouring countries to control cross-border trade all constitute important events that may influence the substantial volume of informal trade that has traditionally taken place between Paraguay and its two big neighbours, Argentina and Brazil.

3. The main variables

a) **Economic activity**

The surge in the production of cotton (21%) and soybeans (23%) –following a downturn in the former and flat growth in the latter in 1994– was a key factor in the 4% increase in GDP recorded in 1995, which was similar to the rate observed in 1993. Indeed, supply in the agricultural sector, which accounts for one quarter of GDP, expanded by more than 7% after having contracted slightly the year before. Manufacturing and construction also picked up somewhat, resulting in a rise of more than 5% in goods production, after the negligible increase seen in 1994.

The beverage, timber, and printing and publications industries continued to grow apace. There was also a sizeable increase in output from the tobacco, textile, leather and hides, and non-metallic minerals sectors, which reclaimed

the ground they had lost the year before. Trends were favourable, too, in clothing and footwear, although the starting-point for these activities was very low due to the severe setbacks they had experienced in previous years.

Basic services continued their brisk advance (9%), which was spurred on by increased electricity generation. Other services slowed, however, owing, in particular, to the sluggishness of commerce and finance as a consequence of the banking crisis and the rise in domestic interest rates.

These factors held back private consumption, which expanded by barely 1%, the lowest figure in recent years. This poor showing was more than offset, however, by an upsurge in the other components of demand. The improved cotton supply, together with heavier demand from neighbouring countries, fuelled a rapid expansion of exports (9%). The real increase in government consumption (5%) also strengthened domestic demand, while fixed investment, much of it in the public sector, continued expanding at an annual rate of over 4%. The resulting 4% upturn in total demand boosted the physical volume of imports by a similar amount.

b) **Prices and wages**

The scant increase (3%) in the price of the dollar during 1995 and the slow rate of expansion in private consumption were important factors in the near-halving of inflation to less than 11%, the lowest figure in the last 14 years.

The prices of goods –particularly tradables such as food, clothing and footwear– rose at an annual rate of nearly 8%, which was only half as much as the increase in the prices of housing, health and education services.

The slowdown in inflation was most marked in the first half of the year since, during the second half, the effects of the adjustments in the minimum wage and public utility charges made themselves felt. The increases made in utility rates and fuel prices in February 1996, along with the decision to raise the minimum wage again in April, also lent fresh impetus to inflation. Even so, the cumulative increase in consumer prices for the 12 months up to July was only around 9%.

In May 1995, the minimum wage was raised by 15%, which added nearly 2% to that wage's real purchasing power in comparison to the preceding year's average. An even larger real pay increase was received by manual workers. This improvement in total wages was partly eroded by a slight rise in the unemployment rate, which reached over 5% in urban areas.

c) **The external sector**

As in previous years, Paraguay's current account deficit with the rest of the world was financed out of its copious inflows of foreign capital, a significant proportion of which continued to be entered under the heading of net errors and omissions.

It should be noted that, owing to serious shortcomings in the registration of external transactions, Paraguay's balance of payments contains a number of inferences concerning important entries in its current and capital accounts. For example, the level of unregistered exports of goods and services is 40% higher than the level of registered exports. Furthermore, in 1995, the figure for net errors and omissions –a heading which, although it figures as part of the capital account, may include transactions that have not been included in the current account– was well over double the figure given for registered capital movements.

The value of merchandise exports climbed by 12% in 1995. Almost half of this increase was attributable to the increased supply of cotton and the higher prices paid for this product on the international market. Re-exports to neighbouring countries also continued to display a good deal of momentum, expanding by more than one fifth.

In addition to what has already been said about cross-border transactions, it should be noted that 60% of registered exports went to MERCOSUR, with Brazil alone accounting for nearly half of all registered external sales.

Net foreign exchange earnings from tourism services was also considerable. Having expanded by nearly 30%, tourism now accounts for over one third (US$ 700 million) of total merchandise exports. Royalties and fees paid to Paraguay for the use of the binational hydroelectric complexes at Itaipú and Yacyretá continued to generate

significant inflows of foreign exchange (approximately US$ 300 million, or three percentage points of GDP).

The value of merchandise imports rose by only 5%. MERCOSUR was also a major supplier of registered imports (27% of the total); this subregional grouping was the source of nearly 40% of such imports and, of that percentage, nearly half originated in Brazil.

The net outcome of the country's current external transactions was a deficit equivalent to 13% of GDP, which was similar in size to the deficit recorded the preceding year. One third of this shortfall was covered with long-term capital resources, with half of these resources being received in the form of direct investment and the other half coming from external loans. The remaining two thirds were entered under the heading of net errors and omissions (US$ 840 million), which includes short-term capital inflows and transactions not registered in the current account.

The public external debt expanded by 7%, thus rising to 15% of GDP. This debt is evenly divided between international agencies and the Paris Club.

PERU

1. General trends

Throughout 1995, the Peruvian economy continued to show the robust growth, investment upturn and stability that have characterized it in recent years. Continuity in economic policy and the structural reform process were strengthened as a result of President Fujimori's re-election in April.

Beginning in the second quarter, however, the level of economic activity showed a definite decline –a tendency that was accentuated in the first quarter of 1996– owing to the measures introduced by the Government to rein in the excessive growth reflected in an abrupt expansion of imports.

As early as the first quarter of 1995, rapid growth in spending and the high income elasticity of imports made it predictable that the merchandise trade deficit, which had doubled in amount every year since 1993, would be very large. In June, the Government sent a letter of intent to the International Monetary Fund (IMF), in which it committed itself to implementing a macroeconomic policy that would help reduce the rate of growth, in order to put the balance-of-payments current account on a path towards a more sustainable deficit.

To this end, the authorities first took steps to reduce the money supply and then in the last quarter cut back considerably on public-sector investment; this was accompanied, on the supply side, by a slow-down in fishing activity. The combined impact of these factors was a sharp drop in the growth of gross domestic product (GDP) from 13% in the first quarter to virtual stagnation in the last quarter. As a consequence, the annual growth rate was a little under 8%, substantially lower than the impressive figure of 14% recorded in 1994.

Growth in spending slowed less than growth in GDP, so that a substantial portion shifted towards imports; although this eased inflationary pressures, it also brought about a further deterioration in the merchandise trade balance, which showed a deficit equivalent to 5% of GDP. Notwithstanding deliberate attempts to cool down the economy, imports expanded strongly, showing that they would react only slowly to restrictive measures. The larger trade deficit in turn led to a widening of the balance-of-payments current account deficit, which reached 7.5% of GDP.

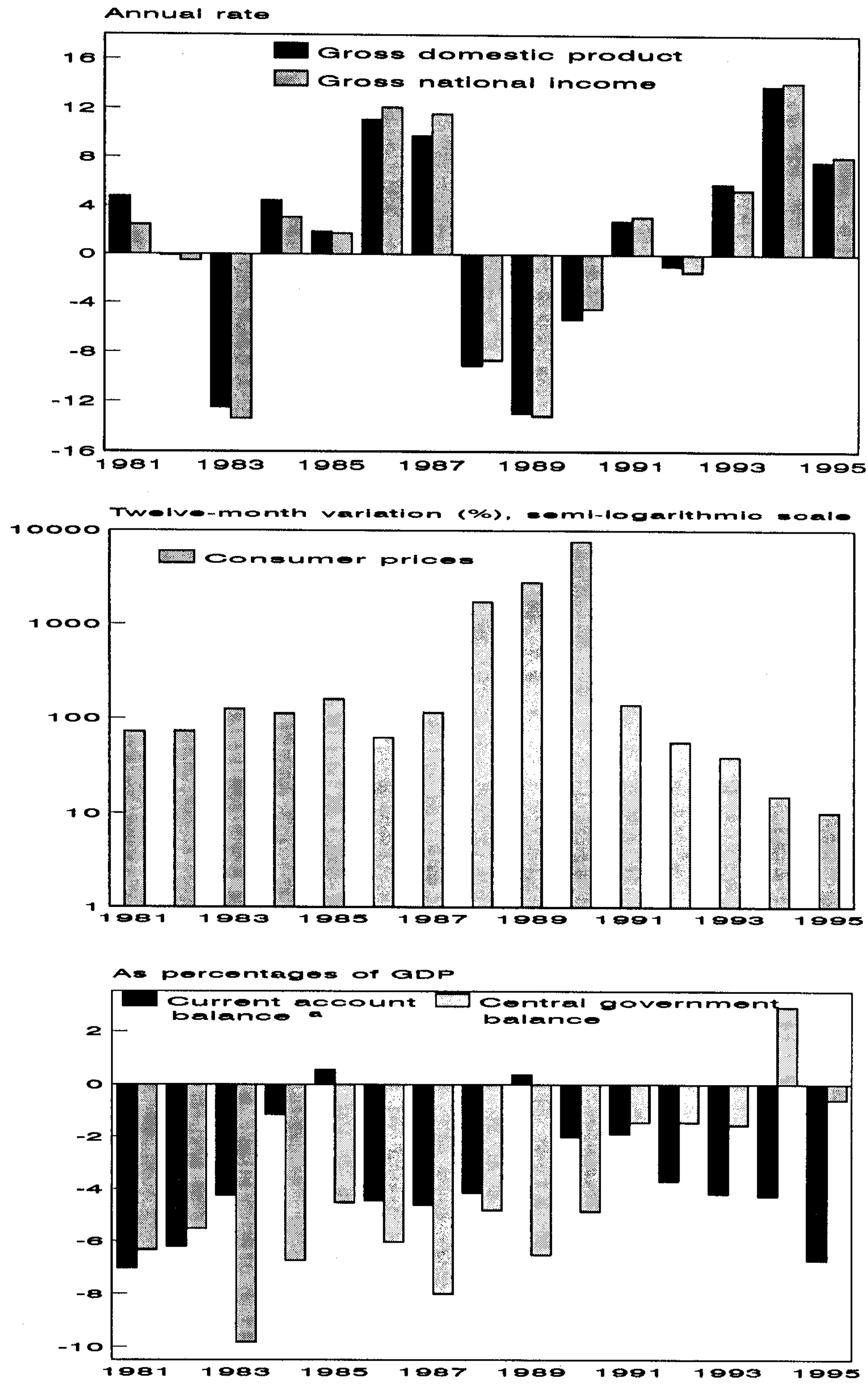
The crisis that occurred in Mexico in late 1994 had little effect on inflows of external capital into Peru; the impact of the crisis only began to be felt during the first quarter of 1995, when deposits in foreign currency and foreign exchange reserves in the financial system decreased, while the stock exchange price index and index of trading volumes both showed declines. In the second quarter, however, nearly all these indicators began to recover.

The slight rise in the nominal exchange rate owing to devaluations that did not keep pace with domestic inflation combined with a slower expansion in the money supply and growing confidence on the part of economic agents, resulted in a further decline in the inflation rate, to just 10.2% in 1995, five points lower than the year before and in sharp contrast to the runaway inflation of the early 1990s.

The most important development in the area of international relations in 1995 concerned the preliminary agreement reached between the Peruvian Government and creditor banks.

In accordance with the agreement with the international commercial banks to be formalized in the second quarter of 1996, as well as an agreement with the Paris Club, in June 1995, the Government was obliged to send a new letter of intent to the IMF, in which it committed itself to

Figure 1
PERU: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

lowering the growth rate in 1996, in order to be able to reduce the balance-of-payments current account deficit and maintain inflation just slightly above the level recorded in 1995.

The turn in the level of activity which had begun in the second half of 1995 carried through into early 1996; in the first quarter of 1996, output fell by 3.2% with respect to the same period of the previous year. However, there was no corresponding adjustment in the level of imports, the cumulative value of which reached US$ 2,360 million in April 1996, equalling the figure for the first four months of 1995. Even so, the trade deficit narrowed to US$ 510 million, US$ 200 million less than in the same period of the previous year. This improvement was due to the positive performance of exports, which rose by 12% overall, with even higher growth for traditional exports. Inflation accelerated during the first two months of 1996 over 1% per month, but slowed again in April and May, to reach a cumulative figure of 5.9% for the first five months of 1996, versus 4.8% for the same period of 1995.

2. Economic policy

Peru's economic policy in 1995 can be divided into two periods: the first six months were characterized by a policy of strong growth in public spending, which accelerated in the period prior to national elections in April; in the second six months the rapid pace of growth began to slow, after public spending was cut and the increase in the monetary base was reined in to cool down an overheated economy. The aim of these policies was to improve the balance of trade, which had progressively worsened over the previous three years.

a) Fiscal policy

After the first half, marked by rapid growth in both current expenditure (wages and goods and services) and capital investment, amounting to 20% and 56%, respectively, compared with the same period in 1994, fiscal policy became more restrictive. In the fourth quarter, the real rate of expansion in public-sector consumption dropped to under 5%, while capital expenditure fell by 18% compared with the same period of 1994.

Moreover, Peru succeeded in meeting the target agreed upon with the IMF, which was to increase tax yield to about 14% of GDP (including income from the National Housing Fund and other revenues), one point higher than in 1994. This achievement came as the result of a drive to improve administration undertaken by the Office of the National Superintendent of Tax Administration (SUNAT). The largest source of tax revenue was the general sales tax, which yielded the equivalent of 5.8% of GDP, some 2.5% of the amount being attributable to imports.

The slowdown in the growth of fiscal expenditure in the second half enabled the non-financial public sector to post a small primary surplus (i.e., excluding interest payments) of 0.3% of GDP at the end of the year (versus 1% in 1994). In contrast to the previous fiscal year, the non-financial public sector ran an overall deficit equivalent to 0.1% of GDP. Excluding income from privatizations, which totalled 1.6% of GDP (versus 4.5% in 1994), financing requirements increased to 1.7% of GDP. The economic authorities are predicting that the slow down in government spending will continue throughout 1996, and for this reason the latest letter of intent submitted to the IMF has stipulated as a goal a primary surplus of 2.5% of GDP.

b) Monetary policy

At the end of the first quarter, the need to restrain the expansion in domestic demand obliged the economic authorities to adopt a more restrictive monetary policy; they were assisted in this by the fact that the influx of foreign exchange was considerably lower than the previous year. The policy instruments used to absorb liquidity were the sale of securities by the Central Reserve Bank of Peru (BCRP) and deposits to the Central Bank by the public sector and Banco de la Nación; as a consequence, primary monetary expansion slowed from 57% in late March to 37% in December. During the first nine months of the year, money creation was due to an

Table 1
PERU: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	-9.1	-12.9	-5.4	2.8	-0.9	5.8	13.9	7.7
Per capita gross domestic product	-10.9	-14.6	-7.1	0.9	-2.6	4.0	12.0	5.9
National income	-8.7	-13.2	-4.5	3.1	-1.4	5.4	14.2	8.1
Gross domestic product, by sector								
Goods	-8.2	-13.3	-4.6	4.5	-1.8	7.6	18.3	7.4
Basic services	-4.9	-8.6	-4.9	2.2	2.1	6.1	8.0	7.3
Other services	-9.6	-11.5	-6.0	2.3	-1.9	3.9	11.0	11.5
	Percentages							
Contribution to growth of GDP [c]								
Consumption	-7.4	-9.2	-4.8	1.1	1.1	2.7	7.8	5.2
Government	-1.4	-0.6	-0.8	0.2	0.2	0.3	0.7	0.8
Private	-6.0	-8.6	-4.0	1.0	0.9	2.4	7.1	4.4
Gross domestic investment	-2.1	-7.4	2.6	2.4	-0.2	2.5	6.8	5.8
Exports	-0.6	1.6	-1.8	1.4	0.2	0.6	2.5	1.0
Imports	1.0	2.0	-1.3	-2.1	-2.0	0.0	-3.3	-4.3
	Percentages of GDP [b]							
Gross domestic investment	22.8	17.7	21.4	23.1	23.1	24.2	27.3	30.7
National saving	19.3	18.0	19.5	20.8	18.5	19.9	22.7	23.6
External saving	3.4	-0.4	1.9	2.3	4.6	4.3	4.6	7.1
	Percentages							
Employment and wages								
Activity rate [d]	...	61.2	61.3	57.2	58.8	60.8	59.7	62.4
Open unemployment rate [e]	7.1	7.9	8.3	5.9	9.4	9.9	8.8	7.1
Real average wage (Index: 1990=100)	210.1	114.5	100.0	115.2	111.1	105.7	127.4	116.7
	Growth rates							
Prices (December-December)								
Retail prices	1 722.3	2 775.8	7 649.6	139.2	56.7	39.5	15.4	10.2
Wholesale prices	1 877.1	1 917.9	6 534.0	96.0	50.5	34.1	10.5	8.8
External sector								
Terms of trade (Index: 1990=100) [b]	96.8	94.1	100.0	94.3	93.5	90.1	91.2	95.3
Nominal exchange rate (new soles per dollar) [f]	0.16	3.48	0.19	0.76	1.25	1.99	2.20	2.26
Real effective exchange rate (Index: 1990=100)	195.8	122.1	100.0	82.1	80.9	89.1	84.6	85.6
	Millions of dollars							
Balance of payments								
Current account	-1 334	132	-678	-813	-1 657	-1 643	-2 103	-3 747
Trade balance	-416	920	57	-452	-1 152	-1 118	-1 541	-3 005
Exports	3 563	4 387	4 165	4 261	4 403	4 409	5 681	6 821
Imports	3 979	3 467	4 108	4 713	5 555	5 527	7 222	9 826
Capital and financial account	790	-285	526	-6 197	-29	1 452	3 037	2 608
Overall balance	-2 586	-1 800	-1 754	-737	-790	648	1 980	103
International reserves (variation)	149	-241	-212	-899	-554	-748	-3 038	-947
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	51.1	52.4	58.9	48.0	47.6	60.8	51.5	49.4
Net interest (as a percentage of exports)[g]	29.2	22.0	24.9	18.1	21.1	21.5	17.3	13.9

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
			Percentages of GDP					
Central government								
Current income	...	...	...	9.5	11.3	11.4	13.0	13.7
Current expenditure	...	...	...	8.7	10.5	10.2	11.1	12.3
Savings	...	...	...	0.8	0.8	1.2	1.9	1.4
Capital expenditure (net)	...	...	...	1.4	2.5	2.6	-1.0	2.0
Financial balance	...	...	...	-0.6	-1.7	-1.4	2.9	-0.6
Non-financial public sector								
Financial balance	-8.5	-7.1	-4.5	-1.5	-1.4	-1.2	3.2	-0.1
Domestic financing	5.6	4.6	2.0	-0.7	0.5	-0.3	-4.2	-1.0
External financing	2.9	2.5	2.5	2.2	0.9	1.5	1.1	1.1
			Growth rates					
Currency and credit								
Money balances of banking system								
Net international reserves[h]	...	...	24.9	183.6	25.5	20.0	106.6	10.4
Net domestic credit	766.3	1 456.7	3 923.5	177.4	53.7	80.7	-20.0	63.4
To public sector	267.3	1 932.3	5 350.4	...	...	...	...	...
To private sector	500.9	1 860.2	5 505.0	284.8	96.4	74.0	65.0	44.1
Money (M1)	491.5	1 805.7	4 627.2	124.6	71.3	48.1	58.1	23.4
Local-currency savings and time deposit	359.2	4 061.9	2 161.9	273.0	46.9	59.0	96.2	45.6
M2	440.3	2 400.4	3 508.1	164.4	60.5	50.0	71.5	30.7
Dollar deposits[h]	...	...	6.8	140.5	17.2	37.0	35.0	17.7
			Annual rates					
Real interest rates (annualized)								
On deposits	...	-47.2	-54.3	13.7	1.9	3.4	6.0	5.2
On loans	...	-31.2	-13.0	248.2	55.8	41.2	32.8	24.0
Equivalent interest rate in foreign currency[i]	...	85.0	-33.8	83.0	12.7	8.8	24.1	6.7

Source: ECLAC, on the basis of official figures.
Note: The growth rates under the heading "Currency and credit" referring to 1990 were corrected with respect to those published in the "Economic Survey of Latin America and the Caribbean, 1994-1995".
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] For 1987 and 1988 the exchange rate is expressed in new soles per one thousand dollars. [g] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [h] Growth rates on figures in dollars. [i] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
PERU: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product (Index: 1990=100)[b]	98.3	109.5	109.3	110.7	109.1	126.9	120.9	126.2	123.3	138.1	128.3	127.0
Consumer prices (12-month variation, %)	51.3	49.9	47.0	39.5	31.6	24.2	19.5	15.4	11.9	11.1	10.0	10.2
Real effective exchange rate (Index: 1990=100)	87.6	90.5	89.7	88.4	84.2	83.3	86.5	84.3	85.2	89.1	84.4	83.7
Real interest rate (annualized, %)												
On deposits	-5.5	1.4	8.7	9.2	3.8	9.2	5.1	5.9	5.2	4.1	7.9	6.2
On loans	37.1	39.0	44.2	44.3	36.0	38.1	28.5	28.8	24.0	23.8	27.0	23.9
Money (M1)[c] (12-month variation, %)	87.2	63.9	60.4	54.7	50.4	66.2	70.1	61.8	60.3	49.3	33.4	28.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant prices for Peru, without seasonal adjustment. [c] Based on quarterly averages.

external factor, namely the increase in international reserves. In the final quarter, it was necessary to rely on domestic sources –sterilization deposits of the banking system– to meet external debt obligations; although this contributed to an expansion in the monetary base, it had no major impact on domestic prices, since the demand for money increased during that period due to seasonal factors.

The growing confidence of economic agents in government policy facilitated the continued remonetization of the economy, preventing the increase in the money supply of some 23% in 1995 from having inflationary effects. Local-currency quasi-money grew by 46%, foreign-currency quasi-money by just 17%, reflecting the fact that the dollarization ratio (the ratio of foreign-currency deposits to total deposits) declined from 79% to 75%.

The real interest rate on local-currency loans declined during 1995, averaging 24% for the year, compared with 32% in 1994. Since the rate on deposits remained below 6%, the spread in the banking system was close to 19%. Interest rates on dollar-denominated loans showed a gradual increase, from 15% in December to an average of 17% for the fourth quarter, in response to the slower growth in deposits; this, in turn, caused the 30-day deposit rate to increase to 7.6%. The rise in interest rates on foreign-currency denominated loans, 60% of total lending, tended to curb growth in economic activity during the final quarter, despite the fact that the rate was not used as an instrument of monetary policy in Peru's economy, since open market operations were relatively minor.

c) **Foreign exchange policy**

The system of floating exchange rates with Central Bank intervention remained in place during 1995. This, together with agents' growing confidence in the local currency and economic stability, meant that the exchange rate for the dollar continued to decline over the course of the year, despite lower external capital inflows compared with 1994 and the concomitant decline in foreign exchange sales. However, measured in terms of the basket of currencies of Peru's main trading partners, the local currency did not appreciate significantly, compared with the previous year.

d) **Structural reforms**

In 1995, Peru continued to privatize State-owned enterprises, although the programme proceeded at a less intense pace than in previous years, especially during the first half, owing to the impact of the electoral process and the uncertainty it generated. The most important operations of this sort were the sale of 60% of the stock of Empresa de Generación Eléctrica de Lima (EDEGEL) for US$ 520 million in October, and the sale of 68% of the stock of Banco Continental. Data provided by the Commission for the Promotion of Private Investment (COPRI) indicate that during 1995, privatization sales brought in revenue equivalent to US$ 1.1 billion and that future investment commitments total somewhere in excess of US$ 200 million. In addition, the process of privatization through capitalization got under way. Under this method of privatization, the Treasury does not receive any income, but rather accepts an investment commitment on the part of a private agent, who in exchange receives a percentage of the stock in the privatized entity. The first experiment of this type was the bidding on the Empresa Termoeléctrica de Ventanilla; the equity interest was awarded to a consortium made up of Peruvian interests and the Empresa Nacional de Energía (ENDESA) of Spain, in return for a commitment to invest US$ 120 million to increase generating capacity from 200 MW to 480 MW.

More recently, the process of selling off Petróleos del Perú (PETROPERU) got under way with the auction of 60% of the stock in the La Pampilla refinery. Also privatized were a number of facilities owned by Electricidad del Perú (ELECTROPERU), Empresa Minera del Centro del Perú (CENTROMIN), and Servicio de Abastecimiento de Agua Potable y Alcantarillado de Lima (SEDAPAL), a water and sewerage enterprise. COPRI estimates that these transactions generated US$ 1.2 billion in revenues.

During 1995, it became necessary to make a number of adjustments to the social security

reform process, in order to correct some shortcomings detected in the two years since the reforms were implemented. Under the new arrangements, private pension funds had been authorized to operate alongside the public system. The funds began operations in 1993, but met with less success than had been anticipated. For this reason, the legislation was amended in July 1995 with the aim of bringing costs in the private system –until then more expensive– into line with those in the public system, thus helping to attract people into the new pension system. To achieve that aim, the contribution channelled into the individual account under the private system was temporarily reduced from 10% to 8%, thus putting it on the same footing as the public system. In addition, the "solidarity contribution" of 1% was abolished, as was the value added tax on commissions and insurance. Finally, beginning in November, authorization was given for participants in the private system to switch freely between funds.

By December 1995, pension fund assets had reached a figure in excess of US$ 710 million, and they could boast 1.2 million participants. The Office of the Superintendent of Private Pension Funds estimated that after 35 months of operation, the funds' annual average return was 7%.

3. The main variables

a) Economic activity

In spite of government efforts to restrain domestic demand, its rate of growth declined by just four points with respect to 1994 from 15% to 11%, considerably less than the level of economic activity, and the differential meant that a larger proportion of demand shifted towards imports; as a result, imports grew by 27% at constant prices, a trend that revealed their marked downward inelasticity over the short term.

Public-sector consumption increased by 10%, while public-sector investment rose by 16%. The expansion in fiscal expenditure during the first half had a strong multiplier effect on private-sector spending, particularly on investment; however, since in the second half private investment followed the downward trend of public investment, gross fixed capital formation grew by only 20%, 11 points below the rate recorded the previous year. Nevertheless, the rate of investment rose by over two points to nearly 30% of GDP. This high level of investment was financed by both national savings (23%) –which increased nearly 1% with respect to 1994– and external savings (7%).

The pace of economic activity gradually slowed during 1995, thus interrupting the rapid growth experienced since late 1994; this downturn worsened dramatically in the second half, so that by year's end production was stagnant. The slow down was attributable to the impact on the fishing industry of ocean current-related adverse weather conditions; this, combined with the imposition of closed seasons by the authorities in an effort to conserve marine resources, led to a sharp drop in the sector's output (-14%). That, in turn, had a ripple effect on the resource-based processing industry, whose production levels declined by 6%, after growing by 15% in 1994. Public spending cutbacks and reduced liquidity also played a role. In consequence, growth in manufacturing output dropped from 16% to 5% for the year. In contrast, the expansion in commerce was strong (11%), although lower than the 17% recorded the year before.

Thanks to good weather conditions, agricultural production once again expanded, though at a slower pace (6%); some of the major crops recorded increased harvests: raw cotton (29%), sugar cane (16%), potatoes (34%) and soft maize (24%). The livestock products showing the greatest increases were poultry (16%) and eggs (24%).

The mining sector benefited from good prices for metals on world markets, but recorded growth of under 3%, showing that new investments in mining had yet to produce returns. Only copper and silver production registered significant expansion, growing by 11% and 10%, respectively.

The rate of growth in the construction industry fell sharply from 32% in 1994 to 17% in 1995, chiefly as a result of reduced public spending on infrastructure. During the first half, the sector's

growth was practically the same as the year before, but subsequently dropped sharply to just 7%.

b) **Prices, wages and employment**

The inflation rate fell to 10.2% in 1995, slowing most dramatically in the second and third quarters, for a fifth consecutive year of declining inflation. One of the chief contributing factors was the trend towards a more moderate increase in the nominal exchange rate. Other contributing factors related to supply, the slow growth of farm prices and containment of monetary expansion helped keep inflation down in the second half.

Nominal wages and salaries rose only slightly, a factor that also helped curb inflation. The quarterly survey of establishments employing 10 or more workers found that salaries declined by 8% in real terms and real wages by 15%. On the other hand, the minimum living wage increased slightly (2%).

With the exception of commerce, the slow down in the pace of activity was accompanied by a decline in employment. The demand for labour in the manufacturing and service sectors declined by 3% and 1%, respectively; in contrast, commerce increased its demand for labour by 10%.

c) **The external sector**

The weak point in Peru's economic development has been its balance of trade, which has deteriorated sharply in recent years, a trend that persisted in 1995. The merchandise trade balance incurred a deficit of US$ 2.1 billion for the year, while the deficit in non-financial services totalled US$ 800 million, bringing the total trade deficit in goods and services to 5% of GDP, almost two points more than in 1994.

The deficit on the balance-of-payments current account, excluding interest arrears owed to international private banks, amounted to US$ 3.7 billion, equivalent to 7.5% of GDP. This shortfall was financed with US$ 1.7 billion in foreign direct investment inflows (including US$ 640 million from the sale of public-sector enterprises), and over US$ 2 billion in short-term capital flows, including US$ 200 million in portfolio investment.

Special financing, obtained through short-term external debt negotiations, debt cancellation and refinancing of external debt and payment arrears, amounted to US$ 840 million; as a result, net reserves increased by US$ 920 million.

Export performance was highly satisfactory for the second year in a row, increasing by US$ 1 billion. Traditional exports accounted for most of the export growth, since prices for mining, fishing and farm products (with the exception of coffee) improved dramatically.

The total value of merchandise imports rose by US$ 2.1 billion, showing great inelasticity in response to the slow down in domestic spending. As in 1994, external purchases of goods tended to be concentrated in intermediate and capital goods, which accounted for more than 70% of the total and grew by almost 40%. The rate of growth in imports of consumer goods –the first to be affected by the downturn in economic activity– declined relatively little (33% as compared with 50% in 1994).

The external debt totalled US$ 27.5 billion in December 1995, increasing by US$ 800 million in medium- and long-term debt and US$ 1.2 billion in short-term debt. New medium- and long-term loans included US$ 206 million granted by the Paris Club and US$ 506 million granted by international institutions.

The most important development in international relations in 1995 was the preliminary agreement reached between the Peruvian Government and representatives of 240 creditor banks, headed by Citibank, under the Brady Plan. The preliminary agreement was based on a 45% discount on the face value of the external debt. The amount to be rescheduled included principal of US$ 4.4 billion and interest arrears estimated at around US$ 5 billion. The annual debt service cost that will result from the agreement, due to be signed in July 1996, will depend on a set of options.

There are four options with regard to the principal: i) a par bond guaranteed by the United States Department of the Treasury, with a 30-year term and grace period, at rates of interest rising gradually from 3% to 5%; ii) a discount

bond, also guaranteed by the United States Treasury, with a 30-year term and a 45% discount, at a rate of interest equal to the six-month LIBOR plus 0.81%; iii) an interest reduction bond, with a 20-year term, amortizable in 25 half-yearly instalments beginning the eighth year after issuance; iv) a debt buyback option in the form of a Dutch auction, partially realized by the Government of Peru during 1995, for an amount not officially disclosed. Most of the interest payment options involve a 20-year repayment period and a five-year grace period, at 0.81% over the three-month LIBOR; the interest rate on unpaid interest will be 2.5% per annum. Lastly, it will be possible to use the Brady bonds issued by the Peruvian Government to purchase public-sector enterprises that are up for sale.

One of the commitments contained in the preliminary agreement with the commercial banks requires Peru to pay 0.5% of the principal on a quarterly basis and US$ 225 million when the agreement takes effect; this amount is to be financed from the proceeds of privatizations and by loans provided by multilateral organizations (the Inter-American Development Bank, the World Bank and the Andean Development Corporation (ADC)).

DOMINICAN REPUBLIC

1. General trends

In 1995, economic activity in the Dominican Republic expanded by a slightly higher rate (almost 5%) than in the preceding year and, as a result, per capita gross domestic product (GDP) increased for the fourth consecutive year, even though the unemployment rate remained high at 16%. This trend was in keeping with the structural adjustment programme undertaken in September 1994 in an effort to reduce the external imbalance, narrow the fiscal deficit, limit the growth of the money supply and curb inflation. With the exception of the targets relating to monetary expansion, these goals were met, mainly as a result of the strong performance of the external sector, which contributed to a substantial increase in national income.

The restraint of fiscal spending resulted in a small surplus in public-sector accounts. For its part, the strong performance of the tourism sector led to a turnaround in the current account, whose chronic deficit gave way to a surplus, thereby permitting a build-up of international reserves.

The higher level of national income boosted private spending, thus fuelling an expansion of production and imports. This expansion was reinforced by an upturn in credit based on the growth in the money supply caused by the build-up of international reserves. The steadiness of the nominal exchange rate and improved supplies of goods helped to moderate pressures on prices, which rose 9%.

In the first quarter of 1995, the Dominican Republic was admitted as a member of the World Trade Organization (WTC). During this period the country was also stepping up structural reforms relating to the liberalization of both trade and investment.

2. Economic policy

The authorities' achievement of a balanced budget was not matched by similar success in controlling monetary aggregates, since this goal was difficult to reconcile with the maintenance of a stable nominal exchange rate at a time of increased foreign currency inflows.

a) Fiscal policy

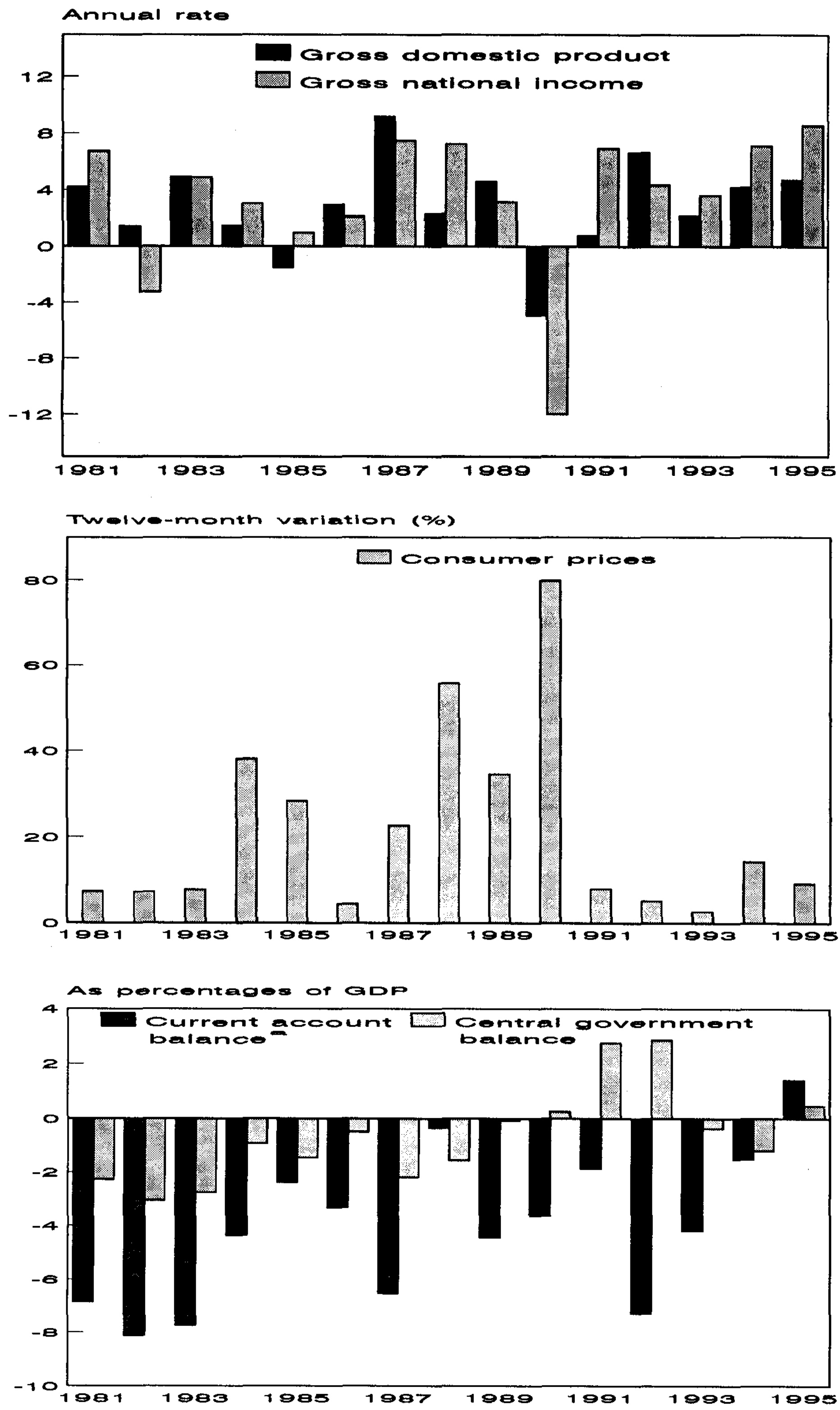
Fiscal policy was in keeping with the guidelines established for the adjustment programme initiated in September 1994 with a view to balancing the budget. The results were satisfactory, since an overall surplus was recorded in central government accounts and in the accounts of the consolidated non-financial public sector (0.5% of GDP); in addition, the central government was able to save the equivalent of seven percentage points of GDP.

The central government's surplus was attributable entirely to a decrease in spending from slightly over 16% to 14.5% of GDP, since income held steady at around 15%.

The share of tax revenue and non-tax revenue (93% and 7%, respectively) in the central government's total current income did not vary, and the tax ratio therefore remained in the 14% range. Receipts from direct taxes increased more sharply than indirect tax revenue due to the expansion of the income-tax base and thus came to account for close to one-fifth of total tax income.

Product taxes, which represented 43% of indirect taxes, were clearly the largest component in this category and accounted for half the

Figure 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

increase in these receipts. Among these commodity taxes, the oil tax (38% of the total) and the duty on the transfer of manufactured goods and services (19%) were the most important sources of revenue. Taxes on foreign trade represented 29% of tax revenue and were responsible for 14% of the growth in total indirect taxes. The large share of receipts accounted for by this item indicates just how sensitive tax revenues are to the trade liberalization process. Under an act which was passed in May to standardize excise taxes, beer and cigarettes are subject to a rate of 20% and alcoholic beverages, to one of 25%; however, it remains to be seen what effect this will have on the tax yield.

The decline in spending was attributable to a lower level of capital outlays, which totalled close to 7% of GDP in 1995, i.e., two percentage points less than in the previous year. Under this heading, fixed capital investment and capital transfers both declined and the relative weight of these items in overall spending thus fell to 32% and 17%, respectively. Current expenditure rose very slightly –to approximately 8%– but the Government obtained this result only by delaying service payments of 500 million pesos on outstanding debts and payments to contractors which could add up to over one percentage point of GDP.

In terms of appropriations, the share of economic and financial services increased at the expense of disbursements for social services, which contracted as a result of the decrease in expenditure under the heading sewerage and drinking water supply. Despite the decrease in overall social spending, expenditure on education and health showed a slight increase, representing 4% of total spending in 1995.

The fiscal surplus, together with the receipt of non-recurrent income from domestic sources, enabled the central government to make payments on its foreign debts and reduce its deposit liabilities with the Central Bank.

b) **Monetary and foreign exchange policy**

Monetary policy had an expansionary effect due to a sharp increase in international reserves, notwithstanding the explicit objective of controlling monetary aggregates which was set out in the adjustment programme. The authorities continued to pursue the process of amending the legal framework, which they had initiated in late 1994, in order to forestall excessive money creation, and the Monetary Board passed a number of resolutions designed to prevent the extension of credit to the public sector.

The build-up of international reserves and, to a lesser degree, the expansion of credit to decentralized government institutions made it impossible to achieve the authorities' monetary target. In order to be compatible with projected real GDP growth and the decline in the rate of inflation, expansion of the monetary base should not have exceeded 12% but in fact, it was far above this level in spite of the sale of bonds in an attempt to regulate the money supply and the domestic credit restraints created by a policy of cutting back on loans, rediscounts and credit to the central government.

The money supply (M1) increased 23%, while local-currency broad money(M2) went up 20%; this may be attributed to the slower rate of increase in quasi-money, in which was apparently related to the downward trend in interest rates on deposits.

Nevertheless, by the end of 1995, interest rates on deposits as well as on loans were still fairly high (approximately 13% and 27% in real terms) and the interest rate on domestic accounts denominated in foreign currency was over 14%. A more stringent monetary policy would have yielded even higher rates, which would have pushed up the cost of the domestic debt of the Central Bank. Moreover, it would have added to the upward pressure on the local currency, which was being maintained by the monetary authorities at a constant exchange rate of 12.87 pesos to the dollar, while the floating exchange rate fluctuated within a narrow margin below the 14-peso mark. Since domestic inflation was higher than the external rate, a small real appreciation of the peso was observed. Indeed, a comparison of annual averages reveals that the average for 1995 was 4% higher than the figure for the preceding year.

c) **Trade policy**

The existence of an official exchange rate that was lower than the free market rate meant that

Table 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	2.3	4.6	-4.9	0.8	6.7	2.2	4.3	4.7
Per capita gross domestic product	0.1	2.4	-6.9	-1.2	4.6	0.3	2.3	2.9
Gross national income	7.2	3.2	-12.0	7.0	4.4	3.7	7.1	8.6
Gross domestic product, by sector								
Goods	-1.0	4.6	-7.3	-0.4	8.9	0.4	5.5	4.0
Basic services	0.6	5.6	-6.6	6.8	15.8	7.0	4.9	9.1
Other services	5.8	4.5	-2.6	1.0	3.4	3.0	3.1	4.7
	Percentages							
Contribution to growth of GDP [c]								
Consumption	5.3	4.5	-10.1	7.6	8.5	-2.4	1.8	1.4
Government	0.2	0.0	0.2	0.0	0.2	0.0	0.1	0.0
Private	5.0	4.4	-10.2	7.5	8.3	-2.5	1.7	1.4
Gross domestic investment	-4.5	4.5	-4.5	-2.2	5.4	1.9	1.7	3.4
Exports	1.8	-0.6	1.7	-2.4	1.6	2.3	3.2	2.3
Imports	-0.2	-3.7	8.0	-2.2	-8.8	0.4	-2.5	-2.3
	Percentages of GDP [b]							
Gross domestic product	25.2	28.4	25.1	22.8	26.4	27.8	28.3	30.2
National saving	24.9	22.9	20.8	20.2	15.5	21.3	26.0	32.5
External saving	0.4	5.5	4.3	2.6	11.0	6.5	2.3	-2.3
	Percentages							
Employment and wages								
Real minimum wage (Index 1990 = 100)	115.0	102.9	100.0	97.0	118.0	112.1	119.1	121.6
	Growth rates							
Prices (December-December)								
Consumer prices	55.8	34.6	79.9	7.9	5.2	2.8	14.3	9.2
External sector								
Terms of trade (Index: 1990=100) [b]	137.1	131.1	100.0	119.2	116.1	124.3	126.7	139.2
Nominal exchange rate (pesos per dollar)	6.11	6.34	8.29	12.61	12.79	12.68	13.16	13.62
Real effective exchange rate (Index: 1990 = 100)	151.0	109.2	100.0	100.6	101.3	96.0	95.4	93.5
	Millions of dollars							
Balance of payments								
Current account	-19	-327	-280	-157	-708	-425	-159	163
Trade balance (goods and services)	-102	-463	-402	-351	-818	-472	-333	-23
Exports	1 903	1 966	1 832	1 857	1 911	2 210	2 544	3 026
Imports	2 005	2 429	2 233	2 208	2 729	2 682	2 878	3 049
Capital and financial account	-16	160	-17	-138	76	-65	270	-20
Overall balance	1	-241	-418	253	-63	34	-386	143
International reserves (variation)	59	-90	-49	357	64	154	-385	113
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	73.8	56.7	58.4	55.0	45.4	45.0	37.7	35.0
Net interest (as a percentage of exports) [d]	14.2	6.3	8.7	3.9	6.3	8.1	3.6	3.5

Table 1 (conclusion)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Central government								
Current income	15.5	13.5	10.3	13.1	15.3	15.9	15.1	15.0
Current expenditure	7.5	6.7	5.4	5.3	6.0	8.2	7.7	7.9
Savings	8.0	6.7	4.9	7.9	9.4	7.8	7.4	7.1
Capital expenditure	9.5	6.8	4.6	5.1	6.5	8.1	8.6	6.6
Fianancial balance	-1.6	-0.1	0.3	2.8	2.9	-0.4	-1.2	0.5
Domestic financing	0.3	0.1	-0.2	-2.5	-2.2	1.4	2.1	0.5
External financing	1.2	-	-	-0.3	-0.6	-1.1	-0.9	-1.0
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	...	...	...	...	53.8	45.3	-91.4	519.3
Net domestic credit	...	...	21.7	5.5	24.5	17.3	39.1	10.7
Money (M1)	...	...	21.1	27.6	15.3	25.1	2.3	23.5
Local-currency savings and time deposits	...	...	18.0	48.9	38.9	30.3	13.9	18.2
M2	...	...	19.6	37.4	27.1	27.9	8.7	20.4
Dollar desposits	...	...	...	...	94.7	-71.4	-8.4	-3.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. the coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

Table 2
DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	7.6	4.3	4.3	2.8	5.6	8.2	10.0	14.3	14.2	11.8	11.8	9.2
Real effective exchange rate (Index: 1990=100)	96.6	98.4	97.5	97.2	95.9	94.9	95.8	94.8	91.8	95.3	94.4	92.5

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

certain export and import activities were actually subject to a system of implicit subsidies and taxes. In particular, official trade transactions penalize traditional exports, such as sugar, and subsidize the consumption of petroleum and petroleum products.

The Government's advocacy of the prospective free trade area of the Americas (FTAA) and its decision to become a member of the existing Association of Caribbean States (ACS) highlighted its intention to intensify efforts to integrate the country into the global economy. On the other hand, the real appreciation of the peso, in a context of trade liberalization, did not provide any incentives to the tradables-producing sectors of the economy.

Shortly after the legislature had ratified the agreements reached during the Uruguay Round in January 1995, the Dominican Republic joined the World Trade Organization (WTO). Various bilateral arrangements were also renewed in 1995, including textile agreements with the United States and Canada which had originally been signed in 1979 and 1988, respectively.

Moreover, in June 1995, the foreign exchange surtax on imports was abolished system of minimum export prices for agricultural exports was discontinued. The tariffs applied to domestic and imported goods were standardized. Notwithstanding these measures, there is still some degree of dispersion in the tariff structure and, according to estimates, some sectors enjoy an effective level of protection of over 200%.

d) **Structural reforms**

In the course of the year, progress was made in the implementation of structural reforms designed to provide a legal basis for the liberalization of the economy. In December Congress approved the new Foreign Investment Act, which replaces the legislation enacted in 1978, with a view to attracting foreign capital by offering the same treatment as is granted to national investors. The proposal for joining the Multilateral Investment Guarantee Agency (MIGA) was another step in keeping with this policy.

The debate continued on a number of supplementary bills to the reform package launched in September 1994 whose objective would be to close the fiscal gap by raising income and reducing expenditure. The proposed amendments to the tax code seek to increase the tax yield, fiscal transparency and administrative efficiency and to prevent excessive money creation. The projected reform of energy legislation would ensure a more efficient supply and a reduction in the government subsidy provided to the Corporación Dominicana de Electricidad (CDE).

3. The main variables

a) **Economic activity**

In 1995 the rate of domestic activity was on the upturn, and this higher growth rate (almost 5%), together with the substantial improvement in the terms of trade with the rest of the world and the higher level of private remittances, generated a substantial increase (over 8%) in gross national income.

This increase was coupled with an expansion in aggregate domestic demand which was fuelled, in particular, by private consumption and private investment, and this, in combination with the growth in the volume of exports of goods and services, resulted in a 5% rise in total demand. However, the bulk of this higher level of demand was channelled towards imports, which swelled by 5.5%.

Private consumption was up 2% thanks to an increase in wages and family remittances in real terms. The downward trend in real interest rates presumably gave the country's households greater access to credit facilities. Gross investment maintained a growth rate of almost double the 1994 figure (11.6%); as a result, this variable, which had stood at 25% of GDP in 1990, climbed to 29.4% within a context favourable not only to stability in the exchange rate and in domestic prices but also to a downward trend in interest rates.

Exports of goods and services increased by almost 8%, which was a lower rate than in the

two previous years. The fall in shipments of the country's two main exports (sugar and ferronickel) was not entirely offset by the rise in these products' prices on the international market.

Almost one fifth of the total increase in GDP was generated by the agricultural sector, which grew by 6% in spite of adverse weather conditions that included a drought in the first half-year. The crop-farming subsector played a key role in the increase and, within that subsector, a particularly strong performance was turned in by grains (rice and maize), oilseeds (peanuts) and root crops (sweet potato and cassava), i.e., crops intended for local consumption –which were up 16%. On the other hand, export-oriented agriculture was down (-2%), primarily owing to a decline in the output of the sugar industry, which was hampered by financial difficulties, run-down machinery and equipment, and short-comings in the management practices of the Corporación Estatal del Azúcar (CEA). Livestock production recorded some gains, mainly under the headings of poultry and milk.

In contrast to the overall performance of the economy, the manufacturing sector was in the doldrums, and its contribution to GDP fell below 14%. The country's in-bond processing industries turned in a highly dynamic performance, however. In fact, this segment was so buoyant that in 1995 it accounted for almost a quarter of total foreign exchange earnings, its capital investment rate went up by 8% and 30 new companies were founded, bringing the total number of such firms to over 500 by the end of the year. On the other hand, local industries –in particular the sugar industry– did not benefit from the growth in demand. Indeed as a result of financial constraints and outdated technology, their production levels actually declined, with sugar and sugar products falling back 10%, thereby obliging the Dominican Republic to increase its sugar imports from 35,000 to 40,000 tons.

The mining sector experienced a 9% improvement and its contribution to GDP growth amounted to 6%. Ferronickel production scarcely increased at all, even though demand on the international market was strong.

The downturn in construction, a sector which in any event still recorded 6% growth, was marked by the uneven patterns of public and private investment; the latter was stimulated by the increased availability of housing and business loans and by the decrease in real interest rates. The Duarte highway and the Monción dam were the largest infrastructure projects carried out by the Government in 1995, but the amount of public investment in construction was lower nonetheless.

The performance of the different production sectors was hindered by an inadequate electricity supply. The electricity, gas and water sector experienced a 4% downturn due to a decrease in the output of the CDE and an increase in line losses. The contribution of private producers, on the other hand, continued to expand, reaching one third of the total available power supply for the year and alleviating the shortfall.

Transport and communications were up 10%. Communications services expanded significantly, particularly in the case of the telephone subsector (19%), which substantially increased the number of available lines. Telecommunications accounted for 14% of the growth in output in 1995 and show considerable potential. The remarkable increase in tourism (17%) was mainly attributable to gains in hotel services.

b) **Prices, wages and employment**

A number of factors combined to bring inflation down from 14% to 9% in 1995. Some of the most important of these factors were the carry-over effect of the tight monetary policy applied during the preceding year, the consolidation of the real exchange rate for the peso and an increase in the supply of food poducts, which are the most heavily weighted component of the consumer price index (CPI). Food, beverages and tobacco recorded the same rate of increase as the overall index; on the other hand, the cost of housing rose more sharply (12%), while clothing was up by just 5%.

The National Minimum Wage Commission awarded a 20% increase –effective as of May– in the minimum wage for workers in the private sector and in the country's export processing zones, which amounted to an improvement of close to 7% in real terms. The increase in

public-sector wages was more substantial: 30% and 19%, respectively.

The available data indicate that the unemployment rate remained in the 16% range despite the increase in economic activity. The tourism sector accounted for the highest number of new jobs: 39,000. On the other hand, the rate of job creation in the export processing zones, which provide employment to 8% of jobholders who declare their income, declined with the introduction of changes in management policies.

c) **The external sector**

The performance of the external sector improved significantly. The current account balance, which has traditionally shown a deficit, yielded a surplus of US$ 163 million, while the capital account deficit fell to only US$ 20 million. Following the substantial erosion observed the previous year, there was a US$ 113 million build-up in reserves in 1995.

The chronic deficit in the country's trade in goods and services virtually disappeared thanks, above all, to the expansion in exports of services, especially in the tourism sector. Tourism generated the most foreign exchange earnings –US$ 1.6 billion– of any single sector, thus bringing in the equivalent of almost half as much as the Dominican Republic's total sales of goods and services on the export market.

The value of merchandise exports rose 15%, with an increase in volume and a rise in international prices contributing equally to the upturn. The volume of exports of some products, such as sugar, cocoa and ferronickel, were down, however. In the case of the last two of these commodities, the decline in shipments was easily offset by the rise in prices; this was particularly true in the case of ferronickel sales, whose value jumped 22%. The 14% rise in the price of sugar was not sufficient to offset the decline in shipments, however, and the value of sales thus showed a 12% contraction. Earnings from the country's other main export products were higher, with textiles and bananas benefiting from an increase in the quotas maintained by the United States on the former and by the European Union on the latter. The value of non-traditional exports approached US$ 190 million, or one quarter of total exports.

A larger increase in merchandise imports was observed, in absolute (US$ 100 million) as well as relative terms (4%), as a result of an upswing in both their volumes and their prices. More than half of total imports were raw materials and intermediate goods, which expanded by 34%. The greatest relative increases were those recorded for food imports, however. On the other hand, imports of durables and capital goods were lower.

Remittances from Dominican nationals residing abroad continued to increase, exceeding US$ 530 million.

Largely as a result of a slackening of net capital outflows, the capital account's tendency to move towards a more balanced position became more definite than it had been before. Lower amortization payments and an increase in disbursed loans led to a decrease in long-term capital outflows, while the fact that domestic interest rates were higher than external rates discouraged short-term outflows. Another positive factor was the continued moderate improvement in foreign direct investment flows, which amounted to almost US$ 200 million in 1995.

The external debt remained in the US$ 4 billion range but diminished as a percentage of GDP. In terms of exports of goods and services, it declined from 143% in 1994 to 123% in 1995; interest payments were also lower, representing just over 3% in 1995.

URUGUAY

1. General Trends

After four years of rapid growth, the Uruguayan economy contracted by 3% in 1995 as a result of the fiscal adjustment undertaken by the Administration that took office in March and the slump in demand from Argentina. The annual rate of inflation dropped to 35%, the lowest rate since 1982, and the fiscal and external deficits narrowed. As a consequence of the recession, open unemployment rose to almost 11% and real wages declined by 3%.

The financial disturbances that swept over the region following Mexico's economic crash in late 1994 affected the Uruguayan economy only indirectly, through their impact on Argentina. This was because the banking system in Uruguay channels the bulk of its non-resident deposits to external borrowers and because the purchase and sale of private debt paper on the securities market are of negligible significance.

On the other hand, as has also occurred under similar circumstances in the past, the Uruguayan financial system increasingly came to be viewed as a haven within the subregion and therefore began to attract an additional inflow of funds from residents of neighbouring countries. However, the impact of the turnaround in external financial flows on the Argentine economy triggered such a sharp contraction in this country's demand for Uruguayan goods and services that stronger demand from Brazil failed to offset its effects.

For its part, the Administration that took office in March geared its economic policy to a rapid financial adjustment; this adjustment was to be accomplished chiefly through spending cuts, since, as private consumption slackened, a decrease in real income was anticipated. After climbing to 8% per year during 1990-1994, private consumption went down by 4% in 1995. The downturn in investment –which had expanded by one-third its total level during the previous four-year period– was on a larger scale (8%). As the physical volume of exports contracted less than the volume of imports, the country's large deficit in its external trade of goods and services diminished.

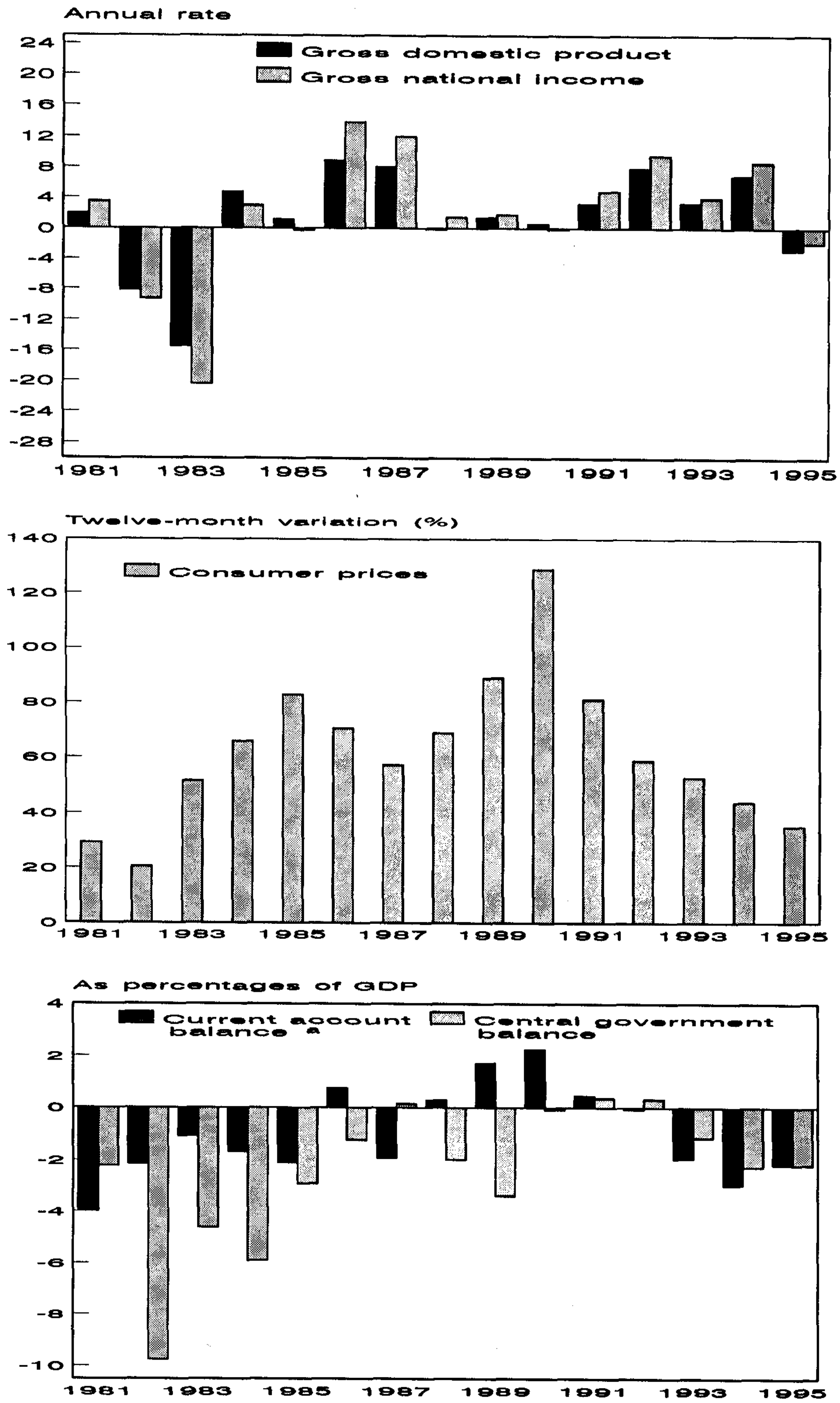
A strong trend towards a narrowing of the fiscal gap and a decline in the rate of inflation were the most notable features of the authorities' economic policy during the last quarter of 1995.

The financial programme for 1996 has been designed to bring inflation down to 20% by reducing the public-sector deficit to less than 1% of GDP and by devaluing the currency by an amount similar to the expected rate of inflation. With this aim in view, starting in April the devaluation rate applied to the floor of the flotation band was reduced to 1.8% per month. As of May, the cumulative variation in retail prices over the preceding 12 months had fallen to 30%.

The economy remained in a recession during the first few months of 1996. Trade in goods and services showed a widening deficit due to sluggish exports and a new burst of momentum in imports. Against this background, the unemployment rate rose to over 12%.

Since only moderate growth has been projected for the other countries of the Southern Common Market (MERCOSUR), the Uruguayan economy will probably recover only partially from the setback it suffered in 1995.

Figure 1
URUGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

2. Economic policy

The short-term objectives of the new Administration have been to bring inflation down and restore the economy's external competitiveness. For the longer-term, the reform of the social security system is high on its list of objectives in the area of structural change.

The implementation of the Southern Common Market early in the year marked the culmination of Uruguay's process of integration with Argentina, Brazil and Paraguay.

a) Fiscal policy

The new Administration's decision to place priority on the effort to reduce inflation by maintaining the currency band's rate of crawl at 27% per year caused increased importance to be attached to fiscal policy.

The public sector's fiscal deficit, which had represented 3% of gross domestic product (GDP) in 1994, widened to 3.7% in the 12-month period to March 1995. Given the fact that any increase in government borrowing was to be avoided, financing this deficit through monetary expansion would have been incompatible with the objective of lowering inflation to an annual rate of 35%.

The Administration's first actions after taking office in March were to increase the tax load and cut back on government spending. The minimum and maximum value-added tax (VAT) rates of 12% and 22% were raised to 14% and 23%, and the tax on personal income was raised and made applicable to the general public. In addition, the prices and rates charged for public-sector goods and services were raised in real terms. The authorities' management of public expenditure was geared towards slowing down investment, which had increased sharply, and reducing the proportion of current expenditure.

Fiscal policy thus assumed a procyclical character, inasmuch as, after following an expansionary line during the growth phase, it then began to focus on bringing about an adjustment, hence becoming contractionary, in anticipation of a fall-off in both domestic and regional demand due to the ripple effect of the Mexican economic crisis. Moreover, by awarding industrial firms a six percentage point reduction in employer contributions, fiscal policy was also used to buoy external competitiveness.

The adjustment proved so successful that the consolidated public-sector deficit shrank to 2.1% of GDP, which was three-tenths of a point below the target.

The pricing policy of public-sector corporations and, in particular, the cutback in capital expenditure enabled these firms to post a financial surplus equivalent to 1.3% of GDP, which was almost 1% above the figure for the preceding year. The central government surplus (even counting disbursements from the police and armed forces' pension funds) represented over 3% of GDP, thanks to a combination of higher revenues and lower current and capital expenditure. On the other hand, the deficit of the social security system widened from 5.2% to 5.8% of GDP, while the quasi-fiscal deficit generated by the financial system added another 0.6%.

The 2% real decline in fiscal revenues was primarily due to the concentration of external purchases within MERCOSUR, since it maintains a special system of preferences under which lower import duties are applied. About one-third of that decrease, however, was due to the effect of the contraction in domestic consumption on tax receipts.

b) Foreign exchange policy

The affirmation of its commitment to carry forward the country's existing exchange-rate policy was a priority matter for the new Administration, since it eased the uncertainty prevailing among economic agents regarding the consequences of the change in government and the repercussions of the Mexican crisis on the Argentine financial market.

The Central Bank thus maintained its scheduled devaluations at the rate of 2% per month for the minimum level of the 7%-wide flotation band. Accordingly, the peso depreciated by 27% against the dollar in 1995. Since the variation in domestic prices tended to be in line with the variation in the foreign-exchange anchor

Table 1
URUGUAY: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	-0.1	1.4	0.6	3.2	7.8	3.3	6.9	-2.8
Per capita gross domestic product	-0.7	0.8	0.1	2.6	7.2	2.7	6.3	-3.3
Gross national income	1.5	1.8	-0.1	4.8	9.6	4.0	8.6	-1.9
Gross domestic product, by sector								
Goods	-0.5	1.0	-2.3	1.2	5.8	-4.4	5.8	-2.7
Basic services	5.9	3.4	3.2	9.2	13.0	8.2	11.4	3.1
Other services	1.0	3.0	1.9	1.3	4.7	5.1	3.9	-3.2
	Percentages							
Contribution to growth of GDP [c]								
Consumption	0.4	1.5	-0.6	3.1	8.3	4.2	8.7	-3.2
Government	-0.3	0.2	0.3	0.2	0.2	0.1	0.6	0.0
Private	0.7	1.3	-0.9	3.0	8.1	4.1	8.2	-3.2
Gross domestic investment	-0.9	-1.1	0.0	3.1	1.6	2.0	1.7	0.3
Exports	0.7	1.6	1.7	0.3	3.3	0.5	1.7	-1.8
Imports	-0.3	-0.7	-0.4	-3.3	-5.4	-3.4	-5.2	1.9
	Percentages of GDP							
Gross domestic investment	12.1	10.8	10.8	13.5	13.9	15.4	16.0	16.7
National saving	12.4	12.4	12.8	13.9	13.9	13.1	12.2	13.9
External saving	-0.3	-1.5	-2.0	-0.4	0.1	2.3	3.7	2.9
	Percentages							
Employment and wages								
Activity rate [d]	59.4	59.7	59.4	59.6	59.5	59.0	60.6	62.1
Open unemployment rate [e]	8.9	8.6	9.3	9.1	9.0	8.4	9.1	10.6
Real average wage (Index: 1990=100)	102.3	109.7	100.0	103.8	106.1	111.2	112.2	109.0
	Growth rates							
Prices (December-December)								
Retail prices	69.0	89.2	129.0	81.5	58.9	52.9	44.1	35.4
Wholesale prices	60.5	80.7	120.7	68.6	46.9	31.1	41.0	27.7
External sector								
Terms of trade (Index: 1990=100)	102.9	105.5	100.0	100.6	105.1	106.8	115.4	117.7
Nominal bank exchange rate (pesos per dollar), annual average	0.359	0.606	1.17	2.02	3.03	3.95	5.06	6.35
Real effective exchange rate (Index: 1990=100)	86.7	86.3	100.0	88.1	84.1	76.8	76.6	79.4
	Millions of dollars							
Balance of payments								
Current account	22	134	186	42	-9	-244	-439	-348
Trade balance (goods and services)	325	474	499	235	150	-105	-237	-208
Exports	1 753	2 032	2 159	2 201	2 632	2 760	3 248	3 288
Imports	1 428	1 558	1 659	1 966	2 482	2 865	3 485	3 496
Capital and financial account	187	-6	-86	-429	-92	224	672	373
Overall balance	-38	65	136	82	138	189	238	209
International reserves (variation)	-47	-3	40	114	186	179	243	162
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	84.4	89.1	89.5	75.2	64.9	63.4	59.6	63.1
Net debt (as a percentage of GDP)	42.2	41.4	35.5	25.7	20.5	19.2	18.6	16.5
Net interest (as a percentage of exports)	17.4	17.2	14.9	10.6	7.1	5.3	5.0	2.5

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Non-financial public sector								
Current income	21.8	23.8	28.9	31.1	31.8	30.7	32.0	32.2
Current expenditure	22.4	23.5	24.5	25.7	26.4	27.7	29.0	29.1
Savings	2.4	0.3	4.4	5.4	5.4	4.0	3.0	3.1
Capital expenditure	3.8	3.8	4.0	4.1	3.9	4.8	6.0	4.5
Financial balance	-1.4	-3.5	0.4	1.3	1.4	-0.8	-3.0	-1.4
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	58.2	156.5	161.1	66.9	45.8	25.5	48.7	56.7
Net domestic credit	112.3	104.5	97.0	90.7	49.4	38.9	45.8	38.2
To public sector	106.6	77.6	85.0	17.7	60.1	31.4	48.0	7.5
To private sector	75.4	73.5	87.6	65.8	70.2	46.8	51.4	58.2
Money (M1)	62.4	69.1	112.3	95.5	70.1	58.4	42.2	31.9
Local-currency savings and time deposits	54.6	59.1	66.4	76.6	44.1	47.6	27.5	57.9
M2	58.1	63.5	87.5	86.4	58.3	53.9	36.4	41.6
Dollar deposits	97.2	144.4	132.3	77.7	45.7	29.5	48.5	47.2
	Annual rates							
Real interest rates (annualized)								
On deposits	-0.7	-2.3	-13.1	-3.1	-2.9	-8.7	-4.9	2.2
On loans	19.5	20.3	20.5	39.8	37.0	29.4	35.5	47.9
Equivalent interest rate in foreign currency [f]	8.7	4.7	0.4	10.9	9.1	10.3	9.0	9.3

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Interest rate deposits, deflated by the variation in the exchange rate.

Table 2
URUGUAY: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product [b] (Index: 1990=100)	114.9	111.9	114.9	117.0	119.2	123.0	123.3	123.6	122.1	121.2	115.3	119.3
Consumer prices (nationwide) (12-month variation, %)	54.3	56.4	53.0	52.9	47.9	42.6	41.3	44.1	45.3	44.9	42.2	35.4
Real exchange rate (Index: 1990=100)	80.1	78.1	75.4	73.4	73.1	72.8	80.3	80.3	80.2	79.4	78.6	79.2
Real interest rate (annualized, %)												
On deposits	-9.9	-16.5	-7.6	-0.7	1.6	-5.6	-6.8	-8.6	0.7	-2.0	1.2	8.7
On loans (not prime)	28.5	17.2	28.7	43.2	45.9	35.3	31.5	29.4	43.7	43.5	47.8	53.1
Money (M1) (12-month variation, %)	67.7	47.1	48.3	60.9	46.7	47.0	50.4	43.9	40.6	34.1	33.7	32.3

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] On the basis of seasonally-adjusted figures at constant domestic prices.

and the relevant portion of external inflation, the local currency's ability to compete against the basket of currencies of Uruguay's major trading partners remained virtually unchanged. This was the result of the Uruguayan peso's depreciation against the Brazilian real and its appreciation against the Argentine peso and the currencies of the other countries outside the subregion. Nevertheless, the annual average real exchange rate in 1995 was higher than the average registered for the preceding year owing to the sharp appreciation of the Brazilian currency during the second half of 1994.

c) **Monetary policy**

Under this foreign exchange policy, monetary policy played a passive (endogenous) role near the boundaries of the currency band but became more aggressive within it. During most of 1995, the exchange rate for the dollar stayed at or very close to the floor of the band.

At this point, the Central Bank's policy management role was limited to maintaining the desired level of liquidity while avoiding any sharp swings. The tools used by the Central Bank to accomplish this were the short-term interest rates that it paid on deposits made by the country's banks, the sale of peso-denominated Central Bank securities on the open market, and the interest it paid on interest-bearing reserves.

The monetary base expanded 22% in 1995 owing to an increase in international reserves (US$ 210 million). Overall, net domestic lending by the Central Bank had a contractionary effect, but para-fiscal expenditure generated about one-third of the growth of base money. The redemption of bonds that had been floated as a means of regulating the stock of money also added to the local money supply. On the other hand, financial institutions' deposits with the Central Bank had a contractionary impact. Sales of six-month foreign-currency "monetary regulation bonds" brought in more than enough to cover the increase in credit to the public sector (most of which consisted of credits to the central government that were denominated in foreign currencies and were paid through the Central Bank). This method of financing marked a departure from the approach used in previous years, when the Government had issued 10-year Treasury bonds at floating rates linked to the London Interbank Offered Rate (LIBOR).

The money supply expanded 32% in 1995, which, broadly speaking, meant that M1 kept pace with nominal transactions. Savings and time deposits increased more swiftly (58%), partly because of technological developments such as increased availability of automatic teller machines and the more extensive use of bank cards for the payment of personal wages into savings accounts. Towards the end of the year, higher real returns also played a part, since, in nominal terms, interest rates declined more slowly than inflation. Another factor contributing to the expansion in quasi-money was the high rate of return in dollars of interest paid on local-currency deposits at a time of strong public confidence in the system of pre-established adjustments in the exchange rate. The broadly defined money supply (M2) thus grew (42%) more than consumer prices.

Bank credit to the private sector swelled almost 17% in real terms. This expansion was derived from the increase in credit denominated in foreign currency, which represented 80% of total credit, since local-currency lending remained fairly constant. Consumer credit, which has low default rates, showed the highest increase and mainly took the form of credit cards issued by banks or by companies specializing in this form of financing that have been founded by banks in partnership with other business firms.

Offshore transactions continued to expand. Indeed, following the Mexican crisis and its impact on the Argentine financial system, the level of these types of transactions surged. The expansion of this market was manifested in an increase not only in the volume of deposits by and loans to non-residents but also in the number of institutions involved. Although almost all the institutions in the banking system carry out operations of this sort, the number of firms whose main business activity is external financial intermediation increased in 1995. Non-resident deposits grew by one-third in 1995, amounting to close to US$ 3.15 billion. Loans to non-residents climbed at a slower pace, reaching US$ 950 million by the end of the year.

d) **Structural reforms**

As part of its structural reform process, Uruguay joined forces with Argentina, Brazil and Paraguay within the framework of the Southern Common Market, which became operative on 1 January 1995. A common external tariff entered into force and the bulk of the trading operations among these countries were liberalized. Since these instruments are subject to a list of exemptions, this will be an imperfect customs union for some time to come. In the course of the year, advances were made in the negotiations concerning the possibility of Bolivia and Chile becoming members of MERCOSUR and in the formation of a free trade zone with the European Union.

Intra-MERCOSUR trade has intensified considerably. In 1995, the subregion bought 47% of Uruguay's merchandise exports and sold it 46% of its imports, compared with 35% and 40%, respectively, in 1990.

As another facet of the country's structural reform process, changes made in the social security system in 1995 became effective in April 1996. The level of expenditure under Uruguay's pay-as-you-go social security system has been very high (over 16% of GDP) and has been running up a deficit equivalent to around 6% of GDP. In 1995, this distributive system was replaced by a mixed scheme consisting of a pay-as-you-go component and a funded component. The new system divides up pensionable remuneration into three brackets. Up to a salary level of close to US$ 800, both employer and employee contributions are compulsory and are paid into the distributive (or joint) scheme. Between this level and US$ 1,600, employer and employee contributions are still compulsory but are apportioned to two different funds; the employer's contribution is credited to the public distributive system and the employee's contribution is paid into the individual funded pension system, which is managed by private companies. Above this second limit, contributions are channeled entirely into the funded system and are optional. The new system is mandatory for workers under 40 years of age and optional for older employees.

3. **The main variables**

a) **Economic activity**

The economic turnabout was led by domestic demand –which contracted almost 3% after expanding at an average annual rate of 8% in 1991-1994– and was the key factor in the performance of the Uruguayan economy in 1995. External sales and imports, measured at constant prices, recorded similar declines. Thus, GDP fell back almost 3%, after having grown at an annual pace of 5% during the preceding four-year period.

The fiscal adjustment –particularly as reflected in cutbacks in public investment during the first half-year– and the shrinkage of domestic demand in Argentina in the second half of the year were the main causes of the erosion of total demand. The turnaround in private consumer spending was considerable; having expanded by 32% in the four preceding years (11% in 1994), it receded 4% in 1995. The downswing in gross fixed capital formation was even more pronounced. In the case of investment, the 4.5% increase recorded the year before was cancelled out by a much sharper decline (7.6%) in 1995. Nevertheless, the notable rise in stocks, especially in the case of agricultural products, more than made up for this setback, and gross domestic investment therefore exceeded its 1994 level. This overall showing was compounded by a drop in the real level, in terms of value, of the demand for tourism services, almost all of which is generated by residents of neighbouring countries, especially Argentina.

The external demand for goods was also affected by the decline in demand from Argentina. In particular, there was a sharp reduction in this country's purchases from the automotive industry, whose level of production tumbled to half its former level. On the other hand, demand from Brazil and stronger prices for traditional exports served to boost certain branches of industry.

Weakening demand, in its turn, prompted a real decrease (-6%) in the level of imports, although it was still double the 1990 figure.

Within this economic environment, the most seriously affected activities were construction (-15%) and commerce, restaurants and hotels (-11%). In the first case, the downturn was evident both in public works, on account of the fiscal adjustment, and in private construction, which suffered from the fact that building projects in Punta del Este and neighbouring resorts came to a virtual standstill.

The slump in manufacturing was also drastic and was a result of downswings in transport equipment, textiles, machinery and metal products, non-metallic minerals, chemicals, paper, meat and sugar. Nevertheless, with the return to normal operations of the State-owned oil refinery, which had been undergoing retrofitting during the previous year, the overall decline in manufacturing was no more than 3%.

By contrast, electricity services expanded –although the low water levels caused by the drought prompted an increase in thermo-electric power generation– as did transport and, above all, communications. There was also an increase in agricultural production, as a result of advances in farm output. Gains in rice, barley and sunflower production accounted for much of this result, since the wheat harvest was down. In the livestock subsector, increases in the output of beef and dairy products compensated for the decline in wool production.

b) **Prices, wages and employment**

As a consequence of the fiscal adjustment and the overall recessionary situation in the subregion, for the first time in several years consumer price movements tended to fall into line with the combined effect of the rate of exchange and imported inflation. Indeed, the price of the dollar was up 27%, while the rate of international inflation affecting the country (approximately 7%) served mainly to underscore the higher levels of prices in dollars in European countries, inasmuch as, unlike the situation during previous years, inflation originating in neighbouring countries was quite low. In this context, consumer prices rose 35% in 1995, the lowest rate on record since 1982.

The weakness of domestic demand affected the labour market, reducing both the demand for labour and the real average wage (the latter was 3% lower than in 1994). Since personal income tax rates were also increased in the course of the year, the real erosion of wage-earners' income was even greater.

In addition to the decline in the demand for labour, there was also an increase in the labour supply. From a long-term perspective, however, employment levels were high and the activity rate (62%) was above the average for the decade (60%). Nonetheless, the average unemployment rate for the year was close to 11%, with the highest level in the last nine years being recorded in the second half of 1995.

The rise in unemployment was particularly intense in the construction sector, since it was in the downswing of its business cycle, and in commerce, where production fell back sharply as a result of the decline in domestic demand. Employment was also lower in manufacturing; a downward trend has been in evidence in this sector for a number of years now and has brought the unemployment rate in manufacturing activities in Montevideo to close to 13%. Agriculture and transport and communications services managed to sidestep this general slump.

c) **The external sector**

As in previous years, foreign capital inflows were more than sufficient to finance Uruguay's current account deficit, and the country's international reserves therefore rose once more. In 1995, the gap in the current account was reduced to 2% of GDP (versus almost 3% in 1994) and external funds equivalent to over 3% of GDP were received.

In the first half of the year, Brazil's implementation of the Real Plan had a favourable impact on Uruguay's external accounts, whereas the fall-off in demand from Argentina had just the opposite effect. The terms of trade remained stable, since both merchandise export and import prices increased by slightly over 6%.

The increase in the value of commodity exports made the largest contribution to the improvement in the trade balance, since earnings from merchandise exports rose almost 11%, whereas purchases were up by only 3%. Even so, the trade balance showed a US$ 565 million

deficit, equivalent to just over 3% of GDP. The expansion in exports was entirely attributable to the increase in purchases by Brazil, which were 43% higher than in 1994 and represented one-third of total exports –the largest share ever to be accounted for by a single trading partner. The expansion took place in the first half-year; in the second, there was an abrupt slowdown. The sluggishness of economic activity in Argentina, on the other hand, resulted in a 30% reduction in exports to that country, whose share of Uruguay's total exports thus shrank to 13%. Weakening Argentine demand also affected income from tourism, which declined 3%.

Traditional exports recorded the strongest growth (16%) due to higher prices, since shipments of meat and wool were lower than in the previous year. The value of external sales of all non-traditional exports was up 8%. Another factor contributing to this increase was the upswing in exports of commodities, in particular dairy products, barley, fish and rice. The continuing brisk expansion of wood exports represented the initial returns on major forestry investments. By contrast, exports of transport equipment were down by a full half following a rapid growth phase based on bilateral agreements with neighbouring countries.

Merchandise imports continued to advance, albeit at a substantially slower pace. Purchases of capital goods recorded the highest rise (12%), while the steady growth of imports of consumer goods brought their share of the total to 28%. Imports of raw materials and of non-petroleum intermediate goods declined, however, as a result of the downturn in manufacturing.

The deficit registered on the external current account was more than offset by capital inflows of around US$ 560 million. Official borrowing in the form of sales of debt instruments brought in half of the inflow. Direct investment was again a significant factor, contributing a total of US$ 120 million. Net errors and omissions climbed to US$ 185 million; although private capital inflows accounted for a substantial portion of this amount, unregistered purchases by non-residents, in particular by Argentines, represented a considerable percentage as well. Thus, international reserves held by the monetary authority (the Central Bank and Banco de la República Oriental del Uruguay) continued to increase, as has been the pattern for over 10 years now.

The public sector's gross external debt rose 5%. Private debt not backed by government guarantees, including non-residents' foreign-currency deposits in Uruguayan banks, increased by almost US$ 1 billion, but as banks did not lend out the entire amount on deposit, their net debt decreased to less than US$ 450 million. Total external debt service remained at about 4% of GDP, of which three quarters corresponded to interest payments.

VENEZUELA

1. General trends

In 1995, the Venezuelan economy continued to be marked by internal and external imbalances, despite price control and exchange rate measures in place since mid-1994 in an attempt to moderate their impact. Although this situation created uncertainty and inflationary expectations and restrained domestic activity, the economy benefited from greater international demand for oil and gas, together with expanded output by the national oil company, which was committed to implementing an investment programme over a period of several years. Accordingly, oil production rose by about 6%, enabling the Venezuelan economy to achieve 2% growth after two years of recession. This was not enough, however, to prevent a further rise in the unemployment rate to over 10% of the labour force in the second half of the year.

Imbalances persisted in the fiscal, monetary and external spheres and were compounded by interaction between the three. The fixed exchange rate system that remained in place for most of 1995 was a major obstacle to government efforts to curb the fiscal deficit accumulated over a period of several years. In consequence, the public sector ran a large deficit, equivalent to 6% of GDP, though lower than that of 1994, since the most serious phase of the 1994 banking crisis had been surmounted. The deficit fed money supply growth and put pressure on prices, thereby contributing to an outflow of capital and a loss of reserves, which foreign exchange controls could not prevent. The decline in reserves amounted to US$ 1.9 billion, in spite of a positive trade balance and current account position attributable to higher export earnings.

With abundant liquidity still in the system and demand for money falling, inflation hovered around 57%, though this figure was lower than the previous year owing to price controls and maintenance of the nominal exchange rate for most of 1995. The rise in prices had an adverse effect on real wages, since nominal wages failed to keep pace with inflation.

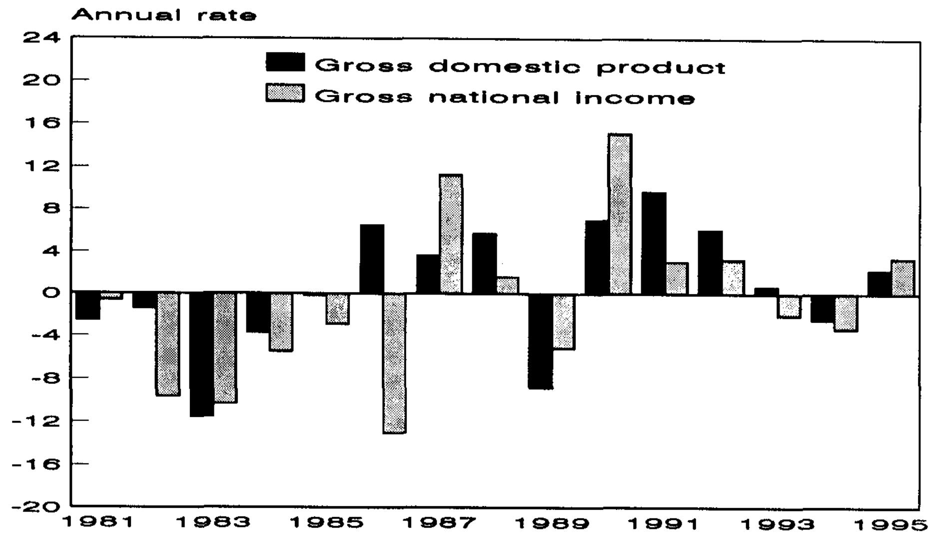
Faced with the problem of overcoming these imbalances and curbing exchange losses within the framework of the economic policy then in place, the authorities decided in April 1996 to begin implementing a wide-ranging adjustment programme dubbed the "Agenda Venezuela", which provided, among other things, for the lifting of exchange rate and price controls. They also renewed efforts to seek additional funding from the International Monetary Fund (IMF), the World Bank and the Inter-American Development Bank (IDB).

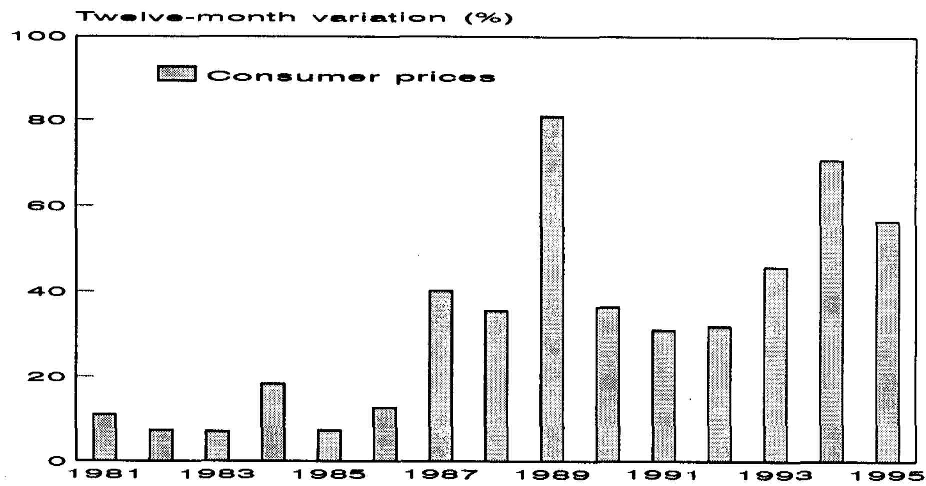
2. Economic policy

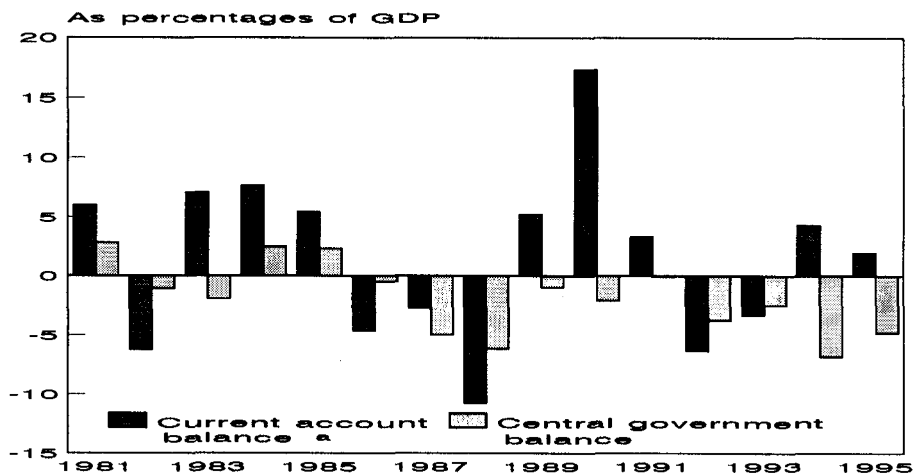
The Government left in place the exchange and price controls it had introduced in July 1994 and persevered in its efforts to rein in the fiscal deficit, which was creating a highly inflationary climate. Once it was no longer bound by an active exchange-rate policy, the Central Bank of Venezuela attempted to mitigate the pressure on prices by ensuring that liquidity did not expand excessively.

Due to the difficulties in achieving those objectives and the decline in foreign exchange reserves despite exchange controls, the authorities began in the second half to lay the groundwork for a return to self-regulating goods and foreign exchange markets; their efforts took the form of the above-mentioned adjustment programme, which served as the framework for

Figure 1
VENEZUELA: MAIN ECONOMIC INDICATORS







Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

loan negotiations with the International Monetary Fund and other multilateral agencies. The programme was finally implemented in mid-April 1996, and it was also at this time a preliminary agreement was reached with the IMF on a stand-by loan of US$ 1.4 billion. The chief features of the programme were the dismantling of exchange controls and liberalization of foreign currency transactions, the gradual lifting of price controls, and measures designed to reduce the fiscal deficit substantially.

As part of the opening of the oil industry to foreign capital, in 1995 the Congress passed a bill allowing foreign firms to explore for oil in new areas and take part in oil and gas production on a profit-sharing basis with Petróleos de Venezuela S.A. (PDVSA); this move resulted in tendering on several exploration areas in January 1996. There was no change in tariff policy, apart from the reduction of some duties applicable to the motor vehicle industry and the replacement of the price-range scheme of farm price supports then in effect with the Andean Group-scheme.

a) **Fiscal policy**

In 1995, the central government deficit declined only slightly to a little under 5% of GDP, just one percentage point less than in 1994. Overall the public sector recorded a financial deficit, though there was a significant improvement with respect to the 1994 budget results, thanks to sizeable disbursements in the form of assistance to banks; the deficit narrowed from the equivalent of 14% of GDP in 1994 to less than 6% in 1995, owing to improved results by decentralized public-sector agencies, such as the Deposit Insurance and Bank Protection Fund (FOGADE), responsible for providing financial assistance to ailing banks.

Consequently, the current revenues of central government, which were equivalent to 16% of GDP, continued to lag behind expenditure, which amounted to 21% of GDP. This shortfall was chiefly a result of the maintenance over most of the year of a fixed exchange rate for the bolívar, which prevented the local-currency equivalent of dollar earnings, of crucial importance to the budget, from increasing in step with other budget items affected by the high domestic inflation rate.

For example, revenues from PDVSA taxation increased by less than 40% in current bolívares, i.e., declined in real terms, in a year in which the firm posted its largest net dollar profit ever. The decline meant that the oil sector's contribution to fiscal income dropped yet again and accounted for less than 50% for the second year in a row. The percentage of central government financing provided by oil revenues had been on the wane since the start of the 1990s, tax revenues from petroleum declined from approximately 19% of GDP in 1990 to below 8% in 1995.

Non-oil revenues decreased in real terms, despite the tax reforms introduced in 1994, especially the application of the general sales tax to wholesale transactions and luxury consumption, receipts from which more than doubled. Income tax receipts roughly kept pace with inflation. Together, the two taxes contributed more than two thirds of non-oil revenues.

Expenditures were affected primarily by the growth in interest payments on the public debt to nearly 5% of GDP. This growth was due in particular to payments on domestic bonds. The drive to reduce spending was once again reflected in a low level of government fixed investment, which again accounted for barely 3% of the total. Analysis of the distribution of expenditure by sector indicates that, debt servicing aside, the greatest relative increase was for social development, while the largest sums continued to be earmarked for education, though not in amounts sufficient to keep up with inflation. The second largest component of budget expenditure was defence, which remained unchanged in real terms, thus overtaking health spending, which grew at only half the rate of inflation.

With these results, central government saving was meagre, equivalent to less than one percentage point of GDP. Moreover, the gap between total expenditure and income might well have been greater, were it not for the fact that the Government was behind in debt service payments and in wage and transfer payments. The gap was covered largely by domestic borrowing through the sale of government securities and central bank financing. Securities were also placed in the German market in the

Table 1
VENEZUELA: MAIN ECONOMIC INDICATORS

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Growth rates							
Growth and investment [b]								
Gross domestic product	5.7	-8.8	7.0	9.7	6.1	0.7	-2.5	2.3
Per capita gross domestic product	3.0	-11.2	4.4	7.1	3.6	-1.6	-4.6	0.1
Gross national income	1.6	-5.1	15.2	3.1	3.3	-2.0	-3.3	3.4
Gross domestic product, by sector								
Goods	6.1	-8.4	9.9	10.2	5.4	2.9	-1.7	3.7
Basic services	8.0	-4.3	1.3	5.8	5.1	1.6	-2.2	3.8
Other services	5.7	-8.8	4.3	7.9	6.3	-2.1	-2.7	-1.6
	Percentages							
Contribution to growth of GDP [c]								
Consumption	7.7	-9.0	1.6	8.2	7.2	-0.9	-4.8	2.2
Government	0.8	-0.2	0.4	1.3	0.0	-0.4	-0.6	0.0
Private	6.9	-8.9	1.1	6.9	7.2	-0.5	-4.2	2.2
Gross domestic investment	3.2	-12.0	-0.9	8.2	6.4	-4.1	-6.2	2.8
Exports	1.6	1.2	5.5	2.6	-0.6	3.8	2.0	1.7
Imports	-6.8	11.0	0.8	-9.3	-7.0	1.8	6.5	-4.4
	Percentages of GDP [b]							
Gross domestic investment	22.8	11.9	10.2	16.8	21.9	17.7	11.8	14.2
National saving	10.8	16.9	27.2	20.1	15.0	14.0	16.3	16.7
External saving	11.9	-5.0	-17.0	-3.3	6.8	3.6	-4.5	-2.5
	Percentages							
Employment and wages								
Activity rate [d]	56.7	57.5	58.6	60.1	59.6	58.2	59.1	61.6
Open unemployment rate [e]	7.3	9.2	10.4	9.5	7.8	6.6	8.7	10.3
Real minimum wage (Index: 1990=100) [f]	163.3	126.1	100.0	86.5	123.3	108.0	121.0	113.3
	Growth rates							
Prices (December-December)								
Retail prices	35.5	81.0	36.5	31.0	31.9	45.9	70.8	56.6
Wholesale prices	17.0	106.2	20.4	23.1	26.0	47.4	89.5	
External sector								
Terms of trade (Index: 1990=100) [b]	72.2	91.0	100.0	83.4	81.0	76.4	76.8	77.0
Nominal exchange rate (bolívares per dollar)	16.61	34.68	46.91	56.82	65.60	87.30	148.63	176.84
Real effective exchange rate (Index: 1990=100)	81.2	96.1	100.0	93.9	88.5	88.9	92.5	72.9
	Millions of dollars							
Balance of payments								
Current account	-5 809	2 161	8 279	1 736	-3 749	-1 993	2 450	1 507
Trade balance (goods and services)	-3 891	4 712	9 355	2 698	-1 629	90	4 609	3 279
Exports	11 052	13 988	18 806	16 388	15 514	16 119	17 197	19 757
Imports	14 943	9 276	9 451	13 690	17 143	16 029	12 588	16 478
Capital and financial account	-2 043	-5 432	-5 023	1 741	2 700	2 002	-3 636	-3 182
Overall balance	-4 735	-1 668	1 514	1 961	-1 348	-530	-1 484	-1 901
International reserves (variation)	-3 872	1 077	4 376	2 645	-845	-144	-1 173	-1 901
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	66.5	82.2	74.5	68.8	66.3	68.2	70.0	49.9
Net interest (as a percentage of exports)[g]	14.7	16.5	5.9	-0.2	5.4	6.2	4.4	...

Table 1 (concl.)

	1988	1989	1990	1991	1992	1993	1994	1995[a]
	Percentages of GDP							
Central government								
Current income	18.2	19.4	22.4	22.8	17.2	16.5	17.2	15.9
Current expenditure	16.8	16.7	18.7	16.9	15.6	13.9	14.6	15.1
Savings	1.4	2.7	3.7	5.9	1.6	2.6	2.6	0.8
Capital expenditure (net)	3.5	1.5	2.6	2.1	3.2	2.8	2.4	2.9
Financial balance [h]	-6.1	-1.1	-2.1	-0.1	-3.8	-2.5	-6.8	-4.8
	Growth rates							
Currency and credit								
Money balances of banking system								
Net international reserves	-25.4	211.9	69.4	51.0	18.9	11.7	35.5	45.1
Domestic credit [i]	41.6	-21.1	49.4	47.2	17.5	43.1	108.4	38.3
To public sector	811.3	87.0	0.6	-63.2	191.0	254.9	182.3	110.1
To private sector	30.8	13.2	25.1	47.9	33.1	12.0	6.5	46.4
Money (M1)	22.8	9.5	41.2	51.2	8.3	10.6	129.9	34.3
Local-currency savings and time deposits	9.1	64.2	72.5	48.7	23.3	32.1	29.9	38.3
M2	15.1	38.6	60.9	49.5	18.4	25.7	56.3	36.7
	Annual rates							
Real interest rates (annualized)								
On deposits	-17.2	-24.0	-2.3	3.9	7.0	16.9	-11.0	-17.7
On loans	-17.5	-27.8	3.6	11.3	15.0	24.8	2.6	-5.2
Equivalent interest rate in foreign currency [j]	9.0	-20.3	15.3	12.6	9.1	29.6	9.4	-1.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). [f] Beginning in June 1992, includes food and transport allowance. [g] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [h] Includes as expenditure net loans granted, extrabudgetary expenditure and Central Bank losses, which in 1995 were equal to 2.8% of GDP. [i] Includes the net amount of other accounts, which in 1995 was equal to -1,290 billion bolívares. [j] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
VENEZUELA: MAIN QUARTERLY INDICATORS

	1993				1994				1995[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product (Index: 1990=100)	119.9	120.3	123.5	118.8	109.4	109.8	102.2	101.5	119.4	119.4	126.2	126.5
Consumer prices (12-month variation, %)	34.1	35.9	39.0	45.9	47.5	60.2	69.6	70.8	70.4	61.3	51.7	56.6
Real effective exchange rate (Index: 1990=100)	90.0	88.8	87.9	85.5	83.8	97.1	101.6	88.2	81.2	73.9	67.7	69.0
Real interest rate (annualized, %)												
On deposits	14.8	23.4	12.8	16.7	17.3	-19.0	-19.0	-23.3	-12.3	-21.4	-8.8	-28.5
On loans	24.6	33.7	21.1	19.9	32.8	-6.4	-7.8	-8.1	3.9	-10.4	4.6	-19.0

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

amount of 500 million deutsche marks, although on less favourable terms than on previous occasions. This was the first issue placed abroad by Venezuela since 1993.

The task of putting public finances in order formed a central focus of the economic adjustment programme contained in "Agenda Venezuela", a plan aimed at drastically reducing the public deficit in 1996, despite elimination of the bank loan tax (which Congress declined to extend). In April 1996 a major increase in petrol prices was announced, and Congress was presented with a proposal to raise the tax rate on wholesale transactions and on luxury consumption (renamed the "general sales tax") from 12.5% to 16.5%. Also contemplated were measures to reduce tax evasion, raise utility rates, revive the privatization programme, grant subsidies for public passenger transport and provide a comprehensive social programme to alleviate the adjustment programme's adverse effects on lower-income groups.

b) **Foreign exchange policy**

The exchange controls introduced in June 1994 remained in place during 1995, and the exchange rate of 170 bolívares to the dollar held until mid-December. As a result, the strong rise in domestic prices translated into a sharp appreciation of the real exchange rate. Halfway through the year, national exchanges were authorized to trade in bolívares dollar-denominated Brady bonds representing external public debt, a step that amounted to the creation of a parallel foreign exchange market. The exchange rate implicit in these transactions gradually rose, reaching around 350 bolívares to the dollar in late 1995 and 500 bolívares in March 1996.

In October 1995, it was announced that this implicit exchange rate would officially apply for travel abroad and credit card transactions outside Venezuela. This measure remained in effect until 10 December, when the Government and the Central Bank adjusted the exchange rate, applying a uniform rate of 290 bolívares to the dollar for all transactions.

The promised return to a floating exchange rate took effect on 22 April 1996, as part of "Agenda Venezuela". From that date onwards, the bolívar was allowed to float freely and in the absence of Central Bank intervention in the foreign exchange market, it quickly stabilized at around 465-470 bolívares to the dollar. However, the Central Bank contributed to this result, as it reduced demand for dollars by offering high yields at its money desk, which resumed operation for the first time since 1992. The Central Bank subsequently intervened in the foreign exchange market in order to shore up the exchange rate and early in the second half of 1996 set up a currency band system under which the bolívar was allowed to float within a range of 7.5% on either side of a central parity of 470 bolívares to the dollar, which was to be increased by 1.5% a month to the end of the year.

c) **Monetary policy**

After following an active policy of selling securities in 1994 in order to absorb part of the liquidity generated by the public sector, the Central Bank decided in mid-December of that year to suspend its issues in order to facilitate the sale of government bonds. Open market operations recommenced in late January 1995 with a new instrument known as "monetary stabilization bonds" (TEMs), which replaced zero-coupon bonds.

The financing of the budget deficit was the chief factor contributing to money supply growth in 1995. Central Bank credit to the public sector practically doubled during the period, and credit to the central government increased at an even greater rate. The injection of liquidity continued to stimulate demand for foreign currencies and helped bring about a loss of international reserves, which served to moderate the effect of the extra liquidity on the growth of the monetary base until the bolívar's devaluation in December.

Given this moderate expansion in liquidity, the Central Bank stepped up open market operations at certain times with the aim of supporting the trend. Over the year as a whole, however, new issues were insufficient to offset redemptions of maturing securities. This caused the monetary base to expand by roughly 25% in 1995, while the money supply (M1) increased by about 34%, far less than nominal GDP. Growth in

broad money (M2) was only slightly higher (37%). Real balances held by individuals continued to decline during the first quarter of 1996, while nominal liquidity rose by a mere 6%.

The decline in real balances reflected not only trends in the money supply, but also a noticeable decline in demand for money in a context of raised expectations of inflation and devaluation, together with persistently low interest rates. Rates on deposits continued to be negative in real terms, as were rates on loans for a large part of the year. To provide the market with guidelines, the Central Bank changed the regulations governing upper and lower limits for rates during the year.

The trend towards negative real interest rates intensified in the first quarter of 1996. However, in the last week of April, following the dismantling of controls on the foreign exchange market and the elimination of the above-mentioned limits, interest rates began to move sharply upward as a result of intervention by the Central Bank, which offered high rates at its money desk and on its sales of TEMs. The rise however, did not offset the high prevailing rate of inflation. The yield on TEMs subsequently dropped to around 40% in early June. The "Agenda Venezuela" provided for a rise in interest rates, which, once inflation had declined, would result in positive real rates on loans and deposits in coming months.

3. The main variables

a) Economic activity

GDP rose by 2.3%, which was barely sufficient to compensate for the decline in per capita GDP registered in 1994. Gross national income grew at a faster rate, owing to favourable trends in foreign transactions.

With the domestic economy sluggish, it was external demand which gave the economy momentum and boosted output. A leader was the oil sector, which grew by about 6%, with both production and exports of petroleum maintaining the upward trend evident in recent years. Crude oil production climbed from an average of 2.5 million barrels per day in 1994 to 2.75 million in 1995, while exports of crude oil and refined products rose from 2.3 to 2.5 million.

In addition, investments by oil companies in Venezuela provided a stimulus to other local industries; the latter, together with a number of export-oriented non-oil industries, were able to compensate for the poor performance of the rest of the economy, which was hurt by yet another decline in private-sector investment (-15%). Thanks to investments in the oil sector, however, total fixed investment decreased by only 1% and as a result continued to be equivalent to a little under 14.5% of GDP.

Since external saving did not contribute to this level of investment, national saving was clearly higher, although even so it did not exceed 17% of GDP, 10% lower than in 1990. Nevertheless, domestic saving was close to 30% of GDP, owing to the need to meet external obligations and other effects of external transactions.

Imports, the other component of aggregate supply in the economy, expanded significantly (19%), fuelled by the increasing real appreciation of the local currency and the build-up of inventories due to expectations of devaluation.

In keeping with this pattern of activity, sectors producing tradable goods, other than the oil sector, grew by over 4%, while sectors producing non-tradables contracted by almost 1%. The worst performer in this last category was the construction industry, which suffered a slump for the third year running (on this occasion -11%). Another major factor shaping the overall trend was the decline of more than 3% in the important sector of commerce, restaurants and hotels. On the other hand, the two mainstays of the economy, mining and manufacturing, whose tradable output (including oil production and refining) was predominant, grew by around 5% and 7% respectively. Once more there was a notable increase in bauxite production.

These results were reflected in trends in the mining-based processing industry: production of steel, aluminium, and petrochemicals such as olefins and fertilizers increased, generally by significant amounts. In contrast, cement production felt the impact of the slump in the

construction industry. In addition, there was a decline in the number of motor vehicles assembled locally, which in turn depressed tire production.

For the first time in the decade, the agricultural sector, a relatively insignificant contributor to GDP, was unable to maintain its previous level of production, despite improved harvests of products for domestic consumption (except fruit) and increased fish catches.

b) **Prices, wages and employment**

During 1995 the Government continued to control the prices of some basic goods and services, a policy that entailed periodic authorized readjustments. In this context, the relatively moderate growth in liquidity and the maintenance of the exchange rate meant that the increase in the consumer price index (CPI) was lower than the previous year, though it was still high. Prices rose by almost 57% in 1995, compared with 71% in 1994, with the wholesale price index recording a slightly smaller increase. This sizeable rise in prices was chiefly attributable to reduced demand for money and its counterpart, increased velocity of circulation, in a climate of raised inflationary expectations.

The factors that moderated price increases were most in evidence during the first three quarters of 1995, when inflation slowed. Devaluation of the bolívar in December led to a fresh spurt in prices. Inflation further intensified following the devaluation, an increase in petrol prices and the elimination of controls that occurred in April 1996. By the end of the first half of 1996, the cumulative inflation rate over the previous 12 months exceeded 100%. The adjustment programme called for a sharp slowdown in prices in the second half.

Due to these factors, local products increased more in price than imported items. The rise in CPI originated primarily in the service sector, including both public services (electricity, transport and communications, among others) and private services (rents, education, restaurants and hotels), which because of their non-tradable nature were less exposed to competition from imports. Late in the year, however, there were steeper price hikes on durable goods.

Inflation had a strong impact on real wages and salaries, which again declined (by around 14% in urban areas), since the wage increases authorized in 1995 did not keep pace with inflation, despite the anti-inflationary measures adopted. One government initiative was to grant subsidies to private-sector workers on lower incomes; in conformity with labour regulations, it also raised public-sector wages by some 30% and readjusted the urban minimum wage from 21,000 to 31,000 bolívares.

The expansion of domestic activity was not sufficient to absorb the nearly 600,000 workers who entered the labour market, many because of declining living conditions. The employment rate rose, but so did the open unemployment rate, which climbed from 8.5% in the second half of 1994 to 10.2% in the same period of 1995. The proportion of workers employed in the informal sector varied little from the high level recorded the previous year; more than 48% of workers fell into this category as of late 1995, compared with under 41% two years before.

c) **The external sector**

For the second year in a row, the balance-of-payments current account showed a surplus in 1995, although at US$ 1.5 billion it was considerably lower than the figure for 1994 (US$ 2.45 billion). This result was once again due to the large merchandise trade surplus (US$ 6.9 billion), since the service and income profits balance continued to be in deficit.

Again in 1995, there was net outflow of capital; though lower than the previous year, the figure was close to the US$ 3.2 billion mark. Consequently, foreign currency reserves shrank by US$ 1.9 billion in spite of the exchange controls in effect. By the end of the year, the level of international reserves had declined to less than US$ 11 billion, enough to finance eight months' worth of imports of goods and services.

The merchandise trade balance benefited from a new expansion of exports, although, in contrast to the previous year, the value of imports also rose. Greater international demand for oil, stemming in part from the economic upturn in the developed countries, led to an increase in the average price of Venezuelan fuels from

US$ 13.20 per barrel in 1994 to US$ 14.80 per barrel in 1995. This improvement, combined with expanded export volumes, resulted in over US$ 1.8 billion in additional sales, which nonetheless did not match the high level recorded in 1990. Oil continued to be the leading export product, with a share of more than 70% of total merchandise exports.

With regard to non-oil exports, the bulk of the increase in sales was in aluminium and petrochemicals, the two main categories after oil, which experienced growth of around 50%. In contrast, sales of gold, which had shown promising growth the two previous years, fell by three quarters. Colombia consolidated its position as the leading market for Venezuela's non-traditional exports, while the relative share of the United States, the second most important market, continued to decline.

Despite foreign exchange rationing at the official price, imports rose by US$ 3.4 billion, marking a reversal of the downward trend evident in the two preceding years. The level of imports thus reflected large pent-up demand, resulting from the maintenance of the local currency's nominal value, and the build-up of inventories in expectation of a devaluation. Much of the increase however, was due to a significant rise in unit prices. In terms of volume, the expansion was concentrated in consumer goods and raw materials; in contrast, imports of building materials declined. Transport equipment was responsible for the slight increase in capital goods purchases, since imports of machinery and tools fell by about 10%.

Trade in services resulted in a deficit of almost US$ 3.6 billion, larger than the previous year's, despite the fact that foreign travel expenses, the main item in this account, declined slightly due to changes in the availability and price of foreign exchange authorized for the purpose. The deficit on the factor income account was attributable to public debt interest payments; such payments exceeded US$ 1.9 billion in 1995.

The deficit recorded on the capital and financial account was attributable notably to the amortization of long-term external debt and the outflow of short-term private capital. Amortization amounted to over US$ 3.2 billion, a considerable increase over the preceding year. Adding in higher interest payments, total external debt service reached the unprecedented figure of over US$ 6.3 billion in 1995. Owing to the net deficit in these capital flows, total external indebtedness declined for the second consecutive year, to around US$ 38.7 billion by the end of 1995. Public-sector liabilities accounted for 88% of that amount.

The remainder included debt incurred for short-term financing of imports, which underwent a considerable shift in 1995. In contrast to previous years, reimbursements were well in excess of new credits, and as a result the surplus of almost US$ 1 billion in 1994 turned into a deficit of more than US$ 2.1 billion.

THIRD PART

CARIBBEAN ECONOMIES

ECONOMIC TRENDS IN THE CARIBBEAN

1. General trends

Gross output of the English-speaking Caribbean[1] subregion expanded by 2.6% in 1995, less than the preceding year, resulting in an increase of 1.2% in per capita gross domestic product (GDP). In most countries of the subregion, the growth rate slowed, and in three, economic activity contracted as a result of natural disasters: hurricanes in Anguilla and Antigua and Barbuda, and a volcanic eruption in Montserrat (see table 1). Meanwhile, inflation recorded an overall decline. Most countries, especially the smallest maintained their traditionally low rates of inflation, although in some of them the rise in prices was higher in 1995 than in the preceding year. In the larger countries with higher inflation, strong macroeconomic measures were taken to curb inflation. The process of trade liberalization undertaken in some countries also helped to reduce inflation by allowing an influx of cheaper goods. Suriname, where inflation had risen to 350%, achieved a significant reduction, bringing the rate to under 40% in 1995.

Overall, the trade balance deteriorated in the Caribbean countries, with exports expanding by 18% and imports by 26%. The service account also showed poor results, especially with respect to income from tourism, at a time when the number of residents of the subregion travelling abroad was also on the increase. Nevertheless, current transfers more than tripled as a result of greater inflows of grants and insurance payments, so that the current account deficit was reduced. Under the capital account, an improvement was noted in portfolio investments and long-term private capital inflows, and this generated an overall surplus and an expansion in international reserves.

Economic activity was conducted in a context of heightened anxiety as Caribbean Governments sought to stabilize their economies in the face of reduced protection under revised trading agreements. This shift in policy required Caribbean firms to improve their productivity in order to respond to growing competition from abroad and presented a major challenge to Caribbean authorities one requiring concerted action in macroeconomic and trade policies. Regional producers also faced a wide range of difficulties. Banana producers, for example, had been accustomed to reserved access to the European Union market. Similarly, some manufacturing activities that had become accustomed protected domestic or regional markets were affected by the reduction in the common external tariff in the countries of the Caribbean Community (CARICOM).[2]

While the issues faced by all countries were, in general, similar, their responses differed quite widely. Some tried to apply innovative measures, while others limited themselves to tried and familiar policies which had worked well in the past. The success of these policies depended on their credibility and the countries' prospects for integration into global markets.

In general, the smaller countries seemed to experience a greater sense of vulnerability in the

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

[2] These include the Bahamas, Barbados, Belize, Guyana, Jamaica, Trinidad and Tobago and the countries of the Organization of Eastern Caribbean States (OECS).

Table 1
CARIBBEAN SUBREGION: TOTAL GROSS DOMESTIC PRODUCT
(Annual growth rates)

	1990	1991	1992	1993	1994	1995[a]	1981 1990	1990 1995[a]
Caribbean subregion	2.0	2.4	2.0	1.9	3.6	2.6[b]	-0.2	2.5[b]
Antigua and Barbuda[c]	3.5	4.3	1.7	3.4	5.5	-3.8	6.4	2.1
Barbados	-3.2	-4.0	-6.2	1.5	3.8	2.7	0.9	-0.5
Belize	10.3	3.1	9.5	4.3	1.5	3.8	4.5	4.4
Dominica	6.3	2.2	2.7	1.9	2.1	1.8	4.4	2.1
Grenada	5.2	3.6	1.1	-1.3	2.3	2.3	4.9	1.6
Guyana	-3.0	6.0	7.8	8.2	8.5	5.1	-2.7	7.1
Jamaica	5.5	0.7	1.5	1.4	0.8	0.5	2.5	1.0
Saint Kitts and Nevis	3.0	3.8	3.6	4.0	3.2	2.0	5.8	3.3
Saint Vincent and the Grenadines	7.0	3.1	6.5	1.3	0.4	3.0	6.5	2.9
Saint Lucia	4.4	2.3	7.1	2.3	2.8	3.8	6.8	3.6
Suriname	0.1	3.5	5.8	-4.5	-0.8	...	0.5	...
Trinidad and Tobago	1.5	2.7	-1.7	-1.6	4.2	3.5	-2.4	1.4

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures. [b] Does not include Suriname. [c] Based on figures at factor cost.

face of new international developments. Natural disasters caused severe damage in several single-product economies, while political changes affecting banana exports to Europe served as a reminder to the smaller producers in the Organization of Eastern Caribbean States (OECS)[3] that they could no longer rely on guaranteed markets.

In short, 1995 was a difficult year for most of the countries. The smaller OECS states, whose previous economic performance had been sound, seemed increasingly vulnerable, partly owing to natural disasters. Guyana had experienced a steady expansion since 1991, and growth remained good in 1995, although the strong momentum of the early 1990s seemed to be slipping. Both Barbados and Trinidad and Tobago were gradually adapting their economies to more open markets, but while new prospects were opening up for the latter in industries related to natural gas and petrochemicals, Barbados had greater difficulty in sustaining steady growth in its export earnings. Jamaica continued to experience high inflation and low growth, the protracted period of adjustment and high debt-service costs seeming to sap policy resolve and investor confidence. Loose monetary policy in 1995 rapidly eroded the external account and the value of the currency and threatened to negate past efforts to contain inflation.

For the OECS countries, the challenge was to raise productivity in traditional exports, especially in bananas; diversify economic activities, preferably into export-oriented industries; and expand their tourism sectors along sustainable lines. Fiscal accounts also required revision to make revenues less dependent on import taxes and secure a more stable source of revenues for national development without creating disincentives to industry. For the OECS countries as a group, aggregate product expanded by about 2%, reflecting a steady decline since 1992. Nevertheless, individual country performance

[3] The OECS is made up of Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines. For the purposes of this study, it also includes Anguilla, which, while not a part of the OECS, is a member of the Eastern Caribbean Central Bank.

varied widely. Some countries, such as Saint Vincent and the Grenadines and Saint Lucia, managed in 1995 to reverse the poor performance of the two preceding years by expanding agriculture and tourism. In contrast, Anguilla and Antigua and Barbuda, both strong performers in the period 1993-1994, experienced shocks to their economy and a serious decline in tourism. Others, like Dominica and Grenada, continued their modest performance; Dominica showed a slightly slower rate of expansion owing to a contraction in the agricultural sector, while Grenada, experienced a slightly better rate of growth, led by agriculture, since performance was weak in the tourism sector. Montserrat, meanwhile, suffered its second year of economic contraction, reflecting the uncertainty and dislocation caused by its sporadically active volcano.

The remaining CARICOM countries recorded a slowdown in economic activity compared with 1994, except for Guyana, which continued to grow strongly, although at a slower pace because of problems that cut down on production in the gold sector, one of the main contributors to the country's recent economic recovery. However, the agricultural sector remained buoyant, despite a contraction in the sugar industry, with rice, livestock and forestry activities all expanding. Both manufacturing and the service sectors also expanded. A strong performance in these export-oriented industries helped to narrow the balance-of-payments current account deficit, although amortization payments widened the overall deficit. Stronger fiscal accounts allowed increased capital spending. Inflation was also trimmed to half the level recorded for 1994.

In *Trinidad and Tobago*, minimal growth in the petroleum sector and a decline in export agriculture resulted in slower economic expansion. Production increased slightly in the petroleum sector and by 2.5% in the non-oil sector, ensuring a general economic expansion for the second consecutive year. The application of tight fiscal and monetary policies yielded a surplus in the public sector and balance-of-payments accounts, while both inflation and the unemployment rate fell.

In *Barbados*, the rate of expansion achieved in 1994 was not replicated because of a weaker performance in the sugar subsector and only modest growth in tourism. Nevertheless, the other agricultural subsectors and industry demonstrated an unexpected vitality and merchandise exports expanded; in spite of this, the balance of payments deteriorated because of increased domestic demand. Credit to the private sector swelled by almost 40%, requiring a rise in interest rates in the second half of the year. The restrictive fiscal policy helped to curb monetary expansion, and inflation, although steeper than in 1994, still remained low. Unemployment also fell.

Jamaica continued to experience economic instability in 1995, after the progress achieved towards the end of 1994, including a decline in inflation that persisted into the first few months of 1995. Credit was eased with a view to stimulating the economy, and this led to a 38% expansion of the broad money aggregate (M2). Expanding credit, together with large wage increments granted to public and private sector workers and substantial private transfers all served to increase demand. The effect was a sharp deterioration in the external account, a 16% devaluation of the Jamaican currency and a reversal of the downturn in the rate of inflation, which averaged 1% per month in the first half of the year and 2.7% in the second. Overall, economic performance was sluggish, with expansion averaging only 0.5%, practically the same as the average for the period 1991-1994. The listless performance in 1995 was due to difficulties in stabilizing the economy, the cost of debt-servicing and poor results in some sectors, notably manufacturing and mining.

Economic activity gathered pace in *Belize*, benefiting from strong growth in agriculture (8%), manufacturing (4%) and public utilities (3%). Export earnings were strong and imports contained, so that the overall external balance showed a surplus. Fiscal performance continued to be problematic, for although the deficit narrowed, this was at the expense of capital outlays. A revised tax system was introduced towards the end of the year to include a value added tax, and measures were taken to cut back on current expenditure. Inflation rose marginally while still remaining low.

Lastly, in *Aruba*, one of the non-CARICOM countries, tourism-led growth, once again ensured a strong performance.

Table 2
CARIBBEAN COUNTRIES: UNEMPLOYMENT RATES
(Percentages)

	1991	1992	1993	1994	1995
Barbados	17.2	23.0	22.1	21.8	19.7
Jamaica	15.4	15.7	16.3	15.4	16.2
Trinidad and Tobago	18.5	19.7	19.8	18.5	17.3

Source: ECLAC, on the basis of official figures.

2. Fiscal policy

Public finance remained a key area of focus for Caribbean Governments as they adjusted their economies for integration into the global economy. They were increasingly cognizant of the fact that fiscal deficits siphoned off resources from production activities, yet the demands for government intervention in areas such as infrastructural development, human resources and social equity remained acute. In view of these competing claims, countries resorted to different methods to secure fiscal balance. Tax systems were also placed under scrutiny to ensure that they did not discourage individual initiative or new corporate investment and yet provided for a stable source of revenue. Tax reform had previously been undertaken in several countries with the above aims but also as a response to the impact of trade liberalization. In 1995, Belize joined in with the adoption of a value added tax, the full effects of which were expected to be felt in 1996.

The fiscal position of the OECS countries deteriorated in 1995, with an overall deficit equivalent to 2.5% of GDP, compared with 1.8% the preceding year. Revenues expanded by 4%, but taxes on imports, which accounted for close to 60% of tax revenues, declined by 4% owing to exemptions granted for the purchase of materials to repair hurricane damage. This reliance on commercial taxes complicated the situation of the OECS countries, given the steps being taken to liberalize trade within CARICOM and with the rest of the world. Current expenditure, on the other hand, increased to almost 22% of GDP, leaving just under 2% of GDP for capital expenditure and causing some countries to continue to record current deficits. Within total expenditure, wage for public employees and transfers increased.

The erosion of the fiscal account was particularly notable in Saint Kitts and Nevis, where the deficit amounted to 6% of GDP. Both current and capital expenditure increased, and the current account went from a surplus of 0.4% in 1994 to a deficit of 1.1% in 1995. Capital expenditure rose by 70%, with the bulk of this sum being allocated to infrastructure projects. The deficit also increased in Antigua and Barbuda, with the current account moving into a deficit position again after achieving a fleeting surplus in 1994. This deficit widened from 2.4% to 3.4% of GDP as a result of the outlays required to deal with the effects of the hurricane. In Saint Lucia, the deficit also expanded, from 0.7% to 1.6% of GDP. The erosion was most evident in the current account, notably under wage expenditure. In Grenada, sustained efforts to reduce the fiscal deficit bore some fruit, since measures taken to improve tax collection and restrain current and capital spending eliminated the deficit, which had been equivalent to 2.4% of GDP.

In 1995, *Barbados* recorded a fiscal surplus of just under 1% of GDP, compared with a deficit of 2% in 1994, as increases were seen in current income as well as expenditure. The improvement in current income was due to the higher income tax revenues yielded by the expansion of the payroll tax base, and to higher corporate and property taxes. The increase in expenditure was attributable to the settlement of arrears, adjustments in remunerations and higher

disbursements for interest payments and subsidies. Capital expenditure, however, declined by 13%, thereby reversing the upward trend observed in the two preceding years.

In *Belize*, after a period of steady expansion, the fiscal deficit started to diminish gradually in 1994 and dropped to 4.8% of GDP in 1995 despite a further erosion of the current surplus, which fell to 2% of GDP in 1995. Fiscal revenues declined by around 3%. Under tax revenues, income tax receipts were lower as some taxpayers benefited from tax relief while others build up arrears owing to flaws in the tax-collection system. In contrast, receipts from international trade improved with the implementation of stricter enforcement measures by customs authorities. Total expenditure declined by over 7%, as the net result of a 3% rise in current expenditure and a decrease of almost 28% in capital expenditure; current spending on wages and salaries, pensions, interest payments and transfers increased. Having failed to meet their fiscal targets, in late 1995 the authorities adopted new policies designed, *inter alia*, to cut back on the number of civil servants, along with interim measures to compensate for tariff rollbacks. The introduction of a value added tax was also scheduled for 1996 under a sweeping tax reform programme designed to offset the reductions to be made in tariff rates as the trade liberalization process proceeded.

In *Jamaica*, the stabilization of the exchange rate and lower inflation provided a basis for policymakers' target of a fiscal surplus of 2% of GDP. However, stricter measures –aimed at achieving a surplus of 3% of GDP– became necessary by the middle of the year owing to the absence of a tight monetary policy. Meanwhile fiscal income showed a substantial gain of almost 50%. Tax revenues also increased to almost 22% of GDP (a rise of 5% compared with the preceding year) thanks to higher taxes on income, consumption and trade. Gains in receipts from consumption and trade taxes reflected buoyant consumption, while the upturn in income tax receipts was attributable to substantial wage increases in both the public and private sectors. Authorities were able to hold down expenditures in part because of lower interest payments. However, expenditure on wages and salaries went up by about 19% as a result of retroactive wage payments to civil servants. Amortization payments showed a 32% decline due to reduced debt obligations, improved debt management, and debt forgiveness and rescheduling operations. It was thus possible to boost gross investment in 1995 and achieve a small surplus compared with a deficit equivalent to 5% of GDP in 1994.

In *Trinidad and Tobago*, fiscal accounts showed a surplus, as in the previous year. Although some of the tax measures that were implemented reduced the yield of certain taxes, fiscal income grew by 11%, while expenditure expanded by 9%. The current surplus thus increased by 1% of GDP to 2.4%. Revenue increases derived mainly from the petroleum sector, although corporate and personal taxes in the non-oil sector also were higher despite reduced tax rates; however VAT revenues were down slightly and receipts from international trade also declined as tariffs were lowered. All categories of current expenditure rose slightly, including wage payments, as the Government paid part of the sum it owes to members of civil service. Subsidies also increased, following the restructuring of two public-sector enterprises, while interest payments on the public debt rose marginally. Capital expenditure, which rose by 30%, was allocated mainly to upgrading physical infrastructure.

3. The main variables

a) Level of economic activity

i) Crop-farming sector. The performance of the agricultural sector was satisfactory in almost all countries except Trinidad and Tobago. In *Barbados*, a reduction in sugar output was offset by other crops, which recorded strong increases. The agricultural sector in *Belize*, which is quite diversified, turned in a robust performance in 1995, primarily because of a 53% expansion in citrus production. Fires in the country's sugar-cane fields caused a 15% drop in sugar

output, and banana production also slipped, but several domestic-market crops posted higher production figures.

In *Jamaica* the agricultural sector's expansion continued for the sixth consecutive year, although at a slower pace. Growth was underpinned by both non-traditional exports, which recorded gains of 5%, and traditional exports, especially bananas and sugar, even though sugar production figures were slightly lower. In *Trinidad and Tobago*, export agriculture recorded a scant 2% expansion whereas agriculture for the domestic market enjoyed a recovery of almost 5% following the downturn of preceding years. The 8% decline in sugar production was too severe to be offset by the expansion, albeit fairly strong, of other subsectors. Accordingly, the sector as a whole contracted by almost 1%.

The OECS countries recorded moderate growth in the agricultural sector in 1995 with the exception of Dominica, where hurricanes devastated the banana plantations, thus making it a difficult year for the island. Saint Vincent and the Grenadines recorded a marked improvement in agricultural output, especially of bananas, while attempts to diversify production into new areas geared to both the domestic and export markets met with varying degrees of success. In Saint Lucia and Grenada, the sector expanded by 7%-10%. Following two years of contraction, agricultural growth in Saint Lucia was attributable mainly to the upturn in the banana industry, although figures for non-traditional crops also improved. In Grenada, growth was led by the cocoa (50%) and nutmeg (20%), crops which recovered from an earlier decline. In Montserrat, the sector suffered a 1.2% contraction due to natural phenomena.

Bananas

Banana production was affected by uncertainty over future European Union (EU) marketing regulations and adverse weather conditions. The latter prompted wide swings in the earnings of several producing countries, although the export volumes and earnings of CARICOM countries as a whole were up by 7% and 8% respectively. The OECS countries performed somewhat better, but not well enough to make up for the contraction of the two previous years; export earnings increased by 10% in response to a 13% expansion of shipments.

Within the OECS group, performance was mixed, reflecting the vagaries of the weather and, specifically, the impact of hurricane damage in Dominica. Saint Vincent and the Grenadines recorded the strongest performance with a 54% rise in export earnings, thus making an almost complete recovery from the downturn caused by adverse weather conditions in 1993 and 1994. Similar circumstances surrounded the recovery in Saint Lucia, where, however, the 11% expansion in earnings was insufficient to counteract the 32% decline recorded over the two preceding years. The most seriously affected country was Dominica, where banana production was suspended altogether in the last quarter of 1995 and earnings fell by almost 20%, thus prolonging the downward trend seen during the past three years.

In *Belize*, export figures plunged when unseasonably dry conditions, followed by flooding and irrigation problems, destroyed almost 20% of the crop. Labour disputes further hampered production although a reallocation of EU quotas –due to the fact that several Windward Island producers were unable to meet theirs– allowed Belize to export an additional 12% by volume. In *Jamaica*, favourable weather, improved technology and better management all contributed to the over 8% increase in export volumes. Productivity also improved in the major plantations, resulting in an increase in the yield per hectare.

In addition to their inability to meet their EU quotas, the Windward Islands also experienced problems in producing bananas of a suitable quality, and the prices they were able to command therefore declined by 11%. All Caribbean producers, moreover, face the prospect of having to compete freely on the European market as a result of the pressure being brought to bear on the European Union through the World Trade Organization (WTO) by the United States and other producers in the Americas.

Sugar

Sugar producers within CARICOM continued to benefit from preferential prices for their exports

to the United Kingdom. In 1995, the average price moved up from US$ 607 to US$ 670 per ton, a much higher figure than the going price on the world market, which was on the order of US$ 390. Despite this preferential treatment, a number of producers were unable to meet their contractual obligations, and the industry continued to decline.

Sugar production in *Barbados* contracted further in 1995, falling to less than one-third of the 1980 level. Having dropped by over 20%, the total volume was thus 28% below the volume necessary to meet export commitments. Accordingly, Barbados had to invoke the *force majeure* clause in order to defend its preferential quota. In contrast, the industry performed creditably in *Belize*, for while the size of the sugar-cane harvest declined slightly, sugar output remained the same because processing efficiency rates were better. Nonetheless, exports declined marginally, although the quantities sold under preferential arrangements increased thanks to the temporary reallocation of other producers' unmet export quotas. The increased volumes exported to the preferential markets, together with the relevant prices, boosted earnings by 18%. In *Jamaica*, sugar output declined slightly, although the volume and value of exports increased by 15% and 30% respectively. Despite this increase, Jamaica did not meet its full quota allocation of 156,000 tons for 1995. Exports from *Saint Kitts and Nevis* increased slightly and were sold in their entirety on the United Kingdom market, where favourable prices and exchange rate movements increased earnings by over 12%. As was also the case of a number of other sugar-producing countries, *Trinidad and Tobago* recorded lower production figures than in 1994, partly because of unfavourable weather conditions. Nevertheless, the shortfall was covered by these countries' large inventories, and, accordingly, both export volumes and earnings actually increased.

ii) Manufacturing. This sector constitutes a relatively small portion of most Caribbean economies, inasmuch as its contribution to GDP exceeds 15% in only a few cases. It is based essentially on three types of industries: agroindustrial activities, industries geared to the local or regional market, and new activities, often set up in free zones, which mainly produce goods for export. The performance of the first set of activities is usually determined by the pace of agricultural production but, as in traditional agriculture, generally show little vitality. The second set of activities once flourished under the high levels of protection provided for the regional CARICOM market or for national markets in the larger islands. Many of them are now stagnant or on the decline, however, as they find it difficult to expand globally or even to satisfy internal needs as these markets are opened up to external competition. The third set of activities are essentially assembly industries that produce for international markets. These enterprises, which have been affected relatively little by the disincentives associated with the outdated systems in use in the manufacturing sector are still fragile, but are thriving.

In *Barbados*, the manufacturing sector expanded for the second consecutive year, although this must be seen in the light of an average decline of 4.9% over the four preceding years. Indeed the output of the sector did not match either that of 1989 or of 1978-1981, when CARICOM trade was at its height. This performance reflected the difficulties being experienced by traditional activities in adapting to new circumstances. In *Belize*, where manufacturing is closely related to agribusiness, the sector's growth in 1995 was attributable mainly to increased production of the citrus fruits used to make juices and concentrates.

In *Jamaica*, the manufacturing sector contracted slightly in 1995 due, among other factors, to reduced protection, deficient infrastructure, regulatory obstacles, crime and labour disputes. Nevertheless, a 12% rise in exports of manufactured goods coincided with an increase in imports of machinery and equipment. Gross export earnings from the free zones climbed by 10%, and inflows to the local economy from these inbond industries were up by 26%. Taken together, these indicators point to an industry in transition, where traditional, protected sectors are finding it difficult to improve their productivity, while some non-traditional export activities are expanding their market share.

Manufacturing[4] in *Trinidad and Tobago* continued to grow but more slowly than in 1994, when it had advanced by 18%. Nevertheless, the expansion was broad-based, with assembly and related industries progressing by 15%, printing and paper up by 10% and food processing up by 6%. Declines were recorded, however, in beverages and tobacco, and garments and footwear. Generally speaking, the sector seemed to be weathering the shift to a more open economy relatively well.

Manufacturing activity in the OECS countries was concentrated in agroindustry, garments, beverages and the assembly of electronic components. The sector suffered from the constraints associated with limited market size and low productivity and, as in other Caribbean countries, was particularly vulnerable to the effects of market liberalization. Nevertheless, it recorded 6% growth in 1995, following a 2.5% contraction the previous year. Manufacturing output expanded in six member countries thanks, in particular, to increases in soap production in Dominica, in the output of paper products and alcoholic beverages in Saint Lucia, where the sector rebounded from a slump in 1994, and in rice processing in Montserrat. The sector contracted, however, in Antigua and Barbuda and in Saint Vincent and the Grenadines; in the first of these countries, the downturn was due to disruptions caused by hurricane damage.

iii) Petroleum and mining. The petroleum sector accounted for 28% of GDP in *Trinidad and Tobago* in 1995, but its growth rate flattened out following an 8% expansion in 1994. This reflected a slower pace of activity in exploration, production and refining, the suspension of operations in a major south-coast well and numerous labour disputes. The petrochemicals subsector grew by only 3%, after having expanded by 25% in 1994. Towards the end of the year, construction was started on a new methanol plant which was due to come on stream in 1996 at the same time as a new ammonia plant.

Mining and quarrying accounted for almost 9% of GDP in *Jamaica*, down slightly from the previous year. This was the result of a 6.5% contraction in the bauxite and alumina subsector, following labour disputes and operational problems. Total exports declined in volume by about 7%, whereas alumina shipments increased. Prices were buoyant throughout the year, however, so the industry's gross earnings showed gains of about 16%.

iv) *Tourism.* This sector is a major source of foreign currency earnings in most Caribbean countries, with the exceptions being Guyana, Suriname and Trinidad, although tourism was the main source of activity in the latter's twin island of Tobago.

In general, stopover arrivals increased only marginally throughout the Caribbean. After a slow start in the first quarter of the year, arrivals picked up in the second and third quarters. There was a slowdown in the final quarter, however, as a result of hurricane damage at several major destinations. While reallocation was made to unaffected areas to handle much of the subregion's tourist flows, uncertainty regarding weather conditions discouraged a number of potential travellers.

The OECS countries experienced a 4% reduction in stopover arrivals. The most seriously affected were Antigua and Barbuda, with stopovers down by over 18%; Montserrat, with a decrease of 17% due to volcanic activity; and, to a lesser extent, Saint Kitts and Nevis (6%). In all cases, arrivals were strong in the first half of the year, but then dropped off drastically after the hurricane season. Just the opposite occurred in some OECS destinations, however, such as Saint Lucia, where tourist arrivals were up by about 6%. Dominica and Saint Vincent and the Grenadines recorded an increase of 7%. Cruise passenger arrivals were up in all the OECS countries, especially Saint Vincent and the Grenadines (47%), where income from tourism was further boosted by a steady flow of stopover guests. Total visitor arrivals for the OECS, including cruiseship passengers, increased by 4% in 1995; this is regarded as a creditable performance, given the number of natural disasters, but the sector's rate of increase was, nonetheless, clearly lower than in 1994 (10%).

The larger CARICOM countries recorded a modest advance in stopover arrivals. Barbados,

[4] The oil and sugar industries are not included here.

although benefiting from tourist reallocations following hurricane damage in neighbouring islands, still recorded an increase of less than 4%. The sector's performance in the early part of the year was weak, with a decline of 2.5% being recorded for the first quarter, but a 7.5% rise was recorded for the remainder of the year. Similar trends were observed in the Bahamas and Jamaica, where stopover arrivals showed a 5% increase for the year.

Among the non-CARICOM countries, the tourism sector's performance was mixed. Tourist arrivals were down in the countries that suffered hurricane damage, in particular Anguilla (12%), the United States Virgin Islands (18%), and Saint Maarten (over 18%); tourist arrivals to the Netherlands Antilles as a whole decreased by about 14%, although Curaçao recorded a decline of only 1%.

The United States remained the main source of tourists, and arrivals from that country showed the sharpest increase (5%) as well. Saint Lucia benefited the most from this increase, as it recorded a gain of over 10%, while Jamaica, the Bahamas and the OECS countries recorded increases on the order of 5%. Arrivals from Europe were up 3%, with the main destinations being Dominica and Saint Lucia and, to a lesser extent, the other CARICOM countries. On the other hand, tourist arrivals from Canada contracted by 3%, affecting mainly Antigua and Barbuda, the Bahamas, and Grenada, where visitor arrivals were down by over 15%. Jamaica and the Netherlands Antilles recorded over 5% growth.

b) Prices

Most of the Caribbean countries, and especially the smallest among them, maintained their traditionally low rates of inflation, although in a number of the OECS countries, prices rose faster in 1995 than in 1994. The exceptions were Antigua and Barbuda, where the rate was negative, and Anguilla. In such countries as the Bahamas, Barbados and Belize, the rate remained low but did show a slight increase. The larger countries, where inflation was higher, applied restrictive macroeconomic policies designed to curb price rises. The process of economic liberalization under way in some countries also helped to tame inflation, since producers and consumers were able to secure lower-priced imports.

In Barbados, inflation was modest for the third consecutive year, in part because of the wage freeze which had been imposed in 1991 but was lifted in 1995 when wage settlements providing for an average adjustment of 3% were signed. Price rises were noted in areas such as alcoholic beverages, tobacco and housing. Prices rose marginally in *Belize*, with increases being noted in the categories of medical care, rent, water, fuel and power. In *Guyana*, the rate of inflation continued to fall, thereby resuming the trend that had begun in 1991-1993 but had been interrupted in 1994. Contributing factors were a relatively stable exchange rate and lower customs duties.

In *Jamaica*, the authorities set themselves the goal of bringing the annual average rate of inflation down to 12%. They did achieve a reduction compared with 1994, but failed to reach the targeted rate. Actually they were ahead of their target for the first six months, with an average rate of 6%, but then inflation accelerated in the second half-year. This acceleration was due mainly to a looser form of liquidity management, which increased demand, thus eroding the external account and leading to a depreciation of Jamaica's currency. A fall in output for some crops, the increase in wheat prices on the international market and the removal of subsidies for some foodstuffs all contributed to significant price rises in the food and beverage category. The price of fuel also rose, but less sharply (just over 9%).

The rate of inflation fell in *Trinidad and Tobago* for the second consecutive year, mainly as a result of trade liberalization measures, which reduced the rate of price rises for food items, and exchange rate stability. Prices declined steadily throughout the year and fell even more sharply in the fourth quarter.

c) Employment

In *Barbados*, employment increased in several sectors, most notably in commerce, manufacturing, and government services and information services. In manufacturing, the subsectors showing the greatest improvement in

Table 3
CARIBBEAN COUNTRIES: CONSUMER PRICES
(Average annual variations)

	1991	1992	1993	1994	1995
Anguilla	4.9	3.0	4.1	4.0	1.6
Antigua and Barbuda	2.1	1.2	1.5	7.1	-0.6
Bahamas	7.1	5.7	2.7	1.3	2.2
Barbados	6.3	6.1	1.1	0.1	1.9
Belize	5.6	2.8	1.3	2.6	2.9
Dominica	2.0	4.4	1.7	0.8	1.4
Grenada	1.0	4.6	3.5	1.9	2.1
Guyana	70.3	14.2	7.7	16.1	8.1
Jamaica	51.0	77.3	22.1	35.1	19.9
Montserrat	9.2	1.4	0.7	2.8	4.4
Saint Kitts and Nevis	4.5	1.5	1.4	1.3	2.6
Saint Lucia	7.3	2.5	0.7	5.8	4.7
Saint Vincent and the Grenadines	2.3	3.1	4.5	0.4	3.1
Trinidad and Tobago	3.8	6.5	8.7	9.4	5.4

Source: ECLAC, on the basis of official figures.

employment were the food, beverage and tobacco industries. In *Belize*, the rate of unemployment declined by just over two percentage points of GDP; the female unemployment rate was down to 19.2%, while male unemployment fell to 13.7%.

In *Jamaica*, job creation was not sufficient to absorb the 28,500 new entrants to the labour market. Accordingly, the unemployment rate rose by almost one percentage point. The majority of the unemployed were in the under-25 age group, and the rate was particularly high among the women in this category, although the imbalance affecting women in general was reduced slightly. Nevertheless, unemployment among young males also increased, from 18.5% in 1994 to 25.1% in 1995. Among young females, the rate climbed from 37.7% to 44.6% while for older women, it descended from 16.9% to 14.5%. The services sector contributed the most new jobs, a majority of which were taken by women.

Unemployment in *Trinidad and Tobago* fell for the second consecutive year despite a 2.3% expansion in the labour force. The majority of new jobs were created in the services sector, which already accounted for 56% of the total. Slight increases in employment, were registered in all the other sectors except agriculture, which lost over 5,000 jobs. Unemployment in the 15-24 age group remained above the average, although it fell from 32.5% to 30.9% in 1995, which was a sharper decline than for other age groups. Female unemployment (20.6%) remained higher than male unemployment (15.1%).

d) **The external sector**

i) *Foreign trade and the balance of payments.* The trade balance deteriorated throughout the subregion, although less markedly in the smaller OECS countries. Exports rose by almost 18% but imports grew more (26%). For the OECS, both imports and exports recorded more modest increases. The services account, which usually serves to offset the substantial merchandise trade deficits incurred by most of the Caribbean countries, was sluggish, mainly because the percentage increase in tourism earnings was lower than in previous years. Moreover, in several countries burgeoning domestic demand, which inflated the merchandise import bill, also reduced the travel surplus, since nationals used some of the readily available credit to take vacations abroad.

The external accounts of the OECS countries strengthened appreciably, chiefly as a consequence of inflows related to indemnification for and repairs of the damage done by hurricanes. Merchandise exports climbed by 8%; this was mainly attributable to a 10% increase in the export earnings of banana producers in Saint Vincent and the Grenadines and Saint Lucia, and to a lesser degree, to larger inflows from the sale of cocoa by Grenada (12%), sugar by Saint Kitts and Nevis (12%), and soap by Dominica (4%). Meanwhile, at 5%, the increase in imports was relatively modest. The surplus on the services account was, however, disappointing, for while it had grown steadily between 1990 and 1994, it contracted by 9% in 1995 as a result of the decline in gross tourism receipts in Anguilla, Antigua and Barbuda, Grenada, and Saint Kitts and Nevis. On the other hand, current transfers more than trebled owing to increased inflows of grants and insurance payments, so the current account deficit narrowed to just over 10% of GDP, compared with 11% in 1994. Portfolio investments and long-term private capital inflows also rose. The outcome was an overall surplus and an increase in reserves of close to US$ 50 million.

The trade deficit also widened significantly in *Jamaica* –by over 44%– even though exports grew at a faster rate than in the two preceding years. Both traditional and non-traditional exports increased, although the rate of the latter slowed somewhat. Among traditional exports, bauxite earnings fell, while in the non-traditional sector, earnings from manufactures declined by about 12%. Imports grew faster than exports because of a more accommodating monetary policy. All categories of imports showed an increase with the exception of motor vehicles, which slowed for the second year after an unusually high peak. The positive balance on the services account also diminished, for while tourism earnings increased, expenditure by Jamaicans travelling abroad was up even more sharply, in line with the upturn in total expenditure, so that net travel earnings declined. The current account moved from a surplus in 1994 to a substantial deficit in 1995 despite a 20% increase in transfers. The capital account was again positive, though inflows (largely made up of private funds) were 13% lower than the previous year. Nevertheless, they were sufficient to generate a positive balance and to build up reserves by a small amount.

In *Barbados*, exports from all sectors, except for sugar and electrical components, were up slightly, but the growth rate of imports greatly outstripped these increases. Consequently, the trade deficit expanded considerably. Imports of consumer items grew by over 12%; this was especially true of purchases of motor vehicles, whose domestic price fell as duties declined. Intermediate imports also climbed –by 9%– owing to the buoyancy of construction activity, while imports of capital goods swelled by 14%. Income from services increased just 3% compared with 19% in 1994. This decline was due in part to the reduced contribution of tourism earnings and in part to increased spending by Barbadian tourists travelling abroad. Transfers were up only slightly and, as a result, the current account surplus contracted by over one third. A slight deficit was incurred on the capital account but, even to, reserves increased. However, the overall balance was less than half of what it had been in 1994.

In *Trinidad and Tobago*, the trade surplus decreased by 20%. Export earnings from oil and petrochemicals and from manufactures increased but imports grew more rapidly because of trade liberalization measures and more accommodating monetary conditions, which encouraged spending on consumer and capital goods. Meanwhile, food imports rose by 33%. Net outflows on the services account diminished thanks to a higher level of income from transportation services. Net inflows corresponding to investment income declined. On the other hand, external transfers went up. The capital account deficit showed a slight overall increase; private-sector inflows declined as a result of a reduction in direct investment and the deficit in official transactions widened due to a downturn in loan disbursements to the central government and higher external debt payments. An overall surplus was recorded for the third consecutive year, but it was less than one quarter of the surplus recorded in 1994.

A slightly larger trade deficit was recorded for the *Bahamas*, with both imports and exports

Table 4
CARIBBEAN COUNTRIES: BALANCE ON CURRENT ACCOUNT
(Millions of dollars)

	1991	1992	1993	1994	1995
Anguilla	-7.9	-16.7	-12.8	-10.3	-8.3
Antigua and Barbuda	-33.5	-18.9	-0.5	-18.0	-16.7
Bahamas	-183.6	-34.1	-54.5	-214.5	-199.8
Barbados	-23.4	145.5	65.4	123.8	78.8
Belize	-26.2	-29.1	-49.0	-30.5	-21.2
Dominica	-33.6	-25.8	-24.7	-40.0	-42.6
Grenada	-46.4	-32.3	-43.6	-21.4	-29.0
Guyana	-118.0	-146.7	-137.9	-100.8	-94.9
Jamaica	-255.8	10.9	-194.2	18.3	-255.1
Saint Kitts and Nevis	-34.9	-15.8	-30.0	-27.1	-25.9
Saint Lucia	-71.9	-54.8	-49.3	-53.8	-30.2
Saint Vincent and the Grenadines	-44.0	-25.5	-46.7	-61.3	-57.9
Trinidad and Tobago	-20.7	122.6	67.3	339.4	193.0

Source: ECLAC, on the basis of official figures.

increasing modestly. The surplus on the services account rose by about 5% even though net earnings from tourism were down slightly. Outlays under the heading of investment income were lower, but earnings from transportation and offshore services higher. The capital account surplus also increased, owing mainly to the fact that private long-term investment capital doubled. Overall, the balance of payments moved from a small surplus in 1994 to a moderate deficit in 1995.

In *Belize*, merchandise trade was fairly brisk, and the deficit narrowed by 22%. The growth in export earnings was attributable to increased sales of sugar, citrus fruits and marine products. Imports showed an overall decline; the decrease of manufactures was particularly sharp despite higher imports of food, fuel and lubricants. The surplus registered for services shrank, mainly because inflows linked to military operations virtually ceased. Earnings from tourism, on the other hand, increased by almost 6%. The capital account once again showed a deficit due to a reduction in long-term capital inflows as a result of net official-sector outflows and a slight increase in private inflows. International reserves climbed slightly to the equivalent of 1.5 months' worth of imports by the end of the year.

ii) The external debt. The total external debt of the Caribbean countries increased due to their mounting service arrears. Apart from these arrears, the countries' debt has contracted during three of the last four years, although the reduction in 1995 was less than 1%; within the OECS group, however, the opposite trend was observed, with the debt expanding by 2%. In most of the countries except Guyana, external debt service payments remained below 20% of the value of exports of goods and services.

Public and publicly-guaranteed debt in the OECS countries swelled to just under 33% of their aggregate output. The degree of concessionality of the debt had also been falling for the past three years, and the ratio of concessional debt to total debt thus declined from 68% in 1993 to 65% in 1995. Disbursements fell in comparison with 1994, and a net outflow of resources was registered.

Despite renewed efforts to reduce interest arrears, disbursements under this heading actually increased by 8.5% in 1995 and thus come to represent 2.3% of GDP and 4% of exports of goods and services.

The stock of external debt increased in a few countries. In the OECS countries, loan funds were procured primarily for utilities (25%), industrial development (17%) and tourism (17%), while

Table 5
CARIBBEAN COUNTRIES: EXTERNAL DEBT[a]
(Millions of dollars)

	1991	1992	1993	1994	1995
Total	**9 794.2**	**9 553.4**	**9 465.9**	**9 346.8**	**9 046.5**
Anguilla	8.4	9.2	8.6	8.7	7.8
Antigua and Barbuda	261.1	250.6	235.8	231.4	234.7
Bahamas	412.4	440.4	453.3	411.4	392.2
Barbados	417.2	377.5	352.0	357.2	358.9
Belize	142.8	141.4	167.4	180.4	183.9
Dominica	92.8	94.1	90.0	98.7	102.2
Grenada	84.2	80.9	79.0	88.2	88.3
Guyana	1 873.3	2 054.0	2 062.0	1 999.5	2 058.3
Jamaica	3 874.3	3 678.0	3 687.2	3 651.9	3 451.9
Montserrat	3.4	5.2	10.0	10.2	10.2
Saint Kitts and Nevis	39.1	39.2	40.1	52.1	52.4
Saint Lucia	81.0	97.1	100.9	106.0	113.6
Saint Vincent and the Grenadines	66.1	70.8	77.5	87.5	86.9
Trinidad and Tobago	2 438.1	2 215.0	2 102.1	2 063.5	1 905.2

Source: ECLAC, on the basis of official figures and information provided by international financial institutions.
[a] Does not include debt service arrears.

agriculture accounted for 5% and education, training and housing accounted for a further 3%. In *Barbados*, external debt increased marginally to just under 24% of GDP, while in Guyana it increased by 3% due to the fact that new debt was incurred –mainly with multilateral agencies– so that the country could consolidate its bilateral arrears. Other countries registered a contraction in their external debt. In the *Bahamas*, it decreased by 5%; public debt –equivalent to 40% of the total– remained unchanged, but debt contracted with commercial banks and with offshore financial institutions, together with bilateral debt, all decreased; in contrast, debt owed to international financial institutions increased by about 4%. Overall debt obligations were quite low at 22% of export earnings, and debt servicing represented less than 5% of exports (both of these coefficients were the lowest of all the countries surveyed). Debt also declined slightly in *Belize* to 37% of GDP) or 62% of export income. Net capital flows were negative for the first time ever, and this reversal thus marked a turning point in the profile of Belizean capital flows. Bilateral debt, commercial bank debt and suppliers' credits all contracted but debt contracted with multilateral institutions to finance infrastructure projects increased by 8%. Debt servicing was equivalent to 6% of GDP, or 20% of export earnings.

In *Jamaica*, the external debt declined for the third consecutive year, falling by 5% in 1995. All categories showed a decrease; bilateral debt, accounting for 52% of the total, diminished slightly and multilateral debt recorded an even sharper decline (10%). Debt service payments swelled by 11% while amortization payments, accounting for 68% of the total, increased by 15%. On the other hand, the debt service burden remained constant because of the increase in export receipts. The Paris Club and the Government of the Netherlands also helped to ease the debt burden of the country, which has received over US$ 46 million in debt relief since 1990. In *Trinidad and Tobago*, external debt declined for the sixth consecutive year and the debt-GDP ratio therefore descended from 44% in 1994 to 37% in 1995. The only new flows to be received were provided by international financial institutions for ongoing projects, but these inflows were exceeded by outgoing amortization payments. Debt-reduction measures and an improved debt profile contributed to a decline in the debt-service ratio from 27% to 16% of the value of exports of goods and services.

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