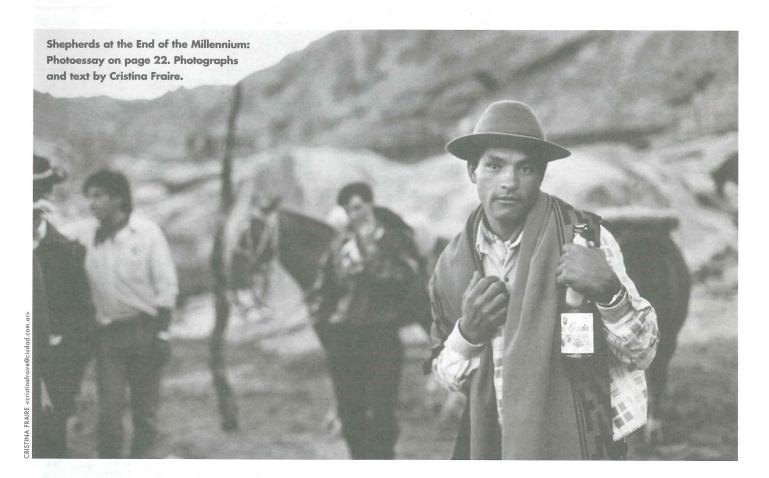
DAVID ROCKEFELLER CENTER FOR LATIN AMERICAN STUDIES

DRCLAS NEW SLETTER

HARVARD UNIVERSITY OF ALL 1999 NEW SLETTER



The Economy in Latin America

Its Strengths, Problems, and Future

BY RICARDO HAUSMANN

atin America can take a punch. Its endurance of a whole series of rather large shocks in the last two years is a tribute to the region's extensive structural reforms. The consequences a decade ago would likely have been much worse. However, this resilience also reflects Latin America's greater experience at enduring financial crises: as I like to say, we are two crises ahead of East Asia. This issue of *DRCLAS NEWS* focuses on the economy in Latin America: its reforms, its strengths, its problems and its future.

In this issue, economists and non-economists examine a wide range of subjects. Dani Rodrik opens this issue with an analysis of the impact of economic insecurity in Latin America. Jeff Frieden examines the general issue of currency reform (p. 13), while Juan Carlos Moreno Brid takes a close look at dollarization (p. 16) and Eli Cohen looks at the same issue in Argentina (p. 18). Florencio López de Silanes examines privatization in



People who wish to subscribe to the calendar, DRCLAS DATES, or the newsletter, DRCLAS NEWS, can use the insert card, pick up a form at 61 Kirkland Street, obtain an electronic form on our website. <http://www. fas.harvard. edu/~drclas/> or e-mail <drclas@ fas.harvard.edu> Mexico (p. 20). Betty Ann Donnelly explores the role of the church in encouraging debt relief (p.11), while John Gallup and Jeffrey Sachs write about the intriguing relationship between geography and economy (p. 7). Felipe Larraín recounts the history of the Harvard Institute for International Development's Central American Project (p. 30).

We at the Inter American Development Bank (IDB) have looked at many of the issues raised in these articles, some of which focus on the stages of development in each country, including demographic transitions, urbanization, the development of new markets, and the accumulation of physical and human capital, and found they are key determinants in the individual progress of each country.

Many of these articles not only focus on the situations in individual countries, but on the relationship of each country to the global economic situation. It is that area that has the most question marks, as I would like to explain here to provide a bit of context for this provocative issue of DRCLAS NEWS. Our countries have done much to correct what for a long time was wrong with domestic policy, and the recent shocks that Latin America has suffered do indeed appear temporary. If now we can fix what is wrong with arrangements between national economies, the world can be made a safer and more prosperous place for everybody.

Conventional wisdom about capital markets and capital flows has changed in an important way: capital flows and asset prices are too volatile and too closely correlated across countries to be the consequence of righteous, selective indignation toward policy missteps in this or that country.

Withdrawal of capital flows from Latin America is not primarily against something that is wrong with Latin America. Sifting yet again through the data on Latin America will therefore not yield the answer, because the phenomenon is not, or not only, a Latin American phenomenon. Look at trends in bond prices in Bulgaria and Brazil, for example, or in Mexico and Morocco, and you might conclude that the correlation of capital flows to different countries is based as much on the alphabet as it is to geography or policy.

The theories that explore how to fix global capital markets fall into two groups: what I call theories of too much, and theories of too little.

Theories of too much assert that various distortions cause private returns to exceed social returns, leading to flows of capital larger than they should be. However, to me the mystery is not why there is so much capital flowing around the world, but why there is so little. One of the puzzles of international finance is that most domestic investment is financed domestically. What, then, is wrong with this so-called globalizing world that is keeping capital flows so small?

The fear that sovereign nations can disavow contracts with impunity is one risk factor. The specter of liquidity crisis, another major factor, signifies that international capital flows will be small and very unstable with investors

always looking over their shoulders for the first signs of a bank run. Such crises are avoidable if there is a lender of last resort such as the International Monetary Fund (IMF).

The combination of global capital flows and weak national currencies appears to be a dangerous mix. Latin American currencies are considered weak because Latin Americans prefer to hold their assets in other currencies, long-term markets in these currencies are thin to nonexistent, and when we borrow abroad we do so in foreign currency. This naturally generates financial fragility, because Latin American countries are also net importers of capital.

Floating regimes paradoxically tend to generate procyclical rather than countercyclical results, according to recent IDB studies. Countries with floating currencies tend to import Federal Reserve decisions, for example, through movements in interest rates. Indeed these influences are even greater than those observed in countries with fixed exchange rates. So there is actually less monetary autonomy rather than more.

We thus find ourselves in an intolerable situation: fixed exchange rates do not work because they do not stay fixed, yet floating exchange rates do not work either. Not only do they fail to deliver the benefits that theory advertises, but they produce shrunken financial systems and a high real cost of capital as well. Both types of regime seem prone to financial vulnerability—the former by producing crises when a fixed rate becomes unfixed, the latter through the resulting feebleness of the financial system.

It is against this background that DRCLAS NEWS takes a wide-ranging and multidisciplinary look at the Latin American economy, which can only be understood in terms of both its particular history and its relationship to a globalized world.

Ricardo Hausmann, a Venezuelan citizen, is Chief Economist of the Inter-American Development Bank.

DAVID ROCKEFELLER CENTER FOR LATIN AMERICAN STUDIES

Director John H. Coatsworth

Executive Director Steve Reifenberg

Publications Director June Carolyn Erlick

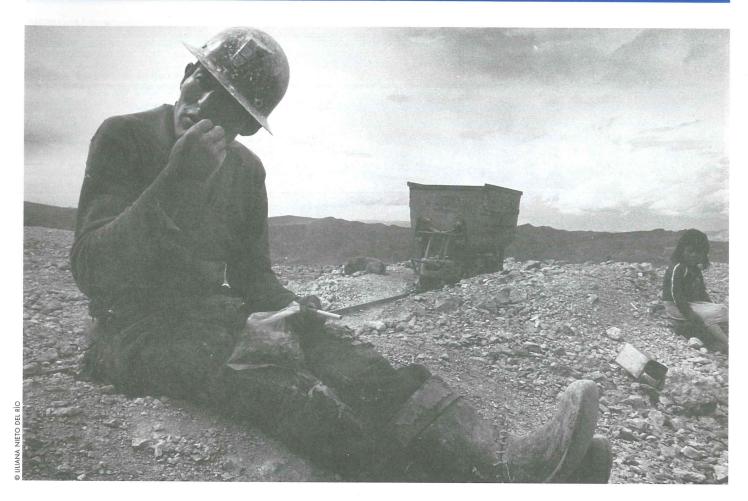
Conference Coordinator Neida M. Jiménez

Design kelly design

61 Kirkland Street Cambridge, MA 02138 Tel: (617) 495-3366 Fax: (617) 496-2802

E-mail: <drclas@fas.harvard.edu> <http://www.fas.harvard.edu/~drclas/>

This newsletter is made possible by the support of the Peggy Rockefeller Memorial Fund Copyright © 1999 by the President and Fellows of Harvard College.



Economic Insecurity in Latin America

Cutting Across Class Lines

BY DANI RODRIK

23-YEAR OLD BRAZILIAN WOMAN was among 10,000 job applicants seeking a desk job at Banco do Brazil. When asked why she was seeking employment that actually paid less than her present salary, she was quoted as replying, "I need stability in my life." The New York Times (August 26, 1999, C4) recently highlighted this poignant example of economic insecurity in Brazil. One out of every 160 Brazilians were competing in August 1999 for jobs at this bank, a government-run institution that "pays salaries on time and in full" and provides comprehensive health insurance and pension benefits, according to the Times article.

During the 1990s Latin America's per-capita income grew at an average

rate of two percent per year, after having fallen at a rate of one percent during the 1980s. Despite the recovery, however, the region remains gripped with a disconcerting level of economic insecurity. The view that pervasive economic insecurity threatens political support for the ongoing market-oriented reforms is a common refrain in current discussions on Latin American affairs.

A large, cross-national survey of 14 Latin American countries recently found that 61 percent of respondents believed their parents had lived "better" than they do while less than half (46 percent) believed their children would live better than themselves. Almost three-quarters of the respondents favored increased spend-

ing on unemployment insurance, and more than 80 percent expressed a desire for more spending on pensions. Moreover, the responses were fairly uniform regardless of income levels, educational background or type of employment. Surveys of this type suggest a pervasive sense of economic insecurity in Latin America and a corresponding demand for social insurance, both of which appear to cut across class lines. In fact, in some of the largest countries of Latin America-Argentina, Brazil, Mexico, and Venezuela in particular—the middleincome groups are more pessimistic about their children's future than the lowest-income groups.

How do policy makers make progress on this issue? A first step is

Working in Bolivia: Miners of Cerro Rico, Potosí. Portraits of Latin American workers, the backbone of the economy, will be featured throughout this issue.



ABOVE: Working in Bolivia: the Cerro Rico Potosí mine

> BELOW: Working in Guatemala: In the Market

understanding the root causes of economic insecurity. In this article, I discuss some of the contributing factors.

THE TRAUMA OF THE 1980S

The debt crisis of 1982 engulfed Latin America in a deep and prolonged recession, reminiscent in some ways of the Great Depression in the United States during the 1930s. During the Great Depression, incomes declined on average by 35 percent between 1929 and 1933, and unemployment peaked at 25 percent (in 1933). The decline in real incomes (and rise in unemployment) was not as steep in Latin America after 1981. However, with the notable exception of Chile, the recovery in Latin America was more gradual. Moreover, the United States economy, boosted in part by World War II, experienced a much faster rate of expansion in the 1940s than it had during the 1920s. Latin America's growth rate during the 1990s has failed to match the record of the 1960s and 1970s.

The United States responded to the Great Depression with a series of major institutional innovations that greatly expanded the role of the government in the economy and for the most part represented a sharp break with the past. Many of these innovations took the form of social insurance: social security, unemployment compensation, public works, public ownership, deposit insurance, and legislation favoring unions were among the new mechanisms created to deal with the perceived shortcomings of the private marketplace.

In Latin America, the upshot of the debt crisis was a series of reforms that actually served to weaken insti-

tutions of social insurance. Employment generally became less secure, and publicly provided safety nets were weakened. One reason is that Latin America entered the 1980s from a very different vantage point than the United States had entered the 1930s. Most of the countries of the region had industrialized behind government-imposed trade restrictions, public enterprises had become commonplace, and fiscal deficits and macroeconomic mismanagement were the proximate causes of the debt crisis. Govern-

ments were seen as part of the problem rather than as the solution.

STRUCTURAL REFORMS AND THE DECLINE OF JOB PROTECTION

Moreover, the reforms that Latin America adopted in the 1980s-privatization, deregulation, trade liberalization, and financial liberalizationhad the predictable effect of increasing risk for workers and households. While there has not been much change in formal legislation on employment protection, the available evidence suggests that the proportion of workers with "secure" jobs has declined in practically all countries of the region for which relevant data exist.

One indication of this is the sharp reduction in trade union strength since the 1980s, in all countries except for Chile. This is significant since bargaining for greater job security on behalf of their members is a key function of trade unions. Another indicator of job insecurity is the proportion of workers that are not "protected" by formal written contracts or inclusion in social benefit programs. By this measure, all Latin American countries with available data have experienced a decline in job



protection (see accompanying table). The fact that the informal economy -according to the International Labor Organization-accounts for 80 percent of new jobs created in Latin America over the last two decades is telling in its own right.

Has the evident decline in job protection been compensated by lower rates of unemployment overall? The answer is no. While unemployment fell during the late 1980s, it has subsequently risen since the mid-1990s. It is striking that at least eight of the countries in the region (Argentina, Brazil, Ecuador, Mexico, Nicaragua, Peru, Paraguay, and Venezuela) had higher unemployment rates in 1994-98 than they did during 1981-88.

ERRATIC CAPITAL FLOWS

While the fear of a drastic reduction in income associated with job loss and unemployment is an important part of economic insecurity, another is volatility in the household income stream. As Latin America entered the 1990s it found itself in a world of high macroeconomic volatility. On the average, volatility in Latin Americameasured by the standard deviation of Gross National Product (GNP) growth rates—tends to be double the level of industrial economies.

This volatility is increasingly driven by erratic private capital flows. In fact, for the 1990s the evidence suggests that the instability in private capital flows has been the most important single determinant of macroeconomic volatility. Some of the smaller countries of the region with comparatively little access to private capital flows (Bolivia and Guatemala) have experienced the lowest levels of macroeconomic volatility. Argentina and Venezuela are at the other extreme, with very high levels of exposure to volatility in private capital flows and correspondingly high levels of macro volatility. Countries like Brazil, Chile, and Colombia, which have managed private capital flows, are somewhere in between.

The spread of international financial markets and the region's enthusiastic embrace of them have left

macroeconomic policy hostage to short-term investors. Key instruments such as fiscal policy and the exchange rate have been increasingly determined by capital flows and can no longer be targeted on domestic stability. The result is a divorce between macroeconomic policy and the real economy.

THE IMPORTANCE OF INSTITUTIONS OF VOICE

A key shortcoming of Latin American social and political institutions is that they have not been adequately responsive thus far to the clamor for greater economic security. As mentioned above, states have retrenched rather than take on the added responsibilities that managing risk in market-oriented societies requires. But the problem goes beyond governments. Political systems as a whole have failed to create viable mechanisms of voice: national legislatures have been fragmented and unrepresentative, and political parties weak. Trade unions

Jennifer Schirmer's The Guatemalan **Military Project: A Violence Called Democracy** (University of Pennsylvania Press, 1998, Spanish edition, FLACSO-Guatemala, 1999) will receive the 1999 PIOOM **Human Rights** Award. Schirmer, a Harvard Lecturer on Social Studies and Anthropology and Associate at the Weatherhead Center for Inter-

national Affairs,

will be honored at

the University of

Amsterdam on

Human Rights Day,

December 10. The

Netherlands-based

interdisciplinary

human rights and

security research

Program on Root

Causes of Human

Rights Violations

(PIOOM) works

to analyze root

causes of human

rights violations.

with UN agencies

The Decline of Employment Security "UNPROTECTED" TRADE UNION TRADE UNION DENSITY **EMPLOYEES** (% OF EMPLOY-MEMBERSHIP (% OF NON-AGR COUNTRY (THOUSANDS) LABOR FORCE) EES) 1990 21.7 **Argentina** 1986 3262 1986 48.7 1995 3200 1995 25.4 1996 34 **Bolivia** 1994 276 1994 16.4 1991 28 34.8 1997 Brazil 1991 15205 1991 32.1 1985 63.6 68.5 1996 1990 Chile 1985 361 1985 11.6 17 1993 684 1993 15.9 1996 22.3 Colombia 1985 877 1985 11.2 840 1995 1995 7.0 1985 7.9 1994 59.1 El Salvador 1985 79 1995 103 1995 7.2 1997 61.3 Mexico 1990 43.4 1989 9500 1989 54.1 7000 31.0 49.6 1991 1991 1997 Peru 1991 1990 25.5 1991 442 7.5 1996 34.1 Uruguay 1990 222 1990 19.9 1993 151 1993 11.6 Venezuela 1988 1700 1988 25.9 1995 1153 1995 14.9

Source: See Rodrik, "Why Is There So Much Economic Insecurity in Latin America?" for

Note: "Unprotected" employment refers to the proportion of employees without written contract or social benefits, depending on the country. Employees covered refer to private sector or urban employment.

have been unable to develop an adequate and encompassing strategy for dealing with job insecurity and have lost members. And the monopolization of policy discussions around a narrow, Washington-consensus view of development policy, sharply constrained by the "requirements" of global economic integration, has prevented the emergence of an alternative (or at least complementary) vision of economic reform driven by local concerns and national aspirations.

The demise of military rule and the transition to democracy have been the most encouraging developments to take place in Latin America during the last two decades. Econometric work and a range of case studies suggest that the degree to which a political system is open to participation from below does affect the quality of macroeconomic management for the better. Participation helps in a number of different ways. First, democracy allows a smooth transfer of power from failed policies and politicians to a new group of government leaders. Second, participation enables mechanisms of consultation and bargaining, allowing policy makers to fashion the consensus needed to undertake the necessary policy adjustments decisively. Third, institutionalized mechanisms of "voice" obviate the need for riots, protests, and other kinds of disruptive actions by affected groups, as well as lowering the support for such behavior by other groups in society.

Working in Azuay,

Ecuador: Rosa

harvesting corn

Yet social and political institutions in Latin America retain a number of important weaknesses despite the transition to democracy. Trade unions, an important institution of collective voice, have lost membership in most countries. The old style of trade union activity, consisting of lobbying for legally mandated job protections and wage advantages, is arguably not well suited to the requirements of economies with competitive markets and smaller production units. Neither trade union leaders nor policy makers have yet been able to fashion an environment in which unions are seen as responsive to the needs of workers.



The broader political system in Latin America is faced with what Jorge Domínguez has called a "crisis of representation." Government officials in Latin America are perceived as corrupt, political parties as a collection of factions, legislatures as ineffective, and presidents as either saviors or rascals to be impeached. While military coups have all but disappeared, new forms of threat to constitutionalism have emerged, as Domínguez emphasizes, in the form of rule by presidential decree, mutinies led by disgruntled middleranking military officers, or presidential "coups" against the legislature.

LOOKING FORWARD

Economic insecurity in Latin America is multifaceted and has many sources that feed on each other. Some of the insecurity arises from the decline in employment protection and increased volatility of household outcomes. Some of it is the result of erratic capital flows and the systemic instability generated by a divorce between the instruments of stabilization and the real economy. Finally, an important component is the weakness of the institutions of voice and representation.

An important implication is that programs aimed at social protection per se will not make much of a dent in the situation. Well-functioning safety nets—unemployment compensation, old-age and medical benefits, targeted social funds—may help cope with some of the idiosyncratic risks that households face. But they will have to be complemented by macroeconomic policies (with regard to capital flows and the exchange rate in particular) that are more conducive to the stability of the real economy. They will also require access to representative institutions—trade unions, political parties, and legislatures—with greater responsiveness and legitimacy than those that exist presently.

But perhaps what Latin America needs most is a vision of how social cohesion can be maintained in the face of large inequalities and volatile outcomes, both of which are being aggravated by the growing reliance on market forces. In today's advanced industrial countries, the expansion of markets' role historically has gone hand in hand with the strengthening of the institutions of social insurance. Since the New Deal in the United States, and even more so since World War II in Europe, that has meant the growth of the public sector and the erection of a welfare state. If Latin America is to carve a different path for itself, the region will have to develop an alternative vision that articulates how the tension between market forces and the yearning for economic security can be eased.

The good news is that this question is at least being addressed. The bad news is that no-one, least of all economists, have a very useful answer to offer so far.

Dani Rodrik is Professor of International Political Economy at the John F. Kennedy School of Government, Harvard University. This article is based on a larger study prepared by the author for the World Bank. For fuller documentation and references, please see "Why Is There So Much Economic Insecurity in Latin America?" which can be downloaded from http://www.ksg.harvard.edu/rodrik/papers.html. The author is grateful to Mary Gardner Abbott for help in shortening the paper.

Health and Wealth

How Geography Influences Socioeconomic Development

BY JOHN GALLUP AND JEFFREY SACHS

HE DIFFICULTIES OF OPERATING IN A TROPICAL environment were already abundantly clear during the building of the Panama Canal more than a hundred years ago. "The effect of the climate on tools, clothing, everyday personal items, was devastating," described historian David McCullough. "Anything made of iron or steel turned bright orange with rust. Books, shoes, belts, knapsacks, instrument cases, machete scabbards, grew mold overnight. Glued furniture fell apart. Clothes seldom ever dried."

The decisive challenge, though, was malaria and yellow fever. Although the French made major investments in medical care, in the 1880s they did not understand the means of transmission of these two major mosquito-borne diseases. Besides the fearsome mortality of workers and the recurrent debilitation of those who survived, many of the most dynamic project leaders and engineers perished from tropical disease. On top of unrealistic technical goals and organizational difficulties, the loss from disease was more than the project could sustain. At least twenty thousand lives were lost to disease during the nine years of the French effort.

Geography has always had strong and pervasive effects on economic and social development in Latin America, as elsewhere. The tropical Caribbean and the temperate Southern Cone differ greatly by almost any measure of development. Within Brazil, there is a gulf between the dry, poor Northeast, the rich, temperate Southeast, and the still sparsely populated wet tropical Amazon region. In all of the neighboring countries with an Amazonian frontier, the jungle regions are a world apart. In Nicaragua, the malarial east coast is isolated from the more productive west coast. For Bolivia, being landlocked is a fundamental aspect of economic life, and the highlands, the valley region, and the tropical lowlands have each developed separate urban centers with limited connections between them. Similar patterns hold for the distinct geographical zones of Colombia, Ecuador, and Peru.

Although more middle income countries exist in the tropics of Latin America than the rest of the tropics around the world, the geographical gradients within Latin America are nevertheless clear and dramatic. The 1995 purchasing-power parity GDP per capita levels in the region follow roughly a U-shape in latitude, with much higher levels in the temperate south, and a minimum level just below the equator in the 20∞ South to 0∞ latitude band. The geographical tropics is defined as the region from 23.45∞ South to 23.45∞ North where the sun is direct-



Argentina: snow landscape ly overhead at some point during the year. The tropics have much lower income levels than temperate South America or temperate Mexico. The average GDP per capita of \$4580 U.S. dollars in the 20∞ South to 0∞ latitude band is just under half the level at the temperate high points. The variation in income by latitude within Latin America is more striking given that the countries in the region share many common aspects of colonial and cultural history.

Physical geography mainly impacts economic and social development through three pathways: accessibility, agricultural productivity, and disease.

Two simple facts suggest the magnitude of the economic impacts of geography. Tropical countries have an average income per capita of just one-third that of non-tropical countries. Likewise, landlocked countries have an average income per capita of only one-third the income of countries with access to the sea.

The economic disadvantage of the tropics can be largely attributed to lower agricultural productivity and a higher burden of disease. Natural disasters, especially hurricanes, probably also play a role, but one that is difficult to quantify for lack of good data.

Agricultural yields depend sensitively on climate and soil resources. Climate and soil conditions are characteristically different in temperate and tropical ecological zones. Furthermore the tremendous differences in the natural plant and animal communities of the tropics and the temperate zones suggest that the productivity of the narrow range of plants used for agricultural staples would also be systematically different between the two regions. Although it is possible, in principle, for food staples to be adapted to be equally productive in temperate and tropical zones, in practice this has not happened. Even after accounting for differences in input use in agriculture, tropical yields of the main agricultural crops are starkly lower than temperate yields.

Here we choose to focus on disease as one of the primary side-effects of geography. The range and intensity of many diseases, particularly vector-borne ones, vary according to climate. Malaria, hookworm, and schistosomiasis, have been relatively easy to control in temperate zones, but still defy major control efforts in the tropics.

The relationship between geography and development in the region extends beyond purely economic indicators. Latin American infant mortality rates peak in the tropics and decline more or less continually to either side of the peak. The highest rates in the 10° to 20° South are more than double the rate in the southern temperate zone, and 50% higher than the rates in the northern temperate zone. The tropics are a more challenging disease environment, regardless of income levels.

When Europeans brought Africans to the New World as slaves, they also imported a panoply of African diseases new to the Americas. Malaria, yellow fever, hookworm, schistosomiasis, and other diseases further devas-

tated the indigenous population and have had a persisting impact on the burden of disease since then. Most of these diseases remain major public health and economic problems in the American tropics to the present day.

The tropics have had much poorer economic performance than the rest of the world because of the impacts of climate on agricultural productivity and disease. The tropics are, essentially, a band of poverty. Among tropical health problems, malaria in particular is strongly correlated with poor economic performance. The relationship of malaria to poor economic performance is distinguishable from the tropics, per se, because the intensity of malaria varies considerably within the tropics. Malaria is one of the least likely health problems in the tropics to be ameliorated by economic growth through better living conditions and household behavior.

Yellow fever is no longer a major public health problem due to a successful worldwide control effort by the 1930s and the development of an effective vaccine. The situation for malaria is completely different. The worldwide eradication effort begun in the 1920s and intensified in the 1950s and 1960s largely failed in the tropics. Vaccines are still many years from development, due to little funding and the extraordinary complexity of the pathogen and its life cycle. Currently, all the inexpensive drugs for treatment of and protection from malaria are losing their effectiveness in the face of resistance strains. Latin America has made great strides since 1965 in terms of pursuing policies conducive to international trade and making government institutions more efficient and responsive to citizens, which our analysis suggests is crucial. Geography appears also to play and important role in Latin America's performance compared to the wealthiest countries. Improving health, including malaria, and overcoming other tropical and accessibility problems could help Latin America to catch up economically with the more developed countries in the world.

Life is short in the tropics. Inhabitants of the temperate northern and southern ends of Latin America can expect to live about 75 years, but the trend line sags markedly in the tropical middle, dropping down to 65 years just south of the equator. The very low average lifespans, below 60 years, are all in the tropics, seeming to drip from the sagging trend line. The below-60 life expectancies are in provinces of Bolivia and Peru, and in Haiti. The two provinces close to the equator with life expectancies above 75 years are also in Peru: the capital Lima and its sister *departamento* of Callao, a clear sign of the regional disparities within the country.

Poor health and poverty are closely linked. Bolivia and Haiti, with the low life expectancies, are poor countries. Peru is not as poor, on average. We have already seen that income per capita is lower in the tropics than the temperate zones of Latin America. Perhaps poor health in the tropics is simply due to poverty, not direct geographical influences. If we are concerned with life expectancy as a measure of human welfare, it doesn't matter much whether

The relationship
between
geography and
development in the
region extends
beyond purely
economic
indicators.



Working under the sun: Nicaragua

climate affects it directly, or indirectly through economic development: welfare is lower in the tropics. If we want to change health conditions, though, it matters a great deal whether it is necessary to curtail the transmission of disease directly, or it is perhaps more effective to invest resources in economic growth which will solve the health problems indirectly.

To assess the direct influence of climate on disease, we control for the influence of income levels. Provincial life expectancy in Latin America is still strongly correlated with climate after taking into account income levels. Provincial GDP per capita levels are independently correlated with life expectancy, but their inclusion does not change substantially the association of climate with health.

One of the most robust correlates of health status is the education of mothers. When the influence of female literacy on health is included along with income levels, it is large and significant, and income loses its independent association with life expectancy. Climate, however, is still strongly correlated with health outcomes. Controlling for female literacy and GDP per capita, life expectancy is four years lower in the wet tropics as in the moist temperate zone. The regression results predict that life expectancy is seven years lower in the wet tropics than in desert and dry regions with the same income and female literacy. Similar results pertain to infant mortality, which is a component of life expectancy. Infant mortality is four percent higher in the wet tropics than in humid temperate regions, and six percent higher than dry regions, other factors being equal.

Our analysis suggests that rising income levels per se

will not take care of health in the tropics; direct action is required. For some tropical diseases there are few affordable and effective treatment and control strategies; for others the means of conquering the disease are well known, but major efforts of education and mobilization required. The prime example of the former is malaria. Vector control in the worst affected areas is at best a holding action, and the effective drugs are rapidly losing their effectiveness due to drug resistance Tropical diseases do not get the benefits of spillovers from biomedical and pharmaceutical research in the developed countries, because there are no significant tropical developed countries. The tropical countries are too poor to offer an attractive standalone market to induce pharmaceutical firms to invest in drug development for tropical diseases.

POLICY AND CONCLUSIONS

Geography may be largely immutable, but its impact on the economy and society are not. The right policies or technological developments can overcome many geographical obstacles. Tackling geographical problems has important "public good" aspects. Investments to overcome these obstacles, such as disease control or roads, typically benefit whole regions rather than particular individuals. To make these investments at the socially desirable level, they need coordination by the government or other organizations. The individual will not capture the benefits that he or she provides to the wider society, and so is likely to invest less than is desirable. Individuals would not likely take upon themselves the task of controlling a dispersed disease vector, for example, but everyone ben-

efits when each person contributes a small amount to the eradication of the disease. Sharing the burden requires coordination.

The evaluation of the social return on infrastructure investment in geographically-challenged regions is complex. There are many white elephants among the projects pursued in the name of regional equity, with many examples during the decades of public investment in Southern Italy. Just because there are public good spillovers does not mean that investing in difficult regions will be more socially beneficial. The economic rate of return to infrastructure is likely to be lower in areas with difficult geography. It may be more successful to help isolated regions by investing more productively elsewhere creating economic spillovers to the isolated regions. Certain basic infrastructure, nevertheless, can have large impacts on poverty, such as the building of inexpensive, basic, roads with labor-intensive methods.

The geographical

deficits of the

tropics in agri-

culture and health

suggest that basic

research is a high

and applied

priority.

The geographical deficits of the tropics in agriculture and health suggest that basic and applied research is a high priority. Unlike most other parts of the economy and society, the technological advances in the wealthiest countries in the areas of agriculture and disease will not spill over as readily to poor countries in the tropics precisely because the agricultural and disease processes are distinct there.. Developing country consumers cannot pay premium prices for new drugs and vaccines, so they do not provide a profitable market. At the same time the tropics is left out of the revolution in corporate scientific research, public fund-

ing for research on tropical agriculture and disease has been, if anything, declining. The research and development budget of the entire CGIAR system of institutes studying developing world agricultural problems is less than half of the R & D budget of one life-sciences multinational, Monsanto.

With a new era of rapid advances in biology, applied research on the obstacles to tropical agriculture and disease appears promising. Agricultural research, most of it public, has always had very high rates of return. The nearterm welfare of more than half the households in most tropical countries (69% of the labor force of low-income economies on average in 1990), and an even higher proportion of the poor, still depends on agriculture.

Tropical medicine research funding is also severely limited due to the lack of market incentives for pharmaceutical firms. Malaria, with an estimated 2.4 billion people at risk, and 1.5 to 2.5 million deaths per year, receives a total worldwide research funding of about \$84 million in 1993 (Welcome Trust, 1999).

John Luke Gallup is a Research Fellow at the Center for International Development, Harvard University and Institute Associate at Harvard Institute for International Development.

Jeffrey D. Sachs is the director of the Center for International Development at Harvard and serves as an economic advisor to many developing nations.

American Geographical Zones POPULATION GEOGRAPHICAL **POPULATION** WITHIN 100 KM GDP DENSITY ZONE GDP PER **DENSITY (PER-**(\$1000/SQ KM) SQ KM OF COAST (%) SONS/SQ KM) 1.9 **Tropical Highlands** 4343 226 95 302 0.8 4950 Lowland Pacific Coast 240 2.2 5216 Lowland **Atlantic Coast** 31 5246 Amazon 35 264 7552 **Temperate** Southern Cone 30 Mexican-U.S Border 7861 134 1.1 16 Highland and **Dry Southern Cone** Source: Authors' calculations

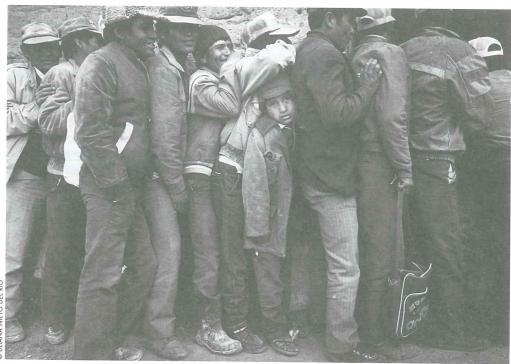
Proclaiming the Jubilee

Global Coalition Demands Further Debt Relief for Poorest Countries

BY ELIZABETH A. DONNELLY

ARMEN RODRÍGUEZ HEADS THE Charismatic Movement in a sprawling shantytown parish south of Lima, Peru. She and other lay leaders of the Lurín Diocese have been preparing for the upcoming millennium in an unusual way. Earlier this year, after having participated in Lenten workshops offering economic and theological perspectives on debt relief, they went door-to-door and gathered some 90,000 signatures on an internationally circulated petition calling for a one-time cancellation of the unpayable debt of highly indebted poor countries by the end of the year 2000. Countrywide, more than 1,850,000 Peruvians signed the petition in just three months' time. Worldwide, 17 million people from over 160 countries signed the petition, which was presented to G-7 leaders in Cologne, Germany in June. The delegation presenting the petition signatures to German Chancellor Gerhard Schroeder, who accepted then in the name of the G-7 leaders, included such disparate figures as Archbishop Oscar Rodriguez Maradiaga of Tegucigalpa, Honduras and Bono of the Irish rock group U-2.

An extraordinary global coalition of churches, anti-poverty groups, and other civil society organizations, called the Jubilee 2000 campaign, organized the petition drive. Invoking a biblical norm from the Book of Leviticus, the campaign is urging the international community to mark the millennium by recognizing a period of "jubilee" in which debts are forgiven and the freed up resources are used to alleviate poverty. Campaign organizers, led by such groups as Christian Aid (UK), OXFAM, EURODAD (the European Network on Debt and Development), and Catholic national episcopal conferences, relief agencies, and the Vatican, argue that heavily indebted countries devote an inordinate portion of



their national budgets to making interest payments on the debt, leaving too little available for desperately needed outlays for health, education, housing and job creation. They also charge that structural adjustment programs (SAPs), mandated by the International Monetary Fund in conjunction with debt rescheduling and relief, have placed a disproportionate burden on the poor. Jeffrey Sachs, director of the Center for International Development at Harvard, serves as an advisor to the group and has met with the Pope on the issue.

The Latin American debt crisis had previously centered attention on large, middle income countries whose possible default on loans threatened the stability of the international financial system. Limited debt reduction and rapidly expanding private sector investment in "emerging market" countries in the late 1980s largely defused the crisis in the eyes of creditor country policymakers and the international media. However, a

movement grew to press for debt relief for the poorest, most heavily indebted countries, which tend to owe the vast majority of their external debt to bilateral and multilateral creditors rather than commercial lenders.

In September 1996, the leadership of the IMF and World Bank launched the Heavily Indebted Poor Country (HIPC) Initiative as the first comprehensive plan to reduce the bilateral and multilateral debt of qualifying countries to sustainable levels. While the overwhelming majority of the 41 countries that currently qualify for HIPC debt relief are in Sub-Saharan Africa, they also include Bolivia, Guyana, Honduras and Nicaragua.

THE COLOGNE DEBT INITIATIVE

The G-7 leaders meeting in Cologne responded to widespread criticism that HIPC debt relief must be deeper, broader and faster. To date, only four of the HIPC countries (including Bolivia and Guyana) have advanced to a point in the review process at

Working in Bolivia

which they have actually received debt relief. At Cologne, the G-7 leaders agreed in principle to cancel an additional \$45 billion of the bilateral and multilateral debt owed by the 41 qualifying countries. This is to be added to the \$55 billion already proposed through the Paris Club of bilateral creditors (\$30 billion) and the HIPC Initiative (\$25 billion).

The Cologne Initiative would also lower the level of debt which is considered "sustainable" under HIPC (principally measured by two ratios:



Working in Azuay, Ecuador

a net present value of debt of 150 percent of annual export earnings, down from 200-250 percent under HIPC, and, for countries highly dependent on export income, a net present value of debt of 250 percent of annual government revenue, down from 280 percent). Countries with debt above this level are also to begin to receive debt relief after demonstrating compliance with IMF-mandated structural adjustment for three years, down from six years under HIPC. The G-7 leaders also directed the IMF and the World Bank to assist qualifying countries in the drafting and implementation of poverty reduction plans "for the effective targeting of savings derived from debt relief, together with increased transparency of budgetary procedures to protect social expenditure." The leaders also recommend, but do not require that the IMF and World Bank consult civil society groups in the design and implementation of such programs.

While Jubilee 2000 leaders especially welcomed the explicit link

between debt relief and poverty reduction, the call for civil society participation, and greater transparency of budgetary procedures to protect social expenditures, they nonetheless objected to several features of the plan.

The amount of relief is still insufficient. Critics suggest that the debtto-export earnings ratio of 150 percent and debt-to-government revenue ratio of 250 percent are still much too high to be considered "sustainable." Critics such as Sachs have charged that the IMF and the World Bank could afford far more extensive relief. The G-7 leaders did call for the IMF to sell up to 10 million ounces of its gold reserves to finance both HIPC debt relief and IMF concessional loans available through its Enhanced Structural Adjustment Facility (ESAF). They also called for governments and the private sector to contribute to a special Millennium Fund and the existing HIPC Trust Fund to finance reductions in debt service payments. Some creditor country legislatures are reluctant to fund more relief. For example, H.R. 1095, "The Debt Relief for Poverty Reduction Act of 1999," is a bill endorsed by some Jubilee 2000 member organizations that has garnered bipartisan support, and yet it still faces an uphill battle in the U.S. Congress.

Too few countries will receive relief. The Jubilee 2000 campaign (UK) has estimated that of the 41 HIPC countries, perhaps 24 will qualify for some reduction in debt service payments by the end of the year 2000, and that the reduction will be significant for only 16 of these. No additional debt relief was offered to countries that do not qualify as HIPCs but also have high debt servicing requirements which impede government commitment to poverty reduction. Among Latin American countries, the World Bank categorizes Haiti as a "Severely Indebted Low Income Country," and Argentina, Brazil, Ecuador, Jamaica, and Peru are considered "Severely Indebted Middle Income Countries"; however, none of these countries will receive additional debt relief under the HIPC or Cologne Initiatives. In addition, countries emerging from armed conflicts and/or natural disasters require special treatment. After Hurricane Mitch, creditors granted Honduras and Nicaragua a two-year moratorium on debt servicing, but critics point out that interest is continuing to accrue during this period, and that a more lasting solution must be found. The IMF, World Bank, and bilateral creditors are currently negotiating more substantive debt reduction packages with the two countries' governments.

The IMF and the World Bank will wield more control over the debt reduction process. Countries receiving debt relief must still undergo structural adjustment through the IMF's ESAF, which critics have long charged exacerbates poverty and contributes to environmental degradation. Jubilee 2000 supporters have demanded that civil society groups be consulted in IMF and World Bank programs for their countries as well as any poverty reduction programs, and question the increased IMF role in designing the latter, given its track record on sustainable development. The IMF and the World Bank leaders have committed their institutions to a comprehensive review of HIPC, including consultation with civil society groups. At a July seminar in Addis Ababa, Ethiopia, representatives of creditor and debtor country governments, the International Financial Institutions, regional development banks, relevant UN agencies, and African and Northern NGOs met to examine practical ways to strengthen the link between debt relief and poverty reduction. Conference participants agreed that ESAF should be revamped to strengthen its focus on poverty reduction.

NETWORK FEATURES

While the "jubilee" norm has undergirded the work of NGOs and churches pressing for debt relief since the late 1970s, the upcoming millennium has provided the motivation for a reinvigoration and rapid expansion of the network. Also, as in the cases of other transnational networks that have coalesced to work on issues such as human rights, protection of the environment, and women's rights,

North-South collaboration of advocates for debt relief has been much facilitated by e-mail and web sites that provide activists a readily accessible medium for information exchange.

Within the debt network, groups with diverse strengths collaborate. Some mobilize constituencies for demonstrations and lobbying, others conduct research and provide alternative information, and others exert moral suasion, such as the Vatican and regional and national episcopal conferences. A distinct feature of the network as compared with other transnational networks has been the unusual leading role of churches. The World Council of Churches, the bishops of the Anglican Communion, Pope John Paul II, and national Catholic bishops conferences of various creditor and debtor countries have all called for more extensive debt forgiveness.

A reformist/radical cleavage has marked the network since the mid-1980s, increasingly lining up on a

North/South axis. While many Northern-based members have been willing (albeit reluctantly) to support legislation financing debt reduction with continued SAP conditionality, other network members, principally in debtor countries reject any such conditionality and demand wholesale debt cancellation. The Tegucigalpa Declaration, issued last January by Latin American Jubilee 2000 campaigners from 16 countries gathered in the Honduran capitol, pointedly requested that Northern groups not accept terms less favorable than those demanded by their Southern allies. Southern groups are particularly concerned that by accepting the Cologne Initiative consideration of further debt reduction will be cut off.

Father Tomás Burns, a Maryknoll priest in Perú active on the debt issue for over 20 years, recounted in a telephone conversation the exceptional effort Peruvians made to gather signatures on the Jubilee 2000 petition,

knowing that Peru would not receive additional debt relief under the HIPC Initiative. "We've seen what it is in Peru to sacrifice a generation because of the debt overhang and insufficient funds for education and health. It's a case of the people here expressing their solidarity with the poor in Sub-Saharan Africa, what we call 'globalization from below': South-South solidarity."

Elizabeth A. Donnelly is a Ph.D. candidate in the Government Department. She served as a Maryknoll Lay Missioner in Lima, Peru from 1981-1983, and holds an M.T.S. from Harvard Divinity School. Her article on the transnational network of organizations advocating debt relief will appear in Sanjeev Khagram, James V. Riker, and Kathryn Sikkink (eds.), Restructuring World Politics: Transnational Social Movements, Networks and Norms (University of Minnesota Press, forthcoming).

President Clinton last month pledged to cancel the debt owed to Washington by the world's poorest nations, in addition to seeking \$1 billion for an initiative to retire poor nations' debts to international leaders. "Perhaps as important as Washington's debt forgiveness, **President Clinton's** announcement will challenge other nations to meet and go beyond their pledges in Cologne and cancel their own debts."

-New York Times editorial, Oct. 4, 1999

Currency Politics

Dollarization and other Dilemmas

BY JEFF FRIEDEN

URRENCY POLICY IS ONE OF THE MOST IMPORtant choices facing Latin American governments and peoples today. Exchange rates have long made frontpage news in Latin America. Argentina's "Convertibility Plan," which tied its peso to the U.S. dollar, has impressed many in the region with its ability to end the country's chronic hyperinflation. On the other hand, the 1994-1995 Mexican peso crisis threatened to bring down all Latin American economies, as did the 1997-1998 crisis of the Brazilian real. Current discussions of "dollarization," the adoption of the U.S. dollar as the national currency, are the most recent headline appearance of formerly arcane exchange-rate issues.

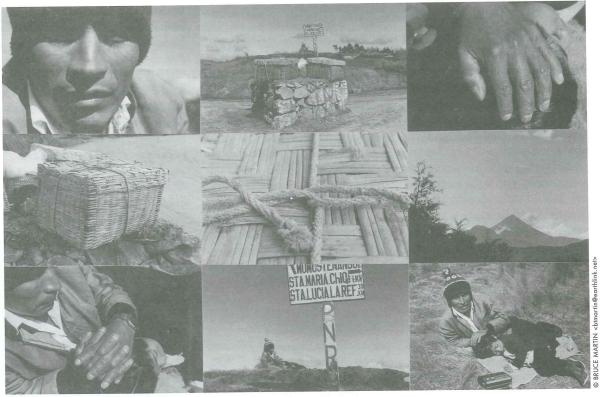
This great—and increasing—prominence of exchange rates in Latin American economics and politics is not surprising. The region's countries have opened their borders to international trade, finance, and investment over the past 20 years. Higher levels of cross-border economic activity expose ever-larger segments of the economy to currency movements. Businesses, farmers, and workers who used to be comfortably ensconced behind high trade

barriers and capital controls are now subject to the pressures brought about by exchange rate changes.

Yet currency policy remains poorly understood by many observers and participants. In particular, there has been very little analysis of the *political economy* of currency policy, of how economic and political factors influence governments as they make exchange rate decisions — even though all agree about the fundamental interaction of economic and political conditions in this realm.

A government typically faces two interrelated choices with regard to its currency. The first is whether and how the monetary authorities should maintain the national money's value in terms of other currencies. At one extreme, the government might fix the exchange rate against another currency, typically the dollar, and commit itself to sustain this "peg." This is the case of Argentina, which has held one *peso* equal to one dollar since 1991. At the other extreme, the government might let the exchange rate be determined by foreign currency markets, so that if demand outstrips supply the currency rises (and vice versa). This is the case of Peru, where the *sol* has been allowed to fluctuate more

ECONOMY CURRENCY POLICY



Currency Controls: Puzzling it Out

or less freely for most of the Fujimori regime. Many possibilities exist between these two extremes. A government might announce that it will only allow the currency to move up or down five percent against the dollar, but that within this "band" it will not intervene. Or a government could try to manage the currency only to avoid rapid fluctuations in its value, without keeping to any particular exchange rate against the dollar or other currencies. In the past year, there have been proposals that countries go even farther than the Argentine-style extreme of pegging to the dollar, and actually abandon national currencies to adopt the dollar (as in fact several small countries in the region, such as Panama, have long done). This choice, over the management of the currency relative to others, is usually called the decision over the exchange rate *regime*.

The second, related choice that governments must make involves the currency's value. Analysts typically distinguish between strong or *appreciated* currencies and weak or *depreciated* currencies. And while governments cannot move currencies at will, they can often affect the strength or weakness of the exchange rate for relatively long periods, perhaps three to five years in the medium-size countries of the region (very small countries have less leeway). This choice, over the relative value of the currency, is usually called the decision over the exchange rate's *level*.

These two choices can be politically controversial. The first, over the exchange rate regime, is a particularly hot issue when the question is whether to fix the currency. Supporters of fixing typically argue that it reduces the unpredictability of volatile exchange rates, and that it helps bring inflation down. The effect on predictability is straightforward: a fixed rate does not fluctuate against the partner cur-

rency (the dollar, for most of Latin America). The anti-inflationary effect holds because if the national currency is held constant against the dollar, this means local prices can only rise by roughly as much as American prices (otherwise local goods would be driven out of the market by imports). When the Argentine *peso* was fixed against the dollar in its currency-board arrangement, Argentine inflation was forced down from over 2000 percent in 1990 to just four percent by 1994 – only a bit above American levels.

While most people favor currency stability and low inflation, there are tradeoffs, and this is why fixing exchange rates can be controversial. A country on a fixed rate against the dollar essentially gives up its own monetary policy, and is forced to follow that of the United States. This is true if the country is financially open, which virtually all of Latin America is — at least to the extent necessary for this to apply.

If interest rates go up in the United States, they must go up in Argentina – otherwise people would sell their pesos and buy dollars in order to be able to earn the higher U.S. rates. This makes it impossible for the Argentine government to use monetary policy for domestic purposes, say to lower interest rates and stimulate a stagnant economy. Those more concerned about a local recession than about inflation or currency volatility – small businesses, labor and the unemployed, for example – may oppose tying the government's hands in this way.

Some worry about fixing the exchange rate because it risks inviting "speculative attacks" on it currency. In difficult economic times, a government is often tempted to abandon its fixed-rate commitment, in order to devalue and lower interest rates to help stimulate the local economy. Domestic and international investors understand

Government

exchange rate

policy is a serious

matter that can

affect societies in

dramatic ways.

that recessionary conditions make a devaluation more likely, and get their money out of the currency (and the country) – which just puts more pressure on the government and the economy. Eventually, the authorities can be forced to devalue by speculative pressures, and such forced devaluations can lead to substantial economic crises – as in much of Latin America in the early 1980s, in Mexico in 1994-1995, and much of Asia in 1997-1998.

But there remains strong support for fixed exchange rates, and for using them to ensure low inflation. Those particularly heavily involved in international trade and payments – financial, commercial, and investment groups, for example – are most likely to support a fixed rate because cross-border exchange becomes more predictable. Those most concerned about inflation most likely also support a fixed rate for anti-inflationary purposes. In Latin America, two kinds of countries have been the most prone to adopt fixed rates. The first are the very open, usually small,

economies, such as the nations of the Caribbean and Central America, whose citizens engage in so much cross-border exchange that currency volatility is very inconvenient. The second are countries such as Argentina that have run very high or hyper-inflation, where the return for help in defeating persistent inflation is worth risking problems of fixed rates.

The second controversial exchange-rate policy choice concerns its level, whether the government should try to keep the currency strong or weak. Here the trade-

off is straightforward. A strong currency raises the value of the nation's money. But it also raises domestic prices above foreign prices – a 10 percent increase in the *peso* against the dollar raises Argentine prices by 10 percent in dollars. This makes the country's exports expensive to the rest of the world, and the country's imports from the rest of the world inexpensive. If a currency strengthens (appreciates), citizens can buy imports more cheaply. This is good for local purchasing power and real incomes, but bad for local producers who compete against imports and for local producers who sell for exports.

In other words, a strong currency risks pricing local producers out of their markets, by making local goods too expensive. Not surprisingly, many Latin American firms competing with foreigners on world or domestic markets – especially manufacturers – want to keep the exchange rate low (depreciated). They also oppose fixing because the currency could not be devalued if local producers should face competitive pressures or a weak local economy. And the movement from high inflation and a floating rate to low inflation and a fixed rate can be very difficult. In Argentina between 1991 and 1994, for example, local prices rose nearly 40 percent while prices in the United States rose by only about 10 percent – putting Argentine producers at a 30 percent cost disadvantage against American and other foreign goods. Here too, policymak-

ers face difficult options: to pursue a strong currency and risk driving domestic firms out of business because they cannot compete, or to pursue a weak currency and reduce the living standards of local residents.

Electoral factors, too, can affect exchange rate policies. A government can gain popularity with consumers through an appreciated currency, which increases local income. Middle-class consumers especially can take advantage of a strong currency to buy imported consumer goods, such as television sets and automobiles, at artifically cheap prices. As elections near, Latin American governments often engineer or allow a strengthening of the currency to increase the electorate's purchasing power. Although the exchange rate will eventually have to be devalued, this temporary boost to consumer income can help get governments reelected — and serves to destabilize economies. It is no coincidence that recent Mexican, Colombia, and Brazilian currency crises all came in the context of this sort of electoral manipulation

of the currency. Incumbent governments delayed depreciation, keeping their currencies artificially strong, until after the elections – at which point serious speculative pressure helped force devaluations that dragged the economies into recessions.

Over the past year, the success of the Argentine currency board, the example of European monetary union, and the failures of less firmly fixed rates in Asia and elsewhere has led some in Latin America to champion the dollarization of the region's monetary systems. This would rep-

resent a particularly strict version of a fixed exchange rate, giving up any semblance of national monetary independence for the benefits of lower inflation and greater integration with the United States. These proposals have been as hotly contested as earlier currency policies. However, they are unlikely to fade from the political agenda. Indeed, as economic and political integration in the region grows – whether under the auspices of NAFTA, Mercosur, or other regional institutions – arguments for some form of monetary unification will also likely increase.

Whatever the future of current debates, government exchange rate policy is a serious matter that can affect societies in dramatic ways. The complex economics and politics of Latin American currencies will be at the center of the region's development for the foreseeable future.

Jeffry Frieden is Professor of Government at Harvard University. He specializes in the politics of international monetary and financial relations. Frieden is the author of Banking on the World: The Politics of American International Finance (1987) and of Debt, Development, and Democracy: Modern Political Economy and Latin America, 1965-1985 (1991); and the editor or co-editor a number of other books on related topics. His articles on the politics of international economic issues have appeared in a wide variety of scholarly and general-interest publications.

DRCLAS Visiting Scholar and Fellow **Program now** includes seven onesemester fellowships (\$20,000 plus travel) for researchers from or working on Brazil, Central America, Colombia, Ecuador, and Venezuela. Fellowships are also available for scholars from Argentina or Mexico and for researchers whose projects focus on "Philanthropy, Social Change, and **Civil Society in Latin** America." DRCLAS also invites a limited number of visiting scholars and fellows with other funding for up to one academic year. Deadline for September 2000 is April 1, 2000. Contact: Jill Konz, tel. 617-495-3366; e-mail <jkonz@fas.

harvard.edu>.

Dollarization in Latin America

Is it desirable?

BY JUAN CARLOS MORENO-BRID

T THE DAWN OF THE XXI CENtury, the drastic lowering of barriers to foreign trade and financial transactions, coupled with the volatility of international capital markets, seem to be propelling the world towards the elimination of monetary divisions. Indeed, a number of regional experts and business leaders -in export oriented sectors-argue that Latin America should abandon its diversity of local monies and adopt the United States dollar as its common currency. In brief, they consider that such formal dollarization is not only unavoidable for Latin America given the increasing globalization of production and finance, but also a necessary step to promote the region's dynamic insertion into the world economy. In their view, this monetary reform, by eliminating all uncertainty regarding nominal exchange rate variations, would produce enormous benefits for the region: greater price stability, reduced transaction costs in foreign trade, lower inflation and interest rates and thus healthier banking systems and higher levels of economic activity. However, notwithstanding its potential benefits, the surrendering of monetary sovereignty entails important costs and risks that should not be overlooked.

The different paths of inflation in Latin America and the United States are likely to create complications. Inflation in developing countries is caused by structural, deep-seated factors that go beyond the mere influence of external prices or monetary expansions. These factors may include distributive struggles, fiscal imbalances, as well as a more heterogeneous evolution of productivity in the various branches of economic activity. Moreover, certain rigidities in pricing of goods and services as well as in labor contracts create inertial inflation. These factors may stop Latin America's inflation rate from reaching U.S.

levels, even with full dollarization. Moreover, if prices of Latin American goods and services would keep expanding at a faster pace than those of its competitors in the United States market, dollarization would end up deteriorating the region's international competitiveness. Ultimately, it would slow down the expansion of regional production and employment. Such effects, if persistent, may eventually plunge Latin American economies once again into a long-term decline and acute levels of unemployment and under-employment.

No developing economy—irrespective of its monetary or exchange rate policies— is immune to the impact of abrupt changes in the global economy that may drastically alter the demand for its main exports, its foreign investment, or even its access to international financial markets. Consequently, however credible and convenient Latin America's dollarization may seem, it does not guarantee that the region will never again suffer external shocks that mandate macroeconomic adjustment programs. Such occasions would be a severe test of the viability and adequacy of dollarization in the region. Countries with formal dollarization may never modify their nominal exchange rate, so any adverse external shock in the world economy would have to be accommodated by cuts in the nominal level of its domestic wages and prices. However, the widespread dynamics of monopolistic competition in Latin America and the rigidities in many of its labor markets—deeply rooted in the region's tradition of high inflation- make it difficult to implement major cuts in nominal wages without risking overall political and social stability. In such circumstances, breaking the inertia in price and wage formation may require deeper and more prolonged reductions in real output and employment than those deemed necessary under a policy of floating exchange rate. Therefore, the

Wal-Mart in Mexico



The adoption of

the US dollar as

the official

currency would

cancel out

possibilities of

independent

monetary policy.

burden of domestic macroeconomic adjustment required to face external shocks would lie even more heavily on the workers and underemployed. And, unless radical changes in the region's labor and production are implemented, dollarization would likely elevate the social costs of macroeconomic adjustment relative to those in economies not fully dollarized, that still have the option of flexible exchange rate policies.

These social costs may be particularly high because Latin America lacks typical compensatory mechanisms to reduce the impact of contractionary shocks by channeling resources to regions affected by adverse circumstances. Indeed, welfare and unemployment benefits are largely absent in the region. The core of the region's social security system barely protects a minority of workers, those employed in the modern sector of the economy.

If Latin America should adopt the US dollar as its unique and official currency, it would cancel out all possibilities of an independent monetary policy. Key monetary variables like money supply, credit, and nominal interest rates would then be decided -implicitly or explicitly-by the United States Federal Reserve. There is no guarantee whatsoever that, in such situation, the Fed's decisions will be favorable to Latin America's economic development. As its chairman, Alan Greenspan, has said, the Federal Reserve takes only into account the interests of the United States economy. In addition, the Deputy Secretary for the US Treasury recently stated that any country contemplating the use of the American dollar as its formal currency should first consult the relevant American economic officers and in any case be aware of its potential consequences, favorable or not.

The loss of autonomous monetary policy would, in particular, imply that any Latin American economy embarked in dollarization would be unable to provide financial support for its domestic banking sector even in cases of severe crisis such as Mexico's. Thus, under full dollarization, such financial institutions would likely have to cease their operations. Therefore,

the substitution of local currencies for the US dollar, though helping to avert Latin America's recurrent foreign exchange and balance of payments crisis, may simultaneously make the region more prone to banking crises and severely tight credit restrictions. Is it economically sound to let such banks go broke, instead of temporarily providing extraordinary financial resources to restructure them? This is a decision to be carefully weighed by national governments and should not be a mere consequence of the implementation of

a formal dollarization of the economy.

Given the above mentioned limitations and risks, dollarization may easily end up being a costly and failed experiment in Latin America's quest to guarantee price stabilization. To achieve price stability in the region may prove to be an elusive goal. But in its pursuit, policy makers should take into account the po-

tential risks and costs of such policies in terms of the fulfillment of other relevant economic and social objectives.

However, even with the abovementioned limitations, some argue that the road ahead for Latin America is nevertheless rapidly moving towards integration with the United States economy, forming a continental Monetary Union. Such monetary arrangement would go beyond the adoption of a common currency. It would also imply free movement of labor and capital in the region as well as a common fiscal policy with explicit arrangements for compensating economically disadvantaged areas.

A monetary union with the United States may or may not be sound strategy for Latin America, but major political, institutional and economic factors must be taken into account. First of all, there is no political will within the United States to embark on such a continental monetary union. And even in Latin America, the consensus does not

favor any movement in that direction. In fact most of the region's Finance Ministers oppose such radical monetary rearrangement. Secondly, and most significantly, it would be necessary to agree on a timetable for the removal of all restrictions to the free movement of capital and of labor within the region. As it is painfully evident for millions of Latin Americans, there is no political support in the United States to lift the restrictions on the entry of foreign workers.

Even for Mexico, by far the econ-

omy most closely integrated with the United States, the possibility of establishing a monetary zone is not an option in the foreseeable future. Neither the objectives and the necessary steps to achieve them, nor the timeframe or the required institutional framework have even been agreed upon or identified.

For the time being Latin America, notwithstanding its rich cultural tradition of magic realism (Realismo mágico-so marvelously expressed by García Márquez, among others) should refrain from believing in dollarization as a magical cure for its real economic illnesses. Adopting as a common currency for the region the US dollar or a newly minted one with the face of Columbus -or for that matter Ricky Martin- without ensuring the necessary changes in its institutional and economic structure, including the free movement of labor into the United States may easily end up hindering Latin America's economic development.

Juan Carlos Moreno Brid, a DRCLAS Research Associate, specializes in Latin America's economic development. This article is partly based on joint work with David Ibarra to be published in Puchet, M. & L. Punzo, (Eds). Mexico Beyond NAFTA: Perspectives for the European Debate, Routledge Press.

Rockefeller Center Series on Latin **American Studies** now has four books: Crossings: Mexican Immigration in Interdisciplinary Perspectives (1998), edited by Marcelo Suárez-Orozco, Latin America and the **World Economy** Since 1800 (1999), edited by John H. Coatsworth and Alan M. Taylor, The United States and Latin America: The New Agenda (1999), edited by Victor Bulmer-Thomas and James Dunkerley; and Bitter Fruit: The Story of the American Coup in Guatemala by Stephen Schlesinger and Stephen Kinzer.

Order from Har-

vard University

2242, <http//

edu>.

Press, 1-800-448-

www.hup.harvard.

The David



Working in Argentina: preparing straw for a roof

Is Dollarization a Good Idea?

Focus on Argentina

BY ELI COHEN

RGENTINA'S CURRENT ECONOMIC OUTLOOK IS bleak. Last spring's shock to international capital markets which caused a devaluation in Brazil has now combined with uncertainty over the upcoming presidential elections to cause high interest rates, crippling public debt, widespread unemployment, and rising inequality. Neither the Peronist nor the Alliance Party presidential candidate will distance his economic policy from current president Peronist Carlos Menem's programs of privatization and convertibility. A fiscal rescue will be difficult and a monetary expansion is outlawed. Low labor productivity, an overpriced exchange rate and market uncertainty suggest that the current situation is likely to remain for at least another year and perhaps even longer. Into this situation, the debate over dollarization, the replacement of the Argentine peso with the U.S. dollar as national currency, intensifies.

Argentina has made great strides toward entering the "first world" economically over the last decade. In 1989, inflation reached as high as 200 percent per month! To put this in context, if one sat down for dinner in the summer of '89, dessert would be more cost more at the end of the meal than at the beginning. Since the Menem regime and Peronist Party took over at the beginning of the decade,

large-scale changes have been put in place. Huge, inefficient publicly owned companies have been privatized in an effort to raise large amounts of hard currency. This cash has been used to support the current Convertibility Law, the Menem government's most proud achievement. Under convertibility, a currency-board-like arrangement is put in place that forces the US dollar to be fully convertible, one to one, with the Argentine peso. Devaluation (equivalent to increasing the supply of money or lowering interest rates by the central bank) is outlawed. Every peso is backed up with a dollar in Argentine reserves and thus there is no threat of "forced devaluation" due to bankruptcy of the central bank. This scheme has reduced inflation to nearly zero and until recently provided the economy with large amounts of cheap capital by reducing the currency risk involved with investment.

However, the depth and length of the current Argentine recession may be, in part, a result of the convertibility scheme itself. Though it is certainly an unpopular suggestion to contend that convertibility should be dismantled now in favor of a floating exchange rate, the current situation does have clear implications for the long-term viability of the current regime. Though lower than they would be if the *peso* floated against the dollar, interest rates remain

ECONOMY, CURRENCY

The public

consciousness is

wedded to the

middle ground

of convertibility.

too high for all but the largest firms to have access to borrowed funds and consumers pay extremely high rates for credit. Furthermore, convertibility can be a terrible constraint on the economy. Brazil, via devaluation, is exporting its way out of its recession at the expense of Argentine goods, which are now far too expensive to compete.

Interestingly, the public consciousness is wedded to the middle ground of convertibility. Public opinion is against official dollarization because Argentines have too much pride to use only the US dollar as currency. However there is also a refusal to even consider a floating currency because no one trusts the Argentine peso to hold its value. Indeed most large transactions already take place in dollars.

When faced with a disastrous collapse in competitiveness due to foreign price shocks, like the devaluation in

Brazil, a country has two choices. First it can devalue its own currency causing an immediate cut in wages across the board in real terms. This makes exports appear cheaper to foreigners, and increases the money supply. Or a country can go through a long transition period with high unemployment until wages are bargained downward by each individual firm which either manages to lower its costs or goes out of business while trying. This second

mechanism is much more severe, and it is exactly the process Argentina is experiencing right now because devaluation is outlawed. Thus convertibility remains mired in a middle ground with both limits on monetary flexibility and high interest rates.

Dollarization has recently been dismissed by many as a publicity ploy of the Menem government to ease investor's fears of devaluation. However it should be given legitimate consideration as possible long-term solution that would provide lower interest rates. Indeed when Argentine economists, members of the Finance ministry, and bankers are asked, "Is dollarization a good idea?" the answer is generally yes, though they only rarely say that to the public. Though devaluation is outlawed, there is constant fear in bond markets that the government will change the laws. This fear leads to higher interest rates and country risk. Dollarization removes that risk because, once dollarized, Argentina would have a very hard time returning to its own inflationary national currency. Thus when comparing dollarization to the current convertibility law the bankers are correct. Dollarization would cause lower interest rates that would provide cheaper capital, more investment, and more jobs. Almost everyone in the economy would be better off and welfare would be improved. A perceived loss of national identity and pride is easily overcome. If Argentines resent George Washington on their money, they can, like the Panamanians, keep peso notes while abolishing peso deposits and thus still have a fully dollarized economy. No more national identity is given up under a dollarized regime than under the current convertibility law, except for the possibility of future monetary independence. Thus dollarization has the same faults as convertibility with some added benefits. It seems Menem just jumped the gun in his rash desire to make bold initiatives as a lame duck in office. The debate should continue.

However it is essential to recognize that dollarization would still leave the Argentine economy open to long and deep recessions like the one it is experiencing now. A rarely asked question that should be near the center of any Argentine economic debate is "when will the peso be viable on its own?" One answer I have heard repeatedly is, "not now." Indeed dollarization is only an appropriate long-term solution if the peso will never be viable again. Will the scars from the hyperinflation of the eighties ever heal? It seems as much a question for psychologists as for economists (both of which Argentina has in abundance). But Brazil and Mexico have

> both allowed their currencies to float and had generally positive results. From my point of view, a flexible exchange rate is the appropriate long-term regime for a country with an economy the size of Argentina. Perhaps more important, one can conclude from the current recession that a long-term link to the dollar would not solve all of Argentina's problems.

In terms of efficiency, it seems painfully clear that George Soros was right when

he said earlier this year that the Argentine peso is overvalued. Great strides in labor productivity are necessary to bring it back into equilibrium. The extremely high rate of unemployment is proof. An over-valued wage makes the market clear through high unemployment as supply of labor vastly outstrips demand. Wage levels are too expensive for businesses to afford. Argentina's economy will only start growing again when the labor market comes back into balance through lower wages, and higher productivity.

In conclusion, there needs to be a long-term focus to this discussion over currency regime. The dollarization debate must focus not on the immediate benefits, but rather on whether an Argentine peso could ever be viable on its own. In which case the permanence of dollarization would be a drastic misstep. Furthermore the economic discussion must focus on longer term goals of increased employment and equality as means for efficiency and stability instead of solely on GDP growth though the topics are not mutually exclusive. Finally the government should focus on improving economic structures and institutions to create confidence, at which point an Argentine currency could be viable on world markets on its own and dollarization would no longer be a consideration. Though dollarization would provide large immediate benefits in comparison with convertibility, the current recession suggests that neither regime is the appropriate long-term solution.

Eli Cohen, a Harvard undergraduate in economics, received a 1999 DRCLAS Summer Research Travel Grant Award to examine the costs and benefits of dollarization to the Argentine economy.

The Benefits of Privatization—

The View from Mexico

RY FLORENCIO LÓPEZ DE SILANES

HROUGHOUT LATIN AMERIca—and in many other parts of the world, such as Eastern Europe—people are asking if increased profits of privatized firms are a result of higher prices of products, and extensive layoffs and lower wages of workers of privatized firms. Critics often argue that the benefits of privatization come at a significant cost to society.

To what extent do price increases explain better performance? Do higher profits result from the expropriation of workers? Or does the improvement reflect better incentives to perform? In a recent joint study with Harvard Assistant Professor of Economics Rafael La Porta, we looked at the evidence from Mexico, one of the world's largest case-by-case privatization programs. We found dramatic improvement in the performance of the newly privatized firms, with operating profits rising as much as 24 percentage points.

The examination of data for Mexican privatized firms shows that the dramatic increase in output and

BEATRIZ TERRAZAS cherrozos@dollcsnews.com> @ DALIAS MORNING NEWS

improvements in performance of privatized firms seems to offset the possible costs to society.

In 1982, more than 1,200 state enterprises in almost every sector of the Mexican economy received subsidies and other transfers equaling almost 13 percent of the Gross Domestic Product. These state enterprises, however, produced only 14 percent of the national output, employed around four percent of Mexico's labor force, and accounted for 38 percent of fixed capital investment.

The government began to unravel the state sector in 1983. By June1992, the number of firms under state control had been reduced to less than 220 firms. Our study looks at data for 98 percent of all privatized firms. For each one, we've examined profitability, efficiency, employment, output, prices, and taxes paid before and after privatization

We found large increases in operating efficiency underpinned the gains in profitability in the Mexican sample. Average costs per unit plummeted 21.49 per cent, while the average ratio of sales to fixed assets rose 64.64 percent. The average sales per employee nearly doubled and operating income per employee skyrocketed. Employment cuts are part, but not nearly all, of the picture. Privatized firms reduced the number of whiteand blue-collar employees by half. Productivity gains are largely due to improved incentives. Privatized firms quickly bridge the pre-privatization performance gap with industrymatched control groups.

We examined four indicators of operating efficiency to capture changes in the ability of firms to extract output from a number of inputs. We found that sales increase quickly in the



post-privatization period, although the stock of fixed assets remains basically unchanged and the number of workers falls sharply. This increased efficiency coupled with higher levels of sales translates into large gains in profitability. The industry-adjusted ratios suggest that privatized firms are "catching up" to the profitability and operating efficiency of their peers in the private sector.

In the year before privatization, half the installed capacity of most firms was idle, so no large investments could be expected. However, we found that investment indicators show a moderate increase in the rate of capital accumulation. The ratio of investment to sales increased from 3 percent to 4.5 percent. Thus, privatized firms were able to increase sales despite halving their workforce and increasing their capital stock only modestly.

Moreover, in answer to politicians' prayers, privatized firms became significant taxpayers. Slightly more than half their gains in operating income go to taxes, offsetting transfers from



the rest of society that result from privatization. The average privatized firm is contributing \$57 million more to taxes, meaning that the additional revenues that resulted from privatization would have been enough to give \$212,727 to each of the 550 laid-off workers from the average firm.

Higher markups for consumers are not a big factor in profitability gains, since the mean increase in the firms' prices compared to the producers' price index is only 4.14 percent, accounting only for about 5 percent in the increase in profitability. Firms do not simply increase their markups following privatization. Instead, they undergo a radical restructuring process. Deregulation appears to complement privatization, prompting firms to restructure for increased competitiveness.

But the question remains whether privatization can only reap profits through layoffs and wage cuts. Here, our analysis of the data was sometimes-though not always-counterintuitive. Wages actually increased substantially in the firms in the sam-

ple for which data are available. The mean average annual real wage (i.e. discounting for inflation) was \$4,815 in the pre-privatization period and rose to \$8,500 in 1993. Interestingly, gains were larger for blue-collar workers than for white-collar workers: the mean blue-collar real wage rose from \$3,067 to \$7,090, and the mean white-collar real wage from \$8,978 to \$13,990. These large increases in real wages are all the more striking given the stagnation of real wages in the overall economy during the sample period.

We also discovered that there is no evidence that pre-privatization wages exceeded market levels as a result of income redistribution or of policies to cure failures in the labor market. Our research shows that jobs in stateowned companies were coveted because they required little effort and not because they paid well. After privatization, employers shed excess labor and increased wages of retained employees in exchange for increased worker effort.

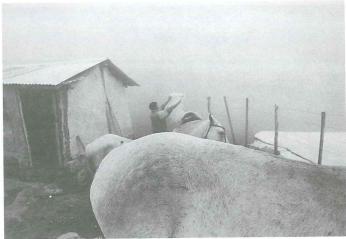
To estimate the savings due to layoffs, our study looked at the counterfactual questions of how much lower profits would have been if all laid-off workers had been retained at their old wage. As it turns out, the savings are small relative to the layoffs, for two reasons. Wages tend to be low in Mexico. Total wages were equal to less than a quarter of sales in the pre-privatization period. And after the privatization, labor costs were spread over a much wider base, since sales increased rapidly —an average of 60 percent. The mean savings from layoffs were equal to 6.88 percent of sales in 1993, indicating that savings due to layoffs account for about a third of profitability.

Overall, the evidence shows that close to two-thirds of the gains come from the restructuring of the firms and the efficiency gains in production. In the worst case scenario, if we assume that firms were not allowed to lay off workers after privatization and that they had to keep paying them full wages without producing anything, the higher wage bill would only reduce the increase in operating profits by 33 percent. Price hikes account for only five percent. The growth in output and the reductions in costs are very striking. Most firms, in both the competitive and noncompetitive sectors achieve their higher profits by restructuring their operations and increasing their efficiency.

Florencio López de Silanes is Associate Professor of Public Policy at the Kennedy School of Government. He specializes in Financial Markets, Corporate Law Reform, Privatization and Deregulation. He has served as an advisor to the Peruvian, Mexican, Russian, Malaysian, Egyptian, and Yemenian governments on issues of privatization, deregulation, corporate and bankruptcy law, industrial policy and financial regulation. He has also been a Senior Economic Advisor to the Ministry of Industry and Trade in Mexico and a Consultant to the Ministry of Finance and the Ministry of Communications and Transportation in issues of privatization.

DRCLAS sponsors the Latin American and Latino Art Forum, an opportunity to exhibit work at Harvard University. Open to Latino/a artists as well as artists from Latin America, Spain, and Portugal. Non-Hispanic artists with work related to Latino(a)/ Latin American, or Iberian themes will also be considered. **Contact: Laura** Serna, tel. 617-495-9701, e-mail <serna@fas.harvard. edu> or see our website http:// www.fas.harvard. edu/~drclas/ programs/art.html>.









Shepherds at the End of the Millennium

Inequality in the Argentine Countryside

TEXT AND PHOTOS BY CRISTINA FRAIRE

"Shepherds at the End of the Millennium" is an examination of marginal and forgotten Argentines. Argentina is marked by a distorted development that favors the great urban centers— especially Buenos Aires— and restricts growth in the country.

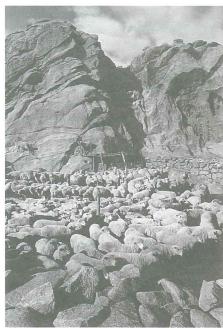
Changes in the world economy have resulted in even more inequality in the countryside. There is a lack of funding for programs to enable the development of an integrated nation. Until fundamental political changes occur, we can continue to say that an isolated community that has not grown yet will not grow. The isolated communities

of Argentina are victims of this fate.

The highlands of Pampa de Achala are in the province of Córdoba. There, a traditional community is moored. It exists in utter isolation. There are no roads, no electricity, no telephones. This community survives on a simple economy based on herding goats and sheep.

The residents live scattered in the mountain, attached to that place where they were born and have buried their dead. In spite of the distance they have a strong sense of community which is reflected in celebrations such as Easter or the day of the patron saint. Until recent-









ly, and in spite of the scarcity of means they have lived in social harmony with the environment facing their only predator: the puma.

My background, formation and experience, linked closely with the world of aesthetics, with nature and the social problems, drew me to this place. I was captivated by fascination and awe. At first there was a certain magic about the weather and landscape, the fog taking over the land and reducing the vast space to a setting filled with isolated objects and ghostly characters. I was moved by those people living in that inaccessible wilderness, so isolated, so concerned in their relationship with nature: such stubbornness and effort to remain there. These same people transforming the landscape, gutted animals or recently dead, hanging like fruits from the trees. Then, I discovered a 'non-urban' relationship with nature and death, sometimes almost scrawny and brutal.

My photographic work is born of this estrangement before a landscape which presents itself as ambiguous; magic and beautiful and at the same time harsh and rigorous; of my unease before people living in so demanding a landscape, whose lives are so entrenched in the exigencies of nature.

Cristina Fraire, an Argentine photographer, began her career as a photojournalist. Entranced and compelled by the life in Pampa de Achala, she now devotes her energies to photographing the community with grants from the the John Simon Guggenheim Foundation and Argentina's Fondo Nacional de las Artes (National Fund for the Arts). Her most recent exhibition was at a group showing of ten Argentine photographers at the Institute of Contemporary Photography in New York. Her photographs are included in the collection of the Bibliotheque Nationale de France, in the Museum of Fine Arts of Houston, USA, and in the books La FotoGalería, and Fotografía Argentina Actual Dos, both published by the photographic publisher La Azotea, and other publications. She can be reached at <cristina fraire@ciudad.com.ar>.

Art and Economy

Focus on Cuba

RY ESTHER WHITFIELD AND JACQUELINE LOSS

WITH a dollarized economy and increasing numbers of foreign tourists, the island finds itself in a controversy that is as much about art as it is about economics. The question of artistic existence and survival has become a pressing one, and ideology has had to form a pact with what cultural discourse elsewhere might call high art. In this climate, artistic integrity is pitted against commercialization, original-

of new, mainly foreign markets. New questions are being asked: who are artists producing for? what drives them, in the shift from an isolated economy to one in which there is increasing freedom of exchange with other countries? how do these exchanges affect their work? what is art in the time of globalization, and where is culture in a world of commodities?

To a degree, the issue of art and economics is one affecting all of Latin America as economies move from tling against the forces of imperialism and of a majority culture which seeks to consume and redefine it according to its own tastes and desires.

Since the Soviet Union collapsed and withdrew its support, Western cultural capital has circulated more freely in Cuba. The legalization of the dollar in 1993, during the Special Period of severe hardship, was an economic necessity rather than an acceptance of capitalism, but it nevertheless accel-

erated interaction with capitalist economies. This encouraged cultural change, too. Restrictions governing cultural and educational exchange between Cuban and the US have recently been relaxed but, even before these official stimuli, contact between

tomatic, however, because yet again a

Latin American country sees itself bat-

individuals affected artistic production. Tourism, an economic phenomenon that brings increasing numbers of foreigners to Cuba every year, has spawned a series of sub-industries: around medicine and ecology, vintage cars and tobacco, spiritualism and sex and, inevitably, music, art and literature. Each of these areas has its own marketplace, its own chains of supply and demand as well as players from inside and outside the island. Plastic arts were the first to take advantage of foreign investment on a large scale, and consequently more people have turned to art as a means of making money. Painters mass produce scenes of Old Havana and pristine 1950's cars under palm trees at Santa María beach although, to be fair, as in most professions, they try to find some time to respond to their own and not the market's demands.

The increasing international popularity of salsa has an effect on national production. The musical profession attracts more and more people, and every hotel bar in old Havana plays tracks from Buena Vista Social Club



Young pioneers look to the future

ity against prescription and - in a curious turnaround, considering the "Revolutionary" slant of literature in the past three decades—aesthetics against politics.

Postmodernism, understood as "anything goes", is perceived as a threat to both the unity of the Revolution and the respectability of art. The literary establishment, like the political one, is worried about preserving its difference in a world where globalization threatens Cuban autonomy. Creativity is feared to be in peril as cultural production responds to the demands

state-subsidized and centralized systems to free-market ones. The debate is also a vital one in Eastern Europe, where some artists and writers find themselves groping in market economies without state support and others previously excluded from the system find themselves without the aura of dissidence. The Cuban dilemma is unique because its politics set it apart: it has a system which, with one hand, has invested heavily in education and cultural institutions, yet, with the other, has taken away, or at least restricted, artistic freedom. It is symp-

Can the writers.

the artists and

the system they're

working in main-

tain a balance?

album. Another apparent response to the market is the fate of "santería," a previously somewhat suspect syncretic religion has become a profitmaking venture thanks to tourists' interest in it. Now, the government sponsors events that attract a dollarpaying crowd to these formerly more private rituals.

The fact that Buena Vista Social Club won a Grammy and that Afro-Cuban religious ceremonies have become a crowd-puller does not, however, have to be seen as a sell-out to the capitalist world. These art forms continue to develop on their own, away from the tourist areas where there are no foreign visitors there is little "Chan Chan" and santería is less of a spectacle. Those who may appear simply to be sell-outs merely may be adopting provisionary sell-out stances, doing what is demanded of them insofar as it makes it easier to do what they want. Instead of understanding art purely as commerce, music as Musak, santería as impotent, or for that matter, literature as pornography, why not look toward the spaces in-between-content and presentation, communities of interpreters, and versions of performances.

Take, for example, recent Cuban fiction. Until 1989, fiction was printed and edited in Cuba, and showed a preference for Revolutionary themes. The industry, though, was hit directly by the post-Soviet paper shortage and forced to consider costs for the first time. Thanks to material support from Eastern Bloc countries, editors had previously been able to focus on the literary (and ideological) merits of works. Economic change resulted in a disparity between creative and material output and fewer and less lavish works, such as the "plaquette" stories printed during the hardest years on recycled paper and card. The situation eased during the past five years because, with more money at its disposal, the Ministry of Culture can fund more generously. The influx of foreigners to the island has had more direct effects, though. New markets have emerged, at home and abroad:

the "mercado de frontera" books sold in dollars to visitors to Cuba accounts for a significant percentage of sales, and sales outside the island are increasing. Publishers have entered into joint ventures with foreign editorials similar to those with Spain, Mexico, Canada and elsewhere for hotels that have sprung up along the coastline. Arguably they, too, have

embarked on a construction project: the reconstruction, or reorientation, of Cuban literature. Literature is no longer addressed solely, or even principally, to Cuban readers. What the foreign publisher wants to

read and what will sell abroad have become a consideration - the main one, say some critics.

The summer of 1999 slowly passes and the Special Period has not been officially declared over, although the hardest years seem to have passed. However, survival is still a struggle and entails different forms of hustling: these have become a standard theme of Cuban fiction, at their harshest in the novels of exiled writer Zoé Valdés but present, too, in younger writers resident on the island. The novisimo group of writers born after 1959, championed by the late Havana University professor Salvador Redonet, consider these themes of social deprivation and others that previous decades swept under the carpet. Homosexuality, for example, was a taboo that once caused severe retribution as exposed in the documentary Mauvaise Conduite (1984) (Improper Conduct;) but the young writers - encouraged, perhaps, by the institutional acceptance of Tomás Gutierrez Alea's and Juan Carlos Tabío's 1993 film Fresa y Chocolate (Strawberry and Chocolate)- have made it commonplace. Erotic fiction is making a comeback in an environment which permits all but the most overtly political themes, and young writers are resorting to it more than ever.

This contrasts with the 70s and 80s when all writings challenging revolutionary paradigms were considered subversive. After Heberto Padilla, the 1968 UNEAC poetry prize winner was imprisoned for betrayal, then forced to apologize for his own actions and betray his friends, many intellectuals abroad publicly distanced themselves from the Revolution. For-

eign cultural imports were restricted for years even though the Revolution embraced the African, European, Asiatic and indigenous as foundational elements to the island's history and identity. Contact with the

outside world was mediated through a particular ideological framework, embracing the Soviet Union and other sites of Socialist fervor. Work that emerged from the period was somewhat uniform in nature in its focus on the state of Cuba and the revolution, and non-conformity was a charge that sent many, like Reinaldo Arenas, into rehabilitation.

Themes which were once taboo recur today with such frequency that they are perceived as a sell-out, aimed at publishers, mainly from Spain and elsewhere in Western Europe, who set down a crude prescription: sex, salsa, starvation and political repression. Writers' response to these demands-which is first and foremost a response to the economic situation-is being met with resistance by the cultural establishment, by the critics who run the country's institutions and fill the columns of its literary journals. Just as the Boom novels of the 1960s have been re-evaluated as an economic phenomenon, with Europe and the US avid for tales of a surreal and primitive Latin America, the relation between writer and market in Cuba is coming under scrutiny. Zoé Valdés, and those on the island who have not entirely ignored her example, are criticized for betraying creative standards. El Caimán Barbudo, the cultural newsFor the first time,
DRCLAS will take a
group of Harvard
students to Cuba
for a series of
lectures entitled
"Havana in
Literature" in
January, 2000.

paper linked to the Union of Young Communists (UJC) is in the throes of a debate about the implications of writing for an international market, of sensationalizing oneself and one's people.

Unity and seamlessness are still the mission of the political establishment and the literary old guard, even as they admit the inevitability - the necessity - of foreign cultural invasion. They struggle to maintain the image, at all costs: colonial houses on the Prado, the historic walkway from the sea to the Parque Central, are renovated in facade only, leaving the homes behind them in ruins; carnival - always controlled abandon - is more visibly reined in than ever, with barriers keeping the crowds from the

parade and an early curfew for the main festivities. Yet both the new Prado and the more lavishly festive areas of carnival - inflatable Havana Club rum bottles, well-stocked dollar-only bars - are to an extent an attempt to accommodate tourists, for cultural purism cannot but bend to economic necessity. The question is: can the writers, the artists and the system they're working in maintain a balance? Can they use capitalism to their advantage, participate in globalization of culture to the extent that it allows entry to markets, but maintain a sense of integrity (for artists) and of autonomy (for the Revolution)? Can they buy in without selling out? It's a race against time; a race, in fact, against economics.

Esther Whitfield is a graduate student in Romance Languages & Literatures at Harvard. She studied in Cuba as an undergraduate in 1992 and has returned several times since. She is writing her dissertation on language and economics in contemporary Cuban narrative published in Cuba, Spain and the United States.

Jacqueline Loss is a graduate student in Comparative Literature at the University of Texas at Austin. Her dissertation reevaluates different versions of cosmopolitanism in the context of late nineteenth and twentieth-century Spanish American literature, with a focus on Cuban narrative.

Venezuela in the 1980s, the 1990s and beyond

Why Citizen-Detached Parties Imperil Economic Governance

BY JAVIER CORRALES

ENEZUELA USED TO BE CONSIDERED A MIRACLE country. Until the early 1980s, it was one of the only four Latin American countries certified by the World Bank as an upper-middle-income economy. It was also a stable, center-left democracy, quite an oasis in a region plagued by authoritarianism, insurgency, or unrest.

TODAY, VENEZUELA IS IN RUINS. IT IS ONE OF THE FEW LATIN American countries to have had, not one, but two "lost decades:" the 1980s and the 1990s. Never really able to recover from currency and debt crises in the 1980s, Venezuela plunged further into economic chaos in the 1990s (see table on p. 28). Inflation remained indomitable and among the highest in the region, economic growth continued to be volatile and oil-dependent, growth per capita stagnated, unemployment rates surged, and public sector deficits endured despite continuous spending cutbacks. Real wages today are almost 70 percent below what they were 20 years ago. In eight of the last 12 years, Venezuela suffered some sort of economic emergency—a critical fiscal deficit, a banking crisis, a currency crisis, an economic recession or a combination of these. More than two-thirds of the population now live below poverty levels. A recent report estimates that, for an average Venezuelan with 12 years of schooling, the probability of ending up poor is 18.5 percent, up from 2.4 percent only a decade ago. Education—a common antidote against poverty has simply ceased to work.

This economic plunge has been accompanied by a gradual, and as of 1998, terminal collapse of the party system. The once-invincible political parties, Acción Democrática (AD) and Copei, were summarily defeated in a series of elections in 1998-1999. The power vacuum has been filled by the most anti-establishment political figure to emerge in 1998, Hugo Chávez Frías. A not-too-repentant coup-maker himself, Chávez won the December 1998 presidential elections and, in a hastily convened elections for a constitutional assembly, his supporters captured 93 percent of the seats.

I argue that these two outcomes—economic collapse and party system collapse—are intimately related. Venezuela's repeated failure to reform its economy made existing politicians increasingly unpopular, who in turn responded by privileging populist policies over real reforms. The result was a vicious cycle of economic and political party decay, ultimately paving the way for the rise of Chávez.

VENEZUELA'S AX-RELAX-COLLAPSE REFORM CYCLES

Why hasn't Venezuela escaped its economic malaise? The answer is not for lack of trying. Every administration since the early 1980s has come to office hoping to introduce economic correctives, to the point where almost every policy approach has been tried: heterodox stabilization (1985-1988), shock therapy (1989-1992), gradualism (1996-1998), reforms by executive "special powers" (early 1980s, 1993-1994, 1998), reforms by negotiations with opposition parties (1996-1998), stabilization through price controls (1994-1996), deep trade liberalization (1990-1993), concessions to economic losers from trade liberalization (1994-1998), and direct subsidies to vulnerable sectors (1990-1992). Nothing has worked. These policies failed either to deliver a lasting solution or to last long enough to achieve results.

Essentially, Venezuela has been stuck in an ax-relax-collapse cycle of reform. Each cycle begins with the eruption of an economic crisis, to which the government responds by implementing harsh cutbacks and adjustments—the "ax." After some initially positive results, the reforms soon lose momentum, becoming either haphazardly implemented or prematurely abandoned—the "relax" stage. This culminates in yet another economic crisis—the "collapse." With the launch of "Agenda Venezuela" in 1996, Venezuela embarked on its fourth such reform cycle since 1979, succumbing shortly after to the same pattern of relaxation and collapse. The main difference was that, this time, the economic collapse (in 1998) was the worst ever.

Venezuela is thus neither a case of reform avoidance nor of neoliberal transition, but rather of reform non-consolidation. It is the prototype of a "reform-lagging" country. Reform-lagging countries develop special political problems that complicate the capacity of the political system to manage the economy.

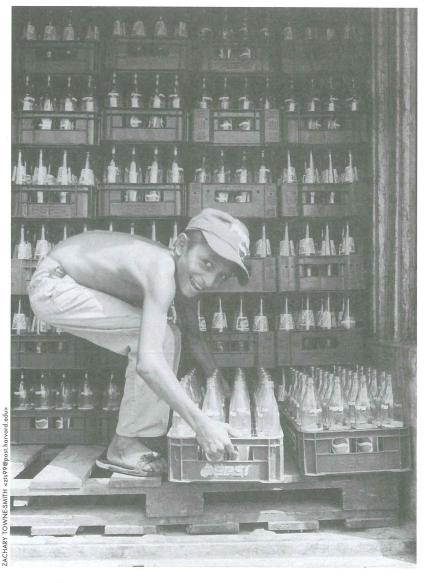
One such problem is a chronic decline of citizen confidence in the state and politicians. When states repeatedly falter on their promises to fix the economy, economic agents lose confidence in state authorities, undermining their desire to cooperate with future reforms. Another problem of repeated reform failures is that reform opponents gain ground. Reform opponents argue, groundlessly but convincingly, that ailments are caused by the attempted reforms, conveniently avoiding the real diagnosticthat ailments are the result of not completing the reform process. Venezuela's two most recent presidents (Rafael Caldera, 1994-1999 and Chávez, 1999-present) came to office by invoking this fallacy. Repeated reform failures also make common citizens equate adjustment, a word that they had been hearing for the past twenty years, as wasted sacrifice, as one more scam by which traditional, corrupt politicians pass on the costs of adjustment to the citizenry, only to squander the resulting savings. Confidence in the state and professional politicians tends to evaporate in reform-lagging countries.

POLITICAL PARTY DECAY AS A CAUSE AND EFFECT OF REPEATED REFORM FAILURES

When reform effort collapse, politicians become increasingly concerned about "vote flight" and reluctant to embrace harsh but necessary reforms increases. They step up populist appeals, on the mistaken assumption that votes could be regained through populist handouts rather than by demonstrating competence in resolving public policy issues. This sets the stage for the failure of the next round of reforms, which in turn, lowers the popularity of parties even further. In a nutshell, this is what has happened in Venezuela since the early 1980s.

Dominant parties reacted to their decline in popularity, not by renewing themselves, but by actually becoming increasingly closed off to new leadership and initiatives. Internal party rules exempted party leaders from having to compete electorally to earn leadership positions, thus diminishing the incidence of rotation of party leaders, even as parties suffered setbacks at the polls. This distinguished Venezuela's major parties from the leading party in Mexico, the PRI, which, although less democratic, always under-

Working in Venezuela: Stacking Coca-Cola



went rotation of leaders with every new administration. In 1993 Caldera capitalized on the anti-party sentiment of the population by cobbling together an alliance between a small, leftist party (Movimiento al Socialismo, MAS) and a last-minute coalition of independent leftist-nationalist forces (Convergencia). Once in office, this coalition proved to be fragmentation-prone and reform-adverse. Caldera had no option but to court the very same parties that he had campaigned against—AD and Copei. These parties, however, sold their support at a very high price, consenting only to tepid reform in return for populist concessions.

THE DEMISE OF THE PARTY SYSTEM AND THE PROSPECTS FOR BREAKING THE CYCLE

The electoral results of 1998-1999 demonstrated, not so much the popularity of the new president, which is unquestionably high, but rather the repudiation of traditional parties, which was overwhelming. Chávez has won elections comfortably, but 42.6 percent of voters still voted against him. In the Constitutional assembly, his candidates obtained 61 percent of the total popular vote, with an abstention rate of 54.

What is clear, nonetheless, is that the old parties were completely repudiated, both in the presidential elections and the elections for the delegates to the constitutional assembly in July 1999. Unwilling to align themselves with existing political parties, opposition candidates ran as inde-

Venezuela's second "lost decade"the 1990s 1988 1998 **ECONOMIC INDICATOR** 3,221 GDP per capita (US\$)/a 3,190 29.5 35.8 Inflation Rate (annual %)/a 11.2 Unemployment Rate (%)/b 7.9 Real Wages (1984 bolivares)/c 2,900 1,100 13,500 Consumption per capita 18,000 (1984 bolivares)/d -4.5 Non-financial public sector -8.5 balance (percent of GDP)/a Population below 68 46 poverty (percent)/c Probability of being poor 2.4 18.5 with 12 years of schooling/c /a Inter-American Development Bank /b ECLAC /c Congreso de la República /d Cordiplan

pendents in the elections of July 1999. Opposition voters thus faced a plethora of opposition candidates from which to choose. Their votes were dispersed among many candidates, making it difficult for opposition candidates to amass enough votes to win seats.

Does the demise of the old party system and the accumulation of power by Chávez enhance Venezuela's prospects for escaping its ax-relax-collapse policy cycles? So far, Chávez has been non-committal about economic intentions. This summer he declared: "The year 2000 will be the year of the economy," indicating that he would not be bothered with the economic crisis at least during his first year in office. The official economic program calls for a "humanistic" economy, which is as vague a predictor of what is to come as one could imagine.

If Chávez ever converts to market economics, as most Latin American populist-militaristic leaders did in the 1990s, he will clearly enjoy favorable political assets—a devotional following, a demoralized opposition, and high levels of reserves in the Central Bank. However, not everything is idyllic. Chávez could still be encumbered by the same political constraints that fettered previous presidents.

One constraint is the propensity of the ruling coalition to fragment, especially if market reforms are ever announced. Chávez's ruling coalition, Polo Patriótico, is almost identical to Caldera's— an ad hoc, last-minute mélange of small, marginal parties of the left and the military sector, with support from defecting factions of some traditional parties. This coalition is also susceptible to the same structural instability as the preceding one. None of the parties in the Polo Patriótico has developed a strong political machine, which might compel Polo's leaders to use state resources to build political machineries. This is tantamount to pressures for populism from within.

The other problem is the non-renewal of the old left—Chávez's closest allies. Like the traditional politicians of AD and Copei, old left leaders have been historically exempted from the need to compete for votes in order to justify their leadership positions within their respective parties. Until the 1980s, the old left held a permanent minority status—a status that its leaders resigned themselves to. This resignation meant exempting themselves from pressures for self-renewal and elite rotation. The payoffs for self-renewal were simply too small. Regardless of how much renewal there was, they would still fail to defeat the two largest parties.

In 1993, the old left came to power almost by accident—by cleverly aligning themselves with the most probable victor, Rafael Caldera. And despite their disastrous performance in office since 1994, they still managed to retain power, again by conveniently bandwagoning with the most likely winner, Hugo Chávez.

The old left has always been on the fringe of political competition, and hence, insulated from mechanisms that would penalize, and possibly expunge, political vices. It is, therefore, unclear that the old left has freed itself of the same excesses that doomed the politicians of traditional

ECONOMY COUNTRY SPOTLIGHTS

parties—a propensity to privilege populism over real solutions to economic predicaments, to arrive at decisions through closed-doors deliberation, to create impediments for the entry of new talent and ideas, to be disdainful of dissent. These are the same vices that precluded Venezuela's old political leadership from responding responsibly to continued economic crises.

Much has changed in Venezuela in the last year. But one of the country's most pernicious political scourges the capacity of political elites to retain leadership position regardless of electoral contests— still lingers. As long as this democratic deficit endures, don't expect Venezuela's fiscal deficits to go away that easily.

Javier Corrales (Harvard Ph.D. 1996) is Assistant Professor of Political Science at Amherst College, Amherst, Massachusetts. Parts of this piece draws from "Reform-Lagging States and their Refusal to devalue" forthcoming in Riordan Roett, ed., tentatively titled Currency Crises and Latin America.

Will Brazil Restructure Its Domestic Debt?

It Could Be a Matter of When

BY SIMON ROMERO

HE ECONOMY IS MATURE BUT the Government, an adolescent." That's the way Gustavo Franco, a former president of Brazil's central bank and a Harvard-trained economist, recently described how the country's handling of public finances is viewed by many foreign investors. To be sure, when it comes to honoring obligations with its creditors, recent history is not on Brazil's side. In the last twenty years, Brazil has defaulted on its domestic debt three times, during "Cruzado," "Bresser" and "Collor" economic programs, in addition to three "technical" defaults on the foreign debt, in 1982, 1986 and 1990.

Now, in the jockeying ahead of the 2002 presidential elections, the issue of restructuring Brazil's estimated \$200 billion of domestic debt has reemerged, thanks largely to another well-known Harvard personality from Brazil, law school professor Roberto Mangabeira Unger. Unger is the principal advisor to Ciro Gomes, the presidential candidate from the northeastern state of Ceará whose rapid rise in the polls and much-publicized romance with actress Patrícia Pillar has made him the darling of the Brazilian media. Together, Gomes and Unger are advocating a re-negotiation with the Government's creditors that would

hopefully result in longer maturities and lower interest rates on Government bonds. They say their proposal would lay the groundwork to narrow the budget deficit, which at the equivalent of 12 percent of gross domestic product is the main stumbling block

to sustainable economic growth.

Their proposal is risky, having already been characterized by President Fernando Henrique Cardoso and some investors as a "default." Unger, though, sees it differently. "One thing is not paying creditors. Another is changing

the context in which you bargain with them," Unger says in "The Second Way: Present and Future of Brazil," a type of manifesto distributed by Carta Capital, a São Paulo-based magazine. Part of the way Brazil could change the bargaining context would be to charge the central bank with controlling the entry and exit of capital flows. The key ingredient for making all of this work would be a "Government capable of exchanging colonial fatalism for a commitment to Brazil."

Of course, the elections are a long

way off. And Cardoso's Government has been able to gradually lower the interest rates it pays on its debt in recent months in an effort that could eventually accomplish what Unger and Gomes say could only be attained through tough negotiation. Yet Unger

The issue of

restructuring

Brazil's estimated

\$200 billion of

domestic debt

has reemerged.

isn't losing any time, after saying that he may run for mayor of São Paulo in a campaign that would give him lots of space in the media to espouse his views. And Gomes? The 41-year-old former finance minister, who also spent time at Harvard as a visiting re-

searcher in 1995, is basking in the attention that his campaign, and his proposal for restructuring Brazil's debt, are receiving so far. "I don't want to become President of the Republic by fooling anyone," he says. "I want to be elected with the public having clear knowledge of my proposals."

Simon Romero, who graduated from Harvard in 1994 with a History and Literature concentration, writes for The New York Times from São Paulo, Brazil.

variety of working papers, ranging in subjects from Caribbean identity to the Guatemalan military to the Argentine pampas. For a complete listing, see our website http://www. fas.harvard.edu/~ drclas/publications /workingpapers/ index.html> or e-mail <jerlick@fas. harvard.edu>.

DRCLAS offers a

The Central America Project

Central America at the Crossroads

BY FELIPE LARRAÍN B.

FTER DECADES OF ARMED CONFLICT AND POLITICAL instability, Central America is entering a period of peace and democracy that opens promising perspectives of economic and social progress. The signing of the Guatemalan Peace Treaty in December 1996 marked the end of four decades of violent confrontation in that country. For Central America as a whole this was a particularly meaningful date: for the first time in one hundred years, the region started 1997 without any internal or external armed struggle

After this long period of internal conflict, the countries of the region are now facing the immense challenge of improving living conditions for their people and tak-

In this context, Harvard University was commissioned to help design the policies that would lead countries toward these objectives. This has been a joint effort with INCAE, a regional business school, counting on the active participation of government and private sector representatives from the region. The initial assessment determined the need to direct research and advisory efforts into five main areas: business competitiveness, environment, governance, legal reform and macroeconomics. Because economic and social development is a multi-faceted process, isolated progress in a particular area cannot produce successful development. Only a coherent effort in several fronts may succeed in this task.

As part of this effort, faculty from Harvard Business School, Harvard Law School, the Harvard Institute for International Development (HIID), the John F. Kennedy School of Government, the Center for International development and the David Rockefeller Center for Latin American Studies have been engaged in a threeand-half year multidisciplinary effort. The results of this project, which have already been presented to the Presidents of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, will give shape to a series of volumes to be published under the Harvard Studies in International Development, a collaboration of Harvard University Press and HIID. It is impossible to do justice in a short space to the work of so many people. Therefore,

this article concentrates mainly on how macroeconomic policies can contribute to development.

In the early 1960s, Central America had an average per capita income similar to that of the other Latin American countries and higher than East Asia's. Three decades later, East Asia's per capita income was five times larger than Central America's, while Latin America's income was twice as large. The decade of the 1980s was particularly hard for the region, which saw its income per capita decline at an average of 1.5% per year.

What happened to Central America over these thirty years? Why, in spite of its privileged geographical location, so close to the largest world market, did the region stagnate? The answer must be found in the mix of political instability, violence and failed economic policies.

The resolution of major political conflicts and armed



For Central America's future

ing advantage of the rich base of resources they possess. More than 50% of Central Americans live under the poverty line, although the situation varies from country to country. Countries have a moral imperative to implement policies that would lead their people out of poverty. There is another dimension to this, too. Successful integration of the poor into the society will provide a growth bonus for the countries as well.

In a lucid and far-sighted decision, the region's Presidents formed the Alliance for Sustainable Development in Central America in August 1994. Responding to the opportunity provided by the advent of peace, the region's governments joined their efforts to seek higher and sustainable levels of human development. The goal of this initiative was to pursue economic development in tandem with social welfare, political democracy and environmental balance.

struggles in the 1990s has brought new hopes to Central America. Growth has resumed, real wages have increased, and the countries are attracting significant foreign investments. Exports have shown interesting dynamism, especially in non-traditional sectors. Despite all these good news, however, the region still has a lot of unexploited potential. With adequate policies and some foreign cooperation (especially in terms of market access), Central America can aspire to economic growth of 5 to 6% over the next two decades. This can be achieved through increased investment coupled with faster productivity gains.

The characteristics of the region in terms of location, size, cost of the labor force, and climate render export-led

growth as the only viable economic development strategy. Central America is privileged in its proximity to the U.S. market, but so far this advantage has not been exploited adequately. For example, despite the fact that the distance between Central America and the U.S. is a third of that between Asia and the U.S., the cost of shipping goods to North America is lower from Asia.

So far, Central America's exports have been concentrated in a few natural resources. The share of natural resource exports in total exports ranged between 50 and 70% for the different countries in

1996. Even though these are large numbers, they show an improvement with respect to 1985, when the same ratio ranged between 70 and 90% of total exports. Efforts are currently focused on diversification, moving towards a composition of exports with a larger base on manufactures and higher value added products. Honduras and Nicaragua, and more recently Costa Rica, have experienced a remarkable change in this respect over the last decade.

Diversification of exports will reduce the region's vulnerability to external shocks. The current expansion of Export Processing Zones (EPZs) is broadening the export base. Remarkably, the arrival of Intel to Costa Rica is giving a big boost to the diversification of manufactured goods and exports. By itself, Intel is already generating over \$1 billion of exports, which amounts to around 10% of Costa Rica's national output.

Perhaps paradoxically, Central America has become an unintended casualty of the North American Free Trade agreement (NAFTA). NAFTA was, of course, never intended to hurt this region. Nonetheless, as a consequence of the Agreement, Mexico now enjoys preferential access to the U.S. market with better terms than Central America. Mexican goods now face lower tariffs in the U.S. through NAFTA than Central American goods through the Caribbean Basin Initiative (CBI). Moreover, NAFTA is a treaty, whereas the CBI is a unilateral concession. The garment industry in Central America, a vitally important sector, has been affected by this differential treatment.

Foreign investors with an eye on the U.S. market find Mexico to be a safer bet. In the dynamic and competitive global economy, this hurts both exports from Central America and foreign investment in the region. It is imperative for Central American development to get on an equal footing with Mexico on access to the U.S. market. A recent U.S. Senate bill led by Senator Graham has attempted to correct -though only partially-this disad-

Changes in fiscal policy can also make a large contribution to development. Public sector expenditures are too low in El Salvador and Guatemala to fulfill the necessary role of the government as provider of goods and services. A problem also exists with the composition of those

expenditures: public spending in education and health is notoriously low almost in every country, insufficient to meet the most basic needs and to promote an equitable development process. The Guatemala Peace Treaty of 1996 included an important commitment to improve social expenditure, which is a good indication in that respect.

Tax reform is also needed to provide an increase in total tax collection in the countries where the public sector is too small and a reduction of distortions caused by overly complex tax systems. A simplified system will rebuild public trust

and will help combat tax evasion. Tax policy must also contemplate specific corrective levies geared to align private incentives with environmental considerations.

Another important factor constraining development is the burden of the external debt. This problem severely affects Honduras and Nicaragua. Their low level of income makes an even more urgent case for them to obtain relief on their debt obligations from the international community. The Highly Indebted Poor Countries Initiative (HIPC) -including its recent more flexible interpretation- appears as a possible alternative, although current conditions may still delay relief quite substantially and/or provide insufficient relief. The international community should provide a fast and deep response to this problem.

There are, to be sure, many steps that the Central American countries can take on their own to foster development. One pending issue that may bring important positive effects in several areas is the reform to the social security systems. So far, this reform has only been implemented in El Salvador. Currently, pensions systems cover a very low fraction of the population, with the exception of Costa Rica. Their financing basis—a pay-as-yougo formula—delivers low return in the demographic context that Central America is facing, with low fertility ratios and increasing life expectancies. The moment seems appropriate for countries to move to schemes based on the funding of contributions and private management. The cost of such a move is low now, precisely because

Countries have a

the coverage of current social security is very low.

The benefits of such a reform will have multiple dimensions. Funded systems can obtain larger rates of return than the systems they replace. This implies that rates of contributions can be reduced, which benefits workers directly. At the same time, distortions in the labor market are reduced and coverage of a larger fraction of the population becomes more feasible. Pension funds can also have a crucial role in the development of financial markets, as the experience of countries that have gone through this reform, such as Chile, attests. For Central America, where financial markets have low levels of development, private pension funds can constitute a cornerstone for their expansion.

Financial markets may contribute significantly to the development process, as recent empirical studies show. For a long time, however, financial markets were repressed in the region. Limits to interest rates and government intervention in the allocation of credit were common throughout the region in the 1980s. In Costa Rica, El Salvador and Nicaragua the whole banking sector was public. During the 1990s, financial liberalization proceeded. Interest rates were freed and credit allocation reduced remarkably, while increased private sector participation has been allowed.

The liberalization of the financial sector has required substantial improvements in the regulatory skills of the government. In some cases, the expansion of financial activities has gone faster than the capacity of governments to respond to the changes and provide appropriate supervision of financial institutions. A few financial companies have been liquidated in El Salvador and the situation of banks is believed to be rather fragile in some countries.

The greater the extent of privatization, the more important the role of the government becomes as an efficient regulator. This imposes a new role on the government in terms of providing skilled and up-to-date regulation techniques. Even though this may seem costly, countries in the region can avoid the duplication of costs by integrating regulatory efforts across the region. This would save resources and would constitute a significant step towards economic integration. Moving towards regional institutions that regulate and supervise different activities will be a strong force towards homogenization of rules and standards across the region. This, in turn, will facilitate the operation of firms across borders.

The recent tragedy of Hurricane Mitch highlighted another crucial element for successful development in Central America: the need to reduce its vulnerability to natural disasters. There is a clear need for a stronger safety net in the region, which should include environmental, economic and social elements. Much has been accomplished in Central America during the current decade, but much still remain to be done.

Felipe Larraín is a Robert F. Kennedy Visiting Professor of Latin American Studies and Director of the Central America Project at Harvard University.

Rockefeller Center
for Latin American
Studies Corporate
Partners Program
offers unparalleled
access to Harvard
University's
experience and
expertise on Latin
America. Corporate
partners will
receive invitations
to send representatives to
conferences and

two special annual

events. For more information,

contact Magdalena

Sofía López, tel. 617-495-9628,

e-mail <lopez3

@fas.harvard.edu>.

The David

A Look at Zamorano

Yankee pragmatism transplanted to the tropics

BY JUNE CAROLYN ERLICK

ORGE IVAN RESTREPO WAS INtrigued. Every morning, he watched his professor leaning on a railing to observe cows as they came in from the pasture to be milked. Finally he got up the courage to ask why. The professor—who was also in charge of the production department—explained he could tell by the way the cows moved if they were sick.

The pastures of Zamorano, a field-based college in Honduras, from which Restrepo graduated as an agronomist in 1982, seem worlds apart from Harvard, where he received his Masters in Public Admin-

istration in 1998. Yet the two share many links in graduates, exchange programs, and advisory boards.

Restrepo, a 1997-98 Mason Fellow at the John F. Kennedy School of Government who recently directed the Environment Division of FES Foundation, Cali, Colombia, says that the professor's answer taught him the value of practical experience.

"From that moment," he said, "I understood that it wasn't just important to understand in theory what illnesses attacked cows or the scientific description of those illnesses, but also that one had to look at the way the cows behave and to observe them.



At Zamorano, I found the answers to learning in the real world."

Keith Andrews, Zamorano's director, agrees. "All of our students, all of our graduates are proud that they get their hands dirty; that's very much different from the scholastic tradition that predominates in most other Latin American universities," he said in an interview on a recent visit to Harvard. "Because we had a strong technical orientation, kind of Yankee pragmatism transplanted to the tropics, it allowed us to attract a strong student body with remarkable faculty to go in a different way from other academic institutions."

Zamorano, which was Central America's first private, non-religious college, now has 4000 graduates. Started as an agronomy school with a junior college environment, it has now expanded to a full four-year university curriculum including agricultural science and production, management of agrobusiness, agroindustry (food technology, inducing change in production, both food and lumber); social development and environment. Courses range from animal nutrition and plant physiology to advanced physics and macroeconomics and agricultural policy.





eas all tries to find underprivileged students o betwith academic promise.

"These have shown themselves to be diamonds in the rough, and we support a lot grab them up, and we support a lot

be diamonds in the rough, and we grab them up, and we support a lot of them," explained Andrews. This recruitment effort goes on in 15 countries. Freshman students receive courses to compensate for differences in writing skills and familiarity with the Internet. In many countries, there are pre-Zamorano programs in which students can upgrade their skills in mathematics and chemistry. Zamorano is also working on a distance education program to better prepare future students. Ironically, Andrews observes, the dropout rate for both groups is about the same: poor kids may find the course too academically difficult, while some wealthier students find the program too demanding and don't like the lack of comfort.

For Zamorano students from wealthier backgrounds, the insitution's outreach program may be an eye-opener on poverty; for the students from less privileged background, it provides a training ground to take new skills back to their communities. The large outreach program trains about 10,000 people each year, most of them peasants and their families in Honduras, Nicaragua, and El Salvador.

"We are working mainly with hillside farmers on environmental aspects of agricultural production and community development and other environmental issues," explains Andrews. "And we have done it in a way that In the Dairy and Meat Products Enterprise, students produce yogurt, a dozen kinds of cheeses, ice cream, and milk. These practical activities complement the theoretical instruction offered in Zamorano's new Food Technology Career.

In the Intensive Crops Enterprise, students learn to produce highquality vegetables in plastic greenhouses.

"The first three career areas all focus on making the status quo better and creating wealth," explains Andrews, who has been at Zamorano 19 years, seven of them as director. "The fourth area is a direct frontal assault on poverty in the forgotten areas of Latin America." In this part of the program, there is strong focus on converting subsistence farmers into micro entrepreneurs."

The revised curricula is not the only change at Zamorano. The college, all male students until 1981, is now 23 percent women. Its students and faculty come from way beyond the borders of Central America: last year's class had 850 students, who came from 23 countries, half from Central American, half from the rest of Latin America, with a "sprinkling" from Caribbean and Europe, according to Andrews. Diversity has also been encouraged by recruiting among Haitians and indigenous groups, particularly from Ecuador and Bolivia

"We aspire to be the region's number one undergraduate leadership preparation program," he added. "Our mandate is to train human resources for Latin America."

Zamorano uses a two-pronged recruiting program to encourage social diversity in its student body. The first recruits all over the region for students who are self-subsidizing and able to pay tuition that is expensive by Latin American standards. The second recruitment process targets poor, mainly rural high schools and

has maintained the spirit of the idea that we are here to be supportive of what societies decide they should do rather than us as perceiving ourselves as many academics do as a driving force behind social change. It puts us in a different role in society; we're here to produce the people that shake up the world, but we don't shake up the world ourselves."

Students do go on to become leaders, and several graduates—including former Mason Fellow Restrepo—

have done postgraduate work at Harvard, with whom institutional links are informal but strong. Francisco de Sola, a member of the Advisory Committee of the David Rockefeller Center for Latin American Studies, is also on the International Board of Advisors at Zamorano, a group of 25 members from nine countries. Harvard Business School Professor Ray Goldberg sits on the same board. Philip Lehner, another DRCLAS Advisory Committee member, is a trustee, as

is DRCLAS donor George Gardner.

Zamorano also has very close links to another Central American institution officially affiliated with Harvard—the Central American Business Institute, INCAE (see p.).

"INCAE is different from Zamorano in two ways: they focus on management and business, and they work entirely at the postgraduate level. We work almost entirely on the undergraduate level, so there's a wonderful complementary there. We prob-

munities scattered throughout

Zamorano and its Neighbors

Lizet and Living Locally

BY NINA RABIN

We walked along together, 12-year-old Lizet and I, down the narrow, ragged paths that connected the various houses of El Chaguite to one another. "Let's call in from here," Lizet said quietly. "They have dogs that bite." Or at another house, "Oh, no one talks to this family. People say he killed his wife years ago." Throughout my time working in El Chaguite, and particularly in those initial days trying to organize a youth group in this unfamiliar, slightly hostile place, Lizet was my tireless helper, a constant source of information on the complex relationships and personalities that filled this small community of 70 families in rural Honduras, a few miles but light years away from my base at the Zamorano campus.

Lizet loved to explain to me the special names they had for the fruit trees in their region, the different customs they had for using plants for medicinal reasons, the superstitions they had about certain animals or weather patterns. And over time, my open ear was all it took for her to begin expressing and articulating her thoughts about her community, her goals, her friends and frustrations. This type of selfawareness and expressiveness, rare in young girls in any culture, was almost unheard of in the girls I met in rural Honduras. And what was especially exciting to me was to see Lizet take an increasingly active leadership role in her community, as if her self-awareness was freeing her to take control of her life in a way that few in her community could. Over the course of our conversations. she was able to "look at herself in the mirror"and her selfawareness enabled her to give back to El Chaguite.

My relationship with Lizet gave unexpected, but powerfully fulfilling, form to the vague economic and ecological ideas that had landed me in Honduras. Inspired by a Harvard undergraduate conservation biology seminar, I had decided that I wanted to work on local level environmental education in Central

America after graduation. In addition to my interest in conservation in the tropics, community- level work in a developing country also appealed to me as an opportunity to escape the oasis-like quality of campus life, which had been increasingly weighing on me. I had been rooted in academia all my life - the first 18 years as the daughter of a Stanford professor, and the next four as a Harvard underaraduate - and so I found it hard to shake the sense of living in an isolated community with elevated standards of living. But after researching various alternatives, I found that the best means of pursuing my interest in local level environmental education was through the UNIR rural development project, based on the campus of the Zamorano agricultural college in Honduras. So, despite feeling somewhat leery of living on yet another university campus, I found myself heading for Zamorano.

Once there and faced with the realities of life in the com-

the steep green mountainsides surrounding Zamorano, everything that had brought me to Honduras was turned upside down. The beauty of these communities—the crops hugging the mountainsides, the splashes of color from tropical flowers and butterflies and clothes hanging out to dry, the red shingled roof tops tucked away behind unexpected turns of the winding dirt road - was breathtaking. Yet this beauty is the product of a degree of remoteness that is intensely disturbing as well. The steep mountainsides that are these people's homes create unbelievable limitations on their lives, both physically because of inaccessibility to health care and proper nutrition and electricity, and mentally because of inaccessibility to any knowledge about the diversity and richness of the world beyond these mountains. It is impossible to romanticize their remote lives when one sees the poverty that goes hand in hand with the simple beauty - the dilapiably have 250 of our graduates who have gone on to INCAE,"said Andrews. "As we work more closely with INCAE, we think that will bring us closer to Harvard. Clearly, it is to Central America"s benefit to use any mechanism to bring first-rate human resources anywhere in the developed, wealthy world to bear on the developing problems in Central America, as Zamorano intends to do."

Zamorano has conducted student and faculty exchanges, sabbaticals,

and in-service training with leading institutions of higher education around the world, including Harvard. Other educational partners are Purdue, Florida, Cornell, McGill, and Berlin University, among others. Andrews hopes to strengthen ties with Harvard. One of his dreams is to establish a program with a first rate U.S. college or university that would allow Zamorano students to receive the first two years of a liberal arts education at a U.S. university, com-

pleting university on the campus outside of Tegucigalpa "to learn the real issues that confront Latin America and (to) get first-hand experience to complement what they're studying...wouldn't it be great if we could do it with Harvard?"

June Carolyn Erlick is the Publications Director at the David Rockefeller Center for Latin American Studies. She worked as a foreign correspondent in Central America from 1978-1988.

dated homes, the dirty wandering children, the swarms of flies.

After seeing this reality, I felt inclined to talk to the community members about sanitation rather than biodiversity, and about self-esteem rather than stewardship. It made me question whether my previous enthusiasm for conservation was misplaced. In a country like Honduras, did the truly important work lie in fields like public health and food distribution? At the same time, the contrast between these realities in the communities where I worked and the lovely gardens, unlimited cafeteria food, and computer centers of Zamorano became increasingly uncomfortable to me. I did not begrudge Zamorano any of its accommodations - I savored the e-mail access, hot showers, and excellent library as much as anyone but it was hard to feel at ease living amidst these contrasts. I found myself struggling harder than ever with how to live responsibly and productively in a world with such fundamental inequities.

These questions became all the more intense in November, when Hurricane Mitch hit Honduras. The river receded in a

matter of days, but the currents of pain, loss, destruction, despair, and economic devastation coursed through the area relentlessly. As Mitch's emergency phase somewhat subsided, I saw more clearly that the problems now attracting such an outpouring of international support were not truly created by the rains. For most Hondurans, life is so thinly based - economically, spiritually, socially, ecologically - that all it takes is several days of heavy rains to sweep away the thin veneer of acceptability and uncover the severe underlying deficiencies of their society.

My relationship with Lizet gave me something to hold on to amidst this confusing, upturned world. Her growth, through the growth of our relationship, showed me that potential for change exists, even in a world fraught with such deep inequities and chaotic tragedy. Mutual inspiration flowed between us; she inspired me with her sincerity, her enthusiasm, and her quiet bravery, while I inspired her with the realization I could provide of the possibilities for change in her life and her community. Through my relationship with her, I discovered an approach

to conservation that felt appropriate to the realities of the communities where I worked: conservation centered around the concept of self-awareness. Giving sustainable development work this focus would directly address the region's shortterm, destructive use of natural resources, for I found these unsustainable habits are often the product of a pervasive sense of powerlessness shared by many Hondurans. They feel they can only control the immediate, and thus seek to maximize it, because they have so little faith in their ability to control events down the road. Sadly, most development efforts I encountered only seemed to be furthering this sense of powerlessness. I know that spending one-on-one time with every young person in every rural village in Honduras is an unrealistic proposition, but with a shift in framework and some creativity, perhaps this emphasis on personal awareness could be integrated into larger- scale conservation work.

Equally important, I think, is the need to apply this approach to campus life. I know that Zamorano is a college, not a rural development

program, and its responsibilities and goals are diverse and far reaching. Local-level work is perhaps becoming more of an institutional priority, but it needs to become more so to provide a powerful and illuminating example to both Zamorano students and the community. By investing time and care into local level relationships, I believe, self-awareness and inspiration could run both ways, just as it did for Lizet and me. We led one another, each in our own way, through the reality and potentiality of her community, so close to Zamorano and yet so far away.

Nina Rabin graduated from Harvard College in 1998 in the department of History of Science, an interdisciplinary concentration in which she focused on the social and scientific dimensions of conflicts over natural resource use in American history. She received a travel grant from the Baker Foundation to spend the year following graduation in Honduras, pursuing her interests in environmental education and sustainable development. She is currently working at the Environmental Law and Policy Center in Chicago, and preparing to enter law school in the fall of 2000.



The Birth of INCAE (1963-1965)

A View from Harvard

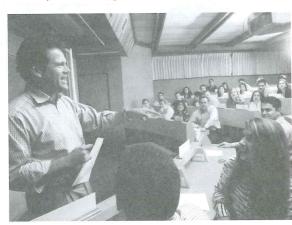
BY GEORGE CABOT LODGE

INCE THE BIRTH OF INCAE WAS CLOSELY TIED TO THE beginning of my career at Harvard Business School, the reader will perhaps forgive the autobiographical tone of these reflections. And right at the start, it should be said that both beginnings were marked by uncertainty; there were reasons to doubt that either would succeed. I like to think the infants nourished each other.

In February 1963, after an unsuccessful run for the U.S. Senate, I joined the faculty of Harvard Business School on a very temporary basis to help direct the division of international activities, which oversaw various management schools Harvard had set up in the Philippines, India, Turkey, and later Iran.

As assistant secretary of labor for international affairs during John F. Kennedy's administration, I had many friends in Washington, including Walt Rostow, then head of the State Department's policy planning staff. When I told Walt about the School's desire to be useful in Latin America, he immediately suggested that Central America might be the appropriate place for us to go. The need for managers was great, he said, and funding for Harvard's effort could undoubtedly be arranged through the Agency for International Development (AID) as part of Kennedy's Alliance for Progress.

The Central American site seemed promising to me because of the research and learning opportunities it offered HBS—six very different countries, in varying stages of development, engaged in creating new regional organizations to manage their increasing interdependence. Since I suspected there might be hesitancy about government funding, I asked Walt if the invitation for the project might come directly from the President. I soon found myself hacking out a draft for President Kennedy on Walt's typewriter. It said, in part, "My recent



talks with the Presidents of the Central American nations reemphasized our mutual concern for the rapid development of human resources in this critical area. The participation of the Business School in a program to strengthen management would constitute a vital step toward sound regional integration, a major objective of the Alliance for Progress."

Two HBS senior professors, Henry Arthur and Thomas C. Raymond, traveled with me to Central America to meet with business and university leaders. We met with mixed reactions about establishing a graduate school of management in the region. Many felt that management could only be learned by experience and doubted that professors from the United States, ignorant of Central America, would be of much help. University officials viewed the case method and field-based research with suspicion, preferring theoretical conceptions of higher education.

Then one evening at an embassy reception in San Salvador, I met Francisco de Sola. He took me aside in the serious way he had and asked me to tell him what we at Harvard had in mind. I described the case method: going out into the fields and factories of Central America, identifying the actual problems that managers confronted, analyzing how they were dealing with them, and discussing possible improvements. We certainly were not suggesting that we as teachers, especially Harvard teachers, had the answer to Central America's problems. Those would have to come from the region itself. After three hours of conversation, Don Chico said, "We have no choice. We must do it." That, I think, was the moment INCAE was conceived.

Managing the introduction of change seemed to me of paramount importance to Central America and thus to INCAE; Francisco de Sola and the other members of what became INCAE's board of directors agreed. This commitment to the management of change as well as the case method itself has meant that INCAE has never been the captive of any ideology—capitalism, socialism, or whatever. It also established early that INCAE's primary concern was to train managers—for both the private and public sector—in order to promote the welfare of the communities it served.

There was much excitement in the early days—and many problems. We began by organizing a series of four-week seminars for business leaders and government officials. The second seminar we held was in Boquete, a beautiful, remote village in the mountains of western Panama. We chose the site not wanting executives to be distracted by urban diversions.

The seminar was held in a local high school which had one large open air room built of concrete with a very high ceiling. The first problem was one of acoustics: voices were swallowed up by echoes. A rug was flown up in a DC3 from Panama City. Then there was the blackboard problem. One of the most challenging aspects of the Boquete program was the erection of blackboards,

which Harvard professors use prodigiously. Two-by-fours had to be nailed together to reach from the floor to the ceiling, which was about 40 feet in the air, then braced, framed and made to hold the massive boards. My Spanish was none too good, and my carpentry worse; nevertheless, even though local carpenters found the requirements appalling, we finally erected a structure that withstood the pounding my colleagues gave it. The simultaneous interpreters—from New York in those days—arrived to discover that none of their equipment worked. Happily, a highly skilled electrician with the local phone company passed by at the crucial time, and

INCAE Today

INCAE, a private international institution dedicated to teaching and research in business administration and economics in Latin America, has a long-standing tradition of more than 33 years in training Latin American business people and top executives.

Harvard Business School Professors James E. Austin, Wickham Skinner, James L. Hesket, Ray Goldberg, and George Cabot Lodge, as well as Weatherhead Center for International Affairs (WCFIA) director Jorge Domínguez, serve on INCAE's advisory board, and Harvard professors frequently serve as visiting faculty.

INCAE's Center for Competitiveness and Sustainable Development—which had its roots in a 1995 meeting with Harvard Business School Professor Michael Porter and Central American heads of state and business leaders at INCAE's campus in Costa Rica, in January 1995.

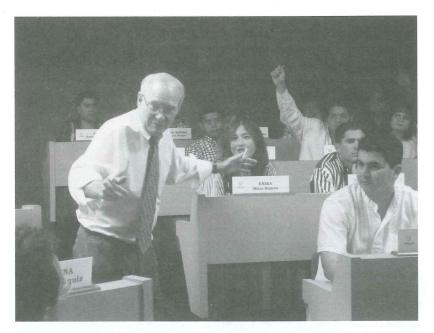
INCAE routinely sends its top graduates —which includes the president of the U.S. Fortune 500 company H.B. Fuller Co. and several current Latin American government ministers— to Harvard to pursue their doctorates, in exchange for a five year teaching commitment upon completion of their degrees.

INCAE now offers a Master's in Business Administration (MAE) a Master's in Business Economics (MEE), Master's in the Administration of Natural Resources, and the Master's in Industrial and Technological Administration. Also offered is a continuous sixteen month MBA program at the INCAE campus in Montefresco, Nicaragua, and an Executive Masters program given on a rotating basis in a different Latin American nation every year. INCAE has two campuses, one in Alajuela, Costa Rica, the other in Montefresco, Nicaragua, as well as offices throughout Central America and Ecuador.

The school has graduated thousands of students and now has a student body of more than 400 from 15 countries. Women, whose participation is encouraged, make up 20% of the student body.

Master's programs rely heavily on field work, which has been carried out in more than 43 companies throughout Latin America, including Carrier Corporation in Monterrey, Mexico; Filanbanco in Quito, Ecuador; Bayer, L.A., British American Tobacco, L.A., and the Stock Exchange of Lima, Peru.

INCAE has extensive library systems, with approximately 81,000 volumes total. They are among the most complete business and economic libraries in Latin America, with CD- ROM and on-line data bases as well as Internet access. INCAE also has 3,000 cases written by its faculty on Latin American business and economic topics.



all was saved.

Boquete proved productive. As the seminar drew to a close, the participants drafted a statement on "future social and economic changes in Central America and Panama." In the fall of 1964, INCAE directors decided that the institution should be located in Nicaragua because of the Nicaraguan business community's pledge of free land and \$250,000, as well as the fact that

Nicaragua had fewer regional agencies than the other countries. A team from Harvard's Graduate School of design arrived, was flown over central Nicaragua, spent days driving here and there, and eventually recommended the site on which one of INCAE's campuses is located today, a few miles outside of Managua in the highlands.

The main campus is now in Costa Rica, and the world has changed in the last 30 years. It has become more interdependent and more competitive. There is no possibility of isolation; there is no place to hide.

To produce the changes Central America needs, to raise the living standards, and to retain control of its political and economic systems, Central America must be competitive. This requires a community committed to high levels of education for all of its people. It requires a community of managers who see their purpose as the service of community needs and their relations with those whom they manage as being cooperative rather than adversarial. These are the prerequisites for communitarian success in the world today, Their achievement is the challenge facing INCAE and its graduates.

George Cabot Lodge is Jaime and Josefina Chua Tiampo Professor of Business Administration (Emeritus). He was assistant secretary of labor for international affairs in both the Eisenhower and Kennedy years (from 1957 to 1961) and one of the founders of INCAE.

The Latin America

Research Office

will cover Mexico.

South America

and the 7

countries in

Central America.

Breaking Ground in Latin America

Latin America Research Office

ARVARD BUSINESS SCHOOL IS scheduled to open its new Latin America Research Office by August 2000 in Buenos Aires.. The office will provide support to HBS faculty conducting research in Latin America. Dean Kim B. Clark visited Latin America last fall and met with a number of alumni and prominent business leaders. A faculty advisory group on Latin America is now meeting regularly to iron out the details of the new research center, and a Latin America Advisory Committee has been created.

"Latin America is a fascinating region," said Clark after his trip to Brazil and Argentina. "I was thoroughly impressed by the tremendous entrepreneurship and energy there. HBS is eager to be involved in a mutually beneficial way." The new

office in Latin America will serve as "home away from home" for HBS faculty members and a facilitation point for research in Latin America. While the School has been involved in the region in a number of ways over the years, the center will leverage the School's research, course development,

and impact in Latin America.

Professor Howard H. Stevenson, a pioneer in the area of entrepreneur-

ship, leads the HBS faculty advisory group. Other members include James

E. Austin, Rafael Di Tella, Pankaj Ghemawat, Herminia Ibarra, Ashish Nanda, Rogelio Oliva, Thomas R. Piper, William A. Sahlman and Steven C. Wheelwright. The Latin America Research Office will cover Mexico, Central America and South America. The Buenos Aires office will serve as a hub for research

conducted throughout the region and will be staffed by a local director and research associates.

DRCLAS: Two New Chairs

HE DAVID ROCKEFELLER Center for Latin American studies recently received two gifts to create new chairs at Harvard University.

THE ROCKEFELLER HARVARD PROFESSORSHIP FOR THE STUDY OF LATIN AMERICA

David Rockefeller, business leader and philanthropist, has created the "Neil L. Rudenstine Professorship for the Study of Latin America" with a gift of \$3.5 million. The chair, which can be used in any of Harvard University's nine faculties, will be named "the Rockefeller Professorship for the Study of Latin America" until Rudenstine completes his tenure as President of Harvard University.

"David Rockefeller's vision, generosity, and constant personal involvement have led to the creation—and the flowering—of our Center for Latin American Studies, which celebrated its fifth anniversary this spring," said Rudenstine. "It has been more than a privilege for me to be able to be able to work with him, and to come to know him during the past several years. And it is a special honor for me to be associated with the David Rockefeller Center for Latin American Studies through the endowed chair that David has created."

In a phone interview, Rocke-feller reminisced about how Rudenstine approached him on the creation of the Latin American center after he became president of Harvard. In his previous position at the Mellon Foundation, Rudenstine had become very active in another Rockefeller initiative, the Americas Society. Rudenstine's proposal led Rockefeller to pledge \$11 million in 1994 for the creation of what became Harvard's David Rocke-

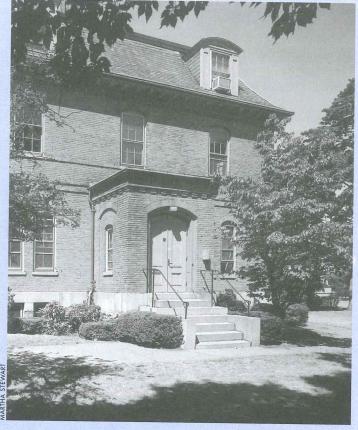
feller Center for Latin American Studies, named, he noted, "without my knowledge and a very generous thing to do." Part of that initial pledge went for the creation of Harvard's first university-wide chair in Latin American Studies, also named for Rockefeller.

Rockefeller said that when he determined to add a new pledge to his initial gift, he decided to honor Rudenstine with a second chair in Latin American studies.

"Neil's commitment to Latin America is indisputable," observed Rockefeller, who traveled together with Rudenstine to Brazil and Argentina last month. "We'd been partners in creating the Center. I thought it would be important to have two university-wide professorships in the Latin American area. Since one was bearing my name, it would be nice to have it named for the other person who was in a very real sense the founder of it, namely Neil."

The admiration is obviously mutual. Rudenstine says of Rockefeller, "What David has done for the Center represents only a modest fraction of all he has done for Harvard during the past half century—quite apart from all that he has contributed nationally and internationally. He is a wonderful friend; a person who leads by his combination of commitment, astuteness, knowledge, and modesty; and a benefactor who gives of himself as generously as he gives of his resources."

John Coatsworth, Monroe Gutman Professor of Latin American Studies and DRCLAS Director, said, "This is a splendid new gift that links the two spirits who together have put Latin America on Harvard's map. It is also wonderful tribute to the faculty, students, and staff who have made the David Rockefeller Cen-



ter such a lively and successful addition to Harvard's international studies community."

The new chair will support the appointment of a "distinguished scholar of international stature whose work has contributed significantly to the knowledge of the business, economic, social, political, environmental, or historical development of Latin America, to the understanding of Latin America's artistic and cultural achievements, or to the study of Latin America's relations with the rest of the world." The Rockefeller Harvard Professor may be appointed in any Faculty of the University at the discretion of the president in consultation with the appropriate deans and the director of the David Rockefeller Center.

"I think it's fair to say that the Center has clearly made it known throughout Latin America that Harvard now at long last has taken the lead in recognizing that close relations with Latin America are important for them and for us," observed Rockefeller. "We've done that previously with China, with Japan, Europe, the Middle East and so on with Centers, but it has never been done before in Latin America."

MONIQUE AND PHILIP LEHNER PROFESSORSHIP FOR THE STUDY OF LATIN AMERICA IN THE FACULTY OF ARTS AND SCIENCES

Philip Lehner, chairman and chief executive officer of Leigh Fibers, Inc., and his wife Monique, have made a gift of \$3.5 million to Harvard University to create a professorship for the study of Latin America in the Faculty of Arts and Sciences.

Under the terms of agreement with the Lehners, the Monique and Philip Lehner Professorship for the Study of Latin America "will support a distinguished scholar of international stature whose work has contributed significantly to the economic, social, political, environmental, or historical development of Latin America, to the understanding of Latin America's artistic and cultural achievements or to the study of Latin America's relationship to the rest of the world."

The gift creates the fourth new chair in Latin American Studies established at the University since the inauguration of the David Rockefeller Center for Latin American Studies in 1994. The Lehner's gift is the first such chair created in the Faculty of Arts and Sciences. The other three can be assigned by the president either to the FAS or to another faculty.

"The wonderful gift of the Lehners will contribute enormously to strengthening Latin American Studies at Harvard," said Jeremy Knowles, Dean of the Faculty of Arts and Sciences. "Through their generosity, we shall be able to bring to Harvard a professor whose teaching and scholarship is focussed on this region of the world."

Philip Lehner, who is also a member of the Advisory Committee of the David Rockefeller Center for Latin American Studies, said in a phone interview, "For nearly 40 years, Monique and I have been interested in Latin America, particularly Central America. It is where we have many close friends and various business activities. We have always been concerned about the numerous issues facing these countries in their efforts to improve their economies and have wondered about the appropriateness of the economic and political advice they have received."

Lehner, who graduated Harvard College in 1946, heads the firm founded by his father in

1921, which processes, imports, exports, and markets textile fiber wastes and industrial cleaning compounds. Philip and Monique, who graduated from Smith College in 1952, have four children and a dozen grandchildren.

"When David Rockefeller founded the Latin American Center in 1994, he created an opportunity for us to support Harvard and our interests in the region. We hope this professorship may help to bring to light answers and solutions that will benefit the people and bring

improvements to the area. Fred Glimp and John Coatsworth have been very helpful in structuring the professorship. We thank them very much," he concluded.

The Lehner Professorship will be allocated to a department in the Faculty of Arts and sciences by the Dean in consultation with the appropriate Department Chairs and the Director of the David Rockefeller Center for Latin American Studies.

"This splendid gift from Monique and Phil Lehner will make a huge difference for the David Rockefeller Center and for Latin American studies in the FAS and throughout the University," said John Coatsworth, Monroe Gutman Professor of Latin American Affairs and director of the Center. "Phil has supported and participated in many of the Center's activities, especially those related to Central America, ever since the Center was founded. He and Monique are wonderfully generous and gracious people. The Center is fortunate, indeed, to have such friends."

BOOKS

The New Agenda

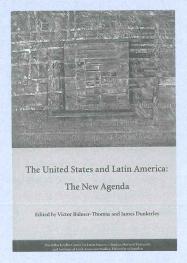
The United States and Latin America: The New Agenda, edited by Victor Bulmer-Thomas and James Dunkerley

Published by the David Rockefeller Center for Latin American Studies, Harvard, and the Institute of Latin American Studies, University of London, distributed by Harvard University Press, 1999

A REVIEW BY PATRICK J. MCDONNELL

T WOULD BE LOVELY INDEED to think that policy-makers in Washington were committed to the notion of a "New Agenda" in hemispheric relations. The concept of a New Agenda, as outlined in this timely volume, remains somewhat amorphous, but at its core it is this: a reconfiguration of what has long been a skewed regional relationship, replete with (from the U.S. side) open condescension, unbridled profiteering, rampant ethnocentrism, and, on many occasions, ill-advised military interventions, not infrequently causing great loss of life.

In their "Conclusions" section, Victor Bulmer-Thomas and James Dunkerly, the book's editors, cite the Spanish-American War of 1898 as "the decisive establishment of the asymmetry in continental power." Previous U.S. regimes, they note, generally refrained from implementing



the sabre-rattling rhetoric of the Monroe Doctrine or Manifest Destiny. (The Mexican-American War was the glaring, big-stick exception.) This enduring imbalance in U.S.-Latin American dealings has surely distorted the collective politic and inflicted lasting damage on both sides. Yet it is far from clear that the U.S.

political establishment is ready to embrace a more equitable arrangement.

This new collection, published jointly by the Institute of Latin American Studies, University of London, and the David Rockefeller Center for Latin American Studies at Harvard, consists of 15 chapters examining U.S.-Latin American relations in a historical context. Contributors explore many of today's headline-grabbing issues, including free trade, drug trafficking, migration, and, of course, Cuba. Versions of the papers were presented at a conference at the David Rockefeller Center a year ago (October 1998). The authors are leading academics- from the United States, Europe and Latin America—whose mastery of their fields is evident. Their styles, voices and orientations differ considerably, one of the strengths of this approach. But it seems fair to surmise that all adhere to the view that it is high time to place hemispheric relations on a more even footing. Whether one agrees or disagrees with individual contributors, the positions taken are inevitably thought-provoking.

The end of the millennium, it is argued here, may be a propitious historical juncture in which to begin to set things right in the Americas. A driving force behind this belief, of course, is the demise of the Cold War, which served to cement and harden U.S. hegemony in the name of fighting communism. The Cold War, and its aftermath, looms large in these pages.

Jorge I. Domínguez endeavors to apply a kind of logical/illogical scorecard to assorted interventions during the Cold War epoch. His conclusion: U.S. heavy-handedness in Chile, Central America and the Dominican Republic fail the logic test and were ultimately counter-productive: a triumph of ideology over reality. Most U.S. policies towards Cuba, however, are judged "not disproportionate," though Domíguez labels "illogical and immoral" Washington-sponsored "terrorism" against Cuba during the 1960s. Whether these questionable U.S. actions throughout Latin America made political points on the homefront —the true target audience— is a different matter altogether.

It has been ten years since the Berlin Wall came tumbling down. The free market, at least as defined in U.S. global-political terms, now bestrides the world triumphantly, the dollar even traded openly in Castro's Cuba. The twin mantras of "globalization" and "free trade" are chanted breathlessly from the Sonoran desert to Patagonia. Meantime, military governments, long the suppressors of regional democracy movements (and long key U.S. allies in the region), now seem an

unpleasant vision out of some distant past. But civilian governments can also be authoritarian and anti-democratic. A case in point: Alberto Fujimori of Peru, whose flouting of democratic principles has not raised hackles in Washington.

The march towards more democratic governments is generally viewed, and rightfully so, as a potential unifying force in the Americas. Democracy is even breaking out in Mexico, threatening the reign of the world's longest-ruling political party. The chapter by John H. Coatsworth, including a trenchant review of Mexican history going back more than a century, takes note of the limitations of what, in U.S. discourse, often passes as an allinclusive definition of democracy - namely, periodic elections judged to be relatively fair. This circumscribed view, Coatsworth writes, ignores the equally vital concept of "social democracy," something that is often not on the radar screens of U.S. diplomats. This refers to the availability of jobs, housing, health services, education and other necessities. Lamentably, closer U.S.-Mexico ties will likely not alleviate simmering social stresses in a nation that, since colonial times, has failed miserably to invest adequately in is population.

In the Americas today, it is not only world political and economic trends that can be viewed, broadly, as a unifying force. As Marcelo Suárez-Orozco notes in his insightful look at contemporary immigration, the large-scale arrival of new settlers from abroad is swiftly reshaping the demographic face of this nation. Its population, and its national culture, are becoming more Latin American. Latinos will soon eclipse African-Americans as the country's largest "minority." Salsa has supposedly already surpassed ketchup as the number 1 condiment. But immigration has also

been a divisive phenomenon, especially in California, where new arrivals, mostly from Latin America and Asia, have radically altered the population makeup. The emerging Latino plurality has helped ignite a fierce backlash and nasty statewide

The end of the millennium may be a propitious historical juncture in which to begin to set things right in the Americas.

campaigns targeting immigrants, affirmative action and bilingual eduation.

Perhaps the most troublesome issue raised in this book is the wide swath of destruction radiating from the U.S. "War on Drugs." This crusade, which in some respect has replaced the battle against communism, has apparently done little to curb the voracious U.S. appetite for forbidden pharmaceuticals. But the collateral damage in front-line sites -and, arguably, to the cause of democracy—has been dramatic. In his provocative report, "Hooked on Drugs: Colombian-U.S. Relations," Roberto Steiner traces the evolution of the narco-fixation, from the 1970s onward, and the disastrous consequences for Colombia. Poisoned by drugs, bilateral relations devolve from friendly cooperation to outright hostility, even as the drug-related slaughter continues on the streets and townships of Colombia. And, most ominously, Steiner cites a growing, U.S.-backed militarization that, in the author's view, threatens a noble tradition of democracy. A similar, albeit less dramatic scenario may be unfolding in Mexico. In Bolivia, writes Eduardo A. Gamarra, a "Vietnam-like mentality" drives a drug-war strategy that also tends to undermine democratic institutions.

For more than a century, the U.S. reflex on many issues in Latin America has been to act unilaterally. To this day, there is little evidence of a U.S. commitment to a multi-lateral approach to regional issues, including drug trafficking and illegal immigration. This does not bode well for advocates of a New Agenda. Compounding matters is the fact that Latin America, with the possible exception of Mexico, is not now a priority for Washington. Nor is a united European Union poised to step into the region and provide a counterweight to U.S. domination, as many Latin Americans would like.

Despite such limiting factors, the editors of this collection do see hope. Indeed, they point to some small advances. The United States did work collaboratively to resolve a nasty border dispute between Bolivia and Peru. Recently, the Organization of American States, long a vehicle for U.S. interests, has put on a more independent face in its election-monitoring activities. In addition, there seems to be an increasing U.S. commitment to multi-national summitrythough such gatherings are often more show than substance. After all the analysis, there remains a fundamental question: Is Washington interested in a true New Agenda that restores some balance to U.S.-Latin American relations? It remains to be seen.

Patrick J. McDonnell is a Nieman Fellow at Harvard during the 1999-2000 academic year. He is a reporter at the Los Angeles Times who covers immigration issues and has written frequently about Latin America.

Inequity as the Modern Plague

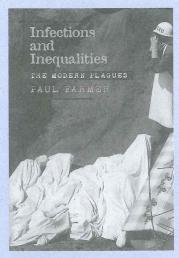
Infections and Inequalities: The Modern Plagues by Paul Farmer University of California Press, 1999

A REVIEW BY KRIS HEGGENHOUGEN

READ PAUL FARMER'S BOOK while on a short visit to Venezuela, and found that setting, at this historical moment in time, particularly pertinent and highly conducive to the arguments Farmer makes. While the book's message and appeal is (unfortunately) universal, it is particularly relevant for those interested in Latin America. Most of the numerous, and convincing, examples of the interactions between inequalities and tuberculosis, and inequalities and HIV/AIDS (the two infections prioritized), are drawn primarily from Haiti and Peru, where Farmer and his colleagues have worked for many years.

As I began Farmer's book late this summer, I had just finished listening to a television speech by the new Venezuelan president emphasizing health and the social sector as the most important for the nation. The president—criticized by outsiders as an autocrat, but tremendously popular among most Venezuelans who in the recent election gave him an overwhelming democratic victorycalled for a peaceful revolution to revitalize the country, ridding it of corruption, taking care of street children ('the children of the nation") and in particular, combating the obscenity of having 80% of the population living in poverty in a country as rich as Venezuela. He seemed set to engage in quite a similar kind of social restructuring called for in Farmer's book as a requisite to improved health (for the total population).

What will actually happen in Venezuela, and how quickly, is



still an open question, and whether a real reduction in inequity will take place, cannot be certified, but for the first time in 40 years, Venezuelans of different backgrounds told me, there is optimism and hope in the country. In terms of health, the hope is that at least the health services will be more equitably available to the totality of the citizenry. The health sector is being restructured for that purpose. Farmer says, "Greater access to effective medical services is but a necessary first step in stanching these epidemics" (17). And thus, because of its implications, the renaming of the Ministry of Health to the Ministry of Health and Social Development, is highly significant since it makes it clear that health is linked to, and dependant on, a variety of social factors and that these, not least of which is poverty and the degree of social and economic inequity, are directly related to people's health.

Farmer, in his book, makes a compelling case for the interconnection between inequity and infectious diseases and assembles a vast amount of evidence showing the preponderance of infectious diseases among the poorest segments of all populations (and especially so in the poorest of the world's countries). He says, "Clearly we live in a time of unprecedented wealth and technological advancement. But a growing and globalizing market economy has not, as promised, lifted all boats. Instead, increasing world wealth has been linked to a sharp rise in inequalities of various sorts." And he also deplores the commercialization of health and all its pharmaceutical, legal and medical 'business partners.' "If there is no role for any but the profiteers, what sort of 'health care environment' have we created?" He laments that any concern for the health of one's fellow being seems primarily based on a crass self-interest, and he asks, "By the crude calculus of

Farmer makes a compelling case for the interconnection between inequity and infectious diseases.

modern public health, will selfprotection become the sole justification for effective measures to contain the plagues of the poor?"

Tuberculosis has been referred to as a re-emerging disease, but not so says Farmer. It may have been out of sight and out of mind, as far as the well-to-do in rich nations were concerned, but it has persisted among the poor. It is a misnomer to suggest that TB is re-emerging. It has been emerging and persisting among the poor for a long, long time. This perspective also makes it clear that it is not primarily cultural differences and lack of patient compliance which are the crucial factors placing people at risk for TB or for AIDS and inhibiting treatment. Rather it is the structural violence of inequitable societies

One of the many strengths of Farmer's book is that he moves us to a different perspective from that which most of us look at the world. And as the clinician and anthropologist that he is he provides us with a complete and a complex picture, drawing not only on evidence from objective clinical studies, or on more qualitative anthropological data, but also on history, economics and politics. He moves us into the real world of the patients he treats in Haiti, in Peru, in Siberia, and closer at hand, in Roxbury (Boston), and he does so with passion and with disciplined scholarship—a powerful combination; an enviable ability.

And thus, instead of presenting tuberculoses or AIDS as the modern plagues—which of course they may well be called—Farmer tells us that "inequity itself [must be] seen as the most pernicious plague of our modern era." Inequity, because as long as it persists, as long as large reservoirs of populations in poverty persists, vast numbers of people will be at risk of a multitude of

infectious diseases which will continue to be visited upon the growing numbers of people who are disenfranchised on society's margins. Of tuberculosis, for example, Farmer notes that, "The poor have no option but to be at risk for tuberculosis; thus tuberculosis is merely one factor in an environment of structural violence. As long as inequity exists there is little chance for eradication of infectious disease. I can only agree.

Farmer refers to Amartya Sen who says, "'When we assess inequalities across the world in being able to avoid preventable morbidity, or escapable hunger, or premature mortality, we are not merely examining differences in well-being, but also in the basic

freedoms that we value and cherish." And to Wilkinson, who says, "It is now clear... that the scale of income differences in a society is one of the most powerful determinants of health standards in different countries, and that it influences health through its impact on social cohesion." Farmer ends his book by saying, "The poor, we're told, will always be with us. If this is so, then infectious diseases will be too—the plagues that the rich, in vain attempt to keep at bay."

I may be naïve in believing that significant and necessary structural changes will occur in Venezuela, but at least they are making a start, at least they are trying. Jonathan Mann would respond to those who threw up their hands and said

that changing the world was an impossible task (better to concentrate on smaller more manageable efforts) by saying that it was surely impossible if one did not try.

Venezuela is currently rewriting its constitution, and I was so inspired, both by Farmer's book and by the process going on in that country, that after meeting the former Director of Medical Services who, as a member of the National Constitutional Assembly, is charged with rewriting the chapter on Health for the new Constitution, I sent him a copy of Farmer's book. I strongly recommend this book to students of Latin America, to students of Public Health, and to all those concerned with health and human rights and with a healthy

future for us all.

Kris Heggenhougen is an Associate at the Harvard Institute for International Development, where he is initiating a research and intervention program on health and care of orphans. A member of the DRCLAS Policy Committee, he is on the faculty at Harvard Medical School where he teaches a course on Medicine, Human Rights and the Physician, and also on the faculty of the Center for Population and Development Studies.

The opinions expressed in the review are those of the reviewer and do not necessarily reflect those of the institution to which he is attached.

FROM THE EDITOR

Looking Ahead for DRCLAS NEWS

Pavid Rockefeller Center for Latin American Studies at Harvard University. In a magazine-like format, it focuses on different issues related to Latin America, Latino/as, and the Iberian Peninsula. In past issues, we've looked at immigration, women, social justice, the environment, education, and the Internet's impact on Latin America.

The Winter 1999 edition of *DRCLAS NEWS* will be devoted to Cuba. We encourage photographers—professionals and amateurs—to submit photographs made in Cuba. Historical photos are also welcome. Any format is acceptable: black & white and color prints, slides, or digital with high-quality resolution.

Faculty, students, alumni, and other Harvard associates are also urged to send information and story ideas about Cuba-related projects. Story ideas and project information should be submitted before December 1; photographs must be submitted before January 15.

The Spring 2000 edition of this newsletter will focus on Latinos and Latinas in the United States. Story suggestions, on either Harvard-related projects or Latino/a general concerns, are welcome before January 15, 2000. Photos of Latinos and Latinas of different origins and throughout the United States are also solicited. Deadline for photos is March 1, 2000.

A special thanks to all the authors in this Fall 1999 issue on the

economy and, in particular, to photographers Cristina Fraire, Liliana Nieto del Río, Anita Baca, Rachel Eckstein Osterman, Bruce Martin, Beatriz Terrazas, Victor Leal Muñoz, Zachary Towne-Smith, Martha Stewart, and Hispano Duron. If you wish to communicate with the photographer, we have included an e-mail beside the photocredit in most cases.

Last, but not least, *DRCLAS NEWS* is quickly outgrowing its name. We welcome suggestions for alternate names that more closely reflect the content and style of this publication. The author of a successful suggestion for a new name—to be adopted in Fall 2000—will be publicly recognized and privately appreciated! Non-Harvard participants in this informal contest are welcome.

Please send story ideas, photos, and name suggestions to June Carolyn Erlick, Publications Director, David Rockefeller Center for Latin American Studies, 61 Kirkland St., Cambridge, MA 02138. Queries can be made by calling 617-495-5428 or by sending an e-mail to <jerlick@fas.harvard.edu>.

June C. Erlick

What's Inside



The Economy in Latin America

Introductory Essay By Ricardo Hausmann	1
Economic Insecurity in Latin America By Dani Rodrik	3
Geography and Socioeconomic Development By John Gallup and Jeffrey Sachs	7
Global Coalition: Debt Relief for the Poorest Countries By Elizabeth A. Donnelly	11
·	



Currency Policy

Country Spotlights	
Dollarization: Looking at Argentina By Eli Cohen	18
Dollarization: The Path Ahead? By Juan Carlos Moreno Brid	16
Currency Politics: Dollarization and Other Dilemmas By Jeff Frieden	13



Shepherds at the End of the Millennium (photoessay) By Cristina Fraire	22
Art and Economy: Focus on Cuba By Esther Whitfield and Jacqueline Loss	24
Venezuela: Why Citizen-Detached Parties Imperil Economic Governance By Javier Corrales	26
Brazil's Debt By Simon Romero	29



In the Field: the Harvard Factor

Harvard Business School: Breaking Ground

Brazil's Debt By Simon Romero

Central American Project By Felipe Larrain	
A Look At Zamorano By June Carolyn Erlick	
Zamorano and It's Neighbors By Nina Rabin	
The Birth of INCAE By George Cabot Lodge	

The Benefits of Privatization: The View from Mexico By Florencio López de Silanes

30
32

34 36 38

40

20

Comings & Goings

at Harvard

Two New Latin American Chairs

Books

13		æ	67		16
28		1	1		
1	100	m	1	ia i	2
		-	h 15		
23		POR	B 1		1000

39	The	United	States	and	Latin	America:
	The	New A	genda	A Rev	iew by	Patrick J. Me

The New Agenda A Review by Patrick J. McDonnell	
Infections and Inequalities: The Modern	4
Plagues A Review by Kris Heggenhougen	



Harvard University David Rockefeller Center for Latin American Studies 61 Kirkland Street Cambridge, MA 02138

BULK RATE U.S. POSTAGE PAID PERMIT NO. 55 PLYMOUTH, MA