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Encounter of South American Economists

The Alexandre de Gusmão Foundation and the International Relations Research Institute-IPRI, in cooperation with Construtora Camargo Correa, held a First Encounter of South American Economists on November 7, 2007, at the Itamaraty Palace in Rio de Janeiro.

The encounter was attended by outstanding specialists of the regions' twelve countries, who were invited to submit their reflections or summaries about their national economies. The full text of their presentations is presented in this issue of *Diplomacy Strategy Politics – DEP* magazine.

The reports on each country fueled a meaningful debate among participants, during which it became clear that, in addition to a valuable exchange of views and information about the countries' internal situation and prospects, there is a greater sense of belonging to the region and a keener awareness of a shared history.

Worthy special mention was the significant Construtora Camargo Correa's contribution, which made possible this First Encounter of South American Economists and testified to that enterprise's enlightened understanding of the importance of an ongoing dialogue involving the academic and diplomatic worlds as well as the private sector.

The recovery of Argentina's economy

*Aldo Ferrer**

Since mid-2002, Argentina's economy has grown at an annual rate of over 8 percent under conditions of macroeconomic governability and improved social indicators. This performance contrasts with its course over a long period, particularly with the period that began in 1998 and culminated in the crisis of 2001 and early 2002, when GDP sustained a cumulative 20-percent drop, the unemployment rate reached 25 percent, and the proportion of people living under the poverty line exceeded 50 percent. Ultimately, the convertibility regime and the peso-dollar parity collapsed, bank deposits were frozen to prevent the flight of capital, and the government declared default on the foreign public debt. This disarray was reflected in the impossibility of honoring contracts, particularly those denominated in dollars, as well as in the circulation of sixteen currencies issued by the provinces in face of the collapse of the monetary system and of public finances.

The crisis was the epilogue to an economic strategy based on a model that proved incompatible with Argentina's economic growth and social welfare, and

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with the elementary equilibriums required for the functioning of an economic system. This strategy led to an unprecedented deterioration of the country's social fabric and productive apparatus, and ended up by playing havoc with the three fundamental axes that keep a modern economy in order, namely, the budget, international payments, and the currency.

At the same time it was submerged in this economic crisis and social convulsion, Argentina also faced a serious political crisis. The Vice-President's resignation in 2001, followed by that of the Nation's President, signaled a state of institutional instability and impotence. By mid-2002, prospects for Argentina's future were the worst possible: hyperinflation, social chaos, and an undeniable need for international rescue.

Now, five years later, reality is totally different from what was then envisioned. Argentine democracy has survived the crisis. In 2003, the country peacefully elected new authorities and is now approaching new elections, all in accordance with the Constitution. The economy experiences unprecedented growth. Macroeconomic foundations, under favorable international conditions, are sufficiently solid to propel Argentina's vast growth potential. The financial crisis, now encapsulated within its own limits, has not hindered the growth of the real economy or the investment rate, which rose from 12 percent in early 2002 to 23 percent today, financed by domestic savings. Recovery has been achieved with internal resources, without the need to ask anything from anyone, and debts have been paid.

Serious problems persist, particularly in the social area. Unemployment has declined but still holds at about 10 percent, poverty still affects one third of the population, informal labor without social welfare coverage accounts for 40 percent of the labor force, and income is still extremely concentrated. Economic policy faces other challenges, such as the need to make a high growth rate consistent with reasonable price stability. Be as it may, the change of course has been so radical that it deserves an interpretative study and an exploration of future prospects. This is the aim of this essay.

1. The economic policy model

The Argentine economy's remarkable recovery in the last three years reflects the convergence of new circumstances brought about by the crisis itself and the

management of these new circumstances through political and economic action. These two factors have permitted the recovery of economic governability.

In early 2002, the depth of recession had widened by 30 percent the gap between real and potential GDP. Idle resources were available, which permitted the recovery of production and employment, while demand expanded and economic governability was established. The crisis also caused a marked decline in imports, which, combined with exports' considerable growth, led to a 60-billion dollar trade balance surplus in the last five years. In turn, it was possible to recover tax collections, finance public spending, and generate in 2004 a consolidated primary surplus of the State and the Provinces of about 6 percent of GDP. Although this surplus declined thereafter, it has remained over 3 percent of GDP. Lastly, devaluation and a domestic prices' increase equivalent to just one third of the exchange adjustment improved the competitiveness of the production of internationally traded goods and services. This extraordinary change in circumstances has strengthened the current conduction of the economy, which, after dropping convertibility, regained the command of monetary policy and resumed the administration of the exchange rate.

Economic policy responded effectively to the challenges and the new circumstances brought about by the 2001-2002 crisis. Here lies the main cause of the Argentine economy's current recovery and growth.

This made it possible to recover the command of the economic policy instruments and to apply a shock to the returns of activities, particularly of manufacturers and of small and medium enterprises, which had been castigated by the exchange overvaluation and by other elements of the previous policy. It was at this point that the recovery of Argentina's economy started.

The main features of the current economic policy are as follows:

- Maintenance of an exchange rate that is consistent with the competitiveness of the production of tradable goods;
- Reemergence of the State as arbiter of the conflicts inherent in a market economy and a pluralist society;
- Consolidation of the macroeconomic equilibriums in the budget, the currency, and the balance of payments, so as to ensure the proper functioning of the economy and the nourishing of the economic agents' expectations;

- Gradual reduction of foreign indebtedness of both the public and the private sectors, so as to consolidate macroeconomic equilibriums and doing away with the private sector's financial exposure; and
- Use of the income policy as a complementary instrument to macroeconomic equilibriums to guide the evolution of prices and manage inflationary pressures without depressing the level of economic activity and employment.

Various elements of the current model of Argentina's economic policy are to be found, both in the past and now, in the countries that have achieved high levels of development, mobilization of their productive potential, symmetrical participation in the international system, as well raising the welfare of their societies. None of these countries has maintained exchange rates adverse to the competitiveness of their production, or unsustainable indebtedness levels. In this sense, it may be said that Argentina is moving toward normalcy and, even more important, the same thing seems to be happening to public opinion's prevailing criteria.

Because *abnormal policies* were applied in Argentina for so long, the country failed to arrive at a basic long-term consensus about the economic policy that was both necessary and possible for developing its productive potential. As a matter of fact, a debate still goes on, based on complex reasons inherent in the country's history, as to whether a market economy is a system subject to global norms administered from world power centers or a system capable of deciding its own course in the context of a network of global trade relations, investment, and financial flows.

According to the model on which the [economic] policy of the nineties was founded, the world order is a worldwide system under which most economic transactions take place and decisions are made by transnational power centers, namely, the financial markets, the big corporations, and, to a certain extent, the governments of a small number of highly industrialized countries, the United States in particular. In this scenario, the other countries and their national states seem to have lost their ability to make decisions about such fundamental issues as production, investment, and income distribution.

Seen from this angle, the countries that are peripheral to the system's power centers lack the power to make their own decisions and their national

states are unable to determine the course of events. Moreover, as the markets know better than the State, public policies defy economic rationality. The only possible attitude then is to go with the flow and do what the markets expect. Economic policy's role is thus reduced to issuing signals that are favorable to the markets' criteria and interests. Accordingly, the global markets will supposedly incorporate peripheral countries into the development process and raise the entire population's welfare level.

This model's foundation is flawed in many ways. In the first place, the majority of economic transactions and capital accumulation occur mostly within the national space. World exports account for 20 percent of gross world product and the investments (including the reinvestment of profits) of transnational corporations' subsidiaries (these investments quantify the equity contributions for expanding productive capacity) finance less than 15 percent of the productive capital in the international economy. Thus, 80 percent of the world's production are sold on domestic markets, while domestic savings finance over 80 percent of capital accumulation. As a result, the globalization of the world order coexists with the fact that domestic markets and the countries' domestic savings are essential as a source both of demand and of resources for growth and cannot be ignored by a realistic strategy aimed at development and at incorporation into the global economy.

Secondly, economic development depends on society's capacity to set in motion processes of accumulation in a broad sense. That is, accumulation of capital, technology, public and private management capacity, education, economic regulation, and creative relations between the public and the private sectors. This accumulation process can be managed only from within each society and cannot be transplanted from outside. Neither can it be achieved independently from the market and from the mass of technologies and knowledge available in the world. Accumulation and development are equally impossible if subject to external factors that disturb a country's social cohesion and productive apparatus, or apart from globalization. Hence, the irrationality of the premises that inspired the neoliberal policies that led to the Argentine crisis.

When countries manage to meet globalization's challenges and opportunities consistently with their national development, they open up opportunities for all, promote investment and growth, and establish symmetrical rather than subordinate relations with the global order. Otherwise,

underdevelopment, poverty, inequality, and dependence on world power centers remain. Argentina's history provides emblematic examples of this.

The accumulation and development capacity and the effectiveness of responses to globalization depend on the countries' national density, i.e., on their social cohesion, the ability of their leadership to accumulate power and retain control over their main resources, as well as providing employment opportunities for the majority of their citizens, ensuring institutional stability, and endorsing functional, appropriate ideologies for exploiting the potential of available resources.

Historical antecedents are conclusive. A look at today's reality shows that what characterizes the most successful Asian countries, such as Korea, Taiwan, and Malaysia, as well as China and India, is a national density sufficient to set in motion processes of accumulation in a broad sense, and thus to fuel growth and enhance their populations' welfare. In Latin America, though, social fractures, leaders that accumulate power subordinated to transnational interests, fragile institutions, and the influence of what Prebisch used to call "centric thinking", hinder the achievement of dynamic economies open to the world while retaining control over their own destiny.

This dilemma regarding the nature of the Argentine economy, its placement in the world, and its development pervades the current debate about economic policy. Proposals on specific issues, such as the interest and the exchange rates, the currency, public spending, and taxes, are consistently based on one of these two views. Thus, the clarification of these issues ceases to be a mere theoretical exercise and involves specific, punctual problems that must be solved, so as to make the Argentine economy's current recovery into an accelerated, long-term process of sustainable development with equality.

2. Phases of the economy's ongoing development

Policies under the revamped developmentist model¹ have made possible the Argentine economy's recovery and growth. Since when the crisis reached bottom (end-2001 and early 2002), the economy has gone through two phases

1 L. C. Bresser Pereira calls "new developmentism" his proposed economic strategy for Brazil, which has much in common with Argentina's revamped developmentist model. See *Microeconomia da estagnação*. São Paulo: Editora 34, 2007.

before ending up in a new scenario in which growth and stability issues may be raised again.

The first phase

It extends from mid-2002 through late 2003. During this period, aggregate demand increased owing to the considerable international payments surplus and to the substitution of tradable goods, triggered by the change in post-devaluation relative prices. The stimulus of aggregate demand more than offset the contracting effect of the consolidated public sector's primary surplus.

This aggregate demand expansion and the recovered competitiveness of the domestic production of tradable goods widened the margin of return, boosted private activity in the industrial sector, and allowed the reduction of the productive apparatus's idle capacity. It also contributed to the sustained growth of agricultural and livestock production and, a little later, to the rebounding of construction. The supply response reflected in the remarkable GDP growth and employment recovery.

After the initial domestic prices adjustment following the dropping of convertibility and the subsequent stabilization of nominal parity at around three pesos to one dollar, the increase in domestic prices ended up by representing a real exchange rate 30 percent higher than the average of the last thirty years.

The good performance of the economy and the enterprises was made possible by the gradual normalization of the economic and social context. The economy's governability thus played a fundamental role in the recovery, which was ensured by the following:

- The balance-of-payments surplus and the Central Bank's higher reserves;
- Changing relative prices that favored domestic production's competitiveness;
- The monetary system's pesification [unpegging the peso from the dollar] and the attendant monetary authority's recovery, as well as the normalization of banking operations; and
- The successful operation to cease defaulting on part of the public foreign debt's principal, and the substantial reduction of the private sector's foreign exchange exposure.

The recovery of juridical security and of the contracts regime helped create a scenario favorable to production, investment, and employment. The norms in force under convertibility were unsustainable, as they were founded on an economic and financial regime based on a foreign currency, increasing macroeconomic disequilibria, and impossible requirements, such as the requirement to fix the prices of public services in dollars and indexing them to U.S. inflation. After the inevitable collapse, juridical relations and the contracts regime were gradually normalized.

The new directions of the economic policy contributed to the recovery of the country's self-confidence and reliance on its own strengths and on its capacity to manage itself and to exploit its productive potential.

The extraordinary dynamism of agricultural and livestock production and of agro-industrial value influenced the Argentine economy's recovery process. Another contribution came from the considerable increase in the sector's production, fueled by the capacity of rural entrepreneurs, who assimilated the technological revolution caused by the new agronomic practices, such as direct sowing, technological packets, and transgenic crops. The opening of new markets, particularly in the Asia-Pacific region, and the higher commodity prices have also rendered a similar contribution.

The second phase

The second phase, which started in early 2004, is now ending. During this period, the impetus of aggregate demand was fueled by the marked increase in consumption (owing to the recovery of employment and salaries) and the remarkable increase in domestic investment. The consolidated primary surplus in public accounts has slowed somewhat this expansion impetus of consumption and investment.

This phase saw the continuing positive effects of the economy's governability and of the changing relative prices that favored the local production of tradable goods. This latter factor tended to weaken, given the peso's progressive appreciation, and bodes future uncertainty about the behavior of the real exchange rate in the medium and in the long term.

Supply continued to respond to the stimulus of demand. GDP maintained growth rates close to 9 percent a year, with a sustained though

moderate recovery of employment and real salaries. Throughout the productive apparatus, attractive return possibilities persisted, which explains the increase in gross domestic investment.

The current stabilization policy rests on the solidity of the system's macroeconomic equilibriums and on an income policy implemented through agreements achieved in the markets and in respect of critical products, tax withholdings on various exports, subsidies to public services of mass consumption, control of the prices of privatized public services, and orientation about the acceptable limits of salary increases.

The income policy is a heterodox instrument of economic policy; it is legitimate and has many antecedents even in advanced industrial economies. It has two main objectives: to manage the income distributive tensions and to influence the internal distribution of income among productive and social sectors. This includes administrating the differences between domestic relative prices and international market prices, so as to influence the allocation of resources within the national economy. This is the case of taxes (*withholdings*) based on the exchange rate applied to the various commodity exports.

In Argentina, the current income policy has all these motivations. Its feasibility depends in large measure on how fluid is the dialogue between the government and the economic players and on how consistent it is with the requisite return possibilities that are essential to sustain the continuous growth of supply.

3. The path to future development

The completion of the two first phases of recovery has exhausted the growth impetus fueled by the change in the rules of the game. Also completed is the stage at which the new economic model could function with the relatively simple instruments of fiscal adjustment, the pesification of the monetary system, the determination of the exchange rate, and the recovery of the administrative power's essential functions.

It is necessary to consolidate the achievements and to realize that the fundamental challenges of development, technological changes, and the accumulation process in all its complexity pose new challenges to the country. It is necessary to identify the objectives to be pursued from now on, so as to

achieve development and welfare levels consistent with the available talent and resources. That is, it is now the time and this is the opportunity to raise the real country to the level of the possible country.

At this point, three fundamental issues arise, which must be addressed: raising the level of social welfare, integration of the productive apparatus, and the country's assertive inclusion in the globalization process. The full development of small and medium enterprises is a *sine qua non* for meeting these challenges. Small and medium enterprises are an essential part of the country's productive apparatus and social fabric, the main source of employment and thus of welfare, as well as a crucial element for the establishment of a symmetrical, dynamic relationship with the world economy.

To hew a path to long-term growth, economic policy must perform more complex tasks than in the two recovery phases. It must now hone its instruments to support growth and the economy's transformation, as well as enhancing the country's presence on the international scene. To this end, it must open new opportunities for creativity, demonstrate that our country is the most profitable, safest place for investing savings, and definitively settle the social debt.

Fundamental issues

Social development. So far, employment's initial recovery and the various social programs have been sufficient to alleviate in some measure the tensions caused by the rupture of the country's social fabric and the disruption of the productive apparatus, as well as the attendant consequences in the form of the poor, the indigent, and the marginalized. But the claims of a society affected by poverty, inequality, and all the years of blunders still persist. Quality employment, the incorporation of all workers into the formal market, the strengthening of protection schemes, and a greater supply of public goods (health, education, security, the environment) now come to the fore as fundamental issues in the social field.

Productive structure. The two phases of recovery reestablished to some extent a more diversified and complex productive structure, with an impetus that encompassed different regions of the vast national territory. These facts opened the way to the building of a modern, integrated, open, and competitive economy.

Structural diversification is crucial for allowing scientific knowledge and technology to pervade the country's entire productive apparatus and social fabric, address the changes in demand and in technology, and for setting into motion the processes geared to capital accumulation, qualification of human resources, and resources management – the very essence of development. A flexible, evolving structure, as diversified and complex as required by the current status of knowledge, is capable of being equal to the changes imposed by the new technologies and the ensemble of market demands. It is also capable of expanding innovation sources and disseminating the application of knowledge through the entire social fabric and productive apparatus. A modern knowledge society is unthinkable if it relies on a productive structure supported by only one or few sectors, no matter how complex the production process that sustains it, as such a structure would suffer from an insufficient degree of integration into the rest of the economy.

Argentina has the good fortune of having valuable human resources available as well as extensive and varied natural resources capable of making it self-sufficient in food and energy. These factors, transformed and linked to industrial development and to knowledge-bearing services, provide a development platform.

History is conclusive: only industrial countries that value their natural resources and establish sound national science and technology systems know prosperity. Experience also shows that such aims are not the spontaneous result of market forces but the outcome of the exploitation of talent and private initiative under public policies that make use of the available potential.

International participation. A cohesive society and a diversified, complex productive base are essential for full, dynamic, and constructive participation in the global flows of trade, investment, finance, and knowledge. They are equally essential for ensuring that domestic production of tradable goods satisfy the demand for more differentiated products that involve innovation and take into account the market's changing tastes and preferences. The more diversified and complex the domestic productive structure is, the greater will be its competitiveness in the dynamic flows of international trade.

Participation in the international division of labor based on *intra-industrial specialization* regarding products rather than branches is the style adopted by countries that maintain symmetrical, not subordinate relations with

globalization. This is the objective to be pursued for closing the technological content gap between exports and imports, whose asymmetry is an eloquent indicator of the country's relative underdevelopment.

Economic policy

The resurgence of the State as an irreplaceable protagonist in a market economy and in a democratic society occurred in the two first phases of recovery, with the precarious instruments that survived the dismantling of public policies. This was sufficient to achieve economic governability and to produce a returns shock that changed the course of the economy.

A requirement of sustainable, long-term growth with equality is the construction of a State as small as possible for discharging its essential functions, an efficient, working State that is transparent and subject to the checks of a democratic system. This is indispensable for consolidating, in the medium and long term, the governability achieved in the economy's fundamental variables, for widening the margin of return throughout the national economy, and for reinforcing the country's self-confidence and capacity to govern itself and to build a prosperous future with opportunities for all.

At the beginning of recovery, disorder was so appalling and the loss of economic policy instruments was so great that drastic, fundamental decisions (pegging the peso to the dollar, exchange adjustment, increased tax collections) managed to recover the national economy's governability and to stand the country on its feet. Now the demands of governability are more subtle and the fiscal, monetary, and exchange instruments must be fine-tuned to ensure growth and stability. The maintenance of a competitive parity now requires the upgrading of a series of instruments that complement the monetary authority's measures to sterilize the excess of liquidity. This includes the control of speculative capital and an appropriate complementation of monetary and fiscal policies.

Once the income policy has been reinstated as a legitimate instrument of economic policy, price agreements must be gradually complemented or replaced owing to improved competitiveness and a more fluid dialogue between economic players and the government. The agreements' stabilization objective should make part of a broader consensus about expanding productive capacity.

After consolidation of the rules of the game that ensure the system's macroeconomic governability, economic policy faces the challenge of achieving

the fundamental objectives of social development, the transformation of the productive structure, and full participation in the international economy.

Social initiatives cannot be a byproduct of economic policy, as was the case under the neoliberal model, for alleviating some of the supposedly inevitable consequences of injustice today. Quality employment, welfare, education, the supply of various public goods must be taken into account in the formulation of economic policy and its fiscal, monetary, and international payment instruments. The economic policy's challenge in the new phase is to include social development in the rules of the game that govern and promote the development of the economic system and its participation in the international scene.

It is not true that technological development and globalization inevitably promote inequality and deprive considerable segments of the population of the fruits of development. This happens in the lack of appropriate exchange policies that enhance the system's growth, expanding markets and creating new sources of initiatives and innovation. Just as Keynes, in the thirties, found a way out of the crisis of a system incapable of solving it with its own dynamics, a new worldwide model is needed today to integrate both exchange and accumulation into social development. As the world order advances in this direction, our country must adopt, to the greatest extent possible in solidarity with the other countries of the region, development policies that encompass social change.

Economic policy has many instruments available for impelling technical change, the integration of value chains, the development of regions, a major role by private initiative, the widening of the return margin throughout the country, the qualification of human resources, the incorporation of the entire labor force into the formal market, and quality employment with rising salaries. The establishment of a diversified, complex, open, and competitive productive structure based on the existence of vast natural resources and on industrial development depends on the creative synergy of private initiative and public policies. This is also the foundation capable of determining the country's participation in globalization so as to close the gap regarding the country's foreign trade's aggregate value and technological content.

Inflation

Price increases are a major problem today in the Argentine economy and thus deserve special if brief consideration. It awakens past ghosts and

understandably raises public opinion's concern. On the eve of elections, it is a sensitive issue in the political debate. According to official figures, the consumer price index is rising by 10 percent a year, while according to the harshest opposition the real figure is 15-20 percent. Experience shows that moderate inflation, of about 10 percent, is consistent with a high production and employment growth rate.

The debate about this issue is centered on the alleged acceleration of inflation. This deserves a closer look.

To follow a pattern of constant increases at consistently higher rates, i.e., to accelerate, inflation presupposes at least one of the three following conditions:

1. Serious disequilibria in public finances, balance of payments, and the monetary system, usually occurring in situations of heavy indebtedness and possible insolvency. When this happens, distributive tensions and preventive price increases aggravate. The system then becomes extremely vulnerable to the expectations of internal operators and to external shocks and the volatility of international finances, as dramatically shown by the Argentine experience under convertibility and other circumstances in the past.
2. Critical prices markedly misaligned with their equilibrium position in the economy as a whole. The indispensable adjustment of one or various prices, as for instance the exchange rate, salaries, or public services tariffs, inevitably accelerates the rising of the general prices level.
3. Extreme social tensions reflected, for instance, in state coups or in continuous general or sectoral strikes that can be called wild in major segments of the work force and are out of control of the authorities. Massive salary increases that usually result in serious labor conflicts of this kind aggravate uncertainty, heighten expectations, and accelerate inflation as well.

Argentina's inflation history shows high average inflation in the long run (world record in the 20th century), with episodes of acceleration that often culminated in hyperinflation. These occurrences have *always* resulted from one, two, or all three of the conditions mentioned. None of these conditions occur in the Argentine economy's current situation.

Indeed, the economy now operates with a twin surplus in the budget and the balance of payments. In turn, the monetary system, now based on the national currency, is being actually managed by the monetary authority. Accordingly, the money supply and its incidence on prices are under control. The fact that current turbulences have not affected Argentina's economy, except for changes in the pricing of securities and moderate interest rate adjustments, shows the solidity of the macroeconomic equilibriums. It also shows the successful resolution of the default on the public debt and the normalization of the private debt.

With respect to the economy's critical prices, none is particularly misaligned as regards its equilibrium position in the system as a whole. The exchange rate experiences pressures toward appreciation more than toward devaluation, necessary adjustments of public services tariffs remain within the limits of current inflation, and salary increases occur within the same limits and according to productivity's performance. There is some tension here and there, of course, but no extreme situations capable of destabilizing the system and accelerating inflation occur.

As regards social relations, except for notorious, partial, and geographically localized conflicts, missed hours indicators, etc., social relations unfold in a reasonably stable environment, within a constitutionally-based institutional framework and under prevailing democratic institutions.

In sum, no conditions exist at this time for accelerating inflation. We do have an inflationary problem, regardless of the reference indicator used and the reliability of the available indicators. An economy that has grown at more than 8 percent a year in the last sixty months has to ensure that the general level of prices oscillate no more than 10 percent a year.

Keeping inflation at moderate levels is essential for raising the savings and investment rate to 30 percent of GDP, which is necessary for the economy to continue growing at rates comparable to current rates and to increase employment, salaries and social welfare. It is thus necessary to consolidate macroeconomic equilibriums, prevent prices from deviating from the levels of dynamic equilibrium, and preserve social peace, as well as maintaining rationality in the resolution of distributive tensions, which are inherent in every pluralist, democratic society and in a market economy.

This poses new challenges to economic policy. It is necessary to coordinate the fiscal, monetary, and exchange policies for stimulating savings and investment, managing aggregate demand, promoting progressive income distribution, and shielding the system from speculative attacks. Among other things, this requires a delicate management of the sterilization of excess money supply stemming from genuine accumulation of international reserves; the avoidance of opening (through an effective interest rate in dollars) of opportunities favorable to short-term financial speculation; and the maintenance of a predictable, stable real exchange rate in the medium and long term. The predictability of productive investment is necessary as is the uncertainty of financial speculation.

A primary surplus and the consolidation of fiscal solvency are an indispensable anchor for such policy in a scenario in which the debt is under control and can be administered by the instruments available to the economic policy. Fortunately, the current international environment is also favorable – and promises to remain so in the long term – for exploiting the Argentine economy's extraordinary development potential, while maintaining the general level of prices reasonably stable.

4. Mercosur

Argentina's development prospects are heightened in the Mercosur scenario and in the context of South American integration. The latter is in itself a sufficiently complex undertaking but, differently from the European experience, which provides the model for this kind of process, the Mercosur member countries face huge simultaneous challenges: they need to go forward with their own national development, to change the form of their participation in a globalized world order, and to address the sharp asymmetries among themselves, as regards both size and development stage.

This set of circumstances surrounding Mercosur's formation (and by extension South America's) is specific to the region. It is thus question of an unprecedented undertaking. At other latitudes, such as in Europe or in the Pacific Basin, integration occurred originally among advanced industrial or emerging economies at a comparable development stage, whose social structures were markedly cohesive, and which maintained a symmetrical, not subordinate relation with the world order.

This is not the case of Mercosur, or of any previous Latin American integration experience, for that matter. Here, integration is pursued by countries that have not yet consolidated their national identity in regard to key issues such as social cohesion, that maintain a vulnerable position vis-à-vis the rest of the world under the center-periphery model, and that display asymmetries of size and development stage among themselves.

This points to the complexity of Mercosur's formation. Here, the process is not limited to fixing norms for the integration of members and to setting community-encompassing public policies. It encompasses and is conditioned by the decisions of each country for promoting their national development and by joint initiatives to change the form of the region's participation in the global scenario and to solve the existing asymmetries.

These circumstances, which are specific to Mercosur, do not invalidate the project, but characterize its complexity and condition the integration strategy.

The social fragmentation and prevailing asymmetries in the region help explain the policy differences among Argentina, Brazil, Chile, Uruguay, and Venezuela, whose current governments are driven by a renovating, progressive impetus.

Conclusions are far from being pessimistic if one compares the results so far achieved by Mercosur and other South American types of association with the past, i.e., with relations among our countries at the outset of the convergence between Argentina and Brazil, and thus of Mercosur, with the signing of the 1985 Foz do Iguaçu Act. The comparison shows that since then notable progress has been made on many fronts, including trade, investment, democratic solidarity, and international stance. It is thus necessary to discard the vision of an *ideal integration* and above all to implement a realistic, comprehensive, and well-rounded strategy for our countries' integration, in accordance with actual reality and not with fantasies.

There are currently governments in the region on whose agendas the social issue is understandably given priority. Each country will address the claims of its society consistently with its particular realities. This is a key national development issue that has a bearing on regional integration but pertains to each country's internal affairs.

On the path toward transformation that each country must carry out in its own way, regional integration has considerable potential for expanding markets,

coordinating productive complexes, developing common infrastructure, promoting science and technology, and agreeing on common positions vis-à-vis the world order in respect of critical issues that affect us, such as peace and security, environmental protection, the fight against drug addiction and drug trafficking, and international trade reform, intellectual property, and financial regimes.

One should thus discard any pessimistic attitude based on imagined new splits among our countries and on the failure of ideal integration projects that have proven unfeasible from the beginning, given the region's prevailing realities. An objective, factual assessment shows that one cannot postpone the construction of Mercosur and of any possible type of South American integration in the many existing areas of convergence, which are much wider and much more fecund than at any other point in our shared history.

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Translation: João Coelho.

The Bolivian economy: diagnosis and plans for 2008

*Luis Alberto Arce Catacora**

Introduction

Bolivia, a landlocked country in central South America, is a unitary, democratic, representative, and presidentialist Republic. It is politically and administratively organized into nine departments. La Paz is the seat of government. Spanish is the official language, and the currency unit is the boliviano (BOB). It covers an area of 1,098,581 sq km and has a population of 8,239,676. The country is rich in mineral deposits, including silver, tin, iron, and zinc as well as hydrocarbons, particularly natural gas. It produces corn, wheat, cotton, potatoes, rice, sorghum, soybeans and timber, among other products.

The table below shows the performance of the various economic variables since the 1970s. One can see that the Bolivian economy has experienced major macroeconomic disequilibria over the decades, which has affected the population's welfare. In the last two years it has approached the per capita GDP levels of the 1970s.

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Major economic and social indicators
(Period averages – in percentages) 1970-2007

	1970-1979	1980-1989	1990-1999	2000-2005	2006-2007
Real GDP growth rate ¹	4.5	-0.4	4.0	2.9	3.9
Real GNP growth rate ²	4.3	-0.4	4.3	2.9	3.3
Per capita GNP (US\$)	1,023	850	907	968	1,007
Monthly inflation ³	1.42	11.99	0.76	0.28	0.61
Fiscal deficit/surplus ¹ (GDP %)	- 2.1	- 11.4	- 3.7	- 5.8	3.8
Current account deficit (US\$ millions) ¹	-	- 210.6	- 347.8	84.2	1,107.2
Population ²	4,709.388	5,940.923	7,416.825	8,917.934	9,638.389

Source: National Statistics Institute-INE and Ministry of Finance Prepared by: Fiscal Analysis Network

Note: 1. First semester of 2007

2. End-2006

3. September 2007, in percentage

This article is divided into two parts: the first focuses on the economy's current situation and provides a diagnosis of the real, external, monetary, and fiscal sectors and a brief description of current issues, accompanied by an analysis of major social indicators; the second part dwells on the outlook for the economy in 2008, in light of the National Development Plan.

I. Description of the economy

This section describes the performance of the main macroeconomic variables in 2006 and in the first semester of 2007.

1. The real sector

In 2006 the Bolivian economy benefited from a very favorable external environment and by a correct administration of the economic policy, both of which greatly influenced its performance.

The gross domestic product in real terms grew by 4.63 percent in 2006 as compared with 2005. This was the highest growth rate recorded in the past seven years. This growth was driven mainly by the manufacturing sector, which contributed 1.33 percent. See Table 1 below.

Table 1
Gross Domestic Product by economic sectors
(In 1990-BOB millions and in percent) 2005-2006

	Millions 1990-BOB		Growth %		Incidence %	
	2005	2006	2005	2006	2005	2006
GDP at market prices	25,936	27,137	4.04%	4.63%	4.04%	4.63%
Indirect taxes	2,470	2,599	7.43%	5.24%	0.69%	0.50%
GDP at basic prices	23,466	24,537	3.70%	4.57%	3.36%	4.13%
GDP Extractive	2,809	2,933	13.0%	4.42%	1.29%	0.48%
Crude oil and natural gas	1,769	1,854	14.54%	4.81%	0.90%	0.33%
Metallic and nonmetallic minerals	1,040	1,079	10.37%	3.75%	0.39%	0.15%
GDP Non-extractive	20,657	21,604	2.55%	4.59%	2.06%	3.65%
Agriculture, forestry, game and fisheries	3,773	3,945	4.82%	4.55%	0.70%	0.66%
Manufacturing	4,285	4,631	2.70%	8.06%	0.45%	1.33%
Electricity, gas and water	515	534	2.64%	3.55%	0.05%	0.07%
Construction	679	709	2.61%	4.48%	0.07%	0.12%
Trade	2,125	2,199	2.70%	3.50%	0.22%	0.29%
Transport and communications	2,847	2,963	2.78%	4.09%	0.31%	0.45%
Finance, insurance, real estate	2,914	3,088	0.39%	5.96%	0.05%	0.67%
Public Administration Services	2,373	2,459	3.63%	3.65%	0.33%	0.33%
Other services	1,897	1,941	1.20%	2.33%	0.09%	0.17%
Imputed banking services	-752	-865	7.40%	15.14%	0.21%	-0.44%

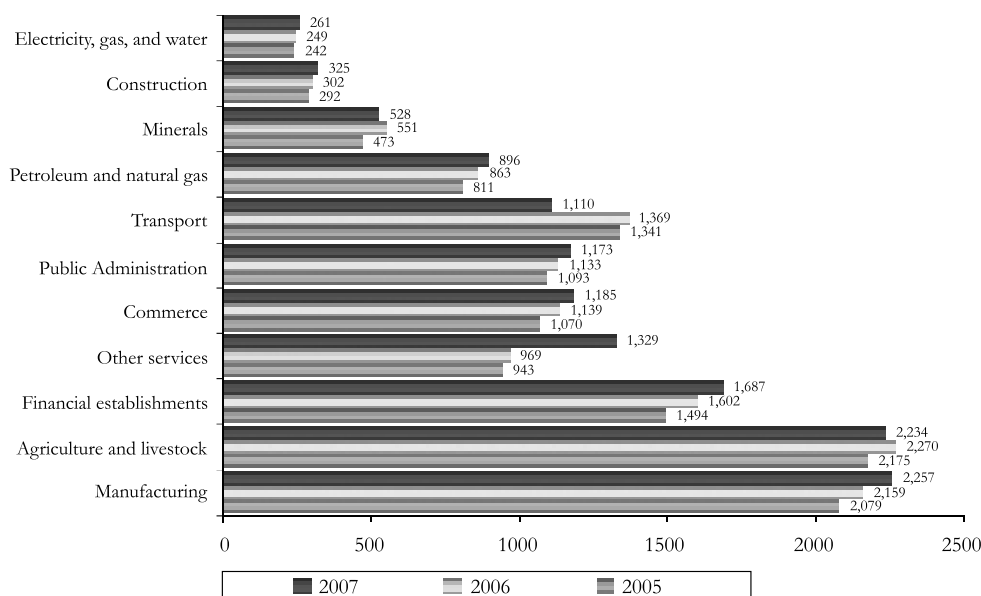
Source: National Statistics Institute-INE

Compiled by: Fiscal Analysis Network

In the first half of 2007, GDP grew nearly 3.15 percent, recording an upsurge in nearly every sector (Chart 1), except for the agricultural and livestock sector, which was adversely affected by El Niño. This climate phenomenon produced a negative supply shock, thereby preventing the normal flow of food into the economy. This put a strong pressure on the level of prices.

Chart 1

Real Gross Domestic Product per economic sector
(In 1990-BOB millions) 1st semester 2005 – 1st semester 2007



Source: INE

Compiled by: Fiscal Analysis Network

The growth of internal demand in 2006 had a positive effect (Table 2) on the economy's total expenditures, of approximately 2.63 percent of the real GDP 4.63-percent growth. Internal demand grew 2.7 percent in respect of all of its components. Household consumption rose 3.88 percent owing to the income policy implemented by the government, which raised real minimum salary by 9.7 percent since May 2006. The export sector also recorded higher real earnings owing to the correct orientation of the exchange policy, coupled with high external demand for raw materials and manufactures. Gross fixed capital formation grew 7.09 percent, owing to the construction sector's greater dynamism and to a stable political environment. Government spending grew 3.2 percent, less than in 2005, as a result of an austerity policy implemented in 2006. External demand growth recovered from -1.27 percent in 2005 to 2 percent in 2006.

Table 2

Gross Domestic Product per category of spending
(In 1990-BOB millions and in percent) 2005-2006

	1990-BOB Millions		Growth %		Incidence %		Participation %	
	2005	2006	2005	2006	2005	2006	2005	2006
GDP AT MARKET PRICES	25,936	27,137	4.04	4.63	4.04	4.63	100.00	100.00
Internal demand	25,323	26,006	5.51	2.70	5.31	2.63	97.64	95.83
Public spending	2,989	3,087	3.36	3.27	0.39	0.38	11.53	11.38
Private consumption	18,644	19,369	2.72	3.88	1.98	2.79	71.89	71.37
Investment	3,689	3,550	24.78	-3.78	2.94	-0.54	14.22	13.08
Varex	333	-44	-225.1	-113.25	2.40	-1.45	1.28	-0.16
Capital formation	3,356	3,594	94.14	7.09	0.54	0.92	12.94	13.24
NET EXPORTS	613	1,131	-33.99	84.61	-1.27	2.00	2.36	4.17
Exports of goods and services	9,040	9,909	9.87	9.61	3.26	3.35	34.86	36.52
Imports of goods and services	8,427	8,778	15.44	4.16	4.52	1.35	32.49	32.35

Source: INE

Compiled by: Fiscal Analysis Network

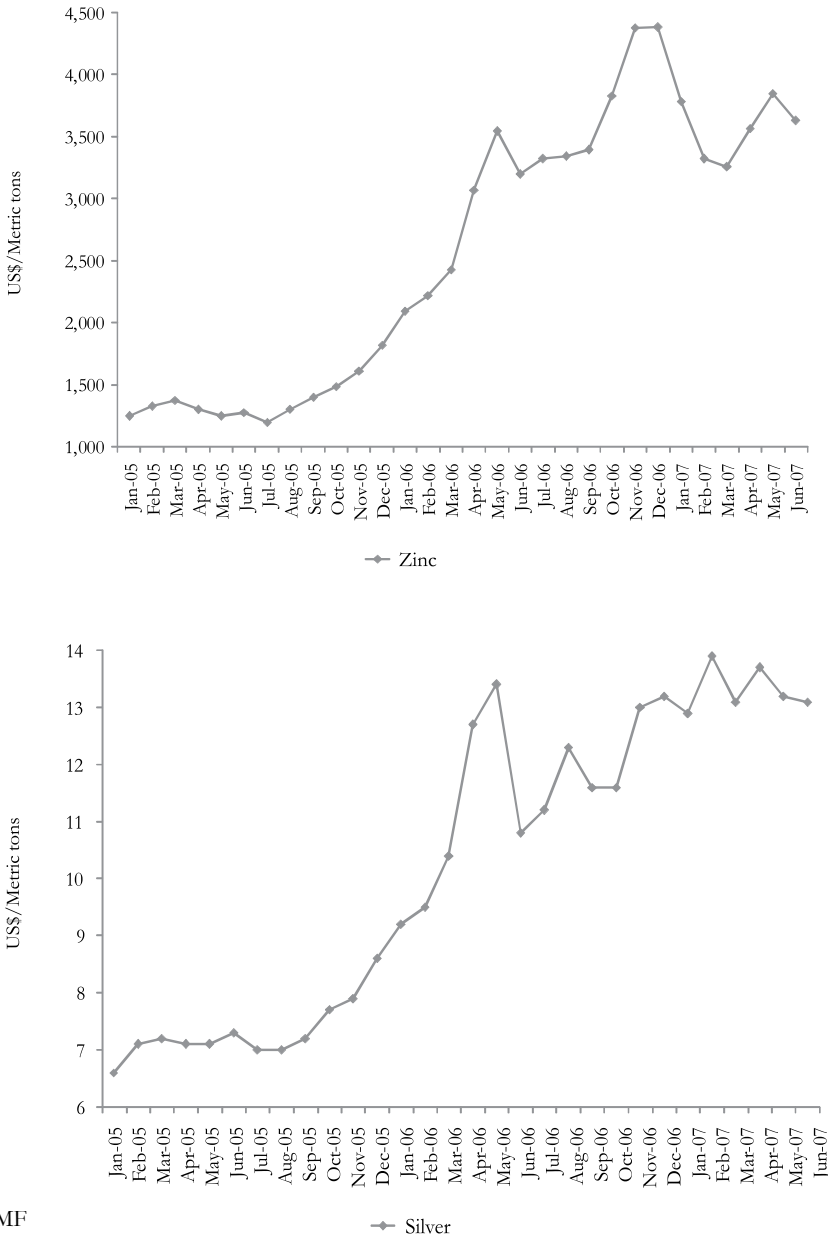
Net exports grew 84.6 percent in 2006, thereby reversing the negative growth of -33.9 percent in 2005. Various factors explain this positive development, including greater demand of raw materials by India and China and favorable international prices on the external front, as well as intense negotiations by President Morales's government, which ensured better prices and a greater volume of natural gas exported to the Republic of Argentina and the Republic of Brazil. A good example was the negotiation with Argentina, which improved export prices by 65 percent on the average.

2. The external sector

International prices were favorable in 2006 and have remained so in the first half the current fiscal year, as shown by a monetary policy report by the Central Bank of Bolivia-BCB.¹ An additional factor was the greater dynamism of the Asian economies, particularly China's and India's, and of the euro zone, coupled with the rebound of the United States's economy. All these elements led to a period of bonanza that still endures (Chart 2).

¹ *Informe de Política Monetaria*. July 2007.

Chart 2
Prices of major mineral exports (In US\$ per unit) 2005-2007

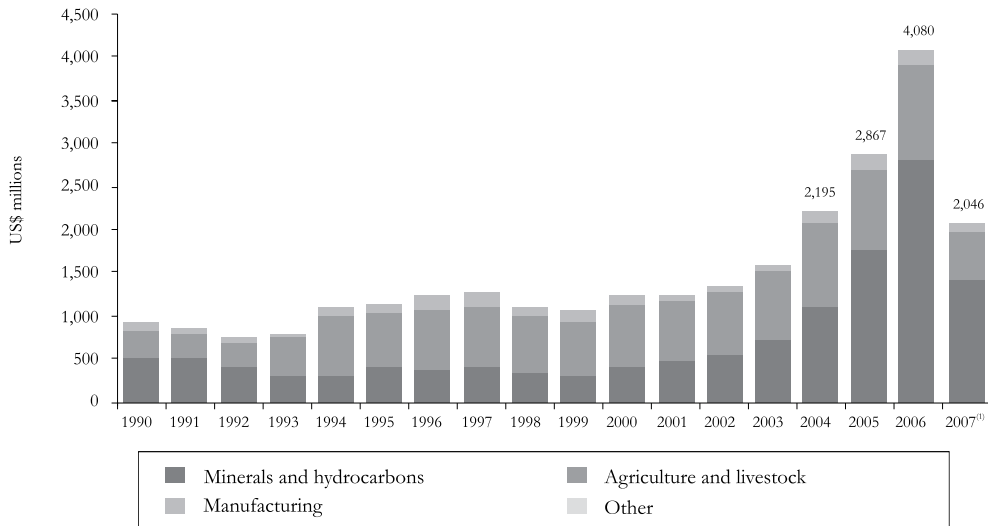


Source: IMF
Compiled by: RAF

Exports have struck historical records: they totaled US\$4.080 billion in 2006 and US\$2.046 billion, a higher figure than any prior to 2003 (Chart 3).

Chart 3

Exports according to economic activity (In US\$ millions) 1990-2007



Source: INE

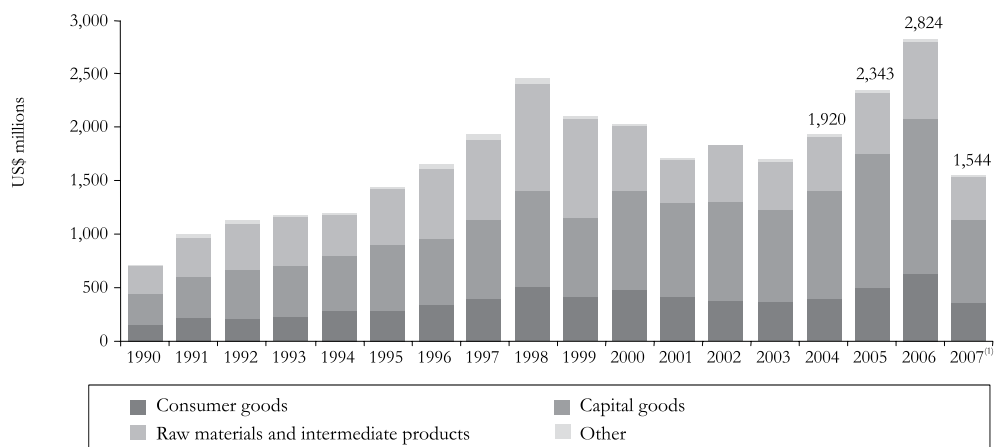
Compiled by: RAF

(1) Exports from January-June 2007

The value of imports both in 2006 and in the first half of 2007 followed an ascending curve between 2001 and 2006. Over 50 percent of Bolivia's imports consist of raw materials and intermediate products. Capital goods imports in 2006 were slightly higher than in 2005 (Chart 4).

Chart 4

Imports according to use or economic destination
(In US\$ millions) 1990-2007



Source: INE

Compiled by: RAF

Imports from January to June 2007

The favorable external scenario combined with proper management of the exchange policy translated into a balance of payments surplus in 2006 and in the first half of 2007 (Table 4), which in turn reflected in current account and capital account surpluses.

Table 4

Balance of Payments current account and capital account
(In US\$ millions) 2004-2007

	2004	2005	2006	1 st semester	
				2006	2007
Current account	337.4	622.5	1,319.1	471.2	676.1
Capital and financial account	-211.5	-118.8	266.2	374.2	22.9
Balance of payments	125.9	503.6	1,515.5	845.5	698.9

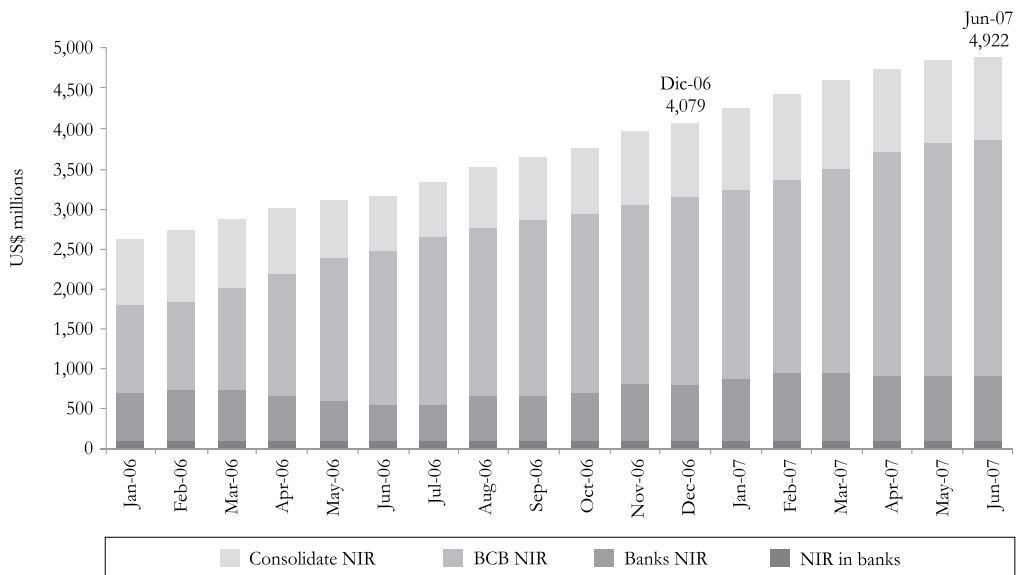
Source: BCB

Compiled by: RAF

The inflow of remittances and the trade balance surplus led to a balance of payment's current account surplus of US\$1,319.1 billion in 2006 and of US\$471.2 million in the first half of 2007, of which US\$1,054.2 billion and US\$375 million in the first half of 2007 are attributable to the trade balance.

The positive trade balance, the significant inflow of remittances in 2006 and in the first half of 2007, the alleviation and payment of the foreign debt, coupled with lower financing requirements of the fiscal sector are reflected in a greater accumulation of net international reserves (NIR) by the BCB and the financial system, which reached historical records by June 2007 (Chart 5). This allowed the economy to ensure stability and the coverage of over 100 percent of deposits in the financial system.

Chart 5
Consolidated international reserves of the financial system
(In US\$ millions) 2006-2007

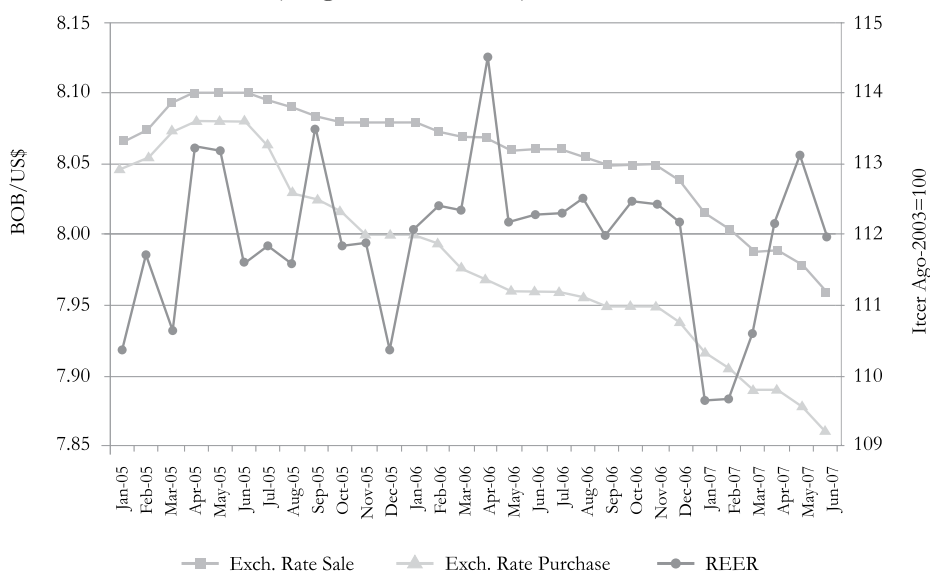


Source: BCB
Compiled by: RAF

In June 2007, net international reserves totaled US\$4.999 billion (79 percent of the Consolidated Reserves of the Financial System). This impressive volume of reserves forced the BCB to appreciate the national currency against the dollar by 0.62 percent in 2006 and by 2.7 percent in September of the current year.

In 2006, the real effective exchange rate (REER) depreciated by 0.09 percent owing to the faster pace of appreciation and inflation rates of our trade partners. In 2007, the REER appreciated by 0.73 percent (Chart 6).

Chart 6
Nominal Exchange Rate and Real Effective Exchange Rate Index
(August 2003=100) 2006-2007



Source: BCB

Compiled by:RAF

Gross Foreign Direct Investment (GFDI) totaled US\$435.1 million, or an additional US\$30.7 million over the previous year. During this period investment favored the mining sector (56.4 percent of total investment), which grew by 37.3 percent, owing mainly to large mining projects such as the San Cristóbal and the San Bartolomé projects. GFDI in the hydrocarbon sector (24 percent of the total) remained at about the same level in 2005, when investment totaled US\$104.5 million (Table 5). GFDI declined in the first half of 2007

as compared with US\$23.9 million in the same period in the previous year. However, disinvestment in the current year is less than in 2006.

Table 5
Foreign Direct Investment (In US\$ millions) 2005-2007

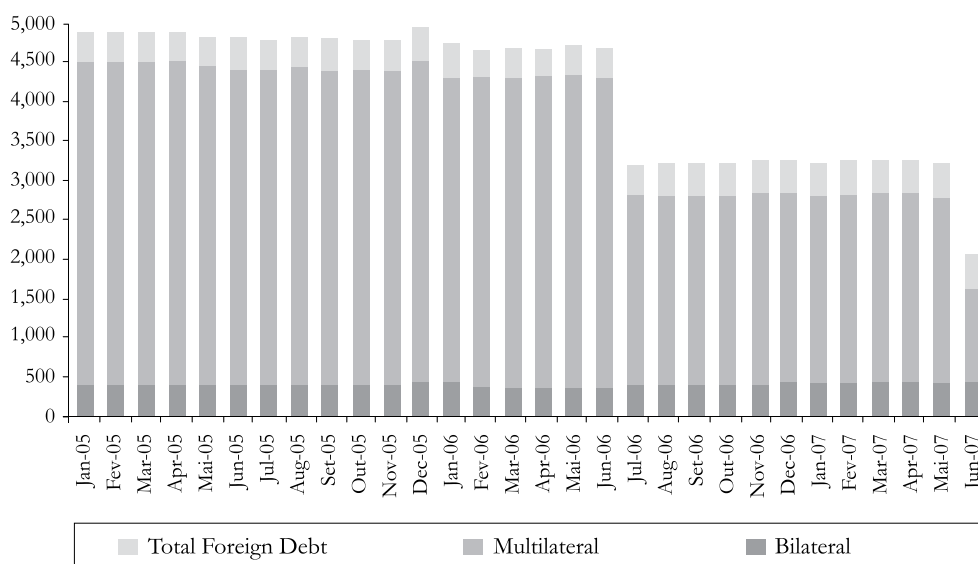
Economic Sector	2005	2006(p)	January-June		Ratio 1 st semester		
			2006(p)	2007(p)	Absolute Variation	Share %	Growth %
GROSS FDI	404.4	435.1	240.8	216.9	-23.9	100	-9.9
Hydrocarbons	105	104.5	31.3	22.9	-8.4	10.6	-26.8
Mining	183	251.3	137.1	122.3	-14.8	56.4	-10.8
Industry	58.3	47.8	8.9	20	11.1	9.2	124.7
Transport and communications	45	16	33.6	36.8	3.2	17.0	9.5
Trade, electricity, and services	13.1	15.5	30	14.9	-15.1	6.9	-50.3
DISINVESTMENT	-643	-195	-227.5	-119.8	-	-	-
NET FDI	-238.6	240.1	13.4	97.1	-	-	-

Source: BCB Compiled by: RAF

By late December 2006, the stock of the foreign debt stood at US\$3.248 billion, as a result of debt forgiveness by the World Bank and the Japanese Government. By the end of the first half of this year, the stock of the debt had dropped to US\$2.056 billion, thanks to debt forgiveness by the Inter-American Development Bank (Chart 7). These events have reduced the economy's vulnerability to the negative effects of interest rates and to the external sector's foreign exchange risk.

Chart 7

Stock of the Foreign Debt by Creditor (In US\$ millions) 2005-2007



Source: BCB

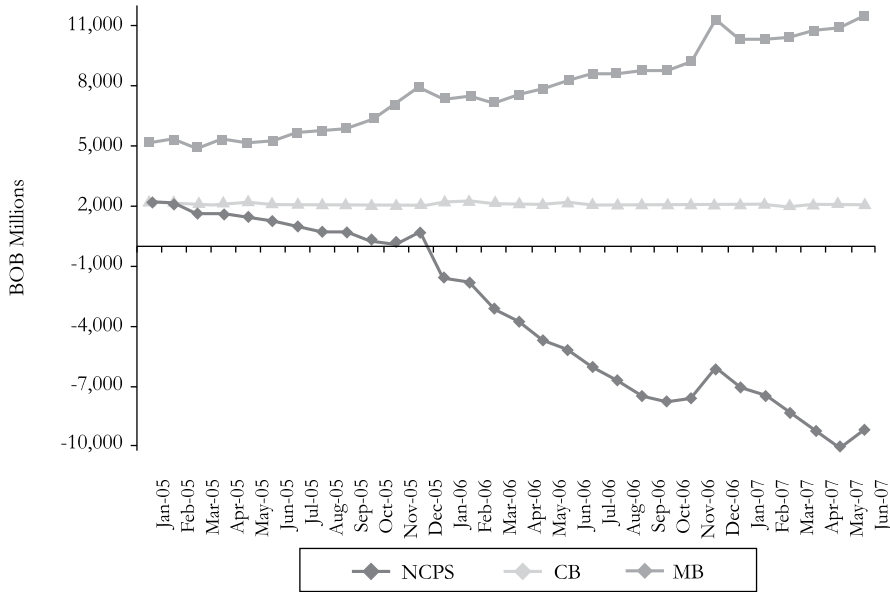
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3. Monetary sector

Under Law 1670, the BCB is charged with ensuring the stability of the national currency's purchasing power. To this end, the BCB is implementing a monetary policy that uses instruments for achieving intermediate targets (it sets a ceiling for NIR and a threshold for net domestic credit). This allows it to maintain an optimum NIR level consistent with an adjustable exchange rate and a net domestic credit level that does not inflate prices (Chart 8).

Chart 8

Monetary base net credit to public sector and credit to banks
(In BOB millions) 2005-2007



Source: BCB

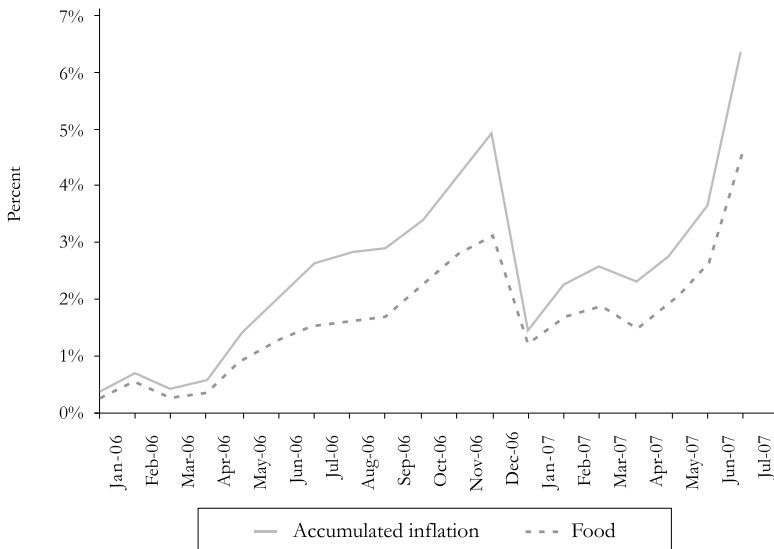
Compiled by: RAF

All the monetary policy instruments used by the BCB are aimed at achieving BCB's main objective of controlling inflation. For 2006 the BCB announced a target inflation range of 3 percent – 5 percent; by the end of the year, accumulated inflation was 4.91 percent, thus falling within the target range.² Since November 2006, though, supply shocks have driven prices up. These shocks associated with the El Niño phenomenon gained force in January 2007 and extended until the middle of the current year's second quarter, directly affecting food prices (Chart 9). To this should be added the economic agents' inflation expectations after a series of news items and rumors spread by many analysts who did nothing other than prove self – fulfilling prophecies and put further pressure on prices. Nevertheless, underlying inflation both in December 2006 and June 2007 was lower than observed inflation, which means that the higher prices can be explained by seasonal factors and transitory shocks (Chart 10).

² Previous administrations used to announce a specific punctual target.

Chart 9

Accumulated inflation and food performance (In percent) 2005-2007

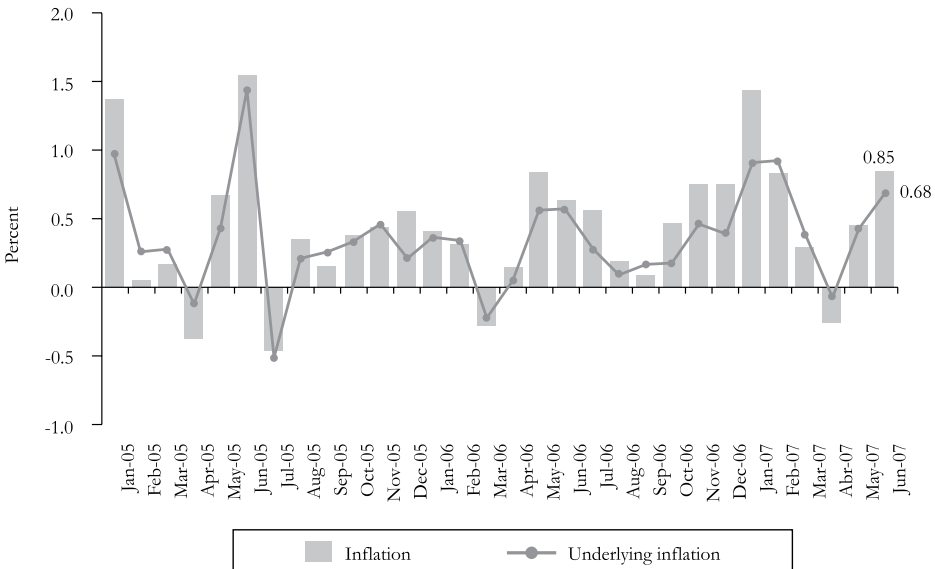


Source: INE

Compiled by: RAF

Chart 10

Monthly inflation and underlying inflation (In percent) 2005-2007



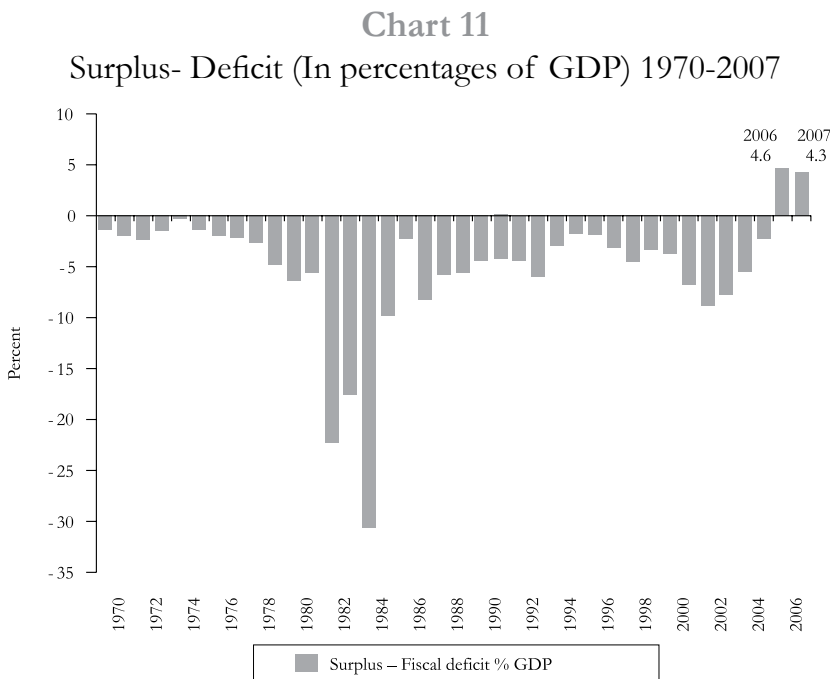
Source: INE

Compiled by: RAF

The reserve requirement ratio remained constant at 12 percent for deposits in national currency and at 21.5 percent for deposits in foreign currency throughout 2006 and the first half of 2007. Open market operations, the main indirect instrument utilized by the BCB allowed the withdrawal of US\$248.9 million from the economy, equivalent to 173.5 percent of the balance in December 2005. For the first semester of the current fiscal year the balance is US\$498.3 million, which neutralizes the NIR's potential impact on inflation.

4. Fiscal sector

Fiscal policies implemented in 2006 permitted a nonfinancial public sector surplus of BOB 4.101,4 billion, or 4.6 of GDP – a historical figure without precedent in over sixty years (Chart 11). The fiscal surplus in the first half of 2007 is 4.3 percent, as a result of the implementation of a sovereign financial program.³



Source: Fiscal unit of Programming (UPF)

Compiled by: RAF

³ Under a section of the National Development Plan titled “Sovereign Bolivia,” the country completed its stand-by program with the International Monetary Fund-IMF on March 31, 2006. The Ministry of Finance is now implementing a sovereign financial program without the influence of any international organization.

In 2006, the tax authority adopted policies to raise revenues and optimize fiscal expenditures. Some policies were implemented in combination with hydrocarbon policies to raise revenue from the nonfinancial public sector (nationalization of the hydrocarbon sector and negotiation of better prices and larger export volumes of natural gas). The tax base was broadened and the efficiency of collections was improved. A considerable tax pressure increase has occurred since 2005, owing essentially to the favorable external context and the dynamism of the internal economy (Table 6). Direct taxation of hydrocarbons produced a significant change in the tax system's collections structure: in 2006, this sector's participation in collections was 6.1 percent, or 3 percent over the previous year.

Table 6
Tax Revenues 2004-2007

	In BOB millions				Percent				GDP percent			
	2004	2005	2006	2007*	2004	2005	2006	2007*	2004	2005	2006	2007*
INTERNAL REVENUE	10,571	10,571	20,376	10,960	94.0	95.0	95.7	95.6	15.2	19.8	22.8	22.6
VAT	4,411	4,411	6,405	3,465	39.2	33.1	30.1	30.2	6.3	6.9	7.2	7.1
IUE	1,122	1,122	2,311	1,286	10.0	11.1	10.9	11.2	1.6	2.3	2.6	2.6
IT	1,567	1,567	1,812	1,007	13.9	10.7	8.5	8.8	2.3	2.2	2.0	2.1
ICE	558	558	782	465	5.0	4.2	3.7	4.1	0.8	0.9	0.9	1.0
IEDH	1,147	1,147	2,000	1,124	10.2	11.9	9.4	9.8	1.6	2.5	2.2	2.3
IDH	0	0	5,497	2,747	0.0	14.7	25.8	24.0	0.0	3.1	6.1	5.7
Other	1,766	1,766	1,568	865	15.7	9.3	7.4	7.5	2.5	1.9	1.8	1.8
CUSTOMS REVENUE	672	672	921	509	6.0	5.0	4.3	4.4	1.0	1.0	1.0	1.0
<i>Tax revenue</i>	11,243	11,243	21,297	11,469	100.0	100.0	100.0	100.0	16.11	20.9	23.8	23.6
<i>Tax Revenue less IDH</i>	11,243	11,243	15,799	8,722	100.0	85.3	74.2	76.0	6.1	17.8	17.7	18.0

Source: National Revenue Service and National Customs

Compiled by: Fiscal Analysis Network

(*): Data updated to June 2007

(1): Collections since June 2005.

(2): Annual GDP: BOB 69.626 billion in 2004; BOB 76.154 billion in 2005, BOB 89.428 billion in 2006; and BOB 48.556 billion in the first half of 2007.

IUE: Tax on enterprise profits

IT: Sales tax

ICE: Specific consumption tax

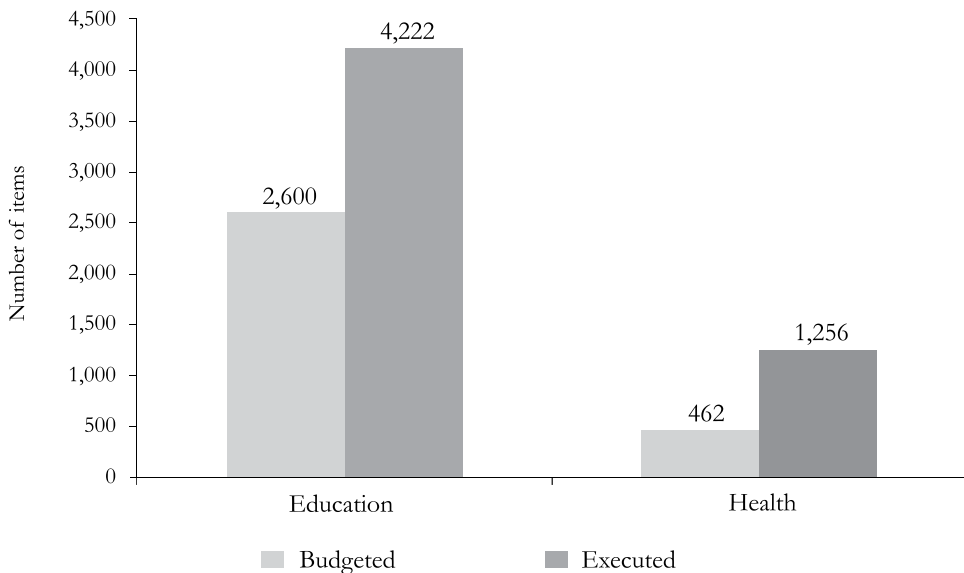
IDH: Direct hydrocarbons tax

IEDH: Specific tax on hydrocarbons and byproducts

The austerity policy implemented since 2006 aims at reallocating resources toward social sectors that were marginalized and neglected in the past. Since March 2006, the government has implemented an austerity, shared sacrifice policy that has set a remuneration ceiling for the Executive Branch (President of the Republic, US\$1,861; Ministers of State, US\$1,737) and expenditures with the public sector's representation in the interior were eliminated and the corresponding resources were channeled to new work categories in the areas of education and health (Chart 12).

Chart 12

Austerity policy new work categories in health and education 2006

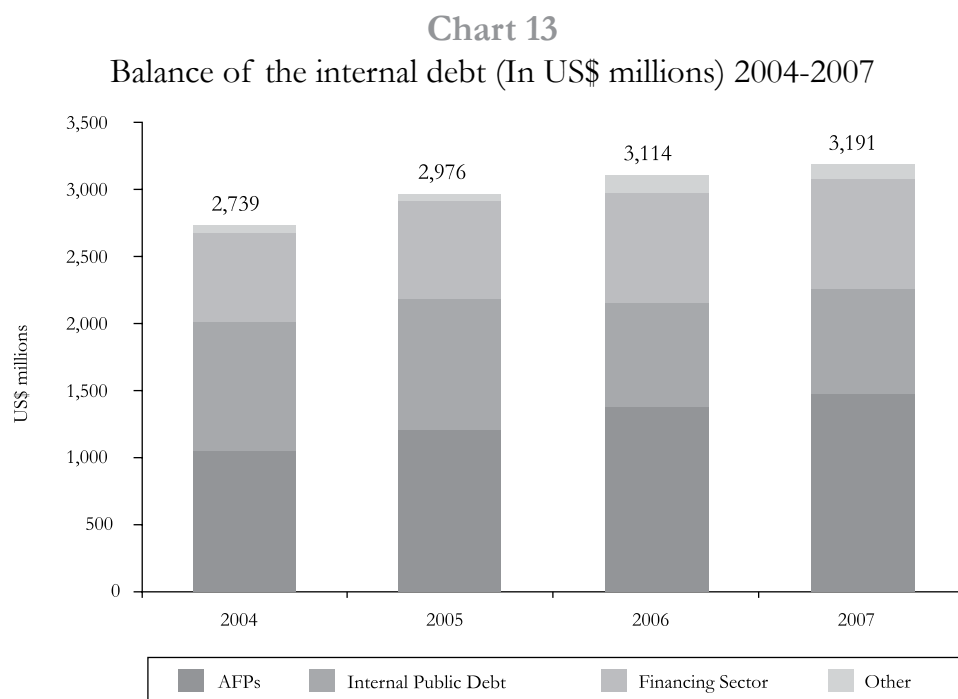


Source: Ministry of Finance

Compiled by: RAF

The fiscal policy aimed also at eliminating reserved expenditures and at ensuring transparency vis-à-vis society in respect of the use of public funds. Information about public spending by the Central, Municipal, and Local Governments is available to the public on the internet.

In 2006, a reduction of US\$212 million in the internal debt service as compared with 2005 was due in part to the cancellation of liquidity credit to the Central Bank of Bolivia (Chart 13).



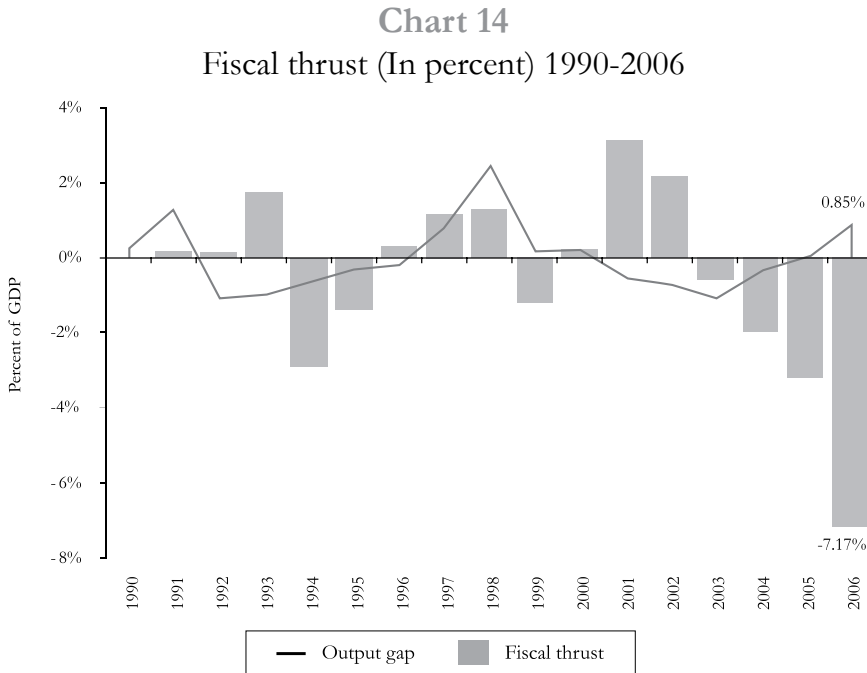
Source: Ministry of Finance

Compiled by: RAF

A problem associated with the growth of the internal debt in the past was the intense dollarization. At end-2003, over 80 percent of the internal debt was denominated in dollars, which exposed fiscal accounts to an exchange rate risk. Recently, the Ministry of Finance has endeavored to reduce the dollar-denominated debt by using debt instruments denominated in Housing Foment Units-UFV. As UFV-denominated instruments are pegged to the Consumer Price Index, the yield of these papers depends on price variations. To the extent that the monetary authority is able to control inflation, it is possible to attenuate the internal debt instruments' volatility risk.

These fiscal results in 2006 and part of 2007 show that the fiscal policy was more contractive than in the last 16 years. In addition, a positive output

gap may be an indication that the 2006 fiscal policy was not only contractive but also anticyclical, as can be seen from Chart 14).



Source: INE, Ministry of Finance

Compiled by: RAF

II. Outlook

Part I of this article expounded the Bolivian economy's current situation. Part II focuses on the economic outlook for 2008 and some years thereafter.

As to the real sector, productive activity should be driven by investments in the mining, hydrocarbon, industrial and construction sectors. Private initiative is expected to invest US\$ 460 million and will thus account for 34 percent of total investment. The public sector will account for the other 66 percent by investing US\$886 million. Table 7 shows investment in the hydrocarbon sector by the nationalized Yacimientos Petrolíferos Fiscales Bolivianos – YPFB. Owing to this process aimed at retaking full control of the hydrocarbon resources, which has been under way since May 2006, it is possible that YPFB will now participate in the country's entire hydrocarbon productive chain.

Table 7
Investment in strategic sectors (In US\$ millions) 2008

	2008	2009	2010	2011
TOTAL INVESTMENT	1,336	1,202	1,230	1,048
PRIVATE INVESTMENT	450	414	542	436
MINING	294	457	568	477
Mutún and other	271	433	556	461
COMIBOL shared risk	24	25	13	16
HYDROCARBONS	106	-94	-92	-92
GTL plants	-132	-94	-92	-92
Gas pipelines	238			
ELECTRICITY	50	50	66	52
PUBLIC INVESTMENT	886	788	688	611
FINANCIAL	107	114	128	156
Industry	100	100	100	100
Construction	7	14	28	56
Housing	7	14	28	56
NONFINANCIAL	779	674	560	455
HYDROCARBONS (YPFB)	152	94	92	92
Gas pipelines	20			
Natural to liquid gas Project	132	94	92	92
CONSTRUCTION	627	580	468	363
Homes	2	4	7	14
Roads and infrastructure	625	577	461	349

Source: Ministry of Finance

Compiled by: RAF

As regards the external sector, the favorable international context should still be a determinant factor in the national economy. Evidently, the deceleration of the real estate market in the United States poses a risk to the continuity of the economic bonanza. However, China's expected growth of over 10 percent and the world economy's dynamism are exogenous factors that should boost the country's exports.

In respect of the monetary policy, the Central Bank of Bolivia will steer all its measures toward keeping inflation low and stable and thereby maintain the national currency's internal purchasing power. In 2008 and 2009, the annual inflation rate should be around 4 percent, plus or minus on percentage point, so as to tend toward the medium-term target of 3 percent under the National

Development Plan. Management of the exchange rate will also be subject to the ultimate inflation objective.

To keep inflation low and stable, President Morales's government issued three Supreme Decrees-DS to rein in the increase in food prices, combat speculation, and guarantee supply to the markets. The essential objective of each of these norms is as follows:

- Temporary authorization of meat and cattle-on-the-hoof at zero tariff (D.S. 29228);
- Temporary suspension of wheat flour, wheat, and animal and vegetable fat exports, and definition of a mechanism to curb contraband of these products, and of the applicable sanctions (D.S. 29229);
- Authorization for the establishment of the Food Production Support Enterprise-Emapa with initial capital being provided by the Nation's General Treasury-TGN (approximately US\$24.8 million). In its first phase, Emapa will give priority to wheat and rice production.

The Nation's General Budget for 2008 is geared to the objectives of the National Development Plan. This should improve the capacity for formulating policies for the rural development, production, small enterprise, and hydrocarbon sectors. It will attach priority to programs and projects with a direct impact on job creation, economic growth, and social protection. Work is also being done toward the implementation of a Stabilization Fund, which would permit saving part of hydrocarbon revenues for implementing anticyclical policies.

Also envisaged is the establishment and functioning of productive units both in rural and urban areas, so as to encourage small enterprises. The State will promote job creation by executing infrastructure, housing, mining revival, and other investment projects. The social protection policy will be consolidated through the encouragement of social investment, particularly in the areas of health and education, so as to reduce poverty. The Government's fiscal transparency policy will be maintained. All the fiscal policy initiatives undertaken by the Ministry of Finance in 2006 and in the first half of 2007 have the main purpose of preserving the country's macroeconomic stability. To this end, the 2008 financial program will be drawn by the Ministry of Finance in collaboration with the Central Bank of Bolivia.

As to medium- and long-term projections, the National Development Plan is intent on introducing an alternative development model. To this end, the following objectives have been set:

- *Dignified Bolivia* – free of poverty and any form of exclusion;
- *Democratic, participative Bolivia* – grounded on a plurinational, community-centered society, in which the people hold the power, from the regional level up;
- *Productive Bolivia* – where industrialization of the natural resources is accomplished, accompanied by increased aggregated value of exports, all with the backing of the State as a development promoter and actor; and
- *Sovereign Bolivia* – that makes its own, autonomous decisions according to its needs, so as to maintain harmonious, balanced relations among the countries.

Results envisaged by 2011 are as follows:

- Average GDP growth of 6.3 percent;
- Reduction of open unemployment from 8.7 percent in 2004 to 4 percent in 2011;
- Creation of 90,000 jobs per year;
- Per capita income increase from US\$1,000 in 2005 to US\$1,411 in 2011;
- Change in the energy matrix of 50 percent of the automotive sector, and reforestation of half a million hectares;
- Industrialization of nonrenewable natural resources;
- Annual inflation under 5 percent; and
- Public debt sustainability. **DEP**

Translation: João Coelho.

A qualitative approach of the Brazilian economy

*João Paulo de Almeida Magalhães**

Introduction

In addressing this article's topic, it would be natural to start with a descriptive and quantitative exposition of the Brazilian experience. We have chosen another approach for two reasons. First, because data on the country's reality are readily and widely available in a score of sources accessible via Internet. Second, because, despite conditions that are extremely favorable to development, Brazil currently finds itself in its third decade of semi-stagnation. This is why an analytical and qualitative approach has been chosen, capable of allowing the identification of the causes of the problem and a description of possible solutions.

An American development bank has made a list of countries that, given their potential growth, should wield great weight in the world economy in a not-too-distant future. The list includes countries such as the BRIC countries – Brazil, India, China, and Russia. The conditions usually deemed favorable to

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development are a large domestic market, an abundance of natural resources, a favorable population/land ratio, linguistic and cultural unity, absence of internal ethnic and religious conflicts, and good relations with neighbors. None of the other three BRIC countries meets all of these favorable conditions as Brazil does.

As it happens, in the last twenty years China grew at an average annual rate of 9 percent, while India grew at 7 percent a year. In the last ten years, Russia also grew at 7 percent a year. In contrast, in the last twenty years Brazil raised its GDP by only slightly over 2 percent a year.

Armínio Fraga (2006) has precisely summed up the problem in the introduction of a recent book showing that in the first eighty years of the last century Brazil recorded a 3.1-percent yearly growth of its per capita GDP, second only to Japan's 3.2 percent. In the 1980s, that rate fell to 0.5 percent, rising to 1 percent in the following decade, when Asian countries were recording a 6-percent increase in their per capita GDP. Available data show in addition that in recent times Brazil not only grew much less than the emerging economies but also a little less than mature economies. As development is measured by the difference between developed and lagging economies, it can be said that Brazil not only failed to develop but also became immersed in a process of increasing underdevelopment. This is the paradoxical situation this article purports to analyze to see how it can be redressed and to what extent the requisite measures are politically and economically feasible.

This article is divided into four sections: diagnosis, current situation, possible solutions, and outlook.

Diagnosis

1 – In the thirty-five years following World War II, Brazil grew at an average annual rate of 7 percent, based on the import substitution model. Then, it entered a semi-stagnation period that extends to today. The first question is thus: What caused this model's collapse and what should be made to counter this situation? Specialists agree that the cause stemmed from insufficient markets, or, specifically, that the dynamic process ceased because the stock of substitutable exports was exhausted.

The two interpretations suggested ways to solve the problem: one was based on the expansion of the domestic market and the other on recourse to the external market. Each had its own explanation for the failure of the import substitution model. According to Celso Furtado, whose analysis is clearly Marxist, the problem was congenital to underdeveloped economies. Mature economies have a feedback mechanism, whereby GDP's increase determines a proportionate increase in the salary mass, automatically guaranteeing the market necessary to absorb excess production. This does not happen with underdeveloped countries because, although their economies are characterized by an overabundance of labor, they are forced to resort to labor-saving technology imported from the developed countries. This perpetuates a kind of "reserve industrial army", which keeps salaries low, thereby preventing the emergence of a demand proportionate to increased production. This was allegedly the reason why the country did not automatically move from the import substitution model to self-sustained growth based on an internal market. The way to overcome this impasse would be a far-reaching income distribution policy to correct the market insufficiency stemming from the absence of the feedback loop. Income redistribution would expand the internal market to the extent needed to offset the loss caused by the exhaustion of the stock of substitutable imports.

The second interpretation was propounded by Magalhães (2005) and was based on the analysis by Rosenstein-Rodan (1961) and Nurkse (1955). These two authors studied the problem of market insufficiency as an obstacle to development policies. The difficulty stemmed from the technologically-determined diminutive size of productive units. According to Magalhães, the market created by GDP's increase, complemented by the stock of substitutable imports, was sufficient to counter the problem of the diminutive size of productive units. The problem arose when the opportunities for import substitution were exhausted. The solution would be to complement the internal market with exports.

Two interpretations, accompanied by proposals for maintaining a high growth rate, were then presented. In the 1980s, little could have been done. The entire Brazilian economy was geared to the task of producing the trade balance surpluses required by the servicing of the external debt incurred through loans taken out in the previous decade to overcome the difficulties created by the

oil shocks. In the 1990s, though, the issue had been solved, owing in part to the Brady Plan. At that time, however, the Brazilian Government had opted for the neoliberalism of the Washington Consensus, which rejected any State intervention. Economic strategies were considered not only unnecessary but also harmful. The consequence was the chronic semi-stagnation that victimized the Brazilian economy. The responsibility of the Washington Consensus for the problem (admitted today by their very champions, for that matter) is indirectly confirmed by the success of the Asian countries that ignored it.

2 – In this context, two questions ought to be answered. First, why did not only Brazil but also the Latin American countries in general accept the neoliberal formula, while the Asian countries rejected it, preferring what the World Bank had recognized in the report titled “The East Asian Miracle” (1993) as a “market-friendly intervention”? The answer suggested by Magalhães is that this was due to the difference between the mimetic patterns that inspired each region.

Underdeveloped countries do not create models or theories capable of guiding their economic policies. They simply copy known successful cases that become their mimetic patterns, and these are always countries with a history and culture similar to theirs, in addition to geographic proximity. The Asian countries’ mimetic pattern was Japan, a country that as late as the mid-19th century not only was underdeveloped but also retained medieval characteristics. Its success in terms of growth resulted from systematic action by the State, which created enterprises that were later transferred to the private sector, invested in the training of qualified labor, sponsored technological modernization, created a modern infrastructure, and so on. Japan did exactly what any nation willing to come out of its economic backwardness should do. All of this was just the opposite of the recommendations of the Washington Consensus. This explains the Asian countries’s resistance to adopting the latter’s neoliberal formula.

Latin America’s mimetic pattern was the United States, a country that never knew underdevelopment and, like Germany, only made part of the second industrialization wave. Its growth was based on private initiative and market mechanisms. Government action was restricted to protectionism, an instrument which mainstream economics seek to underestimate today. It was only natural, then, that Brazil and the other countries of Latin America in

general should accept the Washington Consensus primer, not only readily but even with eagerness.

This explains the different behavior between the newly industrialized Asian countries and the Latin American countries. How can one explain the Japanese case, though? Japan did not take as its base the economic policies implemented by other countries; it copied directly from what was happening in the American and the European economies. Commodore Perry, who bore to Japan the request for the opening of its ports to Western countries failed when, with the display of military power, he intended to elicit from that country the same behavior as China and India. He might have succeeded if, instead of a display of force, he had presented local authorities with a copy of Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations*, introducing it as the Bible that had ensured the prosperity of Western economies. Emulating Smith's formula of the invisible hand, Japan would have opened up its economy and rejected any State intervention in economic activities. It would then have remained underdeveloped, dragging in its wake the rest of Asia.

3 – The second question is why the Washington Consensus's neoliberalism did not yield the announced results, particularly if one considers that its proposals were based on what was most advanced in terms of the economic science.

Before World War II, Economics was seen as any other science, of assuredly general applicability. This science knew nothing of underdeveloped countries. There were simply economies that had not had time to achieve full development or that were poor because they were implementing wrong economic policies. Once the conflict was over, though, the awareness arose that not only there were underdeveloped economies but also that their backwardness was steadily aggravating. The general applicability of the conclusions of any science depends in each case on the validity of the premises on which they are based. In the 1950s it began to be accepted that the premises differed between developed and underdeveloped countries.

At first, an optimistic perception of the problem prevailed. It was thought that worldwide development was both desirable and possible. Those were the United Nations development decades. That was also the golden age of Development Economics that even earned two of its specialists the Nobel Prize, namely, Gunar Myrdal (1974) and Arthur Lewis (1979), both from developed countries.

Development Economics was born, in the final analysis, of the recognition that lagging growth did not replicate the historic experience of the currently developed countries. There is thus no sense in applying to the underdeveloped countries the conclusions accepted and championed by mainstream economics. Development policies involving systematic State intervention in the economy were essential for overcoming economic underdevelopment, as underdevelopment was but the result of a serious market flaw.

It did not take developed economies long to realize that worldwide development policies would entail a heavy burden on themselves in terms of higher prices of nonrenewable natural resources and of investment to reduce environmental aggression perpetrated by their economic activities. Support for policies aimed at overcoming economic backwardness lost impetus and grants extended for Development Economics research dried up or were drastically reduced. This discipline (at least as formulator of paradigms or theories adapted to lagging economies) fell into decline or practically dried up. Major contributions such as Arthur Lewis's on development under conditions of unlimited labor supply, and Rosenstein-Rodan's on market insufficiency as a handicap to development, were simply discarded, instead of being carried further. The formulas and interpretations of mainstream economics once again were deemed to be of worldwide application.

Dutt and Ros (2003) correctly define the problem, asserting that mainstream economics rarely recognizes the existence of other than its approaches. Mainstream economics is now called neoclassical economics (see p.7). They further assert that although there had been various competing schools at first, by mid-20th century neoclassical economics had become relatively standard and established its dominion over the profession (despite the growth of Keynesian economic that became increasingly 'neoclassical'). This neoclassical economics tendency to dominate the economist's profession reached such a point that most economists, particularly in the United States, would define economics as neoclassical economics (see p.8).

Thus was born what has become known as the monolithic thinking, which has given rise to what could be called ideological barrier. Owing to this barrier, analyses such as Prebisch's protectionism theory (1949) and the heterodox inflation theory of Brazilian economists have been rejected without being effectively refuted (in the former case) or have been ignored in major

debates, such as that on Central Bank independence (in the latter case). This deserves further examination.

Before World War II, industrial countries ensured their monopoly on production of manufactures through instruments such as the colonial pact imposed on a major part of Africa and Asia. In the case of independent countries, such as Latin American countries, other types of pressure were used. In Brazil, there was England's imposition of a maximum customs duty of 15 percent on its products, when products from Portugal were subject to a 16-percent tariff. This lasted until the mid-19th century, precluding the merest pretension of protectionist policy in that critical period. As these instruments ceased to be used after the conflict, their role was taken over by the monolithic thinking and by the ideological barrier, of which the Washington Consensus became the principle vehicle.

Imposition of the monolithic thinking was facilitated by the fact that, although they had not created the science, the underdeveloped countries imported it. And under mainstream economics, the neoliberal prescription was presented as a guarantor of maximum efficiency. There is no doubt about the importance, for the operation of the monolithic thinking and the ideological barrier, of the fact that international financial organizations, such as the IMF and the World Bank, condition their assistance to the acceptance of the dictates of the Washington Consensus. In truth, though, the main strength of these two instruments of domination comes from the fact that the underdeveloped countries' leadership is convinced that by accepting neoliberalism they are acting in their countries' best interest. This did not happen in respect of the policies imposed before World War II, as those who subjected themselves to them were fully aware of their negative aspects.

Since the 1950s, there is no longer the idea of maintaining the agricultural specialization of underdeveloped economies; it has been replaced by that of preventing them from going beyond the production of industrial commodities. Or, in the case of countries such as Brazil, which had already started the production of more sophisticated manufactures, the intention now is to reverse this condition through instruments such as the FTAA and WTO's Doha Round.

Lastly, it should be noted that the monolithic thinking had two basic consequences. The first consisted in the abandonment of studies and research work on the specificity of laggard growth. The second was preventing the

scientific justification of policies favorable to development. To underline the importance of this second consequence, it is worth recalling what happened in the 19th century with the protectionism that made possible the industrialization of the United States and Germany. Alexander Hamilton, taking into account his country's reality, already preached the protection of the American manufacturing sector against foreign competition. But his preaching would hardly have succeeded against the liberalism sustained by mainstream economics, had it not been provided a theoretical foundation by List's protectionist theory.

In brief, the analyst of Brazilian economy is not called to propose this or that economic policy to redress the country's long period of semi-stagnation. What is important today is to overcome the monolithic thinking and to eliminate the ideological barrier, for as long as they persist they will pose an obstacle to the adoption of any economic strategy capable of putting the country again on the track of accelerated growth.

Current situation

1 – Let us now look at how the monolithic thinking and the ideological barrier are affecting the conduction of economic policy in Brazil.

Mainstream economics, based on the experience of mature economies with no economic lag to overcome, value the short term. The Government's role is restricted to guaranteeing the fundamental exchange, fiscal, and monetary equilibriums; economic growth will occur by the mere action of the markets. This short-term view has dominated the conduction of economic policy in Brazil. This was clearly shown by a survey done under the sponsorship of Cepal and IPEA by Bielschowsky and Mussi (2002), who interviewed forty-three of the country's most outstanding economists. These were asked about their proposals to put Brazil back on the track of accelerated development. The survey authors' opinion was that the issue was not part of the analyses and studies of the interviewees and that their concern over the short term seriously distorted their perception of the problem. This explains to certain extent how the country's economic situation was viewed until then.

As inflation is low, the public debt is under control, and the trade balance shows surpluses that are not only positive but substantial and growing,

fundamental equilibriums are also under control. Thus, the economy “is doing well”. This view has been subscribed fully and without restrictions not only by experts but also by public opinion makers (political and social leaders, economic commentators of major newspapers, et al.). So, despite the serious political crisis that occurred during President Luiz Inácio Lula da Silva’s first term, it was asserted that his reelection was assured because the Brazilian economy “was doing well”.

No one was concerned over the fact that the country was growing only a little over 2 percent a year, when estimates indicate that just to absorb the annual increase of labor entering the market, GDP should grow between 4 percent (Saboia 2005) and 6 percent (Rocha and Albuquerque 2006). In addition, no notice was taken of the fact that Asian and neighbor countries, such as Venezuela and Argentina, were growing three times as fast as Brazil, or that Brazil itself had grown without any problem 7 percent a year in the three decades following World War II.

No consideration was given to the fact that monetary stability was being achieved on the basis of one of the highest interest rates in the world, which discouraged private investment, or that public debt control was based on primary surpluses that destroyed the Government’s investment capacity, or yet that in the area of foreign trade the overvaluation of the currency discouraged exports with a high technology content and high added value per worker (thereby encouraging imports with equal characteristics). This process was identified by IEDI, a major research institute, as the country’s relative de-industrialization. Such optimism was shaken only by an episode that, paradoxically, serves to underscore the ideological barrier’s strength.

2 – In August 2005, the Sixteenth Congress of Brazilian Economists was held in Florianópolis, state of Santa Catarina. It approved a widely disseminated Florianópolis Charter, titled “Need for a long-term view of the Brazilian economic policy”. Although it addressed an issue of utmost importance for the country, that document had no repercussion.

This situation changed only when a major paper, commenting on newly released statistics on Latin America, in a typical journalistic maneuver, headlined the information that, in terms of GDP growth, Brazil ranked only above Haiti. The impact of the news on public opinion led those responsible for the Brazilian economy to admit for the first time that the “spectacle of growth” so

insistently announced by the President of the Republic early in his first term was far from happening. It was finally perceived that the economy “was not going well”. As a result, early in 2007, the first year of President Lula’s second term, a Growth Acceleration Plan (PAC) was introduced. There is no doubt about the importance of this initiative, which expresses the recognition that the achievement of the three fundamental equilibriums (exchange, fiscal, and monetary) is not sufficient for resuming accelerated growth, and that GDP’s growth rate is the crucial criterion for assessing economic policies. Among other initiatives, the Plan calls for doubling public investment (even though this would mean only an increase from 0.5 percent to 1 percent), increased private investment, and other measures to stimulate development. But the truth is that PAC has not managed to look beyond the short term.

Between 1850 and 1930, Brazil experienced accelerated growth based on the primary exports model. Between 1930 and 1980, even better results were achieved on the basis of import substitution. What was expected now from PAC was the definition of a new strategy to allow the country to grow again, at least over the next fifty years, at a rate no lower than the 7 percent a year maintained for a long period in the past. However, PAC covers only four years; in practical terms, what can be expected from it is nothing more than the achievement of better economic results in the current President’s second term than in his first.

Investments under PAC are concentrated basically on infrastructure, as is the case of policies adopted to correct short-term recessive trends. According to Hirschman (1959), investment on infrastructure only permits but does not determine development. There is no point in building roads if there are no trucks to use them, or in building hydroelectric plants if there are no enterprises to benefit from them. Development programs, still according to Hirschman, should be based on directly productive activities, which is not the case with PAC, as from this point of view it failed once again to look beyond the short term.

Analysts of Brazil’s semi-stagnation point to the extremely high interest rates prevailing in the country and to the currency’s overvaluation as distortions that must be corrected for restarting economic development. PAC has not done anything in this respect, as this would disturb the fundamental equilibriums. Low interest rates might lead to the flight of foreign capital and

increase inflationary pressures. Currency devaluation would raise the prices of imported goods and thus have an inflationary impact also. From a short-term perspective, these are unacceptable corollaries.

Lastly, PAC has set a ceiling for GDP growth at 5 percent a year. The explanation is simple. It is feared that growth at a higher rate than 5 percent might trigger inflationary pressures and possible negative exchange and fiscal consequences. Thus, maintenance of fundamental equilibriums continues to have priority over accelerated growth.

3 – To round off this analysis, one may speculate about what PAC could or should be from a clearly developmentist perspective. This is important because, among other things, the economic authorities often claim that critics do not present alternatives.

The document titled “A development strategy for Brazil” (2006) published by the Development Studies Center-CED of the Rio de Janeiro Regional Council on Economy shows that there are at least two proposals for a new economic strategy for Brazil. It should be noted that in general they take up the proposals put forth by Furtado and Magalhães in the eighties. In a way, this indicates the potential efficacy of the document’s suggestions for preventing another long period of semi-stagnation such as the one that has victimized the country.

A first point to be established is that economic strategies are formulated and adopted in function of the market on which they are based. Thus, we have had the primary exports strategy, based on the external market for primary goods, and the import substitution strategy, based on the internal manufactures market. The market’s central role has been confirmed by the experience of the Asian countries, which demonstrated that the development policies’ success does not depend on an adequate savings level, as was believed until recently, but on the existence of a market of adequate size and endowed with adequate dynamism.

In the last analysis, this perception resulted from the conclusions of the World Bank’s 1993 report on *The Asian Miracle*. According to this report, growth acceleration in the Asian countries preceded, not followed, increased savings. Analysts showed that in the face of investment or development opportunities, savings grew endogenously. Now, such opportunities do nothing other than

signal the existence of a market, available and guaranteed, which is the main conditioner of development policies' success.

According to CED, the first proposal of a new development strategy for Brazil comes from the *Instituto de Cidadania*, connected with the Workers' Party (PT), to which the current President of the Republic belongs. The *Instituto de Cidadania* advocates the resumption of accelerated growth on the basis of the internal market. It proposes that, by correcting the high levels of income concentration prevailing in Brazil, the country be transformed into a mass consumption society. This would ensure an internal market of sufficient size to provide the basis for a new, successful development model.

The alternative to this proposal, put forth basically by the academic community, is growth based on exports. Not on external sales of agricultural and industrial commodities, as occurs today in Brazil. The idea is to base the new phase of growth on the international competitiveness of high-technology products and high added value per worker. This would be a replication of the model adopted by Asian countries, such as South Korea, Taiwan, Hong Kong, and Singapore.

CED has shown that, because the country is in a semi-recessive situation or because the assets of high-income groups are fixed assets, any sort of income redistribution of the magnitude required for resumption of growth would be economically and politically unfeasible. This makes also unfeasible the strategy of inward growth of a successful type under the import substitution model.

As regards the strategy of outward growth, its success would depend on the exports' multiplying effect on the internal market. Now, given the high import content of consumption among high-income groups and the latter's participation in Brazil's GDP, the multiplying effect would be necessarily low. This conclusion is confirmed by the reduced effect, in terms of growth, of the recent increase in Brazilian exports.

Thus, still according to CED, the two proposals are naturally complementary. Outward growth, based on dynamic, high added-value sectors, would accelerate the product's growth and any additional growth could be used to reduce income concentration, thereby raising the exports' multiplying effect. A virtuous circle would thus be created, capable of pulling Brazil out of its prolonged period of semi-stagnation.

These are just the main lineaments of a new strategy combining the two alternatives proposed. Some of its other characteristics can also be pointed out. In terms of outward growth, the process should be spearheaded by domestic capital enterprises, because multinationals may face restrictions for entry into the large world markets, which are already controlled by their headquarters, or because the effort for creating international competitive capacity to be sponsored by the Government should naturally aim at benefiting domestic enterprises. On the other hand, the priority to be assigned to the high technology sector should not imply disregarding the agricultural and industrial commodities segment, in respect of which the country enjoys natural comparative advantages. Support for this sector should aim at increasing the added value content of its exports.

As regards the internal market, redistributive measures would be complemented by protectionism for the time needed to prevent imports originating in recently industrialized countries with low labor cost from hindering the viability of important sectors of the national economy. Defensive measures should also be adopted on behalf of high technology sectors for as long as they need to become internationally competitive.

In respect of international institutions, Mercosur would be redefined so as to advance beyond mere trade opening and eventual creation of instruments of the kind already existing in the European Union. Definition of a joint development program would be an important part of the program. The FTAA, which owing to American competition would inevitably lead to Brazil's specialization in commodities, should be rejected outright. The same applies to the Doha Round, in which the exchange of advantages in the agricultural sector for the opening up of the manufacturing and services sectors would lead to the same result.

In brief, recognition of the negative results of neoliberalism has not yet proven to be sufficient for the thorough elimination of the tendency to think only of the short term in Brazil. To get rid of it and thus open the way for the adoption of long-term strategies, it is essential to eliminate the monolithic thinking that shores up the ideological barrier. This can be done, as will be seen.

A possible solution

1 – The first question to be asked is whether the monolithic thinking that underpins the ideological barrier is the result of an anti-developmentist conspiracy sponsored by the mature economies.

H.J. Chang (2002), professor at Cambridge University, answers this question in the affirmative. In his *Kicking away the ladder*, he takes up List's thesis, according to which the developed countries are indeed consciously and systematically sponsoring policies aimed at preventing the access of lagging economies to full development. In contrast, it might be recalled that the decline of the Development Economics and the attendant emergence of the monolithic thinking did not result from the setting of any insurmountable obstacle on the way of the experts in the matter. What occurred was simply the lack of interest in the subject on the part of the rich countries, with the natural drying up of the funds that financed research on underdevelopment. In his speech of acceptance of the Nobel Prize, Myrdal already manifested his concern over the fact that the economists from underdeveloped countries were not adequately contributing to the study of their economies. Had they taken up the research abandoned by the First World's academe, there would have been no room for the predominance of the monolithic thinking. Without taking sides on this debate, let us simply look at the reasons for the persistence of the monolithic thinking.

Specialists in the Philosophy of Science show that one theory can only be defeated by another theory, because it is the theory that indicates to the scientists what should be researched, how to carry out the research, and how to interpret the results obtained. In the specific case of Economics, Blaug (1979) showed that although the American institutionalist school had raised serious objections to the neoclassical vision, the latter was never defeated. Its persistence was due simply to the fact that the institutionalists proved incapable of presenting an alternative theory.

When a theory fails in its predictions or comes into shock with observed reality, it is simply subjected to ad hoc modifications so that it can continue to be used pending the emergence of a better theory. The Washington Consensus, inspired on the neoliberal views, has met with a resounding failure throughout Latin America. As no alternative has yet been presented to the neoclassical theory that underpins it, it simply was subjected to an ad hoc modification represented by the Augmented Washington Consensus.

According to the latter, the original Washington Consensus remains perfectly valid. It needs only to add to its proposals the requirement of institutional adjustments, i.e., the adoption by the underdeveloped countries of rules of the game consistent with economic growth. In the last analysis, it requires the countries to implement legislation guaranteeing property rights, ensuring jurisdictional security, flexibilizing labor advantages, defending shareholders, regulating the bankruptcy process, and so on.

To be defeated, the Washington Consensus would have to be confronted with another theory or model based on the specific characteristics of laggard growth. This did not happen. Let us look at how this could be corrected.

2 – There are in Brazil today first-rate economic research centers. Consistently with South Hemisphere tradition, though (and this applies to all scientific branches, not only to Economics), they are, with rare exceptions, applicators rather than creators. This does not have much importance in the case of exact sciences but has highly negative consequences in the area of social sciences, and of Economics in particular.

To counter this problem, CED has proposed the setting up of a critical thinking nucleus with the following basic characteristics:

- a) A technical team consisting of researchers selected from among the most qualified in the country, and foreign specialists working on Development Economics;
- b) Research geared to the creation of a model adjusted to laggard growth and capable of providing scientific inputs for economic policies, taking into account the specificity of this growth; and
- c) Work done along the lines of scientific research programs as defined by Lakatos.

The last item is extremely important and should be made more explicit. Scientific research programs concentrate, on a permanent, uninterrupted basis, on a given, previously defined aspect, discussing and deepening the results obtained, confronting them with the results of alternative programs, and advocating or modifying them as needed. We have mentioned Prebisch's protectionist theory, which was rejected without being effectively refuted. This happened because his proposal was not part of a scientific research

program, under which it would have been worked out in greater depth and defended against criticism that was not directed at its fundamental postulates. The situation was different with the heterodox inflation theory developed by economists at the Rio de Janeiro Pontifical Catholic University. It was conceived under a scientific research program carried out by the University and the validity of its conclusions was confirmed by *Plano Real's* success, which put an end to the Brazilian hyperinflation process. Soon after, though, the Program was dismantled and abandoned, with the result that the orthodox monetary stabilization formulas once again were applied in Brazil.

In brief, topic contributions, no matter how high their level, are not sufficient for Development Economics. Contributions must be part of steady, uninterrupted work in the context of a scientific research program.

3 – Overcoming monolithic thinking will not be an easy task, as one runs against myths engendered by it and that must be first dispelled. The first myth is found in the Augmented Washington Consensus, as it affirms that the inadequacy of institutions is the root cause of underdevelopment. The second myth refers to the relationship between development and inflationary upsurge. Let us start by the first.

H. J. Chang, himself an institutionalist, refutes the allegation that the original version of the Washington Consensus failed because it did not propose the establishment of institutions adjusted to development. Chang shows that many of the currently underdeveloped countries have more advanced institutions than those of currently mature economies had in their phase of accelerated expansion. He also says that great many of the existing institutions in the developed countries are the result of, not the cause of economic growth.

More important, though, is Brazil's own historical experience. In the thirty-five years that followed World War II, the country achieved one of the highest growth rates in the world. According to the Augmented Washington Consensus, this could only have happened if institutions had been perfectly adjusted to that dynamic process. The fact, though, is that in the eighties, Brazil fell into semi-stagnation, which has gone on for three decades already. Again, according to the Augmented Washington Consensus, this could have happened only as the result of a serious institutional collapse. The case was just the opposite. Not only there was no collapse, but also Brazilian institutions have steadily improved since then.

Such facts did not keep the World Bank from devoting its 2002 report to the thesis on the need of institutional change to ensure development. The report even adopts as a superscription a quote by D. North (1993), who in his major work pronounces the bankruptcy of Development Economics.

As regards inflation, two myths have seriously hindered a correct interpretation of the process. The first asserts that any price increase tends to accelerate, while the second posits that inflation is highly damaging to lower-income groups.

The first myth took hold in Brazil under specific circumstances. The Fernando Henrique Government managed, as of 1994, to curb hyperinflation on the basis of the *Plano Real*. As he adhered to the Washington Consensus, though, he was unable to put the country back on the track of accelerated growth as he expected, and thus began to value a conservative policy, which was adopted by his government, saying that its objective was to preserve the monetary stability achieved by the *Plano Real*. To reinforce this justification, he created the myth that any price acceleration, no matter how small, would fast escape control.

His argument lacks any factual fundament. In the seventies, on the occasion of the two oil shocks, Asian countries, including South Korea, accepted inflationary acceleration as a way of preserving their development. In that period, South Korea lived with inflation at an average yearly rate of 20 percent. In the following decade, inflation dropped to 5 percent, without any intervening hyperinflation episode. Other Asian countries had a similar experience.

In the first thirty years after World War II, Brazil experienced an average yearly price increase of about 20 percent (while GDP was growing at 7 percent a year), without any tendency toward uncontrollable acceleration. Hyperinflation at the end of the period resulted from avoidable mistakes, such as the military Government's refusal to correctly adapt itself to the oil shocks and failure to adopt a strategy capable of maintaining the economy's accelerated growth. Another contributing factor was the adoption of indexation without control. The fact is that neither Brazil's prolonged experience with inflation under control nor facts observed in other countries warrant the myth that any inflationary surge tends inevitably to accelerate.

The myth that inflation inflicts serious, irreparable damage on the lower-income groups had possibly in Franco (1998) its main disseminator. According to him, "inflation and fiscal deficits proved fundamental as mechanisms to

make possible, through forced savings, the maintenance of high levels of public investment, significantly contributing to holding investment aggregate rates around 25 percent of GDP. Growth could be sustained at higher rates for many years, owing to this high pace of capital formation, but at the cost of increasing difficulties. The impact on income distribution of growth heavily and increasingly dependent on inflation was the worst possible. Brazil grew, but became industrialized at the expense of an extraordinary increase in the levels of inequality.” (pp. 59-60).

Franco thus asserts (a) that inflation kept the country’s savings at 25 percent of GDP; (b) that this permitted high growth rates for many years; and (c) that this was how Brazil was able to become an industrial country. The objection has to do with income concentration, which must be examined.

Obviously, one cannot think on the basis of uncontrolled inflation that is observed after oil shocks, as it is incompatible with development. According to Franco, the price spiral that ensured Brazil a long period of accelerated growth, savings rates close to 25 percent, and an accelerated industrialization process, was the one that held at about 20 percent a year in the three decades following World War II. Let us now look at its distributive impact.

With this level of inflation, a salary of 1,000 reais dropped by the end of twelve months (i.e., by the eve of a new readjustment) to 830 reais, with an average of 900 reais and a 10-percent loss of purchasing power. With stable inflation, the loss would be limited to this percentage. It should be noted, though, that under an accelerated growth process, salaries increase proportionately to the per capita product. Accordingly, with GDP growing at 7 percent a year, as was the case in the period analyzed by Franco, this loss would have been offset in two or three years.

Another important consideration is that for the Brazilian economy to be able to provide jobs for about 1.5 million new workers ready to enter the labor market each year, GDP should grow 4-6 percent annually, according to estimates already mentioned. This was the case in the two and a half decades after World War II. In Franco’s bona fide opinion, that was made possible by the inflation surge at that time. So, why see inflation as completely and necessarily unfavorable to workers?

A possible way of heeding Franco’s social concern might be to ask labor unions if they would accept a 10-percent salary reduction to allow the job supply

to rise to 1.5 million work posts a year, making it clear that this salary decrease would be offset within three years at the most. There is no denying inflation's negative impact on salaries' purchasing power, but the contention is that the issue should be looked at in the global context of development policies. From Franco's perspective, inflation would probably be seen as favorable to workers.

A last observation is appropriate. During the fifties and sixties, a group of outstanding Brazilian economists advocated the idea that moderate, controlled inflation was important for ensuring the economy's accelerated growth. As prices steadily rise and salaries are periodically adjusted, profits also rise and so do savings. Now, however, the Asian countries' experience shows that if correct development strategies are adopted, savings will endogenously rise. Thus, there is no sense in positing inflation as an acceptable instrument of development policies.

The problem is that owing to the Brazilian economy's protracted period of semi-stagnation and its attendant distortions, growth can hardly be re-accelerated without the emergence of inflationary tensions susceptible of evolving into full-blown inflation. This would mean a strictly temporary, rapidly controllable disequilibrium. The myths of the unstoppable acceleration of the prices spiral and of its evil social consequences prevent the acceptance of such disequilibrium; this is why it is extremely difficult to introduce economic strategies capable of putting the country back on the track of accelerated development.

The Asian countries' experience shows that accelerated growth may be achieved with a 5-percent ceiling to prices' yearly increase. But it also shows that in special situations moderate, controlled inflation must be accepted for maintaining or resuming development. These are the lessons that should be heeded by any rationally conducted economic policy.

Ultimately, the basic objective of the Critical Thinking Nucleus is to define, on the basis of rigorous scientific analysis, the specific characteristics of laggard growth, describe germane economic policies, and prevent the proliferation of myths such as the ones mentioned.

Outlook

1 – The preceding analysis showed the Brazilian economy's complex situation. The negative results stem from psychological, social, and political rather than economic factors. Any forecasting should take this into consideration.

A determinant factor for the future of the Brazilian economy is the fact that it is currently commanded by the Central Bank.

After 1994, owing to the success of the *Plano Real* aimed at monetary stabilization, the rate of inflation dropped to one digit. In 2002, when it became clear that the next President of the Republic would be a leftist leader, prices rose by 12 -17 percent. The financial advisors to the Government inaugurated in 2003, moved by an exaggerated fear of the problem coddled by Fernando Henrique Cardoso's Administration, convinced the political top leadership that the country was on the brink of hyperinflation. The task of preventing it both in the short and in the long term was assigned to the Central Bank, which then started dictating the rules of the national economic policy.

There are serious reasons to believe that the alleged hyperinflation risk never existed. In the last year of the Kubistchek Government (1960) the annual price increase rate reached 30 percent. In the following period, the chaos created by the resignation of a President of the Republic and resistance to the inauguration of his legal successor, caused prices to increase by as much as 60 percent a year. After the situation was normalized in 1974, the price spiral returned to its historical level, without any threat of hyperinflation. Such facts were not taken into account and, as a consequence, the management of the economy has been driven since then by the need to maintain price stability. This means that inflation targets, administered by the Central Bank, have taken absolute precedence over the objective of resuming accelerated growth.

In this context, an average annual GDP growth rate of 4.5-5 percent is to be expected, as envisioned under PAC. A 5-percent rate is seen as a ceiling, as any "threat" of a higher growth rate will be stopped to prevent a possible aggravation of inflationary pressures. In this connection, the Brazilian Central Bank does nothing more than imitate the U.S. Federal Reserve that, so as not to jeopardize monetary stability, adopts measures to restrict GDP growth tending to exceed the yearly rate of 4 percent.

A 4.5-percent rate is also a minimum, because under PAC, the GDP growth rate is also, together with fundamental equilibriums, one of the criteria to measure economic success. Any lower growth rate will be considered insufficient. And as the official economic team's developmentist faction has recently gained force, helped by the setting up of an Extraordinary Ministry for Long-Term Policies, any lower rate will be promptly combated. Because

long experience shows that Brazil has no difficulty in growing as much as 7 percent a year, corrective measures will be immediately adopted in such a case. In sum, the Brazilian economy will most likely grow at a rate of 5 percent, owing less to economic motives than to political dictates.

What is to be expected in the long term, though? This question can be approached two ways. The first is by asking whether if current conditions are maintained, a 4.5-5 percent rate can be indefinitely maintained. A major group of Brazilian economists do not think so, as fundamental problems have not been solved yet, such as a high interest rate, exchange overvaluation, a heavy and rising tax burden, public spending increase above GDP's, and so on. Probably, though, the most objective, pessimistic assessment of long-term prospects stems from the lack of a strategy for the Brazilian economy. The contemplated infrastructure investments will create jobs and accelerate GDP growth for the duration of the scheduled public works. Once these are completed, semi-stagnation will recur, unless a development strategy is adopted, based on activities aimed at creating dynamic markets. The alleviation period may even have the negative effect of leading to the assumption that the economic problem has been solved and that any strategy is thus unnecessary.

The second approach to the long-term issue is as follows: Brazil has conditions that are exceptionally favorable to development, and numerous countries with less favorable conditions are growing at a much higher rate than 5 percent. Why then consider this rate as acceptable or as a ceiling to GDP growth? Awareness of this fact will not ultimately lead to the elimination of the monolithic thinking and the ideological barrier?

The advocates of maintaining the 5-percent ceiling argue that as the demographic growth rate is now lower in Brazil, a 5-percent growth corresponds, in per capita terms, to the 7-percent rate of the past. They argue that there is no sense in running the risk of a recurrence of disequilibria, such as inflation, by further accelerating growth.

But if the purpose of development policies is to eliminate economic lag as quickly as possible, a growth rate of 5 percent – far beneath the country's actual capacity – is unacceptable. Rapid GDP growth does entail exchange, fiscal, and monetary tensions, but this is a normal, integral part of any accelerated growth process. Defining the means and ways of keeping these tensions under control is part of development policies.

Another major argument put forth by the developmentist current is that, given the imitation or emulation effect, laggard economies do not have the option of growing rapidly or slowly. The lower-income segments in these countries become aware of the high living standards of the mature economies, which are copied by the richer segments of their own countries, forcing the Government into expenditures that lower its savings level. The private sector savings' level is also lowered as the Government, to counter claims, raises taxes and the minimum salary, extends the vacation period, reduces the allowed number of working hours, and so on.

In Brazil, this type of problem is evident, for instance, in the fact that in the past Government savings amounted to 4 percent of GDP, while today savings are negative. Pension payments account for 7 percent of GDP today, which some analysts consider excessive for an underdeveloped country. If, after 1980, GDP had continued to grow at 7 percent as in the previous year, the savings rate would be three times as high, while pension payments would amount to a third of the current rate. Here again, it is a case of insufficient economic growth to meet the demands of better living conditions.

Phenomena of this sort illustrate the imitation effect, which makes development into a race between the pressure of the demands for higher living standards and the Government's capacity to meet them without compromising the savings margin required for maintaining growth.

In sum, from a long-term perspective, there are reasons to believe that a break with the monolithic thinking and the ideological barrier will at last occur, which will finally allow Brazil to grow at the pace indicated as possible and normal by its favorable economic conditions and historical experience. Explanation as to if, how, and when this will happen is up to political scientists and sociologists rather than to economists.

Conclusion

As Brazil has conditions that are extremely favorable to development, the nearly thirty years of semi-stagnation since 1980 can only be explained by fundamental mistakes in economic policy. These mistakes consist essentially in the lack of a development strategy, which in turn is a consequence of the adoption of the neoliberalism championed by the Washington Consensus.

Ignoring attempts to perpetuate it under the Augmented Washington Consensus, PAC has taken the first step toward pulling the country out of semi-stagnation. This initiative should be complemented by the definition of a new development strategy, which would do away with short-termism, the monolithic thinking's basic corollary.

To this end, it is necessary to establish a paradigm for laggard growth, capable of providing an alternative to mainstream economics and a high-level scientific foundation for the new strategy proposed. Some steps are being taken in this direction, based on a long-term version of Keynesian theses. A first contribution to this new focus is found in a theoretical appendix to Unctad's 2006 report, which prescribes autonomous investments whose final result would be a corresponding increase in savings.

In Brazil, João Sicsú (2005) argues that the neo-Keynesians have distorted Keynes's own contributions, and innovates by asserting, with Philips and against the neoclassical theory of rational expectations, the possibility of reducing unemployment through new investments. With Bresser Pereira, Sicsú proposes what he calls a new-developmentism, whose theoretical justification is now being outlined.

Mention has been made of the importance of expanding and consolidating this effort through a critical thinking nucleus. Its establishment will be important not only for Brazil but for all of Latin America, which did not have, as the Asian countries did, the benefit of a mimetic pattern adjusted to their respective reality. Hence, the convenience of joint work by the countries of the region toward the establishment of such a nucleus.

Cristina Kirchner (2007) backs this position, saying that "it is a good thing (...) provides critical thinking to the region's governments, which for so long have adopted modes of thinking often contrary to the interests of their countries, a product of other intellectual plants, which do not exactly serve the interests of the region. I thus believe that new winds are finally blowing in the Latin American region." (p. 5).

Appendix

Introductory note

This note sums up the analysis offered in a lecture to be published soon. As the exposition was directed at nonspecialists, a less technical language was used.

Impact of the monolithic thinking on economic theories¹

1 – In other works we have had the opportunity of showing how Prebisch's protectionist theory and the Brazilian economists' heterodox inflation theory were put aside without having been effectively refuted or replaced. Something similar happened to Development Economics. We now intend to show how the maintenance of Development Economics and the deepening of its analyses could have pointed different directions for the economic policies implemented in Brazil, thereby entailing major benefits for the country. Curiously enough, these policies would have been very close to those implemented by the countries of East and South Asia.

Our analysis will concentrate on the contribution of W. A. Lewis, certainly the most important in this field, which earned him the Nobel Prize in Economics.

According to Lewis, laggard growth, differently from what happens in developed economies, occurs under conditions of unlimited supplies of labor. This simple fact has important corollaries for the definition of development policies.

The main consequence of an unlimited supply of labor is the generalized occurrence of disguised unemployment. For example: in family farming, children are automatically incorporated into the economic activity, without any increase in production. Thus, there will be no reduction in production if these children are shifted to another activity. Hence, it is proper to say that they are technically in an unemployment situation, although this unemployment is disguised by an activity, without any effective result.

This simple fact points to the utmost importance of this for underdeveloped economies, and to the difference between real costs and

¹ The negative impact of the monolithic thinking is also examined in *CED- Economia brasileira, do pensamento único a vinte e cinco anos de semi-estagnação* (chap. V).

opportunity costs. Real costs are given by the totality of inputs incorporated into each product. The opportunity cost of product A is measured by the value of product B that is not produced, so as to make possible the production of product A. The approach to real costs is essentially microeconomic and is the only one taken into consideration by the market for the enterprises' decision-making. The approach to opportunity costs is macroeconomic, as it takes into account a global view of the economy, and implicitly takes also into consideration the existence of idle factors that can make feasible the production of a good without reducing the supply of other goods.

In the case of underdeveloped countries, where there is widespread disguised unemployment, labor's opportunity costs are zero. However, any enterprise hiring a worker in a situation of disguised unemployment must pay him a salary, which creates a difference between the real cost and the opportunity cost. As decisions based on the price mechanism consider only real costs, i.e., decisions based strictly on market price indicators, as required under the neoliberal view proposed by the monolithic thinking, these decisions are less than optimal in underdeveloped countries. The way to correct this distortion consists in systematic State action in the economy, based on a development policy.

A simple arithmetic example could serve as an illustration. A hypothetical underdeveloped country is considering the possibility of investing in an industrial activity that will produce an item whose value is 100. Estimated costs are 30 in salaries and 70 in other inputs, totaling 100. Under the strict terms of market indicators, the production of such an item should be considered antieconomic, as its price is lower than its cost. In terms of the opportunity cost, though, the value of labor is zero and thus the total cost of the item is 70, a level perfectly consistent with the 100 price. That is, we are in the face of a market flaw that in underdeveloped economies puts into doubt the efficacy of the price mechanism. The first consequence of Lewis's analysis is that in underdeveloped countries the price mechanism functions inadequately, which makes systematic action by the State in the economy of crucial importance.

2 – We have seen that development policy's main conditioning factor is the assurance of a market. Now, as the investment decision takes into account real costs and not opportunity costs, this unwarrantedly reduces the internal market that is of great importance at the initial stages of development policies. This must be corrected through protectionist measures adopted by the State.

An important illustration of the negative consequences of this market flaw can be found in international economic relations. Brazil's industrialization provides a good example.

Orthodox thinking, based on the propositions of mainstream economics, rule out the adoption of any protectionist measure by a country, as this would result in the local production of goods whose real cost would exceed the cost of the equivalent imported products. One of the allegations was that it made no sense to stop producing coffee, in which we were efficient, so as to produce industrial goods that were expensive and of poor quality. This reasoning was correct in terms of real costs but wrong for an underdeveloped country, as it did not take into account the zero value of labor's opportunity costs. In terms of opportunity costs, the Brazilian product was perfectly competitive. That is, we were faced with a market flaw that had to be corrected by a protectionist measure.

Had market mechanisms been strictly observed, Brazil's industrialization would never have occurred. It happened only as a result of the Great Depression in the 1930s, which, by knocking down the price of coffee, drastically reduced the country's capacity to import foreign-made manufactures. The low opportunity cost of Brazilian industrial products was confirmed by the fact that, contrary to orthodox expectations, the manufacturing activity grew rapidly without any decline in agricultural crops. The second corollary of the deepening of Lewis's analysis is thus that the guaranteed share of the internal market required by development policies depends on protectionist measures implemented by the State. This protectionism is technically justifiable because it corrects a serious market flaw.

3 – So much for the internal market. A similar problem occurs in respect of foreign trade and involves the definition of the exchange rate. From a long-term perspective, the only one that is relevant in terms of development policy, the exchange rate between two countries is determined by the parity of the purchasing power of their respective currencies. If a basket of goods in the United States is worth 100 dollars and the same basket is sold in Brazil for 200 reais at the natural rate of exchange between the two countries, which results from the free action of the price mechanism, the exchange rate tendency will be toward a 2 reais/1 dollar ratio. This would be the natural rate of exchange determined by the prices prevailing in the two countries' respective markets – prices determined by the goods' real costs.

It happens, though, that in terms of the price mechanism, only real costs are considered.

Supposing that labor's opportunity cost in Brazil is zero and is equivalent to 50 percent of the cost, the Brazilian basket will be quoted by twice its real value. With two dollars, Americans should be obtaining two baskets and not only one, i.e., the Brazilian product is too expensive for them, and this explains the low volume of Brazilian exports to the Americans. Conversely, the American goods would be cheap for Brazilians exchanging only one of their baskets instead of two for one American basket. This leads Brazil to import much from the United States.

The solution for a return to balanced exchange would be if the Brazilian Government, devaluing its currency, set the exchange rate as 4 reais/1 dollar. Americans would then be able to buy two Brazilian baskets for one American basket, while Brazilians would have to give two of their baskets for one American basket. Along the analytical line proposed by Lewis, the devaluation of the national currency is necessary and justifiable in developing countries as a way of winning external markets, which is necessary for their development policies.

4 – Another case in which the discarding of Lewis's theory meant actual or potential loss to underdeveloped countries was the anti-inflationary policy. To confirm this we should begin by recalling the two explanations proposed for inflation. According to the first, inflation results from excess money, which leads to cost or demand increases. Another explanation claims that the price spiral results from the economic agents' dispute over the GDP, when the sum of their claims exceeds GDP. This is the heterodox theory of inertial inflation that provided the basis for *Plano Real*, which put a stop to hyperinflation in Brazil. This issue deserves a further look.

For the purpose of simplification, if we assume that there are only two economic agents – workers and entrepreneurs – this dispute translates into successive salary and price increases. An important point that helps one to understand the difference between the two approaches is that while an increase in the money supply may be considered the main cause of inflation according to the first concept of inflation surge, according to the second concept it is seen as its effect. Thus, in view of the successive salary and price increases, the Government is forced to increase the money supply to prevent a liquidity crisis.

In developed economies, there can be no dispute over GDP because if it happens it is usually when salaries decline as a consequence of price increases by the enterprises' intention of raising their profit margin. In such countries, labor is scarce and the unions have strong bargaining power. When they see that salary adjustments are neutralized by a new price increase, they impose a sliding pay-scale whereby any price increase is promptly offset by a proportionate salary increase. This precludes any dispute over GDP.

In underdeveloped countries, where labor is overabundant, as shown by Lewis, the unions have little bargaining power and are thus unable to effectively protect their remuneration's purchasing power through effective measures such as the sliding pay-scale. In Brazil, for instance, despite a 20-percent average annual inflation in the thirty years following World War II, unions were never able to impose a sliding pay-scale. This confirms the view that inflation results from a dispute over GDP, a view accepted by the proponents of the heterodox inflation theory, whose validity has been corroborated by *Plano Real's* success.

Another simple example may illustrate the procedure adopted by the *Plano Real*. With a 20-percent annual inflation, a real salary of 1,000, which is readjusted every twelve months, declines to 800 by the end of the period, thus averaging at 900. Profits' behavior is exactly the opposite, dropping to their minimum level with 1,000 salaries, and reaching their maximum level with salaries at 800. The heterodox inflation control formula sets salaries at their 900 real average level and does the same to the prices that determine total profits. As the sum of the real average remuneration of the economic agents is by definition equal to GDP, this procedure eliminates the main cause of the price spiral.

What is important from the standpoint of development policies, is that inflation in underdeveloped countries being the outcome of an economic agents' dispute over GDP, it should be controlled by income policies, not by monetary policies.

The extremely high interest rates prevailing in Brazil, which have seriously prevented or hampered resumption of development, are justified by the Central Bank as a form of containing inflation, when the correct thing to do would be the adoption of an income policy. This is a fundamental mistake that would not happen if the corollaries of Lewis's contribution were taken into account.

5 – The preceding analysis also solves the paradox that puts into question the very validity of economic sciences. The Latin American countries that, based on the Washington Consensus, strictly followed the mainstream economics prescription have met with resounding failure. The Asian countries that ignored the prescription and often did exactly the opposite of its recommendations, met with exceptional success. This seriously compromises Economics as a science.

The preceding analysis, which explores the corollaries of the main theoretical contribution to the analysis of laggard growth, permits addressing the issue in more favorable terms for the discipline. As a matter of fact, the basic lineaments of the development policy implemented by the Asian countries essentially followed the four corollaries proposed in the preceding for Lewis's contribution: (a) the countries of the region experienced extensive, systematic action by the State to stimulate and guide their economies; (b) through protectionist measures, they protected domestic activities until they could achieve international competitiveness; (c) they facilitated the entry of their products in the external market through exchange rates that devalued their currencies; and (d) they maintained price stability not through monetary policies such as higher interest rates but through income policies.

What is actually in question is not the validity of Economics as a science, but the unacceptable attempt to apply the theorizations of mainstream economics to contexts in which the preconditions on which these theorizations are based are not valid – such, as for example, the relative labor scarcity, typical of mature economies, while the underdeveloped countries have an unlimited labor supply, as asserted by Lewis. The problem does not lie in the shortcomings of Economics as a science but in the unwarranted persistence of the monolithic thinking.

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Chile's economy and development challenges

*Mauricio Jélvez M.**

I. The Chilean economy under democracy

The “Chilean model” has been presented in the international concert in recent decades as a successful example for achieving a combination of macroeconomic equilibriums, high growth rates, and effective combat against hunger.

This assertion suffers from two flaws that may induce one into error. First, the experience of the extreme neoliberalism implemented under the dictatorship (1973-1989) differs substantially from the experience of growth with equality implemented under democracy (1990-2007).

In the first case the objective was to establish the primacy of the market system through the application of the prescriptions of orthodox economists, which consisted in the liberalization and deregulation of the markets, the unilateral opening of the economy to international trade, and a policy favorable to foreign capital, re-privatization and privatization of public enterprises, reduction of public spending, and a new tax structure that lost its progressive

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character. In the second case, impetus was given to reforming the previous reforms, so as to correct the inherited model, with the injection of a major dose of pragmatism and progressiveness. To this end, the exchange authority proceeded to raise the investment rate, adopt a macroeconomic management conducive to sustainable financial and real economy equilibrium, reduce vulnerability to external shocks, and meet the most pressing social demands. The purpose was to reconcile macro-social and macroeconomic equilibriums and introduce an economic policy consistent with the new democratic scenario. Accordingly, at the outset of the democratic transition government in 1990, two projects signaled a rupture with the previous model: one project called for tax reform to raise fiscal revenues and modify the composition of public spending, by increasing social outlays; the other project called for labor reform, one of whose objectives was to strike a negotiating power balance between employers and workers and endow the labor legislation with greater legitimacy.

Manuel Castells has thus summed up the difference between the two experiences: “We have moved from a development model that was liberal in economics, authoritarian in politics, and socially exclusive to a model that is politically democratic and socially inclusive, while maintaining its liberal economic matrix.”

Secondly, differences are not limited to each model’s policy focus; they extend to the sharp contrast between the results achieved by the two models. In this regard, figures speak for themselves:

Results during the government of:	Pinochet 1974-1989	Concertación 1990-2006
Effective GDP growth (%)	2,9	5,5
Per capita GDP growth (%)	1,3	4,2
Exports growth (%)	10,7	8
Inflation (%)	79,9	7,5
Unemployment (%)	18	8,3
Real salary (1970=100)	81,8	125,2
Gross fixed investment (% of GDP) in pesos 2003	13,6	20,6
General government surplus (% of GDP)	0,3	1,6
Structural surplus (% of GDP)	n.d	0,7
Population living in poverty (1989 vs. 2006)	38,7	13,7
Income distribution (Q5/Q1)	18,5	14,8
Demographic growth (%)	1,6	1,4

Although comparison between the dictatorship and the democracy periods show an overwhelmingly higher balance for the latter, the average figures for the democratic period mask a more nuanced reality. If we separate the two periods of Concertación governments, we find that the strictly economic results between 1990 and 1998 were better than those achieved between 1999 and 2006. A look at key macroeconomic indicators in the two periods shows that results were better in the first period. These are the averages: Effective GDP growth, 7.1 percent vs. 3.6 percent; exports growth, 9.9 percent vs. 5.8 percent; unemployment, 7 percent vs. 10 percent; and inflation, 11.7 percent vs. 2.9 percent, respectively.

The gap between the two periods evidenced failures and contradictions, as well as the lack of a more thorough reform of the reforms.

Owing to the contagion of the Asian crisis, the final stage of President Frei Ruiz-Tagle's term (1999) and the first quadrennial of President Lagos's (2000-2003) unfolded in a depressed economic environment. In 1999, effective GDP had declined by 0.8 percent and the subsequent stagnation affected mostly the nonexport sectors, which accounted for about 70 percent of GDP. This stagnation had also a negative impact on small and medium enterprises (SMEs) and on employment.

Although external circumstances affected the expansion of the exports volume, which was accompanied by deterioration in the terms of trade, the domestic market accounted for about 80 percent of the loss of dynamism. This lays the responsibility directly on our macroeconomic policy.

Had our economy been burdened with a heavy foreign debt, without international reserves and without external credit, and with high fiscal liabilities, the internal propagation of the external shock would have been understandable. But none of these limiting conditions prevailed in Chile at the time. A luster of recession was the consequence of the decision not to counter a negative external shock with a positive internal shock.

The Asian crisis' contagion in Chile spread through two channels: serious deterioration of the terms of trade, of about 3 percent of GDP; and a generalized reduction in capital flows toward emerging countries. Thus, beginning in late 1997, strong depreciation expectations arose, which the Central Bank combated with determination in the course of 1998, as it

feared an inflationary upsurge in an already overheated economy, and had the explicit intent of facilitating the amortization of the dollar debt of the national economic groups.

First, massive foreign exchange sales took place, at an artificially low market price. Then, in mid-1998, the Bank drastically reduced the amplitude of the exchange band to send a signal of stability in the dollar's nominal quotation, combined with a monetary policy's higher real interest rate, which reached 14.5 percent. In this critical context, there occurred not only a reduction in external credit but also a flight of capital and residents. Beginning in January 1998, the exit of a tremendous volume of resources took place, particularly from pension funds – which had speculated against the peso – totaling nearly 5 percent of GDP in 18 months. This, of course, had a contraction effect on monetary liquidity and on aggregate demand, entailing a costly, recessive adjustment in terms of growth and equality.

The gap between effective GDP and production was followed by a drop in productive investment. Just as in Mexico and Argentina in 1995 and in Korea in 1998, investment in Chile suffered an abrupt drop in 1999, and in 2004 it had not yet recovered its 1998 level.

The wide gap between effective GDP and potential GDP pointed to an underutilization of capital and labor in the 1999-2003 period. These factors kept the Chilean economy from maintaining the 7-percent yearly rate of expansion of the productive sector in the nineties, bringing it down to just 4 percent.

But the sound macroeconomic groundwork laid down in previous years allowed the authority, with political determination, to further intensify social spending after the crisis. Comprehensive support programs for the poorest were introduced: (Chile Solidario) [Chile in Solidarity] and the Programa Salud AUGE [Maximum Health Program]. This was made possible in part by a new structural fiscal policy scheme that prevents cycle-prone reactions of the fiscal policy, all of which led to further poverty reduction.

Since 2003, international markets have experienced a significant increase in the price of raw materials, which has applied a strong, positive shock on economies that are intensive in the production of these resources. Chile recorded a remarkable increase in its terms of trade, equivalent to 10 per cent of

GDP between the 1999-2003 recessive period and in 2004-2005. This positive exogenous shock raised aggregate demand and thus the average growth rate of the effective product rose from 2.6 percent to 5.8 percent, respectively.

Naturally, the intensity of recovery was also based on the own merits the national economy had accumulated in the preceding years, but the predominant force was the external shock. The improved terms of trade also increased the private sector's spending capacity, and economic expectations for 2006 became more optimistic.

Various projections had estimated a GDP growth rate close to 6 percent in 2006, but they were not confirmed, as the growth rate did not exceed 4 percent. The main reasons, other than punctual situations, may have been as follows: (i) premature application of a break to the monetary policy, with successive rate increases, particularly in 2005 and 2006; (ii) excessive exchange appreciation and its negative impact on the production of tradable goods, as shown by a sharp increase in imports demand and a decline in the demand for internal production; (iii) despite the sterilization of a substantial part of the expansive effect of copper's high price, the major part of the recessive effect of the increase in oil prices was not countered; and (iv) insufficient force of the fiscal policy aimed at structural equilibrium, which moved from a cycle-prone to a neutral position, without advancing to a counter-cyclical position, as stabilization of spending is neutral, not countercyclical.

These circumstances and a favorable international scenario and of a significant fiscal thrust – the 2007 budget calls for a 9-percent increase in public spending – warrant the projection of a growth of economic activity in the range of 5.75-6.23 percent a year, while internal demand is expected to grow at 7 percent a year, helped by a similar expansion in private consumption, and investment is expected to grow more than 8 percent a year.

As regards the labor market, unemployment should continue to decline in 2007, maintaining an annual average rate of about 7 percent.

Moreover, the outlook for the external sector also remains favorable for 2007. Copper has not been the only export to gain from the sound dynamism displayed by China, India, and other commodity-importing economies; other primary products, such as metals, raw materials, and foodstuffs have also benefited from this greater economic dynamism. Commodity prices have

far exceeded their long-standing levels; since early-2004, they have risen 100 percent, measured in dollars. Exports of goods should total about US\$65 billion, while total imports should level at about US\$39 billion. A current account surplus of about 4.5 percent of GDP is thus expected for 2007.

Only inflation has not behaved as expected: for official purposes, it has been situated by the Central bank within a range of 2-4 percent. Current projections, though, estimate an inflation rate of over 6 percent by the year's end.

The main causes of higher inflation are associated with external and exogenous factors, such as the steady increase in the prices of oil, milk products, and meat and a harsh winter that considerably affected the production of fruit and vegetables, which impacted on inflation, owing to their relative weight in the latter's calculation basket.

Be as it may, our economy's situation shows significant improvement as compared with 2006. This bonanza has led to an unprecedented consensus among economists, from both the most orthodox and the heterodox schools, who agree that the higher growth rates expected for this year are largely explained by a reactivating internal shock imparted by a more expansive budget, reflected in an 11-percent increase in social spending.

The overall picture thus described has produced an unexpected "collateral effect" in Chilean society. To wit, the exceptional conditions stemming from the high price of copper, which warrant projecting an accumulation of fiscal surpluses of US\$30 billion in 2008, not to speak of Central Bank reserves projected at an additional US\$15 billion, have injected into the public debate the feeling that we face a historic opportunity for determinedly meeting the challenge of a successful journey on the second half of our path toward development.

There has been an unquestionable upward movement on the curve of Chileans' expectations. These expectations are closely associated with the need to construct a country project that would signal a turning point in our development strategy, which admits without qualms the need to have a more pro-active State in the construction of a more equitable society and in the thrust toward productive development with higher levels of innovation and competitive capacity.

II. Chile's development challenges

Progress achieved under Concertación's rule provides the foundation on which to base a new development strategy for Bicentenary Chile (2010). Rather than a feeling of discomfort over the past, the demand for exchange is associated with certain fear that we may have introduced an economic system that threatens to fall into a phase of "insufficient returns," particularly if one considers that the Chilean economy continues to display potential growth rates close the 5 percent a year.

We have spoken of another country project, but in reality, the need is for reforms of greater density and complexity.

In this connection, the continuity and change line finds expression in reforms undertaken in many areas and which are being carried out simultaneously.

Obviously, these considerations reflect to a lesser or greater extent the political and ideological stand of their proponents.

For the purposes of illustration, their structure may be reflected in the following innovation elements of some public policies. Regarding social policy: move from a scheme centered on poverty eradication that privileges social spending toward one that addresses inequality and privileges the construction of a State that guarantees social and economic rights for the entire population. Regarding educational policy: move from the achievement of 12 years of compulsory schooling, extended school hours, wider pre-school, secondary, and college coverage, and access to new educational goods and instruments, toward a policy that directly intervenes in the conditions affecting quality and ensures a more equitable distribution of learning opportunities. Regarding productive-economic policy: move from a view that privileges the strict management of macroeconomic equilibriums and emphasizes the exploitation of natural resources so as to take advantage of external markets opened up by Free Trade Agreements toward a policy that backs and monitors small and medium enterprises, with a view to incorporating them into the benefits of new markets, by improving their capabilities regarding competitiveness, innovation, knowledge generation, and adaptation of technological change, and assurance of environmental sustainability. Regarding housing policy: move from a policy centered on solving and overcoming the housing deficit toward one geared to quality of life, which presupposes quality housing and an urban policy capable of integrating, instead of segregating the

population. Regarding political and institutional policy: move from a policy bent on limited, circumscribed improvements of our democratic system that has sought to maximize governability, toward a policy that deepens our democracy, strengthens our civil society, and encourages citizen participation in life in society.

The country has become increasingly aware – even though the process is still incomplete – of the need for a common understanding of an integral development project for Chile. This in turn presupposes the recognition of the interdependence between the management of an economic development policy and the need to expand the political capital (institutional development), and the social and human capital available in society. The sum of these three kinds of capital can generate a synergy that could allow our country to pursue development beyond the mere accumulation of wealth and GDP growth, and to ensure quality of life and the expansion of human liberties.

1. Strengthening of the political capital

A new Constitution for Bicentenary Chile. The axis of this reform should be the constitutional affirmation of our *Democratic and Social Rule of Law*. This affirmation is not purely a semantic question; it is the springboard for a dialogue of utmost importance aimed at breaking away from an individualistic logic bent solely on the protection of private interests, and at reviving the concept of community as the propeller of our society and institutions. The purpose is not to restrict but rather to expand individual freedom, particularly as regards those that are strictly limited for economic and social reasons.

It is necessary to proceed with decentralization, ensuring a wider distribution of responsibilities and powers from the State to intermediate bodies, privileging first the regions and municipalities. The objective is better distribution of resources countrywide and stimulus for regional forces, greater direct contribution to social equality, a reduction of the territorial component of poverty, a more efficient, focused application of social policies, and the promotion of new channels of political influence for the marginalized.

2. Strengthening of the social capital

Society's organization has a bearing on development's economic and political processes. It is thus necessary to promote greater social cohesion to

counter any model that favors individual action by rational egotists, as is the case with the market economy alone.

Thus, the strengthening of civil society as a mechanism to facilitate economic transactions, reduce risk and opportunism, and encourage specialization, creativity, and collective action contributes to society's own growth and development.

It is also necessary to encourage the resurgence of a major labor movement to help balance the social actors' power, which is alarmingly biased in favor of the entrepreneurial sector, and as an essential element for the construction of a labor relations system based on dialogue, cooperation, and negotiation. This would ensure a democratically rather than a unilaterally imposed recognition of the need for flexibility.

Also necessary is political will to legislate and implement public policies aimed at strengthening our intermediary organizations and intensifying the capacity for association.

Thus, to strengthen the links between civil society and the State, at least three things are required: (i) to raise the expectations of the poor so as to strengthen confidence in social change and reduce aversion to risk; (ii) to empower civil society organizations for setting rules and sanctions to ensure compliance with the rules and the rule of law; and (iii) to establish a vertical interlinking of base organizations and the rest of society for ensuring better distribution of available recourses, guaranteeing their sustainability, and making opportunities accessible to all social segments.

3. The State as a strategic leader of Chile's development

Chile needs more State and a better State for formulating a country vision and a development strategy susceptible of rallying and mobilizing the main social actors capable of taking the lead in their implementation.

Chile must demand that the State play its irreplaceable role in the building of a society ready to expand liberties and opportunities for its people. It is also necessary to recognize the State's importance for doing at least the following: guaranteeing political stability and macroeconomic equilibriums; ensuring a sustainable system of social promotion and full protection, not only focusing the poorer segment but also creating conditions for the social mobility of the

middle segments; regulating the markets and ensuring their proper and correct functioning; providing with efficiency the goods and services demanded by society; and encouraging the accumulation of social and human capital.

The State must also play a more active role in the coordination of public and private cooperation for boosting Chile's competitiveness and exporting capacity. It should be more aggressive in calling upon each economic sector and cluster, in working with them in the identification of the main obstacles pertaining to norms, technology, international commercial networks, human capital, and country brand. Joint work is also needed for co-financing the elimination of obstacles to our productive progress. This policy should be applied particularly to small and medium enterprises, as the only way of lifting them out of their precarious condition and extending to them the opportunities that ensure Chile's participation in world trade through the Free Trade Agreements celebrated in the last ten years.

4. An economy for people's development

An economy at people's service presupposes a preferential concern for the real and the productive economy and not only for the financial area, the pursuit of low inflation, and a balanced budget. With a balanced budget, there is a tendency to maintain the economy behind what is called the productive frontier; the country's growth potential is thus wasted, owing to the underutilization of available human, material, and technological resources. This means the underutilization of the creativity and capacity of Chilean men and women.

It is thus necessary to improve the functioning of the markets by stressing the importance of longer-term planning and of production factors. The objective is to ensure a process of endogenous development and of cooperation among all the actors directed, from the inside, at winning world markets. It is essential to regulate capital movements, exchange rates, and trade policy, as is the implementation of productive development policy, which should include the systematic improvement of the factors' markets and the allocation of resources for investment in physical and human capital, so as to substantially improve the distribution of productivity and opportunities throughout society, and to promote the acquisition of comparative and competitive advantages.

The economy must be managed in such a way as to foster innovation, technological change, production diversification, and investment in capital, particularly in human capital, so as to ensure sustained economic growth and to narrow the gap with the developed world.

5. An economy to address the country's excessively heterogeneous productivity

The persistently precarious income distribution cannot be corrected unless the extreme productive heterogeneity of the economy is addressed. This heterogeneity is reflected in significant productivity gaps between enterprises of different sectors, size, and regions, which lead to salary inequalities and employment quality disparities.

We need a productive development policy capable of rendering technological support to lagging enterprises in sectors with great competitive potential, so as to increase the average productivity of our economy and, at the same time, of creating public policy mechanisms to raise the level of accumulation, innovation, and of access to training and financing opportunities characteristic of certain activities with extremely low labor productivity.

A comprehensive policy to foster production should potentiate innovation and entrepreneurship, focusing on small and medium enterprises, which offer more room for producing positive externalities and creating new sources of employment in the quantity and of the quality needed for extending to large sectors the benefits of economic progress and the opportunities provided by the globalized markets.

6. A new fiscal pact for a new social pact

Our country must still meet many challenges to become a development society. The construction of an increasingly more humanized society requires not only a comprehensive country project but also the decision to advance together as a community bound by shared ideas, values, and objectives and engaged in common efforts. In sum, it must see that the values of equality, solidarity, and community find real expression in society, so that Chile may be a nation where rights and opportunities are accessible to all, without distinction based on gender, age, race, origin, or economic status.

Such dreams cannot materialize unless we earnestly and responsibly admit the need for more public resources to discharge these tasks. If we want to narrow the technological gap, improve the quality of education, have a world-class labor force, and expand the opportunities for young people, women, and the elderly, we must gradually increase public spending, so as to reach at least the average level of developed countries. This cannot be done without increasing the tax burden to finance public spending and prevent fiscal deficits.

In this respect, countries such as ours provide a window of opportunity to proceed gradually and steadily on the route toward closer alignment with the developed countries regarding the tax revenues needed to boost productive development and equality.

Naturally, the pursuit of this convergence should first consider measures to reduce tax breaks and evasion, and design a progressive, instead of regressive tax structure conducive to raising collections while exerting a low impact on growth.

Chile must thus adjust its tax burden upward as its per capita product consolidates a convergence trend, so as to transform the State into an agent that promotes equal opportunities and ensures an efficient redistribution, which are necessary for implementing sounder public policies to stimulate growth and reduce inequality and poverty. **DEP**

Translation: João Coelho.

The Colombian economy: a critical approach

*Darío Germán Umaña Mendoza**

Summary

This essay was presented at the First South American Economists Encounter, held in Rio de Janeiro, Brazil. It describes the Colombian economy's current situation and its relation with integration and globalization, starting from the assumption that we are today experiencing a cutoff point in growth owing to the country's financial fragility in both the external and internal accounts, as evidenced by higher interest rates, exchange rate volatility, inflationary flare-ups, and less optimistic expectations about the level of macroeconomic gains.

In general, economic agents as well as the government are excessively burdened with indebtedness, which so far has been met owing to the continuing stability of current revenue balances. Should these flows change, there would be the risk of a recession, whose duration and extent would depend on the internal measures adopted in relation to liquidity and on a possible recession in the United States and its effects on the world economy.

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1. Description

Colombian GDP should grow over 6 percent in 2007, signaling the consolidation of a growth trend that started in 2000, the year in which a severe recession was overcome, seemingly creating external and internal conditions to ensure a positive, sustained development of the Colombian economy.

The facts pointed out by establishment economic analysts to substantiate these assertions include the financial sector's strong indicators, the monetary policy's positive results, a modest negative balance in the current account, a one-digit inflation target, higher international reserves, the recovery of investment, the stability of exchange and interest rates, the consolidated public sector's positive fiscal indicators, the financial sector's greater opening and deepening, better terms of trade owing to higher international prices of primary and agricultural and livestock products, the abundance of external financing, and favorable GDP growth rates.¹

Table 1
Total GDP and annual growth rates 1999-2006
(In millions of constant 1994 dollars)

Year	Yearly variation	% US\$ millions
1999	-4.20	87,411
2000	2.92	89,968
2001	1.47	91,292
2002	1.93	93,057
2003	3.86	96,647
2004	4.87	101,351
2005(p)	4.72	106,136
2006(p)	6.79	113,338

(p) = Provisional

Note: GDP in 1994 dollars = GDP in millions of 1994 pesos at the 1994 average nominal exchange rate

Source: Dirección Nacional de Síntesis y Cuentas Nacionales-DANE and Banco de la República, Estudios Económicos – Estadística.

With respect to the growth of the GDP per capita, it has evolved at important rates since the year 2003, but at lower rates than the growth of the total GDP.

¹ Banco de la República. Grupo de Macroeconomía. 2006. La economía colombiana: Situación actual frente a los noventa y perspectivas.

Table 2
GDP per capita and annual variations 1999-2006
 (In millions of constant 1994 dollars)

Year	Yearly variation	% US\$ millions
1999	-5.96	2,102
2000	1.14	2,126
2001	-0.29	2,120
2002	0.16	2,123
2003	2.11	2,168
2004	3.15	2,236
2005(p)	3.10	2,305
2006(p)	5.11	2,423

(p) = Provisional

Note: GDP in 1994 dollars = GDP in millions of 1994 pesos at the 194 average nominal exchange rate

Source: Dirección Nacional de Síntesis y Cuentas Nacionales-DANE and Banco de la República, Estudios Económicos – Estadística

However, the income concentration GINI index measured up to 2004 shows that capital concentration and centralization does not help improve income distribution. GINI indicators are not available for the last two years, but all seems to indicate that, as a result of the tax and fiscal measures adopted, capital rather than labor will be favored and that increased gains will not be accompanied by better income distribution.

Table 3
GINI coefficient 1991-2004

Year	National total					
	People			Households		
	Total	Capital	Rest	Total	Capital	Rest
1991	0.55	0.53	0.50	0.54	0.52	0.52
1993	0.56	0.53	0.51	0.55	0.53	0.51
1996	0.54	0.50	0.50	0.53	0.49	0.50
1997	0.56	0.52	0.50	0.54	0.52	0.49
1998	0.56	0.52	0.57	0.55	0.51	0.57
1999	0.56	0.52	0.54	0.54	0.51	0.55
2000	0.57	0.54	0.51	0.58	0.55	0.53
2001	0.56	0.54	0.49	0.58	0.56	0.53
2002	0.58	0.57	0.53	0.60	0.59	0.57
2003	0.55	0.54	0.45	0.58	0.56	0.50
2004	0.56	0.54	0.46	0.58	0.56	0.51

Source: Sistema de Información Estadística. CID. Universidad Nacional de Colombia

For the analysts that believe that the crisis has been definitively overcome, the change occurred as of 2002 in both the structural and the institutional areas. However, some say that risks persist, as evidenced by a significant central government structural deficit as compared with the regional surplus; the high, persistent levels of external and internal debt; the weakness and fragility from the financial system to the public debt securities (TES); the unprecedented excess of consumption expenditures; the deterioration of short-term bank portfolios; the inflated price of assets; and the currency revaluation, coupled with competitiveness problems and the instability of interest rates owing to changes in the world financial and economic environment.

Many of these current characteristics of the Colombian economy are similar to those of the crisis in the late nineties. The salient features then were the international turbulence that caused the accelerated flight of short-term capital; excessive spending; lack of foresight and of prudence in portfolio management on the part of the financial sector; higher prices; the housing sector bubble; and the financial markets' irrational behavior. With this behavior and the increased financial flows, consumption expenditure accelerated, affecting the revaluation of the exchange rate, which, coupled with deregulation, hindered the adoption of timely corrective measures and a proper identification of the economic agents' behavior.

2. Financial interpretation

I do not mean that the current situation is similar to the past in every respect. But the current symptoms point to a series of factors that were common to the end of the nineties' boom, especially if one looks at the real, financial, and monetary variables. According to Minsky's "Financial deregulation: fragility and instability" (1986) and Arestis and Glickman's "Open Economy" (2002), disequilibria have their origin in good times when, with the economic agents' short-term balances in order and reliable signs of economic activity, the monetary authority and discipline become lax.²

Currently in the Colombian economy, investment by the economic agents is levered by debt; households are optimistic about lasting consumption

2 Moreno, Álvaro and Gustavo, Junca. "Las consecuencias económicas de Mr. Uribe. ¿Otra vez los felices noventa?" *Bien-Estar y Macroeconomía*. 2007. *Más allá de la retórica*. CID. Universidad Nacional de Colombia. This characterization receives a more thorough treatment in the chapter of the work, whose reading is recommended.

patterns; banks and businesses, particularly large ones, have devised innovative borrowing and credit mechanisms for consumers; financial sector gains are on the rise; and so far there has been abundant supply of external financing at low interest rates.

Thus, short-term obligations are met and, according to the entrepreneurs' perception, the economy and the productive activities will continue to grow, the exchange rate will remain revalued and interest rates low, and the price of assets will grow exponentially as will the price of securities (the nineties' crisis lacked this last component).

The expectations of agents, the government, and the Central Bank are optimistic and the current favorable situation tends toward continuation. However, the markets give signs of deterioration or at least of a slowdown of the world economy, and the housing crisis in the United States seems to be worsening and to be significantly affecting the financial and real sector of the economy.

It would suffice a simple look at Minsky's equation of how the aggregate benefits of an economy stem from the economic agents' spending and from autonomous demand, which is the source of capital return:

$$B = I + (G-T) + (X-M) + C(K) - S(W)$$

Where B stands for aggregate benefits, I for investment, G-T for fiscal behavior, X-M for trade balance, CK for autonomous capitalist consumption, and S (W) for workers' savings. Let us look briefly at what could be expected from the economy's aggregate benefits, taking into account the current situation of the internal and external accounts and the characteristics of the international environment.

3. External accounts

3.1 Trade balance

The trade balance became negative in 2006 and by the second quarter of 2007 it had approached -US\$1.1 billion and by the end of the year it should fall further to -US\$2 billion, which can be attributed mainly to the

peso's revaluation, as the prices of raw materials and agricultural products have maintained their rising trend. Imports are explained essentially by the higher demand for raw materials and inputs and for superfluous and durable consumer goods, especially for transport material.

Table 4
Trade Balance 2000-2007 (In US\$ millions)

	2000	2001	2002	2003	2004	2005	2006	Acum 2007-II
Exports	13,099	12,233	11,794	12,933	16,442	20,818	23,930	12,938
Imports	10,655	11,826	11,653	12,792	15,324	19,431	23,976	14,007
Trade balance	2,444	407	141	141	1,119	1,387	-47	-1,069

Source: Banco de la República

Exports consist essentially of primary and traditional products, which account for 65 percent of the total, while the share of goods with aggregated value or industrial and nontraditional products is declining (35 percent of the total).³

3.2 Services balance

The services balance in the period under scrutiny has recorded significant deficits in the last three years. The 2007 deficit should be similar to the 2006 one: more or less – 2.1 billion dollars.

Table 5
Services balance 2000-2007 (In US\$ millions)

	2000	2001	2002	2003	2004	2005	2006	Acum 2007-II
Exports	2,049	2,190	1,867	1,921	2,255	2,664	3,373	1,645
Imports	3,308	3,602	3,302	3,360	3,935	4,766	5,493	2,727
Services balance	-1,259	-1,412	-1,435	-1,439	-1,680	-2,102	-2,120	-1,082

Source: Banco de la República

3 Umaña, Germán Mendoza. "Política comercial, bilateralismo y sector externo." In *Bien-Estar y Macroeconomía. Más allá de la retórica*. 2007. CID, Universidad Nacional de Colombia. See p. 205 for a table showing the exports' performance.

Services exports are limited to transport, travel, communications, information, and data processing and, to a lesser degree, entrepreneurial and construction services, which accounts for our exports' low aggregated value. However, if remittances from Colombians living abroad are taken into account, the minus sign changes to a plus sign, as these remittances may be statistically considered services exports.

Imports consist mainly of transport and tourism but the aggregated value of these items is significant, which points to a sharp asymmetry in the composition of our trade with third countries.⁴

3.3 Current account balance

As a result, the current account balance tends to a major deficit in 2007, when it should total -6.5 billion, equivalent to more or less 4 percent of this year's GDP.

Table 6
Current account balance 2000-2007 (In US\$ millions)

	2000	2001	2002	2003	2004	2005	2006	Acum 2007-II
Goods	2,633	579	239	555	1,346	1,595	322	-986
Services	-1,259	-1,412	-1,435	-1,439	-1,680	-2,102	-2,120	-1,082
Factors income	-2,277	-2,609	-2,867	-3,398	-4,297	-5,456	-6,003	-3,508
Current transfers	1,673	2,354	2,706	3,309	3,724	4,082	4,743	2,365
Current account	770	-1,088	-1,357	-974	-906	-1,881	-3,057	-3,211

Source: Banco de la República

The growing current account deficit can be maintained only if the exports of goods and services rise more than imports, which does not seem likely, unless there is a structural change in the supply of exportable goods and services.

This current account deficit is owed in large measure to the factors income, as expenditure flows have trebled in the last four years, and should approach US\$7 billion in 2007.

4 Umaña, Germán Mendoza. "Política comercial, bilateralismo y sector externo." In *Bien-Estar y Macroeconomía. Más allá de la retórica*. 2007. CID, Universidad Nacional de Colombia.

It is determined also by current transfers, especially remittances from workers abroad, whose growing net balance is positive. Thus, the current account balance is in a less chaotic situation owing to the departure of nationals for foreign countries and the transfers they send their families. However, various studies alert that these remittances may be contaminated by drug traffic money, while other transfers come from illegal immigrants. So, this is in part an economy of poverty and illegality.

3.4 Capital account

Table 7
Capital account balance 2000-2007 (In US\$ millions)

	2000	2001	2002	2003	2004	2005	2006	Acum 2007-II
Long-term financial flows	2,077	5,035	-1,391	966	2,624	4,361	6,861	4,249
Short-term financial flows	-2,019	-2,588	2,695	-309	581	-1,130	-4,062	3,136
Capital account	59	2,447	1,304	657	3,205	3,230	2,799	7,385

Source: Banco de la República

The capital account, consisting of foreign direct investment, should be divided into foreign direct and portfolio investment. Foreign direct investment is growing only in the already known primary product sectors and owing above all to privatizations and the acquisition of existing enterprises. Investment in new productive sectors is less significant. Short-term financial flows are increasing in 2007, but given the unstable performance of the international economy, their continuance is uncertain. Right now, internal interest rates are rising, while international rates are declining.

3.5 Balance of payments

Table 8
Balance of payments 2000-2007 (In US\$ millions)

	2000	2001	2002	2003	2004	2005	2006	Acum 2007-II
Current account	770	-1,088	-1,357	-974	-906	-1,881	-3,057	-3,211
Capital & financial account	59	2,447	1,304	657	3,205	3,230	2,799	7,385
Net errors & omissions	41	-140	191	133	242	380	280	227
Net international reserves								
International Net	869	1,167	188	-186	2,543	1,723	23	4,400

Source: Banco da República

International reserves have risen, particularly in 2007. In relation to the debt service obligations, though, they represent only a five – or six month – cushion.

In brief, the goods and services balances are increasingly showing deficits and this is aggravated by increased transfers of multinational subsidiaries in Colombia to their parent companies abroad. Only the remittances of Colombians abroad help moderate this trend. So far, the capital account shows a surplus, but maintaining this surplus will depend on the outcome of the privatization of regional enterprises, which is opposed by local players, and of the new merges with and acquisitions by multinational enterprises at the expense of national capital enterprises, not many of which are left.

Expectations of future macroeconomic benefits should thus take into account the possibility that the deterioration of the current account balance and the instability of capital flows may change medium-term expectations of the economy and the economic agents, particularly if the real estate crisis in the United States worsens.

4. Fiscal accounts

In the 2000-2006 period, the central government's fiscal accounts showed an average deficit of 5 percent, except for 2006. In 2007 and 2008 the spending tendency does not seem to decline, especially if one considers military and democratic security expenditures. A reduction of U.S. resources provided under the Colombia Plan and their diversion to more institutional

ends such as the strengthening of justice and human rights rather than their use for armament procurement would force the country to allocate greater, more permanent resources to defense. Some analysts estimate that to ensure sustainable military spending, GDP should grow an additional 2 percentage points, and taxes should be raised, or spending with other items, such as social spending (health or education) should be slashed.⁵

Table 9

Central Government's fiscal accounts 2000-2006 (In percentage of GDP)

Year	With privatization	Without privatization
2000	-5.49	-5.91
2001	-5.83	-5.92
2002	-5.47	-5.47
2003	-4.81	-4.87
2004	-4.44	-4.45
2005	-4.78	-5.00
2006	-3.66	-3.69

Source: CONFIS, Ministerio de Hacienda y Crédito Público

Note: Since 1994, it was used the GDP according to the methodology from SCN93.

In the regional accounts and in the consolidated accounts of the territorial governments, fiscal balances show surpluses in an inverse proportion of the central government's imbalances, which points to a significant degree of discipline in decentralized governments' spending and at the same time to the central government's voracity and delusions of political and economic centralization.

⁵ See Moreno and Junca. Op. cit.

Table 10
Territorial Governments' consolidate fiscal balance 2000-2005
(In billions of pesos)

Year	Tax	Non tax	Transfers	Capital income	Total income	Operating current expenditure	Interest	Transfers	Capital expenditure	Total expenditure	Net borrowing	Fiscal balance
2000	4,695	955	7,300	348	13,297	8,753	787	1,482	3,583	14,606	-239	-1,070
2001	5,030	675	8,851	190	14,747	10,061	608	1,752	2,330	14,751	-4	-0
2002	5,737	953	10,453	276	17,419	11,543	638	1,575	3,436	17,192	8	220
2003	6,854	1,215	12,425	126	20,621	13,685	599	1,597	3,958	19,839	4	778
2004	7,933	1,241	14,136	91	23,400	15,656	620	1,751	3,298	21,325	7	2,068
2005	8,950	1,576	15,513	166	26,205	18,483	602	1,984	4,984	26,054	-423	574

Source: Subgerencia de Estudios Económicos, Banco de la República

Evidently, this situation has created tensions between the central and the regional governments. In 2006, the Congress of the Republic of Colombia approved a reform of National Government transfers to the regions for the areas of health, education, and potable water, which significantly reduced the resources expected from the previous legislature. This has accentuated tensions, which has led the Liberal Party to collect signatures to submit this decision to a repeal referendum.⁶

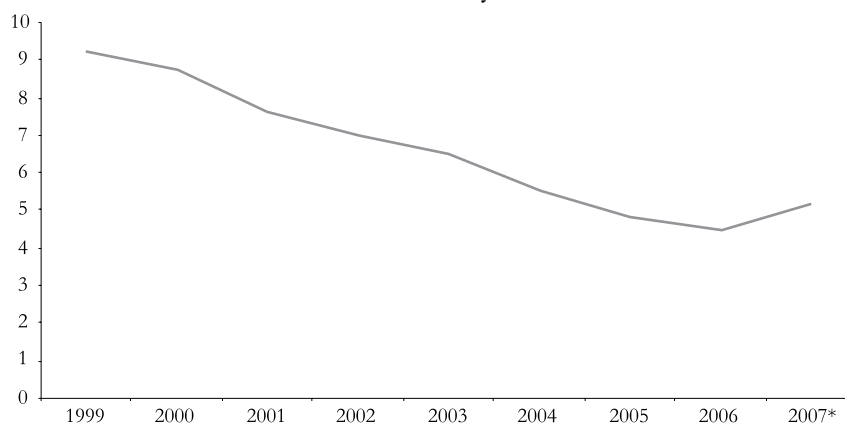
In brief, fiscal risks persist and a contraction of spending would be needed now that the economy seems to tend to lower GDP growth rates; this would diminish the economic agents' positive perception of the performance of future macroeconomic benefits and would possibly further aggravate recession. All of this is a question of economic policy and sound finances.

5. Macroeconomic prices, employment, and inflation

The money supply has been slack in recent years. This, coupled with a large volume of both formal and informal foreign exchange entering the country, has triggered a consumption boom. Owing to the influence of significant imports growth at a revalued exchange rate, this has prevented inflation growth; thus, up to 2006, the Central Bank of the Republic has been able to achieve the inflation targets.

6 For further information on transfers reform, see: Rodríguez, Oscar. "Las transferencias: entre el sistema de protección social, la gobernabilidad macro y la construcción social del Estado." In *Bien-Estar y Macroeconomía, 2007, Más allá de la Retórica*. CID, Universidad Nacional de Colombia.

Chart 1
Consumer Price Index -Yearly Variation 1999-2007



[Accumulated up to November]

[Source: DANE]

In 2007, though, inflationary trends flared up and by November it became clear that the inflation target set by the Bank of the Republic would not be met. It is also clear that the growing delinquent consumer credit and mortgage portfolio has reduced liquidity, leading the Central Bank to raise its interest rates, and private banks to raise their rates even higher, while the exchange rate constantly fluctuates.

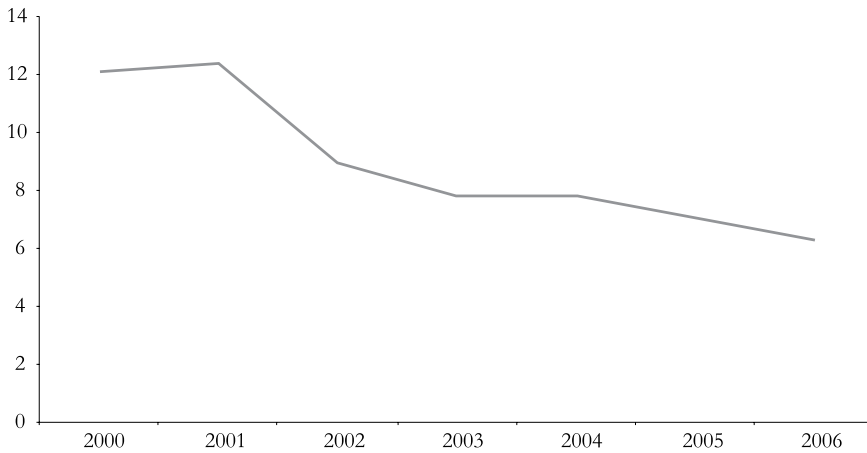
Table 11
Consumer prices index 1999-2007 (In percent)

Month	1999	2000	2001	2002	2004	2004	Base December 1998 = 100		
							2005	2006	2007
January	2.21	1.29	1.05	0.80	1.17	0.89	0.82	0.54	0.77
February	1.70	2.30	1.89	1.26	1.11	1.20	1.02	0.66	1.17
March	0.94	1.71	1.48	0.71	1.05	0.98	0.77	0.70	1.21
April	0.78	1.00	1.15	0.92	1.15	0.46	0.44	0.45	0.90
May	0.48	0.52	0.42	0.60	0.49	0.38	0.41	0.33	0.30
June	0.28	-0.02	0.04	0.43	-0.05	0.60	0.40	0.30	0.12
July	0.31	-0.04	0.11	0.02	-0.14	-0.03	0.05	0.41	0.17
August	0.50	0.32	0.26	0.09	0.31	0.03	0.00	0.39	-0.13
September	0.33	0.43	0.37	0.36	0.22	0.30	0.43	0.29	0.08
October	0.35	0.15	0.19	0.56	0.06	-0.01	0.23	-0.14	0.01
November	0.48	0.33	0.12	0.78	0.35	0.28	0.11	0.24	0.47
December	0.53	0.46	0.34	0.27	0.61	0.30	0.07	0.23	—
Full year	9.23	8.75	7.65	6.99	6.49	5.50	4.85	4.48	5.17

Source: DANE

Chart 2

Interest rates on 90-day term deposit certificates-DTF



[Source: Banco de la República; data provided by Superintendencia Financiera de Colombia.]

As to unemployment, it shows a positive trend; in the first quarter of 2007, it stood at 12 percent of the economically active population and fell to close to 10 percent in the following quarters. The unemployment rate remains constant, though, and informality exceeds 40 percent of the economically active population, which keeps unemployment at the center of attention, as growth does not necessarily lead to better employment and income conditions.

Table 12

Employment, unemployment, and informality 2001-2007

Year		Employment	Unemployment	Informality
2001	Sem I	51.73	15.71	39.50
2002	Sem I	51.56	16.12	38.72
2003	Sem I	52.63	14.61	39.39
2004	Sem I	52.05	14.74	41.37
2005	Sem I	51.87	12.70	41.29
2006	Sem I	52.36	12.01	41.51

Source: DANE – Households Permanent Survey

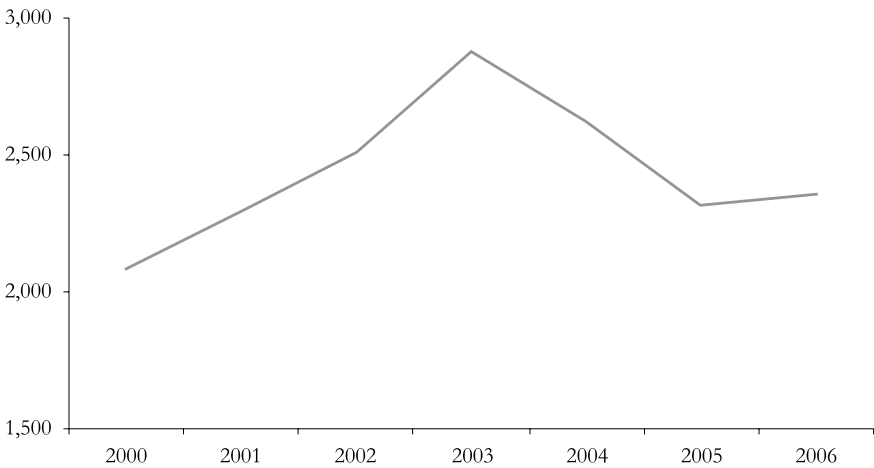
The exchange rate moved from a sharp devaluation in 2004 to a revaluation of equal proportions, which lasted till 2006. It recovered slightly in 2006 and has shown signs of instability and uncertainty in these last months of 2007, an indication that the international market is feeling jittery and awaiting to see what will be the effects of the subprime crisis in the U.S. economy and international liquidity.

Table 13
Representative market rate 2000-2007 (Pesos per dollar)

Period	Average
2000	2,087.42
2001	2,299.77
2002	2,507.96
2003	2,877.79
2004	2,626.22
2005	2,320.77
2006	2,357.98
2007	Fluctuating, uncertain

Source: Banco de la República

Chart 3
Representative market rate (Yearly average)



[Source: Banco de la República]

6. Globalization and integration

This section summarizes the main aspects of Colombia's experience of globalization and economic integration in recent years. A more extensive treatment of this issue is found in the previously mentioned chapter of *Bien-Estar y Macroeconomía*.

Since the past decade, Colombia has endeavored to form part of the unstoppable internationalization of the economy and trade. As part of the World Trade Organization, it has abided by the consolidated, maximum limits of the application of its trade policy as regards the liberalization of trade in goods and services as well as of capital, and has entrusted to the WTO the solution of the differences in respect of the matters negotiated under its auspices, including intellectual property. The difference in respect of intellectual property is that greater liberalization of the knowledge capital is not happening; on the contrary, only a minimum of liberalization is being achieved, which can be modified by higher levels of protection under subsequent bilateral or multilateral agreements.

We will not undertake here a detailed analysis of what our country negotiates at the different international forums. We will simply present a map of our commitments under integration agreements, without making any value judgments.

If a deep integration scheme is understood as one that implies the increasing cession of national sovereignty in political, economic, social, and commercial matters, it should be noted that Colombia does not participate in any scheme of this kind.

The closest to this description is the Andean Community, which has managed to establish not only a free trade zone (goods and services) but also a partial Customs Union, including common trade policies, such as those related to unfair competition and abuse of dominant market position, pricing tiers, sanitary norms, third party safeguards, etc.

Progress has also been made with respect to the free movement of people and the recognition of professional titles among the Cartagena Agreement's signatory countries, including as yet incomplete proposals for the development of integration's social component and draft policies on migrations and social protection in the Andean Community.

There is also a common policy on intellectual property and a less comprehensive policy on investment, all of which is currently under threat owing to the trade promotion agreements celebrated by Colombia and Peru with the United States, Venezuela's withdrawal from the Andean Community, and the elimination of commitments to a Common External Tariff.

In the financial area, a relatively stable institutional framework has been created with the Andean Promotion Corporation, the Latin American Reserve Fund (FLAR); an independent technical Secretariat that has played a major role in ensuring compliance with provisions of the founding Treaty, such as early dispute solution; an Inter-State Andean Court of Justice, institutionally strong but weak in enforcing its decisions; and a sort of Andean Parliament.

Civil society's participation has been limited to the labor and entrepreneurial areas, through consultative bodies that unfortunately never materialized as significant counterparts to the government and whose participation was a bureaucratic rather than a real alternative for enhancing Andean integration.

The Andean Community is losing its relevance: Venezuela, one of its major members, withdrew in 2006, while Peru and Colombia are relegating it to a second plane by adopting an open integration scheme and especially by their bilateral negotiations with the United States, and Ecuador and Bolivia are embroiled in political differences. In sum, the Andean Community is so far an important though failed integration alternative, in which Colombia plays no role today, except for advocating a free trade zone, which, after Venezuela's withdrawal, faces serious difficulties regarding the future.

As it was superseded by the Latin American Integration Association-Aladi, and with the practical disappearance of the Most Favored Nation Treatment owing to Mexico's integration into Nafta, the Latin American Free Trade Association-Lafta, having also failed to extend to the other member countries the preferences it granted the United States and Canada, shows how progress in Latin American integration has been restricted in economic and trade matters to a series of bilateral agreements with other integration zones, such as Mercosur and CAN, in which Colombia participates, or to Colombia's agreements with the northern Central American triangle or partial agreements with Caricom.

In general, these agreements' characteristic is their tendency toward full or partial free trade zones, with lower tariffs, definition of rules of origin to

take advantage of preferential treatment, and other issues devoid of practical relevance. These agreements are also deficient in respect of dispute settlement, clear objectives for advancing toward greater integration, lack of an institutional structure, and failure to include the social issue as part of integration.

There is also a new generation of agreements, such as the ones celebrated by Colombia and Chile with Central America's northern triangle, aimed principally at the liberalization of trade in services, government procurement norms, investment protection, and dispute settlement. As regards binding provisions, though, they are lacking.

The so-called Free Trade Treaties-FTT with developed countries ignore the principle of shared responsibility in the fight against the universal scourge of drugs, the disappearance of unilateral preferences, and the jump to investment protection bilateral treaties.

In fact, a review of the Cooperation Agreement celebrated with the United States but not yet in force shows that Colombia's major gain in trade in goods was the maintenance, with very small additions, of the Andean Promotion Treaty and Drug Eradication Act-Aptdea; it has obtained nothing or very little in respect of the dismantling of subsidies, internal assistance or other equivalent measures in the agricultural sector, or of antidumping, safeguards, integration zone norms related to control and abuse of dominant market position, or the elimination of technical obstacles other than tariff barriers.

On the contrary, Colombia adopts a unilateral opening policy, reinforced by the fact that Colombian norms for controlling unfair competition are quite weak, and are more concerned with opening up the economy rather than protecting local production, as the United States does.

As regards investment, the FTT provides not only for prior protection of foreign investment but even for indirect expropriation; and as to knowledge capital, it neglects or cancels benefits. All the preceding is aimed at preventing the implementation of policies that might affect American investors and tends to ensure nearly unlimited protection of foreign investment, which some see as a symbol of stability, while to others this means an outright surrender of sovereignty.

With respect to dispute settlement, the FTT provides that not only conflicts between States but also divergences between investors and the State

may be subjected to international courts (particularly the International Center for the Settlement of Investment Disputes-Icsid).

The FTT's coverage is wider than any multilateral or any other integration agreement signed by Colombia, as it includes foreign direct investment not only in goods but also in services, capital portfolio (capital control measures adopted by the government or the Bank of the Republic can be claimed only one year after they enter into force), foreign debt, knowledge capital, and it is – surprise! – the only scheme that does not envisage a safeguard clause in case of a balance of payments crisis.

In brief, the FTT is the realization of the American investor's dream that not even the failed Multilateral Agreement on Investment-MAI, proposed by the OECD could make into a reality, as it was attacked around the world by developing countries and even by the Catholic Church – the reason why it was never approved. It exceeds in every respect what had been decided by the Andean Community of Nations-CAN.

As to intellectual property, little or next to nothing has been accomplished in matters of biopiracy control, traditional knowledge, and exceptions in the cultural industries; on the contrary, extension of patentability was accepted, similarly to the protection of reserved information, author's rights, particularly copyright (enterprises that purchase author's rights from their proprietors), piracy control, connections between intellectual property and approval of sanitary registration and longer terms for author's rights, and the automatic incorporation, apart from the WTO, of some aspects negotiated at the WIPO, particularly those pertaining to reinforcement of administrative and coercive controls to enforce respect for intellectual property.

In addition, the population's health is not assigned priority over the monopolistic interests of multinationals and intellectual property norms. Likewise, there is no reinforcement of effective control, pursuant to Colombian legislation, of anticompetitive practices resulting from the monopolistic control based on patents or author's rights.

As regards public sector procurement and services, the crucial fact is that no real, unrestricted access to the markets of the two countries has been achieved, as the United States endorses many geographical and administrative exceptions. The United States excludes the states (about 45) from the FTT

and maintains its exceptions, while Colombia negotiates as a single State. The government procurement liberalization list is thus significantly asymmetric, to Colombia's disadvantage.

In the chapters on services, the FTT does not address the investment issue, which is restricted to the chapter on investment, thereby waiving to a large extent the application of public policies. Mode 4 of the rendering of services (personal services) is not liberalized, nor are migration policies clarified and so far little or nothing has been negotiated in respect of recognition of educational titles or the granting of visas for the rendering of professional services; neither has a mechanism for solving differences in this matter been established.

As to telecommunications services, the main risk lies in the decision on access to public networks based solely on technical rather than economic considerations, and in the private networks' freedom to render services, which might threaten the financial viability of public telecommunications enterprises.

With respect to labor and environmental issues, the FTT does not address the social dimension of integration or respect for the workers' fundamental rights, or adherence to the Kyoto Protocol on gas emissions or to the Amazon Cooperation Treaty. It limits itself to national legislation, the application of fines and eventually of trade sanctions, which implies essentially the application of the social and environmental dumping concepts. Dispute settlement is brought under the FTT, thereby dismissing multilateral forums such as ILO and environmental treaties sponsored by the United Nations.

Although the FTT was signed by the two governments, the Democratic Party has proposed its reopening in regard to labor and environmental matters. This resulted in the unilateral establishment of new conditionalities and sanctions, as the United States was not included in the decisions. We shall see. Meanwhile, the Colombian government is a mere spectator at the negotiations between the major parties and the U.S. Congress.

The dispute settlement system is two-sided. In matters such as trade liberalization, the general mechanism is weak and has little binding force; in relation to investment and intellectual property, it is strong and definitely binding. This is another asymmetry favorable to investors, and these are basically Americans.

Finally, the negotiation of a possible association agreement between the Andean Community of Nations and the European Union is currently in limbo. However, it is realistic to think that in trade matters, Colombia will negotiate with the European Union under similar conditions as it did with the United States.

In sum, as to the liberalization of goods and services that are a priority for Colombia, progress has been minimal under multilateral agreements, and the dispute settlement mechanisms are weak. As to investments, the opposite is true – there has been substantial progress. Thus, it is not inappropriate to say that we do not have a free trade agreement but essentially an investment protection treaty. This is the bilateralism paradise – we are turning our back to Latin American integration and no short-term results are to be expected to change the current account balance's negative sign nor investments to reinforce the capital account. So far everything is changing for the worse.

Conclusion

The preceding presentation of the Colombian economy shows that the recent years have witnessed relative stability and growth, as well as accumulated financial risks in the external accounts – current and capital accounts, balance of payments – and in the internal accounts, the fiscal deficit of the central government, the sustainability of defense spending and democratic security expenditures; all this, combined with the excess of consumption based on credit, which has led to higher interest rates and mild inflationary manifestations, sounds an alert about future performance.

When to this one adds the situation of the U.S. economy and the uncertainty and weakness of the economic and trade integration strategy, it can be said that we face a change of course in economic policy, under risk of a crisis similar to the one in the late 'happy nineties.'

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Translation: João Coelho.

The Ecuadorian economy: overview and a new concept of development

*Fander Falconí Benítez**

Overview of the neoliberal policy in Ecuador

The growth model followed in Ecuador in the last fifteen years has simplified national production owing to the predominance of productive sectors that yield returns aided by favorable international prices. At the same time, the foundations of a national, autonomous productive structure have been undermined by an imports model that benefits high-income consumers and a few importers.

This reprimarization of the economy, scarce productive investment, and the emphasis on financial capital have hindered the reactivation of the national productive structure – after the 1998-1999 financial crisis – and its diversification, which would have supported a more balanced growth.

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Competitiveness was based on the reduction of labor costs and on income from extractive activities at the expense of the ecosystems, in the course of a disorderly market deregulation process, coupled with a tax system incapable of regulating higher-income taxpayers. These factors had serious consequences, as they weakened the role of the State as guarantor of rights, producer of quality public goods, and efficient promoter of stable, sovereign, and human development.

Table 1
Evolution of poverty and extreme poverty, 1995-2006
(As percentage of the population)

ECV	1995		1998		1999		2006	
	Poverty	Extreme Poverty	Poverty	Extreme Poverty	Poverty	Extreme Poverty	Poverty	Extreme Poverty
<i>Region</i>								
Coast	36.07	9.06	46.44	16.30	52.85	15.98	40.31	10.85
Sierra	41.73	18.53	42.15	21.77	51.44	24.65	33.75	12.20
Amazon	60.57	23.80	50.04	22.25	n.d.	n.d.	59.74	39.60
<i>Área</i>								
Rural	63.00	27.37	66.75	33.91	75.05	37.68	61.54	26.88
Urban	23.02	4.11	28.72	7.80	36.39	7.99	24.88	4.78
<i>National</i>	<i>39.34</i>	<i>13.60</i>	<i>44.75</i>	<i>18.81</i>	<i>52.18</i>	<i>20.12</i>	<i>38.28</i>	<i>12.86</i>

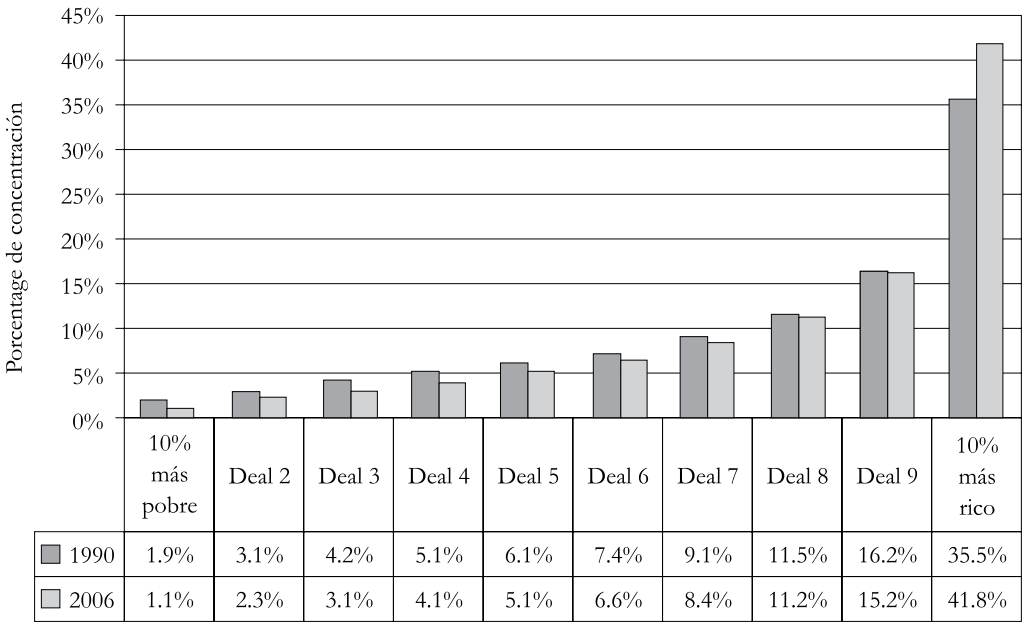
Source: Siise-INEC based on INEC, ECV. Several years.

Prepared by: Senplades

The political environment under the model just described was characterized by continuation of the power relations, with the dominating classes apparently being the only beneficiaries of the fruits of growth. Economic power had great political influence on decisions. The frailty of institutions and the productive apparatus became evident late in the last century, when they proved unable to counter the adverse effects of the El Niño phenomenon (1998) and the banking crisis (1999), which increased poverty from 12.84 percent in 1995 to 52.18 percent in 1999 (Table 1). Owing to the nominal stability achieved by dollarization, poverty and extreme poverty slid back six years later, in 2006, to the levels of a decade ago. Given the demographic growth and the fact that the fertility rate among the poorest is higher than in the rest of the population, it can be said that in the past ten years the number of people living in absolute poverty has increased.

The problems caused by natural disasters, the financial crisis, and the currency change have not affected the entire population the same way. According to SIEH-Enemdu, between 1990 and 2006, only the higher-income households did not see their per capita income drop, while the first eight deciles of the population saw their income steadily decline. In the sixteen years under consideration, the ninth decile maintained its share of income at 16.2 percent, while the more privileged decile increased their share from 35.5 percent to 41.8 percent (Chart 1). In the period under review, a polarization occurred, so that while in 1990 the richest 10 percent's income was 18.6 times that of the poorest 10 percent, in 2006 the difference was 38 times.

Chart 1
Concentration of household per capita income



Source: SIEH-Enemdu, 1990-2006

Prepared by: Senplades

Contrary to neoclassical theory, the opening of the Ecuadorian economy did not increase demand for the most abundant factor, namely, little qualified labor. It did just the opposite, by increasing the demand for highly qualified labor. This widened the salary gap between qualified and unqualified labor,

thereby contributing to higher income concentration and greater inequality.¹

Poverty reduction between 1999 and 2006 (Table 1) was not associated with structural changes, jobs creation, and control of inequality. “Focused” social policies continue to see a poor person as “the other,” who needs assistance but whose social inclusion is left to the improbable reaction of a market that directs investors to the assimilation of labor-saving technologies. Poverty is rather associated with economic cycles, particularly with international oil prices and remittances.

Accordingly, growth understood in an abstract sense² and macroeconomic stability are necessary but not sufficient for reducing poverty. In addition, they are not values in themselves but instruments that must be wielded to the benefit of all and of the poor in particular.

Table 2
Industrial concentration 2005*: Gini coefficient **

	Beverages ¹	Milk products ²	Commerce ³	Hotels ⁴	Construction ⁵
Sales	0,9651	0,9507	0,9411	0,8828	0,8015
Assets	0,9519	0,9434	0,9412	0,9211	0,8948

* Randomly chosen sectors.

** The consumption Gini coefficient is a statistical measure of unequal per capita household consumption, which ranges from 0 to 1. Fully equitable distribution is indicated by 0.

(1) Thirty-one enterprises, seven of which did not report sales

(2) Ninety-seven enterprises, 46 of which did not report sales

(3) Eighty enterprises, 18 of which did not report sales

(4) Top 100 enterprises according to sales

(5) Top 100 enterprises according to sales

Source: Producto Indicador, 2005

Prepared by: Senplades

The unequal distribution of household income and consumption hampers the growth of aggregated demand and the expansion of the economy.

1 No change seems to have occurred. It is not a simple coincidence that average schooling of workers in export activities (the so-called tradable sector) is four times that of workers in sectors geared to the internal market (the so-called nontradable sector of the economy).

2 Abstract because it does not create a productive structure capable of integrating national labor and promoting national sovereignty in the face of variable external factors.

Production has been concentrated in favor of price-forming enterprises at the expense of price-taking enterprises;³ this limits real competitiveness conditions, hinders transparent market practices, and prevents the expansion of the demand for formal, well-remunerated, and inclusive employment (Table 2).

The inequalities consolidated by this growth pattern are not limited to income distribution or the concentration of private ownership of the productive apparatus (by both nationals and foreigners). The primacy of the external sector as a guide of economic growth inhibits balanced human development nationwide, as it impedes the regions' integration under a harmonious process susceptible of reducing disparities.

Despite the emphasis accorded it over the past decade, the tradable sector experienced little productivity increase. Between 1992 and 1997, it increased 2.4 percent, or only 1.3 percent if oil is excluded. Capital-intensive sectors (oil, tradable goods), energy, and water (previously nontradable), recorded significant productivity increases (8.5 percent and 13 percent, respectively), but labor demand in these sectors accounted for only 0.7 percent of total labor demand in the agricultural sectors. Meantime, nontradable, nonagricultural sectors, which accounted for 82.7 percent of total nonagricultural labor, experienced a 0.9-percent drop in productivity.⁴

These figures point to development's lost decade, whose meager growth was reversed by the 1999 bank rescue operation, which nevertheless benefited a sector with serious management shortcomings and a wide discretionary margin, in addition to interests linked to the management of popular savings.

3 Price-forming enterprises are the few monopolistic ones that can raise the price of their products without experiencing a significant decline in demand. Price-taking enterprises are small enterprises that do not have much influence in the definition of market prices.

4 Vos, Rob. "Ecuador: economic liberalization, adjustment, and poverty, 1988-99" in Vos, Rob, Taylor, Lance and Paes de Barros, Ricardo. *Economic Liberalization, Distribution, and Poverty. Latin America in the 1990s*. UK: Edgar Elgar Publishing Limited.

Chart 2
Exports and imports, 1993-2006



Source: Central Bank of Ecuador
Prepared by: Senplades

Since 2000 the main argument for maintaining dollarization has been the need to export increasingly more for financing the external balance in a general context of economic constraint. Although between 2000 and 2005 the Ecuadorian economy's degree of opening rose from 0.748 to 0.812, which orthodoxy would consider adequate, the trade balance deteriorated. The degree of opening was higher owing to a real growth of 45.1 percent in imports, while exports grew only 34.1 percent, particularly because of the international oil prices, an exogenous variable we cannot control (Charter 4).

Increased imports did not lower the costs of national production or raised its degree of competitiveness, as the latter depends on other factors.⁵ On the contrary, increased exports entailed the conversion of a production-oriented sector into an intermediating or speculative sector (financial, real estate), in unfair competition (social dumping) with the popular economy, which was also downgraded into an intermediating condition or jettisoned from the market

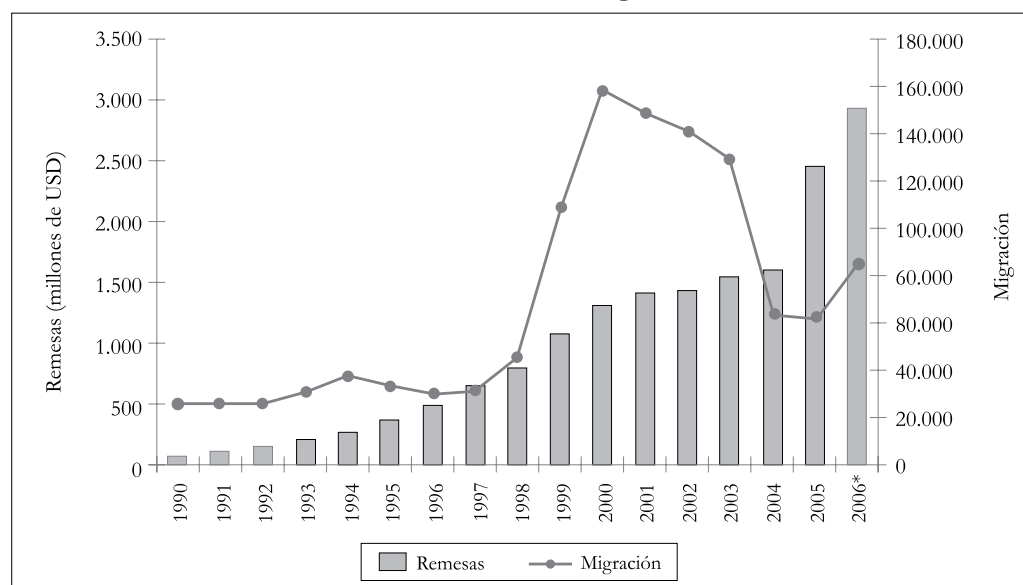
⁵ Major factors include institutional credibility, social peace based on actual justice for all, educational quality and pertinence, an adequate science and technology apparatus, market regulations, and so on.

(small agricultural production). Security and food self-sufficiency quickly deteriorated and, to offset the foreign trade deficit, exports were privileged at the expense of workers' life and of irreversible environmental damage, which caused ecological imbalances that will have grave repercussions in the future.

The accelerated growth of imports and the slow growth of non-oil exports explain the reduced possibility of creating worthy employment. This has helped worsen the population's living conditions because of unemployment, underemployment, precarious employment and low real salaries.

Although it helps to sustain fiscal expenditures, the upsurge of oil exports does not really provide a means of spurring employment growth, given this capital-intensive branch of activity's small capacity for absorbing labor. Ultimately, the opening of the economy, whose results have been negative since 2001, is maintained by foreign remittances from Ecuadorian workers forced to leave a country that does not invest sufficiently in sectors with greater labor absorption capacity (Chart 5).

Chart 3
Income from remittances and migration, 1990-2006



Source: Central Bank of Ecuador and National Migration Directorate, National Statistics and Census Institute

* 2006 data on migration flows are updated to September.

Prepared by: Senplades

In brief, Ecuadorian society has suffered the consequences of the structural adjustment imposed by a coalition of external political and economic forces and by the national elites without a project of their own, in addition to a [wealth] accumulation based on privileged positions. Political ‘turmoil’ and increasing mistrust of institutions prove what the Washington Consensus policies had already anticipated: an ostentatious, unjust society, prone to continuous instability and political conflict.

A new concept of development

The 1990s saw a predominance of stabilization and structural adjustment policies aimed at promoting economic development on the basis of indiscriminate participation in the global market. Economic growth is preferable to stagnation, of course, and it provides a foundation for generating the requisite resources for achieving better living standards, but the possibility of having additional resources does not guarantee that these will ensure human development. The growth model was important. Certain forms of growth may even hinder development, aggravate poverty, worsen the impact on the environment, and ultimately fail to democratize benefits. This has happened in Ecuador and in nearly all other countries of the region in the last decades.

Traditionally, there has been a tendency to confuse means and ends. Economic growth, modernization, and technological change are means for development, and the purpose of development is to expand the capabilities or liberties of human beings. These liberties are essential as values in themselves. Every human being has a right to enjoy these liberties and by doing so he contributes to quality economic growth, society’s democratization, and the establishment of smoother, equalitarian social relations.

Thus, growth ceases to be an end in itself and becomes a means to facilitate the achievement of development in all its aspects: enhancement and potentiation of human capabilities, including good health and adequate access to knowledge and particular skills; and the use each individual makes of these capabilities for self-realization and satisfactory living (at work and leisure, and in productive as well as in social, cultural, artistic, and political activities).

A broader definition of development is needed, as development’s ultimate objective is to replace the quantitative concept of economic growth by a

qualitative one. We thus need a vision that will impel us to strengthen our efforts for achieving more ambitious national goals. We understand development as the achievement of the general welfare, so that all can live in peace and in harmony with nature and thus ensure the survival of cultures. Welfare presupposes the expansion of liberties, opportunities, capabilities and individual potential, to ensure the simultaneous achievement of what society, nations, and the various collective identities and individuals – seen as both universal and particular human beings – value as a desirable life objective. Our development concept forces us to recognize, understand, and value each other so as to make possible everyone's self-realization and the building of a shared future.

Development is more than greater wealth; it is also the expansion of capabilities (cognitive, emotional, and imaginative⁶) and the blossoming of our faculties, thereby guaranteeing the satisfaction of human beings' inherent needs. The satisfaction of needs, equal opportunities, and encouragement for the use of one's capacities are essential to endogenous development and economic growth.

Human development also takes into consideration environmental protection as a fundamental concern. So that they will not destroy the diversity and complexity of the ecological systems, human activities must abide by certain minimum precaution criteria and by certain physical limits.

Sustainability provides the link between economic and ecological systems for indefinitely maintaining life and for implementing the many economic and cultural strategies whereby the various groups, peoples, and nationalities in the country have historically related to nature.

This is not an isolated proposal by the Ecuadorian Government. I believe we are taking a huge step toward a worldwide proposal that will allow us to change course, calling upon the international community to recognize the value of things and actions. This implies a radical turnaround, owing to the realization that there are things that are not necessarily sold or bought on the market but that have no less cultural, aesthetic, or environmental value. One must also realize that there are world public goods and that there is possibility of a development mode conducive to worldwide collective welfare.

⁶ We refer principally to health and physical integrity, the senses, imagination, thinking, practical reason, filiation, respect, play, and control of one's own physical and political environment.

In consonance with these seminal principles, the Government of Ecuador has presented Ecuadorian with a new political, social, economic, environmental, and cultural contract in the form of a National Development Plan geared to the achievement of twelve human development objectives, as follows:

1. To ensure social and territorial equality, cohesion, and integration;
2. To enhance the citizenry's capabilities and potential;
3. To nourish the population's hope and improve its quality of life;
4. To promote a healthy, sustainable environment and to guarantee access to safe water, air, and soil;
5. To guarantee national sovereignty and peace and to contribute to Latin American integration;
6. To guarantee stable, fair, and decent employment;
7. To create and strengthen a public, common meeting space;
8. To assert national identity and to reinforce the different identities and cultural interaction;
9. To foster access to justice;
10. To guarantee access to social and political participation;
11. To establish a sustainable economic system marked by solidarity;
12. To reform the State for the common welfare.

The national development strategy

The promotion of economic and political equality leads to an entirely free society, which is born of full-fledged democracy, the expression of strong social organization and of the full realization of citizenship. As this process's promoter, the State guarantees the universal exercise of civil, political, economic, social, cultural, and environmental rights, which are crucial for eliminating domination and subordination personal relations and creating social and political conditions conducive to personal emancipation and self-realization.

Every citizen's unimpeded development is essential to the unimpeded development of the entire citizenry. Thus, the development strategy's objective

is the enhancement of the capabilities of all individuals to endow them with autonomy for choosing their vital objectives, whether individually or in association with others. Access to a minimum of goods and services is not enough; living conditions must be equally apportioned, so as to potentiate the conversion of the consumption of goods and services into actual human capacities.

As this process rests on the observance of universal human rights, this new development strategy's main lineaments cannot be based on selective policies. The objective of producing and distributing public goods presupposes universal coverage and improved provision, just as the objective of the production of marketable goods and services is to improve the citizens' quality of life.

Thus, the eight general strategies for achieving the National Development Plan's objectives encompass social, economic, cultural, and political aspects that are the essence of man's life in society. The challenge of human development is qualitatively superior to the challenge of economic development. While the former envisages the individual's full realization, the latter limits itself to optimizing the conditions of the market in which consumers and producers meet, the latter is only a subset of the larger, more complex set that is society.

1. Internal development, social inclusion, and real competitiveness

The provision of free, universal public services such as education and health, access to housing and to ongoing training is an appropriate way of to expanding the citizenry's capabilities. Full exercise and development of these capabilities is made possible through the generation of productive employment and the decisive, continuous support of small and medium enterprises, access to productive resources, and promotion of solidarity-based economic organizations (cooperatives and other kinds of association).

Small-scale peasant producers' access to productive assets (land, machinery, tools, fertilizers, selected seeds, and water) is a factor of inclusive development and contributes directly to food security, conservation of agricultural biodiversity, and the full exercise of the right to produce and consume healthy, sufficient, and culturally appropriate foods.

Alternative forms of economic organization and production raise the income level of the country's marginal rural and urban populations, diversify

income sources, and make possible a fair distribution of aggregated value. Some of these alternatives are projects that include the objectives of access to basic services, housing, health, quality education, and greater opportunities; strategic production systems (combining crops such as maize, cocoa, coffee, and rice and the production of meat and dairy products with small-scale cattle-raising) that take into consideration each region's geographical characteristics, production appropriateness, and the population's basic needs; and the social housing plans that ensure a decent life quality for all.

Expanded internal demand for goods and services through government procurement programs and projects to supply government food and education programs and to supply public administration with goods and services boosts production by micro and small enterprises. Similarly, the participative organization of fairs links producers directly to consumers, thereby improving income distribution and product quality.

The State protects the indigenous peoples who live in voluntary isolation, guaranteeing their territories, defining their boundaries, and solving border conflicts so that their efforts to preserve their physical and cultural heritage are not wasted in opportunist adventures. The State also maintains the right to consultation to safeguard the continuity of these peoples' social, cultural, and nature-related processes.

Investment in science and technology is essential to human development when channeled to directly or indirectly meeting basic needs through production support, consumption rationalization, and improvement of the quality of life for all Ecuadorians, together with the interaction of knowledge and worldviews that respect cultural, social, economic, and geographical differences.

This new view of development requires a sufficient underpinning of economic growth driven by uninterrupted productivity gains under conditions of social, economic, and environmental efficiency in the use of resources. Competitive participation in the world market depends on harmonious regional and local development based on integrated productive, social, and environmental policies. In addition to external demand, the promotion of demand on the internal markets heightens the possibilities of integral development, narrows productivity gaps, and helps increase the supply of better products with greater aggregated value. As markets lack self-regulation, the redressing of their imperfections requires a cooperative, independent, and technical institutional structure.

To increase the production of goods and services it is necessary to attach priority to the appropriation and domestic reinvestment of economic surplus, rationalization of resources, improvement of productivity, product diversification and improved quality, public and private entrepreneurial management, and more effective self-management activities. Equally necessary are decent salaries (consistent with the net result of the production of communities and workers' associations), without neglecting any other factor involved. This virtuous process requires goods, services, and factor markets conducive to a fair distribution and use of resources.

As energy, water and other natural resources are finite, they must be used in a responsible, democratic, and rational manner. If possible, the environmental impact of productive processes should be imputed to production costs. If their effects are socially or ecologically destructive, they should be avoided at any economic cost. The productivity of the entire economy, spread out among various independent sectors, subject to physical limitations and viewed from a social effectiveness perspective and not only from a material production standpoint, provides a foundation for sovereign, harmonious, comprehensive development, which in turn is the foundation for real competitiveness.

To redress the sectoral productivity imbalances stemming from exports-fueled growth, an aggressive, ongoing, and generalized strategy is necessary, aimed at strengthening and upgrading the work force's skills and capacities in every branch of activity, particularly in activities with greater labor absorption capacity, such as agriculture, tourism, agroindustry, and tourism. A better qualified labor force makes it easier to raise income, which helps mitigate some secondary aspects of social conflicts.

Sectoral imbalances can also be redressed by local development programs and projects supported by consolidated productive chains defined under agreements involving associations, communities, cooperatives, and individuals. Co-management; financial, technological, and political support; and the organization of the markets that coordinate these chains are State priorities.

The market is a resource allocation mechanism that can be a tool of human development when used in conjunction with a cooperative institutional structure geared to the achievement of the envisaged development objectives. Such is the case, for example, of the State promotion of government procurement systems for the execution of its social policies and discharge

of its basic functions, which at the same time injects dynamism into internal demand. On the supply side, the productive systems thus reinforced help reverse the economic exclusion that affects major portions of the country.

It is incumbent upon the State to maintain and expand an efficient, competitive transport, ports, and airports system, integrating internal trade circuits and facilitating the exportation of goods from every region of the country. It is also responsible for providing speedy, transparent customs services to facilitate, at the lowest cost, export and import activities, improve the control of trade flows and the customs authority, as well as eliminating contraband.

An ethical development process repels any illegal profit-seeking behavior connected with public goods and services, particularly those associated with the use of energy and oil resources. The Government has the obligation to correct such behavior by enforcing the norms issued by independent, professional control bodies. By the same token, the producers of goods and services should demand that corruption and contraband are relentless combated, so as to foster open and fair competition.

The new productivity impetus encompasses social, economic, and productive strategies as well as those aimed at protecting the environment and ensuring the sustainability of the natural assets. Production-oriented policies involve environment considerations and diversification, including the promotion of alternatives to extractive activities or the traditional use of natural resources, such as sustainable tourism in protected areas and community tourism – activities that create many jobs and intersectoral links.

2. Sovereign international relations and active, intelligent participation in the world market

Endogenous development requires a sovereign foreign policy implemented through practical international trade and financial policies that support countrywide, harmonious development. This is the purpose of promoting multilateralism and bloc negotiations and of rejecting unilateral, nonegotiated concessions. Priority is attached to international negotiation of issues related to the environment and to climate change; to the need to negotiate compensation with industrialized countries for environmental damage; to the establishment of global mechanisms for settling the ecological debt; and to

promotion of a worldwide stance on the management of water resources, based on regional and worldwide arrangements and agreements.

Subregional integration and the strengthening of South-South markets are a priority. Foreign trade policy aims at an intelligent participation in world markets, subordinated to the country's internal productive development strategy. To promote economic growth, trade policy must support the improvement of productivity nationwide, the establishment of productive chains, the advantages of economies of scale, and the reduction of internal inequalities.

Trade policy is a prime element of intersectoral and territorial coordination for facilitating agreements involving the State, entrepreneurs, workers, small urban and rural producers, associations, cooperatives, and other forms of individual or collective economic organization. It is also an appropriate instrument for promoting strategic sectors, on the basis of their actual and potential capabilities. The State shall prevent the creation of enclaves under foreign control.

Diligently implemented, trade policy is an instrument for changing the model for the country's production and exports specialization and for diversifying markets and the range of exports. Unilateral trade liberalization is not beneficial when trade is carried out principally with countries with productive structures quite different from Ecuador's. An active trade policy should take advantage of the possibilities open by the World Trade Organization's normative framework, through the use of subsidies, selective tariffs, exports promotion, etc.

The intellectual trade policy is tied to the science, technology, and applied research policy and to the strategies aimed at environmental sustainability and conservation and at the exploitation of biodiversity resources.

International financial flows and the foreign banking system should be subordinated to the development strategy and trade policy, and are instruments for accelerating productive development. Capital inflows are encouraged if they are directed at investment in and the financing of long-term productive activities. Capital controls are appropriate mechanisms for reducing speculation and the risk of banking, financial, and monetary crises, and for controlling private borrowings, favoring the local financial sector in its relation with strategic productive sectors.

Foreign direct investment is encouraged as a channel for the transfer of technology and knowledge in key sectors, and is promoted through trade policy as a support for internal innovation. International cooperation is also encouraged for speeding up social, economic, and political changes deemed indispensable for achieving development's objectives.

3. Productive diversification

Inclusive human development requires higher levels of aggregated value to increase income from the exploitation of primary goods, the production of agricultural goods for processing by the food industry, and the production of intermediary goods and of high-technology goods and services.

Priority is attached to the recovery of the installed capacity of the State oil refining enterprise and to additional investment in high technology to process heavy crude oil and oil with higher sulphur content. The prospects for this type of investment are not determined by the relation between proven deposits and exploitation but rather by the long-term development of a post-oil country, which will continue to need this kind of energy. This decision will alleviate the acute pressures of the balance of payments on the current account, which have suffered from the lack of industrial policies.

To incorporate the extractive sectors into the inclusive human development process, their natural tendency to operate as enclaves disconnected from the rest of the economy will be countered, as will the negative effects that compromise environment sustainability. The country's promising mining undertakings should abide by these criteria. Fiscal measures do not ensure actual social inclusion and the establishment of environmental standards should take into consideration the local communities' opinion.

The coordinated efforts of the State and the small and medium enterprises are directed at stopping the reprimarization of the economy by diversifying the supply of goods and services with higher aggregated value. To this end, the generic drugs chemical industries, tourism, and community tourism will be encouraged as an alternative for exporting conservation, and the petrochemical industry and other strategic sectors will be overhauled. These efforts should consolidate a renewed, practical substitutive industrialization as a mechanism for expanding employment demand and strengthen the balance of payment's current account.

The combination of climate and natural factors that favor Ecuador's physical environment is the ideal platform for planning a highly competitive, inclusive food industry capable of regenerating the social fabric, which has deteriorated over the last decades, and of intensifying the labor demand, not in an attempt to replicate Northern industrial processes, but in an intelligent effort to participate in world markets. This requires a long-term financing strategy, investment in science and technology, training of the work force, coordination of value chains, establishment of minimum sanitary and phytosanitary standards and quality norms, public support for opening markets, and associative schemes, so as to generate economies of scale and rein in enterprises interested in restricting competition. Food self-sufficiency implies food security, which has to do with the regions' food production for their own consumption, even at higher costs (market fragmentation), the strategic definition of technologies and products to meet national demand, and interest in exporting to the country's advantage without depleting the nonrenewable natural resources.

The need to boost employment demand and to diversify the exportable supply of goods and services may be met in part by promoting the production of intermediary goods capable of incorporating aggregated value, based on technologies that are more easily assimilated in an economy with serious competitiveness problems. It is also possible to reverse de-industrialization by promoting the supply of goods and services in activities that incorporate major high-technology components, such as pharmaceuticals, biochemistry, and the software industry, which have both static and dynamic comparative advantages and which can be fostered under strict, long-term protection programs.

4. Territorial integration and rural development

Territorial development's challenge is to pursue a balanced, sustainable advance of all the country's regions, so as to improve the living conditions of the entire population, redistribute wealth, and potentiate the citizens' development, on which should be based the public agents' and the citizens' decisions and actions with major territorial implications.

Territorial development (understood as an ongoing process) should be planned according to technical and participative criteria, so as to achieve a balance among the subnational territorial units. It should be based on coordination, concurrence, complementariness, subsidiary factors, decentralization, and

productivity. It should also emphasize equality and inclusion, ecological sustainability, economic stability, precaution and prevention, transparency, solidarity, and shared responsibility.

Territorial development seeks to establish a gradual equilibrium among the regions to ensure a better geographical distribution of growth between provinces and municipalities and between urban and rural areas. This requires a national covenant to enable the regions to take advantage of economies of scale, improve the coverage of infrastructure and services, execute joint infrastructure and equipment projects, consolidate subsystems of coordinated urban centers to facilitate the country's regional reordering, as well as improving the administration's structure and management, productivity, and efficient political action by the Parliament in respect of the territory.

This new territorial organization is to be consolidated through three basic policy proposals: development of a balanced polycentric system of cities and new functional relations between the countryside and the city; guaranteed, equal access to infrastructure, public services, and knowledge; and rational, responsible management to ensure that nature, productive resources, and the cultural legacy are protected.

The territorial strategy objectives will be pursued by all public initiatives. The national administration will strengthen the intermediary administrations to enable them to generate the endogenous development of their territories.

The combined objectives of development, equilibrium, and conservation in the different regions will provide a foundation for the balanced, sustainable development of the entire country. This requires the strengthening of the structurally weaker zones and the promotion of better living and working conditions in them. Under this process, the already consolidated urban centers can count on a firmer social base to participate in the globalization of capital.

5. Sustainability of natural assets

Development's objective – the continuous improvement of the quality of life – requires respect for the natural assets, strategic management of natural resources, and better environmental planning in urban centers. This forms part of a new development ethics and is the foundation of intergenerational justice.

The protection and conservation areas established by the State are subject to many social pressures and should be consolidated through biodiversity programs and projects capable of ensuring the ecosystems' viability and integrity. To include the natural assets in national planning it is necessary first to improve the State's capacity for planning the use of space.

Activities related to oil exploitation, mining, fisheries, forestry as well as industry and agriculture should be subject to the State's environmental control and supervision. This presupposes the recovery of public authority and the strengthening of local institutions to enable them to manage environmental resources and to formulate and implement policies and strategies. The complex, fragmented, and superimposed responsibilities of public agencies for the management of natural resources can be addressed by the establishment of a national body charged with environmental programs and projects, norms and standards, and control and supervision of natural resources.

New institutions will facilitate the regulation of biosecurity (including the control of genetically modified organisms and the introduction of exotic species), the access to genetic resources, and the protection of the traditional knowledge of indigenous peoples, Afro-Ecuadorians, and other local communities.

Water is a public good and its use, quality, and conservation is incumbent upon the State, which can grant usufruct rights or decentralize its management without thereby resigning its responsibility as the custodian of its sources and rational use. The state must plan the use of this resource, guarantee its sanitary conditions and its appropriateness for consumption by every household in the country, expand the irrigated cultivation area, and devise regulatory instruments and models for water conservation and water quality certification. This requires closer coordination between national and local authorities in charge of water resources and their distribution, as well as their management for human consumption and sanitation, all under a rational, decentralized plan. This presupposes a consistent legal and institutional framework for strengthening the regulatory role of the national water resources authority.

Limits must be set to deforestation and sustainable alternative activities must be implemented, geared to external, internal, and local markets, and control instruments must be used, with the support of the affected communities, in accordance with the principles of sustainable production, maintenance of the forest cover, biodiversity conservation, shared responsibility, and reduction

of the negative environmental and social effects. Valorization of native and planted forests help their sustainable management, as do institutional modernization and the legal framework, the qualification of all those involved, and sufficient funding for the system's operation.

The participation of rural populations, indigenous peoples, and Afro-Ecuadorians in decision-making and in the planning, execution, and monitoring of forestry and conservation programs is a factor of social inclusion and a form of indispensable responsibility-sharing.

The extractive economy is moved by enterprises driven by boundless greed, which often forget their environmental responsibilities. Their concessions and operations should be subject to effective regulation that goes beyond the formal licensing requirement and is capable of mitigating the attendant environmental, economic, and cultural consequences. Local development depends on efficient projects based on renewable sources of energy.

Climate change has reached such a magnitude that its social, economic, and environmental effects must be monitored and prudently managed. Public policies must guide the citizens' behavior and forms of productive organization, so as to halt this change tendency. Risk management must be strengthened by technical civil defense.

The right to preserve natural and cultural riches takes precedence over economic growth. The impact of productive activities in fragile areas of the natural patrimony requires more efficacious control. The capabilities of local and sectoral bodies must be enhanced, so that they can effectively monitor activities that are potentially harmful to the environment and to biodiversity conservation, as well as performing audits and assessment of the environmental impact of industrial and energetic development projects, particularly in the oil, mining, fisheries, and forestry sectors.

The quality of urban environment planning is deficient and heterogeneous. It should be improved in coordination with the municipalities, with a view to implementing initiatives aimed at air decontamination and air quality recovery. General policies must be formulated and norms must be fine-tuned for managing emissions and solid and liquid waste (both domestic and industrial) as a preventive, precautionary measure to ensure the quality objectives. Preservation of the landscape and quality of life in human settlements, particularly in

peripheral areas and risk zones, require norms set and enforced by the different levels of government in coordination.

6. A State with real planning, regulating, and managing capabilities

Ecuador's balanced, inclusive development requires a State characterized by equitable allocation of territorial competences (decentralized and autonomous) and this territorial organization must be complemented by long-term economic, social, and environmental planning.

A National Planning System has been set up to overcome the limitations of sectoral plans based on disconnected ministerial initiatives and interventions, and to coordinate public policies. This planning system's implementation hub is the central government with the compulsory participation of provincial governments. Its design, perspective, and obligatory character are the base for coordination among the different development actors: collective movements, ethnic communities, proprietors and workers associations, nongovernmental organizations, international agencies, and economic groups.

The National Planning System prepares national plans that emphasize the importance of public investment in the full development of human capabilities, without neglecting investment in physical capital, energy, and connectivity. This new priority scale fits in with the new distributive criteria that are essential for expanding the citizens' capabilities and liberties; with the need to correct income disparities and unequal access to public services and national assets; and with the respect for the limits set by environmental sustainability.

After the serious crises of the last decade of the 20th century, a minimum consensus has been achieved on sustaining economic growth. But this is not sufficient to give impetus to human development. A new form of regulation of the goods and services market as well as of the financial market is essential, as is a public authority with sufficient capability to execute social programs geared to income redistribution in accordance with equitable, inclusive income and spending policies.

Markets are not self-regulating. A secure, agile, and competitive business environment needs a fluid, transparent institutional structure designed to attenuate the uncertainty every productive enterprise has to face. Autonomous

technical entities charged with regulation, standardization, information, and control reduce transaction costs, democratize the use of information, and set norms for curbing practices contrary to competition.

The recovery of the State's regulatory capacity requires an independent, autonomous, and effective Judiciary committed to the fundamental values of human development and grounded on universal access to justice. An independent, technical justice administrating system consolidates juridical security, reduces transaction costs, overcomes uncertainty, and enforces the fulfillment of contracts.

Macroeconomic stability is fundamental to security in daily life, for providing minimum certainty referral points for decision-making (investment, borrowing, production, consumption, qualification, and apprenticeship) and in general for enhancing the citizens' capabilities. In the short term, this means price stability, fiscal prudence and discipline, and balance of payments viability. It also means other equilibriums in the economy's real sector, particularly in the employment of the work force and in investment in human resources and physical capital. In the long term, it means sustainability based on renovation and on the equilibrium of natural systems. The objectives of human development demand that the stability of all these factors be ensured.

Economic power cannot be counterbalanced only by civil society. To ensure a more democratic allocation of resources, the State's capacity to regulate the economy must be expanded. This requires a series of interventions aimed at regulating the labor market and the quality of production, ensuring better workers' health and security, curbing environmental deterioration, preventing monopolies, and stimulating competitiveness. The crucial thing is that the State's regulatory activities take fully into consideration the needs of civil society.

The economy's fundamental factor is labor. Social peace rests on fair remuneration based on employment policies that include the setting of minimum salaries and the elimination of any form of precarious jobs, the universalization of social security, and ongoing training programs to improve productivity. The State encourages unionization and the unions' freedom of action as long as it does not interfere with national assets or the quality of the services provided. The insufficient dynamism of public and private investment makes it necessary to counter social exclusion and precarious labor practices stemming from the deregulation of the labor market, by means of

government-sponsored alternative forms of productive organization, such as social and solidarity economy, and cooperatives in particular.

Because it takes place outside the market, work done at home, which is vital for the functioning of the entire economic system, has remained invisible owing to the predominant means of production. It must be recognized and its rights must be guaranteed to conform to the principle of equality.

The competitive production of goods and services must increase its quality through productivity gains. Good corporate management raises productivity in accordance with internationally accepted or internally defined quality standards and with a transparent, agile corporative legislation. This legislation should set minimum conditions for entering and exiting markets, establish the statute of corporate minorities, provide facilities for open investment in shares, and set norms for the professionalization of entrepreneurial management, treatment of foreign capital, corporate responsibility, taxation, and obligations related to the environment and to the provision of truthful, timely, and transparent information. Entrepreneurial productivity in particular benefits from competition rules and the control of monopolistic practices.

Economic growth depends heavily on the rate of productive investment, which in turn is sensitive to financial market and juridical security conditions. Despite its owners' eagerness for profit, the financial system must perform its fundamental social role – to foment savings and efficiently allocate credit so as to promote the expansion of productive capacity on the basis of equality. The banking system's limitations should be offset by the recovery of the public financial system's capacity, thereby expanding the field of action of the securities market and incorporating social security's long-term savings into the supply of financial resources channeled to investment. Financing should give priority consideration to mechanisms of access to credit by small and medium enterprises, through solidarity finance systems that offer real solutions to family or community production and to economic organizations that incorporate social components into their projects.

Strategic areas for potentiating economic growth to support human development (energy, oil, telecommunications, science and technology, mining, water resources, and rural development) deserve special attention from the State. To manage them, public enterprises deemed necessary will be established by legislation; these enterprises should be capable of administering strategic resources

under the responsibility of the State, in an independent, profitable, transparent, and sustainable manner, in accordance with the proposed objectives.

This new model of State is geared to the achievement of results and to greater efficiency and efficacy of public policies, simplified and transparent procedures, improving public services, combating corruption, and recovering public authority.

To this end, the national territory must be reorganized according to a new political and administrative division that will act as a catalyst of decentralization and deconcentration. The purpose is to transfer central government attributions and functions to provincial and municipal governments, pursuant to the latter's capacity to assume new management functions, administer resources, and render accounts to the citizenry. This transformation should take place over the medium and long term, ending up with the establishment of autonomous regions capable of assuming ever more important attributions and functions.

This new political division should bring citizens closer to their governments, providing them with more opportunities for expressing their will to them and to demand from them a rendering of accounts. Overcoming poverty and social and territorial disparities and achieving the population's welfare are a cogent reason for this change toward a State model that is decentralized in administrative and fiscal matters and accompanied by regional autonomy, which is indispensable for fully achieving the collective objectives of human development.

7. Economic democratization and society's major role

The citizenry's needs and demands must guide the development of the State and the market in the pursuit of the objectives of human development. Organized civil society should guide economic activities and the distribution, use, and control of public goods and services. This requires institutional channels to allow associations and individuals a greater role and power in decisions about political processes and criteria to govern the production and distribution of society's wealth. There is a great distance between this model and the statist, free-exchange model of growth and human development.

An active, vigorous civil society must inject dynamism into its forms of collective, voluntary organization, beginning with social networks, associations, social movements, cooperatives, etc. so as to enhance its social power and

exercise effective influence on the organization of production and the allocation of collective resources.

To strengthen civil society, it is necessary to encourage its organizations to assume greater control of state initiatives that condition economic activity and to expand the room for its direct and indirect influence on economic power. A civil society fortified by the promotion of associative action can cement autonomous social powers capable of counterbalancing the powers that be, and of building a society free of exclusion. More and better association forms in the various spheres of life, with a sound balance between community and individual interests provide a foundation for a new form of State and new market structures, in which autonomous, well-informed collective players deepen and expand democracy and generate social power.

The first factor to enhance social power is the State's thorough democratization, which also offsets the enormous influence of the large economic power groups on State decisions. This influence has thwarted the ends of economic activities into the satisfaction of capital accumulation imperatives, neglecting the satisfaction of human needs. In modern societies, the thorough democratization of the State is both an end in itself and a process whereby the provision of public goods and services and the wealth distribution schemes are oriented toward civil society. This is why public services should be democratized, not privatized.

The innovative planning of participative democracy's institutions is important for identifying the population's preferences. Participative budgets lead to more efficient public services, direct public spending toward the less privileged segments, and make control and accountability possible. The participation of civil society organizations and mobilized citizens in decisions about the use and channeling of public resources endows democracy with genuine content.

The process of democratization of the State's ordering is rounded off by close cooperation between State agencies and social associations in various government initiatives, and by the strengthening of representative democracy mechanisms and the promotion of new forms of social control and oversight. This collaboration may take the form of corporative covenants between the State and the entrepreneurial and labor associations to establish different forms of salary regulation and to determine, by consensus, adequate working conditions in specific sectors of the economy.

These cooperation schemes may be extended to other aspects of social life, such as environmental issues, the use of natural resources, and the functioning of public health services and education, so that the various civil society organizations and the State may jointly regulate the use and allocation of collective resources. This implies the promotion of public networks jointly operated by public and private players, and of associative democracy mechanisms for government administration.

Associative democracy's networks and mechanisms must ensure that civil society organizations do indeed represent civil society and that their decisions result from careful deliberation and are transparent and subject to the control of social and political players. The deprivatization of the State requires that the councils and boards in which civil society is represented and which have great weight in public administration be really pluralist, inclusive, and democratic in their makeup and operations. This does not mean detracting from the power of organized civil society groups but rather its proper channeling to ensure that it is a true instrument of democratic citizens' participation in and collective influence on economic life.

The democratic regulation of economic activity is also helped by the joint participation of workers, users, and consumers in the regulation of working conditions and in the quality control of services and goods produced by the enterprises. This generates new social norms for increasing the workers' participation and decision power in the enterprises' administrative councils, with a view to including both workers and clients in these councils and to encouraging the control of entrepreneurial activities by social movements that promote respect for the rights of workers and consumers. To this end, it is necessary to strengthen the collective organization of workers – who have been harmed by the flexibilization of labor – and of users and consumers.

Another way of enhancing organized civil society's power is by strengthening social or solidarity economy through civil society's direct participation in the organization of different aspects of economic activity. Social economy seeks, on a priority basis, to meet human needs rather than the maximization of profits. To promote social economy, the State should fund certain types of socially organized production (art associations, fair trade cooperatives, networks for the care of the elderly and children, etc.) so that those engaged in such activities may enjoy adequate living conditions.

The economic and material deprivation of a large percentage of the population sets serious limits to the strengthening of social power. The organization of this power requires that each citizen devote at least a minimum of time to the task, although this is often impossible for subsistence reasons. In addition, scarce resources force many social organizations to establish a client relationship with political or State entities or to depend on private charity or on groups maintained by foreign funding. This detracts from the organizational autonomy of collective players. It is thus necessary to establish an unconditioned basic income or a universal citizen's income consistent with equalitarian social justice, which is the foundation for civil society's genuine empowerment.

8. Rights guarantee

The Ecuadorian State promotes the full exercise of its citizens' rights – it guarantees their civil, political, economic, social, cultural, and collective rights, as well as their participation in a political community, while requiring that they exercise their responsibility as citizens.

As a county that endeavors to guarantee full citizenship, it incorporates, expands, and maximizes citizenship's intrinsic rights, consistently with its laic nature. This presupposes a public education system that promotes values such as respect, tolerance, recognition of diversity and differences, and freedom of conscience and worship. Full citizenship also presupposes gender equality and the guarantee of sexual and reproductive rights, free of any kind of discrimination, coercion, or violence.

Full, active citizenship is possible solely in the framework of absolute democracy, in which the laws and the Constitution stress the citizenry's role and social power in constructing democracy and its forms of expression.

Promotion the participation of all those that belong to this political community ensures universal citizenship, differentiated and diverse, founded not only on nationality but also on the collective idea of nation, regardless of whether a person is native born or not.

Genuine citizen participation begins with the promotion of mechanisms and instruments of direct democracy, in which the legislative initiative, the freedom of expression, the binding consultation capacity, and social participation, public deliberation, access to information, social control, and

co-management by the citizens are key values of a democracy that combines representativeness and participation.

Full citizenship is not achieved solely on the basis of respect for individual freedoms and political rights, if the State is absent. It presupposes above all an active role by the State in guaranteeing economic, social, and cultural rights.

The guarantee of these rights requires that the State play an active, major role in providing basic social services and in assuring the universal character of essential public policies (health and education, for instance). The model of State consolidated in the sixties and seventies of the last century was characterized by intervention, promotion of rights, and construction of a social citizenry; under the new model, the State has a key role in guaranteeing third-generation rights through an agile, polycentric, decentralized and deconcentrated government apparatus, closer to the citizens and more capable of addressing the problems and the social and local demands.

As provider of health and education services and guarantor of the right to property, work, and worthy housing, the State acts to implement those rights that require specific public action and not only passive respect for individual liberty.

The right to property must be broadened and radicalized so that Ecuador may, in the medium term, become a country of proprietors and producers. In a democracy that prizes itself, no form of property ought to become a monopoly or violate the constitutional principles of environmental protection and integrity of the public space and its destination for common use.

The right to work must maintain the guarantees proper to social rights, such as the freedom of association, the right to unionization, the unrestricted right to strike, the principle of correspondence between salary and work, and so on. The appropriate exercise of these rights is characteristic of a society determined to eliminate all forms of precarious employment and to guarantee a normative and institutional framework that contemplates the right to stability on the job, a just salary, and gender equality in respect of salary.

As what concerns collective rights, of ethnic e cultural nature, the country commits itself to plainly assimilate the international norm, recognizing, for instance, the ILO 169 agreement, that guarantees the indigenous and afroequatorian peoples' rights.

The advocacy of full citizenship should discard the *vulnerable groups* label that has guided public policy in previous decades and applied to people targeted by special protection by the State. The current constitutional definition of *vulnerable groups* must be modified, as it states that children, adolescents, expecting mothers, the handicapped and the elderly are beneficiaries of special public policies and object of the State's and society's priority attention. These social groups cannot be treated as mere objects of a welfare public policy; they must become directly entitled to rights that are guaranteed by differentiated and universal public policies.

Full citizenship encompasses respect for differences, as different cultural groups have particular needs that must be recognized, so as to ensure a multicultural citizenry that fully respects different identities. **DEP**

The Guyana economy, review and prospect

*Rajendra Rampersaud**

1. Introduction

Guyana is the only English speaking economy in South America, has an area of 83,000 square miles or 215,000 square kilometers, is located on the northern coast of the continent. It is bounded on the north by the Atlantic Ocean, on the east by Suriname, on the south by Brazil and on the west by Venezuela. Guyana is almost the size of Britain but more than 80 percent of the country is covered by forest. Only 10 percent of the land mainly along the coast is inhabited by the population.

Guyana is physically divided into four types of land forms (1) a flat coastal and clay belt that is some six to eight feet below sea level where most of the country agricultural activity occurs. (2) A sand belt which includes the Intermediate Savannahs. (3) A central peneplain which comprises the lush, pristine tropical forests and extensive mineral deposits. (4) The highlands that include the high mountains range.

Guyana is also blessed with a plentitude of natural resources, fertile land for agriculture, a wide variety of minerals that included gold, diamond,

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bauxite, manganese, other precious and semi precious stones, a multitude of livestock, fish and shrimp. There are indications of reserves of oil and natural gas that are now being explored.

The country has a multiracial population that totaled 740,000 people with six different races. The country's per capita income is just around US\$ 1,200 which is far below its economic potential. The lower per capita can be attributed to periods of uneven growth and progress since independence.

2. Economic and social performance

Guyana is characterized as a small open economy; that is market oriented and very vulnerable to both endogenous and exogenous shocks. Having gone through a period of fluctuating growth since the late nineties the economy returned to a high level of economic growth estimated at 4.5 percent in 2006. The country continues to depend on sugar, rice, bauxite and gold for its export earnings, which form the main pillars of the economic activities. As a result growth patterns tends to be very cyclical and very much influenced by the vagaries of the prices of commodities in the International Market. Economic activities are also very vulnerable to both domestic and external shocks.

3. Production and exports

In the past, Guyana depended very much on the European Union/ACP preferential arrangements for its export of sugar and rice. Total exports ranges from US\$ 550 millions to US\$ 600 millions in the last three years with sugar (US\$ 137 millions) and gold (US\$ 114 millions) being the largest contributor in 2006. The export performance was buoyed by the very favorable international prices for both sugar and gold in the world market. The current price for sugar is nearly US\$650 per metric tonnes in the EU while the price of gold topped the US\$765 per oz mark in 2007. Bauxite, rice and timber are the other exports that contribute substantially to the economy's export earning. The bulk of the country's export earnings are primary commodities whose prices have been at the mercy and vagaries of International Commodities prices.

Apart from the downside risks of the vagaries of commodity prices, the EU is currently negotiating a new Economic Partnership Agreement (EPA)

with the African, Caribbean and Pacific (ACP) group of countries to replace the Cotonou Agreement. The EPA agreement is not expected to be completed within the time frame as a result there are fears that the EU might opt for the imposition of the General System of Preference (GSP) if there is no trade deal by the end of 2007. This outcome might not be favorable for Guyana.

The Guyanese economy is already reeling from the unilateral imposition of a thirty seven percent price cuts by the EU on sugar beginning this year while the rice price had already suffered from a reduction in prices. The devastation of the price cuts on both rice and sugar has had a serious impact on a large segment of the population that depends both directly and indirectly on sugar and rice. As a result, the preferential erosion will impact negatively on income in agriculture and the economy as a whole.

The gold and bauxite industries have been experiencing better world market prices with gold prices hitting its highest level in the last 15 years. However, mineral prices have been on a roller coaster in the last decade and the windfall gains from higher than expected mineral prices have to manage prudently. Despite enormous potential Guyana had not been able to fully exploit lucrative opportunities in the export of fruits and vegetables to the North American Market especially USA and Canada that boast a large West Indian population. This group has a preference for nostalgia products from the Caribbean. Further, there are greater opportunities for the export of higher value added packaged rice and sugar to Caribbean countries that were not fully exploited in the past.

The manufacturing sector grew by 4 percent in 2006 however; given Guyana natural resource base one would have expected a more dynamic manufacturing sector over the years. There have been some notable achievements in the furniture sub-sector and the bottled rum in the export markets. Despite this, the large raw material base provides ample opportunities for greater diversification of production and exports. The increase in private sector credit by 36.4% in 2006 was a welcomed sign that investment in the manufacturing sector is now taking off in the right direction.

The service sector exhibited strong growth pattern in recent times driven by the hospitality industry especially after Guyana successfully hosted six of the super eight matches in the Cricket World Cup (2007). This was followed by the hosting of other international conferences for instance the Rio Heads of Government meeting and the recently concluded Commonwealth Finance Ministerial Conferences.

These events have led to showcasing of Guyana to the outer world and should contribute to greater interest in Guyana ecotourism drive in the future.

Despite the improvement in commodity prices and the favorable weather, the economy has to be adjusting to the external shocks of the oil prices that rose to its highest level at US\$88 per barrel presently. The higher than usual price of oil is having a negative impact on the Guyana Terms of Trade. The higher oil prices are having inflation spikes that are presenting an unusual challenge for the monetary authorities. Oil imports represent over 25%-28% of Guyana GDP. The prospect of oil exploration in Guyana and the country's hydro power potential are now being fully exploited to mitigate future downside risk of high energy prices.

4. Balance of payments, exchange rate and inflation

The current favorable prices for commodities is expected to dampen the overall impact of higher oil prices thereby reducing the current account deficit to US\$ 475 millions in 2007, an improvement on the 2006 level. This deficit will be further reduced with a net inflow of medium and long term capital of US\$ 173 millions in 2007.

The favorable balance of payments position will have a positive impact on the stability of the exchange rate. Guyana currently operates a floating exchange rate regime that in the past five years has been fairly stable at GY\$200 Vis a Vis the US dollar. However, the economy experiences a rapid spike in inflation over the last few years due to the rapid increase in oil prices. This along with the increase cost in other imports has led to a rapid increase in inflation estimated at 12 percent in June 2007. However, it is expected that with the tightening of monetary and fiscal policies the end of year inflation is likely to decline to the targeted 8% at the end of 2007.

5. External debt and Hipic initiative

Guyana was considered a highly indebted country in the early nineties with a total external debt of US\$2.1 billion that was 675 percent of GDP and consumed over ninety percent of the country's export earning. However, due to the Highly Indebted Poor Country Initiative (Hipic) the current external debt has been severely reduced.

The recent Multilateral Debt Relief Initiative (MDRI) that provided additional debt write off to the original Highly Indebted Poor Country Initiative (HIPC) has returned the Guyanese economy to the debt sustainable level ratio. As a result of the MDRI initiative, Guyana external debt servicing ratio has been reduced to a sustainable 5-7% of export ratio over the next five years. Total external debt stock is expected to be reduced to US\$ 625.6 millions at the end of 2007. Most of these represent debt on concessional terms.

Even though the main macroeconomic variables over the medium term look rather stable, the main challenges ahead are to increase the per capita income GDP at a more rapid rate. Guyana has been able in the decade of the nineties to ignite growth after suffering from the lost decade of the eighties. After growing at a rapid pace at 7% per annum for most of the nineties, the economy lost its way and experienced a period of low and negative growth early in the new millennium. This brings to fore the issue of not only igniting growth but to sustain growth and development over the longer term period.

6. Social sector and the Millennium Development Goals

Guyana has made significant progress in implementing strategies and interventions aimed at achieving the eight Millennium Development Goals (MDGs) but much more is still to be done in order for the country to meet the MDG's 2015 targets. In many cases delays have been due to external and financial constraints.

The eight goals of the MDGs are as follows: 1) the eradication of extreme poverty and hunger 2) universal primary education, 3) promotion of gender equality and empower women 4) to reduce child mortality 5) to improve maternal health, 6) to combat HIV/AIDS, malaria and other diseases, 7) environmental sustainability and 8) to develop a global partnership for development. Each of these goals has targets totaling eighteen to be met within a designated time frame.

The latest review of these goals shows that Guyana has made substantial progress towards reducing poverty as well as eradication of poverty. Latest data shows that there is a decline of children under five suffering from malnutrition when compared with the base line in 1995; Guyana has already met the target in 2007. In an effort to combat hunger, the government is targeting schools and health clinics in nutritional programmes.

Guyana is also on track for meeting the goal on universal primary education. Recent statistics have shown that the rate of children repeating classes has declined from 4% in 1996 to 1% in 2002. The figures reflect changes in the school curriculum, higher teacher to student ratio as well as targeted programmed for needy children. The main focus is to ensure universal primary education by 2009 as there is a large percentage of children in school.

In order to promote gender equality and the empowerment of women, Guyana has signed on to the convention for the elimination of all forms of discrimination against women and the Inter-American Convention for the prevention and eradication of violence against women.

Guyana is on its way to meeting if not surpassing the target on the reduction of child mortality. However, there are some conflicting views on the data between the Ministry of Health and World Health Organisation but there is no doubt that rapid progress has been made on this issue. Progress has also been made regarding improvement in health care provided to pregnant women; there has been a close monitoring in place on the prevention of mother to child transmission of HIV/AIDS and other sexually transmitted infection through intensive training sessions.

The policy to aggressively combat HIV/AIDS, malaria and other diseases is progressing well. The rate of HIV/AIDS in pregnant women dropped from 5.6% in 2004 to 2.6% in 2006. Pregnant women are currently being tested at prenatal clinics, the provision of maternal support to orphans and vulnerable children and the deployment of mobile treatment team of technical personnel to the hinterland and outlying regions augurs well for health care.

Guyana has made significant progress on the implementation of the MDG's eight and progress towards achieving most of the targets by 2015. However, a main constraint has been the availability of domestic resources and the long bureaucratic delays in realizing the much touted aid from the international donors despite completing half of time towards achieving the MDG's by 2015. Despite the progress on MDG's eight, the main challenge is to implement the institutional capacity to sustain the rapid progress in the social sector. The Social Sector Investment has ensured that the progress in the last decade is distributed in an equitable manner however there is a need to sustain institutional capacity for the longer term.

Despite stable macroeconomic environment and the progress in eight of the MDG's, these advancements alone cannot sustain Guyana rapid economic progress. As a result, given the current world environment the government has moved towards the restructuring of the traditional sectors such as sugar, rice and bauxite and encourages the rise and development of the non traditional and emerging sectors.

7. Challenges of the future: diversification of output and markets

The world sugar market is going through major reform as large importers such as the European Union and the United States are forced to remove their subsidies that distorted the market and make their trade regime more W.T.O compatible. The European Union had to cut their subsidies prices by 37% over the period 2006-2007. This price cut will impact on ACP exporters, however, it might be better in the long term as countries are forced to restructure to higher value added sugar.

The Government along with Guysuco has prepared a Strategic Action Plan for the sugar industry some five years ago to meet the challenges of the decline in preferences in sugar. The Action Plan is regarded as a medium term plan to enhance agricultural productivity, diversification based on cane sugar, increased investment in research and development and the building of new processing facilities. The main strategies for diversification are adding greater value to sugar through the development of refining capacity, development of packaging of a brand name Guyana sugar and diversification into the energy sector such as the cogeneration of electricity.

The cogeneration of electricity is a huge project that is looking at replacing some of the high cost fossil fuel with bio fuel. An international conference was held in Guyana this year by the Caribbean Countries, the Inter-American Development Bank, and Inter-American Institute for Agriculture, the Caribbean Development Bank and Caricom that agreed to begin studies to implement the process of the production of Bio fuel. In this regard, Guyana and the Caribbean Countries expected to draw on the experience of Brazil in the production of ethanol. There is also the plan for the construction of a large distillery facility for the production of bottle rum that is a final product at the Skeldon Estate.

However, the main project that is geared towards the complete restructuring of the sugar industry is a US\$169 million Skeldon Modernisation Project, which is expected to be completed in the next few years. The new sugar factory is expected to produce 110,000 tonnes of sugar annually at a cost of 8US cent per pound. This will make production of sugar in Guyana be very cost competitive internationally. The project is also expected to contribute significantly to increasing in sugar production to 450,000 tonnes annually. There will also be rehabilitation of other sugar factories such as Albion to make them more cost efficient.

A major development is the opportunities for downstream refined sugar. The Caricom region provides a lucrative market for refined sugar. The package sugar also has a ready market in Caricom and North America. Bagasse will be used to produce electricity to supply the national grid with some 10 megawatts of power in Berbice. Rum is another by product of sugar that has very good potential. Guyana rum is noted to be consistent winners in the International Rum Fair. A joint venture for the new distilling plant with a large regional private sector company is on the way at the new Skeldon Sugar factory and with Caricom tourism the potential for this rum market will be lucrative for Guyana.

Rice has also suffered as a result of the loss of the preferential market in Europe. However, that loss that occurred since the late nineties is being mitigated by the fact that there is a competitiveness strategy in place to allow the industry to survive outside the walls of protection. Major investments in drainage and irrigation and water control have led to increase in yields. The Research Institute has invested in quality control and tropical varieties that will see the doubling of rice yields. A major restructuring of the Guyana Rice Development Board is now on the way to lead the search for exports market. A large potential of untapped market remains in the Latin American Region which Guyana is expected to explore.

The demand for Guyana's bauxite is once again reaching full potential with major investment by Russia of Russia. Private sector investments of some US\$150 million are expected over the next few years. The main industries in Linden and Everton are expected to be retooled. A plan for an integrated bauxite alumina complex with a feasibility study for a new alumina plant with a capacity of at least one million tonnes per year is now being completed.

Having revived the traditional sectors that formed the main pillars of the economy for over two centuries, attention has now being turned to developing the non traditional and emerging sector of the economy. This diversification of the economic base and the reduction of the country's dependence on commodity exports that is extremely vulnerable to external shocks is the way forward.

8. Manufacturing sector

The manufacturing sector possessed enormous potential but continued to trade below its capacity. The pharmaceutical sub-sector is now growing steadily in both production and exports and it is the leading sub-sector with new products, innovation and research. Exports of pharmaceutical products from Guyana have now penetrated the North American and European markets. The rise of construction has led to an increase in demand for engineering and construction products however; this sub-sector is only at its incipient stage of development.

In the past few years, there are indications of a growing light manufacturing and agro-processing industries. These industrials have utilized raw material and inputs from the domestic economy. It is evident that these higher value added products will stimulate both the upstream and downstream manufacturing industries in Guyana.

The sub-sector that showed good results in the export market has been the livestock, sea food, aqua culture, forestry and fresh fruit and vegetable. Non traditional agricultural exports have been growing consistently at 6 per cent per annum in the last two decades. Guyana is well placed to tap in on a large scale in the Caricom market with a US\$3 billion food import bill. However, a major constrain in the inadequate infrastructure to facilitate rapid export in a timely and adequate manner.

Guyana is now one of the Caribbean Seafood hubs of the North American market and was recently recertified for shrimp export to the United States for the sixth consecutive year. While fresh fruit and vegetable from Guyana are in great demand, its potential is being limited with the export infrastructure. The infrastructure for the preservation of the products that will increase their shelf life is limited. As a result, it has not been able to meet an increase in demand for its products in the export market.

The tropical forest in Guyana provides the furniture sector with different species of wood to satisfy a growing furniture industry. Again the rapid growing housing sector has placed great demand on local furniture. More recently the Cricket World Cup 2007, and the large amount of new hotels have resulted in a larger than expected demand for furniture. The export market was under supplied in the last two years. The manufacturing capacity in furniture is now adjusting to the large demand.

9. ICT sector

Perhaps, the greatest untapped economic potential is in the area of the Information, Communication and Technology (ICT). Guyana geographic location as a continental hub with English as its native language, a highly educated population provides all prerequisite for a dynamic ICT sector. There are certain infrastructure constrains that are now being addressed such as the high cost of international bandwidth and unreliable supply of electricity when corrected will facilitate the rise of the ICT sub-sector. The ICT sub-sector with knowledge based product will provide for high paying job and an acceleration of per capita GDP.

The review of the different sub-sectors in the Guyanese economy is a clear indication of underutilized capacity. The full capacity utilization will contribute to Guyana more than doubling its per capita GDP growth in the next decade. However, for such capacity utilization to be fully harnessed the infrastructural bottlenecks will have to be removed to facilitate sustainable economic growth.

10. Recent infrastructure developments

The existing physical infrastructure is incapable of providing the necessary support for Guyana to take its rightful place in a globalized environment. Moreover, having been unable to access credit in the last decade of the eighties, the physical infrastructure became seriously dilapidated. The challenge of this period is not only to rehabilitate the existing but the creation of new infrastructure that will stimulate output and exports. This is a very costly exercise that will have to be done systematically given budgetary constrains. The next section will highlight some of these developments.

a) Roads and bridges

One of the most important projects that would link Guyana to Brazil is the construction of a highway from Bom Fim Brazil to Linden in Guyana. Work is in progress on the Takutu River Bridge that will link Brazil and Guyana, a most important continental link. The government of Guyana is investing in a GY \$28 million complex at Linden to provide services such as immigration, customs, police and health. This is one of the innovative infrastructure projects to integrate Guyana more fully with its South American Partner Countries. It will also be opportunity for trade, tourism and transportation network in South American.

There is another large Investment Road Project for the New Amsterdam – Moleson Creek Highway at a total cost of over US\$ 5 millions. This will provide easy access for Guyana to its other South American neighbours thereby increasing market opportunities, exchange of cultures and facilitate free movement of people across the continent.

Apart from the rehabilitation of the existing roadway, the construction of new roads will create the available network that will facilitate communications in the non-traditional regions and the larger continental links. The present road network only links the coast and as such has not facilitated developments to the wider regions. The building of the Berbice River Bridge currently in progress by the private sector is another large infrastructure initiative that will link two counties Berbice and Demerara and speed up economic progress in both counties concurrently. This is expected to be the fifth longest floating bridge in the world upon completion. The bridge will replace an outdated river transportation system linking two of the most densely populated territories in Guyana.

The Berbice River Bridge project will coincide with the plans for the construction of a deep water Harbour in the Berbice River. Presently, only small ships can come into Guyana due to the shallowness of the Demerara River where most of the ports are located, as such that the costs of trade almost doubled in Guyana. With the dredging and desalting of the Berbice River, large ships can arrive in Guyana and storage of larger containers can be facilitated more easily. The harbor would provide the opportunity for more modern and upgrade port facilities of international standard. Better port facilities will go a long way in improving Guyana export competitiveness.

b) Electricity and energy supplies

The power supplies in Guyana for more than four decades continued to rely on electricity from an old Guyana Power and Light Company (GPL) of the fifties that continues to use fossil fuel that is rather expensive. The cost and limited supply of Guyana Power and Light Company has been identified as a major constrain for the development of a vibrant manufacturing sector. The Guyana Power and Light Company have been trying to improve efficiency by its plan to improve generations and delivery, reduce commercial and technical loss that is now estimated at over 30 percent. These improvements will enhance Guyana's competitiveness in the manufacturing sector since the cost of energy is a major input in the value of the product.

Guyana's huge potential in hydro power has remained untapped energy potential despite several previous attempts. A private sector company Synergy Holding Inc. is currently securing the financing to develop a hydro power project at Amelia Falls on the Pataro River. This project has the potential to produce 100 MW of electricity for the next 100 years. Commercial operations are expected to come fully on stream by 2010. This is expected to be a large and cheap source of energy that can power Guyana's manufacturing drive.

c) Air transportation

The development of the air transportation sector is now evolving. There were improvements to the Cheddi Jagan International Airport for the Cricket World Cup (2007) and the domestic Ogle Airport that offer flights to the interior of Guyana and the Caribbean Countries that can offer a big boast to tourism. However, the cargo facilities at the airport are still limited. It would be necessary to modernize the cargo and storage facility with improved refrigeration and packing facilities that can boost export of fruits, vegetable, meat and other perishable products.

11. Conclusion

Guyana's economy made good progress over the last decade in achieving macroeconomic stability. The economy achieved positive growth most of the time, inflation was kept under control despite domestic and external shocks. The

macroeconomic foundation is now more resilient to domestic and external shocks. The growth and development in Guyana was more equitable and the economy was able to achieve most of its Millennium Development Goals targets set for 2007.

However, despite its abundance of resources and macroeconomic stability, the economy has not kept pace with a more rapid improvement in per capita GDP. These constraints can be found in the level of physical infrastructure to facilitate growth and development at a faster pace. The rehabilitation of the infrastructure such as communications, powerplants and machinery will contribute to overall acceleration of growth and development and an improvement in the standard of living.

I. Selected economic indicators					
Indicators	2002	2003	2004	2005	2006
1.0 National accounts aggregates					
1.1 Growth rate of real GDP	1.1	-0.6	1.6	1.9	4.7
1.2 GDP at factor cost (US\$M)	617.8	631.0	652.7	683.6	741.2
1.3 GNP at factor cost (US\$M)	562.7	588.4	621.7	663.5	698.1
1.4 per capita GDP (US\$)	829.2	840.2	864.4	902.6	974.9
1.5 per capita GNP (US\$)	755.4	783.5	822.5	875.6	918.2
1.6 Gross national disposal income (US\$M)	705.2	763.7	781.5	931.6	1,032.0
1.7 Private consumption as % of gross domestic expenditure	45.1	44.8	49.2	55.3	47.5
1.8 Public consumption as % of gross domestic expenditure	21.1	23.7	21.8	20.3	18.2
2.0 External trade and finance (US\$M)					
2.1 BOP current account balance	-106.7	-60.6	-70.0	-167.1	-181.4
2.2 Imports of goods and non-factor services (G&NFS)	-758.9	-743.8	-854.5	-984.5	-1,103.2
2.3 Exports of goods and non-factor services (G&NFS)	667.2	669.6	749.9	698.9	748.8
2.4 Resource balance	-91.7	-74.2	-104.6	-285.7	-354.4
2.5 Imports of G&NFS/GDP (%)	122.8	117.9	130.9	144.0	148.8
2.6 Exports of G&NFS/GDP (%)	108.0	106.1	114.9	103.2	101.0
2.7 Net international reserves of Bank of Guyana	183.2	176.2	136.6	160.5	222.3
2.8 External public debt outstanding	1,246.7	1,084.5	1,071.1	1,094.0	920.6

Indicators	2002	2003	2004	2005	2006
3.0 Prices, wages & output					
3.1 Rate of inflation (% changed in urban CPI)	7.1	4.9	7.2	8.3	*4.2
3.2 Public sector monthly minimum wage in G\$(e.o.p)	21,047.3	22,099.0	23,204.0	24,828.3	26,069.0
3.3 % Growth rate	5.0	5.0	5.0	7.0	5.0
3.4 Electricity generation (in M.W.H)	512.7	488.9	514.9	528.4	534.6

Source: Bureau of Statistics and Ministry of Finance

II. Selected social indicators					
Indicators	2002	2003	2004	2005	2006
4.0 Population & vital statistics					
4.1 Mid-year population ('000)	747.7	752.5	755.1	757.6	760.2
4.2 Population growth rate (e.o.p)	0.9	0.3	0.3	0.3	0.3
4.3 Net migration ('000)	N.D	N.D	N.D	N.D	N.D
4.4 Visitors arrivals ('000)	104.3	100.9	121.9	116.6	113.5
4.5 Crude birth rate (per 1,000 persons)	23.5	25.8	23.1	N.D	N.D
4.6 Crude death rate (per 1,000 persons)	7.3	7.3	6.8	N.D	N.D
4.7 Crude marriage rate (per 1,000 persons)	7.3	6.4	5.9	4.8	6.1
4.8 Infant mortality rate (per 1,000 persons)	20.3	17.0	20.7	22.8	18.4
4.9 Under 5 mortality rate (per 1,000 live births)	24.9	21.2	26.0	N.D	N.D
5.0 Health and education					
5.1 Public expenditure on:					
5.1.1 Education as % of national budget	18.2	14.4	15.5	13.7	13.0
5.1.2 Health as % of national budget	8.8	8.9	9.5	7.5	9.0
5.2 Number of physicians per ten thousand population	4.6	4.1	4.2	4.3	4.9
5.3 Number of nurses per ten thousand population	10.5	14.0	34.0	34.0	13.1
5.4 Number of hospital beds per ten thousand population	42.4	43.6	43.6	43.5	24.8
5.5 Low birth-weight babies (<2500g) as a % of live births	11.5	11.9	11.8	11.8	N.D
5.6 Severely malnourished	0.7	0.6	1.0	0.6	N.D
5.7 Moderately malnourished	9.3	8.8	9.3	7.0	N.D
5.8 Overweight	3.9	4.7	5.2	4.7	N.D

Indicators	2002	2003	2004	2005	2006
6.0 Immunization coverage					
6.1 1 year olds immunized against DPT/ (pentavalent) (%)	85.0	91.0	92.0	92.0	92.0
6.2 1 year olds immunized against MMR, yellow fever (%)	93.0	90.0	90.0	92.0	92.0
6.3 1 year olds immunized against polio (%)	93.0	90.0	90.0	93.0	92.0
6.4 1 year olds immunized against TB, BCG (%)	95.0	94.0	94.0	96.0	96.0
7.0 Crimen					
7.1 Reported serious crimes	3,470.0	2,941.0	3,450.0	2,808.0	2,376.0
7.2 Of which: homicides	142.0	206.0	131.0	125.0	153.0

Source: Bureau of Statistics and Ministry of Finance. **DEP**

Translation: Soledad Rojas

Paraguayan economy at a slow pace: current situation and outlook

*Dionisio Borda**

Paraguay's main problem is slow economic growth and the persistence of poverty and inequality. These obstacles stem from limited development of State institutions, which is responsible for a high incidence of informality and lack of an expressive market economy. The discretionary, arbitrary exercise of power slows down the construction of an efficient State, a market economy, and the equalitarian apportioning of opportunities and resources. Contemplated institutional reforms are not sustainable in such a context and economic policies produce only short-term results. On the political scene, no effort is seen for establishing a medium-term strategy capable of reversing the economic and social conditions.¹

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¹ This article is based on the author's previous works, including "Paraguay: resultados de las reformas (2003-2005) y sus perspectivas." Serie *Informes y estudios especiales*. Cepal, Chile, 2007. *Economía y empleo en el Paraguay*. Ed. Cadep, Paraguay, 2007. "Paraguay, crecimiento y progreso social" (draft), KAS, Paraguay, 2007. Borda, D. and Richards, D. "The Predatory State and Economic Reform: an Examination of Paraguay's Potential Economic Transition" in J. M. Fanelli, *Understanding Market Reforms in Latin America: Similar Reform, Diverse Constituciones, Varied Results*. Palgrave, 2007.

1. Institutional and economic background

The Paraguayan economy, differently from the economy of the other Latin American countries, has managed to maintain relative macroeconomic stability, a low indebtedness level, and commercial opening since the sixties. In the institutional area, the country has not been able to forge efficient, credible public institutions. Development of three branches of government has been weak, at first as a consequence of dictatorship (1954-1989); thereafter, during transition, the government was unable to overcome sectarianism and to this day continues to be subjected to partisan political interests. This form of administering the State has been responsible for slow growth and high levels of poverty and inequality. Institutional inefficiencies and insufficiencies are reflected in the low indicators of transparency, governability, and competitiveness at world level.²

Dictatorship created a power relation based on the State, the single party, and the armed forces, which hindered the development of a professional bureaucracy and of opposition parties, and the formation of an active citizenry. Transition to democracy began with a coup d'état staged by the armed forces (February 1989). This military action, aided by the one political party, opened the doors to democracy after 35 years of dictatorship; to this day, though, consolidation of democracy and the development of the State have not been accomplished. The current Administration was preceded by three elected presidents.³ Before completing one year in office, the last one was replaced by a government designated by Parliament,⁴ as he was about to be unseated by a political trial for the assassination of the vice-president (March 1999). In the sixteen years of democracy, there have been three failed coups,⁵ an indication of society's feeble democratic tradition, particularly as regards the political class, and of the State's weak institutional development.

2 Transparency International's Corruption Perceptions Index has ranked Paraguay 98th of 102 countries (2005); 123rd of 133; 140th of 145 (2004); and 144th of 158. According to Latinobarómetro, in 1996, 59 percent of Paraguayans preferred a democratic government, and only 26 percent preferred a dictatorial regime; in 2005, though, only 32 percent still believed in a democratic government, while 44 percent favored dictatorship. The World Economic Forum's Competitiveness Index has ranked Paraguay 76th among 80 countries (2002-2003); 95th among 101 (2003-2004); and 113th among 177 (2005-2006).

3 N. Duarte F. (2003-2008); A. Rodríguez (1989-1993); J.C. Wasmosy (1993-1998); and R. Cubas (1998-2003).

4 L.A. González M., 1999-2003.

5 December 1995, April 1996, and December 2001.

Such a political context necessarily entailed economic consequences. Economic growth in 1981-2005 averaged only 2 percent, while demographic growth was about 2.8 percent. Per-capita growth in this period dropped 16 percent, one of the region's worst indexes. This economic retrocession had various causes. Unfavorable external factors have been recurrent. Economic volatility in neighboring countries, such as Brazil and Argentina, Paraguay's major trade partners, has dealt a recent blow to the economy. Drought and the fall of international prices, particularly of cotton, also contributed to economic stagnation. Mercosur's creation in 1991 reduced triangulation trade (importation and reexportation), especially with Brazil, which adversely affected the internal economy. Internal factors have also been little favorable to the creation of better conditions for market development and private investment in the last two decades. Corruption and the informal economy have put a break on major private investment. High demographic indices, inefficient investment allocation, and the nineties' financial crises did not help economic development. The lack of a strategy for upgrading the quality of human resources, attaching priority to public investment in infrastructure, and achieving institutional development raises a serious obstacle to growth and to the reduction of poverty and inequality.⁶

2. Reforms implemented

In Paraguay, reforms have been partial and discontinuous, and have often been reversed. Neither have they been sequential. There are explanations for this situation, which deserve a closer look as a starting point: macroeconomic instability has never reached the point of hyperinflation, fiscal deficit over 5 percent of GDP, indebtedness over 45 percent of GDP at the worst moments, no delay in debt payment that might have put a stop to external transfers. Differently from other countries, Paraguay had an open economy. The importation and reexportation of goods has been one of the strategies for penetrating the protected Brazilian and Argentine economies, whose adverse effect is reflected in a powerful underground or informal domestic economy, which weakened the exercise of State control and generated corruption. In addition, State intervention has been centered predominantly on the management of State

6 Borda, D. "La Economía y el Empleo en Paraguay," in Borda, D. (Ed.), *Economía y Empleo en el Paraguay*. Asunción: Cadep, 2007, pp. 1-13.

enterprises – public utilities (electricity, water, and telephone); production of goods (cement, steel, alcohol, and sugarcane); and services (ports, airports, navy, airlines, first-tier financial institutions) – rather than on the control of prices on regulated markets. The fixing of family basket prices has not been effective, as the government lacks the capability for exercising such control. It has had more control over interest and exchange rates. The two types of intervention – in public enterprises and in price control – have reinforced corruption and failed to fully ensure the achievement of the respective policies' objectives.

Another peculiarity is that the Paraguayan government, without undertaking an agrarian reform, distributed public lands to small farmers in the sixties and seventies, and was the major employment provider, given the absence of sizable enterprises. Land distribution and the provision of public employment strengthened political loyalties, further hindering the State's development, the emergence of a professional bureaucracy and of a more autonomous citizenry, as well as hampering market development. Power in the hands of the only political party prevented the development of State institutions, market competitiveness, and the functioning of political parties susceptible of assuming power. The State-party relation gave rise to an entrepreneurial class that was strongly dependent on the government and on patronage in connection with the creation of direct and indirect jobs in the bureaucracy and the allotment of public lands. Under this peculiar concept, it is possible to understand the macroeconomic policy's reform initiatives and the liberalization of Paraguay's markets and foreign trade.

Macroeconomic policy

Economic policy reforms have gone through two stages. The first took place in early-1989, when the government faced an inflation surge, fiscal debt, and overdue debt payments. The second took place in early-2003, when the government had to face the same problems, which had recurred.

In the first stage, the new 1991 tax law was enacted, which simplified the tax collections system, broadened the taxpayer base, and made the allocation of resources efficient and neutral, as well as modifying the customs tariff system. The new taxation regime replaced over thirty taxes, in addition to the simplifying and modernizing Paraguay's tax system. The same law called for reforming internal taxes and custom duties, aimed at drastically reducing custom duties to an average of 10 percent.

Another important measure introduced in 1989 was the adoption of a new exchange rate system. The multiple exchange rate system under which different exchange rates were set for the dollar⁷ was abandoned. As of February 1989, the single, free exchange rate was introduced under the floating administration system, under which the market determines the price of foreign exchange, according to a band established by the Central Bank of Paraguay, consistently with the monetary program for controlling inflation. The new system corrected the distortions created by the multiple rates system, but excessively absorbed the cost of inflation control, expressed in terms of an exchange lag.⁸

This first wave of reforms lost momentum because of regulatory decrees that introduced new loopholes in the tax reform and the lack of spending control. By 2002, the fiscal deficit confirmed an expansive trend that started in 1995, with an average annual deficit of 2.5 percent of GDP; it was 3.57 percent in 1999; 4.27 percent in 2000; and 2.95 percent in 2002. This situation reflected in part the modest increase in revenues despite the reform, as collections did not exceed 10.5 percent of GDP, owing to the many exemptions and exceptions to the 1991 tax reform law (Shome et al., 1999), to administrative weakness, and to rampant corruption in the Subdepartment of Taxation and in the Customs Directorate.

This upsurge of disequilibrium began to propagate in the early 21st century. The growing fiscal deficit and the rising public debt led the country to the brink of defaulting on payments. The fiscal deficit and the debt payments arrears were addressed in 20002-2004 through a series of measures: a fiscal adjustment law; reform of the National Treasury; renegotiation of the internal debt; and adoption of a new customs code. The reform started with the enactment of the National Treasury Law (December 29930. This reform consisted in a change in the public sector's retirement and pension system that created a steadily increasing operation deficit, which was financed b y the Central Government.⁹

The tax reform introduced by the fiscal adjustment law enacted in July 2004 called for the economy's formalization and the correction of the tax burden, which was very low (10 percent of GDP) owing to low tax rates; the broadening

7 The different rates were as follows: (i) for exports; (ii) for imports; (iii) preferential rate for inputs and machinery imported for the productive sector; (iv) preferential rate for Government imports; and (v) preferential rate for payment of the foreign public debt.

8 Accumulated inflation was much higher than the increase in the quotation of the dollar in domestic currency.

9 Borda, D. Ed. (2003). *Globalización y Crisis Fiscal: casos de Argentina, Brasil y Paraguay*. Asunción: Cadep.

of the tax base; and the introduction of new taxes. The previous tax legislation had a large number of loopholes (46 exemptions), which made tax administration difficult; it suffered from the absence of other universal taxes, such as tax on personal income, on capital gains, or on the income of the large livestock and agricultural enterprises.¹⁰ The new reform simplified the system into a 10-10-10 formula: 10 percent VAT on all goods and services; 10 percent tax on personal income; and 10 percent tax on corporate income of all enterprises (agricultural and livestock, industrial, and services).¹¹ Collections after the reform law's entry into full force were estimated at 1.5 percent of GDP.

Because of such privileged low taxes, the country's competitiveness has failed to improve.¹² The large public service deficits¹³ and the low quality of public spending are two serious problems that hinder development. One limitation is the misallocation of the scarce resources for investing on human resources and services, particularly on highways that are so important for a landlocked country. Another limitation is the low revenues level because of corruption and privileges. This seemed to be a functional vicious circle for an inefficient, corrupt State and a conservative, rentier entrepreneurial class. Paraguay is the country with the smallest allocation for infrastructure and training of human resources in the region and, paradoxically, with the lightest tax burden. This limits its growth possibilities in a globalized economy.

Another important reform in the fiscal area, associated with the two already mentioned, was the 2004 promulgation of the new Customs Code, which modernizes the rules consistently with international standards, permits the administrative modernization of an institution that is the very symbol of political schemes, and opens the possibility for the professionalizing of human resources.¹⁴

10 Shome, P. et al. *Paraguay: Estrategia de la Reforma del Sistema Tributario*. Public Finance Department, IMF, 1999.

11 Three taxes are relevant: the VAT on soybeans (eliminated by Congress); the personal income tax, levied for the first time; and the tax on the earnings of agricultural and livestock corporations. The reduction in the corporate income tax from 30 percent to 10 percent took into account the fact that, (i) owing to exemptions, this tax never yielded more than 10 percent; (ii) there was a need to introduce the personal income tax (tradeoff); and the capital-issuing firms only paid a 10-percent tax.

12 Paraguay ranks 113th among 117 countries (Brazil, 65th; Uruguay, 54th; and Argentina, 72nd), according to the World Economic Forum's *The Global Competitiveness Report 2005-2006*.

13 World Bank. *The role of the State*. Report No. 15044-PA. Washington, D.C., 1996.

14 According to a survey done by the World Bank and CISNI, the Customs Directorate, the Judiciary, and the Taxation Subsecretariat are among the most corrupt State institutions.

Market liberalization

Liberalization of interest rates and elimination of directed credit were measures introduced in 1990.¹⁵ In October of that year, interest rates were liberalized and since then the market has determined the price of money. Another aspect of the financial reform was the elimination of directed credit.

Major progress has been achieved in respect of the financial sector's regulatory framework, with the promulgation of the Central Bank of Paraguay's Organic Charter, the new Banking Law, and the Insurance Law. In addition, five new laws pertaining to capital markets have been enacted.¹⁶ More specifically in relation to the financial system, major changes were made in the regulatory framework during the second transition phase. The number of regulated (legal) financial firms rose from 29 in 1989 to 61 in 1997. The number of unregulated financial firms, estimated at 60 in 1989, gradually declined to 37. Easy access to the financial firms system and the Central Bank's limited supervision capability helped the outbreak of the financial crises of 1995 and 1998.¹⁷ In 1995 there were 34 banks and 63 financial firms; in 1998, after the series of banking crises, there remained 23 banks and 36 financial firms. After 2002 and the failure of a major bank, the system was further reduced and by 2005 there remained only 13 banks and 13 financial firms.¹⁸

One important lesson learned from the experience with the financial reform's first phase was recognition of the need for speed in a bank's closing. In the reforms' second phase, the government managed to enact legislation (December 2003) creating a deposit guarantee fund to protect savers in case of a financial institution's failure. The weighted active interest rate of 26.8 percent in 2000 was reduced to 15 percent in 2006. Nevertheless, credits continued to be short-term credits. The banks' option of acquiring Central Bank short-term papers hinders the creation of a more competitive banking environment for extending credit.¹⁹ In the State banking area, no changes were

15 In 1989, the interest rate ceiling was 28 percent for the active rate (commercial loans), 12 percent for the passive rate (sight savings), and 18 percent for the passive rate for term deposits. In 1990, these ceilings fixed by Central Bank of Paraguay's Board were 40 percent, 12 percent, and 26 percent, respectively.

16 Law on capital markets, external auditing, risk rating enterprises, commodities exchange, and securitization.

17 In 1988 there were 24 banks; by March 1995, there were 35 banks, before the first crisis. This means that in six transition years, eleven new banks were established.

18 Borda, D. "Políticas y Reformas Empreendidas: Resultados y Desafíos para el Desarrollo" in Borda, D., Ed. *Economía y Empleo en el Paraguay*. Asunción: Cadep, 2007.

19 Borda, D. "Paraguay: resultados de las reformas (2003-2005) y sus perspectivas," Cepal: Informes y Estudios Especiales No. 18, 2007.

introduced during the first reform phase. This should be done in the second phase by the new Administration (2003-2008). A second-tier Development Financial Agency (AFD) was established by the merge of three existing funds and started operating in 2006, while the creation of a first-tier bank has been postponed owing to political interests of the government.

Under the current Administration (2003-2008), the intervention of private capital was considered once again, in the form of capitalization, outsourcing, or concession of some enterprises, particularly the oil-selling, cement, and water enterprises, but nothing came of it. Many of the enterprises operate with losses and cannot honor their debts, which are paid by the Treasury, thus putting further pressure on the fiscal budget. Most of them have failed to improve their services, except for the power enterprise. In sum, public enterprises continue to have the same problems of coverage and deficient services and retain their autonomy, although in the end the Treasury has to assume their foreign debt payments.

Foreign trade opening did not result from reforms. It was part of the country's strategy to penetrate the region's closed economies. Paraguay's integration into the Southern Cone preceded even the signing of the 1991 Treaty of Asunción that created Mercosur.²⁰ Exports of two or three agricultural commodities and the border triangulation trade (or re-exportation) have allowed integration in the region. In addition, Paraguay's extremely porous borders (owing to a high incidence of illegal trade or contraband) permitted the nearly unrestricted entry of goods imported from the region and from the rest of the world. For Paraguay, the Mercosur challenge meant integration based on greater industrialization and larger exports, particularly of nontraditional products.

Social policies

The most important and consistent reforms have occurred in the area of education, ensuring wider coverage, more resources, and a higher schooling level. In the eighties, budget appropriations for the Ministry of Education did not exceed 1 percent of GDP; in the nineties, they rose to 2.5 percent; and in

20 Borda, D. and Masi, F. *Los límites de la Transición*. Asunción: CIDSEP-UC, 1998.

the 2000-2006 period they amounted to nearly 4 percent. A large portion of these resources went to salary increases. Elementary and secondary education coverage has widened but the average national schooling level remained low at 7.5 years in 2005, not to mention the quality of education, which is still unsatisfactory (Shiefelbein, 2007).

No reform has been undertaken in the area of public health, which still suffers from a strong patronage network. However, resources for this area increased 0.3 percent of GDP in the late eighties and exceeded 1 percent in the nineties and in the following years. Health stations have been built, but professional staff and inputs are still scarce, particularly in the country's interior.

One area that suffers from the lack of a strategy and policy is the fight against poverty, despite the establishment of a series of secretariats subordinated to the President's Office. The expansion of soybeans crops and cattle raising and the lack of job opportunities have given rise to a strong migration flow, both internally and to other countries, as well as to unauthorized occupation of rural and urban areas.

Institutional reforms

In general, institutional reforms have not been initiated by Paraguayan political, social, or entrepreneurial leaders. Most of these reforms have originated in external initiatives, without the concurrence of domestic allies convinced that such reforms were necessary, who rather saw them as required under cooperation programs. The weakness of opposition political parties, the absence of reformist leaders within the ranks of the official party, and the little weight wielded by civil society, have not been propitious for the gestation of ideas, except for changes in the Constitution. The first homespun reform introduced changes to the Constitution in 1992, which granted wider powers to Congress to counteract dictatorship's extreme centralism. It established the direct vote, abolished the reelection of the president and vice-president, and instituted municipal elections and elections for the newly created governorships.²¹

21 Previously, there were Government Delegations in charge of public security (police), appointed by the President of the Republic; intendants or mayors, who were not elected but appointed by the Executive, as were the members of the Supreme Court of Justice.

A recent publication (Abente 2007)²² points out some government problems. The Executive continues to abide by the patronage criterion, now severely limited by Congress, which, among other things, can override a presidential veto by a simple majority in the two chambers, or the request for urgency, by one chamber. Congress can also modify the fiscal budget without taking into account revenue estimates and restrictions. The Legislative has discretionary power to control the Judiciary and the Executive in respect of administrative matters. These attributions provide a culture broth for corruption, which further weakens that body's capacity to legislate on appropriate public policies. In addition, it displays intense political fragmentation, and the yearly elections for its leaders and commissions absorb the members' time and attention, leaving them no time to legislate. The Judiciary is strongly politicized, from the Supreme Court of Justice, including the Council of Magistrates, to trial juries to judges. The Judiciary lacks credibility before public opinion and avails itself of various instruments (e.g., unconstitutionality) for prolonging proceedings and negotiating sentences.

Business environment

Enterprise development is limited by various factors, beginning with the uncertainty about public policies and the precarious judicial protection accorded physical assets and intellectual property. This limits foreign as well as national long-term direct investment. Another hindrance is access roads or infrastructure for international trade and the lack of consistent human resources training programs and of proactive public policies for promoting investment and markets. Since the late nineties, foreign mobile phone companies and banks have recorded high return and investment levels, the telephone companies in particular.

Another handicap has to do with the protection of property rights, a particularly sensitive issue in Paraguay, where the economy is essentially agrarian, with a large rural population that depends on agriculture and, at the same time, with a high concentration of land ownership, with a Gini coefficient above 0.90. This family farming economy, which historically had easy access

22 Abente, D. "El malestar de la democracia o la democracia del malestar?" in Abente, D. and Masi, F., Eds., *Estado, Economía y Sociedad: una Mirada Internacional a la Democracia Paraguaya*. Asunción: Cadep, 2006.

to public lands, has since the eighties faced the problem of the exhaustion of public lands. The expansion of soybeans cultivation and of cattle-raising has boosted land prices, thereby impelling part of the rural population toward urban centers. At the same time, a sizeable segment of organized producers began since the nineties to stage the occupation of private lands. Thus duality, the sharp inequality in land distribution, and the lack of an agricultural policy aimed at the consolidation of productive units of less than 20 hectares compromise social stability and the enforcement of property rights.

Lastly, the micro, small, and medium enterprises sector, the major generator of employment, has lost its competitiveness to the imports trade, given the lack of appropriate sectoral policies. To survive, these micro, small, and medium enterprises are driven into informality and the attending low salaries, inappropriate labor conditions, and lack of social security protection. From 1997/98 to 2005, occupation in the informal sector increased while employment in large enterprises dropped (Berry 2007).

3. Results and outlook

The Paraguayan economy has not gone through the same experience of other countries with sharp macroeconomic disequilibria. The fiscal and monetary policies have managed to reverse the inflationary situation and the default on the debt (Table 1). Policy quality is questionable, though. The measures adopted do not address the problems' underlying causes. The fiscal policy has led to tax reforms but there is a tendency to flexibilize the legislation through its regulation or to postpone the entry into force of some articles, thereby weakening the reform under sectoral pressures. This happened with the first law in 1992 and is happening with the second, of 2004, with the difference that in the latter case the taxpayer based has doubled and annual collections continue to rise. The light tax pressure (11 percent of GDP) is offset by profits transfer and the cession of power by the hydroelectric enterprises (4 percent) of GDP. Even so, the tax burden remains light. On the other hand, increased spending is not subject to planning so as to meet government priorities; it continues to be subject to political criteria and sectoral pressures.

The monetary policy has been relatively effective in controlling inflation but not as effective in creating a financial market conducive to development,

owing to the high cost of money and short-term loans. Financial reforms suffered from improper sequence: first, interest rates were liberalized, then normative changes were made, and lastly, thought was given to technical training and equipment for discharging the financial system's control functions. The liberalization of the foreign exchange regime was positive, as it eliminated a factor of serious price distortion and a corruption mechanism. The managed floating exchange rate was at first used for controlling inflation; then short-term bonds became used as a monetary policy instrument and then as a policy for fixing inflation targets. The system's high interest rates are ascribed to the monetary policy (bonds), as is the loss of competitiveness owing to the exchange rate's appreciation. In general, the monetary policy has been less exposed than the fiscal policy to political pressures.

Table 1

Some macroeconomic variables (Average values per period in %)

Periods	Tax Revenue/ GDP	Spending/ GDP	Surplus/ Deficit/ GDP	Inflation	Real Exchange Rate (US\$/G)	Public Debt/ GDP	NIR/ GDP
1985-1989	7.8	8.8	0.5	24.9	n.d.	n.d.	14.1
1990-1994	9.7	13.6	0.8	17.1	-8.4	24.0	13.3
1995-2000	11.2	19.8	-2.5	8.9	2.9	21.7	12.0
2001-2006	11.2	18.2	-0.2	9.8	6.7	35.1	16.4

Source: BCP

The liberalization of markets and foreign trade has not been at the center of reforms. Foreign trade has always been open to imports from and exports to the region (Table 2). Given the State's high degree of corruption and incapacity, price controls and market regulation have not actually worked; the State enterprises' monopoly has not been affected, and cement, steel, and fuel contraband has been a response to such monopoly. The internal market for agricultural products (cotton, sugarcane, etc.) is oligopolistic, owing to problems of infrastructure, inputs supply, and transportation.

Table 2
Growth and foreign trade (Period averages)

Periods	Constant per capita GDP (US\$) 1994 = 100	Per capita GDP growth (%)	GDP growth (%)	Trade Balance/GDP (%)
1985-1989	2,711	0.8	3.9	1.7
1990-1994	2,763	0.5	3.3	-10.9
1995-2000	2,795	-1.4	0.8	-18.2
2001-2006	2,615	0.8	2.8	-18.4

Source: BCP

The greatest hindrance to the country's development is the precarious institutional apparatus of the State, political parties, and entrepreneurial associations. Attempted reforms have not worked because of the political parties' and economic sectors' weakness and the lack of a tradition of efficient civil service. The institutional reforms resulting from external cooperation programs have been thwarted by the informality tradition in the civil service itself. The bureaucracy's planning mechanism and operations are weak and subject to the influence of political parties, while the deeply-rooted practice of corruption survives even under the new forms of organization and rules of the game the reforms seek to introduce.

This type of State establishes an intricate network of relations to benefit from the exercise of power. The political elite establishes personal relations with the economic agents, based on principles that do not favor the building of institutions conducive to the development of the State and the market, such as influence peddling, exemptions from taxes and from regulatory agencies' norms, irregular awarding of government procurement contracts, and even distortion of juridical norms, all of which detracts from market competitiveness and compliance with the rules. The discretionary exercise of power extends also to professional services. The political parties and civil society lack the force to counterbalance an arbitrary, discretionary State; even the opposition parties have fallen into the benefits-seeking practice. External pressure has managed to influence policies and reforms but often fails to realize that the State's informality ends up by diluting the reforms or preventing economic policies from being sustainable in the short term.

Results in terms of economic growth and poverty reduction (Table 2) have not been favorable. Growth rates in the nineties were far below those of the sixties and seventies, and slightly lower than in the early years of this century. Per capita income rose from 2.5 percent in the sixties to 6.8 percent in the seventies, declining by 0.8 percent in the eighties, while in the nineties growth was practically nil (0.1 percent). In 2003-2006 the economy recovered again, with an average growth of 4 percent, although in 2000-2002 growth was severely affected by a recessive phase.²³ Despite GDP's retraction in the nineties, the participation of agriculture (15 percent) – thanks basically to an increase in soybean production (7.4) – and of cattle raising (5.4 percent) exceeded that of the eighties. In 2000-2006, agriculture's share increased (18 percent) and soybean production continued to rise (5.7 percent).²⁴

Social indicators have not improved according to expectations. Poverty and employment levels are still high and inequality has practically remained unchanged. In 1995-2001,²⁵ the poverty and indigence levels were 17.1 percent and 16.1 percent, respectively; between 2002 and 2006, these levels climbed to 22.7 percent and 18.6 percent, respectively. Although the unemployment rate declined slightly, underemployment in the two periods rose from 19.6 percent to 23.9 percent of the labor force. The Gini coefficient for both per capita and household income has not changed – the per capita income indicator actually dropped 0.1 percent. Income distribution between the richest 10 percent and the poorest 40 percent also remained unchanged.²⁶

Progress in the first years of the current Administration permitted the reestablishment of fiscal equilibrium, the elimination of debt payment arrears, and the beginning of economic recovery, helped by favorable conditions in the region. These changes did not extend to the rules of the game, though. Profit seekers in the State or in enterprises linked to the State still are sufficiently strong to prevail upon the innovating sectors, whether in the economic field or in the political arena. Dispute for control of the State continues to be a competition for the control of economic rent. This view of power hinders the market's and the State's development and the exercise of democracy beyond the mere electoral pact and the intent to implement economic reforms.

23 Calculation based on Central Bank statistics.

24 Borda, D. (2007).

25 No reliable data are available before this period; discussion is thus limited to the years mentioned.

26 Based on DGEEC and Cepal data.

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Translation: João Coelho

The Peruvian economy and the challenge of growth with social inclusion

*Enrique Cornejo Ramírez**

1. Introduction

The Peruvian economy has entered its seventh consecutive year of growth, which together with one-digit inflation, significant growth of exports and of net international reserves, makes it into an attractive destination for investment. Favorable prices of basic products on international markets and the dynamism of internal demand suggest that the economy will sustain this vigorous growth process and that it is sufficiently prepared to resist possible external shocks.

The great challenge, though, is to ensure that the fruits of this growth are translated also into sustained employment growth and contribute to a substantial reduction of the poverty (particularly of extreme poverty) and inequality that still exist in the country. Although some of the major social

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indicators have begun to show positive signs, how long it will take for these changes to be perceived by the population – particularly by the lower-income segments – and how close will be the approximation between political timing and administrative timing will be fundamental to ensure that growth is accompanied by social stability and democratic governability. In this connection, a crucial issue is the necessary reform in the administration of the State to enable it to adequately shepherd the process.¹

It is also important to take into consideration the Peruvian economy's peculiar characteristics and how they have a bearing on the effectiveness of the economic policies implemented. Peru is a country of great diversity, encompassing various races, languages, and ecosystems that make for a great potential in areas such as agroindustry, tourism, or forestry. Its complex geography, however, poses difficulties for the physical integration of the Peruvian peoples and tests the most sophisticated engineering. A considerable portion of economic transactions takes place in informality and coexists with the modernity of satellites and the Internet, the practice of barter and the use of the traditional plow in the countryside. Enterprises are in general of small and medium size, and dozens of thousands of so-called microbusinesses exist throughout the country, headed by a family or by individuals that make up a significant share of the working age population.

Four types of economy coexist in the country: a *subsistence economy* (A), which encompasses extremely poor rural sectors; an *informal urban economy* (I), which encompasses about 70 percent of productive activity; a *modern, industrial economy* (M), which implements competitiveness strategies; and a *knowledge and services economy* (C), which as yet is not very large but has great potential.²

Of these four, the first two are the most important, owing to the population and the poverty levels involved; the other two account for the largest share of GDP, foreign exchange generation, and tax revenues, and for most contacts with the modern world. One of the development strategy's objectives should be a narrowing of the gap among these different types of economy, taking into consideration the specific characteristics of types A and I

1 See Cornejo Ramírez, Enrique. "Hacia una Transformación del Estado en América Latina" in Revista "Nueva Sociedad." Caracas, September-October 2005, No. 199, pp. 204-119.

2 Cornejo Ramírez, Enrique. "La Economía Peruana: balance, perspectivas y propuestas" in *Diplomacia, Estrategia y Política-DEP*. Brasília, DF, Brazil, April-June 2005, No. 3, pp.119-141.

(to which standard policies cannot be successfully applied, as they are designed for other contexts) and seeking to approximate them to and incorporate them into types M and C.

There follows an analysis of Peru's economic, social, and political aspects and of its medium-term prospects.

2. Macroeconomic stability and growth

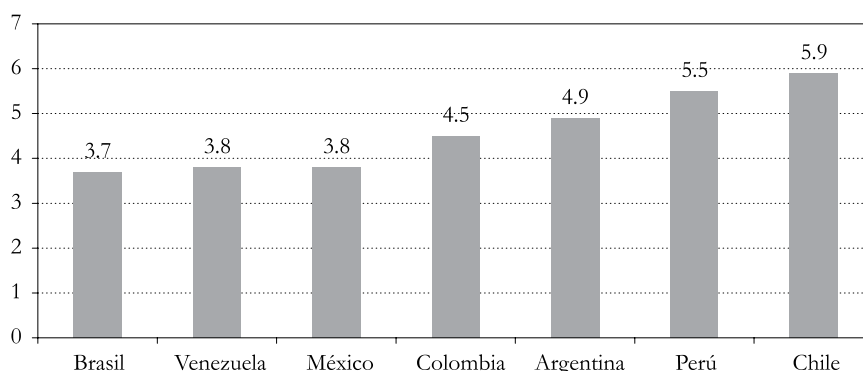
The Peruvian economy is currently experiencing a phase of sustained growth. In 2002-2005, GDP grew at 5 percent; in 2006, the growth rate rose to 8 percent; in 2007, it is holding at 7 percent. GDP is expected to grow at an annual rate of at least 6 percent in 2008-2011. In the previous decades there was no record of such a prolonged, substantial growth. A growth rate above 7 percent is accompanied by other major benefits.

Every year, a contingent of 350,000 Peruvians reach the age of 15 and are thus ready to form part of the economically active population (PEA). According to the last input-product figures available, each GDP percentage point generates 50,000 direct jobs. These figures indicate that the GDP growth rate must be at least 7 percent a year to provide jobs for the new labor force. After many years, Peru is now growing at a pace that generates sustained productive employment.

In the last seven years, Peru has ranked second among other Latin American countries in terms of per-capita GDP, as shown in Chart 1. The sustainability of Peru's economic growth is further seen in the fact that it is due not only to the favorable situation of the world economy but also to the dynamism of internal demand and of the nonprimary productive sectors that are recording higher growth rates.

Chart 1

PBI Per Cápita (Tasa de variación promedio anual: 2000-2007)

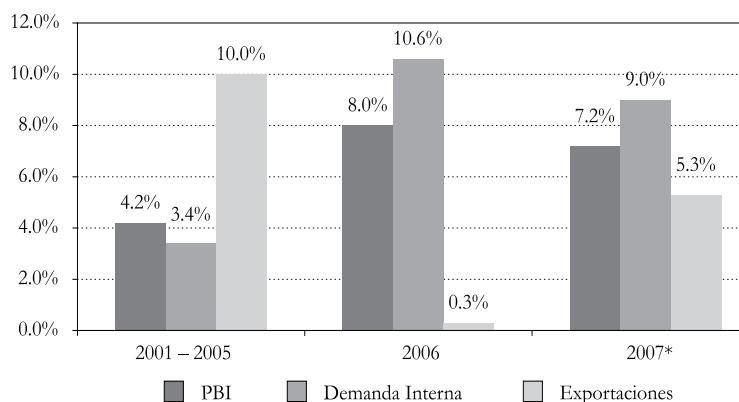


Fuente: World Economic Outlook en Evolución Macroeconómica del último año. Velarde, Julio. Banco Central de Reserva del Perú (BCRP). 2007.

Chart 2 shows that in 2001-2005 economic growth received a strong impetus from exports. In 2006 and 2007, though, it was internal demand that drove growth, as it grew 9 percent and 10.6 percent, far above the GDP and exports growth rates. Also in 2006-2007, the manufacturing sectors grew at an average rate of 8.8 percent, while the primary sectors grew about 4 percent. In these two years, the construction sector has recorded the highest growth rates: 12.5 percent and 14.7 percent, respectively.

Chart 2

Crecimiento de la demanda interna (Variación porcentual)



Fuente: Velarde, Julio. Evolución Macroeconómica del último año. Banco Central de Reserva del Perú. BCRP. 2007.

Economic growth has translated into greater household purchasing power. According to Peruvian Central Reserve Bank figures,³ the Available National Income grew 11.9 percent in 2006 and 12.7 percent between January and June 2007.⁴ The increase in the monthly household income in 2003-2007 obeyed a decentralized pattern, as follows: 53 percent in Cusco; 43 percent in Iquitos; 34 percent in Huancayo; 30 percent in Trujillo; 25 percent in Chiclayo; and 22 percent in Arequipa.

Greater Household purchasing power is shown also in sales figures, which rose in nearly all economic sectors. According to Apoyo Consultoría,⁵ sales figures rose between January and July 2007, as follows: color television, 81 percent; refrigerators, 60 percent; mobile phones, 59 percent; cable television subscriptions, 29 percent; and Internet access, 12 percent. This significant pattern of consumption of hard goods is noticed both in Lima and in the major cities in the country's interior.

As regards construction materials, 2007 figures are also eloquent: 53 percent higher cement consumption, 29 percent higher consumption of floorings, etc. Between 2002 and 2006, the construction sector grew nearly 40 percent, owing to greater consumption of cement, iron, roofing boards, ceramics, and paints.

Table 1 shows that GDP growth per sector in 2007 was as follows: construction (cement, 16.8 percent); trade and services (both over 7 percent); and manufacturing (6.6 percent). These are the sectors that sustain overall growth. Agriculture and livestock have grown 3.5 percent this year, while mining and fisheries have recorded lower figures. According to projections by the Ministry of the Economy and Finance,⁶ this sectoral performance should continue in its essential aspects in 2008, but mining, hydrocarbons, and fisheries are expected to grow at higher rates.

3 Banco Central de Reserva del Perú-BCRP. "Evolución Macroeconómica del Último Año." Presentation by Dr. Julio Velarde, BCRP President at the Council of Ministers, Lima, July 2007.

4 The higher income of Peruvian families was also due to the periodical remittances by Peruvians living abroad, which total an estimated US\$3.5 billion a year; and to higher transfers from abroad, after deduction of the corresponding profits remitted abroad.

5 For further details please check www.apoyo.com, which provides information on the ten enterprises that make up Grupo Apoyo, including Apoyo Consultoría.

6 For further details on macroeconomic projections for the Peruvian economy please check the Ministry of the Economy and Finance's page on the web: www.mef.gob.pe, particularly the information on the 2008-2010 Pluriannual Macroeconomic Framework.

Table 1
Global GDP and sectoral GDP (Real percent variation)

	2006	2007 p/	2008 e/
Global GDP	7.6	7.2	6.2
Agriculture and Livestock	7.4	3.5	4.1
Fisheries	2.4	0.4	3.2
Mining and hydrocarbons	1.4	2.3	6.4
Manufacturing	7.4	6.6	6.3
Construction	14.8	16.8	14.0
Trade	11.1	7.4	6.5
Services	7.0	7.9	5.4

p/ Projected

e/ Estimated

Source: Ministry of the Economy and Finance

Table 2 below shows growth projections for 2008. Analysts from various institutions agree that GDP will grow about 7 percent by end-2007 and 6 percent by end-2008. Projections include those by the IMF, the Reserve Central Bank, the Ministry of the Economy and Finance, the Peruvian Economy Institute-IPE, and two major corporate banks – Banco Continental and Scotiabank Perú.

Table 2
Projected GDP growth: 208 (in percentages)

Entity/Institution	2007	2008
International Monetary Fund-IMF	7.0	6.0
Central Reserve Bank of Peru-BCRP	7.2	6.0
Ministry of the Economy and Finance-MEF	7.2	6.2
Scotiabank Peru	6.2	6.2
BBVA Continental Bank	7.5	6.5
Peruvian Economy Institute-IPE	7.5	6.1

Source: Various institutions.

Current growth is reflected in substantial fiscal revenues, which have raised the available cash holdings not only of the National Government but also of most Regional and Municipal Governments⁷ that receive funds

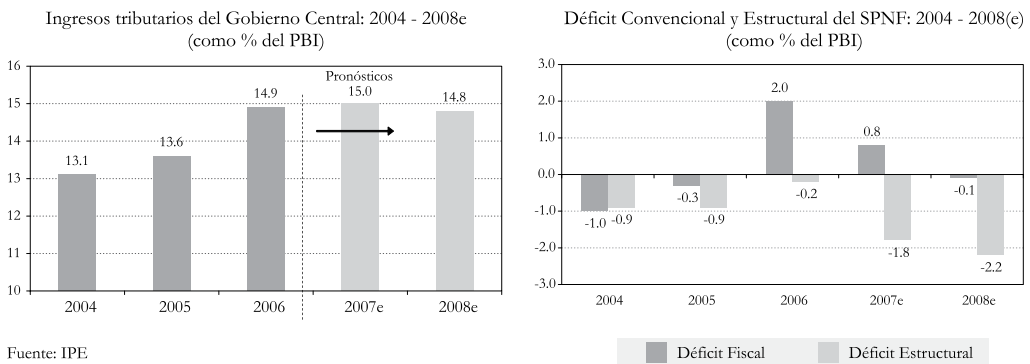
⁷ Peru has 25 Regional Governments, 195 Provincial Municipalities, and more than 1,800 District Municipalities.

from Canon and Sobre canon and from the Municipal Compensation Fund-FONCOMUN⁸ to finance their infrastructure projects and works.⁹ The National Government's tax revenues have risen about 15 percent of GDP and a similar growth is estimated for 2007 and 2008 (See Chart 3).

A fiscal surplus of 2 percent of GDP has been recorded in 2006 and it is estimated that this surplus will be of 0.8 percent of GDP.¹⁰ A look at the structural results of the Nonfinancial Public Sector (SPNF) shows a 0.2-percent deficit in 2006 and a 1.8 percent deficit in 2007. In general, there is evidence of responsible and transparent management of fiscal accounts, which undoubtedly contributes to a confidence-inspiring macroeconomic environment.

Table 3 shows the performance of and projection for the main macroeconomic indicators as well as growth, according to official estimates by the Reserve Central Bank of Peru. In 2006-2007, Peru had Latin America's lowest average inflation: 2.1 percent. Initial estimates for 2007 situate inflation at 2.5 percent, but external factors¹¹ could drive this rate up to about 3 percent, which still means very low inflation.

Chart 3
Resultados fiscales y ciclo económico



8 FONCOMUN is financed by revenues from the Municipal Promotion Tax, which is equivalent to two percentage points of the General Sales Tax-IGV, currently 19 percent of the sales tax (VAT in other countries).

9 One of the problems faced by fiscal management is the slow pace of the execution of projects at the different levels of government. Execution of budgetary expenditures is slow owing to the valuation and inspection procedures, which are still complicated and centralized, as well as to the precarious management capabilities of many subnational governments.

10 According to estimates by the Peruvian Economy Institute-IPE.

11 In the second half of 2007, the Consumer Price Index rose as a result of the confluence of higher prices of food imports (wheat, corn, milk products) and oil, all of which impacts significantly on the family consumption basket in Peru.

Table 3
Peru: main economic indicators

Year	Housing Annual var.	Total Exports (US\$ millions)	Total Imports (US\$ millions)	Net International Reserves (US\$ millions)	Outstanding External Public Debt (GDP percentage)
2005	1.5	17,367.7	12,081.6	14,097.0	28.1
2006	1.1	23,800.0	14,866.0	17,275.0	23.6
2007*	2.5	27,312.0	18,114.0	22,827.0	19.2
2008**	2.0	29,470.0	21,106.0	25,939.9***	17.4

* BCRP projections

** BCRP estimates

*** Author's estimates

Source: BCRP. Author's estimates

Goods exports in 2007 should total US\$27 billion (a record) and approximate US\$30 billion in 2008. It is worth noting that the growth of exports with aggregated value (nontraditional exports) has been higher in respect of certain items than that of total exports. Imports have also steadily increased and are expected to total a little over US\$18 billion in 2007 and over US\$21 billion in 2008. In 2006, capital goods imports grew at 35 percent and, by May 2007, they were growing at 41 percent.

The current level of international reserves in 2007 is about US\$23 billion, equivalent to more than fifteen months of regular imports, and already surpasses the stock of the external public debt. The external public debt to GDP ratio has fallen to 19 percent as a result of a deliberate policy of the Ministry of the Economy and Finance, which in recent years has undertaken various advance debt payments, particularly of its debt with the Paris Club, as well as exchanging U.S. dollar-denominated debt for new soles and improving the profile of future debt servicing in respect of rates and schedule. Peru thus displays sufficient financial strength to honor its obligations and to face eventual external shocks.¹²

It can be said that the Peruvian economy's current growth is supported by a strong impetus in internal demand, the expansion of nonprimary productive

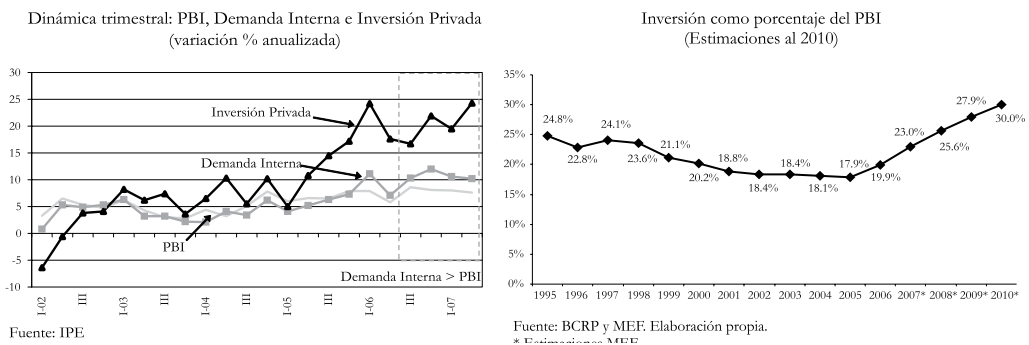
¹² The strong inflow of U.S. dollars from higher exports, foreign investment, remittances, increased receptive tourism, and even drug trafficking create a structural problem owing to the exchange rate's declining trend. The weakness of the U.S. dollar contrasts with the recent strengthening of the Peruvian sol, forcing the Central Reserve Bank to intervene drastically in the foreign exchange market as a buyer so as to prevent a further decline of the exchange rate, which could harm exporters' returns.

sectors, rising investment, trade balance surplus, and responsible management of public finances. This growth is beginning to have an impact on jobs creation and this is happening in a decentralized way.

3. Higher investment and the determination of country risk

The higher investment that is driving growth is clearly reflected in the indicators shown in Chart 4. Between 2002 and 2007, private investment has steadily risen from quarter to quarter, at a 20-percent rate. It is estimated that private investment in 2007 will reach 19 percent of GDP. National and foreign investors have high expectations about the Peruvian economy's future; this leads one to believe that by 2010 investment will rise to 30 percent of GDP.

Chart 4



In 2007-2010 a total US\$20 billion should be invested in major projects in the sectors of mining, hydrocarbons, telecommunications, industry, infrastructure, energy, and services. Table 4 lists the major projects and the enterprises involved, indicating the estimated investment amounts.

Mining projects of great magnitude stand out, such as the Toro Mocho or Río Blanco, each one involving an estimated investment of US\$1.5 billion. As regards hydrocarbons, the second phase of the Camisea project alone will require an investment of US\$2.2 billion, while the so-called Lote 67 may require an investment of US\$1.6 billion. The expansion of the mobile phone

network and of the telecommunications broad band call for no less than US\$1 billion in additional investment, while the construction of the South Pier at the Callao Port will need an investment of US\$600 million.

In respect of industrial projects, expansion of the Cajamarquilla Zinc Refinery and phosphate exploitation in Bayóvar (Piura) will require US\$500 million each. The Brazilian Camargo Correa consortium plans to invest US\$200 million in a new cement plant, and the Backus brewery has already started expanding its plant to the tune of US\$250 million. Cementos Lima intends to invest about US\$180 million in its “El Platanal” project, while major Peruvian and Chilean business firms are planning mega shopping centers in various cities, which will require investment of over US\$250 million.

Table 4
Investment Projects: 2007-2010 (US\$ millions)

Sector/Enterprise	Project	Amount
MINING:		9,697
• Perú Copper S.A	Tormocho	1,500
• Zijin Mining Group	Río Blanco	1,400
• Minera Yanacocha	Minas Conga	935
• Extrata	Las Bambas	930
HYDROCARBONS:		5,051
• Perú LNG	Camisea II	2,200
• Barret Resources	Lote 67	1,600
• Petrobrás-PeruPerú	Planta Petroquímica	800
TELECOMMUNICATIONS:		1,993
• Telefónica del Perú	Expansion mobile network/broad band	1,000
• América Móvil (Claro)	Mobil phone	560
INDUSTRIAL:		2,129
• Votorantim Metais	Expansión Cajamarquilla	500
• Vale do Rio Doce	Bayóvar phosphates	450
• Camargo-Correa	Cement plant construction	200
• Backus	Plant expansion	250
INFRASTRUCTURE:		1,051
• Dubai Ports World Callao	South Callao Pier	617
• Romero Group	Ancón Port	200
ELECTRICITY:		245
• Cementos Lima	El Platanal	180

Sector/Enterprise	Project	Amount
OTHER SECTOR:		784
• Tottus	24 shops: Lima, Trujillo, Chiclayo	100
• Casagrande	Distillery and crops	66
• Sodimac – Falabella Group	Various shops	60
• Parque Arauco	San Isidro Shopping Complex	54
• Corporación Pesquera Inca	Vessels and plant	50
• Parque Arauco, Gloria, Wiese	Mega Shopping Center Arequipa	40
• Wong Group	Lima Plaza Norte Shopping Center	35
• Graña y Montero	Road concession Coast-Sierra	31
• Energo Projeyp Nicogradnjo	Callacuyán-Huamachaco Highway	24
• Agroindustrial Laredo	Arena Dulce Sugar Project	20
	TOTAL	20,960

Source: Inflation Report. Central Reserve Bank of Peru-BCRP, September 2007.

This significant demand for new investment drives the growth of productive capacity and increased productivity, the latter of which had never occurred. According to a study by the Groningen Growth and Development Center, cited by the Central Reserve Bank,¹³ Peru records one of the highest rates of labor productivity in Latin America. Indeed, in 2000-2006, labor productivity in Peru grew 2 percent, as compared with Chile, 1.8 percent; Mexico, 1.4 percent; Brazil, 0.9 percent; and Colombia, 0.4 percent in the same period.

In addition, a survey on Peruvian enterprises' expectations showed that 70 percent of them¹⁴ said that they had recorded increased productivity¹⁵ of over 4 percent in recent years. The already mentioned higher capital goods imports also contributed to increased productivity.

Market diversification, adoption of competitive strategies based on differentiation or intense segmentation, and improved productivity have also contributed to the significant growth of exports with higher aggregate value (about US\$6 billion in 2007). A recent survey¹⁶ shows that 26.5 percent of 166 successful enterprises considered productivity the most important factor

13 The study, done by the Groningen Growth and Development Center and The Conference Board (Total Economy Database), was cited in Banco Central de Reserva del Peru... "Evolución Macroeconómica del Último Año." Op. cit., Lima, July 2007, p. 30.

14 Id. Ibidem, p. 31.

15 The interviewed enterprises' productivity estimates took into account the different measures adopted, such as the number of physical units produced or sold per worker, of physical units produced or sold per raw material consumed, and so on.

16 Cornejo Ramírez, Enrique... "El Desafío Competitivo: Estrategias de empresas exportadoras peruanas exitosas". Lima: Editorial San Marcos, April 2007, pp. 240-242.

to explain competitiveness, while 47 percent said that to increase productivity it is necessary to improve the yield of all productive factors.

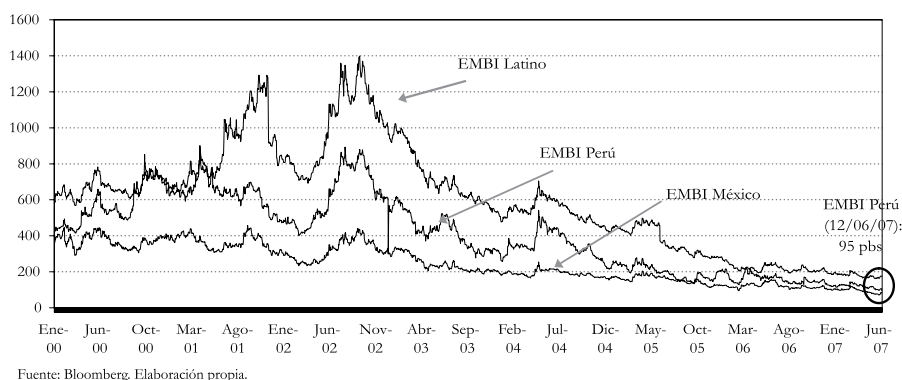
The evaluation of a country's risk is one of the factors of greatest weight in the decision-making of investors, particularly of foreign investors. Every risk classifying bank or agency has its own methodology but their common denominator seeks to determine whether a country is in a position to honor its international obligations and which is the "environment" for good investment performance. This involves consideration of economic, social, political, and cultural factors.

Charts 5 and 6 show that the country risk index has steadily declined since 2002. Over this entire period, Peru's country risk index has remained below the Latin American average, and by mid-2007 it hit its lowest level, approaching Mexico's index.

Gráfico n° 5
Riesgo País: Embi + Perú (pbs) (2000-2007)



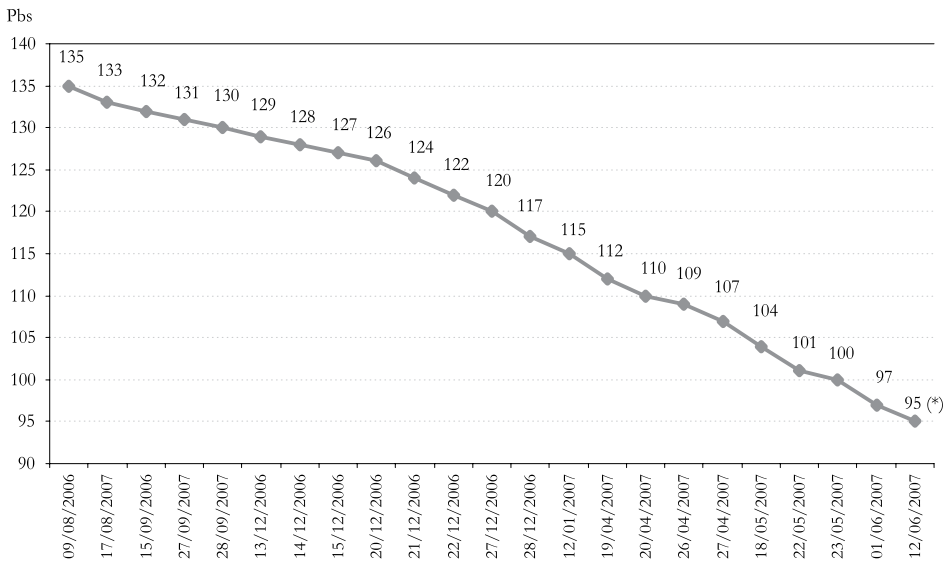
Gráfico n° 6
América Latina – Spreads de Bonos Soberanos (PDI) (en puntos básicos)



What is doubtlessly of most interest to international analysts is the course of Peru's country risk under Alan García's social democratic government, which began in July 2007 and runs through 2011. The particular concern for the performance of the APRA government in its second constitutional mandate is due to the fact that it had serious problems in the economic area during its previous administration (1985-1990).

As Chart 7 shows, between August 9, 2006 and June 12, 2007, Peru's country risk declined steadily, hitting a record on various occasions. This indicates that the international markets look favorably at the Peruvian economy's course and at the Peruvian government's performance in this regard. Some have dubbed this performance "the García effect" or "the born again García effect."

Gráfico n° 7
Perú: distribución de la PEA



In October 2007, the Canadian Dominion Bond Rating Service (DBRS) rated Peru's country risk as low in view of the strength of its economy, fiscal discipline, and adequate monetary policy being implemented by the Government.¹⁷ DBRS is one of the seven Nationally Recognized Statistic Rating Organizations-NRSRO

¹⁷ Ministerio de Economía e Finanzas del Perú-MEF... "Peru: Grado de Inversión." Press notice on MEF's page: www.mef.gob.pe. Lima, October 19, 2007.

in the United States, together with Moody's, Standard & Poor's, Fitch Ratings, A. M. Best Company, Japan Credit Ratings Agency, and R&I Inc. By October 2007, Standard & Poor's had rated Peru BB+ (one step from the investment rating), while Moody's rates it Ba2 (two steps from investment g). Everything seems to indicate that in a short time these two agencies will accord Peru the investment rating, because as analysts say: "in practice Peru already has reached investment grade."

4. Employment and social indicators

At the beginning, this essay stressed that the main challenge before the Peruvian economy is ensuring that the fruits of solid economic growth, examined in detail in the preceding, are perceived as positive by major segments of the population living in poverty or extreme poverty. This is the meaning of "social inclusion," "equality," and "social justice."¹⁸

According to Ministry of Labor and Employment Promotion's official figures for May 2007, urban employment in enterprises with ten or more workers were growing 8.5 percent a year, the highest rate of recent years. Employment growth occurs not only in the city of Lima but also in the country's major regions.

Between January and May 2007 – as compared with the same period of last year – employment grew 21 percent in Trujillo; 17 percent in Talara; 12 percent in Sullana and Arequipa; 10 percent in Piura and Cusco; 9 percent in Lima; 7 percent in Huancayo, Ica, Chiclayo, and Tarapoto; and 6 percent in Puno. This decentralized growth has meant that in certain months, in cities such as Trujillo and Ica, a situation of "full local employment" occurs, in accordance with the seasonal character of the agricultural exports business. Employment growth thus takes place essentially in sectors such as manufacturing, agroindustry, construction, and services.

Table 5 lists a series of social indicators for 2006. It shows that although employment figures have begun to improve in urban zones, the key problem is underemployment, which affects more than half the economically active population. It was estimated that 51.6 percent of the population were living in poverty in 2006. According to these figures, five out of ten Peruvians are poor and two are extremely poor.

18 The main objective of the plan of the APRA government headed by Alan García is development with social justice in the context of an economic and social democracy that victor Raúl Haya de la Torre (APRA's founder) called "a democracy of bread and liberty."

Table 5
Peru: main social indicators (2006) (In percentages)

Indicators	2006
Employment *	91%
Unemployment*	8.5%
Underemployment*	54%
Poverty**	51.6%
Extreme poverty**	13'830,804
Illiteracy	11.4%
Birth (per 1,000)	21.80
Mortality (per 1,000)	6.05
Infant Mortality (1,000)	29.90
Demographic growth	1.4%

* Percentage of economically active population – May-June-July

** 2004 figures

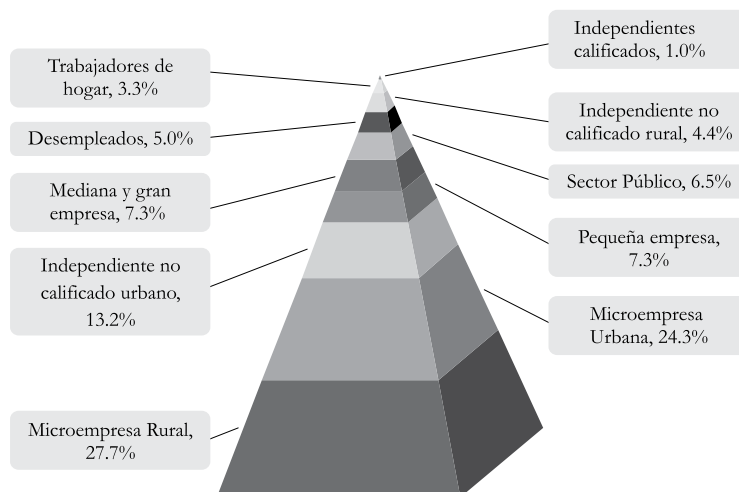
Source: INEI, IMF, Cepal, Author's compilation

The illiteracy rate still holds at 11.4 percent; the gross infant mortality rate is still 29.9 percent, while the malnutrition indicators are substantial, particularly in the child population of lower-income segments. Achievement of the United Nations Millennium Development Objectives is a hard task that will take a long time.¹⁹

Chart 8 shows a pyramid illustrating the distribution of the economically active population in Peru. Rural micro enterprises account for 27.7 percent; urban micro enterprises account for 24.3 percent; and 13.2 percent of the economically active population are unqualified independent urban workers. These three segments make up 65.2 percent of the working age population.

¹⁹ The eight millennium goals are: eradicate extreme poverty and hunger; achieve universal primary education; promote gender equality and empower women; reduce child mortality; improve maternal health; combat HIV/AIDS, malaria, tuberculosis, and other diseases; ensure environmental sustainability; and develop a global partnership for development.

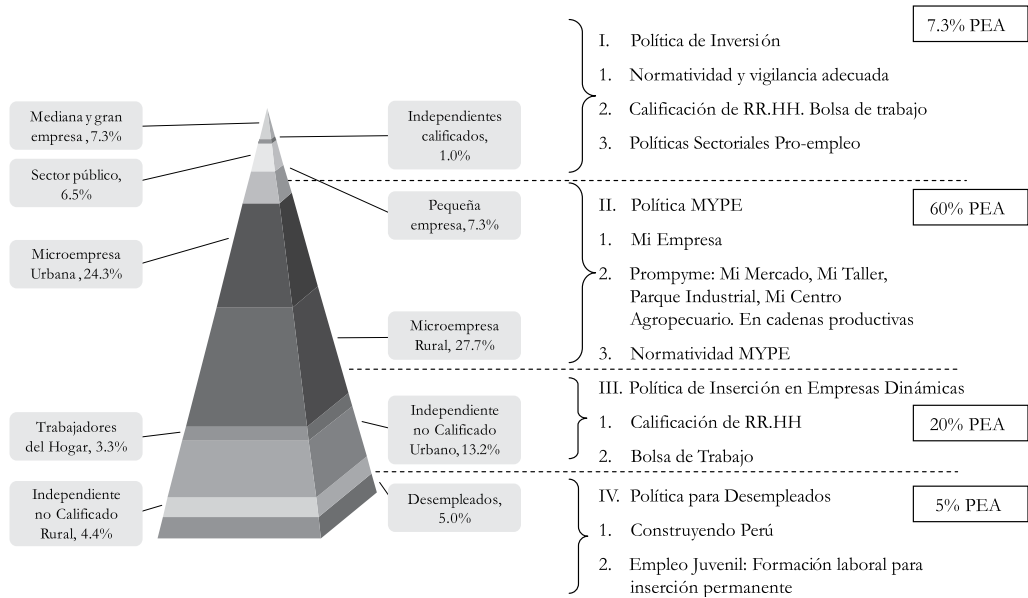
Gráfico n° 8
Perú: Distribución de la PEA



Small enterprises account for 7.3 percent of the economically active population; medium and large enterprises account for another 7.3 percent; public sector workers make up 6.5 of the total; the unemployed, 5 percent; unqualified, independent rural workers, 4.4 percent; women working at home, 3.3 percent; and qualified independent workers, only 1 percent of the total.

Employment policies and social programs under implementation seek to frontally attack the problem focused by the pyramid, as can be seen in Chart 9.

Gráfico n° 9
Perú: Políticas Sociales y de Empleo 2006-2011



As to the unemployed at the pyramid's base, the Government has launched a temporary job program titled "Construyendo Perú" [Building Peru] and a labor training program for young people. The different types of social assistance come under the "Crecer" [To Grow] program. There is also a conditioned transfer program titled "Juntos" [Together], which benefits some 400,000 families living in extreme poverty.

A Worker's Grant has been established for unqualified, independent urban workers and women that work at home. Support for micro and small enterprises is provided under a program titled "My Enterprise" and through initiatives implemented by Prompyme,²⁰ whose objective is to promote workshops, markets, and the construction of industrial parks. As to medium and large enterprises and qualified independent workers, the Ministry of Labor and Employment Promotion establishes the requisite normative framework and oversees compliance with labor rules.

Another program that is greatly emphasized by the Government provides support to financial institutions that extend micro credit, such as Municipal and Rural Banks and the Enterprises for the Development of Micro and Small

²⁰ Commission for the Promotion of Micro and Small Enterprises.

Enterprises-Edpymes.²¹ This support is administered by Banco de la Nación, which operates as a second-tier platform, under agreements, and has extended about 40,000 new micro credits, mainly in poor rural areas.

One of the major reasons of social exclusion is the precariousness or inexistence of basic infrastructure (roads, bridges, water, electric power, telephone, ports, and airports). Studies done in the country or by international organizations show that the poor are the ones most affected by the lack of infrastructure.

Gráfico n° 10

Regiones: infraestructura y apertura

Porcentaje de la población con dos o más servicios públicos, año 2005*

Impacto del Aptdea, 2003



* Agua, desagüe, Electricidad o telefonía

Fuente: Enaho 2005



Fuente: Abusa et. al (2004)

Chart 10 shows that a large percentage of the Peruvian population does not have access to basic public services, particularly in the country's interior, and that a significant portion of it has not benefited from the business opportunities opened by agreements such as the one under the U.S. Andean Trade Preference Act.

21 By late-August 2007, outlays directed at micro enterprises exceeded US\$2 billion, which were used to extend 1,119,000 small loans, each averaging 5,600 new soles. Of these micro credits, 36 percent were granted by the Municipal Banks, 23 percent by Edpymes, and 7 percent by the Rural Banks.

President García's Government is determined to foster growth and promote investment, as well as reducing poverty and inequality, which still affect millions of Peruvians. Table 6 lists the Government's objectives to be reached by 2011.

Cuadro n° 6

President Alan García's Government Plan: goals until 2011

➤ Reduction of poverty from 50 percent to 30 percent.	➤ 800,000 property deeds granted.
➤ Peru's output of 140 billion.	➤ Eradication of illiteracy.
➤ Reduction of malnutrition from 25 percent to 16 percent.	➤ Higher quality education in reading and mathematics.
➤ 250,000 housing units for 1.2 million Peruvians.	➤ Reduction of informal employment from 53 percent to 35 percent.
➤ Potable water and electricity for 90 percent of Peruvians.	➤ Regions and municipalities will have 66 percent of resources needed for public works.

The main goals established include reduction of poverty from 50 percent to 30 percent; reduction of child malnutrition from 25 percent to 16 percent; construction of at least 250,000 housing units and granting of 800,000 property deeds. The plan also calls for providing potable water and electricity for 90 percent of the Peruvian population, reducing informal employment to 35 percent, and eradicating illiteracy.

Achievement of these goals and targets will depend in large measure on overcoming the shortcomings that now hinder public administration's efficiency. As noted, one of the major limitations is the need of transforming the State, whose norms, regulations, and procedures, as well as the mentality of its functionaries prevent bureaucracy's timing from coinciding with political timing. The population requires a prompt answer to its demands. Thus, it is essential to agree on the need to maintain macroeconomic stability and growth as State policies, so as to permit the State to meet the population's demands, while observing fiscal responsibility.

5. Growth, social inclusion, and governability

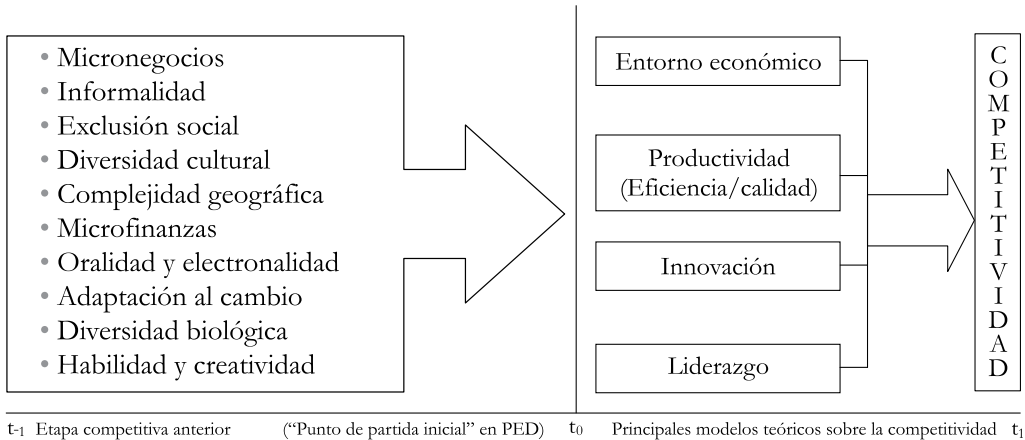
As mentioned, to be sustainable growth has to be accompanied by social inclusion, which must be accomplished in a context of democratic

governability. This is the tripod that must support the development strategy, in which Peru is engaged, with solid macroeconomics and sustained growth, despite major challenges related to social inclusion.

There is a further requirement: in economies such as Peru's, economic policies must take into account the "point of departure," which may not be the ideal but which determines the efficacy of the measures adopted. Table 7 schematically sums up our argument that there is a "previous competitive phase" that is not usually taken into consideration but whose characteristics ought to be understood and transformed into strength.

Cuadro n° 7

Modelo de explicación del "Punto de partida inicial" para el análisis de la competitividad de en países en desarrollo*



t-1 Etapa competitiva anterior ("Punto de partida inicial" en PED) t0 Principales modelos teóricos sobre la competitividad t1

* PED: Países en desarrollo
Elaboración: el autor

The current situation is as follows: small and very small businesses with low productivity, but which involve thousands and thousands of Peruvians. How to include them? This task involves financing, technical assistance, and training. How to make less costly and complex the formalization of enterprises is another problem that calls for administrative and taxation facilities. In addition, banking regulations or the Basel norms have not been designed in terms of microfinancing, but it is the micro financing institutions that are making the greatest bancarization and social inclusion effort.

The cultural diversity, geographical complexity and even the oral tradition that characterize the majority of Peru's population should be put to use so as to ensure a more inclusive growth, in view of the ability and creativity Peruvians show in addressing their most pressing needs.

Taking into account these characteristics of the “previous competitive phase” does not mean that less emphasis should be placed on competitiveness strategies based on increased productivity, innovation, and leadership, which can be employed to advantage by enterprises of sufficient size and with a modern organization. Economic policies should consider both phases and not only the second phase, as is common. Only thus can we ensure that the A and I economies of the model presented at the beginning of this essay may approach the M and C economies, thereby triggering development with social inclusion and democratic governability. **DEP**

Translation: João Coelho

Surinam: macroeconomic evolution

*André E. Telting**

1. Introduction

Surinam is the smallest of all the sovereign countries on the mainland of the South American continent, both in terms of territory and population.

Surinam's fertile land and tropical climate offer numerous possibilities for agriculture; her freshwater rivers potentially provide for irrigation and drainage and besides that are well suited for aquaculture projects.

Natural resources include bauxite, gold, oil, lumber, fish and shrimps. Furthermore a vast, largely unexplored rainforest, of which a substantial part has been set aside as a nature reserve. The main commodities for export include alumina, gold, oil, timber, fish, shrimps, rice and bananas.

Surinam has experienced vehement political and economic instability in the two decades following its independence in 1975. The poor condition of the economy through the nineteen eighties and most of the nineteen nineties arose from a combination of factors, amongst which most importantly: internal political rule, international isolation, weakening of export commodity prices

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and on top of all inappropriate policy responses. Only two years, 1995 and 1996, signaled some recovery, but this was short-lived. Rapid deterioration followed from 1997 until 2000, specifically because of loose fiscal policy and accommodating monetary policy. After this disastrous episode, Suriname achieved significant progress in the subsequent years, resulting ultimately in sound macroeconomic stability and strengthening of the democracy.

This paper highlights the policy responses inspired by a concerted approach to macroeconomic management beginning the last quarter of 2000. First, a brief overview of developments that lead Surinamese economy to a dead-end by 2000. It continues with an explanation of measures taken to address the ultra precarious financial and economic situation; and how the policy eventually brought about a turn around to the present stable macroeconomic environment in Surinam.

2. Point of departure

The brutal elimination of 15 prominent citizens in 1982 by the then ruling military regime prompted strong international condemnation and immediate suspension of financial assistance to the military government. The international community, in particular the Netherlands, France and other European countries, the United States of America, Venezuela, Brazil, instantly discontinued friendly relations with Surinam, however without recalling their ambassadors. The resulting fall in capital inflows coincided with deteriorating export commodity prices. The ruling military government was unable to address the suspension of financial assistance with adequate policy measures. The first few civil administrations (1988-1990) managed to re-establish friendly relations and reinstate financial assistance from abroad. However, they did not succeed in closing the structural gap of the fiscal deficits. Therefore, during eleven consecutive years (1983-1993), successive governments resorted to finance high fiscal deficits solely through monetization. The outcome pictured a problematic macroeconomic scenery featuring:

- Complete exhaustion of the foreign exchange reserves;
- Parallel market in foreign currencies;
- Price distortions and rapid increasing exchange rate volatility;
- Deterioration of output of the economy, and
- Mounting inflation.

A first attempt to address the economic difficulties was made in the early nineties with the adoption of a structural adjustment program in November 1992. This program was aimed at creation of a foundation for growth by:

- Addressing the fiscal problems;
- Reducing state intervention in the economy;
- Liberalizing the exchange rate regime, and
- Liberalizing external trade.

The adjustment measures initially spurred inflation but eventually brought stabilization to the economy in the mid nineteen nineties. By that time new general elections were approaching, after which a new Administration took office in September 1996. This administration reverted once again to expansionary policies.

Four years of rapid deterioration of the economy followed from 1997 until 2000:

- Year end inflation rocketed from minus 0.7% in 1996 to near 100% in 1999;
- Fiscal balances worsened to a deficit of some 12% of GDP in 2000;
- International reserves declined from US\$ 177 million in 1996 to less than a meager US\$ 15 million in 2000;
- The money supply more than doubled in one year's time, the year 2000;
- Government debt increased from 20% of GDP in 1996 to 80% of GDP in 2000, and
- Apparent scarcity of imported goods for consumption and for investments was evident.

3. Re-engineering of the economy

The overall economic climate gave rise to public discontent. Massive demonstrations in 1999 against the government forced early elections in 2000. The new administration that took office in August 2000 recognized the utterly bad

shape of the economy. It called for urgent decisive action. Difficult matters rooting from spiraling fiscal deficits prompted the authorities to enact emergency legislation through Parliament to get hold on crucial problems in the country's finances:

Public finance:

- Discontinuation of the monetization of fiscal deficits;
- Appropriate management of government expenditures, and
- Design and implement a strategy to increase government revenues.

Within one year, grip on these key problem areas opened the way to readily withdraw the emergency legislation. Next was the necessity to address the other urgent areas for special attention:

Debt management:

- Inventory of government debt and determination of the actual debt level;
- Restructuring of domestic and external government debt, and
- Adoption of a new Government Debt Act in March 2002 that not only sets a ceiling to domestic and foreign government debt but also assigns the sole authority onto the Minister of Finance to sign debt agreements; besides it establishes a separate Government Debt Office with the assignment to manage and keep tally of the government debt.

Monetary management:

- Reconstruction of monetary reserve with the Central Bank, including monetary gold and foreign exchange reserves;
- Imposition of reserve requirements on the banks in local as well as in foreign currency;
- The launch of a new currency on January 1st 2004, and
- Amendment to the Central Bank Act that vests virtual independence with the Central Bank.

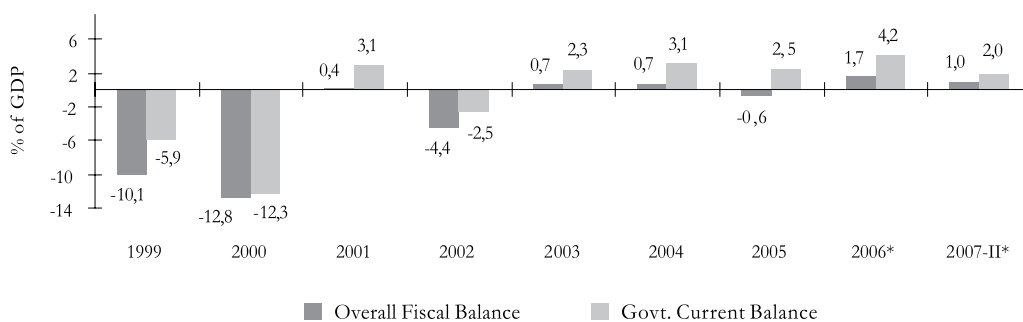
Foreign exchange market:

- Removal of surrender requirements on exports proceeds, and
- Unification and stabilization of the exchange rate.

4. Recent economic performance

Taking advantage of more favorable conditions in the international commodity markets, measures on economic performance produced rapid improvement. Based on our self-adoptive doctrine of “No funding, No spending”, no new monetizing of fiscal deficits was conceded. The government nevertheless succeeded to narrow the fiscal gap between revenues and expenditures and even to record surpluses in subsequent years. These positive fiscal outturns now tend to assume a structural character. Supplementary monetary measures aim at growth of the money supply, stabilization of the exchange rate and lowering of inflation and interest rates.

Fiscal Balances

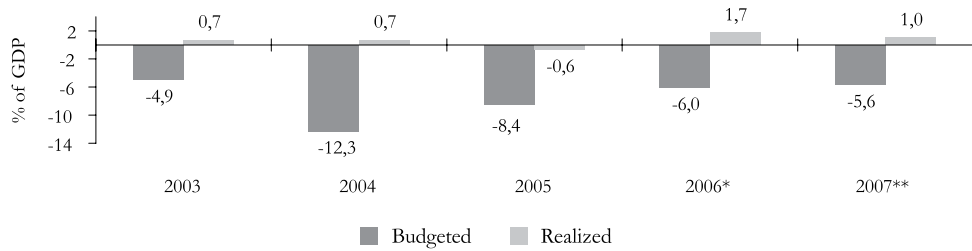


Sources: Ministry of Finance; General Bureau of Statistics and National Planning Office

* Preliminary figures

Over the years 2003-2006, the overall fiscal balance was in surplus averaging 0.6% of GDP. Revenues exceeded expenditures in the first half of 2007, promising another good year with a slight fiscal surplus. For the subsequent fiscal year expectations are that there will be some reallocation and cuts of expenditures implemented since the 2008 budget indicates an overall deficit of 5.6% of GDP. Adherence to our doctrine of “No Funding, No Spending” makes it unlikely that such a budgeted deficit will turn out.

Overall Fiscal Balance: Budgeted vs Realized



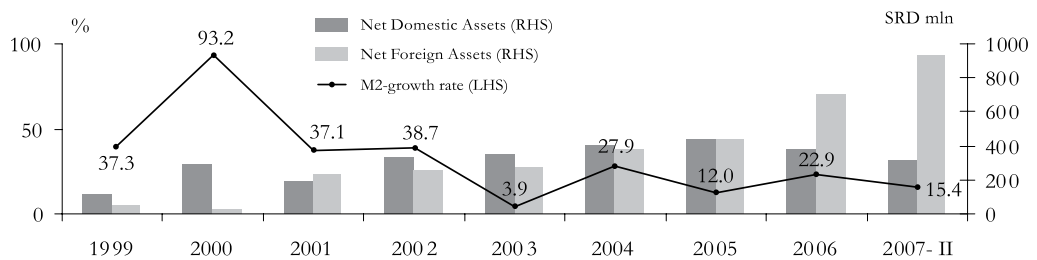
Source: Ministry of Finance

* Preliminary figures

** Budgeted figure for 2007 vs first half realizations

It is noteworthy that the exchange rate has remained fairly stable from 2004 until the present time. Since 2006 growth in the money supply originates solely from net foreign assets inflow.

Money Growth



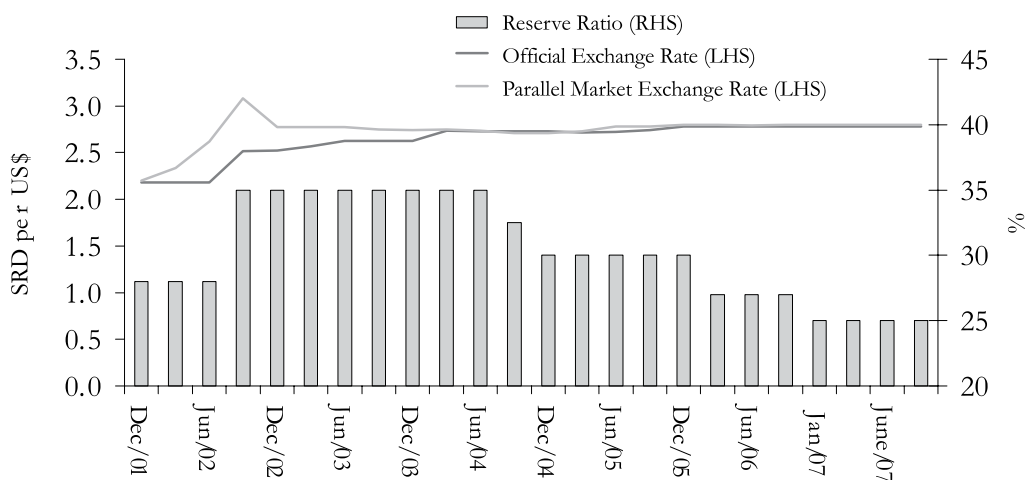
Source: Central Bank and General Bureau of Statistics.

* March 2004 relative to March 2003

** Central Bank projection

The Central Bank subsequently lowered the local currency reserve ratio to make expansion of competitive bank credit more conducive in local currency. Implementing this prudently avoided bringing pressures to bear on the foreign exchange market.

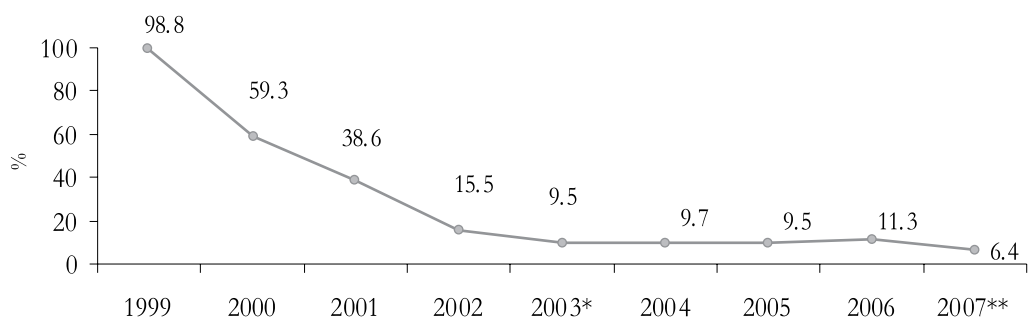
Exchange rate and Local Currency Reserve Ratio Developments



Source: Central Bank

Surinam managed to contain demand pull inflation, but its small wide open economy is highly vulnerable to price shocks from abroad. Current high world oil prices have a direct effect on the CPI. In the last quarter of 2005 the government adopted a new method to determine monthly pump prices for fuel.

Average Annual Inflation



Source: Central Bank and General Bureau of Statistics.

* March 2004 relative to March 2003

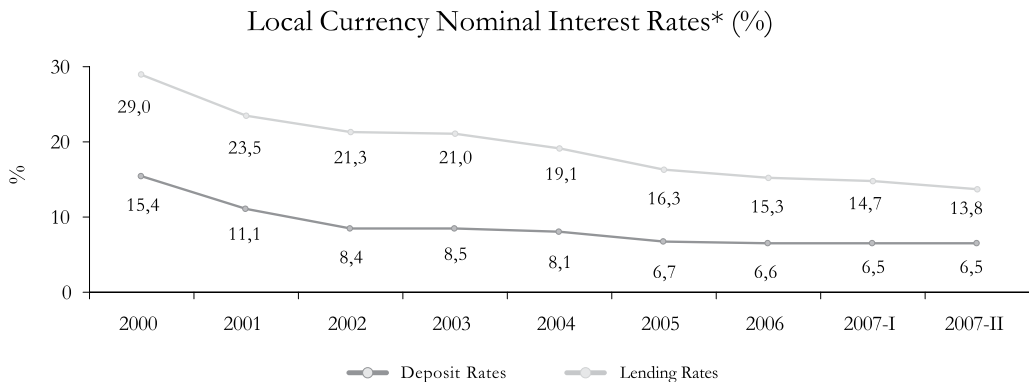
** Central Bank projection

Dollarization

Despite tendencies to settle certain transactions in hard currency, the economy never reached the stage of full dollarization. Abolishment of surrender requirements for export earnings in 2002 added another dimension to growth in foreign exchange deposits of citizens with the local banks. Resulting exposure of the banking system to foreign currency liquidity risks prompted the Central Bank to take precautionary actions. The Central Bank imposed reserve ratios on foreign exchange holdings, first and foremost to protect the banks in the event of a sudden run on them. The ratio was initially set at 17.5%. It now stands at 33.3 % since 2005. These compulsory reserves would be the first to use in the event of a foreign currency run on a bank. The Central Bank has strengthened its own capacity to bail out banks in such a perilous circumstance.

The measure brought the dollarization ratio down from 58% in 2004 to 54% in 2007. We are confident that continuance of the macroeconomic stability and strengthened confidence in the Surinamese dollar will little by little slow down dollarization.

Falling inflation cleared the way for interest rates to decline. Lower interest rates will stimulate growth, bank credit and investments.

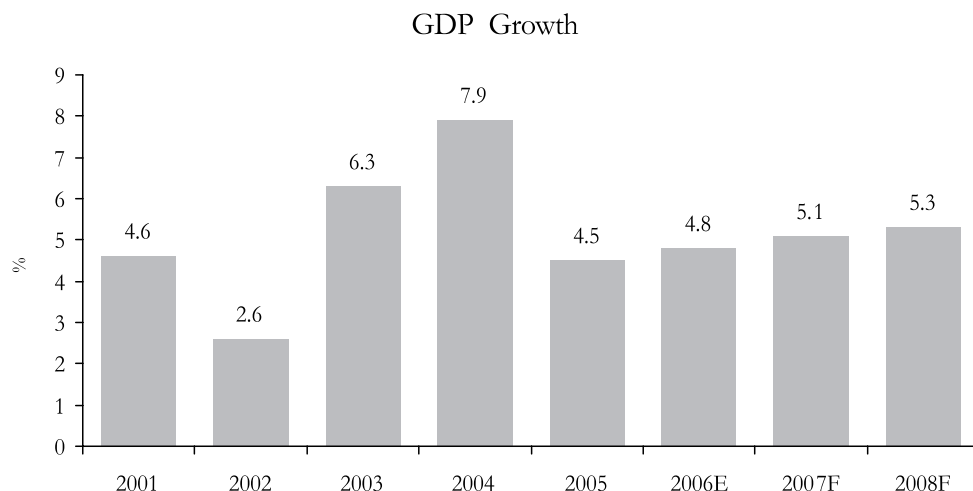


Source: Central Bank

* Weighted average

Production

The economy grew at an average rate of almost 6% from 2003 to 2007. The mining sector constituted the main driving force.



Sources: General Bureau of Statistics and National Planning Office

The *bauxite* sector continued its leading position in exports. In 2006, exports of alumina increased by 45%. The bauxite companies are currently engaged in negotiations with the government to acquire concessions for bauxite mining in the west of the country. Proven bauxite deposits there amounting to some 325 million tons are highly promising for continuity of the industry for decades to come.

The *State Oil Company* recorded high profits in 2006, including a windfall portion from rising world oil prices that came to her advantage. The company plans for new investments in crude production and refinery operations in 2008. She signed exploration and production sharing agreements with foreign oil companies on the sea areas within the continental shelf of Surinam. Exploration data so far are promising. The now settled maritime dispute with neighboring Guyana has determined the sea boundary between the two countries. Until this settlement, the State Oil Company intentionally omitted activities in that area and left it aside to prevent aggravating the dispute. Exploration activity by the State Oil Company and her foreign partners for oil and natural gas is now imminent in that sea area as far as appropriated to Surinam.

The *gold sector* continues to benefit from favorable prices. The Canadian Iamgold Company acquired the Rosebel gold mine in November 2006 after its merger with Cambior, another Canadian Company. The Rosebel mine located in the interior centre of the country produced around 301,000 ounces of gold in 2006. Explorations by the Denver-based Newmont gold mining company may also yield positive results for large scale gold mining in the east of the country. Preliminary exploration findings are encouraging. Small-scale mining, amply practiced by one-man Surinamese miners and Brazilian *garimpeiros*, significantly contributes to the country's gold exports.

Other sectors of the economy, mainly *agriculture* (rice, vegetables, bananas) are also deriving impetus from the combined effect of macroeconomic stability and rising world market prices. The rice sector is refurbishing itself. The banana sector is expected to contribute more to exports due to the anticipated production expansion of 35% in 2007.

Tourism is a nascent industry in Surinam. Based on its growth rate it tends to claim its share in overall economic activity. Presently there are three new hotels under construction in Paramaribo, one of which is wholly Surinamese owned, another is wholly foreign owned and the third is a joint venture of Surinamese with foreign participation.

Other *ongoing activities* include investments in:

Telecommunication:

- liberalization of the mobile telecom market.

Infrastructure:

- road construction and rehabilitation;
- improvement and expansion of harbor pier facilities, and
- modernization of the air traffic control system.

The health sector:

- primary health care centers in the hinterland, and
- radio therapeutic center for the Academic Hospital in Paramaribo.

Education:

- re-opening of primary schools in the southern districts where they had been closed since the time that the guerilla was waged during the second part of the nineteen eighties;
- introduction of a special chair in money and credit system at the university in Paramaribo, and
- expanding accommodation for increased numbers of students for technical and vocational training on a secondary level.

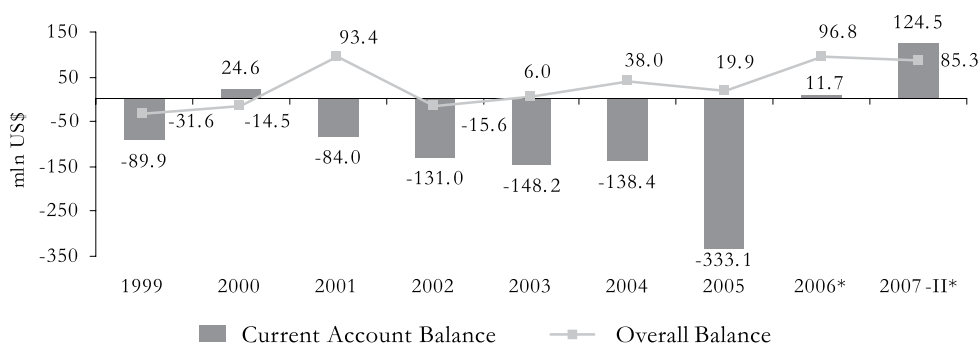
Housing:

- special 7%-mortgage facility with local banks for middle-income groups, launched by the Central Bank, and
- inter American Development Bank funded Low Income Shelter Program for low-income groups.

External sector

Solid performance of export commodities as well as favorable world market prices contributed to the swing of the balance of payments current account from deficit to a growing surplus in 2006 and so far in 2007.

BOP Current Account and Overall Balance

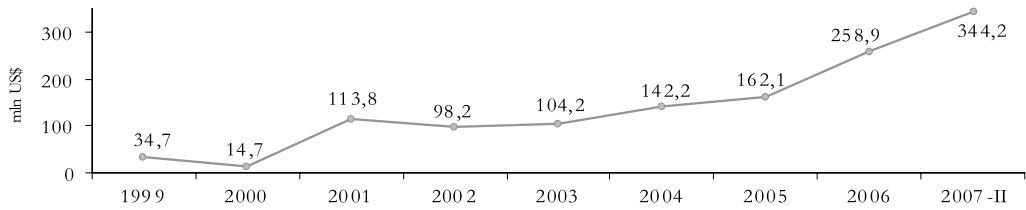


Source: Central Bank

* Preliminary figures

The balance of payments surplus more than doubled the official monetary reserves during 2006 till mid 2007. This cleared the way for recovery of creditworthiness as it made comprehensive repayments possible on foreign debt.

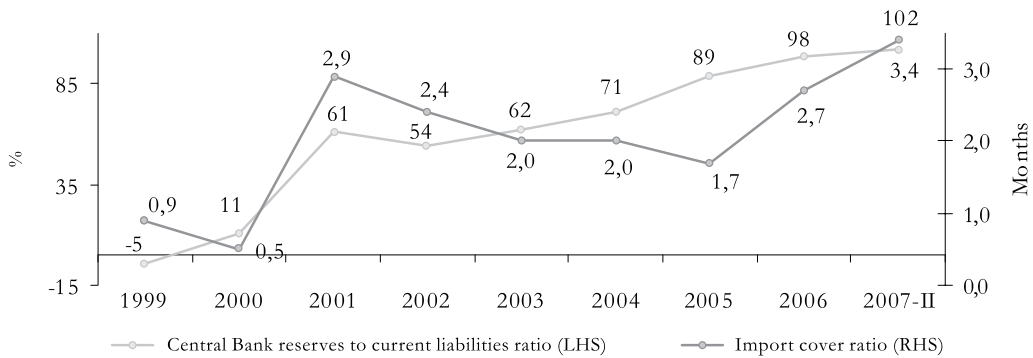
International Reserves



Source: Central Bank

In addition, increased international reserves positively affected the currency and import coverage ratios. The ratio of Central Bank reserves to its current liabilities, set by law at 50%, is now over twice that percentage (100%), depicting a solid foundation for the currency. At the same time the import cover ratio is well over 3 months of imports.

Import and Currency Cover Ratios



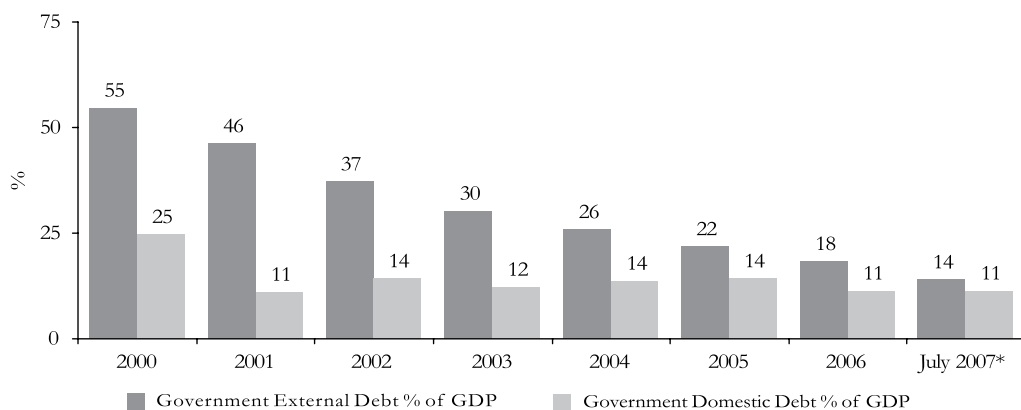
Source: Central Bank

Note: Import cover ratio is based on imports of goods and services

Government debt

Government debt ratios have improved significantly and are approaching single digits.

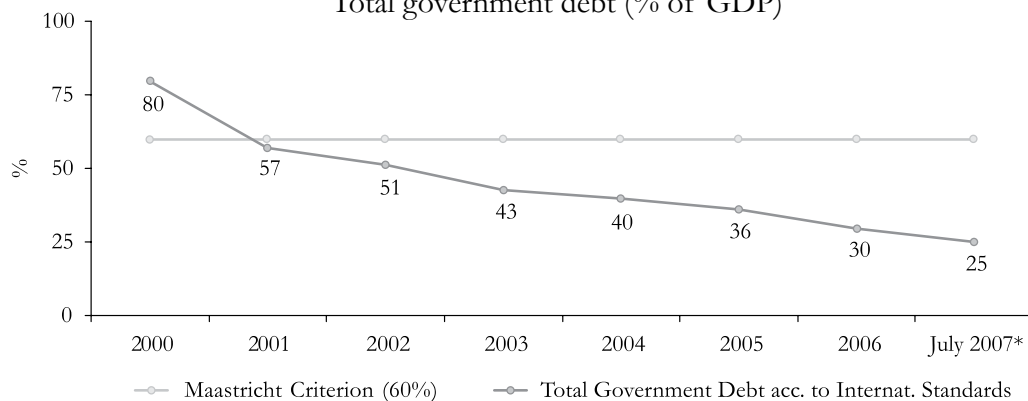
Government Domestic and External Debt (% of GDP)



Source: BSS * Preliminary figures

Since 2001, government debt has been successfully kept within the criterion of the European Union. Currently, the debt levels are far beneath the 60%-ceiling (Maastricht criterion).

Total government debt (% of GDP)



Source: BSS

* Preliminary figures

The government aims at maintaining a comprehensive debt strategy in order to duly service domestic and foreign debt. It is envisaged that ongoing debt repayments will provide a solid record of accomplishment for regaining sovereign reliability, creditworthiness and confidence in the world as a whole.

5. Growth prospects

The President of the Republic, in his address to Parliament at the opening of the new fiscal year on the first of October 2007, announced the government's continued commitment to pursue prudent fiscal policies. The business community received this statement with satisfaction. Apparently, local and foreign entrepreneurs will continue to express confidence in the economy and in its growth potential through their ongoing investments.

The near term prospects are considered favorable, given private sector investments in most every sector of the economy and especially in new projects.

Ongoing are in the already booming mining industry:

- Negotiations for mining bauxite in the Bakhuys area in the west of the country;
- Significant investments intended by Repsol YPF in offshore oil exploration, including drilling;
- Gold explorations by Newmont in the Nassau area in the east of the country are yielding promising results, and
- Expansion of production and refinery capacity of State Oil Company.

Private sector initiatives embrace the emergent tourism industry with facilities for eco-tourists:

- The construction of a new four stars resort in the Berg en Dal area, located in the centre interior of Surinam, partially financed through the Inter-American Development Bank, and
- The Kabalebo Resort in the interior west of the country. **DEP**

The Uruguayan economy: an entrepreneurial standpoint

*Jorge Abuchalja**

1. Introduction

Before addressing this topic from an entrepreneurial standpoint, we must first look at the economy's different behavior patterns in the international and regional context and then at our country's specific situation and medium-term outlook.

2. International outlook and the region

a. The international scenario

As regards the outlook for the short term (one year and a half), it is expected that the favorable conditions now prevailing in the international context will persist. IMF projections indicate that the world product will grow by 4.9 percent both

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this year and in 2008. The world economy would thus record one of the longest periods of growth at rates higher than the average of the last thirty years.

Despite the deceleration foreseen in the United States this year, prospects remain favorable for the various economic zones. It is estimated that the U.S. economy will expand by 2.1 percent this year and by 2.6 percent next year, while the euro area is expected to grow 2.5 percent in 2007 and 2.2 percent in 2008.

Under this scenario, it is possible to anticipate that emerging economies will experience great dynamism. According to IMF projections, they should expand at 7.5 percent in 2007 and at 7.1 percent in 2008. This outlook is closely associated with a good performance by the Chinese economy in the next one year and a half; it should be recalled that the Asian giant's economy has grown around 11 percent this year.

In respect of financial markets, the main scenario on which projections are based points to the stability of short-term interest rates, in line with the expected maintenance of the U.S. reference interest rates. The U.S. currency is expected to continue weakening for the balance of 2007 and in the first few months of 2008, after which it should recover slightly.

Despite the favorable prospects just described, the existence of major risks cannot be ignored, posed by factors susceptible of causing a poorer performance of the world economy in the coming years. Some of the major factors include the recessive effect a drastic readjustment in the U.S. real estate market could entail, as well as inflationary pressures in the main developed economies, which could lead to the adoption and tightening up of restrictive monetary policies. To this should be added the effect of high oil prices and the volatility of the oil market. The conflicting scenarios between countries and inside some of them add to the degree of uncertainty.

b. The situation in neighboring countries

Under this currently auspicious scenario, the region's economies should perform well in the next one year and a half.

In *Argentina's* case, favorable rates of economic growth are expected, as well as new export records, while the Central Bank should maintain the exchange rate at its current levels and the government should score relative success in controlling inflation (which should not exceed 15 percent).

As regards the just described Argentine scenario, two factors could adversely affect these projections: the expectations of the different economic players as a result of the presidential elections in October 2007 and the aggravation of the energy crisis.

Of these two factors, the energy issue seems to pose a more serious risk, although the government has insisted on downplaying its importance. But there is no doubt that if the problems persist for a few months, the growth of the production of goods and services would naturally decelerate. Should fuels become scarce and restrictions be imposed on the use of electric power, industry could be the most affected sector, slowing down the growth pace, which in turn would cause GDP growth also to decelerate, bringing down the 6.5-percent rate forecast for 2007 to 4 percent in 2008.

The *Brazilian* economy should experience considerable expansion in 2007 and 2008. A look at its performance suggests that internal demand is the engine that drives the economic activity's growth in the short run. Under this scenario, GDP is expected to grow at 4 percent a year in the current biennial.

To maintain this growth pace, the economy must meet two major challenges: investment and maintenance of macroeconomic equilibriums. As to inflation, it seems to be under control at around 4 percent.

3. Analysis of the Uruguayan economy and its prospects for 2007-2008

a. Economic growth

Under very favorable international and regional circumstances, economic activity grew 7 percent in 2006.

In respect of 2007, macroeconomic indicators suggest that the Uruguayan economy is on the path of steady growth. This can be explained basically by sustained external demand and more dynamic domestic spending.

b. Monetary policy's dilemma

At end-2006, inflation was below the 6.5-percent target set by the Central

Bank of Uruguay (BCU). In the first half of 2007, retail inflation rose sharply, reaching 8.3 percent in May.

Although the increase in some prices that are very volatile – such as fruit and vegetables prices – has had a significant inflationary impact in recent months, the levels of underlying inflation have remained high since the early 2006. This sends an alert signal to the authorities in respect of the achievement of the inflation target for 2007. Underlying inflation – which excludes the behavior of items with more volatile prices – has consistently remained above 6 percent a year since February 2006.

If items such as fruit, vegetables, meat, and fuels are excluded, underlying inflation permits a more precise assessment of the behavior of what is known as the inflationary core, probably the best indicator for use in monetary policy decisions.

At its last meeting, the Macroeconomic Coordination Committee, which is made up of Central Bank and Ministry of Finance and Economy authorities, recognized the existence of pressures that may drive inflation above the last objectively established range (4-6 percent) for June 2008 onward.

In a communiqué issued in late-March 2007, the Committee asserts that the current inflationary process is caused by a series of factors, including supply shocks (fruit, for instance), economic growth, imported inflation, and salary increases. As regards the latter, the interaction between nominal salaries and prices has been historically decisive in triggering inflation in Uruguay.

The relation between the salary policy and the inflation targets faces the current Administration with one of its main dilemmas, as the salary recovery objective conflicts with the objective of driving down inflation below the current 5-6 percent.

Confronted with this higher-inflation scenario, BCU announced a monetary policy adjustment to be implemented through contractive measures. But, given the delay with which the effects of monetary policy are felt, they could impact only partially on this year's inflation.

There is no reason, though, to think that BCU will flag in its commitment to the inflation objective. On the contrary, the monetary authority will probably continue to apply measures such as raising interest

rates, and to strengthen its efforts to bring the domestic agents' expectations into line with the objective of bringing inflation down to the target set by the Macroeconomic Coordination Committee.

A more stringent monetary restriction could thus occur in the coming months. To ensure that this would bring down inflation, the monetary authority should also allow a reduction in the exchange rate, which should be consistent with the dollar's decline on the international markets (although this measure would not significantly affect the competitiveness of national production or lead to its recovery or real increase).

c. Fiscal policy

In the first half of 2007, the public accounts behaved in general as envisaged under the government's financial plan. The weather permitted a significant decrease in the cost of power generation, which in turn led to significantly better results by UTE, the state power enterprise.

Tax revenue continued to grow at a brisk pace, thereby offsetting a moderate increase in the consolidated primary spending of the central government and the Social Security Bank (BPS), which in turn ensured a public sector primary result of 4.4 percent of GDP in the twelve-month period ending in May.

The favorable economic conditions of recent years have allowed the government to increase outlays for priority areas (social area, infrastructure, and education). The government's objective of increasing expenditures as tax revenues rise is thus being achieved. Nevertheless, there are some questions and uncertainties in respect of the objective of achieving fiscal equilibrium (zero deficit) by the end of the current administration. The improved fiscal results were due in part from the expected economic growth and to higher collections owing to less tax evasion. It should be noted, though, that the considerable growth in tax collections owing to improvements in the internal revenue service (DGI) may face limitations in the medium term.

On the other hand, the growth of spending has accelerated, especially this past year, while the growth of its financing sources (economic growth, reduction in tax evasions, state bank earnings) faces restrictions in the coming years. This poses another dilemma for the government, between implementing

policies aimed at reducing “fiscal vulnerability” and meeting the needs in the areas defined as priority.

4. Uruguay’s outlook

In the light of the aforementioned favorable external scenario and considerations about economic policy, it is possible to identify the prospects for the country.

GDP is expected to grow 5.2 percent in 2008, owing to the sustained dynamism of investment and exports, a strong growth of private consumption, and greater economic activity induced by the Botnia pulp plant’s entry into operation.

As regards inflation, it should be noted that owing to the government’s policy for lowering tariffs and assumption of the attending fiscal cost, and to the reduction of the nominal exchange rate, inflation in dollar terms may be projected to reach 8 percent in 2007 and 8.7 percent in 2008. The resulting reduction in the real exchange rate would be consistent with the weakening of the dollar on the international market, which should not cause a significant loss of Uruguay’s competitiveness in relation to other countries.

a. Indispensable participation in the world economy

It should be born in mind that demand has historically driven Uruguay’s economy and its participation in the international market. The entrepreneurial sector as a whole has not made a strong effort to win international markets. On the contrary, its endeavors have been directed preferentially at the domestic market. As this market is small and circumscribed, participation in the international market should be pursued as indispensable to growth and ways should be sought to reduce the vulnerability of relations with the world.

This implies that Uruguayan entrepreneurs must unquestionably improve their competitiveness in the economy by consistently adjusting quality to the requirements of international demand, so as to establish their place on the external markets and raise a barrier against the entry of goods and services in competition with national production.

Uruguay is determined to pursue – basically through measures implemented by the various Administrations – of new markets for a wider

placement of its products. This effort includes also the diversification of the supply of national products.

This can be achieved only through the adoption of specific initiatives, participation in trade missions, introduction of our products at fairs, and ongoing contacts at the entrepreneurial level.

This issue deserves being looked at in further detail, as it has utmost relevance for our country's sustained development.

It should be recalled that the Uruguayan economy's macroeconomic performance in the nineties could be considered satisfactory, despite the brief 1995 recession, occasioned in part by the "Tequila effect."

The real and per-capita GDP growth rates were relatively high and sustained until 1998, when the country entered a recession period characterized by a marked contraction of the real economy. In 2002, this process culminated in the worst economic crisis Uruguay had to face since the 1930s.

The 2002 crisis affected essentially the financial system, the exchange rate, and the country's fiscal solvency. This could be explained by the confluence of a series of negative external factors, including (a) the devaluation of the Brazilian currency in January 1999 and the tangible pressure this had on the bilateral exchange rates within Mercosur; (b) the Argentine crisis that broke out in December 2001, which had a strong impact on our country, given the Argentina's importance for aggregate demand and relative prices, and which was magnified by the presence of problem-ridden Argentine banks in the Uruguayan financial market; (c) the deterioration in the international terms of trade and the effect of a foot-and-mouth disease outbreak on meat exports; and (d) lack of a vision for the future, combined with the inertia of entrepreneurial players, lulled into complacency by the bonanza derived from Mercosur and the pallid relations with the subregion.

In 2003, the Uruguayan economy began to recover and since 2004 indicators have been highly positive.

However, a noticeable improvement in the population's welfare requires accelerated, sustained economic growth, based on the conditions prevailing in the last four years.

The crisis revealed that incorporation into the world economy was a must, given the limitations of the domestic market. The efforts made in this

direction have permitted the country to achieve scale of production and economic efficiency that would have been impossible otherwise.

Regrettably, it took a serious crisis to internalize this lesson. Entrepreneurs learned to go out in the world to discover new possibilities and take advantage of them; enterprises learned to respect credit and austerity; the understanding sank in that stocks should be maintained only at the requisite levels and that all nonstrategic and noncritical activities and processes could be outsourced.

b. Attracting investment

Attracting investment is of utmost importance for our country, as its positive effects go farther than the original investment, owing to its multiplying effect in the creation of new jobs, demands, and input requirements, and in other interrelations between the economy and society. This is why investment is a key factor of sustained growth over time.

Our country enjoys a favorable business environment, macroeconomic stability, and a privileged geographical situation, as well as political, institutional, and social stability; in addition, it accords national and foreign capital equal promotional treatment.

Uruguay applies no capital or exchange controls. Here it is possible to celebrate and to demand the fulfillment of contracts in any foreign currency. There are no restrictions on the purchase or sale of property. There is no discrimination between national and foreign investment, and the latter can count on great many incentives.

This notwithstanding, investment – both national and foreign – is modest in comparison with other countries of the region. In recent years, investment has been channeled preferentially to the exporting sectors (forestry, food processing, packing houses) and to services (principally software, tourism, and banking). Lately, there has been significant investment in infrastructure, driven mainly by the installation in our country of a pulp plant by Botnia, a Finnish corporation.

Uruguay offers many real advantages and tax incentives to foreign investors interested in the production of goods and services for export. The recent tax reform approved by Parliament contemplates various incentives to investment, including the following:

- Reduction of the income tax from 30 percent to 25 percent;
- Improved reinvestment benefit: up to 40 percent of net taxable income;
- Extension of the deadline for tax losses, from three to five fiscal years;
- Tax exoneration of income from research and development: biotechnology, bioinformatics, and software directed abroad;
- Reduction of financing costs for enterprises;
- Change in the contribution of public enterprises for improved competitiveness through lower tariffs, and
- Eligibility under promotion regimes.

In addition, the Free Zone regime is a strong incentive for the country to become a preferred market place, where transnational enterprises may engage in service activities by setting up Shared Services Centers for the entire region (similarly to what occurs in Costa Rica and Ireland). This system is fast expanding and will certainly have the expected impact, as both government and entrepreneurs are intent on publicizing its many attendant benefits.

Lastly, investment must significantly increase, so as to improve the debt/capital ratio (still high in Uruguay), and be channeled to sectors capable of creating jobs and generating exports, of engaging in technology transfer, and of promoting the training of the labor force.

The changes being introduced in the legislation to eliminate discretionary resource allocation, enhance transparency, and improve efficiency, as well as the restoration of social cohesion under the commitments undertaken by the Government should significantly contribute to the country's stability, security, and sustainable development.

c. Need to multiply business contacts

As benefits under the current Mercosur are not yet those expected, Uruguay is returning to its original objectives.

This implies the need to go on operating under bilateral treaties (Uruguay-Mexico, for instance) and trade missions such as those the President's Office is carrying out in association with entrepreneurs. These initiatives aim at establishing a multiplicity of contacts that can ultimately

permit the identification of needs and thus the opening up and consolidation of new markets.

Of course, the efforts to celebrate bilateral treaties do not mean refusal to work toward regional productive integration according to Mercosur postulates aimed at making its enterprises and societies more competitive, taking advantage of the best they have, and moving forward together in an increasingly globalized, constantly changing world, which demands an ongoing development of innovation and knowledge.

Mercosur's geographical situation and its existing political and juridical agreements warrant seeing it as a powerful platform for launching the necessary foundation and preparation to maximize Uruguay's access to world markets. Although this seems to be the alternative that should be contemplated by the countries of the subregion, various aspects have come to the fore, often as a result of the partners' asymmetry, which have prevented the achievement of the aforementioned objective. This has led our country to assess different ways to achieve incorporation into the world economy. Multipolar schemes are thus proposed, which, although they assign priority to Mercosur, encourage the country to go on seeking integration with the rest of the world – particularly in a multilateral context and under major multilateral agreements – in pursuit of markets for its domestic production. One illustration of this would be the Free Trade Agreement celebrated with Mexico.

Conclusion

Uruguay is carrying out a series of changes in all sectors, just as are many other Latin American countries. These changes, which are part of the Government's Plan and are approved by Parliament, are not the only ones that are needed or that are under way in the country.

The reforms called for at the government level are often of a structural nature. Health reform and State reform, among others, are being done without incurring into populism, on the basis of sound criteria, and, in respect of fundamental matters, and focusing Uruguay's integration into the rest of the world for the welfare of its people.

Since the 2002 crisis, high-voltage changes are being introduced in the entrepreneurial sector also.

Given the premise that the development of a country's economy unquestionably requires entrepreneurial action in complementation of government action, it is necessary to keep up and intensify this sector's development.

To this end, high-quality training is essential at all levels, as is participation with the government in trade missions, and the unceasing identification of investment needs and business opportunities in the various countries, through the work of Chambers of Commerce and Professional Associations.

The development of new categories of export goods and services (including intangible and tertiary goods) will permit the country to take advantage of the vast opportunities offered by the international market. Uruguay has made incursions in the areas of technology, software, financial services, consultancy, steelwork, cultural services, cinematography, advertising, and tourism as incremental GDP factors.

Uruguay is experiencing a good economic moment and the outlook for the medium term, assuming that international conditions and domestic efforts persist, are auspicious.

Recognition of and incentive for the entrepreneurial activity are contributing factors of a perfect synergy between State reform and entrepreneurial activity, as well as determining factors for taking advantage of the opportunities open by the international scenario.

The preparation of new entrepreneurs from the bottom up, as made possible by initiatives such as *Desafío Sebrae* (a program aimed at Uruguayan college students) is an example of the efforts made by the country for achieving its own development. **DEP**

Sources: 2007 Delloite y Pricewaterhouse situation reports.
2005 Business Climate Initiative Report.

Translation: João Coelho.

The present growth period of the Venezuelan economy

*Nelson Merentes**

This article is based on data from the Central Bank of Venezuela, Venezuela's National Statistics Institute, and the United Nations Development Program and on my own end-of-the year estimates.

Main macroeconomic variables

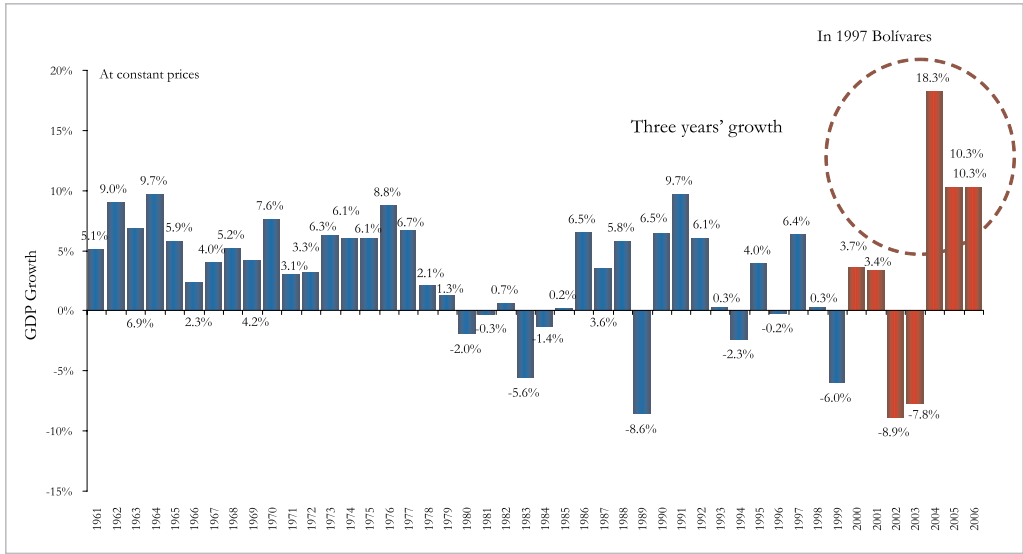
It should be recalled that between the sixties and the late seventies, Venezuela grew at an annual average of 5 percent. In the eighties, the country entered a cycle of alternating growth and decline, which was partly responsible for gradual social sacrifice, as the liberal policies implemented by the governments in power deteriorated. The nadir of this social deterioration was marked by the so-called *caracazo*¹ in 1989 and the military rebellions in 1992, at which time a new political force emerged, led by Chávez, the current president. Its political project proposed was based on a “three-root

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¹ N.T. Civilian revolt that ended with more than 1,000 deaths by police forces.

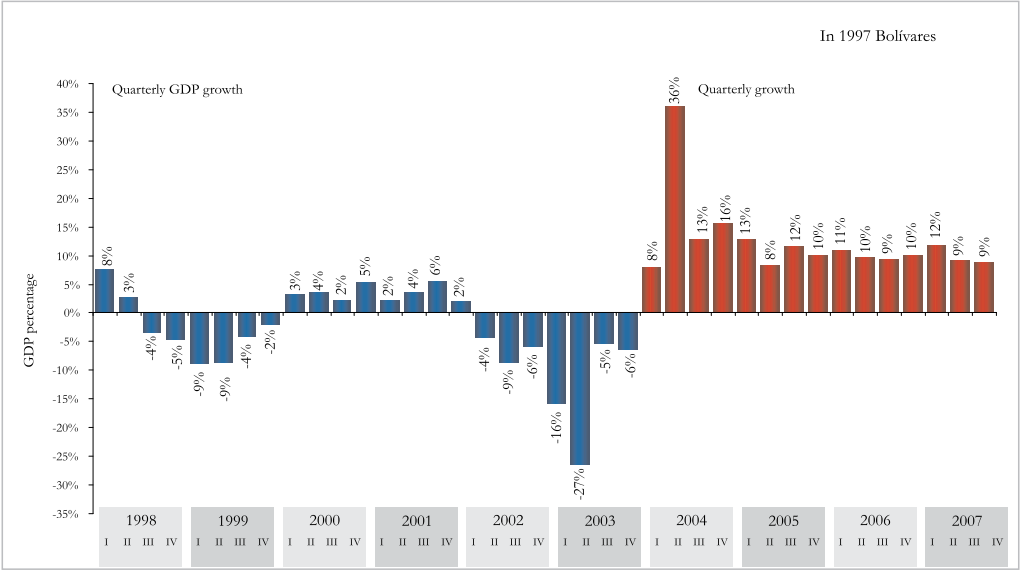
tree,” the roots being the thinking of Simón Bolívar, Ezequiel Zamora, and Samuel Robinson. This project’s strategic lineaments are reflected in the 1999 Constitution approved by the Constituent Assembly and then by the majority of the Venezuelan population in a referendum in the same year.

Since 2007, Venezuela has grown at an average rate of over 8 percent. This growth period has lasted longer than in the eighties, the sixties, and the seventies, as shown in the chart below.



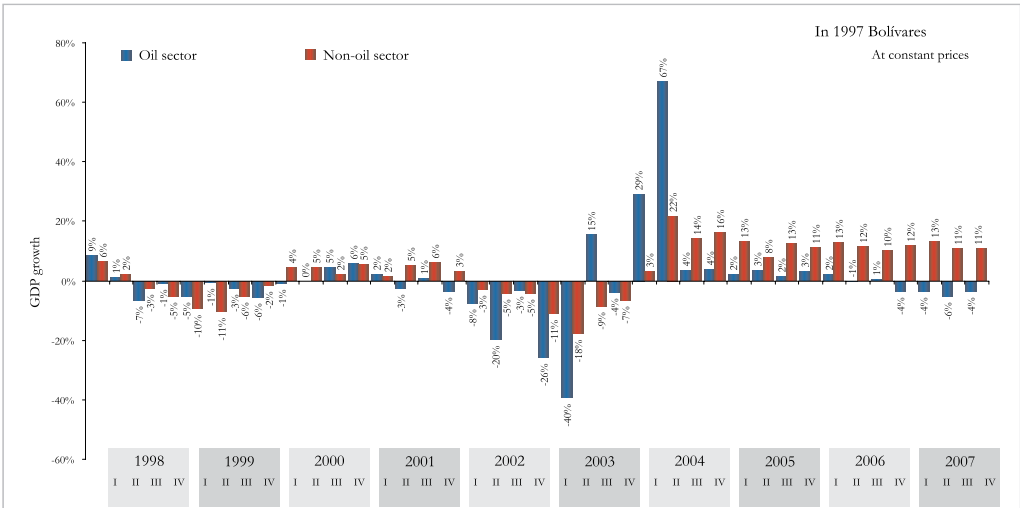
Source: Central Bank of Venezuela

In 2007 a cycle of seventeen successive quarters of GDP growth will be completed, something that had not happened since the seventies. Quarterly GDP growth has exceeded 8 percent, as shown in the following chart:



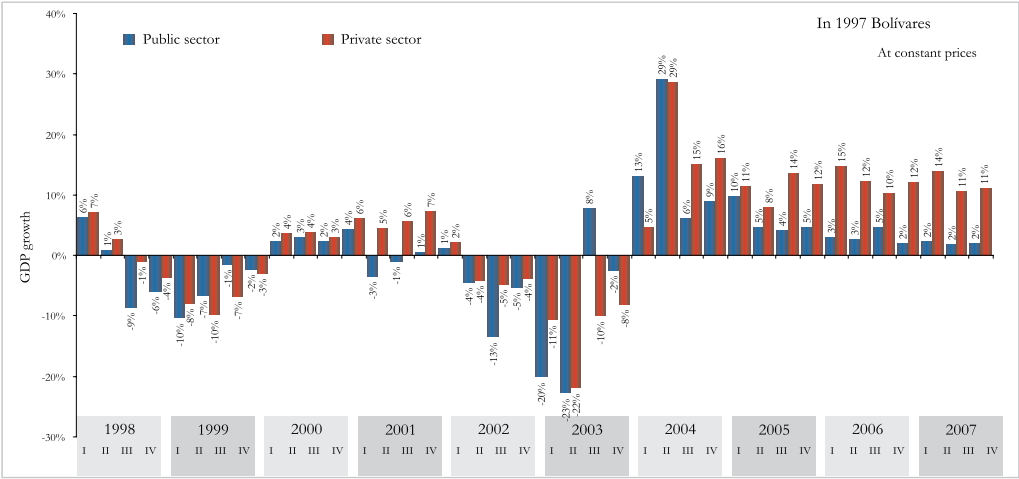
Source: Central Bank of Venezuela

The strongest growth occurred in the oil sector, and exceeded 10 percent.



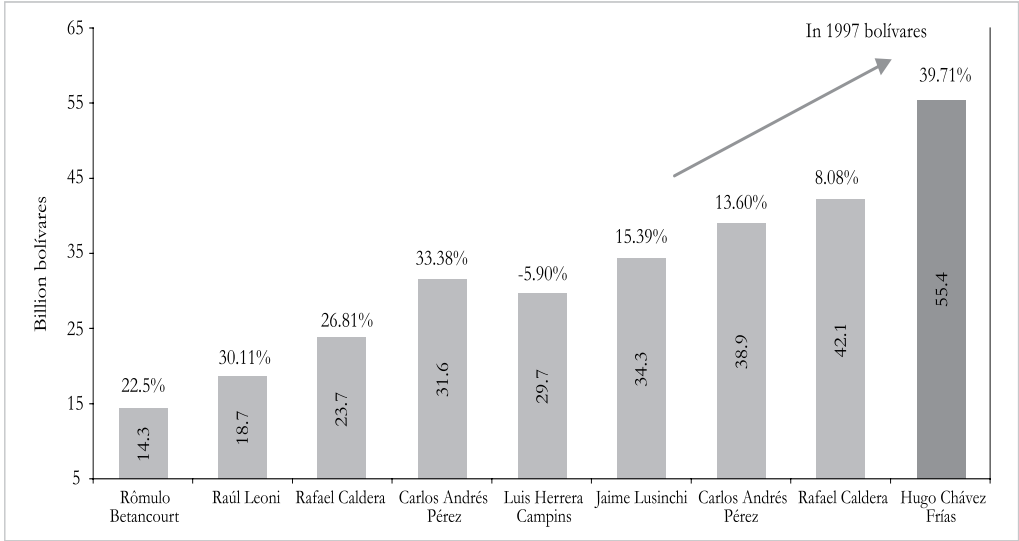
Source: Central Bank of Venezuela

The private sector has started on the growth path again, at over 11 per cent per quarter in the same period.



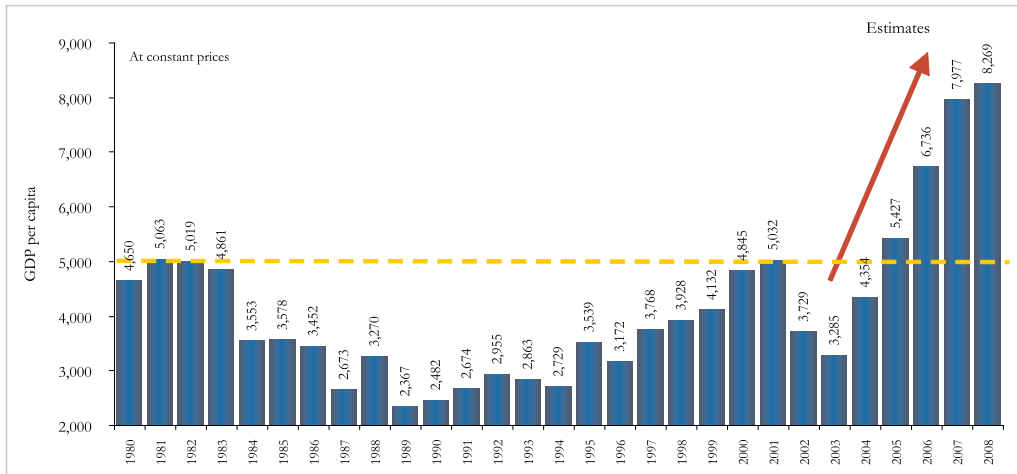
Central Bank of Venezuela

Nominal GDP at end-2007 will probably be twice that of 1998, totaling US\$91.2 billion. It should be noted that although the chart below shows nominal GDP growth in periods of five years (the duration of a president's term in office), President Hugo Chávez's Administration is in its eight year.



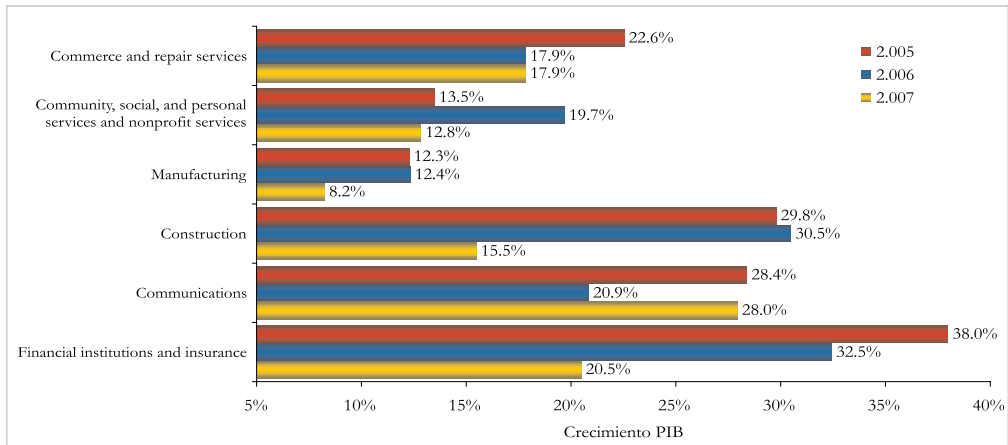
Source: Central Bank of Venezuela

Per capita GDP has risen by about 142 percent these last four years, from US\$3,258 in 2003 to US\$7,997 in 2007, far above the eighties' record.



Source: Central Bank of Venezuela

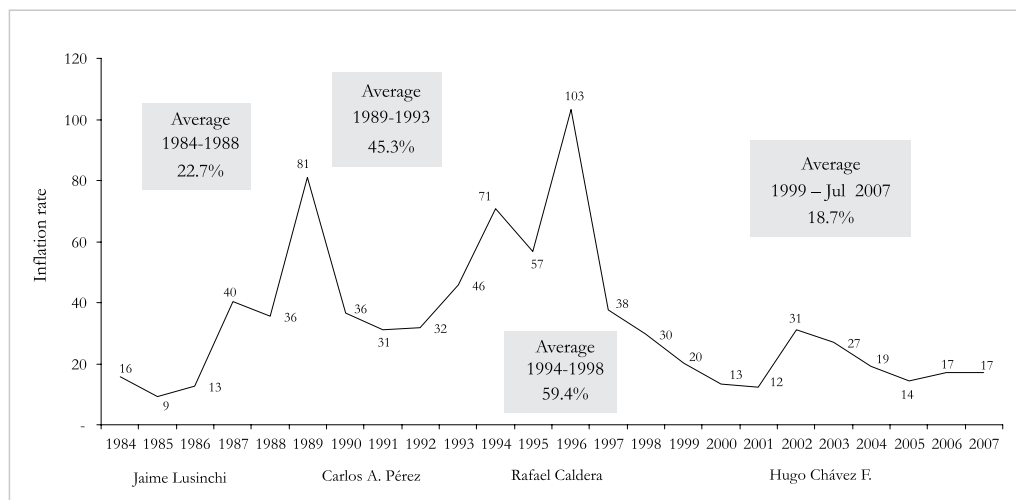
The following economic activities have experienced sustained growth:



Source: Central Bank of Venezuela

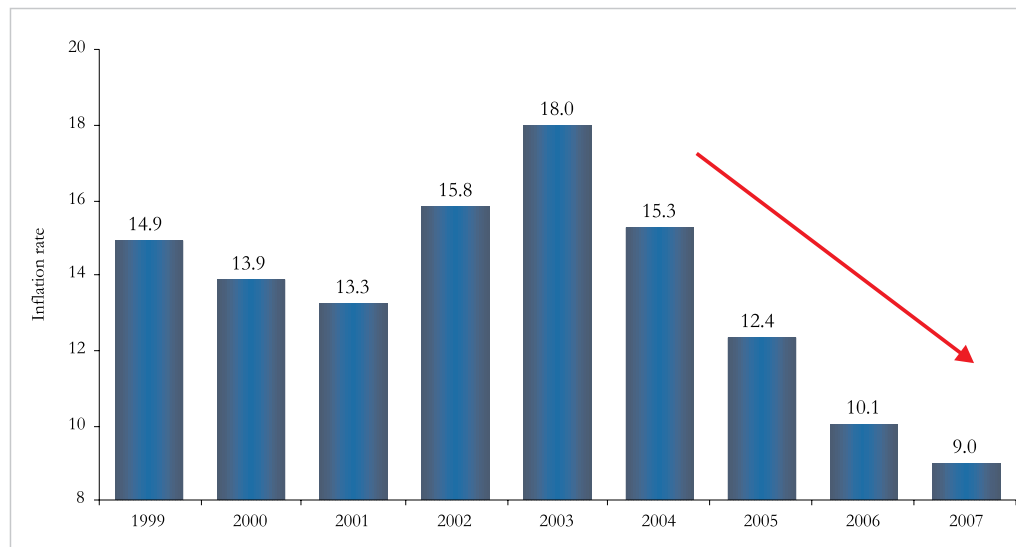
Venezuela has suffered from an inflationary “arrhythmia” since the eighties: inflation was the lowest in 1985, at 9 percent and the highest in 1997, at 103 percent. In 1999-2007, average inflation was 18.7 percent. Which factors are responsible for such sharp fluctuations in the consumer price index (CPI)?

Many factors drive up prices in Venezuela, particularly expectations and political risk (as evidenced in what happened in 2002-2003). This suggests the need of exploring and designing an econometric model to serve as a better instrument for formulating inflation control policies. At the moment, Venezuela lacks such a model for a proper definition of anti-inflation policies.



Source: Central Bank of Venezuela

The current one-digit rate of unemployment is the lowest in twenty years (9 percent). Lower inflation has been accompanied by a real salary appreciation.

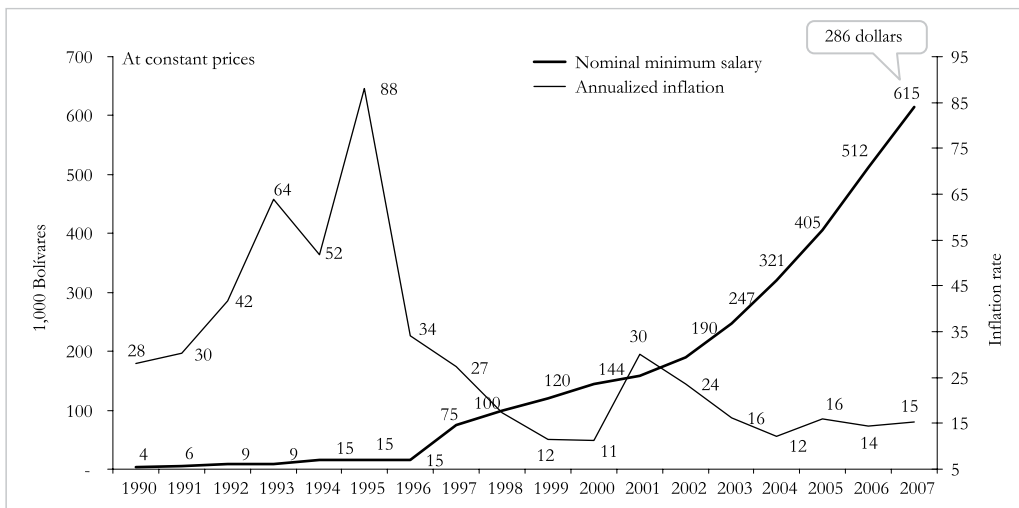


Source: Central Bank of Venezuela

Before President Chávez took office, urban workers earned twice as much as rural workers, and employers of janitors and domestic servants were not under the obligation to pay a minimum salary, as was the case of enterprises in relation to young trainees. Today, all of these categories are entitled to a minimum salary.

Firms that employed up to twenty workers did not have to pay a minimum salary either. This led many entrepreneurs to set up several small enterprises or to transfer their business to the rural sector; large numbers of workers were thus exploited. The Venezuelans' purchasing power has improved, particularly in the lower-income segments (D and E classes), thereby reversing the situation prevalent in the nineties, when salary increases did not keep up with inflation.

In 1996, when inflation exceeded 100 percent, the minimum salary fell to US\$36, one of the lowest in the world. In 2007, it went up to US\$286. Ministry of Labor figures show that with the minimum salary and the food grants, public servants (at ministries and autonomous institutes) earn the equivalent or near the equivalent to the basic basket, which includes food and services.

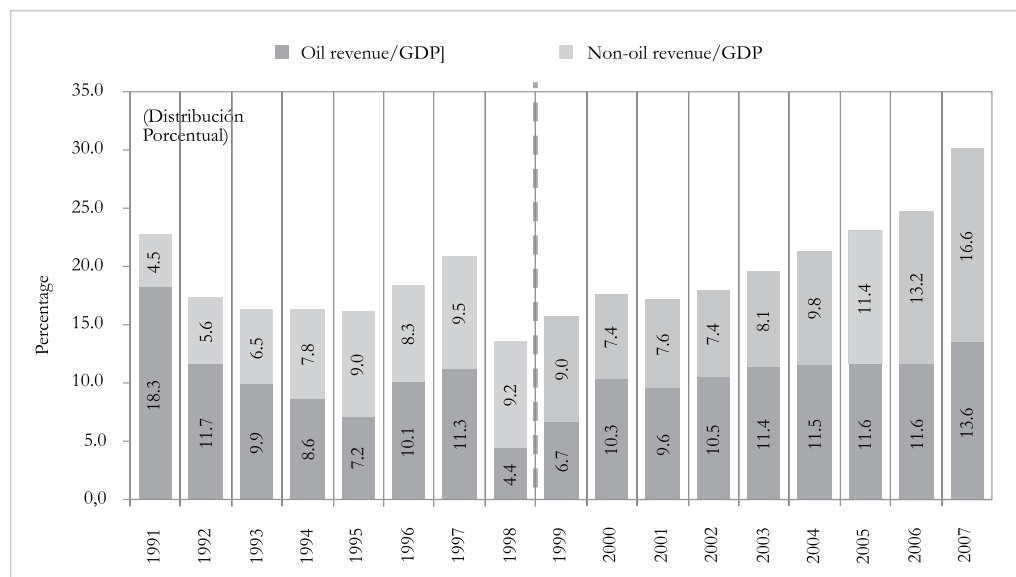


Source: Central Bank of Venezuela, Ministry of Labor

Main fiscal variables

Despite efforts to diversify its economy, the country still depends heavily on the oil and oil byproducts market and on this sector's economic cycles. Nevertheless, fiscal revenue has increased, in both nominal and real terms. Oil

revenues have doubled, from 6.75 percent of GDP in 1999 to 13.6 percent in 2007. This was helped by a combination of the behavior of prices and a drastic oil fiscal reform in 2005 and 2006.



Source: National Budget Office

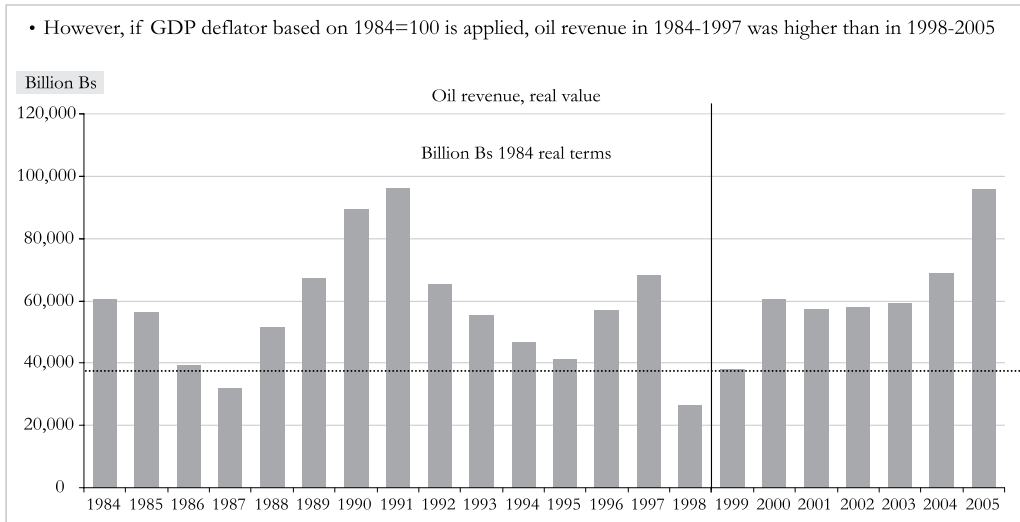
The chart above shows that oil revenues rose from 9 percent of GDP in 1999 to 16.6 in 2007 (in only eight years). This resulted mainly from a zero-evasion and zero-contraband plan, the training of human resources, and the modernization of customs and of the tax system.

In 2005, the Republic's financial flows changed under the Central Bank of Venezuela Law. This allowed the establishment of the National Development Fund-Fonden, which has received about US\$430 billion in the last two years, US\$13 billion of which, or 43.3 percent came from the oil industry. In addition, the oil industry commits US\$6 billion a year to social programs under the strategic *Siembra Petrolera* [oil sowing] plan.

Fonden's financing comes from Petróleos de Venezuela-Pdvsa and the Central Bank of Venezuela, which calculates the amount or scale of the country's adequate (optimum) reserves.

The methodology for calculating optimum reserves has been studied by many authors. Triffin (1948) thinks in terms of month of imports. Other

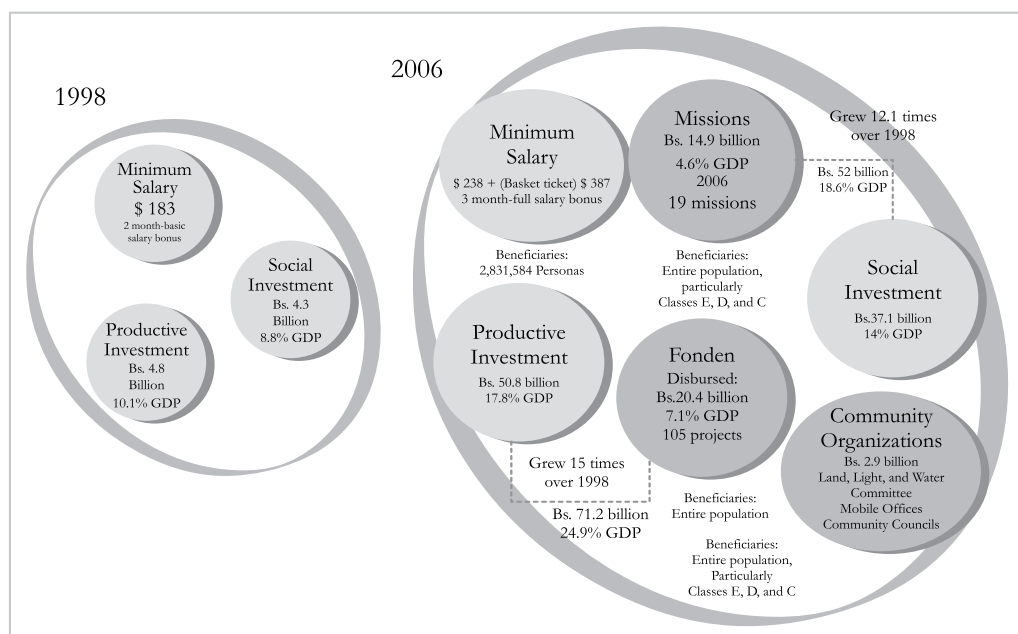
authors, including Wijnholds and Kapteyn, Heller (1996), García and Soto (2004), Frenkel and Jovanovic (1981) have dealt with this issue from different angles. In Venezuela, a multi-criteria method (Rojas 2005) has been used to arrive at a single estimate of the adequate international reserves level.



Source: National Budget Office and the author's calculations

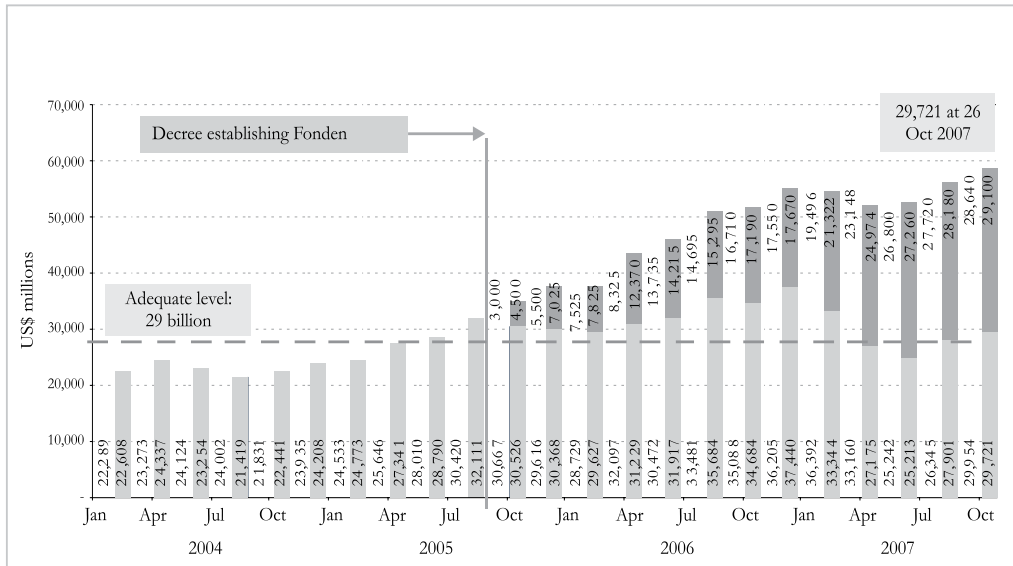
Although in recent years oil revenues have attained their maximum nominal value, it should be recalled that in real terms this growth is lower than in the eighties, as can be seen from the chart above.

Higher oil and non-oil revenues and new financial flows have permitted better income distribution that accounts for an increase from 8.8 percent of GDP in the social sector in 1998 to 18.6 percent in 2006, which represents a 9.8 percentage-point GDP increase. Forty-five percent of the 2006 budget is earmarked for the social sectors. The productive sector increased from 10.1 percent of GDP in 1998 to 24.9 percent in 2006, a 14.8 percentage-point increase.



Source: Author's estimates

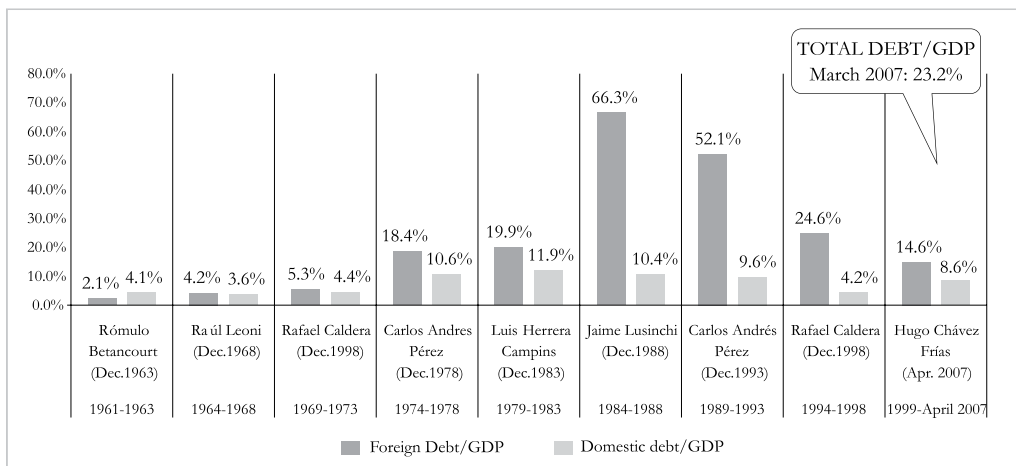
Venezuela's current international reserves surpass US\$30 billion, a level that exceeds that of the country's foreign debt (approximately US\$26 billion). In addition, the establishment of the National Development Fund-FONDEM guarantees financial flows to more than 110 productive projects in various areas, including the social, productive, energy, communications, and science and technology sectors.



Source: Central Bank of Venezuela and author's estimate

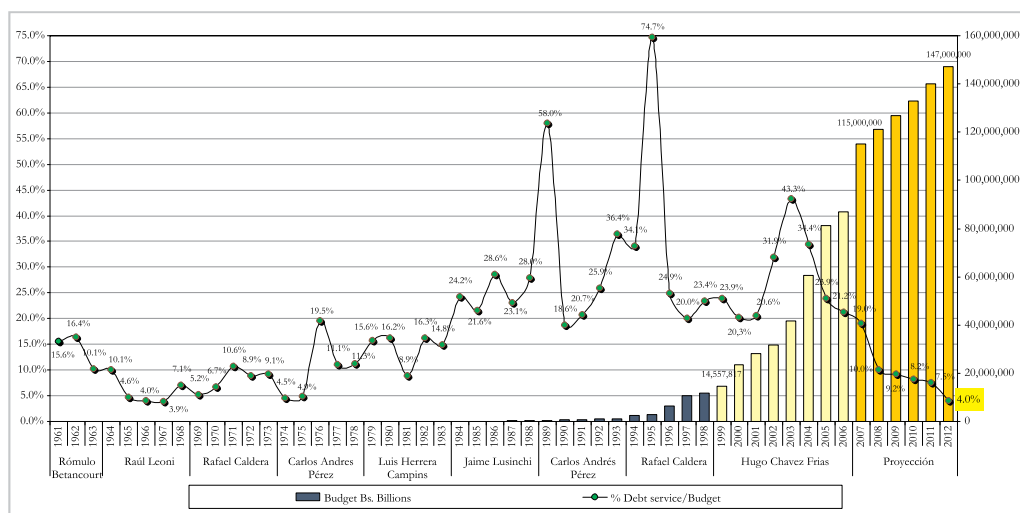
Venezuela has decelerated its borrowing pace; indebtedness declined from 76.6 percent of GDP in 1988 to 23.2 percent in 2006. The major reduction occurred in 2006, when approximately US\$5.5 billion were paid, so that at the end of the year the debt stood at 14.6 percent of GDP.

The internal debt stands now at 8.6 percent of GDP as a result of the rescheduling from four to fifteen years, at a lower interest and with the change of variable- to fixed-rate coupons.



Source: Central Bank of Venezuela and author's estimates

The liberalization of budgetary cash flows previously earmarked for debt servicing, allowed a reduction from 74 percent in 1995 to 19 percent in 2006, thereby freeing up resources for social and productive investment. Basic socioeconomic recovery initiatives consist of a national strategic plan and the so-called missions.



Source: National Budget Office

The social missions are a strategic instrument to address the most extreme cases of inequality, discrimination, and poverty, which give rise to food insufficiency, lack of sanitation, illiteracy, unemployment, and the nonexistence of citizen participation mechanisms, all of which had made the country into a giant producer of social exclusion until 1998.

In 1998, according to Ministry of Health figures, there were 1,628 doctors providing basic health care to a population of 23.4 million. In 2006, there were 19,571 doctors attending 27 million people.

In 1998 there were 417 emergency facilities, 74 rehabilitation centers, and 1,628 primary care centers. At end-2006, there were 8,621 basic care centers, including 6,500 consultation points in poor neighborhoods.

Between 2004 and 2006, more than 400,000 people had had eye surgery and recovered their vision. Before then, such people simply received no attention.

The National Government's development strategy attaches the highest priority to social inclusion and to providing real opportunities for the marginalized majority of the population, so as to incorporate it into the nation's productive activity.

The social inclusion policy assumes that the true mechanism for overcoming poverty is qualification, jobs creation, defense of the real salary, and social income generation through accessible public services to improve the quality of life of the poorest segments of the population.

Social Missions



Source: Bolivarian Missions portal on the Web.

The purpose of the social missions is productive training, health care, provision of basic services and in general the creation of the initial conditions for entire population's incorporation into a socially productive function.

As to the food situation, Food Ministry figures show that in 2006 there were 15,726 establishments in the country selling food at subsidized prices, which meant a difference of 27 percent and 39 percent from market prices in

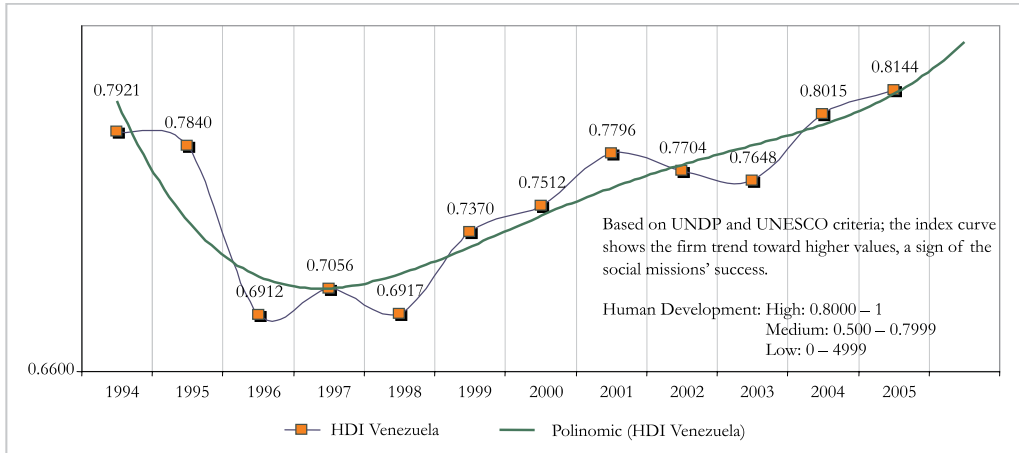
2005 and in 2006, respectively. Programs directed at people living in extreme poverty have been expanded (such as the Food Houses and the program for the provision of foodstuffs free of charge, known as Food Supplementation Program), which benefited 67 percent and 43 percent of the population in 2005 and in 2006, respectively. These data do not include 1,8 million children at school age that benefited from the school food program in 2006, in contrast to 252 thousand children in 1999.

In the area of education, the number of students in Bolivarian primary schools rose from 271,593 in the 1999/2000 academic year to 1,098,489 in 2005/2006. More than 1.3 million people have attended adult literacy programs under Robinson Mission I; more than 1.5 million people have entered the formal basic education system under Robinson Mission II; and 250,000 people graduated from secondary school in 2006, while another 500,000 were nearing graduation. Under the Sucre Mission, over one million students attended higher education institutions in 2006.

In 1993, there were 5.2 million students enrolled; in 1998, there were 5.5 million, a 6-percent increase. In 2006, enrollment had risen to 9.3 million; 1.5 million alphabetized people accounted for this 90-percent increase. Since 1992, an average of 1.7 million people has been reincorporated into the educational system.

The historical schooling gross rate has significantly risen. In 1993, 56 out of 100 people aged 3-24 were attending school; in 2006, the ratio was 80 out of 100.

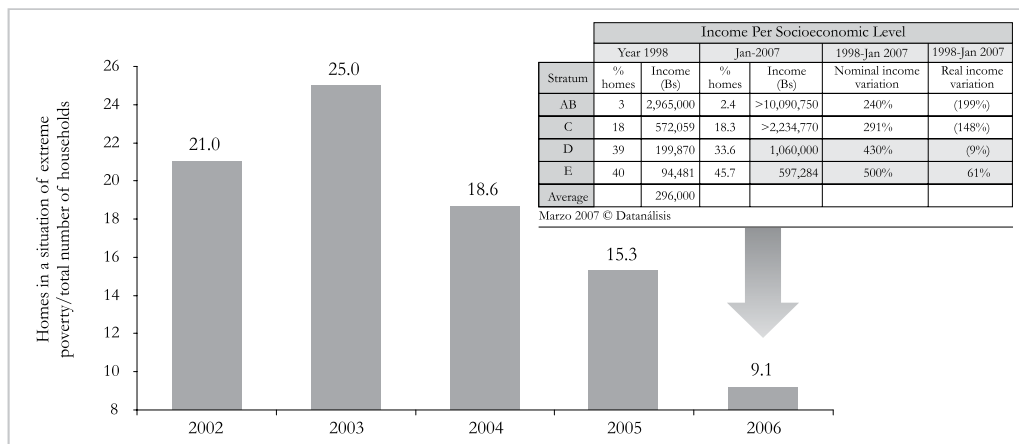
As to the Science Mission, 435 productive innovation networks were established in 2006 and an additional 65 are planned for 2007; these networks provide support to 57,258 associated producers. In 2006, post-graduation scholarships were granted to 1,022 candidates that joined the 4,986 national recipients, 102 of whom belonged to the indigenous people. Moreover, 1,356 teachers from 347 high schools attended refresher courses. In addition, free internet access has been extended to 9,500 monthly users at the 545 infocenters, infomobiles or mega infocenters available to the public.



Source: UNDP

The Venezuelan State will continue to implement its progressive social policy even more intensively as of 2007. Forty-five percent of the BOB 115.2 billion of the 2007 budget will be channeled exclusively to the social areas, an unprecedented figure in the country's socioeconomic history.

Despite the short period of its implementation, this policy's effect can be seen in the human development index, which has risen from 0.7370 in 1999 to 0.8144 in 2005, according to the UNDP's methodology.



Source: National Statistics Institute, Datanálisis

A Datanálisis study updated to March 2007 shows that class E income rose 61 percent in real terms, and according to the National Statistics Institute,

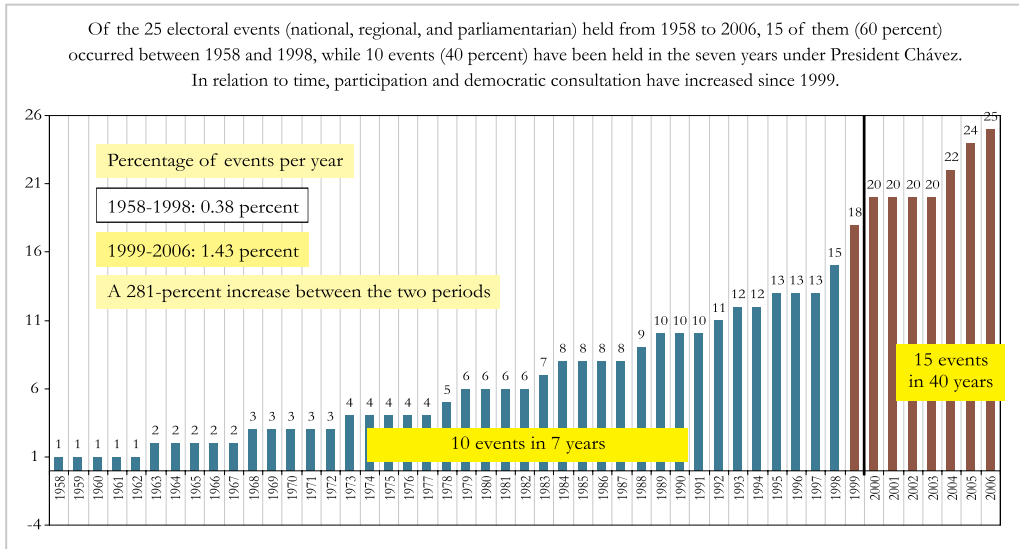
the number of families living in extreme poverty dropped from 25 percent in 2003 to 9.1 percent in 2006.

However, we are conscious that the population faces many problems and needs and that to move faster toward meeting the needs of our peoples we must find efficient mechanisms for South American integration, including financial integration, which will lead to a common currency.

This is why Venezuela, in conjunction with sister countries, has taken the first measures for fostering the development of regional capital markets. This particular policy, exemplified by the purchase of Argentine bonds and the issue of Bonos del Sur [Southern Bonds], has led to a US\$5.5-billion operation. This experience allowed Argentina to obtain the financing needed for its economy and Venezuela to specialize in the emerging bond secondary market, thereby earning US\$400 million.

History has shown that it is impossible for poor countries to consolidate their development under prevailing international conditions. Thus, there is a pressing need to set up a financial development institution aimed at regional integration, with the provision of funds for development projects among South American countries. To date, Brazil, Argentina, Bolivia, Ecuador, Paraguay, Uruguay and Venezuela have agreed to participate in this endeavor, while other countries, including Colombia, are studying the possibility of joining this initiative.

The newly-established Banco del Sur is not a usual financial institution given to onerous loan practices; it forms part of a new strategy to give impetus to Latin America's development. Implementation of the new financial integration proposal could be gradual, in the Telesur fashion, with the participation of two or three countries that would be joined by others in the course of time.

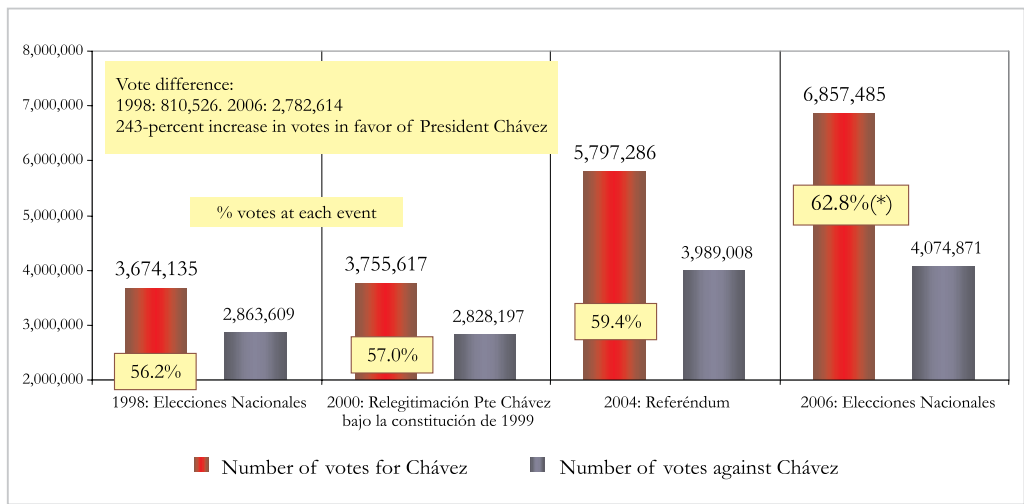


Source: National Electoral College and author's calculations

In conclusion, it is impossible not to mention the Venezuelan political process in both the national and the international context. Between 1958 and 2006, 26 elections were held, eleven of which in the last eight years. Abstention in the December 3, 2006 elections was the lowest since 1989 (25.3 percent) – the last time this had occurred was in the eighties.

This indicates a strong motivation for political participation. We are now nearing another such event to decide on a reform of the 1999 Constitution that was approved by the people at a referendum.

The new policies have been ratified by the confirmation of President Hugo Chávez's leadership in four electoral processes. Between 1998 and 2006, votes in favor of the President increased by 86.7 percent, as compared with a 42-percent increase in contrary.



Source: National Electoral College and author's calculations. **DEP**

Translation: João Coelho.

Don't red card the games of life (1998 World Cup)
Acrylic on canvas 20^{1/2} x 29 inches



Philip Moore: an ancient soul in a modern body

*Agnes Jones**

To understand and appreciate Philip Moore's work, one needs to study his development as a person – from his birth in October, 1921 in the Central Corentyne Region of Guyana; his schooling in the small village school,

* Burrowes School of Art.

Manchester Church of Scotland School, when he was educated and encouraged by a trained teacher, a rare being at that time, to draw, paint, sing hymns and patriotic songs, and recite the poems in his class reading book; his association in adolescence with the Jordanite Movement which introduced him to the study of comparative religion and meditation techniques. All these experiences contributed to the making of the artist Philip Moore.

Growing up in a community where African farmers lived side-by-side with Indian businessmen and farmers, he was daily made conscious of his African heritage. He knew who he was and at the same time appreciated the way of life and the concerns of his Indian fellow-villagers. This urged him to delve more deeply into African religious beliefs and practices. Life in an environment where one lived close to nature and Mother Earth bred in him a certain independence and freedom of spirit rarely experienced by a city dweller. His being was surrounded by mysticism as he probed the realm of philosophy and taught himself to create artifacts from the materials around him inspired by dreams.

Though a proud Guyanese and Caribbean man who, has never travelled to Africa, he is sincerely African in his outlook, his way of life; the work which he produces bears a close resemblance to that of artists in various parts of the African continent. He spontaneously reflects his beliefs in his paintings and sculpture, unconsciously following the technological traditions of his ancestors. Indeed, the keynote of his art is its sincerity, his determination to make his point as a Caribbean man and not merely a copyist of African sculpture or painting. The importance of his contribution is his conscientious desire to reveal his ideas, he says, as “A spirit birthed in an African body in the country of Guyana and the Universe”. He emphasizes the theory that man is more than a body – the soul is of prime importance and God’s presence exists in every man. To him man is “An ancient soul in a modern body”.

In the course of an outstanding videograph, “An Ancient Soul” on the art of Philip Moore, Errol G.R. Brewster the producer states:

“The principal aspect of Philip’s work is not its technical innovation this work is evolving from the private spiritual experience and has its value spiritually and philosophically. They are the products of his encounters with the mysterious imagery springing from the magical world of his subconscious, his explorations of the pure potentiality of African inspired polemics, transforming the known miraculously and enriching all who encounter it”.

As an intuitive and visionary artist whose work came to public notice around 1947; he had been working at sculpture based on visions he had experienced and, as he says. “After I had the visions and understanding, I felt I should share that joy, let the world know that man is more than a lump of dirt”. And he has been generous in his sharing - in addition to carving, modeling and painting, he has written poetry and songs to illuminate his work in the visual arts.

Most of his sculpture and painting tells a story and expresses deep concern for people and existing situations. Sculpture came first, based initially on portraits – King George VI; self-portrait; the Shepherd; Guyanese faces, Lance Gibbs – later showing intense social concern – over-crowded city; standing together; The Mask of Diamonds; don’t take the thorns from the roses. Many of his early sculptures were painted with acrylics and then lacquered. From the mid-nineteen sixties his interest in painting increased, giving scope to his imagination and his individualism.

A Philip Moore painting is recognizable by its play of color and the intricate detail that portrays the quality of tapestry. Many pieces may be thought of as designs for embroidery introducing a variety of multi-colored stitchery. Themes centre around folk-lore, important events, outstanding persons and places, areas of social concern – for example, Jumbie Wedding; Reincarnation of Martin Luther King; King Sparrow; Nat King Cole; Canje Bridge; Togetherness in Guyana; Meditation against Cigarettes; Hurricane Flora. His approach is guileless, figures constructed in almost childlike simplicity, but he cannot be considered a “Primitive” or “Naive” artist since he has over the years read widely, studied and understood the nature of art. He is acquainted with the works of European masters, but prefers to map out his own course. He makes his own laws about painting and sculpture.

During the 1970s Philip Moore was invited to be Artist in Residence in the United States at such prestigious universities as Princeton and Rutgers. During this time also, between 1970 and 1975, he served as Art Director of the Heritage Foundation, New Brunswick, New Jersey and taught at the Trenton Central High School, Trenton, New Jersey.

His stay in North America strengthened his convictions about his art, served as a stimulus to his work and led to the production of large canvases such as Brooklyn Bridge; Big City Sky Seraping; Four Seasons; Architectural

Shadows. During these five years he resisted offers of purchase of his work, determined that the paintings and sculptures should remain in Guyana, his homeland and inform his fellow citizens of the mysteries of life which he felt had been revealed to him. He also had the burning desire to establish a Meditation Museum. His feeling was that, *“This show will inspire thinkers, artists and scientists to study themselves more and try out some of the techniques I have used in my personal achievements to try and understand that the symphony of life is always incomplete and unfinished for the individual”*.

His continuing contention is that, “the Collection – *I sold en bloe* to the Department of Culture, apart from what I sold and donated before needs a special house to show them”. His more than one hundred paintings and pieces of sculpture now form part of the National Collection and are located at Castellani House in Georgetown. The Philip Moore collection has been on show from August 1995 to January 1996, spread over two floors and the attic of the National Gallery, but the artist’s fight for a Meditation Museum continues. In the interim he operates a Cottage Museum at his home at Lancaster Village, Corentyne, but visits Georgetown regularly to keep in touch with art and artists in the capital city, hoping always that his plea will be heard and his dream realized.

Within recent years he has been emphasizing the need for functional art. To him the gallery culture is somewhat irrelevant. Like the traditional African artist he feels that art should play an important part in the decoration of buildings, clothing household articles. He has also been advocating the recycling of waste materials and has devoted much energy to the adorning of barrels with intricate designs, to producing chandeliers out of calabashes, wire, tins, and other materials. He approaches these tasks with as much verve as he would in making a painting or a piece of sculpture. In his zeal for creating artifacts he is an excellent role model to young artists.

For him art is a full-time occupation – everyday, every-week of every month. An artist must find material – commercial, man-made or discarded to carry on his work; an artist’s hands must always be busy.

For the past six months he has been conscientiously carving out a circular piece describing the mini-bus situation in the city of Georgetown. Patiently he carves and paints interpreting the dilemma of living and moving about in a city jungle.

Philip Moore, the father of the intuitive art of the village movement has made no effort to follow trends in Euro-centric art. He is committed to, convinced about, his own approach to art. His busy hands carve out or paint his ideas and his dreams, prime them his dream of a museum which would explain to his countrymen and others, theories which this unique artist wishes to reveal. His contribution to Guyanese art has been endorsed through the recognition and the many awards he has gained locally as well as in England and the United States. In 1975 his design for the 1763 MONUMENT to mark the important Berbice Slave Rebellion, was accepted; he proceeded in this thoughtful and determined manner to erect a landmark which has occasioned much controversy as it is viewed by eyes accustomed only to realistic, figurative representation. In this regard, Philip Moore is in good company since in the History of Art many now-renowned and revered artists have been subjected to scorn, derision and even persecution. Philip Moore's work needs to be examined with an understanding based on his commitment to a message which he feels he is inspired to impart to his fellowmen. **DEP**

Construtora Norberto Odebrecht

Odebrecht's 2007 highlights in South America

Odebrecht's commitment to socioeconomic development in South American countries goes back to 1979, when the enterprise began the internationalization of its operations. The first, successful projects abroad were the construction of the Charcani V hydroelectric power plant in Peru, and the deviation of the Maule River to the Colbún-Machicura hydroelectric system in Chile. These first contracts marked the beginning of Odebrecht's interaction with other nations, cultures, and technologies. This dynamic process has lent support to the development of the enterprise's workforce and yielded economic fruits for Brazil and the client countries. In addition, these initiatives laid the groundwork for the establishment of the trusting relationship Odebrecht maintains with its South American clients, paved the way for long-term partnerships, and opened up new opportunities for the enterprise and its contracting parties.

In 1987, Odebrecht started its operations in Ecuador with the development of the Santa Elena irrigation project in the Guayaquil region.

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In 1989, it constructed the Pichi-Picún-Leufú hydroelectric power plant in Patagonia, its first project in Argentina. In the 1990s, Odebrecht extended its operations to North America and Asia, expanded its presence in Africa, and decisively increased its activity in Latin American countries. In Peru, it implemented the second phase of the Chavimochic project, begun in 1990, for the irrigation of desert areas. In 1992, it began operations in Venezuela with the building of the Centro Lago Mall; in Uruguay, with the implementation of the Montevideo sanitation system; and in Mexico, with the construction of the multipurpose Los Huites dam. In 1993, it extended its activity to two other countries, after its successful bid to build the La Loma-Santa Marta railway in Colombia and the Santa Cruz de la Sierra-Trinidad highway in Bolivia.

Currently, Odebrecht operates projects on four continents, employing 46,000 people of twenty different nationalities practicing five religion and speaking a couple of dozen languages. In the last five years it entered four new markets – the Dominican Republic, the United Arab Emirates, Panama, and Libya. Notwithstanding the enterprise's projection overseas, South America remains its main market, where it has consolidated its strongest bonds with clients and the communities it serves. Consistently with the global macro tendency of economic growth and international trade promotion, the South American region increasingly demands that it be provided with an infrastructure grid conducive to increased production and better transport. Demand for these essential factors for integrating regional productive chains, creating economies of scale, and improving the South American products' competitiveness conditions, has opened to Odebrecht new work opportunities in 2007 as well as further possibilities of reaffirming its leadership in the civil engineering sector in South America.

In 2007, Odebrecht completed twenty years of operations in Ecuador. In this period, we have implemented ten large-scale projects in the areas of transport, irrigation, energy, and sanitation. In June 2007, the Ecuadorian government received the delivery of the San Francisco Hydroelectric Power Plant, Odebrecht's most recently concluded project in that country. The plant uses the turbinated discharge from the Agoyán hydroelectric power dam and has a 230 MW installed capacity. The two turbines are generating 1,446 GW/hour a year, which accounts for 12 percent of all the energy available in Ecuador.



San Francisco Hydroelectric Power in Ecuador

San Francisco is an impressive project, as it consists entirely of tunnels, galleries, and underground caverns. This makes it invisible to those driving by on the highway that follows the course of the Pastaza River, leading to the Ecuadorian Amazon a short distance ahead. At the peak of construction, approximately one thousand workers were local. Another 600 lived in two lodgings – one near the worksite and one in the city of Baños de Agua Santa (pop. 10,000).

Currently, hydroelectric power accounts for 52 percent of Ecuador's energy matrix. To meet the remaining demand, Ecuador resorts to thermoelectric plants, which hinders greater diversification of its energy matrix. But even with recourse to such alternative sources, the country still needs to import electricity from Colombia and Peru. Under this scenario, the San Francisco Hydroelectric Power Project imposes itself as a strategic undertaking to offset the current electric power deficit in Ecuador.

In 2000, twelve South American Heads of State meeting in Brasilia signed a commitment to build nine integration axes on the continent, under a project known as Initiative for Regional Infrastructure Integration in South America-IIRSA. Four of the contemplated axes cross the Peruvian territory.

Odebrecht actively participates in this undertaking, by constructing the Inter-Ocean Axis, the 2,603-km long South Corridor, known as IIRSA South, which connects Urcos to Iñapari; and the Multimodal Amazon North, known as IIRSA North, consisting of a 955-km highway linking the Paita Port on the Peruvian coast to the Yurimaguas river port in Peru's Amazon region, where it connects to the waterways leading to Iquitos and Manaus.

In July, some stretches of the highways under construction were open to the Peruvian population. On the South Inter-Ocean Corridor – an undertaking that will benefit ten Peruvian departments (30 percent of the national territory) and six million people (20 percent of the Peruvian population) – Odebrecht delivered part of the first phase of stretch 2. The work consisted in paving 42 kilometers of roadway and in the construction of 42 bridges, among other works, in the districts of Ccatca and Ocongate, in Cusco. It also concluded the first phase of stretch 3 on the road linking Ponte Inambari to Iñapari, which consisted in paving 60 kilometers of roadway and in 162 meters of bridges and retaining walls, among other works. On the North Road Corridor, work was completed on stretch 1, between Yurimaguas and Tarapoto, and on stretches 5 and 6 on the Paita-Piura-Olmos highway.

The work under way has yielded social and environmental benefits for the population. The team working on the South Inter-Ocean Highway Corridor has implemented the *Estrategia Integral de Acción y Contribución Socio Ambiental* and designed plans of action to be implemented in 2006-2010, as follows: (1) Social Issues Management Plan, consisting in the following programs: "Community Relations," "Hiring of Local Labor," "Land Negotiations," and "Incentive to Local Production;" and (2) Social Responsibility Plan, consisting in the "Tourism and Hotel Administration Training Program" and the "Mobile Health and Education Support Program." As a result of these initiatives, 11,500 people benefited from the mobile program, for which over 60 percent of the hired workforce was local, and from the issuing of identity documents to over 4,000 children and young people, among other benefits.



Workmanships in execution in the South Iirsa, Stretch 2, in Peru

In addition to these initiatives, Odebrecht is proceeding with the implementation of the Olmos Project for irrigation and energy generation, by building a system for siphoning water through the Transandino Tunnel into the Limón reservoir. There is also the Pampa Melchorrita LPG Plant and the Iquitos potable water system. Today Odebrecht is Brazil's largest exporter of engineering services to Peru, where it has operated for thirty years and implemented over fifty projects.

In Argentina, Odebrecht has recently begun work on the expansion of the Argentine Gas Transportation System, under two contracts for the construction of loops, i.e., new stretches of gas pipelines parallel to existing ones. In connection with the Cammesa gas pipeline, 979 kilometers of pipeline and 12 compression stations will be constructed. The Albanesi gas pipeline will be 648-km long and will have three compression stations. The two pipelines will cut the country from the farthest south to the north; after completion, they will increase the capacity of the Argentine gas transportation system by 15 million cu m/day.

In Venezuela, Odebrecht has completed fifteen years of operations. In 2007, the main highlight was the construction of a third bridge over the Orinoco River. This bridge will be 4.8-km long, with towers reaching a height of 137 meters, and a railway running in the lower deck; it will connect the municipalities of Caicara del Orinoco, in the state of Bolívar, and Cabruta, in the state of Guárico. Work started in 2007 and will include one 3.5-km long north viaduct and one 2.5-km long south viaduct.

Equally important was the successful bid for the construction of the Manuel Piar Hydroelectric Power Plant in Tocoma; this will be Odebrecht's first project in the energy sector in Venezuela. Work started also 2007, in Tocoma, 15 km downstream from the Simón Bolívar Hydroelectric Power Plant in Guayana, the last location of exploitation of the hydroelectric complex on the Lower Caroní, Venezuela's second largest river. Upon completion, the Tocoma hydroelectric power plant will have an installed capacity of 2,160 MW.

Also important was the beginning of the construction of the Caracas Metro's Line 5, which will extend for 7.5 km, with six new stations to be connected to the existing two. This line will carry from 227,000 to 300,000 passengers per day; it forms part of the transportation system that begun with the construction of Line 4 in 1998 and of Line 3 (which is under way,

will extend for 5.9 km, with four stations, and carry 240,000 passengers per day). Still in 2007, work has also started on the extension of the Los Teques Metro, with the construction of a new 12.1-km line and six stations in that municipality of Greater Caracas.



Workmanships of the Highway El Cármen – Arroyo Concepción, Two-Ocean Corridor, in Bolivia

In Bolivia, Odebrecht is building the El Cármen-Arroyo Concepción 102-km highway and working on stretch 5, which links Santa Cruz de la Sierra to Puerto Suárez. The construction work employs of 900 people – 95 percent of them members of the local community. The finished highway will link Brazil and Bolivia. Stretch 5, contracted out by Administradora Boliviana de Carreteras-ABC and financed by the Andean Development Corporation-CAF with a total US\$75 million, forms part of the Two-Ocean Corridor that will establish a land connection between Brazilian seaports, such as Santos, to the Peruvian and the Chilean coasts. This will facilitate transportation and

reduce transportation costs between Mercosur and the Andean Community. In addition, the construction will significantly improve transport conditions between the Brazilian border and the Santa Cruz province, bringing down the number of hours required by train, car, or bus travel to eight hours after the road's completion in 2008.

Odebrecht's undertakings in Bolivia extend to the communities adjacent to its worksites. This is the case of the Yacuces town, which has seen its main square reformed and provided with lighting, and benefited from a social and medical assistance program, including free consultation with doctors. There, Odebrecht has already helped 3,000 Bolivians through its social assistance initiatives. These initiatives range from the hauling of tons of garbage from an empty tract of land to doctor's assistance to the community members at request.

These highlights illustrate South America's relevance to Odebrecht, as well as the contribution of infrastructure engineering services not only to South American countries' development but also to improving life quality for the citizens of our continent. Since the launching of its international operations, Odebrecht has completed over 700 projects on four continents. South America has rendered a major contribution to these achievements.

Currently, over 65 percent of Odebrecht's gross annual receipts come from abroad, while in 1985 no more than 30 percent of the enterprise's contracts were with other countries. At end-2006, the number of its employees abroad exceeded for the first time the number of its employees in Brazil. Today Odebrecht has over 26,000 employees in foreign lands and almost 20,000 in its homeland. These figures, coupled with the above-mentioned achievements and realizations, show that 2007 has meant another important step forward in the enterprise's internationalization, a dynamic process that further contributes to the South American nations' integrated development and inspires us to go on serving as best as we can the communities of which we are a part.

Translation: João Coelho

Grupo Andrade Gutierrez

South America: the challenge of the infrastructure

Under the current Brazilian government's foreign policy priority is given to South America, whose integration is viewed as a political project that far exceeds the notion of mere economic coordination among the countries of the region. This emphasis on our geographical surroundings does not imply the abandonment of the long-standing ideal of Latin American solidarity but rather gives it a more pragmatic direction, so as to better identify what is possible to do in each area.

This becomes clearer through the observation of our approach of international affairs since early in the current government rather than simply through the interpretation of the public statements of our highest authorities during the 2002 electoral campaign or at the beginning of this Administration. There is thus a marked interest in maintaining closer relations with Mexico as well as with Central American and Caribbean countries, in addition to a growing presence of Brazilian enterprises in the area. Owing to feasibility considerations, though, the grand political integration project is seemingly circumscribed to South America, as it would be unrealistic to extend it to countries already bound to the United States by legal ties of an economic

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nature. But this does not mean that we are not developing or do not intend to develop a strong Brazilian presence in those countries.

It might be said that in its basic discourse the Lula government has seemingly embraced with even greater emphasis the regional vision of Fernando Henrique Cardoso's, at whose initiative the first summit of South American countries was convened. In an article published at that time in *Carta Internacional*,¹ Luiz Felipe Lampreia, Cardoso's Foreign Minister, made it clear that a decision not to include countries that were "more closely and directly linked to North America, and to the United States in particular" had been made at a meeting that envisioned a "pragmatic project for organizing the South American space." Notwithstanding possible differences of means and styles, continuity can be observed in connection with the establishment on the continent of a new kind of regionalism, namely South-Americanism, different from both Monroe's Pan-Americanism and the traditional Latin-Americanism of remote Bolivarian inspiration. This new kind of regionalism can better identify the most appropriate approach to each region without excluding but rather seeking to reinforce ties to other countries of the Americas.

The current orientation would thus seek – without clashes or attrition with the northern "hyperpower" – to circumvent the engulfing Pan-Americanism that can, owing to the dynamics of prevailing forces, more or less formally draw all the countries of the continent into Washington's orbit. The intention, as expressed by Celso Amorim, our current Foreign Minister, is to develop a mature, more strategic relationship with the United States, in which our country would be seen as "a partner indispensable to the stability of South America and even of Africa." The objective, then, is to assert our geopolitical position in South America, while taking a qualitative jump in our relations with the United States, and thus avoid a more delicate management situation by leaving in a kind of constructive indefiniteness the specific form of relationship with the area that is already *de facto* particularly linked to the United States. In rather simplified terms, our geopolitical view of the continent unfolds in concentric circles: first comes South America, which we wish to see as a close-knit community of democratic States; then, in terms of prior definition of our future action, come Mexico, Central America, and the Caribbean, where

1 "Cúpula da América do Sul", *Carta Internacional*, No. 87, ano VIII, May 2000.



Binational Usina of Itaipu (Brazil - Paraguay)

our capability for diplomatic action would be less significant, not the least because of that area's strong ties to the United States; lastly, the United States and Canada, with which our relations would have a clearly distinct character from our relations with the other regions just mentioned.

Thus, instead of the more comprehensive and somewhat vague options offered by Pan-Americanism and Latin-Americanism, which have made little progress in the past, what the Brazilian regional policy proposes today is to give emphasis to South American integration, based on an already existing integration project, namely, Mercosur, despite its flaws and limitations. To this end, Mercosur must be strengthened so as to become the nucleus of a future subcontinental, integrated bloc. The ultimate objective is thus the integration of South America as a whole, and Mercosur would be a first stage or a requisite instrument for achieving this goal.

This is a highly positive project for both Brazil and all of South America, as systematic, wide-ranging cooperation among all of our countries will make possible the exploitation of potential, so far latent or neglected synergies. This positive character is due not only to the clearly growing political projection of the countries involved but also, in a more restricted, specific sense, to areas such as environmental protection and the development of regional infrastructure, both of which are essential to the area's full, sustainable economic development. It remains to be seen whether such a scheme is feasible or, more specifically, in what timeframe it could be accomplished.

The very nature of the project requires that the first stage should be the strengthening of the structure created under the Treaty of Asunción, as the cornerstone of Brasília's South American project would be a Mercosur deserving of its name as a Southern Common Market. As this stage would partially consist in the fulfillment of commitments already undertaken under that international instrument, two questions immediately come up. The first question is why, after about seventeen years since the treaty's signing, so few of these commitments have been actually fulfilled. The second question is whether there are now conditions to establish within a reasonable timeframe a common market and the requisite institutional framework for its functioning. In other words, whether the four signatories of the Treaty of Asunción believe that they can now do what they had, in 1991, promised to do but have been unable to do so far.

In economic, demographic, and territorial terms, Brazil and Argentina make up 95 percent of Mercosur. In this respect, the two countries practically *are* Mercosur. Overall progress thus presupposes a far-reaching, stable understanding between these two major parties about what they think this political and economic grouping should represent for its member countries, both at home and abroad. As long as one or both see the Treaty of Asunción as a mere trade agreement or as just an element of their subregional policy; as long as Brasília and Buenos Aires fail to have a common perception or at least converging perceptions about how a genuine integration of the Mercosur countries (and ultimately of all South America) will enhance the international image and foster the sustainable development of each country, and that the two countries' must thus work in coordination and solidarity on the external front; and as long as this situation prevails, it will be impossible to achieve effective political commitments and institutional changes capable of making

Mercosur into more than a mini-Aladi. And, still worse: there is the risk that – as it is apparently happening already – that its relevance for the States Parties themselves will decline instead of increasing.

Converging political perceptions between Brazil and Argentina are thus crucial to Mercosur's progress – but not enough. The advance of a political and economic grouping presupposes equal functioning to a certain degree to ensure that the smaller partners will wish to contribute to the progress of all. Today, neither Paraguayans nor Uruguayans seem to believe that the integration process in which they are participating is ensuring this equity or that Mercosur's current institutional framework is capable of redressing perceived injustices, or of sufficiently reducing divergences among its Member States. In Paraguay's case, it is quite significant that in a recent interview to a Brazilian newspaper² Mrs. Bianca Ovelar, who is running for President of her country at next April elections, referred to a pervading feeling among Paraguayans against "Brazil's historic unilateralism when dealing with bilateral issues." She added that although this feeling "has significantly changed under President Lula's government... we still have a long way to go to arrive at an entirely just relationship." This is not the place to determine whether these claims are justified or not. The point is that if public opinion in the neighboring country did not have such a strong perception of injustice – whether well-grounded or not – such statements would not have been made by someone running for President of Paraguay. As regards Uruguay, it has clearly expressed its interest in celebrating a bilateral trade agreement with the United States – which would certainly have a negative impact on the system established by the Treaty of Asunción – as well as its dissatisfaction with Mercosur as it exists today. Moreover, the controversy with Argentina over Uruguay's construction of a pulp plant near the Argentine border evidences a lack of proper regulation in such a key area as environmental protection and the ineffectiveness of common market institutions in solving divergences about issues that are relevant to regional integration.

Such divergences and feelings of frustration are common to all integration schemes where there are marked asymmetries among the Member States. Accordingly, it is essential to solve them and to prevent justified or unjustified perceptions of injustice from undermining the stability of the desired integration. Mercosur cannot escape this rule.

² *O Globo*, 10 February 2008, p. 37.

So far we have dealt basically with issues that are directly connected to Mercosur, although we have made it clear that Mercosur is only the first step on the long way toward the ultimate objective of South American integration. With the specificities of each national situation, the problems mentioned here by way of illustration will tend to multiply as the scope of integration widens.

In a vast integration area characterized by major internal asymmetries, as is the case of South America, two issues inevitably come up. The first is the need for some degree of harmonization of the positions and perceptions of the major partners as regards the main lineaments and objectives of integration. This harmonization is essential for keeping at manageable levels the inevitable differences that arise when the decision-making bodies are at work, so as to allow the main players to act in consonance with each other, thereby ensuring the advancement of their common project. A classical example is the cooperation between France and Germany in building today's Europe, which made it possible for them to move from a past of bloody conflicts to the construction of the European Union. A second issue is the establishment of a working system that ensures a minimum structural equity in the distribution of integration's benefits among all participants so that even the smaller partners may feel that the necessary punctual concessions are more than offset by the advantages of their successful common project. Once again, the European Union provides a cogent example, as its construction required the adoption of mechanisms capable of promoting the prosperity of less endowed regions, without prejudice to economic and trade integration. Such mechanisms permitted the integration of some of the world's most advanced economies with other economies that were relatively poor at the time of their accession, and greatly helped expand the Europe of Six (the signatories of the Treaty of Rome) to the twenty-seven that comprise the European Union today.

The situations mentioned in the preceding by way of example, which illustrate the two types of difficulties pointed out in respect of Mercosur, tend to multiply and to aggravate with the endeavor to extend the integration process to all of South America. This is already noticeable in countries that are only associates of or in the process of being admitted into Mercosur. Without going deeper into an analysis or into the merit of their respective positions, it is easy to see that the Venezuelan government's foreign policy approach and activism, for example, substantially differ from the stance of some other

countries of the region while approaching or influencing the stance of some others. But this should not make us forget that Venezuela is a key piece in any general scheme of South American integration. It is also equally valid to point out that during the negotiations for full membership, a country such as Bolivia, now a Mercosur associate, will have sound arguments for demanding provisions aimed at offsetting some of its economic disadvantages.

The problem is particularly complex because although it may fall into one of the general categories pointed out, each national situation has peculiarities that make extremely difficult a satisfactory solution according to the general formulas applicable to all Member States. It may be relatively simple to formulate general equity or compensation principles regarding situations of flagrant asymmetry but it is much more difficult to move on to operational formulas capable of offsetting actual or perceived equity flaws. Hence, the great difficulty in making operational such a comprehensive instrument as the Treaty of Asunción through full compliance with the commitments and good intentions embodied in it. This would be even more difficult in relation to a still hypothetical, similar instrument encompassing all of South America, if and when such an instrument could be adopted.

In brief, we have a valid regional policy goal, whose achievement could enhance the international presence of the countries involved and lead to the solution of common regional problems, and which is accepted by all potential participants, as no South American country is avowedly opposed to our subcontinent's integration. The great problem is that, understandably, different countries have different perceptions as to what integration should be in practice. Reconciling these differences so as to make possible the establishment of an integration system acceptable to all the countries of the region and which at the same time goes beyond a set of good intentions and commitments that remain on paper will probably be achieved only in a very long run. And to borrow Keynes dictum, in the long run, we are all dead...

What should we do? Abandon a worthy political project only because it cannot be fully achieved within the foreseeable future? Attempt to carry out the premature negotiation of a grand integration scheme in a quixotic effort likely to discredit a desirable objective? Or to move on to undertakings of a lesser scope and thus more realistic, capable of actually bringing South

American countries closer together and of directly or indirectly contributing to the achievement of the ultimate objective of regional integration?

In principle, any understanding that involves more than one South American country in the achievement of a common objective helps cultivate cooperation habits. This in turn can facilitate, if modestly and indirectly, a greater effort toward regional integration. Certain areas should be contemplated in any integration scheme, in which transnational actions of a limited scope will have a more direct effect on the final objective. Such actions might include arrangements aimed at facilitating trade between neighboring countries; binational or plurinational understandings on environmental protection; or undertakings related to regional infrastructure or even to national infrastructure in which entities of more than one country are involved. Regional infrastructure is of utmost relevance as it is essential for the physical integration of South American countries, without which the wished-for political and economic integration will be little more than a rhetorical expression. It is obvious that without proper highways, railways, and waterways as well as an adequate communications network, even the most carefully conceived integration treaty will be worth little more than the paper on which it is written. Diplomacy and civil engineering must thus walk hand in hand if we wish to make into a reality the major objective of South American integration.

Brazil finds itself in a particularly favorable situation to carry out such actions. As South America's largest, most developed economy, with a population of 180 million, it is a particularly attractive market for the neighboring countries. It may, with greater likelihood of success than most of the other countries, promote geographically limited arrangements that can, even without having the substantive coverage of an integration scheme, take into account possible asymmetries and foster its own sustained development as well as that of its partners.

At the same time, our country's vast territory that borders on all South American countries except two and the advanced stage of our civil engineering industry make it important for us to develop a regional transportation and communications network and enable us to render a significant contribution to its construction. It may be recalled that the only Latin American enterprises on a list of the world's fifty largest civil construction companies are Brazilian. This explains the strong presence of Brazilian enterprises such as Andrade

Gutierrez and other major companies in several South American countries, including Argentina, Ecuador, Peru, and Venezuela. In the last analysis, the participation of Brazilian private enterprises in the implementation of large-scale infrastructure projects of interest to our neighbors creates cooperation habits among countries and contributes to South America's physical integration, which is essential for achieving the unanimously endorsed objective of political and economic integration.

The importance attached by the subcontinent governments to the development of an adequate infrastructure is demonstrated by the launching and unanimous approval of the Initiative for the Integration of Regional Infrastructure in South America-Iirsa in Brasília in August 2000. Iirsa provides a forum for dialogue among the authorities responsible for transportation, communications, and energy infrastructure in the twelve South American countries. Its objective is the development of the region's infrastructure to facilitate the participating countries' physical integration and promote a model of equitable and sustainable territorial development. Iirsa's central body is the Executive Steering Committee-CDE, made up of senior representatives from national agencies deemed competent in this field by each government. The Technical Coordination Committee, subordinated to the CDE, consists of representatives from the governments and from the three international financial organizations directly involved in the initiative, namely, the Inter-American Development Bank-IADB, the Andean Development Corporation-CAF, and the Fund for the Development of the River Plate Basin-Fonplata. Iirsa has adopted a 2005-2010 Consensual Implementation Agenda consisting of a first set of thirty-one projects, mainly in the area of transportation, already approved by the participating governments.

It may be too early for assessing Iirsa's actual contribution to the development of physical integration in South America, as by nature infrastructure projects take a long time. But the work done so far – including both the plurinational coordination effort and the specific projects executed by major engineering companies such as Andrade Gutierrez – seems to reinforce this article's contention about the convenience of concentrating efforts on undertakings that though substantively and geographically limited can significantly contribute to any more comprehensive integration scheme. This does not mean abandoning the more ambitious idea of the South American



Interoceánica road (Iirsa)

countries' political and economic integration but simply drawing practical conclusions from facts that seem incontestable. Although desirable, the grand project for integrating all of South America involves, by its magnitude, much greater difficulties and its realization requires much more time. Meanwhile, competing or conflicting initiatives could emerge, making the completion of the grand subcontinental project even more problematic. In a way, this is what happened with the Initiative for the Americas launched by President Bush (father), which led to the much more specific proposal of a Free Trade Area of the Americas-FTAA. The least that can be said is that this process distracted the Latin American countries' attention from the idea of their own integration with the mirage of an unrestricted opening up of the immense United States market. In the case of South America, it did even more, seducing countries that were part or associates of an existing subregional system with the prospect of bilateral agreements with Washington, considered more attractive than integration with the much more modest markets of our subcontinent. A second conclusion is that we can contribute to the success of the final project

by making progress in less controversial areas with undertakings that, although also requiring time and effort, such as the aforementioned construction of a regional infrastructure network, must be carried out anyway before or after the political decision on subcontinental integration is formalized.

In brief, the idea is to keep alive the objective of South American integration but to do so realistically, attaching priority to those areas in which we have competitive advantage and which are more relevant to the ultimate objective, such as the building of a regional transportation and communications network, as well as to areas in which the scale and relative development of our economy place us in a natural, especially privileged position in South America.

Embraer – Empresa Brasileira de Aeronáutica S.A.

Embraer goes international

ntroduction

Airspace industry, of which Aeronautics is the most significant segment, has a wide range of highly demanding characteristics that make it special and differentiated.

Few industries in the world are faced with such an array of awesome challenges as aeronautics – from the simultaneous employment of multiple advanced technologies to highly qualified manpower to the requirements of a global industry by definition to the requisite flexibility to respond to abrupt scenario changes to the enormous amounts of capital required for its operations.

Based on the experience amassed in over three decades of activity in this competitive, aggressive, and sophisticated market, we at Embraer like to say that the aeronautics business rests on five major pillars, which in turn rest

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on a single foundation – our clients' satisfaction, the source of the results that will ensure our stakeholders' gains and the enterprise's continuity over time. These pillars are as follows:

- *Advanced technologies:* in view of the highly demanding operational requirements pertaining to safety, drastic environmental changes, and weight and volume restrictions, the aeronautics industry employs a wide range of point technologies and serves as a lab for their fine-tuning before they are passed on to other productive segments and activities. Complex, sophisticated technologies are involved not only in the product but also in the development and manufacturing methods and processes, in addition to the use of the best practices available in financial and human resources management.
- *Highly qualified manpower:* to ensure the efficient, productive, and consistent use of these advanced technologies, it is essential that qualified personnel be available at all levels of the industry's operations: computer-supported projects, relations with suppliers and clients around the world, manufacturing using sophisticated numerical control machines, and the devising of elaborate financial solutions with international institutions.
- *Flexibility:* abrupt scenario changes that affect the world economy and the geopolitical order, the most recent example of which were the terrorist attacks of September 11, 2001, have immediate impact on the air transport industry and thus on aircraft manufacturers. Flexibility in adapting to such changes with a minimum loss in terms of efficiency and costs is of crucial importance for ensuring survival and preservation.
- *Capital intensity:* owing to the massive investment required for developing new products and raising quality and productivity, coupled with long development and maturation cycles, capital intensity is another major feature of this business sector. For example: the development of the Embraer 170/190 aircraft line required an investment of US\$1 billion and the new A350 Airbus plane should require no less than US\$15 billion!



Legacy 600

- *Global industry:* low output and the high cost of production makes the aeronautic industry an exporting and global concern by nature, as regards both its client and supplier base and the financial institutions that back it. The same Embraer 170 aircraft that operates under the flag of Finnair, Finland's airline, in the severe Scandinavian winter must also stand the high humidity and temperature levels of southern United States, where it operates under United Express's flag. In both cases, Embraer must be permanently available to its clients, providing local technical support and immediate access to parts and components, thereby honoring its commitment to the success of their business and aiming always at their full satisfaction, which will in turn ensure additional orders in the future. At the same time, Embraer must experience the different environments in which it operates, so as to detect positive or negative tendencies and changes in the scenarios and to be able to provide a speedy response.

All these characteristics make the aeronautic industry into a fascinating as well as a high-risk business. Failure of a new product may make the enterprise that developed it unviable and force it out of the market. The disappearance of traditional enterprises, such as the Dutch Fokker's and the Swedish Saab's exit from the civil aeronautic market are two examples of this harsh reality.

Notwithstanding the major risks involved, developing an autochthonous, strong, and autonomous aeronautic industry has been part of the strategic agenda of many nations, which invest heavily in its development over the years, recurrently supporting it by various schemes – celebrating major Defense systems and products contracts, financing new aircraft development programs under favorable terms, and providing all sorts of tax incentives.

Embraer goes international

Aware that winning new markets, which are essential for its growth and consolidation will become effective only if backed by its physical presence in these markets, through industrial plants or units for rendering post-sale services and support to clients, Embraer has, since its privatization in 1994, gradually extended its operations internationally as a strategic objective.

Far from losing its Brazilian identity and distancing itself from its origins, Embraer will, through internationalization, ensure new business deals, the strengthening of its trademark, and the generation of higher-qualification jobs in Brazil, in proportionately higher numbers than in its subsidiaries and controlling enterprises abroad.

In 1997, as it regained strength after introducing in the market its ERJ 145 commuter jet, Embraer launched its internationalization strategy by adopting measures that included (1) expanding or opening sales and marketing offices and replacement parts distribution centers; (2) participating in joint ventures; and acquiring traditional, renowned enterprises specializing in aeronautic services.

United States and Europe: consolidated presence

Embraer has long been active in the United States and in Europe – since 1978 and 1983, respectively – through sales and marketing offices and client support units (parts and services).



Phenom 100 and Phenom 300

The two units have had and continue to have a vital role in the expansion of its operations in those two main commercial aviation markets in the world. Including Brazil, 950 commercial jets, in addition to 800 turboprop planes as well as military planes made by Embraer are now flying. The U.S. and the European markets account for 95 percent of its total exports.

Facilities at the U.S. unit, located in Fort Lauderdale, FLA have been expanded to keep up with Embraer's operation since it delivered the first ERJ 145 commuter jet in December 1996 in that market. In November 2006 it had 234 employees and a spare parts stock of over 50,000 items.

With the increase of its business and client base in Europe, Embraer decided to concentrate into one place, located in Villepinte, near the Paris Roissy-Charles de Gaulle airport, its sales and marketing and client support units, including a major spare parts warehouse, one of which was already located in Villepinte while the other was previously located at the Le Bourget airport. The new integrated facilities should enhance the operational efficiency of a body of 194 employees charged with managing assets totaling 172 million euros and providing services to 37 clients.

China and Pacific-Asia: strategic markets

Given the importance of its economy, which has steadily grown at high rates for the last two decades, as well the strategic significance of air transport as an integrating factor and a development engine on a continental-size territory, China has been selected by Embraer as a strategic goal, which requires specific, differentiated treatment in view of its cultural characteristics, far removed from the Western world.

Embraer's presence in China started in May 2000, with the opening of a sales and marketing office in Beijing, followed soon after by the opening of a spare parts distribution center in the same city.

In 2001 and 2002, it negotiated an agreement with Chinese authorities under which it would be allowed to install an industrial plant to make ERJ 145 family aircraft for the Chinese market.

Finally, in December 2002, an agreement was signed with Aviation Industry of China II (AVIC II), establishing the Harbin Embraer Aircraft Industry (HEAI), a joint venture controlled by Embraer, which holds 51 percent of voting shares.

In February 2004, Embraer announced its first sale in China through HEAI: six ERJ 145 jets sold to China Southern. Other significant sales followed: the same number of the same model sold to China Eastern Jiangsu in March 2005 and to China Eastern Wuhan in January 2006.

In August 2006, Embraer announced the sale of 50 WRJ 145 planes and 50 EMBRAER 190 jets to the HNA Group, China's fourth largest air company. This deal was the first sales contract of an E-Jet on mainland China, with a list price of US\$2.7 billion. ERJ 145 delivery will start in September 2007. The 50-seat jet will be made by HEAI in Harbin, in the Heilongjiang Province.

By end-2006, HEAI will have delivered 13 ERJ 145 planes, which, together with the five sold in 2000 to Szechuan before the establishment of the joint venture, will bring to 18 the total number of these jets currently operated by Chinese airlines.

As regards the Pacific Asian region, in December 2000 Embraer opened a sales and marketing office in Singapore, entrusted with implementing the enterprise's trade strategy for the region's markets, including the Indian subcontinent.



Embraer's Headquarters. São José dos Campos

The Indian aeronautic market is undergoing a deregulation process and shows bright growth prospects. In this context, Paramount, a recently established company, has announced the start of its operations, based on the operational leasing of two jets: Embraer 170 and Embraer 175.

Also in India, Embraer has signed a major contract with the government for the sale of five Legacy 500 jets, particularly adapted to meet the comfort and safety requirements of that country's authorities.

Expansion of Embraer's client services and support base

Embraer plans to continue expanding its client services sector not only to ensure that its clients will achieve excellent dispatchability rates for their aircraft fleet but also to provide them with other services, such as aircraft maintenance and repair, to their full satisfaction, which is essential for the achievement of our goals and the growth of our operations.

Thus, in addition to consolidating its client services in Brazil through the transfer of its Services Center to the Gavião Peixoto Unit, it has expanded its services operations in the United States, with the addition of the new facilities of the Embraer Aircraft Maintenance Services-EAMS, in Nashville, Tennessee, and in Europe, with the acquisition of OGMA-Indústria Aeronáutica de Portugal S.A., in Alverca, Portugal, announced in December 2004, at the completion of its privatization process.

Early in 2005, EAMS expanded its facilities at the Nashville International Airport to raise its services capacity, in view of the growing fleet of Embraer aircraft in the United States. This major decision led to the progressive hiring, as of 2005, of additional EAMS employees, bringing their total to 277 by November 2006.

Since its establishment in 1918, OGMA has devoted itself to aircraft maintenance and is today a major representative of the European aeronautic industry, providing maintenance and repair services for civil and military aircraft, engines and components, and modification and assembling of structural components, as well as engineering support.

Its main clients are the Portuguese, the French, and the U.S. Air Forces and the U.S. Navy, Nato's Maintenance and Supply Agency, and the Dutch and Norwegian Navies, among others. In the trade area, OGMA also provides services to airlines such as TAP, Portugalia, British Midland, and Luxair, and to enterprises, including Embraer and Rolls-Royce.

In addition to doing maintenance work, OGMA also manufactures structural components and composite materials for Boeing, Airbus, Lockheed Martin, Dassault, and Pilatus. By November 2006, its work force totaled 1,606 employees, which makes it Embraer's largest unit and subsidiary.

Preserving culture, values, and attitudes – an enduring challenge

The velocity of Embraer's expansion since 1996, when its ERJ 145 aircraft went into operation, has brought with it formidable challenges in respect of the preservation of culture, values, and attitudes, a concern that continues to guide the enterprise's actions.



EMBRAER 170/190 family

To illustrate the magnitude of such a challenge, suffice it to mention that in April 1997, Embraer had only 3,200 employees scattered through five operational units – three in Brazil and two abroad. Today, nine years later, it has 18,670 employees, scattered through thirteen operational units – five in Brazil and eight abroad. In just one of its units, located in France, 26 nationalities and 19 languages are represented in a work force of 194.

One of the managers' top priorities is to recognize the worker's ethnic and cultural diversity and their different working environments, including specific labor legislations, while developing their maximum potential by directing their energy toward the business's objective, in perfect consonance with the enterprise's ethical and moral values.

The main element for the achievement of this intent is the so-called Management Methodology through Action Plan. Each year Embraer prepares an Action Plan based on a five-year perspective and follows a strategic planning model that takes into consideration markets, competitors, the enterprise's capabilities, opportunities, and risks, priorities, and results, among other factors.

The Enterprise's Action Plan is based on the equivalent internal plans for each corporate, functional, and business area, reaching down all the way to the plant floor, all in accordance with the general guidelines issued by the enterprise's top management. The enterprise's variable pay policy, encompassing all employees, takes into account the targets agreed by the leaders and the led along the entire chain of command. The Action Plan is thus the key instrument for the management of the business, and for all the employees' alignment with and commitment to the agreed targets and results.

In addition to the Action Plan Methodology, Embraer maintains a strong Internal Communication culture aimed at integration with its employees and their families and at disseminating Embraer's central values and concepts.

Internal Communication works in a global, integrated manner, through the use of tools that are both modern and highly attractive to the employees:

- Embraer's Director and President has his own tool for communicating with employees, called *Em Tempo*, issued simultaneously in Portuguese and in English. More recently, *Em Tempo* has been issued in special editions on video;
- Embraer Intranet is a tool of corporate reach and our employees' main source of information, which is accessed an average of 24,500 times a day;
- Some 600 internal communiqués are issued annually and made available to employees through Intranet and bulletin boards; 25 percent of these communiqués are of corporate reach;
- The *Embraer Notícias* [Embraer News] is devoted to issues that are essential to Embraer's culture: the Management Methodology through the Action Plan, the importance of cost discernment and contention, combating waste, team rallying around Embraer's broad entrepreneurial objectives, etc.;
- Interviews with Embraer's top executives are translated and sent to the units located abroad. As they consistently address market evaluation and the enterprise's strategies and objectives, they are well heeded by employees;

- Articles published in the national and international media on themes of interest to Embraer's business are translated and made available to employees.

Armed with this vision and determination, grounded on ethical and moral values, and having integrity as the spring of its actions, Embraer embarks upon an extremely challenging and competitive entrepreneurial activity. And in so doing it brings to the markets the image of an efficient, agile Brazilian enterprise known for its quality products and technological state-of-the-art.

Translation: João Coelho

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