

The Public Sector and the Latin American Crisis

Edited by
Felipe
Larraín
and
Marcelo
Selowsky



International Center for Economic Growth

THE PUBLIC SECTOR AND THE LATIN AMERICAN CRISIS

Edited by
Felipe Larraín and Marcelo Selowsky

An International Center for Economic Growth Publication

ICS PRESS
San Francisco, California

We would like to thank the World Bank for financing this study through research project RP0674-02. The opinions and conclusions of the study, however, are those of the authors and not necessarily those of the World Bank or its affiliated organizations.

F. L. and M. S.

© 1991 International Center for Economic Growth

Printed in the United States of America. All rights reserved. No part of this book may be used or reproduced in any manner without written permission except in the case of brief quotations in critical articles and reviews.

Publication signifies that the Center believes a work to be a competent treatment worthy of public consideration. The findings, interpretations, and conclusions of a work are entirely those of the author and should not be attributed to ICEG, its affiliated organizations, its Board of Overseers, or organizations that support ICEG.

Inquiries, book orders, and catalogue requests should be addressed to ICS Press, Institute for Contemporary Studies, 243 Kearny Street, San Francisco, California 94108. (415) 981-5353. Fax: (415) 986-4878.

Distributed to the trade by National Book Network, Lanham, Maryland.

Cover design by John Paul.

Index by Shirley Kessel.

Library of Congress Cataloging-in-Publication Data

The Public sector and the Latin American crisis / edited by Felipe Larraín and Marcelo Selowsky.

p. cm.

"An International Center for Economic Growth publication."

Includes index.

ISBN 1-55815-119-2 (cloth) : 34.95. — ISBN 1-55815-118-4 (paper) : 14.95

1. Latin America—Appropriations and expenditures. 2. Latin America—Economic conditions—1982– 3. Debts, External—Latin America.

I. Larraín B., Felipe. II. Selowsky, Marcelo.

HJ7664.5.P83 1991

336.8—dc20

90-23156

CIP

Preface

The oil shocks of the 1970s provided the countries of Latin America, and the rest of the world, with hard-earned lessons about how to respond to abrupt changes in economic fortunes. The unstable oil prices of the early 1990s caused by the Iraqi invasion of Kuwait will provide policy makers and economists with the opportunity to discover whether the lessons of the 1970s were learned and retained or forgotten.

In this book, the authors review the responses of six Latin American countries—both oil exporters and oil importers—to the shocks of the 1970s. Those that borrowed heavily to finance the postponement of the necessary economic adjustment, or to adjust only partially, have been burdened with massive debt ever since; furthermore, deficit financing caused major distortions in the monetary system and in price levels, leading to double- and triple-digit inflation.

Amid growing frustration with policies that have not worked, along with a poor development record and few signs of change, attention has turned to the proper role and behavior of the public sector in economic policy.

This volume's authors, all experts on the economies of Latin America's largest debtor nations, analyze the behavior of the public sector in response to external shocks, political and electoral cycles, and

private interest groups. Their analyses and conclusions suggest the need for deep institutional changes in the public sector along with major efforts to reduce debt. Such changes will, of course, take years to implement. We are pleased to publish this volume as a reminder of and a guide to the work ahead. Policy makers in Latin America and other developing countries will benefit from the lessons pointed out in this book.

Nicolás Ardito-Barletta
General Director
International Center for Economic Growth

Panama City, Panama
March 1991

THE PUBLIC SECTOR

AND THE
LATIN AMERICAN
CRISIS

ICEG Academic Advisory Board

Abel G. Aganbegyan
*Academy of Sciences of the USSR,
USSR*

Michael J. Boskin*
Stanford University, USA

Hakchung Choo
Asian Development Bank, Philippines

Rudiger Dornbusch
*Massachusetts Institute of Technology,
USA*

Ernesto Fontaine
*Pontificia Universidad Católica de
Chile, Chile*

Herbert Giersch
*Kiel Institute of World Economics,
Germany*

Francisco Gil Díaz
Ministry of Finance, Mexico

Malcolm Gillis
Duke University, USA

Arnold C. Harberger
University of Chicago, USA

Helen Hughes
*Australian National University,
Australia*

Shinichi Ichimura
Osaka International University, Japan

Glenn Jenkins
*Harvard Institute for International
Development, USA*

D. Gale Johnson
University of Chicago, USA

Roberto Junguito
Banco Sudameris, Colombia

Yutaka Kosai
*Japan Center for Economic Research,
Japan*

Anne O. Krueger
Duke University, USA

Deepak Lal
*University College London,
United Kingdom*

Ronald I. McKinnon
Stanford University, USA

Charles E. McLure, Jr.
Hoover Institution, USA

Gerald M. Meier
Stanford University, USA

Seiji Naya
*Resource Systems Institute, East-West
Center, USA*

Juan Carlos de Pablo
DEPABLOCONSULT, Argentina

Affonso Pastore
Universidade de São Paulo, Brazil

Gustav Ranis
Yale University, USA

Michael Roemer
*Harvard Institute for International
Development, USA*

Leopoldo Solís
*Instituto de Investigación Económica y
Social Lucas Alamán, Mexico*

David Wall
University of Sussex, United Kingdom

Richard Webb
*Pontificia Universidad Católica del
Perú, Peru*

James Worley
Vanderbilt University, USA

* on leave

Contents

<i>Preface</i>	xv
1 The Public Sector and the Latin American Crisis: An Introduction <i>Felipe Larraín and Marcelo Selowsky</i>	1
2 Public Sector Behavior in Argentina <i>Osvaldo H. Schenone</i>	11
3 Public Sector Adjustment to External Shocks and Domestic Pressures in Brazil <i>Rogério F. Werneck</i>	53
4 Public Sector Behavior in a Highly Indebted Country: The Contrasting Chilean Experience <i>Felipe Larraín</i>	89

5	Public Sector Behavior in Mexico <i>Jorge Hierro and Allen Sanginés</i>	137
6	The Behavior of the Public Sector in Peru: A Macroeconomic Approach <i>Carlos Eduardo Paredes with Alberto Pasco-Font</i>	191
7	Public Sector Behavior in Venezuela <i>Miguel A. Rodriguez</i>	237
8	Comparative Analysis, Lessons, and Policy Conclusions <i>Felipe Larraín and Marcelo Selowsky</i>	283
	<i>Notes and References</i>	319
	<i>About the Contributors</i>	341
	<i>Index</i>	343

Tables and Figures

CHAPTER 1

Table 1.1	Public Sector Spending in Latin America, 1970–1985	2
Table 1.2	Public Expenditure in the Big Industrial Democracies, 1938–1985	3
Figure 1.1	Framework of Expected Reaction to Outside Shocks and Their Interaction with Domestic Pressures	5

CHAPTER 2 ARGENTINA

Table 2.1	Sources of Deficit Other Than Public Enterprises in Argentina, 1966–1985	14
Table 2.2	Public Enterprises, Revenues, Expenditures, and Deficits in Argentina, 1966–1985	15
Table 2.3	Index of Public Utilities Prices in Real Terms in Argentina, 1970–1985	16
Table 2.4	Index of Real Wages in the Public Sector and Economywide Average Real Wages in Argentina, 1970–1984	18
Table 2.5	Public Employees in Argentina, 1960–1985	19

Table 2.6	Composition of Argentina's Consolidated Nonfinancial Public Sector Deficit, 1970-1985	20
Table 2.7	Quasi-fiscal Expenditures of the Central Bank in Argentina, 1970-1985	22
Table 2.8	Foreign Debt and Capital Flight Estimate for Argentina, 1970-1985	23
Table 2.9	Price Index of Oil Products in Argentina, 1970-1985	24
Table 2.10	Selected Public Enterprise Deficits in Argentina, 1970-1985	29
Table 2.11	Military Expenditures in Argentina, 1970-1985	30
Table 2.12	Public Sector Foreign Debt in Argentina as a Fraction of Total Foreign Debt, 1978-1986	33
Table 2.13	Public Enterprises' Rate of Return in Argentina, 1971-1985	37
Table 2.14	Summary of Public Sector Behavior in Argentina, 1970-1985	40
Table 2.A.1	Operations of the Consolidated Public Sector in Argentina, 1970-1985	44
Table 2.A.2	Argentina's Terms of Trade, 1970-1976	45
Table 2.A.3	Operations of the National Government in Argentina, 1970-1985	46
Table 2.A.4	Operations of Provinces and Municipalities in Argentina, 1970-1985	47
Table 2.A.5	Operations of Public Enterprises in Argentina, 1970-1985	48
Table 2.A.6	Operations of the Social Security System in Argentina, 1970-1985	49
Table 2.A.7	Argentina's Public Enterprise Rate of Return, 1971-1985—1959 Capital Stock of 20,000 Million Australes and Depreciation Rate of 5 Percent	50
Table 2.A.8	Argentina's Public Enterprise Rate of Return, 1971-1985—1959 Capital Stock of 10,000 Million Australes and Depreciation Rate of 5 Percent	51
Table 2.A.9	Argentina's Public Enterprise Rate of Return, 1971-1985—1959 Capital Stock of 20,000 Million Australes and Depreciation Rate of 6 Percent	52
CHAPTER 3	BRAZIL	
Figure 3.1	Evolution of Major Macroeconomic Indicators, 1970-1985	55
Table 3.1	Brazil's Tax Burden and Government's Disposable Income, 1970-1980	59

Table 3.2	Government Consumption and Savings in Brazil, 1970-1980	61
Table 3.3	Revenues and Expenditures of Federal Public Enterprises in Brazil, 1970-1980	63
Table 3.4	Brazil's Physical Output of Selected Public Enterprise Products per Unit of GDP, 1979	65
Table 3.5	Federal Public Enterprises' Current and Capital Accounts in Brazil, 1970-1980	66
Table 3.6	Evolution of Employment in Selected Large Public Enterprises in Brazil, 1970-1979	67
Table 3.7	Selected Real Price Indexes of Public Enterprise Outputs in Brazil, 1970-1980	69
Table 3.8	Public Sector's Consolidated Capital Account in Brazil, 1970-1980	72
Table 3.9	Components of Public Sector Debt in Brazil, 1970-1980	73
Table 3.10	Tax Burden and Government's Disposable Income in Brazil, 1980-1985	75
Table 3.11	Government Consumption and Savings in Brazil, 1980-1985	75
Table 3.12	Government Employment in Brazil, 1979-1985	76
Table 3.13	Federal Public Enterprise Revenues and Expenditures in Brazil, 1980-1985	77
Table 3.14	Large Federal Public Enterprise Employment and Physical Output Indicators by Sector in Brazil, 1980-1985	79
Table 3.15	Selected Real Price Indexes of Public Enterprises' Outputs in Brazil, 1980-1985	80
Table 3.16	Public Sector Fixed Investment in Brazil, 1980-1985	81
Table 3.17	Public Sector Net Debt in Brazil, 1981-1985	82
Table 3.A.1	Operations of the General Government in Brazil, 1970-1985	86
Table 3.A.2	Operations of Public Enterprises in Brazil, 1970-1985	87
CHAPTER 4	CHILE	
Table 4.1	Selected Macroeconomic Indicators in Chile, 1970-1985	91
Table 4.2	The Public Sector's Stake in Productive Activities in Chile, 1970-1973	95
Table 4.3	Chilean Public Enterprises' Share in Sectoral and Total Output, 1965-1981	96
Table 4.4	Operations of the General Government in Chile, 1970-1985	97

Table 4.5	Real Wages and Employment in Chile's Public Sector, 1970-1976	99
Table 4.6	Operations of Public Enterprises in Chile, 1970-1985	100
Table 4.7	Operations of CODELCO and the Public Copper Mines in Chile, 1970-1985	102
Table 4.8	Operations of the Consolidated Public Sector in Chile, 1970-1985	103
Table 4.9	Real Prices of Goods and Services Sold by Selected Public Enterprises in Chile, 1970-1985	105
Table 4.10	Distribution of Expropriated Land in Chile, May 1978	110
Table 4.11	Wealth Redistribution in Chile's Land Reform Process	111
Table 4.12	Sales of CORFO's Assets in Chile, 1974-1978	113
Table 4.13	Terms of Trade and Prices of Selected Exports and Imports in Chile, 1970-1985	116
Table 4.14	Defense Spending in Chile, 1970-1983	118
Table 4.15	Public and Private Net Foreign Debt in Chile, 1975-1985	122
Table 4.16	Public and Private Gross Foreign Debt in Chile, 1975-1985	123
Table 4.17	Chile's State-run Social Security Program, 1975-1985	127
Table 4.18	Reprivatization of "Odd" Companies in Chile, December 1986	132
Table 4.19	Privatization of State Enterprise in Chile, December 1986	134
CHAPTER 5	MEXICO	
Table 5.1	Operations of the Federal Government in Mexico, 1970-1985	139
Table 5.2	Mexico's Fiscal Deficit, 1970-1979	143
Table 5.3	Mexico's Oil Reserves, Production, and Exports, 1970-1980	146
Table 5.4	Public Sector Revenues in Mexico, 1970-1979	148
Table 5.5	Public Sector Expenditures in Mexico, 1970-1979	151
Table 5.6	Operation of PEMEX in Mexico, 1970-1985	154
Table 5.7	Mexico's Budget-controlled Entities, Excluding PEMEX: Revenues and Expenditures, 1970-1985	156
Table 5.8	Mexico's Public Sector External Debt, 1970-1979	158
Table 5.9	Mexico's Public Sector Internal Debt, 1977-1979	160
Table 5.10	Mexico's Oil Reserves, Production, and Exports, 1979-1982	161
Table 5.11	Mexico's Fiscal Deficit, 1979-1982	162

Table 5.12	Mexico's Public Sector Revenues, 1979-1982	165
Table 5.13	Public Sector Expenditures in Mexico, 1979-1982	166
Table 5.14	Operations of Public Enterprises in Mexico, 1970-1985	169
Table 5.15	Public Sector Savings and Investment in Mexico, 1979-1985	170
Table 5.16	Mexico's Fiscal Deficit, 1982-1985	173
Table 5.17	Mexico's Public Sector Revenues, 1982-1985	174
Table 5.18	Mexico's Public Sector Expenditures, 1982-1985	175
Table 5.19	Mexico's Primary and Operational Fiscal Deficit, 1982-1985	176
Table 5.20	Mexico's Public Sector External Debt, 1982-1985	179
Table 5.21	Mexico's Public Sector Internal Debt, 1982-1985	179
Table 5.A.1	Operations of the Consolidated Financial Public Sector in Mexico, 1970-1985	184
Table 5.A.2	Operations of Public Enterprises in Mexico: Non-Budget-controlled Entities, 1970-1985	186
Table 5.A.3	Federal Revenues and Expenditures in Mexico, 1970-1979	187
Table 5.A.4	Public Sector Savings and Investment in Mexico, 1970-1979	188
Table 5.A.5	Federal Revenues and Expenditures in Mexico, 1979-1982	189
Table 5.A.6	Mexico's Public Sector External Debt, 1979-1982	189
Table 5.A.7	Federal Revenues and Expenditures in Mexico, 1982-1985	190
Table 5.A.8	Mexico's Oil Reserves, Production, and Exports, 1982-1985	190
CHAPTER 6	PERU	
Table 6.1	Public Sector Behavior and Overall Economic Performance in Peru, 1950-1985	193
Figure 6.1	Public Sector Expenditures and Inflation in Peru, 1970-1985	196
Figure 6.2	Outstanding Public Foreign Debt in Peru, 1970-1985	197
Table 6.2	Operations of Public Enterprises in Peru, 1968-1985	200
Table 6.3	Operations of the Central Government in Peru, 1968-1985	202
Table 6.4	Operations of the Consolidated Nonfinancial Public Sector in Peru, 1960-1985	204
Figure 6.3	GDP and Absorption in Peru, 1970-1985	207
Figure 6.4	Foodstuff and Fuel Subsidies in Peru, 1974-1984	211

Figure 6.5	Credit Supply of the Financial System in Peru, 1970–1985	212
Table 6.5	Evolution of Controlled and Uncontrolled Prices in Peru, 1980–1985	216
Table 6.6	Savings and Deficit of Peru's Nonfinancial Public Sector, 1970–1985	225
Figure 6.6	Evolution of the Public Sector Deficit in Peru, 1970–1985	226
CHAPTER 7 VENEZUELA		
Table 7.1	Growth and Inflation in Venezuela, 1954–1985	238
Table 7.2	Selected Economic Indicators in Venezuela, 1970–1985	240
Table 7.3	Central Government Revenues and Disposable Income in Venezuela, 1970–1973	242
Table 7.4	Central Government Spending, Savings, and Overall Surplus in Venezuela, 1970–1973	244
Table 7.5	Venezuela's Nonoil, Nonfinancial State Enterprise Revenues, Expenditures, and Financial Needs, 1970–1973	245
Table 7.6	Venezuela's Consolidated Public Sector Accounts, 1970–1973	246
Table 7.7	Central Government Revenues and Disposable Income in Venezuela, 1970–1978	247
Table 7.8	Central Government Spending, Savings, and Overall Surplus in Venezuela, 1970–1978	248
Table 7.9	Real Wages and Employment Variation in Venezuela, 1977–1978	249
Table 7.10	Venezuela's Nonoil, Nonfinancial State Enterprise Revenues, Expenditures, and Financial Needs, 1970–1978	250
Table 7.11	Oil Sector Accounts in Venezuela, 1976–1978	252
Table 7.12	Oil Sector Net Investment in Venezuela, 1970–1983	253
Table 7.13	Consolidated Public Sector Accounts in Venezuela, 1970–1978	254
Table 7.14	Current Account Balance in Venezuela, 1970–1978	255
Table 7.15	Evolution of Gross External Debt in Venezuela, 1974–1978	257
Table 7.16	Central Government Revenues and Disposable Income in Venezuela, 1978–1982	259
Table 7.17	Central Government Spending, Savings, and Overall Surplus in Venezuela, 1978–1982	260

Table 7.18	Real Wages and Employment Variations in Venezuela, General Government, 1979–1982	260
Table 7.19	Venezuela's Nonoil, Nonfinancial State Enterprise Revenues, Expenditures, and Financing, 1978–1982	261
Table 7.20	Real Wages and Employment Variations in State Enterprises in Venezuela, 1979–1982	262
Table 7.21	Oil Sector Accounts in Venezuela, 1978–1982	263
Table 7.22	Real Wages and Employment Variations in the Oil Sector in Venezuela, 1979–1982	263
Table 7.23	Consolidated Public Sector Accounts in Venezuela, 1978–1982	264
Table 7.24	Current Account Balance in Venezuela, 1979–1983	265
Table 7.25	Evolution of Foreign Debt in Venezuela, 1974–1983	267
Table 7.26	Evolution of Public Foreign Net Debt in Venezuela, 1973–1983	268
Table 7.27	Central Government Revenues and Disposable Income in Venezuela, 1982–1985	273
Table 7.28	Central Government Spending, Savings, and Overall Surplus in Venezuela, 1982–1985	273
Table 7.29	Real Wages and Employment Variations in the General Government in Venezuela, 1983–1985	274
Table 7.30	Venezuela's Nonoil, Nonfinancial State Enterprise Revenues, Expenditures, and Financing, 1982–1985	275
Table 7.31	Real Wages and Employment Variations in State Enterprises in Venezuela, 1983–1985	275
Table 7.32	Oil Sector Accounts in Venezuela, 1982–1985	276
Table 7.33	Real Wages and Employment Variations in the Oil Sector in Venezuela, 1983–1985	277
Table 7.34	Consolidated Public Sector Accounts in Venezuela, 1982–1985	277
Table 7.35	Current Account Balance in Venezuela, 1983–1985	278
CHAPTER 8		
Table 8.1	Public Finances in Latin America: Government and Public Enterprises, 1970–1985	308

The Public Sector and the Latin American Crisis: An Introduction

In few periods in contemporary economic history can one find swings in major macroeconomic aggregates of the magnitude experienced by Latin America between 1970 and 1985. From 1970 to 1981 the economies of this region experienced a sharp and steady increase in aggregate spending, well beyond output, which was principally financed through external loans. After 1981 expenditure fell precipitously when these economies were hit by higher interest rates and terms-of-trade losses and the rest of the world refused to continue financing their current account deficits.

It is clear by now that more conservative macroeconomic policies during the 1970s—expenditures more in line with output—would have been a better strategy from the point of view of long-term development and welfare. Both the magnitude and the strength of the post-1981 contractionary period are proving to be an extremely high cost to pay for the overborrowing of the 1970s. Today per capita income and real wages are still below the 1980 levels. Investment rates in many countries have collapsed, reaching levels that cannot even cover the depreciation of the capital stock. Not only present standards of living but also the productive