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The empty box syndrome

*Pitou van Dijck**

This article examines the thesis –posited in the book entitled “Changing Production Patterns with Social Equity” published by ECLAC– that no country in Latin America was successful in achieving high overall economic growth with a reduction of income inequalities in the 1980s. As compared to the experience of many countries in South East Asia, this was a lost decade for the region. This situation in Latin America has been referred to by Fernando Fajnzylber as the “casillero vacío” or “empty box” syndrome. The examination presented here is based on a comprehensive set of 33 variables related to economic stabilization, structural change, overall economic growth, and the standard of living. It is shown that many Latin American countries did indeed score relatively poorly as compared to Asian countries. However, the study also reveals significant differences among countries within both regions. The relationship between macroeconomic development and human development has been investigated by means of two indexes and is seen to be very complex, as a high pace of overall economic growth does not necessarily result in great progress in terms of human development, but on the other hand, no country has managed to make much progress in human development without being relatively successful in terms of economic development. In the final section of the study, an attempt is made to draw some conclusions from the successful experience of Asian countries that may support the ECLAC proposals for achieving renewed and sustainable development with social equity in the 1990s.

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Introduction

The 1980s were a turbulent decade for Latin America. In some respects, this was a lost decade, and for all involved in macroeconomic management it was a decade of painful learning. The region was plagued by economic disturbances and suffered from serious internal and external disequilibria. Notwithstanding the painful attempts to adjust and restructure the economies, many of the problems are still unsolved and need to be addressed in the years ahead.

The political constellation in which the economic and social problems need to be tackled has changed dramatically with the establishment of democratic governments in nearly all of the countries of the region. The prime task of the new democracies and, indeed, their main challenge will be to combine in an effective and socially acceptable manner measures to stabilize and restructure the economies, stimulate economic growth and alleviate poverty. The economic performance of most Latin American countries during the 1970s and 1980s was far less successful than that of many other newly industrializing countries in Asia and Europe. Countries in South East Asia, in particular, made impressive economic and technological progress during the 1980s. The economic policies pursued by these countries showed themselves to be more suitable for making economic progress in difficult circumstances, and many countries in that area managed to sustain high economic growth with a reasonable degree of social equity over a long period of years.

In comparison, most countries in Latin America scored poorly with respect to economic growth and social equity. As indicated by ECLAC in its study entitled “Changing Production Patterns with Social Equity” (ECLAC, 1990, p. 61), not a single country in Latin America managed to combine successfully objectives of economic growth and social equity. This phenomenon has been referred to as the “casillero vacío” or “empty box” syndrome of Latin America (Fajnzylber, 1990, p. xiv). In the study in question, ECLAC has made encouraging and far-reaching proposals for fundamental changes in economic policy in the 1990s. The set of proposals aims at replacing regressive adjustment policies of the past by policies that stimulate economic growth with social equity, adopting the strategic criterion of strengthening genuine competitiveness. This requires restructuring and further domestic integration, improved insertion

in the international economy, and a new relationship between government and the private sector (ECLAC, 1990, pp. 98-100). The ECLAC report focuses particularly on long-term strategic objectives of economic policy and institutional problems, and not so much on short-term issues and more specific questions pertaining to the effectiveness of instruments or the timing, sequence and speed of economic reform.

The objective of this paper is to analyse factors that contribute decisively to sustained economic growth with social equity as envisaged by ECLAC. The paper studies in particular the syndrome of economic growth and the relationship between economic development and human development. For that

purpose a statistical analysis has been made of the performance in these respects of countries in Latin America, South East Asia and South Asia during the 1980s. The analysis is based on a large number of variables in the areas of economic stabilization, restructuring and growth, creditworthiness, and human development, and shows the different scores of Latin American and Asian countries with respect to these groups of variables. The research results presented here may contribute to the understanding of the nature of the "empty box" in Latin America and the changes in economic policy required to shift the course of development into the direction envisaged by ECLAC.

I

Dimensions of sustainable development

The ECLAC proposals on changing production patterns with social equity cover a wide range of economic policies and will affect many aspects or dimensions of the economic performance of the countries in the region. To take these widely different aspects properly into account and to appreciate fully the differences in economic and social performance between countries, the statistical analysis should include the dimensions presented in table 1, which cover all areas touched upon by the ECLAC strategy for sustained economic growth with social equity.

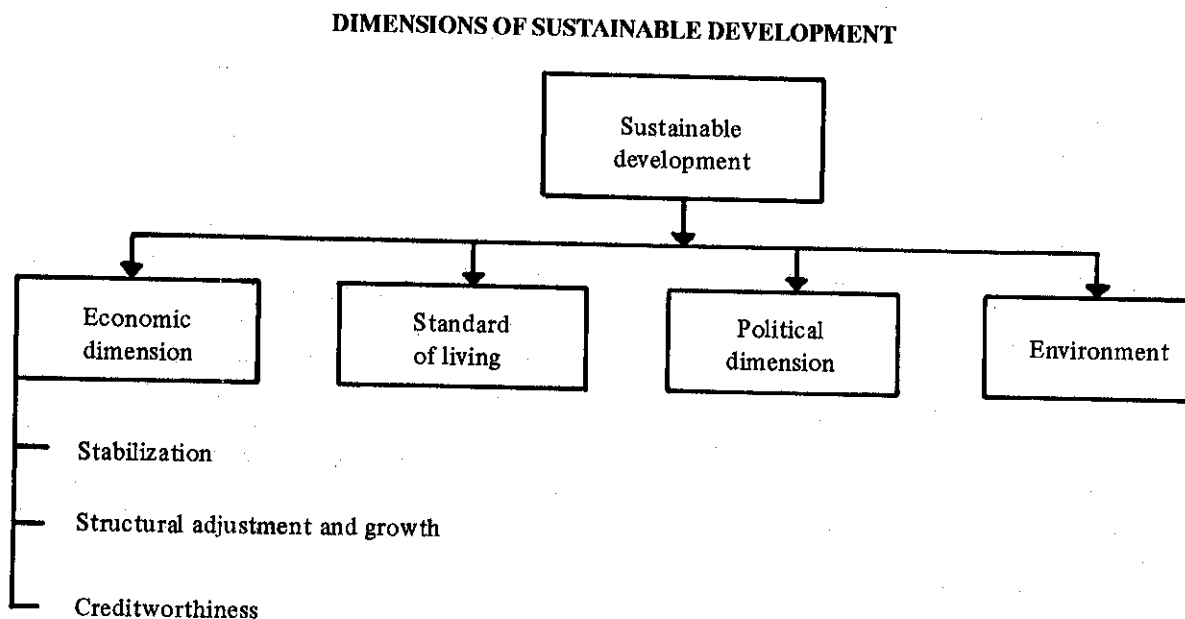
The dimensions have been defined in such a way that they link up with groups of variables traditionally used in studies of the economic and social performance of developing countries, as undertaken by IMF, the World Bank, UNICEF, UNDP and other institutions. However, lack of data in some areas sets limits to the depth and breadth of an analysis of this type. This is particularly true of the non-economic dimensions mentioned above. These dimensions will be briefly discussed below, and in the next section the 33 variables or performance criteria included in the study will be presented.

In the course of the 1970s and particularly during the 1980s, stabilization and adjustment problems dominated economic policy in most developing countries. The monetary approach to the balance of payments, and the policy prescriptions that follow

from it for curing the imbalances, were the subject of an ongoing controversy. IMF analyses traditionally tend to emphasize domestic causes of inflation and unsustainable imbalances in the current account. To monitor the success of orthodox stabilization policies, the Fund has used a limited number of performance criteria such as the rate of growth of domestic credit (particularly growth of credit for the government sector), the government deficit, and the international reserve position.

This rather narrow focus on stabilization measures was complemented in the course of the 1980s by restructuring policies designed to stimulate economic growth, especially by supporting the expenditure and production switching component of stabilization policies. The main components of restructuring policies that have been supported by World Bank sectoral and structural adjustment loans are the liberalization of domestic markets and reduction of protection against imports, timely adjustment of the exchange rate to compensate for domestic inflation that exceeds the international rate of inflation, and direct government support for activities in the tradeables sectors, particularly export promotion. Performance criteria in this area are the current account position, the efficiency of domestic markets, the levels of domestic savings and investment, and the rate of economic growth.

Figure 1



Methodological problems hamper a proper evaluation of stabilization and restructuring policies, and generalizations concerning their effectiveness are hard to make (Khan, 1990). These methodological problems are not always sufficiently appreciated and have often been neglected in the literature. Differences in economic and political conditions set limits to comparisons of economic performance between countries with and without the application of traditional stabilization and restructuring policies. Likewise, comparisons of economic performance before and after the introduction of an adjustment programme do not exclusively reveal the impact of the adjustment programme, but the combined effect of all factors having an impact on the economic situation of the country. For these reasons, the design of adjustment policies, as well as the analysis of their impact, is extraordinarily difficult. This also holds true for alternative plans and proposals to change production patterns.

Notwithstanding these methodological limitations, it is true that many attempts to stabilize and restructure the economies during the 1970s and 1980s were a failure, although some countries were rather successful in this respect, as will be shown in the statistical analysis presented in the next sections. This state of affairs means that stabilization policies must form part of a more comprehensive effort to change production patterns with social equity.

The propensity of domestic and foreign investors to invest depends on a large number of variables at the project as well as macro levels. Private investors such as international banks investigate the investment climate and creditworthiness of economies on the basis of variables related to economic policy, the balance of payments position, the availability of natural resources, and the capacity to export.

Most sovereign risk analyses also include variables related to political stability and cultural factors that in one way or another may have an impact on the profitability of investments and the capacity of governments to service their debts (Heffeman, 1986). The score in terms of creditworthiness determines the position of countries in the international capital market and their rating in the secondary loan market, and determines ultimately the possibilities for supporting economic growth and technological development by foreign loans. Statistical methods such as logit and probit analysis have been applied to assess the risk of foreign lending. However, such analyses include only economic variables and focus predominantly on the very short term.

In addition to these three sets of economic indicators that partly overlap, three groups of non-economic indicators have been introduced in order to permit a comprehensive and truly multi-dimensional analysis of the process of development and structural change. Many studies of the

performance of developing countries during the past few decades have bypassed such non-economic dimensions and have neglected the interaction between economic, political and ecological conditions.

Economic theories still provide only little insight into the relationship between economic growth and social equity. At the same time, data limitations seriously hamper the study of the impact that alternative economic policies have on income distribution and poverty. Although many studies show that poverty increased in Latin America during the 1980s, the relationship between policies actually pursued during the 1980s and changes in living conditions is difficult to establish. Moreover, the meaning of complex concepts such as the standard of living and human development is not entirely clear.

These are not merely theoretical problems but are also relevant in the context of policy formulation, and they deserve serious attention in this context, since improvement of the standard of living is the heart of the strategy that ECLAC envisages. The definition of this concept obviously has important consequences for the type of strategy to be pursued and the type of technological development that should be stimulated. As Sen rightly stresses, the concept of the standard of living should be broad and include a wide range of relevant aspects. At the same time, however, the concept should be quantifiable in order to permit a proper assessment of the actual living conditions in countries (Sen, 1988, p. 20). In one way or another, the concept of the standard of living should express the quality of life rather than the quantity of goods and services that are used or available. Put differently, the criterion should be the opportunity to live in an acceptable manner, and the capability to lead a decent life, rather than the range of products available.

In this context it should be noted that the Basic Needs economic policy approach has contributed significantly to the understanding of the relationship between economic policy and the availability of the shopping baskets of goods needed to satisfy basic human needs. These shopping baskets of goods may be considered as the necessary inputs for an acceptable standard of living. From this line of reasoning it follows that the objective of economic policy is to support the realization of basic human capabilities (Drèze and Sen, 1989, pp. 12, 13 and 42).

The interest in policies focusing on the alleviation of poverty has recently increased significantly,

and new data systems are now being developed by international agencies active in this area. UNICEF has made an attempt to identify the relationship between changes in economic conditions and changes in living conditions and welfare, particularly child welfare. Three types of variables have been distinguished in this complex relationship: input indicators related to the availability of resources, such as household incomes in real terms, real earnings per employee, and employment; process indicators related to the availability and use of key social services, such as per capita consumption, availability of food, calories, vitamins and safe drinking water, availability of health services, and primary and secondary school enrolment; and outcome indicators that show the actual changes in welfare in terms of life expectancy at birth, child mortality, health and skill development (Cornia, Jolly and Stewart (eds.), 1987, pp. 24-58).

To quantify human development and rank countries accordingly, UNDP has constructed an index that includes three variables: per capita income, life expectancy at birth, and literacy rate of the adult population. UNDP has shown that the ranking of countries according to the level of human development may differ significantly from the ranking according to the level of per capita income, although in general there is a strong similarity in the positions of countries with respect to both performance criteria (UNDP, 1990). The present study can only focus on some of the many aspects of the standard of living included in the capability approach outlined above. Data systems that have become available only recently enable the inclusion in this study of 12 performance criteria related to the standard of living.

Political conditions play an important role in the strategy envisaged by ECLAC for two reasons. First, protection of basic human rights can be considered one aspect of an acceptable standard of living. Second, political conditions determine the feasibility of policies and proposals that aim at fundamental changes in the pattern of growth and the distribution of the product. Democratic participation and widespread support are prerequisites for a successful transformation towards greater social equity.

Although most governments have officially recognized individual and collective human rights and have committed themselves to respect and protect them by the ratification of treaties, many of these rights have been violated on a large scale. However,

the introduction of democratic institutions after a long period of military dictatorship has brought about a significant improvement of the human condition in this respect during the last decade.

The human development index initially constructed by UNDP does not include variables related directly to political conditions or human rights. The latest UNDP report, however, includes a much wider range of variables in the area of human development, human rights and freedom, although it is debatable whether all of the selected variables are genuine proxies for universally accepted basic human rights (UNDP, 1991). In the statistical analysis presented here, no variables related to political factors or human rights have been included for lack of data.

The final dimension distinguished here is related to the condition of the environment. The sustainability of development strategies is conditioned by ecological factors. The environmental consequences of economic activities were neglected for a long time, but recent planning takes ecological costs and limitations more explicitly into account. The ECLAC strategy introduces ecological aspects only in general terms and does not explicitly say what the consequences of ecological limitations are for production patterns in the future. However, development strategies for the future should focus in more detail on the relationship between poverty alleviation and ecological decline.

Some indicators are now available with respect to the condition of the environment, but an international comparison of changes in this area during the 1980s could not be made due to data limitations. Put together, these aspects span a substantial part of the development process. Ideally, a fully comprehensive analysis of the development process would include all of these areas. However, the availability of data limits the scope of our study. The 33 variables included in the statistical analysis are related to the three economic dimensions and to some aspects of living conditions. Political and ecological variables could not be included, and several aspects of living conditions have not been covered. In this context, it is particularly unfortunate that data on technological progress are available only for a limited number of countries and therefore could not be included. Also, indicators for the level of competitiveness of industries are not available.

It should be noted that economic dimensions partly overlap and variables can play a role in the analysis of several dimensions of development at the same time. For instance, variables related to the balance-of-payments position can be relevant as performance criteria with respect to economic stabilization and creditworthiness. To put it in statistical terms: the dimensions may not be considered as factors or rotated factors, but are merely different aspects of the economic situation.

II

Performance indicators

The performance of Latin American and Asian countries has been measured by means of 33 variables at two moments in time: 1977 and 1987 (see sources in the appendix). Variables 1 - 8 relate to structural transformation and growth; variables 9 - 16 relate to stabilization; variables 17 - 21 relate to foreign debt and creditworthiness; and variables 22 - 33 relate to living conditions and human development.

The following variables have been included in the analysis:

1. I/GDP = gross domestic investment as a percentage share of gross domestic product.

- | | |
|------------|--|
| 2. S/GDP | = gross domestic savings as a percentage share of gross domestic product. |
| 3. dGDP/dI | = contribution of the growth of gross domestic investment to the growth of gross domestic product. |
| 4. RO/L | = real output per employee. |
| 5. X/GNP | = exports of goods and services as a percentage share of gross domestic product. |
| 6. Xm/X | = exports of manufactures as a percentage share of total exports of goods and services. |

7. HCI = Hirschman Compliance Index in 1972 and 1984.
8. GNP/P = per capita gross national product.
9. (X-M)/M = exports less imports as a percentage share of imports.
10. (T-G)/G = tax income less government spending as a percentage share of government spending.
11. (S-I)/I = savings less investment as a percentage share of investment.
12. G/GNP = government spending as a percentage share of gross national product.
13. INFLATION = rate of inflation, according to changes in the overall price index (GDP deflator).
14. RDR = real deposit rate, i.e., nominal deposit rate less the rate of inflation.
15. RER = real exchange rate, i.e., nominal exchange rate less the rate of inflation.
16. ARI = average annual rate of inflation, 1980-1987.
17. DSR = debt service ratio, i.e., debt service payments as a percentage share of exports.
18. D/GNP = total international debt as a percentage share of gross national product.
19. D/X = total external debt as a percentage share of exports.
20. RES/TDS = international reserves as a percentage share of debt service payments.
21. RES/D = international reserves as a percentage share of international debt.
22. IM = infant mortality rate.
23. LEO = life expectancy at birth.
24. SEp = primary school enrollment
25. SEs = secondary school enrollment.
26. RE/L = real earnings per employee.
27. MIE = employment in manufacturing industry
28. ASW = availability of safe drinking water.
29. CALd/P = per capita daily calory intake.
30. PROTd/P = per capita daily protein intake.
31. IRONd/P = per capita daily iron intake.
32. VITAd/P = per capita daily vitamin intake.
33. HDI* = UNDP human development index (1987).

It should be noted that all variables have been defined in such a way that an improvement of the economic or social situation between 1977 and 1987 is associated with a positive value of the relevant indicator. In most cases, positive rates of growth are, indeed, associated with an improvement of the situation, but in a number of cases this is not true. For instance, progress in the area of economic stabilization results in a reduced rate of inflation, and an improvement of the balance-of-payments position and greater creditworthiness are associated with reduced debt-service obligations. Also, the reduction of infant mortality indicates social progress and human development. Therefore, the signs of the following variables have been reversed: HCI(7), G/GNP(12), INFLATION (13), RDR(14), RER(15), ARI(16), DSR(17), D/GNP(18), D/X(19), IM(22).

Many economic studies have made a comparison between the economic performance of Latin American countries and the four "Asian tigers": Taiwan, South Korea, Hong Kong and Singapore. Some other countries in South East Asia also experienced high economic growth and impressive change in their production patterns during the 1970s and 1980s, however. To enable a comprehensive international comparison of the economic performance of Latin American countries, this study therefore also includes newly industrializing and other developing countries in South East Asia, countries of the Indian subcontinent, and China. Thus, the following 31 countries have been included: Latin America and the Caribbean (19): Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Paraguay, Peru, Trinidad and Tobago, Uruguay, Venezuela. Asia (12): Bangladesh, China, India, Indonesia, Malaysia, Nepal, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Thailand.

III

Economic and human development

Two statistical steps will be made in order to study the economic growth syndrome and the relationship between economic growth and human development, and to compare the scores registered by countries in their economic and social development indicators. First, we will investigate the relations between the 33 indicators, and next we will construct indexes for economic and social development and rank countries according to their scores on these indexes.

Table 1 shows the coefficients of correlation between the 33 variables. As noted in the previous section, an improvement of the situation between 1977 and 1987 is indicated by a positive value of the variable. Here we shall not discuss all relations in great detail but limit ourselves to some observations pertaining to findings that are particularly relevant in the context of the proposals for structural change with social equity formulated by ECLAC.

On the basis of table 1, the following four observations can be made.

1) With respect to the group of variables related to structural transformation and economic growth (1-8), we note that there are significant relations between changes in the shares of investments (1), domestic savings (2) and exports (5) in GNP. This indicates that improvement of the export performance and strengthening of international competitiveness require stimulation of investment and domestic savings. Domestic savings as a share of GDP are particularly stimulated by high real interest rates (14), and to a lesser extent this also holds good for the share of investment in GDP. Conversely, investment and savings are particularly discouraged in destabilized economies with high rates of inflation (16).

2) There is some interrelation among the variables related to economic stabilization (9-16), but there is no relationship between inflation (16) and economic growth (8). This should not come as a surprise, since economic theories differ substantially in their views of the causes and effects of inflation, and many statistical analyses have failed to reveal a strong relationship between inflation and overall economic growth. However, we do find a significant relationship between a reduction of the rate of inflation (16) and increases in the rates of investment

and savings in GDP, the growth of labour productivity in real terms (4), and the contribution of the manufacturing sector to the country's export performance (6).

3) There is no simple, evident syndrome of overall economic growth that holds good in all countries under all circumstances. The analysis presented here does not show clear relations between economic growth, structural transformation and stabilization. Many international comparisons have shown a simple clear-cut relationship between overall economic growth (8) and openness of the economy (5), but such a relationship does not appear to be significant in this analysis. Apparently, some countries in the sample managed to keep up economic growth during part of the period under consideration in conditions of high inflation and a large trade deficit, thanks to the assistance of foreign savings. High growth rates during the first years of the period were succeeded by years with negative growth in this group of countries. Other countries managed to attain a relatively favourable and more stable pattern of economic growth throughout the greater part of the period without opening their economies in a significant way. Finally, there is a group of countries that were very successful in terms of overall economic growth. Some of the countries in this group made great progress in opening their economies, but other countries were already open at the beginning of the period. These differences in starting positions and in strategies during the period 1977-1987 underlie the limited correlation that we have found between economic growth and other variables.

The table shows, however, that the more open the economy, the better its balance of trade position (9), the larger its saving surplus (11), the more favourable its debt servicing position, and the greater its international creditworthiness (17-21).

4) The group of 12 variables related to living conditions and human development includes three types of indicators briefly described earlier: input, process, and outcome indicators. Not surprisingly, there are strong relations among the process indicators (29, 30 and 31). Our analysis does not show many significant and logical relations between the group of variables related to living conditions and

Table 1
MATRIX OF CORRELATIONS AMONG 33 PERFORMANCE INDICATORS

	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33				
1. I/GDP	.73																																			
2. S/GDP	.37	.28																																		
3. dGDP/dI		-.27	.37																																	
4. RO/L		.25	.29	.01	.54	.26	-.14	.21	-.20	.47	-.31	-.25	.41	-.03	.14	-.21	-.13	-.03	-.12	-.19	.14	.28	.42	.15	.45	.17	.18	-.05	.19	.05						
5. X/GNP		-.12	-.21	.05	.59	.18	.46	.07	-.12	-.24	.12	.24	.39	.02	.51	.49	.51	.03	-.09	-.13	-.31	.01	.30	.16	.13	.09	-.04	.07	.19							
6. Xm/X			-.04	-.10	.03	-.42	.11	-.54	.12	-.37	-.10	.37	-.22	-.13	-.21	-.19	-.22	-.15	.06	.40	.27	.03	.23	.39	.13	.09	-.00	.24	-.02							
7. HCI				.09	-.19	.20	.08	.10	.20	.05	-.09	-.10	-.15	-.02	-.05	-.30	-.20	-.01	.22	.12	.00	.04	-.01	.13	-.21	-.31	-.17	.06	-.12							
8. GNPP				.23	-.14	.06	-.20	.18	-.05	.10	.10	-.03	.53	.41	-.11	.02	-.52	-.07	-.07	.19	.51	.18	.23	.13	.08	.05	.21	-.07								
9. (X-M)/M				-.08	.47	-.17	-.18	-.22	.03	.13	.29	.22	.41	.24	.25	-.09	.05	-.29	.06	.22	.15	.13	-.29	-.27	-.09	.09	.25									
10. (T-G)/G				.05	.61	-.19	.41	.03	.40	.21	-.02	.12	.16	.31	.15	-.08	-.23	-.21	.11	-.10	.05	-.36	-.33	-.43	-.18	.07										
11. (S-I)/I				-.03	.29	-.61	.06	.47	.27	.05	.26	.22	.19	.20	-.14	.03	.02	.08	.05	.13	-.37	-.40	-.42	-.14	.45											
12. G/GNP				-.15	.41	-.13	-.32	.21	-.14	-.07	.21	.21	.30	.03	-.06	-.20	.09	-.03	-.07	-.21	.22	-.41	-.42	-.05												
13. Infl.					-.54	-.41	.63	-.36	-.11	-.09	-.35	-.21	-.09	+.46	-.03	.12	.13	-.24	.01	.02	-.05	-.08	.13	.12												
14. RDR					-.02	.83	.10	-.00	-.07	.16	.11	-.17	-.44	-.09	.12	.21	-.34	-.04	.03	-.03	-.09	.08	.02													
15. RER					-.23	.48	.39	.25	.40	.26	-.07	.03	-.07	-.05	.07	-.13	-.07	-.01	.03	-.02	-.14	-.16														
16. ARI						-.16	.02	.13	-.16	-.04	.01	.08	-.10	.03	-.20	.10	-.10	-.04	-.14	.10	.05	.01														
17. DSR						.55	.64	.84	.73	.42	.06	-.10	.19	-.18	.19	.05	-.22	-.20	-.24	.06	.10															
18. D/GNP						.84	.36	.60	-.14	.11	-.17	.39	.10	.27	.01	-.11	-.10	-.13	.40	-.15																
19. D/X						.53	.77	-.11	.04	.16	.15	.00	.40	.11	.02	-.01	-.18	.43	-.02																	
20. RES/TDS						.85	.24	-.06	-.14	-.08	-.09	.10	-.07	.01	-.02	-.04	.10	.19																		
21. RES/D						.06	-.01	-.24	-.05	.02	.19	-.03	.01	-.05	-.15	.35	.03																			
22. IM							.24	.09	.05	-.22	-.08	-.19	-.39	-.11	-.23	.39	.10																			
23. LEo							.29	.11	-.02	.36	.08	-.05	.09	.07	.01	-.38																				
24. SEp							.33	-.19	.42	.56	.17	.31	.09	-.11	-.31																					
25. SEs							.06	.12	.39	-.36	-.06	-.14	-.02	.25																						
26. RE/L																																				
27. MIE																																				
28. ASW																																				
29. CALd/P																																				
30. PROTd/P																																				
31. IRONd/P																																				
32. VITAd/P																																				
33. HDI*																																				

* Correlation coefficients significant at the level of 0.5 are printed in bold type.

^b For definitions of these indicators, see Section II.

variables related to overall economic growth and development. The change in real earnings per employee (26) is positively related with economic growth (8), and this fits in with the relationship between the investment indicator and the change in real output per worker (4). We also find a positive relationship between the growth of the investment share (1) and the growth of employment (27). The UNICEF study suggests that employment and real income are key input indicators for welfare, but here we do not find such

an evident relationship between these two input indicators and the outcome indicators. Apparently, changes in living conditions and human development are determined by more structural factors that have an impact in the long run, and not so much by short-term changes in economic variables, as has also been suggested by the World Bank (World Bank, 1990a, pp. 26-39). This relationship between economic change and human development will be analysed in more detail in the next section.

IV

In search of the empty box

We shall now compare economic and social developments in Latin America, South East and South Asia by means of two indexes for macroeconomic development and human development.

The economic development index has been based on seven variables: I/GDP(1), S/GDP(2), X/GNP(5), GNP/P(8), (T-G)/G(10), INFLATION(13) and, alternatively, ARI(16), and D/X(19).

The human development index has been based on five variables: IM(22), LE(23), SE(25), ASW(28), and CAL_d/P(29). Contrary to the human development index constructed by UNDP, our index does not include income-related variables.

The way our indexes have been constructed differs somewhat from the approach followed by UNDP (UNDP, 1991, p. 211). The values of all variables were transformed into index values with a maximum value of one and a minimum value of zero. The maximum and minimum values of each range were determined by the best and worst performances of the countries in the sample. Next, the index values of the economic and social variables, respectively, were added and transformed into aggregated economic and human development indexes.

Thus, the calculations were made as follows.

$$I_{ij} = \frac{(X_{ij} - X_{i \min})}{(X_{i \max} - X_{i \min})}$$

$$I_j = \sum_{i=1}^n I_{ij}$$

$$(\text{Index})_j = \frac{(I_j - I_{\min})}{(X_{i \max} - X_{i \min})}$$

where

I_{ij} = score of country j on indicator i (0-1)

X_{ij} = value of variable i in country j

$X_{i \min}$ = minimum value of variable i (0)

$X_{i \max}$ = maximum value of variable i (1)

Indexes on the basis of economic and social indicators were made for 1977, 1987 and for the changes during the period 1977-1987. Table 2 shows the correlations among the indicators included in the human development index, economic growth, the indexes for economic development and human development, and the UNDP human development index.

Before we focus on the performance of individual countries in terms of economic and human development, a number of observations are called for regarding the relations among some of the variables that play a key role in this part of the analysis.

Table 2

**CORRELATIONS AMONG VARIABLES RELATED TO
ECONOMIC AND HUMAN DEVELOPMENT**

	LE ₀		SE _s		ASW		CAL/P		GNP/P \ GNP/P			HDI		HDI*		EDI		HDI		EDI	
	77	87	77	85	75	85/87	77	84/86	77	87	77-87	77	87	77	1987	77	87	77-87	77-87	77-87	77-87
IM 1977	-.95	-	-.72	-	-.52	-	-.68	-	-.62	-	-	-.93	-	-.90	-.59	-	.47	.18			
IM 1987		-.99	-	-.66	-	-.67	-	-.69	-	-.50	.11	-	-.93	-.93	-	-.51	.37	-.16			
LE ₀ 1977			.71	-	.53	-	.69	-	.62	-	-	.93	-	-.90	.50	-	-.48	.14			
LE ₀ 1987				.66	-	.68	-	.69	-	.52	-.11	-	.94	.93	-	.51	-.38	.14			
SE _s 1977					.56	-	.49	-	.39	-	-	.82	-	.71	.33	-	-.51	.20			
SE _s 1987						.54	-	.59	-	.54	.17	-	.79	.74	-	.39	-.37	.20			
ASW 1975							.51	-	.53	-	-	.73	-	.56	.21	-	-.60	-.11			
ASW 1985/87								.55	-	.42	-.19	-	.81	.70	-	.33	-.39	.13			
CAL/P 1977									.62	-	-	.80	-	.73	.33	-	-.37	.09			
CAL/P 1984/86										.54	.07	-	.82	.72	-	.38	-.32	.15			
GNP/P 1977										.86	-.41	.66	.68	.66	.69	.44	-.46	-.13			
GNP/P 1977-87											-.05	.57	.58	.56	.73	.64	-.43	.07			
GNP/P 1977-87												.07	-.05	-.06	-.19	.03	.21	.27			
Human Development Index (HDI) 1977													.97	.91	.47	.49	-.58	.13			
Human Development Index (HDI) 1987														.94	.47	.50	-.43	.18			
Human Development Index (HDI*) 1987														.45		-.40	.10				
Economic Development Index (EDI) 1977														.72		-.30	-.19				
Economic Development Index (EDI) 1987																-.21	.49				
Human Development Index (HDI) 1977-1987																					.13
Economic Development Index (EDI) 1977-1987																					

In a sample of 31 countries correlation coefficients above .35 are significant at the level of .05.

- The index related to changes in the level of human development during the period 1977-1987, HDI 77-87, is significantly and inversely related to the variables and indexes for 1977 and 1987. Thus, the lower the level of development initially was, the more progress was made in the subsequent period. Nevertheless, this did not alter very much the ranking of countries according to their level of human development, since the correlation between the indexes for human development in 1977 and 1987 is .97. It should be noted that there is no such inverse relationship between the initial level of economic development and the speed of economic development.

- The indicators for human development are strongly related to each other. Note that a low rate of infant mortality is a positive indicator for human

development, hence the negative signs in the correlation matrix.

- The human development index for 1987 has more correlation with the five selected indicators than the UNDP human development index for 1987 has, as was to be expected. This implies that our index gives a more comprehensive indication for the different aspects of human development than the more limited UNDP index. Nevertheless, the correlation between the two human development indexes for 1987 is very high (.94).

- The correlations between the economic and human development indexes in 1977 (.47) and in 1987 (.50) are significant but not outstanding. Thus, the level of economic development, as measured according to the variables in the index, is not a very

good indicator for the overall level of human development in a country. It comes somewhat as a surprise that the similarity between the level of per capita GNP and the level of human development is stronger: .66 in 1977 and .58 in 1987. Moreover, the two human development indexes have almost the same correlations with per capita GNP in 1987 (.58 and .56). Thus, the economic development index that has been introduced here reflects a specific state of the economy, but this economic condition is not necessarily a good indicator for the average living conditions in the country. To a large extent this is also true of the simple per capita GNP indicator. Nevertheless, all correlations between the levels of economic development and human development are positive and significant.

– It should be noted that there is only very little correlation between changes in the levels of human development that were taking place during the period 1977-1987, and changes in the levels of economic development, be it measured by means of the human development index (.13) or per capita GNP (.21). The experiences of individual countries and groups of countries will be described in greater detail below.

Figure 2 shows the pace of economic development and human development in the 31 sample countries during the period 1977-1987. If, indeed, development in Latin America were correctly characterized as generating only limited economic growth and sharp inequality – as suggested by the “empty box” syndrome – countries in this region should be concentrated in an area quite close to the origin of the axes.

The main findings of this analysis (figure 2) are as follows:

– At the origin of the axes in quadrant three there are only Latin American countries, except for the Philippines. The countries that score lowest on both indexes are Argentina, Trinidad and Tobago, El Salvador, Bolivia, Guatemala, Venezuela and Honduras.

– Nearly all Latin American countries have low scores in terms of changes in the level of human development: 16 of the 19 countries of the region are in quadrants three and four at the lower part of the figure. Chile scores relatively well in terms of economic development and human development as compared to most other Latin American countries.

However, the most outstanding position among the countries of the region is occupied by Brazil.

– Asian countries have the best performance in terms of economic and human development. This is particularly true of Indonesia, and to a lesser extent of Nepal, Sri Lanka and India, which are all located in quadrant one at the upper right hand side of the figure. As compared to these countries, the pace of human development in Bangladesh has been strikingly low. South Korea shows the highest pace of economic development of all developing countries, followed by Singapore and Pakistan.

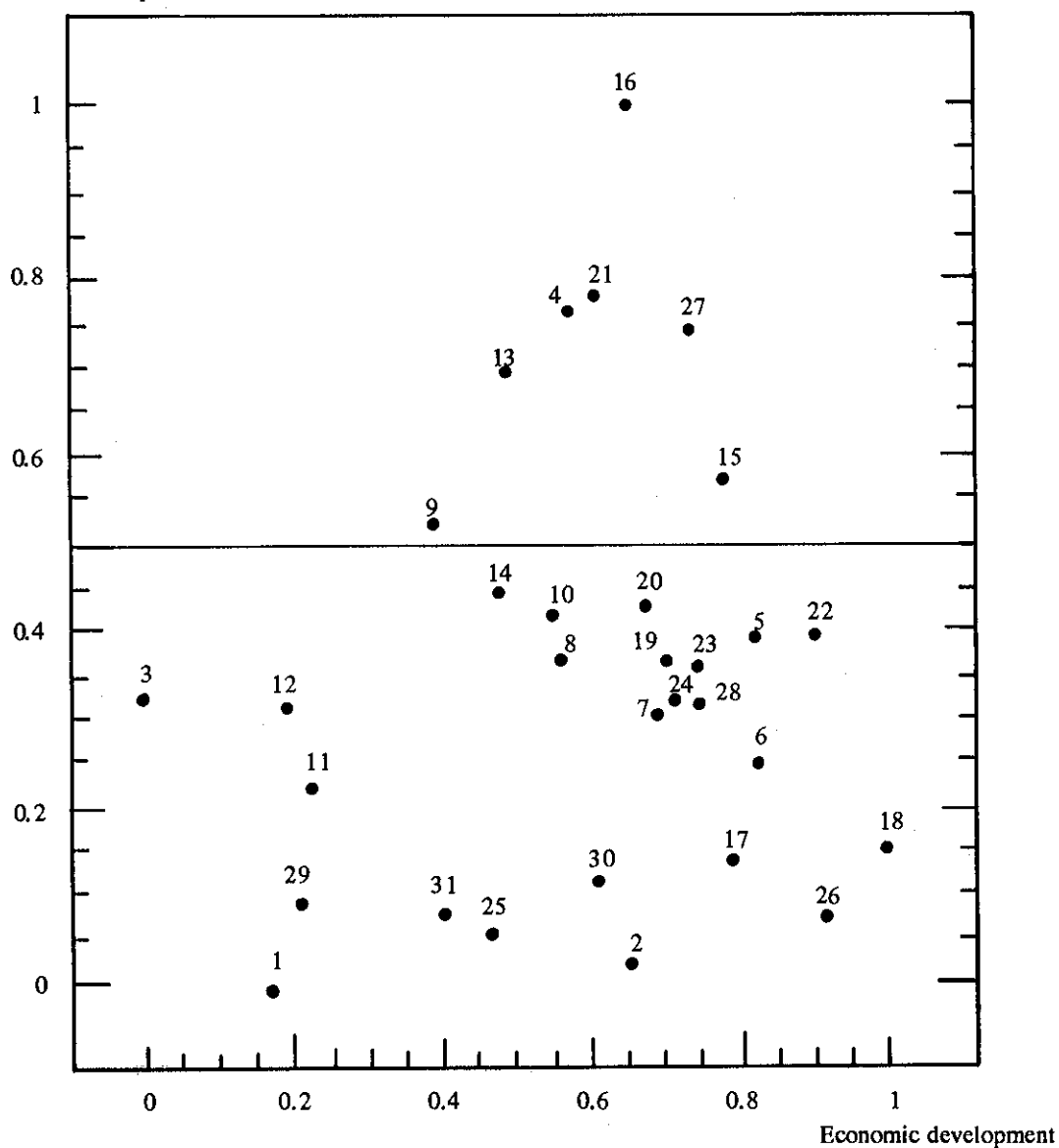
– The positions of the groups of countries indicate that high economic growth and a high pace of economic development, as measured by the variables in the index, do not necessarily result in great progress in terms of human development. However, major progress in human development requires at least some economic growth and development. This follows from quadrant two, at the upper left hand side of the figure, which is almost empty.

The results of this type of statistical analysis should be interpreted with caution. The outcomes of studies that compare the performance of groups of countries depend, of course, very much on the selection of countries and performance indicators, and the period under investigation. For that reason, the classification of countries presented here may differ from classifications in other studies (World Bank, 1990b; UNDP, 1990, p. 99).

Moreover, the pace of development during a period cannot be viewed in isolation from the starting conditions. As shown earlier, the higher the level of human development initially is, the slower progress in this respect tends to be. With respect to some consumption-related indicators that have been included in the study, increases beyond a certain level may even reduce living conditions and life expectancy, and may consequently be considered a negative contribution to human development. Particularly in South Asia, levels of human development are still extremely low as compared to most countries in Latin America. To a much lesser extent this also holds true for many countries in South East and East Asia. Although the 1980s were an extremely difficult period for many countries in Latin America, per capita GNP and living conditions are still much higher than in most Asian countries.

Figure 2
**SELECTED COUNTRIES OF LATIN AMERICA AND THE CARIBBEAN
 AND ASIA: ECONOMIC AND HUMAN DEVELOPMENT, 1977-1987**

Human development



Latin America

- 1 Argentina
- 3 Bolivia
- 4 Brazil
- 5 Chile
- 7 Colombia
- 8 Costa Rica
- 9 Dominican Republic
- 10 Ecuador
- 11 El Salvador
- 12 Guatemala
- 13 Haiti
- 14 Honduras

- 17 Jamaica
- 20 Mexico
- 23 Paraguay
- 24 Peru
- 29 Trinidad and Tobago
- 30 Uruguay
- 31 Venezuela

Asia

- 2 Bangladesh
- 6 China
- 15 India
- 16 Indonesia
- 18 South Korea
- 19 Malaysia
- 21 Nepal
- 22 Pakistan
- 25 Philippines
- 26 Singapore
- 27 Sri Lanka
- 28 Thailand

V

New challenges

ECLAC has outlined new policies to bring about a more sustainable and socially acceptable pattern of economic growth in the future. These proposals are a great challenge to the newly elected democratic governments in the region, and make heavy demands on their capacity to manage the economy. The success of these policies will depend critically on the capacity of governments to stabilize and restructure the economy, improve external creditworthiness, and introduce measures that favour particularly income generation in lower income groups. The question is whether these demands are realistic and what should be done to enhance the capacity of governments to stimulate development in the direction outlined earlier.

Many stabilization and restructuring plans have failed, and this is not only true of the policies formulated in conjunction with the IMF and the World Bank, but also of the heterodox shock policies in the 1980s. Understanding the causes of these failures is a precondition for the appropriate specification and implementation of these new proposals.

As indicated earlier, the effects of economic policies are difficult to assess, and consequently the causes of their failure are hard to detect. Methodological problems hamper not only the evaluation of past policies but also the recommendation of new ones. Notwithstanding these problems and limitations, some of the findings of reviews of traditional stabilization and structural adjustment policies can be of particular importance in this context. The reviews show that the cuts made in government spending have resulted in significant reductions of government investments in physical and human capital (World Bank, 1990a, pp. 11-39). The great political risks involved in cuts in many types of current expenditures explain the preference for reductions in investment programmes rather than in current expenditures. However, these cuts in public investment programmes and in education, i.e., human capital formation, can have a negative impact on private investments and economic growth in the future.

In general, structural adjustment programmes in the 1980s had little success in raising the shares

of total investments and exports in GDP. In many countries with structural adjustment programmes, the shares of investment as well as exports in GDP, measured in constant prices, actually went down (World Bank, 1990a, p. 21). These developments are particularly worrying in view of the key role that exports and investment play in the ECLAC strategy for economic recovery in the 1990s (ECLAC, 1990, pp. 48-49).

The limited response to price measures aimed at stimulating exports may be due to several reasons: the inadequacy of the price effect, measured in real terms, for the producer; an unfavourable product range or low product quality; lack of government and private investments to support the expansion of export production; or inadequate facilities and infrastructure to facilitate international trade and foreign market penetration.

The decision to invest and export is based on expectations regarding the profitability of such investments. These expectations and the response of the private sector to new government policies have been shaped by past experience and policy failures. In this respect, policy failure is not only a missed opportunity but also adversely affects the economic climate in the future and reduces the chances of success for new attempts to stabilize and restructure the economy. Rational expectations help to explain the inertial nature of inflation over a very long period, and the failure of monetarist and heterodox policies to bring down the rate of inflation. Policy failures have also led to restraint over investment decisions, particularly in export-oriented industries. This is particularly true of countries with a long history of discrimination against exports and inconsistencies in trade policy and macroeconomic management that have often resulted in debilitating shifts in policies.

The chances of a successful reorientation of economic policy depend to a great extent on the relationship between government and the private sector, and on the capacity of the government to create an atmosphere that is conducive to investment. In view of the negative effects of inconsistent,

destabilizing and unpredictable policies on production and investment in the private sector, much emphasis has recently been given to the need to limit the economic activities of governments and particularly their intervention in markets. Orthodox stabilization and restructuring policies aim at liberalizing markets and reducing the role of government (van Dijck, 1990). There are indeed many good reasons to scrutinize government activities and their impact on the overall functioning of the economy. However, although it is true that governments fail, so do markets. Markets are not only distorted because of government intervention –so-called policy-induced distortions– but also for many other causes, and in such cases corrective measures are required. Sustainable and equitable growth may require frequent and efficient government interventions to reduce barriers to market entry, control monopolies and oligopolies, and limit pollution and the exploitation of nature. Consequently, the less perfectly markets operate, the more corrective government intervention is required.

Moreover, the private sector often falls short of providing the goods and services demanded by society, and this can make necessary stimulating measures by government such as subsidies and tax reductions, or production by the public sector. This is not only true of (semi) collective goods and services but of many other products too.

It is not possible to make generalizations regarding the optimal size of government or the areas of government activity, and there is no obvious relationship between the size of the government sector and the overall rate of economic growth or the rate of investment. The issue is not so much the size of government, but the objectives of its policies and the effectiveness of the instruments used. At this stage of the analysis it is tempting to draw some general conclusions from the experience of the successful South East Asian countries.

As we have indicated earlier, however, one should be extremely careful in making comparisons across countries with respect to government policies and the response of the private sector. Wide differences among countries with respect to their histories and cultures, natural resource endowments and dependence on external factors create different options for development strategies.

Although, in principle, economic laws are universal and economic mechanisms generally applicable, differences in the initial setting result in quite different types of responses of the private sector to policy measures and price incentives. Consequently, the success story of the four “tigers” cannot serve as a simple blueprint for other countries. In the ongoing controversy over this theme, these limitations tend to be somewhat neglected, and strong statements on the causes of successes and failures have often been based on weak foundations.

The approach followed by the successful “tigers” in South East Asia is definitely not typical of the orthodox development policy that advocates a restricted role of government in the economy (Linnemann, van Dijck and Verbruggen, 1987). Governments in these countries have played a very active role, directly as well as through far-reaching interventions in capital markets and markets for products and services. More specifically, they have been particularly active in the areas of export promotion and the support of technological development and investment: two interrelated key areas in these small and natural-resource-poor economies, which are highly dependent on the capacity to exploit comparative advantages and to penetrate foreign markets.

This, however, does not mean that these interventions have always been efficient and successful. On the contrary, costly mistakes have been made, particularly in efforts to stimulate the use of capital-intensive and more advanced technologies and to upgrade the structure of exports. The Heavy and Chemical Industry Plan of the Korean Government in 1972 is a case in point. More generally, it may be said that government policies aiming at the creation of new comparative advantages in capital-intensive and technologically advanced sectors have frequently failed and have created white elephants all over the world.

Traditional indicators of government behaviour may show some important and indeed striking differences between the Asian and Latin American countries, but a more detailed analysis is required to appreciate fully the differences in development strategies. The most striking differences are not so much related to the share of government expenditure in total spending or the contribution of government firms to total production. Much more striking are

the differences in the imbalances of the government budgets and the destabilizing effects of government overspending on the rest of the economy, as shown in the statistical sections. Also, there are important differences in the size and type of distortions caused by government interventions in markets. Although recently many shock-type changes have occurred in a number of Latin American countries, available indicators show that price distortions are smaller in South Korea and Taiwan than in most Latin American countries. Also, average nominal rates of protection are lower and the export incentives are higher in many countries in South East Asia than in Latin America (Erzan *et al.*, n.d., and Agarwala, 1983). It is true that there are wide differences among the incentive rates given to sectors in many countries in both regions. In some cases these differences reflect the power of rent seekers to lobby, and can consequently be regarded as distortions that hamper efficient use of available resources. However, measures to protect and stimulate industry can also reflect strategic choices that are part of a longer-term strategy to develop technology and stimulate diversification of exports. A key element in the industrialization strategies of South Korea and Taiwan has been temporary protection for potential export firms on the domestic market and price discrimination. Preferential credit allocation by the government enables these firms to improve their productivity and international competitiveness.

The characteristics of the so-called developmental State in South East Asia, including Japan, have been discussed elsewhere and need not be reviewed here. Briefly, they are:

- i) a strong State that steers firms by means of price signals, regulations and compulsion;
- ii) co-operation and frequent consultation between the State and the private sector in key areas such as trade, investment and technological development; and
- iii) predictability of policies and risk reduction for the private sector in order to stimulate investment and production.

The intense and strongly focused relationship between government and the private sector in these countries has played an important role in shaping efficient economies that are able to compete successfully in world markets on the basis of genuine competitiveness.

Technological development is the crux of the ECLAC strategy. In this context Fajnzylber made some observations on the critical contribution of government in creating a proper economic climate in which decisions on investment and production are made. The opening of the black box of technological progress, as Fajnzylber puts it, would require the transformation of a rent-seeking society into a society that is oriented towards savings, investment and competition (Fajnzylber, 1990, pp. 182-190). As follows from the experience of South East Asia, such a type of development can indeed be stimulated by an active government that intervenes in markets in many different ways without hampering efficiency and blocking international competition (van Dijk, 1989).

Some final observations are called for on the role of human capital formation in the process of development as envisaged by ECLAC. Absorption of technology requires not only investment in physical capital but also human capital formation. Moreover, skill formation is probably the single most important factor contributing to the alleviation of poverty. Education, therefore, should be the heart of any policy focusing on the twin objectives of technological development and social equity. A well-educated and highly trained labour force is required in order to develop comparative advantages in dynamic markets and generate more value added in manufacturing and the processing of primary products. Training and skill formation have contributed greatly to the dynamism of the densely populated economies of South East Asia, where initially comparative advantage was based on low wages and poor labour conditions.

Austerity –that is to say, savings and investment– and education are the two engines of economic growth with equity, and a fundamental shift in policy is required to reverse the declining investment rates and the cuts in government spending on investment, education and services that are of critical importance for alleviating poverty.

Appendix

SOURCES OF VARIABLES

Variables 1-6, 8, 9, 11, 13, 15, 22-27:	The World Bank, <i>World Tables, 1988-89</i> , Washington, D.C.
Variable 7:	UNCTAD, <i>Handbook of International Trade and Development Statistics</i> , several issues, Geneva, United Nations.
Variables 10, 12, 14:	IMF, <i>International Financial Statistics</i> , several issues.
Variables 16, 28, 33:	UNDP, <i>Human Development Report 1990</i> .
Variables 17-21:	World Bank, <i>World Debt Tables</i> , several issues.
Variable 29:	FAO <i>Yearbook: Production</i> , several issues.
Variables 30, 31, 32:	United Nations, <i>Report on the World Social Situation</i> , several issues, Geneva.

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