



UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

UNIDO AND LATIN AMERICA

Address by:

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Ladies and Gentlemen. Good evening.

It is a great pleasure to be with you this evening. I am indeed honoured to be asked by the Austrian Institute for Latin America to talk to you about UNIDO and Latin America.

Before coming here when I was thinking about what to say to you tonight, I wondered what message you might expect to hear from UNIDO. Most of the headlines these days appear to be about the World Bank, the IMF or the UN itself, and not its specialized agencies. I do not know if the World Bank and IMF really want to be so much in the news at this time, given the sort of press they are getting.

But it did not take me long to come up with an answer to my question.

My answer was that you would like to hear something straightforward and topical. About what Latin America needs to do to face up to its internal challenges. About, in particular, what it needs to do to face up to its current external challenge: that is, to ward off the contagion of the Asian financial crisis. And, about the strategies my own organization proposes for helping Latin America solve its current problems.

This is what I thought you would like to hear. And, this is what I would like to talk to you about tonight.

Ladies and Gentlemen,

Let me begin with the internal challenges. Latin America is at a watershed in its economic development. It must tackle the pressing challenges it faces or risk losing a decade of solid achievement. In my view, as we approach the end of the 1990s, Latin America must grapple with two broad set of issues - modernization and social development.

Above all, the region needs to continue its efforts to modernize. It needs to modernize its fiscal and financial systems, its public institutions, and the way its labour markets operate. Industry too needs to modernize. Industry has to raise its competitiveness so that the productive sector can play a full role particularly in the western hemisphere economy.

The second challenge is social reform - social reform that is not at the expense of sustainable modernization. We all remember the painful structural adjustment measures of the

1980s. Latin America has still to pursue social objectives, but in ways that do not undermine the viability of its modernization process.

Both these challenges can be met if the agenda is broad and coherent.

To assure the economic viability of the modernization process, we have to:

- Consolidate the economic reforms already in place and apply the lessons of past failures and past successes. Further fiscal strengthening, development of sound financial systems and stabilizing currencies and current-account deficits are crucial.

We have to learn to manage many contradictions. For example, we need to:

- Further reduce the size of the State. Nevertheless, size itself is not the real problem. Also, the State should continue to play a key role in the development process. This role must be recognized and strengthened. But to do so necessitates that it should be clear what the State can do that the private cannot do, or do as well. The State must not do those things that cannot be done as well or better by the private sector. If you like: there should be a subsidiary test for the role of the State.

At the same time Latin America must continue to:

- Strengthen its own private sector, e.g. through a favourable investment climate. But we also have to change the attitudes of the private sector. Many Latin American firms are still asking their Governments for domestic market protection. They will do better to acquire the outlook of innovative risk takers, of businesses prepared for open trade regimes and global sourcing of internationally competitive advanced technologies.

Much more than before, we have to:

- Strengthen regional economic integration to promote new productive structures and international competitiveness.

On the social front:

- Poverty alleviation has to have top priority. Estimates vary as to how many poor people live in Latin America. We are talking of at least 120 million people. The World Bank's poverty profile reveals that a significant number are "working poor" - people who are employed but live below the poverty line. The fact that so many still live in poverty in Latin America should be a call to urgent action for all of us.

We know that in the long run, economic growth is an answer to poverty. But the impact of growth is always limited by inequalities. Latin America therefore has to rethink all its policies with respect to their impact on poverty reduction. Eliminating structural rigidities in the labour market, for example, would have an immediate impact on unemployment and under-employment. It is because of such rigidities that 84 out of every new 100 jobs created in the 1990s (a period of good economic growth, remember), were in the informal, not the formal sector.

- All sections of society have to be involved in the productive system. The benefits of modernization have to be more equitably distributed.
- Human resource development and skill formation are two key determinants of long-term growth and competitiveness. They must be at all education levels and for all parts of society. This may mean less public subsidies for university students and industrial training. Greater involvement of the private sector in both, providing and paying for higher education and training will be essential.

At the same time all aspects of development must be environmentally sound.

Specifically, the immediate task now for Latin America is to consolidate the first round and to undertake the second phase of economic reforms.

The first round, referred to by earlier commentators, saw privatization and financial reform as key factors for short-term stabilization. Its modernization of the legal framework for labour relations has to continue, and the financial system has to be further strengthened.

For my part, I put fiscal strengthening as the top priority. This is crucial for Latin American countries' investment in human resources and the infrastructure on which higher growth rates depend. It will directly impact Latin America's characteristic low savings rates. Prudent fiscal policy will also prevent the large appreciations of currency and the current account deficits that occur with rapid capital inflows.

Without fiscal reform, most of Latin America's economies are vulnerable in the medium and long term. It has to make good the major gaps between social security obligations and available resource flows. In the context of decentralization, it has to prevent state-level and municipal over-indebtedness and link their expenditures with their taxation powers. And it has to make all tax collection and public expenditure much more efficient. This means fewer tax exemptions, better tax administration, and especially better management of social expenditures.

Phase Two has to focus particularly on the fiscal deficit left by pension reforms. With VAT levels already high, we have to develop new ways to fund pension payments in order to eliminate the 26 to 30 per cent payroll taxes that currently burden business. In the medium term, such systemic changes are essential. In the long run, higher taxable incomes will have to come from economic growth of industry and other businesses in Latin America. I would go further. In the long run, the only viable solution to the twin problems of employment and poverty lies in building up competitive capacities to generate output and income.

Ladies and Gentlemen,

Let me now say a few words about Latin America's current financial crisis.

It is easy to blame globalization for Latin America's current crisis. This is wrong. To borrow a metaphor from Domingo Cavallo, who you may know as the former Minister of Finance of Argentina with whom I worked closely in the past, the global crisis is a fire whose flame globalization only stokes up. It has generally been reckless governments and inappropriate policies that set the fire in the first place. Some of the solutions proposed, such as capital controls, will only make matters worse.

I should say that I do not have a magic wand or recipes for solving the financial crisis. But I can offer some relevant suggestions and insights.

A number of countries are running current account deficits as large as their Asian counterparts before crisis. Brazil, as the region's largest economy was the speculators' first target. As the contributor of 45 per cent of Latin America's GDP, however, how Brazil reacts and what happens as a result is significant for the whole region, and indirectly the world economy. Addressing Brazil's problems is therefore crucial.

What can be done? First, what we must not do, namely, rob investors and devalue the currency. Interventions that negatively impact on investors erodes their trust and undermines economic growth. Devaluation reduces the value of the domestic debt held in local currency but leaves the value of the foreign debt unchanged. Interest rates rise, banking and the economy become destabilized and investor confidence again falls.

Capital controls have been suggest by many eminent economists, notably Paul Krugman. I do not believe this is the right policy, even though they can be theoretically justified as a temporary measure. Capital controls have proved ineffective in practice, as in Indonesia and Thailand. They also tend to become permanent with all the attendant risks - large underground or parallel markets, smuggling, mis-invoicing, tax evasion and corruption.

In short, they lead to dislocations that deter long term investment, the motor for long term growth. Capital controls do little to eliminate debt overhangs or promote sound structural policies that are needed to get a country back on its feet. They can therefore do more harm than good.

Governments that tried capital controls such as Malaysia may hurt other countries that try to keep their financial markets open because they encourage capital flight. Here, I agree with George Soros that Malaysia may have embarked on a beggar-thy-neighbour policy that will make it hard for other countries to keep their markets open. The lesson for Latin America is that measures to combat the financial crisis, particular capital controls, have to be seen in a sub-regional context. This reinforces the role of sub-regional frameworks such as MERCOSUR in addressing economic problems and financial crisis in particular.

Chile is often cited as a successful example where short-term inflows declined in the year capital controls were introduced. But they also increased again in the following year. And, unlike East Asian countries, Chile had already addressed the weaknesses in its banking sector and the financial market was more accustomed to handling significant financial flows against the

background of a flexible exchange rate policy. Chile is also coming to the conclusion that capital controls may be hurting long-term investment.

But if capital controls are not the answer, what is? Partly the solutions lie in conventional good governance. But I would emphasize that the backbone of any programme to address the financial crisis has to be based on macroeconomic programmes reflecting sound policies, especially policies that strengthen the financial and banking system. To this can be added large-scale privatization as collateral for bridging loans, and structural adjustment programmes suitable for World Bank financing. Whatever the combination of policies selected they must be sound and credible, particularly to investors.

Nevertheless, urgent attention must be paid to developing solutions to unpayable domestic and external debts. Bolder approaches may be needed, such as: across-the-board debt write-offs and write-downs, and large-scale conversion of debt to equity.

It is important to point out that despite the economic circumstances, no developing country is slamming the door on markets and globalization. There may be a backlash in Malaysia and Russia, but these countries have not given up the market paradigm. They realize that markets remain the best way of maintaining a foothold on and eventually climbing the economic growth ladder. Access to technology and capital can only come from outside. And that full and equitable participation in global markets is the best way to sustainable development.

It is clear that the financial crisis requires a reassessment of current global institutions such as the G-7, the IMF, the WB, and the UN system. This is to ensure that platforms are developed, skills and technological capabilities are acquired by developing countries, particularly the poorer ones, to enable their full participation in global markets.

But let me say that I believe we need a reassessment, not an elimination of these institutions. Or to be more precise, their re-adjustment to respond to these unprecedented challenges. Such re-adjustment of global governance institutions, moreover, should have active participation of leading emerging economies such as Brazil. Perhaps we do need a G-16 rather than a G-7. I hope to develop some of these arguments with you during the course of this meeting.

Let me now turn to UNIDO's strategy to help Latin America to overcome its economic problems.

Substantively, the strategy reflects the main findings of UNIDO's last *Industrial Development Global Report*. This underlined the need to sustain the upturn in the investment rate. At the same time, the region needs to diversify its manufacturing and export base. A move to high-technology and export-oriented industries is essential. Therefore public and private investment should be channeled to develop technological resources and human capital.

We will continue to feature what we call the three 'E's of sustainable industrial development - economic, equitable and environmental development. This focuses our efforts on economic competitiveness, employment for all social groups, and environmentally cleaner production through new energy-efficient and low waste technologies.

As far as possible we integrate them into combined packages that address the challenges posed by globalization on one hand and reform programmes on the other. Integration is seen as one of our comparative advantages. It includes the ability to combine policy advice and specific technical support in support of interventions at the policy-, institutional and enterprise levels.

We will also plan far fewer programmes, concentrating them only on the activities set out under our new mandate: promotion of investment, acting as a global forum for industrial development, and promoting cleaner, sustainable industrial development.

Let me give you some examples.

Economic competitiveness

First, economic competitiveness. A frequent reason for Latin American industry's lack of competitiveness is its companies' lack of quality management and technology management.

In the early 1990s, capital goods industries were diagnosed as suffering from a variety of ills: poor managerial ability, outdated manufacturing, poor product design and non-existent or ill-adapted automation systems. Under a programme of sustainable quality management improvement, UNIDO surveyed 600 firms in ten countries. We then gave them diagnostic tools so they could measure the results of quality improvement programmes. In Colombia, for example,

this reduced mis-allocation of resources, cut materials costs by up to 40 per cent, and increased capacity utilization by over 50 per cent. 2,000 managers and technicians were trained in continuous improvement of product and process quality. Some 140 senior managers visited firms abroad. Their firms cut scrap levels and reduced environmental discharges.

Today, this programme is in the hands of national institutions, in Argentina, Brazil, Peru and Venezuela.

Employment support

UNIDO's strategy for employment support emphasizes employment generation (through creation and sustaining new business and new firms) and stabilization (by helping sustain small and medium firms).

The importance of the small-scale sector in sustaining and creating employment does not need underlining. But my friends and colleagues from the World Bank and IDB will forgive me if I say that this is not solely a matter of obtaining a \$300 million loan to provide credit to SMEs. SMEs' survival and growth depend on detailed understanding - the kind of understanding UNDO provides - of the interaction of many factor inputs - technical and management skills to cope with financial and processing problems, proper understanding and then access and absorption of competitive technology, quality management and other aspects of access to markets. The fiscal and financial reforms mentioned earlier will need to be geared to sustaining small and medium firms, and creating new ones.

Cleaner production

For the third 'E', environmentally-sound manufacturing, I mention the National Cleaner Production Centres that UNIDO and UNEP (the UN Environmental Programme) set up in Brazil and Mexico. This new national capacity in the field of cleaner production gives policy advice and undertakes in-plant assessments, training, and information dissemination.

New programme

A new programme that combines all three 'E's, focuses on compliance with technical standards demanded for exported goods.

The introduction of the well-known ISO 9000 series for quality system standard and more, recently the series ISO 14000 for environmental systems, also introduced a whole new variable into trade negotiations: the concept of firm-level certification. Today some 120,000 firms boast certification under ISO 9000. Now there is mounting pressure for ISO 14000 certification - not to mention a myriad of eco-labels, green labels, and blue labels required in different developed countries.

In developing countries, even large firms shy away from the amount of human and financial resources required to meet those standards. They are further discouraged, a UNIDO survey last year found, by lack of international acceptance of some of their certification. The issue of international compliance will surely increase in complexity. To help, UNDO is developing integrated services to assist governments and industry to create national standards bodies and to rehabilitate existing ones.

The new services will introduce continuous quality improvement methodology and help establish centres for competitiveness. They will provide new business decision-making tools. And, very important in some countries, they will pre-audit national accreditation bodies in developing countries to ensure they meet the requirements of the International Accreditation Forum's Multilateral Recognition Agreement.

The honest broker

Ladies and Gentlemen,

While our programmes for economic, equitable and economically-sound development are specific for industry, as another potentially interesting area I would like to refer to our role as an honest broker. Its value, I can attest from personal experience.

At the beginning of the 1990s, Argentina's automobile industry was in serious difficulties. It was clear to all that the old protectionist framework had become counterproductive and that a modernization programme leading ultimately to liberalization had to be set up. The result became

known as the Automotive Regime. It was a blend of competition and support mechanisms. It would not work, however, the Government felt, unless broad acceptance was obtained through strict and transparent control. A Presidential Decree therefore required a formal audit. It was my decision to entrust this audit to a non-national "honest broker" and the task was given to UNIDO. UNIDO designed a project, approached potential auditors, organized international competitive bidding, and administered the contract with the successful firm.

Looking back, it is clear that the Automotive Regime significantly transformed Argentina's automotive industry. The contribution of a Multilateral Development Institution, in this case UNIDO, was crucial.

I believe that the "honest broker" role for UNIDO will become even more important in the future.

More multilateral impact

One weakness in the Multilateral System, and we in UNIDO also, have to admit this as a past weakness - is that we have found it difficult to cooperate with one another. Our fragmentation not only undermines our inherent comparative advantages over other sources of external assistance to Governments. It also encourages our institutions to expand our mandates and to compete in areas beyond their core competencies.

The challenge for Multilateral Institutions, and for the governments who comprise their member states and sit on their governing bodies, is to recognize the opportunities and advantage of cooperation. At a practical level, support for the small-scale sector is an example where UNIDO and the IDB could work with greater impact by offering integrated packages. UNIDO and the World Bank would offer better service to governments if their policy advisory groups cooperated in areas of industrial and technology policy, particularly in the context of structural adjustment programmes.

I appreciate that major changes, including cultural changes, would be needed. Nevertheless, part of UNIDO's strategy towards Latin America emphasizes working with other agencies. UNIDO will be developing initiatives to establish cooperation with UNCTAD in areas of research, statistics and technology policy. UNIDO and UNESCO could organize a region-wide

programmes to revitalize and reorient research institutions. UNIDO, UNCTAD and ITC can jointly promote industrial and trade-related foreign investment and technology transfer. As I mentioned earlier, UNIDO already cooperates with UNEP to set up National Cleaner Production Centres.

The focus for this cooperation has to be, as I said at the beginning, poverty alleviation and employment promotion. If the Multilateral Development Institutions, including my own, cannot contribute effectively to poverty alleviation, and if they cannot help provide employment, they should change. At the very least, that change will call for effective cooperation between them to provide integrated packages of services. Real impact on poverty and creation of employment are the key criteria on which our strategic plans should be judged. Nothing less.

In conclusion, Ladies and Gentlemen

I mentioned at the outset that Latin America is at a watershed in its economic development. Until recently it has moved forward at a pace we can all be proud of. Now, it risks going backward and runs the serious risk of losing many of its notable achievements, if something is not done about it. As we therefore step on the threshold of the 21st century, let us all redouble our efforts to ensure that Latin America will at last fulfill the promise of sustained and equitable development that has alluded it for so long. Thank you for your attention and this opportunity to share my thoughts with you.