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INFLATION AND GROWTH: A SUMMARY OF EXPERIENCE IN LATIN AMERICA

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FOREWORD

In accordance with ECLA resolutions 81 (VI) and 1 and 8 (VIII), the Secretariat of the Commission is in the course of preparing a study of inflation in Latin America and of its relation to economic growth.

Inflation is a highly controversial subject. For one thing, it is complex and has many facets: movements in prices are associated in various ways with changes in wages, in exchange rates, in the output of various sectors, in investment, in foreign trade, in the supply of money, and so on. In this profusion of cross-correlations, it is easy to interpret any one as a complete explanation, and such over-simplified views are widespread. Even at the professional level there are sharp differences of opinion.

Secondly, the matter is far from being a merely academic one. It affects the daily lives of everyone in each country concerned. The question of what causes inflation is inseparably linked with another question, how it should be cured, and the policies of stabilization which have been adopted in many countries are hotly debated, because they raise far-reaching social and political issues.

When a subject is simultaneously complicated and political, debates over policy tend to be strident and somewhat unfruitful. Partisans of different viewpoints lose sight of the historical background and of the experience in other countries. It may therefore be useful to take stock of the whole problem, and look for the antecedents of today's difficulties in the statistical evidence, such as it is, on what has happened in a number of Latin American countries over the past two or three decades. The aforesaid study attempts to assess some of the main forces at work, to examine their interaction and to make a critical appraisal of the policies followed by the authorities. Thus the basis is provided for indicating the principles on which policy should be based.

The study deals with the relevant features of Latin America's economic structure with external and internal trends since 1929, and with experience in various fields of policy; and it also includes more detailed analyses of four of the countries in the region. This will be published later this year. In the meantime, for the benefit of delegations attending the ninth session of the Commission, some of the interim results are summarized in this paper.

/I. PRELIMINARY

I. PRELIMINARY CONCEPTS

1. The definition of "inflation"

The confused discussion of the subject is partly due to the fact that there is no widely agreed definition of the term "inflation". In everyday language "inflation" means a rapid rise in the general level of prices. It is, however, also used in senses rather different from this. For example, "inflation" is sometimes said to exist when demand tends to exceed supply, even though prices are not actually rising, for example because of controls. Again, some people use "inflation" to describe an increase in the amount of money in circulation, or even simply as the printing of money, and this too may not be closely associated with rising prices.

These last meanings each imply a view about the proximate cause of price increases, and it will therefore be more objective as well as simpler to keep to the common usage, namely that "inflation" means a rapid and general rise in prices, whatever the reason for it. But this usage is a little imprecise and a price rise will only be termed an "inflation" for the purposes of this study, provided it continues for some years and continues at a significant pace.

But what constitutes a significant pace? The answer given to this reflects national experience. Those who have lived in countries where violent inflation has been the rule might consider that a price rise averaging 10 per cent *per annum* for some years would amount almost to stability. On the other hand, in a country which has experienced little price change for a long time, an increase of 2 or 3 per cent a year may appear inflationary. Partly because of this inevitably subjective approach, and partly because the price indices available lack both a full coverage and also accuracy, no attempt will be made here to say that some particular percentage rise in prices would constitute the borderline between relative stability and inflation. The essential characteristic of inflation is, in any case, not so much the quantitative rise in prices, as its chronic and recurrent nature.

/2. Failures

2. Failures in the process of growth

The repeated waves of price rises in a number of Latin American countries are significative of economic and financial maladjustments. In order to see the likely nature of these maladjustments, the most important economic problems of a Latin American economy and the nature of the process of growth, should be briefly examined.

The main typical weaknesses are that *per capita* income is low; that the distribution of income is very unequal, as between different areas and different social classes; that the level of activity depends on a few export commodities; and that many goods, including most forms of equipment, have to be imported. There are three reasons why these problems have become much more dangerous in the past few years. Firstly, the increase in the population, already fast, is accelerating in nearly every country. Secondly, people in Latin America are growing more aware of the contrast between conditions in their own countries and those overseas, and also of the contrasts *within* each country in the region, and they are becoming increasingly unwilling to tolerate living in, or on the brink of, acute poverty. Thirdly, the markets for the major exports of the region are showing not merely their customary instability, but also severe over-supply, despite the general prosperity in the industrial countries; even in "boom" years, commodity markets are far from buoyant.

The general line of development that the region needs is obvious: economies have to be diversified so that they can continue to grow, regardless of trends or fluctuations in world commodity markets. But while this is obvious, it is far from simple. The time factor is crucial, and rapid industrialization imposes great strains, not merely economic strains but also tensions in the social structure and the administrative system. The socio-economic system and the bureaucracy of many countries have defects which are exposed under these pressures, and the process of adjustment may fail to be carried through successfully.

This failure can take various forms. One possibility is that no progress is made with the work of diversification, so that growth continues to depend very heavily on the performance of traditional exports. If these are sluggish, the consequence is economic stagnation, in the sense of

/constant or

constant or falling per capita incomes, accompanied by increasing unemployment and perhaps political instability. The results of failing to diversify the economy are not apparent so long as exports are rising rapidly. It is in fact tempting to forget the need for economic reform under these circumstances. But commodity booms, however vigorous they seem, do not last for ever. When they end, the threat of stagnation materializes, perhaps all the more dangerously if a high proportion of supplies is still imported.

The progress of growth cannot be considered succesful - even though it is both rapid and accompanied by industrialization - if it is achieved without a definite improvement in the conditions of the pocrest sections of the community. The burden of economic transformation has at times been thrown on them by suppressing increases, or even inducing declines, in their real income. It may be possible by such means to release resources for investment and to keep prices steady, even despite the shortages of one type or another that inevitably appear in the course of growth. But relief is only obtained at the cost of aggravating distortions in the income structure. Sooner or later the political oppposition mounts, so this way forward cannot be followed indefinitely. Besides, the growing inequality of income distribution would inhibit the appearance of mass production industries, an essential step in the process of growth.

Then again, as demand grows, it may outstrip the rise in output in some or all of the sectors of the economy. The pattern of investment may not be right, or technical progress may be uneven, or management in some industries may be unenlightened. (These possibilities are not of course mutually exclusive). Agriculture is an obvious illustration in a region where the size of the productive unit and the identity of its controller are determined by inheritance more often than by the play of economic forces. One possibility is to ease the consequent shortages by increasing imports. But the normal supply of foreign exchange, i.e. export earnings and receipts of long-term capital, may not be rising fast enough for this. Then special methods of financing the deficit have to be used: for instance, running down reserves of foreign exchange or accumulating short-term debts. These devices cannot of course be used indefinitely, and persistent recourse to

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them is a sign that the economy is failing to carry out its adjustment satisfactorily.

Inflation is another such sign. This may be attributable to monetary or fiscal policies that raise demand too quickly. It may be due to wage increases greater than the economy can bear. Or the problem may not be so much one of general excess demand or general rises in costs as one of particular bottlemecks in supply. Perhaps some shortages, e.g., of food, cannot be relieved by imports because of transport and marketing difficulties, or because of a lack of foreign exchange. Alternatively, or concurrently, the pressure of demand for imports may, if it is not being met by sufficiently rapid production of local substitutes, lead to devaluation, which also lifts the level of costs. These upward pressures on prices may arise in the course of industrialization, or alternatively, they may be associated with economic stagnation and the failure to develop key sectors of the economy.

The process of growth could of course, at least in principle, take place without these deficiencies. Output could grow sufficiently fast in all sectors so that, despite the population increase, average incomes rose without a deterioration in income distribution or a chronic payments deficit or inflation. One would describe this as a process of dynamic equilibrium. Inflation is best seen as one possible lapse.

3. Monetary and real factors

Inflation is invariably accompanied by some increase in the supply of money, so the former can always be imputed to the latter. It is therefore tempting to say that bad monetary policy is "responsible" for inflation and that there is no need to look further than this. This simple chain of deduction is all the more attractive because it dispenses with the need for analysis of economic trends.

But it is essential to probe deeper. The question necessarily arises during the examination of any particular situation: why did the supply of money increase? Was there a budget deficit? Did the Central Bank expand its loans to the commercial banks? But these questions in turn immediately suggest others. What influences were causing tax receipts to lag, or

/public expenditure

public expenditures to climb? What forces in the private sector were raising costs and increasing the demand for bank credit? And a look at regional experience reveals that some questions are continually recurring: why are the pressures so great on Governments to increase social services and to start public works projects? Why has credit restriction so often threatened to bring with it heavy unemployment?

To answer these questions, account must be taken of the rate of population growth, trends and fluctuations in the supply of foreign exchange, the movement in real wages, and so on. It is hard to explain what has happened in the monetary sphere, without invoking the fundamental economic factors. Changes in the supply of money are, generally speaking the expression of real forces acting in the economy. Conversely, monetary developments are important to the extent that they influence - as they certainly do - real economic developments, such as the level and composition of investment; and monetary analysis is a useful adjunct to economic analysis. But it is no substitute. The problem of inflation cannot be examined in isolation from the central economic problems.

4. The aims of economic policy

This approach guards against framing the question of policy in the wrong terms. To ask: what should a policy of stabilization consist of? would be to assume that stability is something that can be pursued in isolation from the main economic objectives. Such a formulation could lead to policies which were seriously wrong. The fundamental aims of economic policy, outlined above, can be phrased as follows: to make the national income grow as quickly as possible; to distribute it more equally; and to dampen its short-period fluctuations. At times of course there may be conflicts between these three aims, but in the long run they are not inconsistent, indeed it is difficult to imagine how economies could grow rapidly for a long period without their inequality and vulnerability being reduced.

In the last resort, nearly all objectives can be expressed in these terms. Economic objectives as they appear to politicians - for example, the need to provide sufficient employment or to improve living conditions - are really in essence the same, for only if these central aims are achieved is there hope of eliminating unemployment and poverty.

/There are

There are other important objectives, but on careful scrutiny one sees they are not really ends in themselves but rather the means of achieving one or more of the ends already listed. For example, diversification of the economy, through industrialization, is pursued not so much for its own sake, but because it appears to be the only way in which the economy can be developed to a stage at which it would be able to continue to grow without a chronic tendency to deficit in international payments; or because a diversified economy is better able to withstand fluctuations in commodity markets; or because industrialization will break down rigid social barriers that cannot be destroyed in any other way.

5. The drawbacks of inflation

Price stabilization is also in the category of means rather than ends. The first reason for avoiding a persistent price rise is that inflation hampers growth. Uncertainties about price movements greatly complicate rational anticipation and planning, for the Government and private citizen alike; and inflation also discourages saving and distorts the pattern of investment. Secondly, it inhibits policies designed to compensate for fluctuations in exports. Thirdly, it is associated with a shift to profits in the distribution of income.

Unfortunately, the word "inflation" has acquired, over the long years of controversy, certain non-objective connotations. It is no longer used simply to describe a movement in economic indicators. Weaknesses are often ascribed to inflation, although they are in fact due to more fundamental defects in the socio-economic structure. Thus although economic stagnation has been associated with inflation in much of the 1950's in Chile, it has also been the lot of countries with stable price levels, such as Cuba and Haiti. Similarly low rates of personal savings, heavy investment in luxury flats or high profit margins which are typical symptoms of an inflation lasting for a decade or more, can be found in economies which have never known a serious degree of inflation.

In any case, price movements cannot all be condemned out of hand. Except in the most strictly regimented economy, prices of various goods move from time to time upward or downward. The main ultimate justification put forward

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for the price system is that it is intended to achieve the necessary shifts in the factors of production by variations in prices. A process of growth, when substitutes are being developed for imports, involves factor movements on a massive scale. In some types of economy, these movements are achieved by administrative decree or political pressure. In countries of Latin America, however, an important role in transforming the economy must under present circumstances be played by price changes. Yet because of rigidities in various prices, reflecting a widespread reluctance to acquiesce in falling incomes, and because of supply inelasticities in the region, due to factor immobilities which will be discussed below, the working of the price mechanism may well produce more rises than falls, lifting the average level of prices. Indeed, rising prices have traditionally accompanied processes of rapid industrialization. Thus, in Japan prices rose by more than 80 per cent during the decade and a half of intensive growth from 1888/92 to 1903/07, despite near stability in world prices at that time.[1/] But inflation has, of course, not normally been of the speed experienced in Latin America in the past decade.

It is always necessary to go back to the basic aims of policy; a policy that avoided inflation but did not convey a firm expectation of growth, or of a more equal income distribution, or of reduced vulnerability to export fluctuations, could hardly be considered well conceived. On the other hand, it is a mistake to go to the other extreme and conclude that inflation does not matter. Fulfilment of the main objectives, particularly economic growth, is easier if chronic inflation can be avoided.

6. The alleged conflict between growth and stability

Putting the matter in this way shows that it is misleading to ask questions such as: are price stability and growth incompatible objectives? And it is still more misleading to ask: which is preferable?

Posing a choice between growth and stability is to fall into a logical fallacy. The choice is only between various objectives, not between an objective and something which, though it helps achieve a number of objectives, is itself a means rather than an end. The damage done by inflation has to be judged in terms of its effects on growth, equality and vulnerability;

1/ K. Ohkawa and H. Rosovsky, "Role of agriculture in Japanese Economic Development", (Economic Development and Cultural Change, Vol.IX, No.1).

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this has to be worked out through economic analysis. The question for policy-makers is whether the total effects of one policy on the level, distribution and variability of income are better than those of another policy - allowing for the prospect, inter alia, that inflation may be involved in one case but not in the other, or in one more than the other.

In the longer run, the antithesis is even more obviously fallacious. Only through economic development can the economy be made more flexible and strengthened, so that it becomes less prone to inflation. If growth were slowed down in the attempt to avoid inflation, the day would be postponed when the economy could be developed with less strain and thus less danger of inflation. A country that pursues stability at the expense of growth, may find it ends up with neither.

/II. THE

II. THE PROCESS OF INFLATION IN LATIN AMERICA: THEORETICAL CONSIDERATIONS

1. The conditions for dynamic equilibrium

There is no simple and self-evident causal nexus between growth, on the one hand, and inflation, on the other, in either direction. Yet they are obviously not completely unconnected phenomena either. An under-developed country that attempts to change and to grow rapidly faces certain tensions which may result in inflation. Whether this happens or not depends on the following factors:

(a) the pace at which economic change occurs;

(b) whether external developments are favourable or otherwise;

(c) the flexibility of the internal economy (reflecting not merely the productive structure but also a wide range of institutional, social and cultural characteristics);

(d) the extent to which the policies followed by Governments ease or aggravate the process of transformation.

(a) Suppose, for example, that the national product is growing quickly, as it may have to if the rate of increase of the population is high. This implies a fast expansion in demand, especially for some types of goods and services, because, *inter alia*, growth will be accompanied by urbanization. Examples of items of consumption which typically expand quickly in a growing economy are consumer durables, household electricity and passenger transport.

(b) For an under-developed economy such as those in Latin America, these rises in demand may create problems. Of course they can be accommodated, if exports are rising fast enough. Foreign exchange supplies will then permit imports of durables - to continue with the previous examples - to increase, and also allow equipment for electricity generation and for transport services to be purchased overseas. It will similarly be possible to ease other shortages that arise during the inevitably somewhat uneven process of growth.

But imports will have to grow at least as quickly as income if this room to manoeuvre is to be maintained. If, however, export markets are weak, the domestic economy will itself have to satisfy these types of expanding demand. Some sectors, such as the engineering industry will have

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to grow particularly fast. The agricultural sector will also have to expand its output because of the increasing need for food to feed city populations. Not only industries producing 'final' products will be affected but also - and more especially - those producing 'intermediate' goods and services, such as steel, energy of various kinds, and freight transport.

(c) Those brought up in the classical tradition of economics might expect that declines in the sales of export products would induce labour and capital to shift readily into secondary industries of their own accord, because of the more attractive wages and profits to be found there. For this to happen, two conditions must be fulfilled. In the first place, prices must act as signals to show what economic changes are necessary. Secondly, factors of production must move readily and easily in response to such signals.

The first conditions will be met if monopolistic elements are not so severe that they affect the levels of wages or of profits in particular industries, or trends of prices. More important, prices need to be such that profits reflect the full yield to the economy of acts of investment.

The second condition is that labour must be mobile enough in all senses (geographically, industrially and occupationally) to flow in repsonse to wage movements, and that capital should also move into the most profitable openings irrespective of where it arises. ('Profitable' here refers of course to the long term.) This mobility is greatest if the export sector can sell its surplus output in the home market, or if its resources can be used where they are, without much adaptation, to produce other goods. In addition, and perhaps more crucially, entrepreneurs must emerge to take advantage of the possibilities of profits and to combine labour and capital efficiently.

There are certain financial corollaries of this physical transformation. The flow of saving has to be high enough to finance the capital requirements, and has to increase when a rising yield signals that import substitution has to be accelerated. This problem is easier to solve to the extent that capital is available from overseas, and conversely more difficult to the extent that capital is absorbed in the purchase of foreign securities, United States dollars, or gold.

/Apart from

Apart from the physical and financial conditions for dynamic equilibrium, there are also social ones. The purpose of e conomic growth is, in the final analysis, to solve social problems by providing better nourishment, housing, etc. This implies that it is more successful to the extent that inequalities of income are reduced. Indeed, since the manufacturing industries mostly require large markets, increasing equality could in any case hardly be avoided in the long run.

(d) Merely to state these conditions indicates that economic transformation may not come about automatically, through the normal interplay of economic forces. Yet dynamic equilibrium can still be achieved if Government policy is far-sighted and firm enough to ensure that the necessary substitutes for imports are produced and also to curb inessential consumption and investment by fiscal and monetary policy. This in turn implies the need for efficient and honest public servants.

These last two conditions - (c) and (d) - are of course themselves interrelated. Structural obstacles to growth also affect the distribution of political power and the context within which it is wielded.

The question of whether inflation is inevitable in the process of rapid growth therefore resolves itself into three subsidiary questions: are markets for the country's exports buoyant?; is the internal economy flexible?; and is Government policy efficient?

If exports rise rapidly enough, as they did in Venezuela for many years, the economy can grow quickly without serious danger of inflation, even though labour and capital are immobile, enterprise is deficient, and the Government lacks an adequate development policy. In that case, however, the economy will <u>grow</u> rather than <u>develop</u>: it will not achieve enough import substitution to enable it to weather comfortably a subsequent weakening of export markets. On the other hand, if exports are stagnant, or even more if they fall back, then the pace of price rises will depend on structural factors and on Government policy. The greater is the weakness in exports and the more intractable are structural obstacles to growth, the less easy is it for a government to avoid inflation and still to maintain a satisfactory essencial growth.

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2. The mechanisms of the inflationary process

This brief review of ideal conditions points to the ways in which inflation can emerge and propagate itself - the plural is used because there are, in theory at least, several possible processes of inflation. For the sake of exposition, let us suppose that an economy has been growing in dynamic equilibrium, as has been defined above, and that something happens to divert it from this path.

A convenient first hypothesis is that the rise in exports slows down or stops. If growth is to continue undiminished, this must mean an acceleration of the rate of import substitution, i.e. of industrialization. Some local industries will have to expand particularly quickly. Imports of capital equipment, and of materials unavailable locally, will not fall. They will increase, because of the very need for industrialization, so imports of consumer goods will be reduced, probably sharply.

This need to expand certain industries rapidly will have a direct impact on the price level, because goods produced for the first time domestically will almost certainly be more expensive than the imports they replace. Otherwise they would have been produced before. The new substitutes will be produced under the protection of tariffs or import controls; they will be marketed in monopolistic conditions; they will usually be manufactured in rather small quantities because of the limited size of local markets, and in any case the techniques used may be relatively inefficient.

But what is of greater significance for the economy is that the expansion of these industries means a big increase in the demand for certain inputs. To attract workers into the new industries, for example - especially skilled workers - higher wages have to be offered. This creates shortages of certain types of workers elsewhere, raising costs in other industries, and it affects the general wage level. The increased demand for electricity aggravates any energy problem that exists, and the increased need for freight facilities will add to the

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strain on the transport system. The accelerated pace of urbanization associated with this economic development implies that passenger transport facilities, urban social services and food supplies will have to grow more quickly.

Import substitution thus changes consumption functions throughout the economy. It requires from the productive sectors a flexible response which is difficult to achieve in an economy where the markets for labour and capital are imperfect. Failure to make the needed spurt in output means rising prices. Moreover, to the extent that the economic transformation is not complete enough, the pressure of demand for imports will not be relieved, and the exchange rate will be devalued, which will also raise costs. Once prices rise, for whatever reason, this threatens the levels of living of various sections of the community, and leads to attempts to raise wages and other forms of income - attempts which are more or less successful according to the power of the sections concerned. Then, in time, thrift is discouraged, and capital is diverted away from the types of long-term investment which are needed. So inflation gains momentum. Moreover, as prices rise deficits appear in government accounts because of the inflexibility of taxes.

An alternative possibility is that the growth rate of population may accelerate, making it necessary for that of national income to accelerate too. The rate of growth of exports, although previously satisfactory, will then prove too slow, and the same problem of an import "bottleneck" will arise.

So far it has been assumed that the pressure of excess demand appears because imports of some types cannot keep climbing fast enough. It may also make itself felt if supply lags for different reasons. For example, agricultural output may cease to expand at a satisfactory pace. This will mean rising food prices, or, alternatively, increasing imports of food, a state of affairs which aggravates any foreign exchange problem. And, moreover, it immediately stimulates pressure for wage increases. A failure of the output of steel or of petroleum to grow in line with local demand will create the need for rapid import substitution in other sectors, even if exports are rising reasonably fast.

The acceleration of demand for particular goods will pose formally similar problems. This might happen as the result of "autonomous" changes in the pace of urbanization, or in the distribution of income, or in the coverage of consumer credit, or in taste (for example, as a result of the "demonstration effect"). In any of these ways a price inflation can develop, and, once it starts, it develops cumulative features.

Apart from long-term models, such as have been outlined here, inflation might emerge because of fluctuations in exports, even if these fluctuations were to take place around a rising trend. Over the short run, capacity to produce substitutes for imports cannot be increased, so there is an immediate danger of devaluation if the growth of income (and the demand for imports) continues while exports fall back. This is especially likely to occur if there is a chronic long-term tendency to inflation.

Moreover, when exports recover, the process is not necessarily reversed. By that time, rises in internal prices and incomes will have occurred, and it will seem unrealistic to consider going back to the old exchange rate. Incomes will also be rising in the export sector, and so will prices of imported manufactures (if the recovery of the country's exports is part of a world boom). So both in a slump and in a boom prices tend to move upward, and the long-term pace of inflation depends in part on the violence and frequency of short-term fluctuations in commodity markets.

Similarly, a budget deficit might grow because of the decline in revenue from exports, or indeed for any other reason, such as quite irresponsible increases in public outlays. Then again, demand may rise because an expansion of monetary policy causes private investment to outrun private savings. Whatever the cause, an excess of total demand means rising prices. This discourages exports, while it stimulates imports, thus inducing devaluation, and causing a shortage of foreign exchange for certain types of imports.

Again, wage rises may be greater than productivity increases. This at once results in rising prices, especially if the organization of

/industry is

industry is monopolistic. It also unbalances the budget, and increases the costs of basic activities such as electricity production and transport. Either their prices will be adjusted, in which case the upward trend in prices is strengthened, or they will be held constant, in which case the enterprises will lack the finance for investment. Since consumption will be stimulated, familiar problems of shortage of capacity will appear.

While, therefore, there are many ways in which the process may begin, it will in time, however it started, show certain predictable symptoms, including a strained foreign balance, and shortages of particular types of goods.

It should be noted that a different theory is required to explain inflation in semi-industrialized countries like Brazil or Chile and in fully developed countries. In the former case, the model has to allow for the changing patterns of demand, due to urbanization, for the high share of food in workers' expenditure, for hindrances to the mobility of labour and of capital, for the general impossibility of selling frustrated exports in the home markets, for the chronic shortage of capacity, for the lack of certain industries (notably those producing capital equipment), for the inflexibility of the fiscal mechanism and so on. These are features which do not have to be given the same weight (or, in some cases, any weight at all) in the analysis of inflation in developed economies.

Besides, a general theoretical explanation of Latin American experience has to take account of dynamic factors such as population growth. This compels government initiative in providing social and economic capital, and in creating employment opportunities if these do not emerge. Analysis of trends in this region also has to allow for adverse secular trends in markets for primary commodities, and an income-elasticity of demand for imports greater than unity.

The process which has been described cannot be classified as one of "cost" inflation or of "demand" inflation, in the manner customary in professional discussion in Western Europe and North America. It has elements of both, but also structural features and trends which are peculiar to less developed societies.

/The importance

The importance of various aspects of this process varies from country to country, according to the rate at which each grows, its experience with foreign trade, its economic and social structure, and the policies which its Government puts into effect. In some cases the external and internal obstacles to growth make it difficult for Governments intent on economic development to avoid inflation, at least in the short run (i.e. until they can make structural improvements). In others, due advantage may not be taken of a favourable structural situation and possibilities of expanding trade. Perhaps the need to develop basic sectors is ignored, or export markets are lost because of ill-conceived policies in the spheres of public investment, or irresponsible fiscal, monetary or wages policy. Developments in Argentina in the years after the last war illustrate these points.

In the remainder of the present paper the experience of Latin America in the past three decades is summarized with special attention to these questions. First the situation in 1929 is described, with some reference to the inherited obstacles to structural adaptation; then the same section III deals with the decline in exports during the depression, the wartime shortages, the postwar boom and the problems raised by the attempts to pursue development policies in the 1950's, despite recurrent weaknesses in commodity markets. Section IV discusses some features of the policies which have been followed in the attempt to cope with these problems.

/III. A

III. A SUMMARY OF THE RELATION BETWEEN GROWTH AND INFLATION, 1929 TO 1959

1. The position in 1929[2/]

During the nineteenth century, the economy of every country in the region had become organized very largely around its export industries. By the time of the First World War, the main features of economic structure could be summarized as follows. A substantial part of the proceeds of exports was earned by plantations, large cattle farms or mines. Much of this income flowed straight out again. Some of it was remitted as profits to foreign companies or absentee landowners; the rent and profits received by local property owners were mostly spent on imports. The remainder entered the local economy by two main channels, namely, taxes on foreign trade and profits of export and import merchants. These sustained civil service bureaucracies and commercial life in the large cities, where some manufacturing activities could be found, such as food processing and the clothing industry. A considerable fraction of the population, often those of Indian or negro stock, worked on estates, or on smallholdings, or on communal land, for very little remuneration, so they hardly counted as part of the consumer market. They were also cut off from the city labour markets, not merely by distance and bad transport, but also by illiteracy, lack of technical skill, and quasi-feudal obligations to their employers and landlords.

It must not be inferred from these generalizations that all economies were at the same level in the early decades of this century. The scale of manufacturing, the extent of commercial agriculture, and the degree of urbanization varied greatly. Broadly speaking, they were all much more in evidence in the Southern Zone of the region, where the original

2/ The reader should bear in mind that because not a great deal of research has been done on the economic development of Latin America, not enough is known of the structure of most countries, even in a period as recent as the 1920's.

/pattern of

pattern of colonization had been modified by the extensive immigration of artisans, entrepreneurs and working farmers. In Argentina, particularly, the economy had become quite highly unified geographically and socially, at least by comparison with that of other countries in the region.

Where the process of industrialization had already got under way, it received a vigorous impulse from the war of 1914-18. Imports became hard to get. Shipping grew scarce; blockades were maintained by the belligerent powers; and both European and, eventually, North American industries were diverted to the manufacture of munitions. By the 1920's, Chile, Mexico, Uruguay and (especially) the south of Brazil, were well on the same raod that had been taken earlier by Argentina. Substantial proportions of the population were living in urban areas, and local industries could by now satisfy a significant fraction of local demand. The same signs of progress were also appearing in Colombia, Cuba, Peru and Venezuela, although the degree of self-sufficiency they showed was lower, and typical of an earlier stage of development. Meanwhile, Argentine industry was expanding into new fields, such as engineering.

Yet all the Latin American economies were still vulnerable to fluctuations in foreign trade. Their exports, which provided a high proportion of income, were few in number, perhaps only one, and sold to a limited number of buyer countries. The sectors producing for export had, except in the cases of Argentina and Uruguay, very limited possibilities of selling their output inside the economy. Even those countries which were becoming industrialized, and thus growing less dependent on the income generated by exports, were vulnerable to the vicissitudes of external trade, though in a different way. Certain types of goods, not only advanced consumer goods, but also nearly all capital goods and intermediate products had to be imported. The more advanced economies were coming to rely heavily on receipts of foreign exchange to provide the materials and equipment for their industrial sectors.

Despite the progress that had been made, internal developments continued to be hampered by the lack of economic integration. Some improvement had been made in the cultivation of export crops, but

/little technical

little technical progress could be seen in agricultural production for the home market. While owners of large estates still used the major part of their land, even when arable, as unorganized cattle runs, the peasants on smallholdings or communal land were employing techniques which were decades or even centuries out-of-date. Industrial firms, lacking the domestic hinterland they needed for large-scale production, were often inefficient and/or monopolistic.

Nevertheless, as long as world trade was buoyant, as it was in most of the 1920's, economies did continue to grow. Exports expanded, private investment by foreigners was heavy, and Governments could raise considerable finance overseas for public works. Incomes rose, and with them consumption and tax revenues. The cities were able to absorb a continuous flow of migrants from the country districts, attracted not merely by higher incomes, but also by amenities and services such as electricity, water supplies and schools, and in some cases by greater safety.

These physical changes in Latin American economies had been accompanied by others of a financial nature. In the nineteenth century, a number of countries had still used dollars for local currency, while those with their own money had kept it tied to gold; and foreign banks had provided most of the financial services. The countries of the Southern Zone which had made most progress economically had begun to show greater financial independence. They devalued their currencies, on occasion, and suspended convertibility into gold; this was done usually to alleviate the consequences of slumps in world trade. In addition, locally-owned commercial banks played a growing part in the financial life of the more industrialized countries, and during the 1920's several central banks were established.

These moves towards monetary independence had, however, met with setbacks from time to time. There had already been bouts of inflation, especially in Chile, and on occasion local banks had been forced to close their doors. Sometimes devaluation could be ascribed to plain mismanagement of national finance. After the severe financial crises of 1921, when commodity markets had collapsed, there was a general attempt to return to the gold standard. Latin America was in this matter following the example of European countries which were trying to re-establish

/the international

the international monetary system that had broken down in the first world war.[3/]

One of the consequences was that economic policy, as it is known to-day, hardly existed in 1929 in any part of the region. Observance of the rules of the gold standard meant that certain problems never arose. A shortage of foreign reserves could hardly occur, and any incipient price inflation would be braked by shortage of money before it could gather momentum. Among the virtues of the gold standard was that it achieved these ends almost automatically, and the agenda for political decision and administrative action was therefore light.

Few instruments for policy had as yet been created. Taxation was relatively low, being based mainly on import duties, and since a chronic budget deficit would have been hard to finance, expenditure was also limited. Despite the moves towards financial independence, monetary systems were still hardly developed enough to give much scope for deliberate policy. Exchange controls and multiple rates were as yet unknown. In any case, the material basis for a more active and independent policy hardly existed in most countries, at least in the short run, if the lack of local capacity for producing manufactures is taken into account. Monetary expansion would have led quickly to an increase in imports and an unacceptable loss of foreign reserves. Furthermore, the political pressures for such policies were limited, since power was effectively in the hands of those not entirely dissatisfied with developments, and even the discontented could still find some scope for the improvement of their conditions so long as national products were rising and it was possible for them to move out of backward sectors of the economy.

But the almost complete absence of conscious economic strategy proved a serious handicap in the years that followed. Administrations were not gaining experience in formulating policy and carrying it out; statistics were not being demanded because they were not needed, so they remained almost non-existent; and political leaders had become accustomed to thinking

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3/ In one respect most Latin American countries departed from strict gold standard conventions; holdings of the currencies of the industrial countries were treated as if they were gold for the purposes of currency regulations and conventions. It was convenient to hold the currencies of trading partners, and, since they were in fact fully convertible into gold, a "gold exchange standard", as it has been called, was for countries of the region a natural departure from practices followed overseas.

/that economic

that economic developments were, broadly speaking, outside their control and therefore not their responsibility.

2. The consequence of the depression: policy conflicts emerge

Great though its merits were, in retrospect it is hard to believe that this time the larger economies of the region would have been prepared, or indeed able, to maintain the rules of the gold standard indefinitely, even if fluctuations in trade had been avoided. These rules implied an overriding priority for balancing foreign payments and for stabilizing the price level. Income and employment could grow and recessions could be avoided, but only if foreign trade continued to expand. Thus the rate of expansion depended in the last resort on the pace at which national products were growing in the leading industrial countries of North America and Western Europe, a pace which might prove too slow for an area with low per capita incomes and a fast rate of population increase.

However, the question was never put to the test. The depression which started in 1929 was so harsh that the gold standard was discarded as unworkable by the whole world, including the industrial countries themselves. World trade plunged sharply and speculative movements of capital were heavy. The leading industrial countries abandoned convertibility into gold one after another and devalued their currencies. Those that retained the gold standard, as France did, found their exports more and more difficult to market; they had to bring imports down by inducing a fall in activity, and therefore in employment, of a magnitude that in the end proved to be intolerable. The abandonment of the gold standard was the necessary condition for the adoption of social relief schemes, such as public work programmes, which became increasingly necessary.

The slump came as a particularly severe shock to Latin America. Public revenues depended heavily on the taxation of foreign trade; and investment was being largely financed by foreign companies in export industries or in sectors which were linked with them. So the decline in exports, which was in any case relatively much sharper than in the industrial countries, meant reductions in income throughout the economy. At the same

/time, the

time, the foreign exchange shortage was aggravated by the drying-up of the inflow of short-term capital, even in some cases by its reversal. Countries which were accustomed to relying on foreign sources for much of their supplies found it hard to make the necessary cut in their imports.

Governments revoked convertibility, not only into gold, but also into foreign currencies. This led to the appearance of free markets in which exchange rates were at a discount compared with official quotations and fluctuated from day to day. These were not the only breaches that occurred in the old economic order. Like many other countries, industrial or primary producer, those in Latin America introduced quotas in an attempt to correct the deficit in foreign payments and increased duties on imports. (The United States had raised its tariff walls in 1930, under the Smoot-Hawley Act.) Many of them also defaulted on foreign debts, as a number of European countries were doing. Furthermore, several attempts were made, not very successfully, to stabilize commodity prices by international measures to control output.

Apart from these steps, which were common to almost the whole region, one group of countries took additional measures, whereas the remainder did not, and there has been a clear distinction between these two groups ever since. The additional measures can be summed up as autonomous monetary expansion, autonomous in the sense that it was much greater than would have been justified by movements in reserves. This was accompanied by legal and institutional changes such as the establishment of new central banks, or an increase in the power of those that already existed.

The countries which did take such autonomous action were, broadly speaking, the largest and those already partially industrialized - Argentina, Brazil, Chile, Colombia and Mexico. They had the greatest incentive to attempt some form of compensation. Unemployment was a severe problem for their large city populations, which were not by any means powerless politically, and domestic bankers were threatened by the inability to meet

/current obligations.

current obligations. These countries had, moreover, the greatest scope for action: they had industries which could supply some at least of the needs of the local consumer and absorb some of the unemployment (see table 1).

It must not be thought that compensatory action was in all cases deliberately chosen as an economic strategy and that exchange control was imposed to stop the consequent loss of reserves. The crisis developed so quickly that administrations improvised as best they could. Budget deficits appeared because revenues were falling fast, and the expansion of credit was often decided on at a few hours' notice to save banks from having to close their doors.

Although it was some time before the gold standard was consciously and finally rejected, each step represented a further break with monetary conventions. Backing for the currency fell; further devaluation occurred vis-à-vis not merely gold, but also the United States dollar; and more controls were imposed on purchases of foreign exchange. But the depression was gradually changing attitudes as to what constituted permissible policy. Overseas, both professional and political opinion was swinging round in favour of the conscious use of fiscal and monetary policy, backed where necessary by direct controls, to prevent or cure cyclical depressions. The practical example of the "New Deal" in the United States was a particularly powerful stimulus to those Latin Americans who were urging a different and more autonomous approach.

Although a number of Latin American economies had already been in some degree diversified by the end of the previous decade, the depression demonstrated how far this process was from being complete by revealing how much they still depended on imports. Because of the shortage of foreign exchange, the imports of Argentina, Brazil and Mexico shrank in volume by more than one half between 1929 and 1932, and those of Chile fell by more than three quarters. Indeed, according to the League of Nations World Economic Report, 1932-33, Chilean exports and imports fell more than any other of the thirty-nine countries covered. The problem

/Table 1

Table 1

LATIN AMERICA: INDICATORS OF ECONOMIC SIZE AND STRUCTURAL CHARACTERISTICS

(Average 1950-1952)

Country	Approximate gross domestic product ($US millions)	City[a/] population as % of total population b/	Manufacturing output as % of G.D.P.	Exports as % of G.D.P. c/
	(1)	(2)	(3)	(4)
Group U				
Countries which have experienced rapid inflation				
(a) Semi industrial economies				
Brazil	11 000	13	21	12
Argentina	10 000	37	23	9
Mexico	6 000	15	21	14 c/
Colombia	3 000	15	18	14
Chile	2 000	29	17	11
Peru	) 1 000	8 d/	16	16
Uruguay	)	33 e/	...	18
(b) Non-industrialized economies				
Bolivia	) Under	11	...	18
Paraguay	) 500	15	...	9
Group total	33 000	18	21 f/	12
Group O				
Countries which have experienced only moderate inflation				
Venezuela	4 000	17	8	35
Cuba	2 000	22	...	32
Costa Rica	)	18	...	17
Dominican Republic	)	9	...	26
Ecuador	)	15	14	13
El Salvador	) Under	9	12	20
Guatemala	) 500	10	...	18
Haiti	)	4	...	15
Honduras	)	-	9	24
Nicaragua	)	10	...	18
Panama	)	16	11	34 c/
Group total	10 000	13	9 f/	29

Sources: (1) (3) and (4), ECLA, on the basis of national statistics.
(2) Demographic Aspects of Urbanization (Population Branch, United Nations, E/CN.12/URB.18).

a/ "City" population is defined as the population in urban centres of more than 100 thousand. It should be borne in mind that the definition of an "urban centre" varies from country to country.

b/ The year is 1950 or the nearest census.

c/ Exports of goods, except for Mexico and Panama (goods and services).

d/ 1940.

e/ Estimated by Kingsley Davis and Hilda Hertz, (Bulletin of International Statistical Institute, Vol. XXXIII, Part IV, page 237, since no census has been taken since 1908.

f/ Average of countries for which data are available.

of maintaining living standards and limiting unemployment was in part one of adapting financial policy to the new circumstances, but in real terms it was a question of replacing imports with domestic products on a big scale and at short notice - particularly imports of manufacture.

A strong impetus was given to industrialization by the measures taken to protect reserves of foreign exchange. Devaluation, import quotas, higher tariffs - all these had the incidental effect of opening up new markets for the domestic producer, or strengthening his position against foreign competition. The sudden expansion of manufacturing was not, however, easy. One obstacle was the difficulty of financing it. Investment by foreigners was now small; private savings had been depressed by the decline incomes; and equipment had become expensive to import, because of devaluation. There were also more deeply-rooted handicaps to be overcome. The labour force lacked the range of skills needed; the land-owning class was often unwilling to invest time and energy in tasks to which, whatever their economic rationale little prestige attached; and those in trade and commerce usually preferred to follow in their customary family business, rather than undertake the risky and exacting work of founding industrial enterprises.

As regards physical inputs, the new industries' needs in respect of fuel, materials and semi-manufactures were heavy. Moreover, industrialization induced an increased flow of foodstuffs from the farming areas to the cities. What was required, and what was indeed imposed by the circumstances, was a wholesale transformation of the economy. This placed novel demands on a transport system which had been designed mainly as an ancillary to foreign trade.

The official bureaucracy was also hardly capable of meeting the administrative requirements of the new situation. There was, as in many other parts of the world, a severe shortage of public servants capable of framing economic strategy and administering import controls in such a way as to minimize the tensions of the process. Statistics were still, in any case, of such a low quality that policy was inevitably based on "hunches" or biased information.

Although the industrial sector did, in general, grow in response to this stimulus, the products of the new industries were usually expensive.

/New factories,

New factories, like the old, were often very small and inefficient and competition was still far from perfect. The response of agriculture was even more inadequate to the demands of the new situation. If allowance is made for the imported fuel and equipment needed by the new industries and for heavy consumer demand, in part stimulated by excessively expansionist policies, it is not surprising that the demand for foreign exchange did not abate; exchange rates were under continuous pressure.

In Brazil, Chile and Mexico, price levels tended to rise after 1932 (see figure I). This was not true of Argentina and Uruguay. One reason was that the failure of their export markets released foodstuffs which could be consumed at home. Secondly, Argentina had made most progress in industrialization previously: a sizable industrial sector was already in existence at the start of the slump, with some surplus capacity, so substitution for imports involved a less radical departure from previous economic patterns. Thirdly, in both countries, facilities like transport and electricity were at hand for new industries; and the social environment made it easier than elsewhere to find entrepreneurs and suitable workers. Fourthly, Argentina's fiscal and monetary policy was managed in such a way as to offset the effects of fluctuations in foreign trade; and, finally, industrialization there was relatively well balanced.

This experience is an interesting illustration of the relative significance of monetary and real factors, which was discussed above. It is possible to attribute currency devaluation and price rises to the laxness of the authorities, who expanded the supply of money, both by permitting Government deficits to occur and also by extending more credit to the private sector. If this monetary expansion had not occurred, prices and exchange rates would probably have changed but little on balance over this decade. But we must take account of the context of monetary policy. Faced with a catastrophic fall in exports, which was the original cause of the trouble, those responsible for policy had to make a series of choices between unpleasant alternatives. When revenue fell off, for example, Governments were presented with a dilemma.

/On the

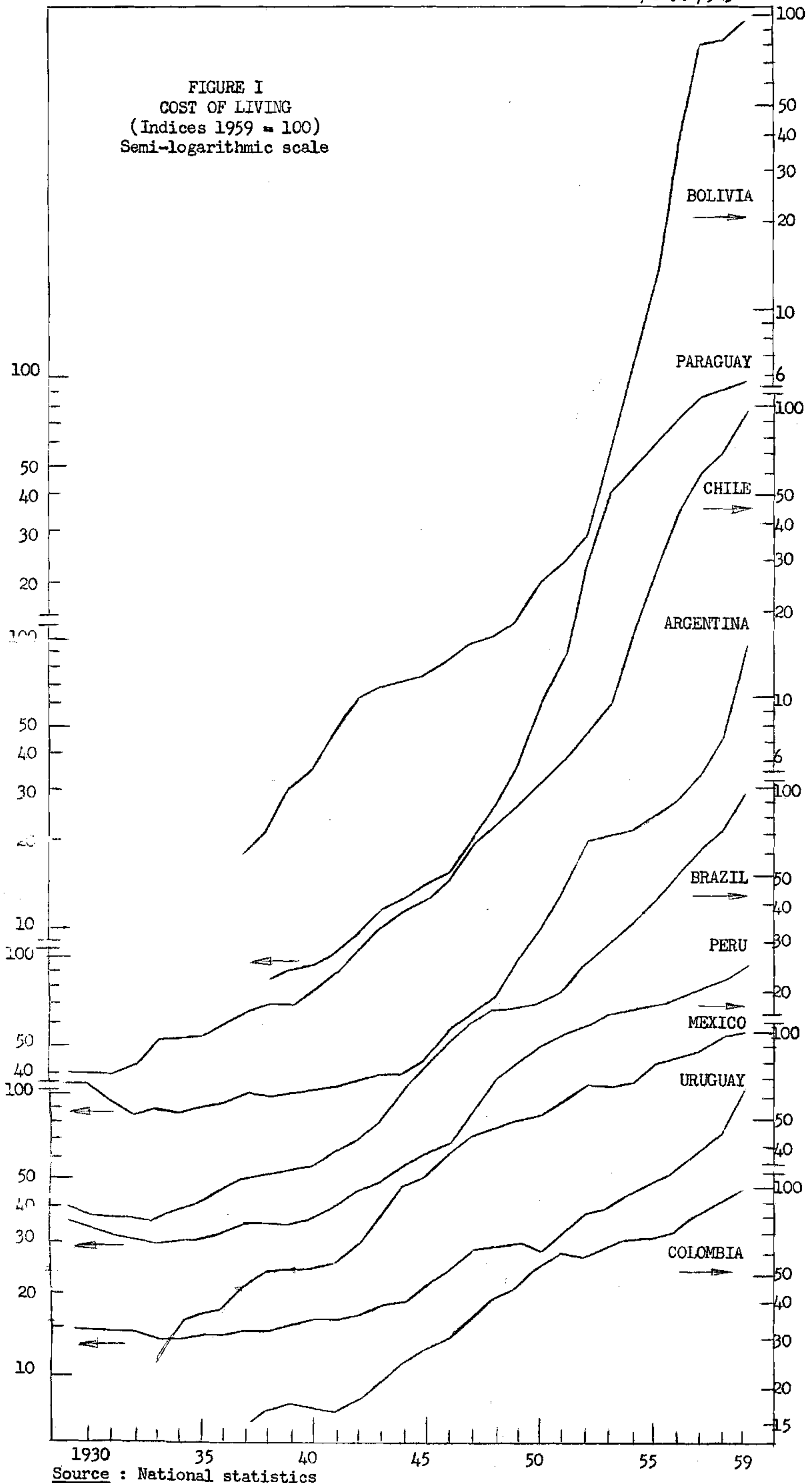
FIGURE I
COST OF LIVING
(Indices 1959 = 100)
Semi-logarithmic scale
BOLIVIA
PARAGUAY
CHILE
ARGENTINA
BRAZIL
PERU
MEXICO
URUGUAY
COLOMBIA
1930
35
40
45
50
55
59
Source : National statistics

On the one hand, they could make equally drastic reductions in expenditure and face the social implications of this, at a time when unemployment was already rising to dangerous levels. Alternatively, they could resort to deficit finance. Similarly, the monetary authorities had to decide whether to contract credit, when their foreign reserves declined, and they had to make this decision at a time when commercial banks and business houses were already under severe financial stress. In many cases, the strain on the balance of payments and price inflation would have been much less if policy had been carefully framed, but the authorities ran risks either way, whether their policy was expansionist or restrictive. In several large economies, they chose rising prices and devaluation rather than falling incomes and unemployment.

In view of the political circumstances of the times in these countries, which included spasmodic violence, it is doubtful whether any other choice was possible. Authorities who tried to adhere to orthodox policies were usually removed from office.

Most of the remaining countries of the region either refrained from carrying out autonomous monetary policies, or at any rate did less in this direction and stopped the practice sooner. Both the need and the opportunity in the small economies of Central America and the Caribbean were limited. For one thing, urban proletariats were relatively smaller. While the depression meant severe hardship, as it did elsewhere, rural workers in the tropics could usually find some food; they did not, in general, have to face fixed payments for rent and facilities such as electricity; and they could often obtain help from better-off relatives or neighbours. In fact a great part of the population worked in subsistence sectors only remotely affected by fluctuations in the commercial part of the economy. Political pressure from this quarter to maintain incomes was therefore not very strong. The banking systems were, moreover, largely in foreign hands and there was opposition to measures which might lead to devaluation of the currency.

In any event, the scope for expansionist policies was quite limited in economies which were still heavily dependent on exports and with relatively small manufacturing sectors. A country which has experienced

/only a

only a little industrialization is particularly deficient in the economic, social and political conditions for further progress in this direction.

Three such countries did attempt unorthodox financial policies at this time and in each case prices rose sharply during the 1930's though the evidence of this is partly the indirect one of exchange devaluation (see table 2). Bolivia suffered from a severe decline in tin exports, which immediately unbalanced the budget, and on top of this came the Chaco war, fought in the midst of the depression. The consequence could only be an unmanageable demand for imports, leading to successive devaluations and internal price rises.[4/] In Ecuador and Nicaragua, also, monetary expansion led to steep price rises, without alleviating internal conditions appreciably.

The region had by now become divided into two groups. Exchange rates of countries in the Caribbean area and Central America which had suffered de facto devaluation nearly all regained the former parity with the United States dollar, or something close to it, as the depression came to an end and made their currencies once more convertible into dollars. They were in effect now on a dollar standard and they continued to maintain orthodox financial practices in the 1940's and 1950's as well. These countries experienced only moderate price rises over these three decades. Nicaragua has reverted to more conservative practices in the past decade and price rises have slowed down there; Ecuador can also be considered a member of the same group, taking the period as a whole.

Venezuela falls into this class too. It possessed in petroleum an export which has proved easy to market until quite recently, and earnings of foreign exchange have climbed very rapidly. Even in the depression, the upward trend was halted, rather than reversed. The need for compensatory policy did not therefore arise in the 1930's and

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4/ Paraguay, Bolivia's protagonist in the war, financed its military expenditures by means which were financially more orthodox and did not, at this time, experience inflation.

/Table 2

Table 2

LATIN AMERICA: CURRENCY UNITS[a] PER UNITED STATES DOLLAR[b], 1929 TO 1959

	1929 (ave.)	1940 (end)	1945 (end)	1951 (end)	1959 (end)
Group U					
(a)					
Brazil (Cr.)	9	20	20	20	202
Argentina (Peso)	2	4	5	14	83
Mexico (Peso)	2	5	5	9	12
Colombia (Peso)	1	2	2	3	7
Chile (Peso)	8	34	32	93	1 052
Peru (Sol)	2	7	7	15	28
Uruguay (Peso)	1	3	2	2	11
(b)					
Bolivia (Bol.)	3	61	64	247 c/	11 885
Paraguay (Guaraní)	...	4	3	32	128
Group O					
Venezuela (Bol.)	5	3	3	3	3
Cuba (Peso)	1	1	1	1	1
Costa Rica (Colón)	4	6	6	7	7
Dominican Republic (Peso) d/	1	1	1	1	1
Ecuador (Sucre)	5	15	14	17	17
El Salvador (Colón)	2	3	3	3	3
Guatemala (Quetzal)	1	1	1	1	1
Haiti (Gourde)	5	5	5	5	5
Honduras (Lempira)	...	2	2	2	2
Nicaragua (Cond.)	...	6	6	7	7
Panama (Balboa) e/	1	1	1	1	1

Sources: League of Nations *Statistical Yearbook*, and International Monetary Fund *International Financial Statistics*.

a/ Free market rates, where applicable and available. This table is only designed to give a general indication of movements in exchange rates. For details refer to sources.

b/ It should be noted that the dollar was itself devalued by 41 per cent in terms of its gold parity in January 1934.

c/ August 1952.

d/ Prior to October 1947, the dollar was legal currency.

e/ Currency consists of United States notes and currency together with the balboa and subsidiary coins.

/the Venezuelan

the Venezuelan bolívar was so strong that it appreciated vis-à-vis the United States dollar. (see again Table 2).

There are therefore eleven countries, which have followed, in general, orthodox policies in the matter of reserves (see table 3) for most of the past thirty years and which have, on the whole, experienced only moderate increases in prices (see figure II). These countries will be known as Group O. They are mostly small economies, unindustrialized and heavily dependent on foreign trade (see table 1). Even Cuba and Venezuela, although much larger, had in 1950 only narrow manufacturing sectors by comparison with their export industries. This type of economic structure tended to be preserved, as in certain other countries, by reciprocal trade agreements with the United States, which offered special marketing advantages for sugar and petroleum respectively, in return for undertakings to restrict the protection of local industries.

The other nine countries of Latin America have mostly followed less orthodox financial policies and have experienced, particularly in the past decade, steady-to-fast price inflation and a series of devaluations. Seven of these are the more industrialized economies of the region, most of which are also large and highly urbanized. As a general rule, exports account for a smaller proportion of output (see again table 1).5/ Bolivia and Paraguay are the other two countries which have followed unorthodox financial policies. Paraguay began to do so after the war. Structurally and in size they belong to the former group. But precisely because they lacked the industrial capacity needed for an expansionist policy, they experienced particularly violent bouts of inflation. So they form a special class.

3. The common problems of the war years

The fundamental contrast between these types of economy was for a time not very obvious. When the world pulled out of the depression,

5/ The figures shown for Brazil in table 1 may be slightly misleading, since the country includes a large, backward, rural area in the North-East. Thus about 20 per cent of the population in the Centre and South lived in cities.

/Table 3

Table 3

LATIN AMERICA: BACKING FOR LOCAL CURRENCIES, 1937, 1940, 1945, 1950 AND 1958

(Central Bank foreign assets as percentage of currency issue a/ end-year)

Country	1937	1940	1945	1950	1958
Group U					
(a)					
Brazil	23c/	24c/	89c/	51	9
Argentina b/	158	134	220	23	-8
Mexico	37e/	42e/	95e/	87	70
Colombia	54	55	142	42	29
Chile	25	15	55	28	7
Peru	62	41	35	55	12
Uruguay	...	131	261	124	27
(b)					
Bolivia	60	62	98	60	33
Paraguay	...	18	133	12d/	44
Group O					
Venezuela	116e/	112e/	84e/	144	239
Cuba	31e/	32e/	139e/	138	83
Costa Rica	29	21	61	22	61
Dominican Republic	122	210e/	259	99	89
Ecuador	81	120	139	118	67
El Salvador	113	115	147	134	95
Guatemala	90	126	152	96	88
Haiti b/ e/	...	...	...	96	-17
Honduras	70e/	49e/	129e/	108	44
Nicaragua	25	91	74	29	43
Panama g/	...	...	...	...	...

Source: International Monetary Fund, International Financial Statistics.

a/ Gross foreign assets of Central Bank except where otherwise indicated, and currency in circulation, as shown in the "monetary survey" section of International Financial Statistics.
b/ Net assets.
c/ For 1937, 1940 and 1945 Banco do Brasil only for both foreign assets and currency liabilities. Subsequently the foreign assets of other "other monetary authorities" were included, and the currency was the net total as for other countries.
d/ 1952. The central bank was formed that year, and the figures for 1952 and 1958 refer to its reserves and currency liabilities. For 1937, 1940 and 1945 foreign assets are those of the Banco del Paraguay but currency is the net total in circulation.
e/ Reserves of the whole banking system.
f/ 1938.
g/ Currency consists of United States coins and notes, and a limited number of silver balboas. There are also substantial holdings of dollar assets by the Government, banks and private individuals. So the backing is much more than 100 per cent.

/Latin American

Latin American imports rose and local price inflations slowed down to a halt. Accordingly, by the end of the 1930's movements in prices appeared to be once more in step. During the war they accelerated again in almost every country.

This even occurred in economies of Group O. Their exports rose in nearly every case. The entire crops of the sugar-producing countries were purchased, usually by the United States; and firm contracts were offered by the same country for supplies of certain minerals, cereals and agricultural materials. Some countries, for example Haiti, were provided with financial and technical assistance for the development of new products. Even non-essentials like cacao and coffee profited from high prices. An exception was banana exports, which fell to very low levels; because of the need for special shipping facilities, bananas did not have much priority in the supply programmes of belligerant countries.

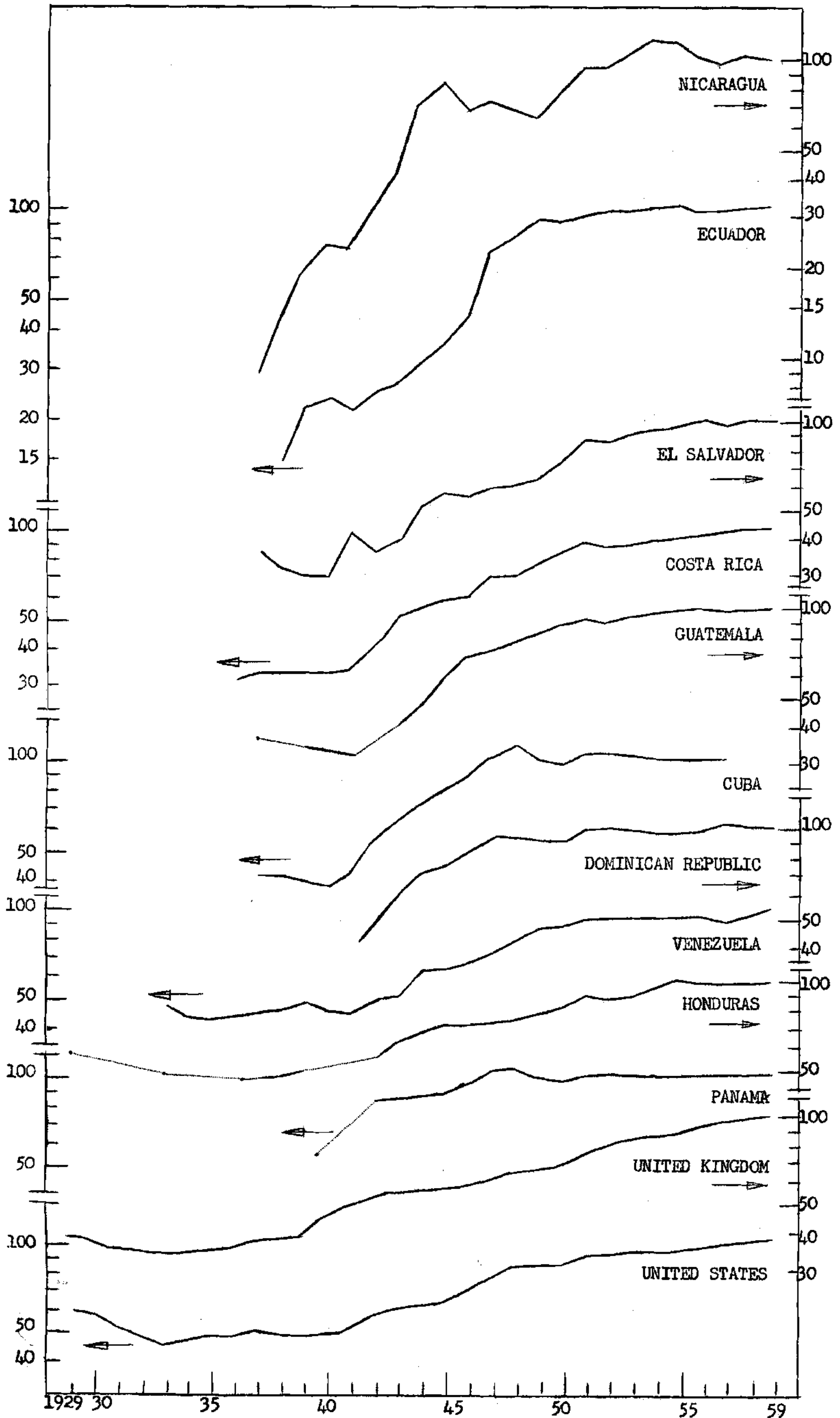
But imports were prevented from rising in step with exports. Goods from Western Europe became increasingly difficult to obtain. These could largely be replaced by purchases from the United States up to the time of the attack on Pearl Harbour; thenceforward the conversion of industry to war purposes in the United States, the shortage of shipping space, and submarine warfare in the Caribbean area severely limited supplies to Latin America. In some cases, the landed cost of imports rose, but the rise was limited because of price controls in the United States.

The expansion of incomes in export industries was therefore much bigger than the rise in the value of imports, and the automatic brake on inflation in dollar-standard countries ceased to function. Increases in foreign reserves induced an expansion of credit and thus stimulated investment in other sectors, so that the total expansion in demand was big. But these economies were quite unable to satisfy certain types of demands themselves. The net result was a moderate-to-fast rise in prices. Figure II shows the price increases in these countries during this period.

The situation was not, in broad outline, very different in the countries which had been following more expansive monetary policies in

/the 1930's.

FIGURE II
COST OF LIVING
(Indices 1959 = 100)
Semi-logarithmic scale



Source : National statistics

the 1930's. Heavy exports were expanding demand, and internal activity was not only stimulated by an export surplus but also by a great increase in the liquidity of the banking systems of several countries owing to the arrival of foreign capital seeking refuge from the war. In some cases, the authorities tried to dampen the effect on credit of the growth of reserves. In Colombia, increases in deposits had to be invested in non-negotiable bonds, which businesses were also compelled to buy, and in Mexico the authorities sold gold to absorb currency, as well as taking measures to limit credit. Authorities in other countries, however, followed less strict policies: now that the rules of the gold standard had been abandoned, there were no generally accepted set of principles for policy.

A further fillip was given to import substitution, although the reason was no longer the shortage of foreign exchange. The nine countries of Group U were beset not merely by the same supply problems as the other group, but also, excepting Mexico and Colombia, with the additional difficulty of long hauls from the United States to their ports. Yet the very circumstances that made it difficult to import finished products, although not the same difficulties as in the 1930's, once again also discouraged purchases of the machinery, materials and fuel which were needed to manufacture them domestically.

Demand for the products of local secondary industry was so high that it stretched capacity to the limit. The war revealed weaknesses in other sectors too. In Peru, for example, food imports were cut by five sixths between 1940 and 1942; and while local production was stimulated, areas of chronic shortage emerged, because of the poor communications inside the country. In Brazil, fuel was a serious problem. Wood and coffee were widely used as sources of energy; coal and gasoline were rationed; petrol was increasingly adulterated with alcohol, and by 1942 cars and lorries were running on gas generated from alcohol and lignite. In Argentina, too, there was an acute shortage of energy supplies. In 1943 alone, 1.7 million tons of wheat, 1.5 million tons of flax and linseed and 0.1 million tons of maize were

/burned as

burned as fuel.[6/] Another general weakness in the region was in basic metals; big efforts were made to develop local resources of iron ore, and such furnaces that existed were used intensively. The shortage of equipment was possibly most severe in transport. The railway from São Paulo to Rio, for example, was at times only allowed to carry foodstuffs and fuels.[7/]

These structural weaknesses did not check the rate of growth. Despite difficulties, important acts of investment were carried out. For example, construction of the Volta Redonda steel plant was started in Brazil, and industries for making simple types of capital goods were established there. The consequence for many countries was a tendency for prices to rise, rather than stagnation. In the effort to avoid the dangers of inflation, Governments once more followed the example of the industrial countries. Although some excess demand was considered inevitable in the United Kingdom and the United States because of the heavy burden of war finance, a big attempt was made to control prices in both these countries on the grounds that inflation would hamper the war effort. Price control plans were also drawn up in Latin America, in some cases with the assistance of United States experts. In a number of countries, these were highly detailed: local price committees were set up in every Paraguayan town, for example: the Peruvian Government controlled food distribution; and in Brazil and Colombia, price controls were backed by elaborate systems of checking inventories and licensing production and imports. In practice, Latin American schemes seem to have had very much less success, judging by index numbers of prices, than those of the developed countries.

6/ ECLA, Economic Survey of Latin America, 1949 (E/CN.12/164/Rev.1), citing the Comité Argentino de Energía.

7/ One effect of the shortages of supplies was a vigorous increase in trade among Latin American countries. This more than doubled between 1939 and 1943. The industries of Argentina, Brazil and Mexico were in the best position to meet this challenge and their exports of semi-manufactures and manufactures rose to several times the pre-war levels.

/The smallest

The smallest price increases for this group occurred in Argentina. Rents were frozen there, but the main explanation, as in the depression, was a better fit between the patterns of supply and demand than in other countries. Supplies of foodstuffs that could not be delivered to overseas customers were diverted into the home market. Government controls were actually used at times to prevent food prices falling severely, although, when transport conditions improved in the Atlantic, policy was reversed and prices were not allowed to rise to international levels. Manufacturing industry was better placed to cope with the situation. It was able, for example, to keep much of the existing equipment in service by repairing or reconditioning it locally.

The degree of inflation in various countries could again be explained by referring to changes in the means of payment. But this is not particularly enlightening. The origin of the problem was that imports were being reduced while exports were rising. It was this that led to a general expansion of credit and incomes in the countries where special steps were not taken to prevent it. Moreover, the shortage of imports was simultaneously creating supply bottlenecks which could not be relieved until more food, fuel, materials and equipment could be ordered from overseas. Consequently, price increases in particular commodities, notably food, led to wage demands. A purely monetary approach might lead to the conclusion that financial policy would have dealt with the whole problem successfully; certainly a firmer fiscal and monetary policy by the authorities in many countries would have checked the general excess demand and reduced the pace of inflation. But supply problems in certain sectors could hardly be eased by global policies.

4. The immediate post-war period: the re-emergence of policy choices

The years following the armistice were, like the middle of the 1920's, a period of prosperity in primary-producing countries. Reserves were high and exports rose rapidly as transport difficulties were eased.[8]

8/ Trade in manufactures within the region fell back however to very low levels, once normal channels were reopened.

/The industrial

The industrial countries required big increases in supplies of primary commodities to enable them to reconvert their industries to peace-time needs and to build up their inventories at all stages from goods-in-transit to final products in the shops.

Banking systems in Latin America were very liquid and sections of the public held big bank deposits, so demand was buoyant. All types of imports rose rapidly. The rise in imports of fuel and materials eased the restraints on domestic production. It took, however, a certain time to make up for the years in which no equipment had been bought for transport and power and to re-equip local industries, for one reason because there were long delays before orders for capital goods could be filled. So certain shortages still lingered on.

Price structures were quite distorted by the time the war came to an end. As international trade was resumed, it became clear that many Latin American currencies were now overvalued, and shortages and controls had produced internal price relationships which were not likely to endure. It is theoretically possible for such distortions to be corrected by rises in some prices and falls in others. But under the booming conditions of trade, with rising export and import prices and some persistent shortages, the general movement was upwards.

In different parts of the region experience once again started to diverge. In the countries of Group O, currencies remained fully convertible, and these became known, together with Canada and the United States, as the "dollar area", or the "hard currency area".[9] Here the rise in prices was limited. As imports climbed and reserves were run down - if not in absolute terms, at least relative to the national product -, the mechanism of a conventional monetary system, which equilibrates the balance of payments and checks price inflation, gradually took charge once more. The price rises which did occur in these countries after the war were mainly the reflection of developments abroad. Many of them import not merely manufactures but also staple foods, materials and fuels, so increases in import prices spread throughout the whole economy.

9/ Bolivia, Colombia and Mexico were also usually considered members of this area.

/Moreover, since

Moreover, since export prices were also climbing and volumes increasing, the money supply could be expanded sufficiently to accommodate a general rise in the price level. This was a pure case of "imported inflation".

The countries in this group, which had experienced the biggest price rise during the war, ended it with their banking system rather less liquid and with exchange rates which were more obviously overvalued. So the operation of the dollar standard mechanism was quicker and more drastic. Thus in Nicaragua, where prices trebled between 1940 and 1945, they now fell back to a lower level and in Cuba, the not-quite-so-fast rise went on until 1948, before being reversed. For most members of the group, the trend in prices was always upwards but it slowed down after the middle of 1948. This reflected the deceleration of price increases in the United States, which went through a brief recession in 1949.

In the group of countries which were following more flexible monetary policies, developments were different. The exchange position at the end of the war gave a rather illusory impression of strength, since part of the reserves represented capital which had fled from the ficissitudes of war and which was now due for repatriation. Moreover, the rise in world prices was steadily reducing the real value of these reserves. Nevertheless, for some years, the foreign balance did not appear a very urgent matter in most of these countries. Consequently, there was some room for choice in policy. The growing acceptance of Keynesian doctrines overseas was having an impression on Latin American authorities after being improperly used to justify inflation. So were measures in Western Europe to redistribute income, such as the "welfare State" in the United Kingdom. In the generally expansionist atmosphere, budget deficits and rapidly rising imports were common, while the possibilities of expanding export industries and seeking new ones were not widely explored.

The most vivid example of this was the case of Argentina. We have seen that since this country exports staple foods, it can absorb what it cannot sell abroad. For the same reason, the level of exports depends to a considerable degree on how much is left over from domestic consumption. Price and wage policies after 1945 had the effect of raising

/the purchasing

the purchasing power of wages in terms of traditional export products. Real wages in Argentina rose by 50 per cent between 1944 and 1947, while domestic prices of traditional exports (though not other farm products) were prevented from following the upward trends in overseas prices. Argentina therefore never fully recovered its pre-war markets for agricultural commodities, especially grains. Imports, on the other hand, rose to a high level, and there was a swift decline in foreign reserves (from 1,700 million dollars at the end of 1946 to 700 million at the end of 1949).[10/] This increase in imports relieved the wartime shortages mentioned above, but nevertheless the increases in wages were greater than those in productivity, so the costs of production rose. Moreover, other forces were at work promoting inflation. A good deal of equipment was worn out and much economic and social capital was below the levels appropriate to post-war incomes. Public investment was heavy but, being badly planned, it widened the budget deficit without curing these shortages. Despite the import surplus and the use of controls from 1947 onwards, price rises averaged over 20 per cent a year in the period 1945-50.

Chile was a different case again. Foreign reserves had not been built up so much during the war; exports fell slightly in volume after it ended; and the terms of trade only improved moderately. Consequently, the volume of imports could hardly be expanded at all and supply problems continued to hem in the Government's room to manoeuvre. Investment was only moderate and the increase in the national product was slow. Although imported foods were subsidized, prices continued to rise at much the same rate as in the war years. In the cases of Bolivia and Paraguay, too, near-stagnation was associated with inflation. Apart from supply problems, cumulative forces had now emerged in these three countries because of the duration and pace of inflation and these forces in turn propelled it further forward. Savings propensities were low, budgets were difficult to balance and investment tended to be directed to projects yielding high and quick returns rather than to developing the

10/ The imports came mainly from Western Europe after 1947 through the use of blocked sterling and prices there were generally higher than in the United States.

/basic industries

basic industries and services which were needed.

Some other countries in this group did much better. In the first place, their exports expanded more quickly; and, secondly, they made use of the opportunity thus provided. Investment was high in Brazil, Mexico and Uruguay, and better balanced; and national products grew at about 5 or 6 per cent a year. In these cases, now that imports could be obtained in sufficient quantities and internal supply problems were eased, price rises became more moderate (5 per cent to 11 per cent a year).

Still, in retrospect, it seems that the region failed to profit fully by the opportunity presented by the export boom of 1945-50. A large fraction of reserves was spent on consumer durables, such as motor vehicles, instead of being used to strengthen economies against the lean period that obviously lay ahead in the not-so-distant future after the reconstruction period, when the industrial countries would have built up their inventories to normal peace-time levels.

5. The position at the start of the 1950's

Despite the developments of the 1930's and the 1940's, the structure of Latin American economies still showed many of the shortcomings of the pre-depression period. Capital was lacking in basic sectors of the economy (see table 4). The inadequacies of the educational system are shown by the low number of teachers relative to the children of school age (see table 5), and their consequences in one sector can be inferred from the very low figures, particularly in certain countries, for professionally trained personnel in agriculture (also shown in table 5). The quality of the labour force is indicated by the low level of literacy, especially in the rural areas, (see table 6).

The distribution of income continued to be highly unequal, because of concentration of property in a few hands, as well as monopolistic profit margins and the incomplete provision of educational opportunity. A large proportion of personal income still accrued to those with habits of heavy personal spending on foreign travel or imported luxuries.[11/]

11/ In 1950, the richest 5 per cent of Mexican families received 40 per cent of the total income, whereas the correcponding families in the United States received 21 per cent (La Distribución del Ingreso y el Desarrollo Económico de México by Ifigenia M. de Navarrete). If taxation were taken into account, the contrast would be even more striking.

/Table 4

Table 4

LATIN AMERICA: INDICATORS OF ADEQUACY OF CAPITAL IN VARIOUS FIELDS FOR ECONOMIC DEVELOPMENT

Country	Improved roads and railways (kilometres per 10 000 ha of arable land) a/ 1954 or 1955	Electric power capacity (watts per capita) 1958	Primary school enrolment (as percentage of population aged 5-14) 1953, 1954 or 1955	Farm tractors (per 10 000 ha of arable land) Early 1950's
	(1)	(2)	(3)	(4)
Group O				
(a)				
Brazil	67	63	32	15
Argentina	33	118	70	10
Mexico	44	79	42	26
Colombia	43	44	35	26
Chile	137	142	69	36
Peru	165	64	44	24
Uruguay	61	124	57	76
(b)				
Bolivia	34	34	31b/	21
Paraguay	14	40	60	3
Group U				
Venezuela	38	94	44	15
Cuba	41	115	49	48
Costa Rica	61	106	59	13
Dominican Republic	42	51	42	9
Ecuador	25	24	45	3
El Salvador	68	34	41	9
Guatemala	80	16	26	6c/
Haiti	72	12	23	1
Honduras	35	15	33	3c/
Nicaragua	16	34	35	52
Panama	41	47	58	9
United States	207	920	96	222

Sources: Columns (1), (2) and (4): International Bank, Comparative Data on Latin American countries based on United States Department of Commerce, Comparative Statistics on the American Republics, where original sources are listed in full.
Column (3): United Nations, Report on World Social Situation Appendix A. Middle of range taken for population.

a/ Estimate for arable land is closest available year. Roads include those unsurfaced but graded and drained. Railways exclude light railways.
b/ 1952. Public schools only.
c/ All types of tractors.

/Table 5

Table 5

LATIN AMERICA: SOME INDICATORS OF ADEQUACY OF PROFESSIONAL PERSONNEL IN VARIOUS FIELDS FOR ECONOMIC DEVELOPMENT

	Elementary school teachers (per thousand of those aged 5-14) 1953, 1954 or 1955	Graduates of higher education in agriculture (per millions inhabitants) 1957
	(1)	(2)
Group O		
(a)		
Brazil	11	75
Argentina	30	130
Mexico	11	115
Colombia	9	54
Chile	...	248
Peru	12	52
Uruguay	17	228
(b)		
Bolivia	12	52
Paraguay	19	3
Group U		
Venezuela	12	50
Cuba	16	112
Costa Rica	24	567
Dominican Republic	7	1
Ecuador	11	28
El Salvador	12	6
Guatemala	10	3
Haiti	5	66
Honduras	12	7
Nicaragua	13	21
Panama	18	26
United States	30	...

Sources: Column (1) Calculated from United Nations, Report on World Social Situation.
Column (2) Un Estudio de la Educación Agrícola en América Latina by Alvaro Chaparro.

/Table 6

Table 6

LITERACY: URBAN AND RURAL, a/ 1950 OR NEAREST CENSUS
(Percentage of those aged 15 and over b/)

	Urban	Rural
Group U		
Brazil	80	42
Argentina	93	80
Mexico	82	49
Colombia	80	51
Chile	92	71
Peru	89	35
Paraguay	86	62
Group O		
Venezuela	76	40
Cuba	90	72
Costa Rica	93	76
Dominican Republic	76	39
Ecuador	86	49
El Salvador	77	34
Guatemala	75	22
Haiti	57	8
Honduras	78	34
Nicaragua	77	31
Panama	95	65

Source: Derived from United Nations, Demographic Aspects of Urbanization in Latin America, Table 23.

a/ "Urban" is defined as those living in centres with more than 20 thousand inhabitants. "Rural" is the remainder. Sometimes the definition is slightly different; see original source.

b/ Lower age limit is 20 for Cuba, 14 for Argentina, 10 for Honduras and Panama, 7 for Colombia and Guatemala, 6 for Mexico.

/The market

The market for domestic industries was correspondingly limited and it was broken up because different qualities were demanded by the various social groups. Mass-production techniques which are needed, especially in the metal-using industries, could therefore hardly be established.

The same contrast can be looked at on another plane, as the difference between urban and rural incomes. In the cities incomes were still very much higher and consumption patterns were distinctly different.[12/] City dwellers ate different foods[13/], were more accustomed to wearing shoes[14/], and used far more electricity.[15/]

Apart from the inflexibility of an economy fissured in this way, the consequence was that pattern of demand would change rapidly during the coming wave of migration to the cities.

Despite the degree of industrialization already achieved, economic structures were still unable to cope with various forms of rising demand. Conspicious gaps could be found in even the more developed countries,

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12/ Data are only available for later years, but the position did not change greatly. In Mexico City in 1956, average family incomes were nearly 2,000 pesos a month; in the State of Oaxaca they were just over 500 (Ingresos y Egresos de la Población de México, Sample Survey Dept. Mexico, 1958). In Venezuela, income in the capital averaged ten times as much as rural income in 1957 (The Fiscal System of Venezuela, p. 32).

13/ In Oaxaca, more than half of the income was devoted in 1956 to maize and maize products; in Mexico City, the proportion was small, less in fact than what was spent on other cereals (Ingresos y Egresos de la Población México, op.cit.).

14/ In rural areas of Mexico, the proportion of the population in 1950 wearing no footwear of any kind ran as high as 60 per cent; in cities it was 2 or 3 percent (El Nivel de la Vida en México by M. Huerta Maldonado, based on the 1950 census of population).

15/ Per capita consumption of electricity in 1950 (excluding manufacturing industry) was about ten times as high in the larger cities of Latin America as in the remainder of each country ECLA Energy in Latin America, E/CN.12/384/Rev.1).

/such as

such as industries for making equipment and heavy chemicals.[16/] Markets were highly imperfect, as was shown by a wide range of different prices in various districts.[17/] Mining sectors, usually dominated by foreign capital, formed what amounted to separate enclaves within the economies concerned.

Table 7 indicates the degree of fragmentation in the region's economies in the 1950's. If mobility were perfect in labour and capital markets, one would expect marginal productivities and thus average productivities in various sectors to be more or less equal, (as they are in industrialised countries). Table 7 shows that, for Latin America as a whole, there were still great differences between output per head, and data for individual countries would show even more striking contrasts.

Socio-economic structures of this type were obviously not well suited to cope with the strains of further import substitution, in some cases rapid, that lay ahead.

6. The stagnation of exports in the 1950's: the acute policy dilemma

This period was, however, postponed somewhat. The post-war commodity boom continued into the opening months of the 1950's. The United States economy rebounded from the recession of 1949, and the recovery in the Federal Republic of Germany was gathering speed. Then the Korean hostilities led to the adoption of armament programmes in the industrial countries and had a more immediate impact on commodity prices. But in 1951, as fears of a general war diminished, prices of primary commodities fell back. In some cases they recovered again for a while later. There was a boom in non-ferrous metals in 1955 and 1956; and petroleum and

16/ In 1948, finished consumer goods accounted for over 50 per cent of secondary industry in Argentina, Brazil and Chile. In Canada, however, the corresponding figure was 28 per cent, less than the output of either the capital goods sector or the group of industries manufacturing intermediate products (United Nations Processes and problems of industrialisation, App. A, Table 6).

17/ Thus in Valdivia, Chile, the same items of clothing cost in 1950 45 per cent more than in Santiago, while food products cost considerably less (Estadistica Chilena).

/Table 7

Table 7

LATIN AMERICA: OUTPUT PER WORKER BY SECTOR IN 1955

Sector	Dollars at 1950 prices
Agriculture	382
Mining	3 667
Manufacturing	1 057
Building	955
Services	1 313
All sectors	816

Sources: United States, Department of Commerce, *Comparative Statistics on the American Republics*, based on ECLA, *Economic Survey of Latin America 1956* and United Nations, *Estudio sobre la mano de obra en América Latina*.

/free-market sugar

free-market sugar prices rose during the Suez crisis. Coffee prices rose to a peak in 1954 and remained relatively high until 1957. But, broadly speaking, there was no further sustained rise in commodity prices after early 1951. Volumes of exports did usually continue to expand, though in most cases the rise was only moderate. On the other hand, although the upward trend in import prices slowed down, reflecting an increased emphasis on price stabilization overseas and the slowing-down in the rate of growth of the world economy, it did not stop. So the terms of trade of Latin America started to deteriorate.

In the countries of Group O (i.e. the countries of the Caribbean area and Central America following conservative financial practices), price rises levelled off almost completely, in the sense that any further rises were in the margin of statistical error, owing to the unreliability of price indices. This can be seen from figure II. Figure III brings out more clearly the closeness with which price changes followed those in the United States, the main customer and supplier of these countries. It does this by comparing the movement of consumer prices in the United States with the median consumer price rise each year for this group. After the war-time discrepancy, attributable to the reasons explained above, both series moved almost in step and both virtually ceased rising from 1951 on. Inflation has continued to be discussed as a problem in the United States, but it has in fact been insignificant in the past decade.

Appreciation of the success enjoyed by these economies in holding inflation in check and then eliminating it must be tempered by the consideration that the closer the adherence to the dollar standard, the more do not only price movements, but also economic growth, depend on external developments. An upward trend in the value of exports raises incomes and reserves, increases the demand for locally-produced goods and also leads to rising imports. The whole set of variables can keep moving upward. But, because of the attractiveness of manufactures, the income-elasticity of demand for imports tends to be greater than unity, despite attempts to protect local industries. So the rate of expansion of the value of exports tends to limit the rate of growth. Account must

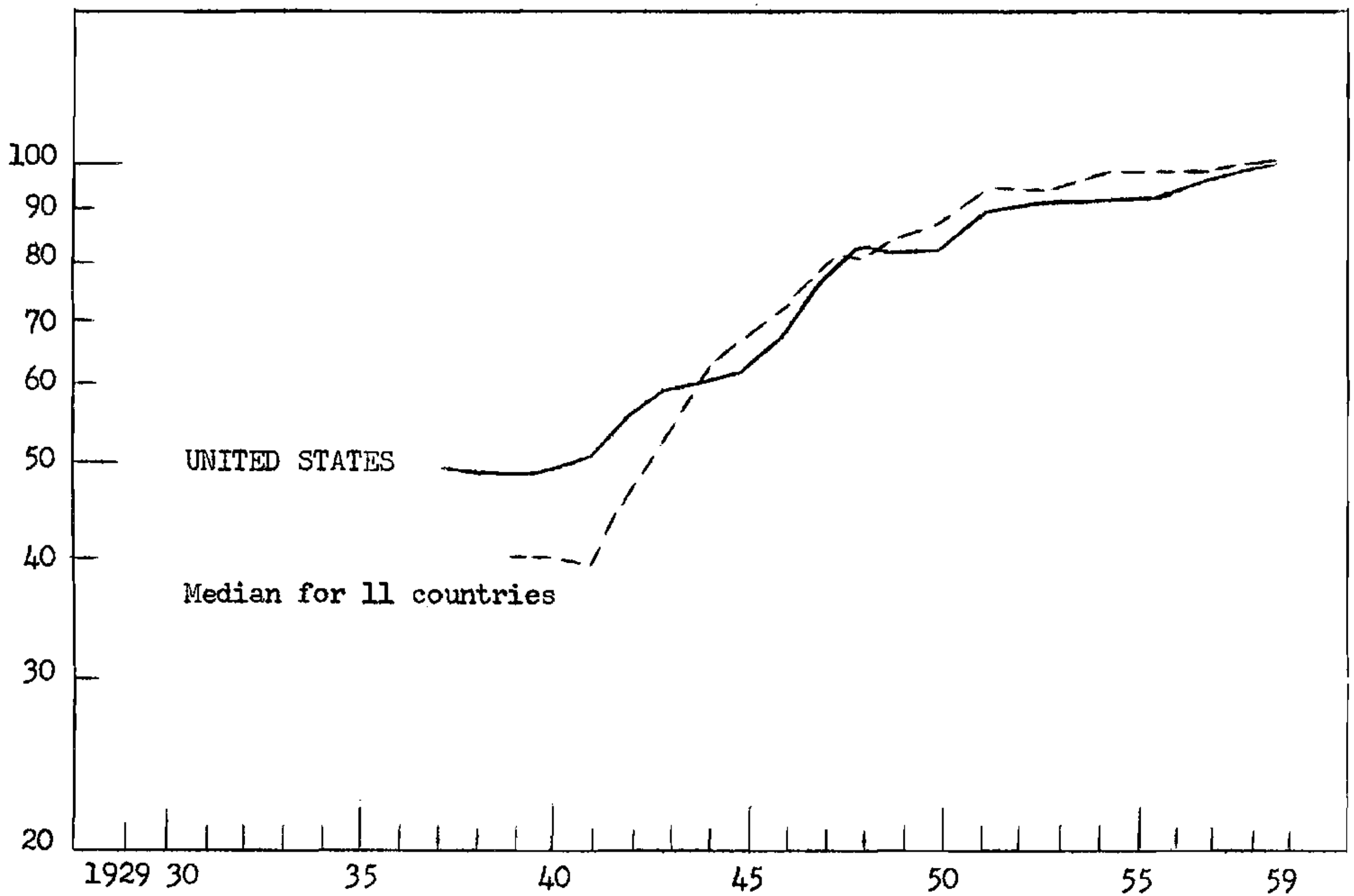
/also be

FIGURE III

COST OF LIVING

(Indices 1959 = 100)

Semi-logarithmic scale



Source : See figure II.

also be taken of import prices, since, if they rise, this will tend to depress the rate of growth by absorbing foreign exchange.[18/] Thus, 'the purchasing power of exports', i.e. the value of exports deflated by an index of import prices, is likely to be the main determinant of changes in the domestic product of a dollar-standard country.

The inflow of capital would also of course stimulate growth just as an outflow would depress it. But, data on capital movements are particularly weak, so this is difficult to allow for statistically. In any case, the effect of trends in capital inflows is not comparable with that of trends in exports, especially if allowance is made for the rising expenditure of foreign exchange in the form of profits and interest, associated with growing foreign investment. Moreover, the progress of exports very much determines the extent of foreign investment even in industries producing for the home market. So the purchasing power of exports can still be considered the main determinant.

There are not many reliable statistical aggregates for the countries of Group O. It is possible to make approximate estimates of changes in the purchasing power of exports (see table 8), and in some cases it is also possible to indicate roughly what has happened to domestic income. However, the estimates of domestic income refer mainly to changes in the sectors using money. Since subsistence sectors have mostly stagnated or declined, these indices probably have an upward bias.

There was evidently some association between exports and income in the 1950's (see table 8 and figure IV). The dispersion around the diagonal line corresponding to equal changes in both variables shows that, in so far as this was not due to purely statistical errors, there were other influences at work, though of comparatively limited strength.

For Venezuela, a big rise in domestic income was associated with a more or less equivalent rise in exports, although, with the heavy investment in the Venezuelan petroleum industry in 1956 and 1957, a bigger

18/ In Venezuela, where there is competition between imports and domestic output over quite a wide range of articles, a relative rise in import prices may stimulate local production.

/Table 8

Table 8

LATIN AMERICA: CHANGES IN THE PURCHASING POWER OF EXPORTS AND IN DOMESTIC INCOME BETWEEN 1950-52 AND 1956-58

(Perdentage changes, at 1950 prices)

Country	Purchasing power of exports a/	Domestic income b/
Group U		
(a)		
Brazil	-13	+32
Argentina	-9	+12
Mexico	+46	+40
Chile	+21	+24
Colombia	+8	+32
Peru	+30	+25
Uruguay	-36	Moderate rise
(b)		
Bolivia	-33	Little change
Paraguay	-4	Moderate rise
Group total	+1	+28
Group O		
Venezuela	+64	+64
Cuba	+2	Moderate rise
Costa Rica	+21	+43
Dominican Republic	+25	Large rise
Ecuador	+36	+25
El Salvador	+46	+45
Guatemala	+27	Large rise
Haiti	-22	Moderate rise
Honduras	+11	Moderate rise
Nicaragua	+70	Large rise
Panama	+39	+34
Group total	+40	+44

Source: ECLA, on the basis of national statistics.

a/ Exports relate to goods only, except for Mexico and Panama (goods and services). The purchasing power has been obtained by deflating the current values of exports of individual countries by the total unit value index of imports into the whole of Latin America. This has been done because in several cases national trade statistics do not yield unit value series for imports which can be used. The main underlying assumption is that for each year the deflation between the national and regional weighting systems is uncorrelated with price movements. This assumption clearly may lead to error in individual cases. Since manufactures have risen more in price than primary commodities over this period, the import prices of group O may have risen more than the regional average, so that the rise in the purchasing power of exports of this group may be somewhat exaggerated here.

b/ Allowing for changes in the terms of trade. These have been estimated by using the regional price index for the reasons given in the previous footnote, and with similar implications. It should be borne in mind that it is impossible to exclude, as is theoretically desirable, subsistence production from the correction made for the terms-of-trade effect.

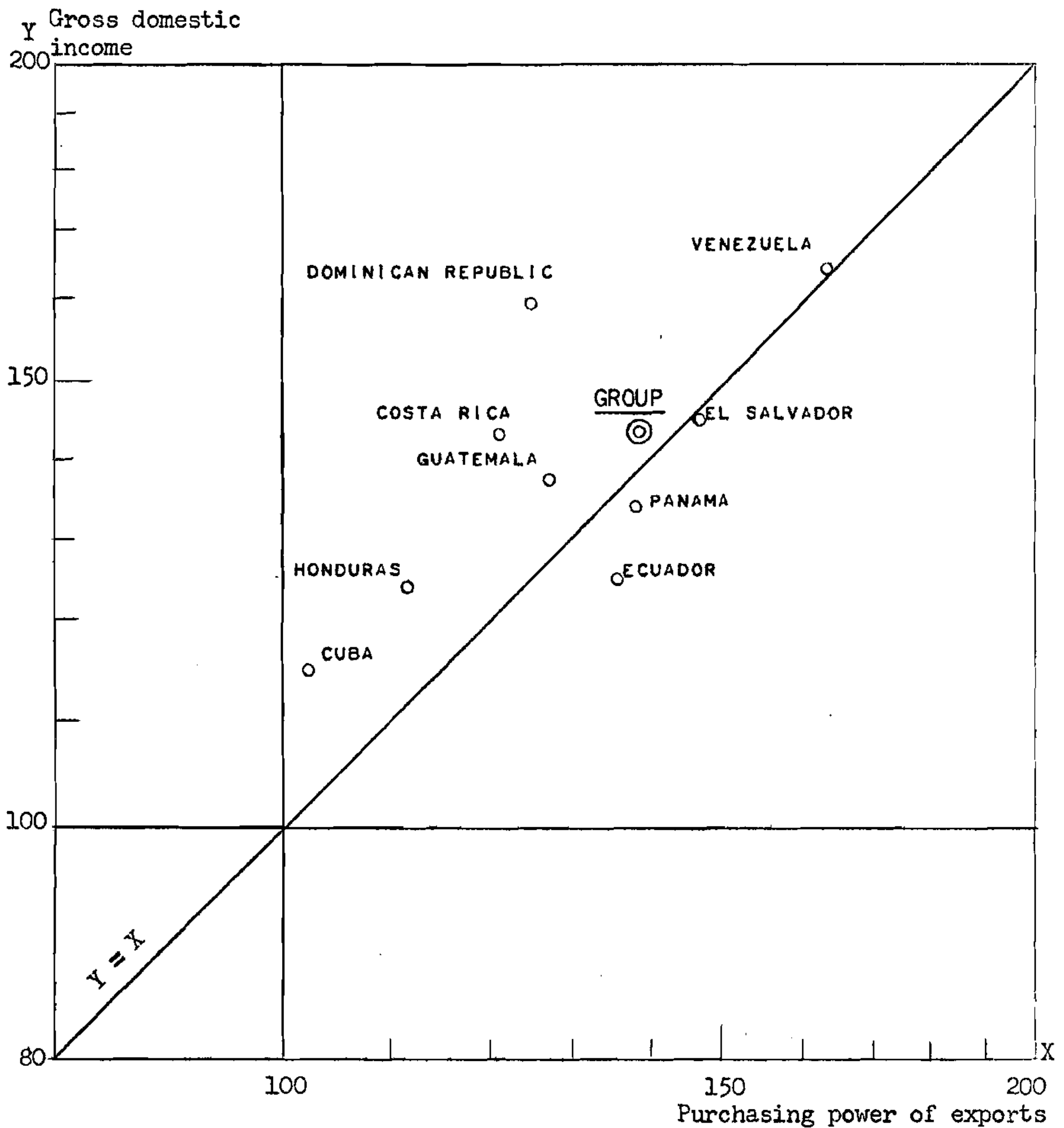
/rise in

FIGURE IV

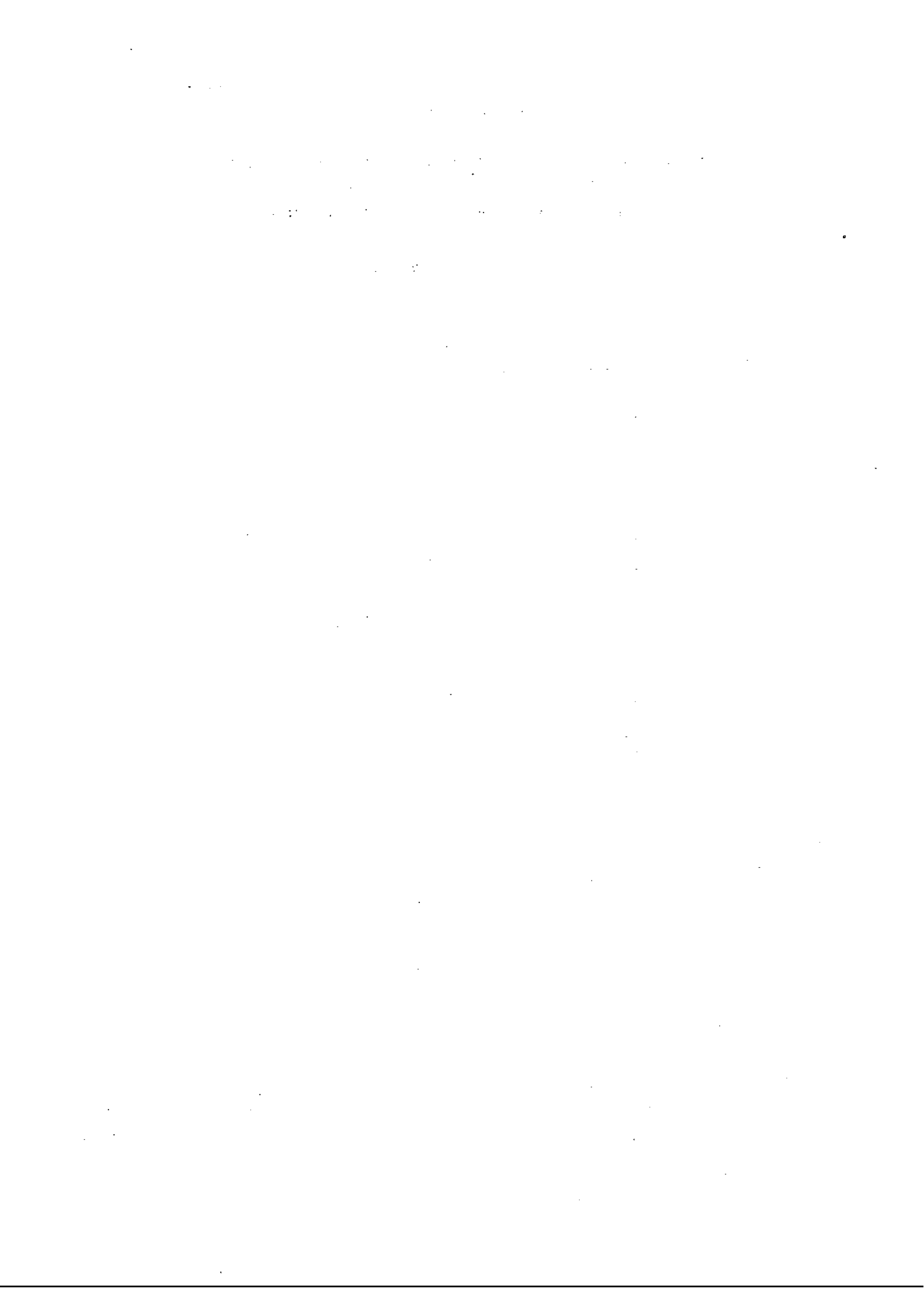
GROUP O : RELATION BETWEEN INCREASES IN GROSS DOMESTIC INCOME (Y) AND IN PURCHASING POWER OF EXPORTS (X)

(Index numbers for 1956-58; 1950-52 = 100)

Logarithmic scale



Source : See table 4.



rise in the former variable might have been expected. Similarly, large increases in both income and exports occurred in El Salvador, Guatemala, Nicaragua and Panama. In other cases, the extent of import substitution appears to have caused a faster (or slower) growth in income than in exports. In Costa Rica and the Dominican Republic, the growth in income appears to have substantially exceeded that in exports, while the reverse was true in Ecuador. In Cuba, Haiti and Honduras, the purchasing power of exports hardly changed and may have fallen; total real incomes nevertheless rose somewhat in these cases, but the substantial reduction in the backing for their currencies (see table 3) indicates again that the temptation to relax monetary practices is strong when exports stagnate. Despite these signs of some monetary expansion, the increase in the total product was so small in these three countries that there was little change, perhaps even a fall, in per capita terms. Since there was quite a close relation between changes in income and in the purchasing power of exports for the largest economy (Venezuela) and for most countries of the group, this was also true for the group as a whole.

After the middle of 1957, the exports of several of these countries fared badly. Prices of petroleum and free-market sugar fell back from the peaks attained in the Suez crisis; coffee markets weakened as the world glut grew and volumes of exports were restricted by international agreement; cotton prices declined; and among tropical commodities only bananas continued to be moderately strong. The penalty for failing to diversify the economy now became apparent in terms of economic stagnation and social unrest. It appears from preliminary figures that, in most of the countries of this group, the rate of growth of income slowed down considerably.

Its biggest members, Cuba and Venezuela, have in fact taken autonomous action to stimulate an expansion of internal activity. In these two cases, political and economic developments have been intermixed, and it cannot be said that it is purely for economic reasons that the dollar standard has been relaxed. Moreover, in the case of Venezuela, the measures taken have not so far been incompatible with the principles of

/this standard.

this standard. The budget has been unbalanced, but the deficit was partly attributable to the repayment of debt. Import controls have been tightened, tariffs raised and exchange control introduced, but the import surplus, like the budget deficit, has been covered by running down reserves and borrowing. Although prices started to rise in 1958, the rise has been moderate. However, banking legislation has been reformed to allow a lower ratio of reserves to central bank liabilities (33 per cent instead of 50 per cent) and to permit lending by the central bank to the Government.

The experience of Group U was very different. Prices continued to rise and, in several cases, the pace of inflation accelerated (see again figure I). There was quite a different relationship between the growth of income and exports. Industrialization was now a more deliberate policy, even in the face of difficulties in marketing exports. Governments refrained from taking steps to reduce internal activity when exports fell back from their peaks, and compensation occurred by default. Budgets slipped into deficit, or deficits grew, particularly in Chile where taxes on profits of export companies form a big source of revenue. Moreover the basis of the monetary structure was further attenuated by allowing credit to increase when reserves fell.

The main problem was not however that exports slipped back from time to time, but rather that the trend was no longer definitely upward. Taking this group as a whole, the change in the purchasing power of exports over this period was virtually zero (see table 8). Yet, population increases were accelerating, except in Argentina and Uruguay, as death rates were driven further down by improvements in health services. The growth of cities, once it is under way, gains a certain momentum and a check to industrialization soon leads to serious social problems. Consequently, Governments had little option but to promote growth and further diversification, and import substitution became an increasingly deliberate aim of policy. Brazil in particular established a programme of priority targets for the basic sectors of the economy (steel, petroleum, transport, etc.).

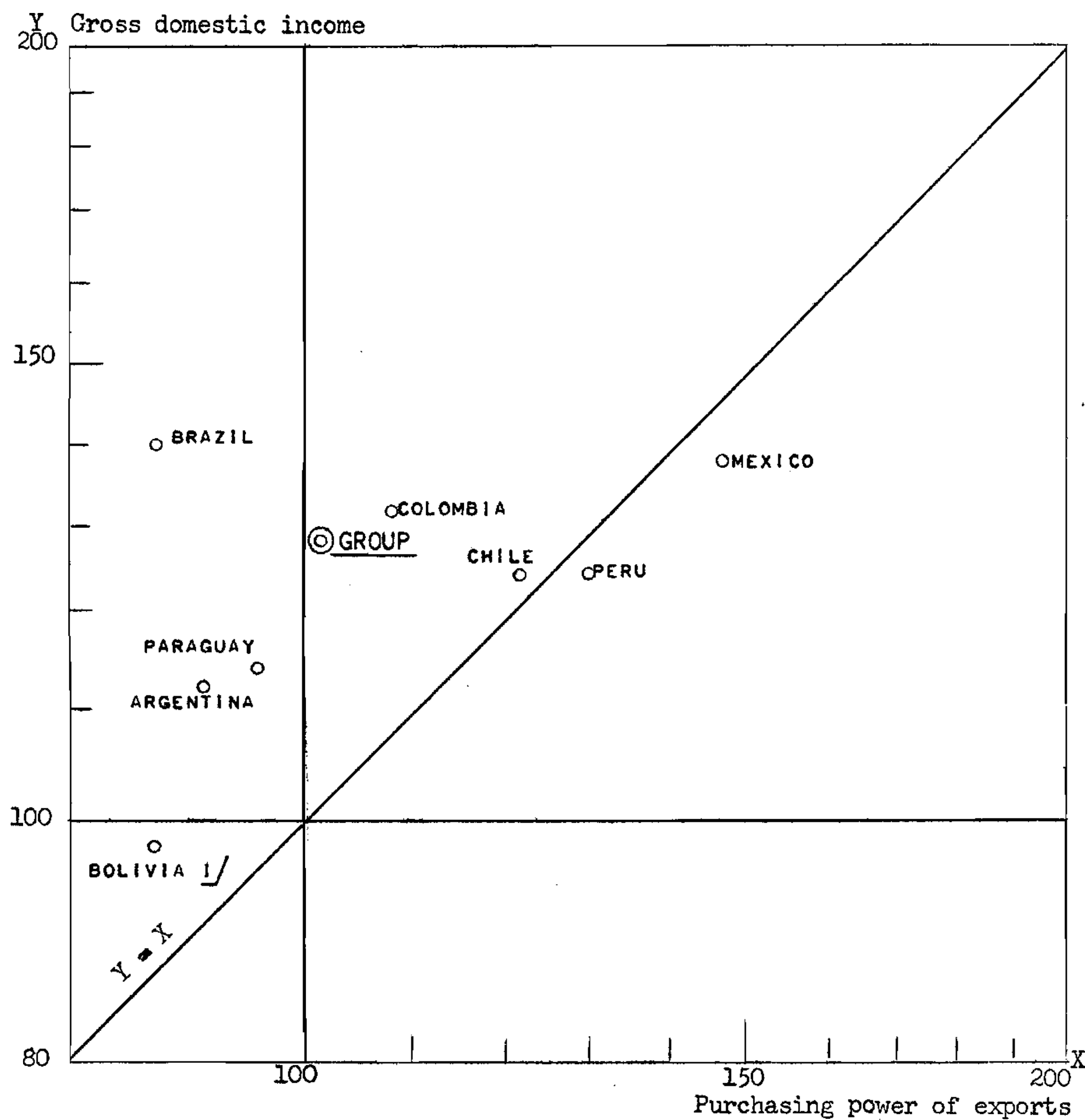
The consequence can be seen in figure V, which is strikingly different from figure IV. It shows that, for most of these countries, the growth

FIGURE V

GROUP U : RELATION BETWEEN INCREASES IN GROSS DOMESTIC INCOME (Y) AND IN PURCHASING POWER OF EXPORTS (X)

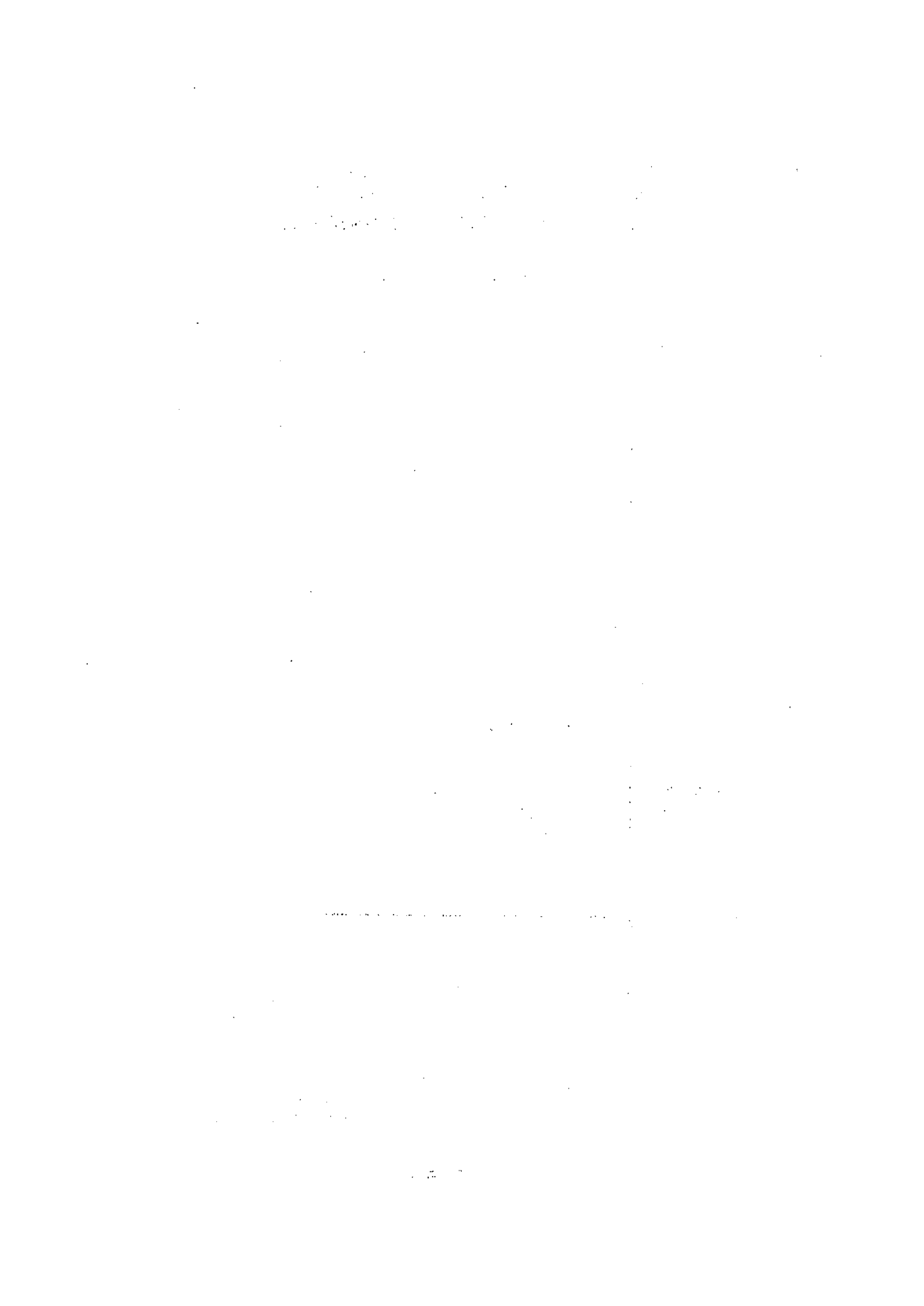
(Index numbers for 1956-58; 1950-52 = 100)

Logarithmic scale



1/ Index number for 1954-55; 1950-51 = 100.

Source : See table 4.



of income has borne little relation to exports. Indeed, the purchasing power of exports did not rise greatly for any member of this group, except Mexico, and in this case it is partly due to the fact that the tourist industry has been included in exports. In Chile and Peru, moderate rises in exports were paralleled by similar increases in income. The exports of other countries showed only small rises or actually fell, but experience with income was much better. Brazil and Colombia, especially the former, achieved the most significant increases in their domestic incomes, in view of the poor performance of their exports which actually declined in Brazil. (Note how far the points for these countries lie from the diagonal line which represents the same proportionate increases in both variables.) Uruguay would doubtless show a similar contrast, if data were available. Argentina achieved some increase in income, and in Bolivia the economy was stagnant, although exports fell somewhat in both cases.

The total product of this group rose about 28 per cent (or over 4 per cent a year), even though the purchasing power of exports was unchanged. Much of this total economic growth was due to progress in Brazil.

7. A summary of external and internal trends in the main economic indicators, 1929-59

It was not until after the Second World War that the purchasing power of Latin American exports recovered the levels at the end of the 1930's; even then it was helped by the improvement in the terms of trade, and since these swung back against Latin America in the 1950's, there was no great further increase in the command over imports offered by the region's foreign sales. In fact, if Venezuela is excluded, there was little change over the whole thirty years (see table 9). Some countries were particularly severely affected. In Argentina, the purchasing power of exports in 1958 was only half what it had been thirty years earlier; and in Chile, too, exports - in this sense - never recovered their pre-depression level (see table 10).

Much the same long-term trends are shown by the volume of imports, since this depends very largely on exports and the terms of trade. The

/Table 9

Table 9

LATIN AMERICA: PURCHASING POWER OF EXPORTS, 1928/29-1958

(1955 = 100)

Year	Including Venezuela			Excluding Venezuela
	Purchasing power of exports	Quantum of exports	Terms of trade	Purchasing power of exports
1928-29	71	83	86	87
1932	39	64	60	46
1940	45	67	67	53
1945	56	82	69	64
1950	97	88	109	105
1951	98	86	114	106
1952	85	86	99	88
1953	98	95	103	105
1954	101	93	108	105
1955	100	100	100	100
1956	105	109	97	105
1957	107	110	97	107
1958	102	111	92	101

Sources: ECLA. Economic Survey of Latin America 1949 and Economic Bulletin for Latin America, Volume V, N°. 2.

/Table 10

Table 10

SELECTED LATIN AMERICAN COUNTRIES OF GROUP U: PURCHASING POWER OF EXPORTS, 1928-1929 TO 1958

(Index 1955=100)

Year	Argentina	Brazil	Chile	Mexico
1928-29	242	78	123	75
1932	148	44	23	24
1940	112	42	64	39
1945	118	70	75	48
1950	154	113	76	81
1951	124	121	86	87
1952	68	93	94	89
1953	129	113	89	77
1954	114	114	87	85
1955	100	100	100	100
1956	102	109	115	108
1957	111	103	99	87
1958	120	96	84	86

Sources: ECLA, Economic Survey of Latin America 1949 and Economic Bulletin for Latin America, Vol. V, N° 2.

/total of

total of imports for the region was in 1958 not very much greater in quantity than it had been in 1928, if Venezuela is excluded. In Argentina and Chile, the volume of imports actually fell over the three decades, and in Brazil the rise was limited (see table 11).

This weakness of imports must be contrasted with the expansion of the region's product, which more than trebled in the same period (see table 12). This was accompanied by a rapid growth of cities,[19/] and it meant not merely a fast rise in total demand but a very fast expansion in the demand for advanced manufactures (especially equipment), for processed foodstuffs and for professional services.

Table 13 shows that, in the 'open economies' of Group O, rising demand was accomodated by imports increasing more quickly than the domestic output of goods for internal consumption. So imports formed a growing proportion of total supply though data only permit a comparison to be made for the period after 1950-1. No doubt a similar tendency would have been observed in Group U, if foreign exchange supplies had permitted, but in all members of this group, except Peru which was in fact an 'open economy' for much of the 1950's, the opposite happened. The import coefficient, defined in this way, fell almost throughout the period, altogether by about a half from 1928-29 to 1957-58. Only in Mexico did the coefficient cease falling after 1938-39.

A big task therefore confronted the domestic producers of this group. They had to provide substitutes for imports which could not be afforded - at first during the depression, but subsequently too. In some cases the task was made harder by price controls or subsidies that stimulated consumption, for example, of energy. Within a stationary or contracting total of imports, imports of petroleum grew rapidly, especially in Argentina and Brazil. Import substitution in steel also lagged in Argentina and Chile, although in the latter case it increased greatly in the 1950's. Output of capital equipment rose everywhere after

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19/ In nearly every country, the city population grew faster than the rural population. For example, the number living in cities of more than 100,000 population grew at over 4 per cent *per annum* in Brazil and Mexico between 1940 and 1950, and the rate was nearly 7 per cent in Venezuela.

/Table 11

Table 11

LATIN AMERICA: QUANTUM OF IMPORTS OF GOODS INTO THE REGION, TOTAL AND *PER CAPITA*, 1928-1958

(Index, 1955 = 100)

Year	Latin America		Latin America excluding Venezuela	
	Total	Per capita	Total	Per capita
1928	72	127	82	144
1932	29	47	33	54
1940	47	67	52	73
1945	49	61	52	66
1950	84	95	87	97
1951	104	114	109	120
1952	98	106	102	109
1953	90	94	90	95
1954	101	103	102	104
1955	100	100	100	100
1956	104	101	103	101
1957	122	116	118	112
1958	113	105	111	103

Sources: Figures worked out by ECLA on the basis of data extracted from the annual statistical publications of each country.

/Table 12

Table 12

LATIN AMERICA AND COUNTRIES OF GROUP U:
DOMESTIC PRODUCTS, 1928-9 TO 1959

(Indices: 1955=100)

Year	Latin America a/	Brazil	Argentina	Mexico	Colombia	Chile	Peru
1928-9	38	38	53	21	34	45	...
1932	35	37	46	21	36	34	...
1940	50	52	62	36	52	56	...
1945	61	60	71	55	62	72	61
1950	80	78	90	74	77	84	75
1951	85	83	93	81	79	86	82
1952	86	86	87	80	85	91	85
1953	89	89	92	84	90	95	92
1954	95	96	95	91	96	96	97
1955	100	100	100	100	100	100	100
1956	105	105	100	108	103	101	103
1957	111	115	104	111	106	104	104
1958	116	125	107	116	109	106	107
1959	119	134	101	121	115	108	105

Source: For the years up to 1945, estimates were taken from ECLA Economic Survey of Latin America, 1949 in the cases of Argentina, Brazil, Chile and Mexico (linked to estimates in Producto e Ingreso de la República Argentina, 1935-54 for the first-named country), and from ECLA, Economic Development of Colombia for this country. For sources of estimates of subsequent years, see ECLA Economic Bulletin for Latin America Vol. V, No. 2, Statistical Appendix.

a/ Weighted by products of individual countries in 1955 (expressed in dollars). For 1929 and 1932, the regional index is based on 7 countries, representing 85 per cent of the total regional output in 1955; for 1940 on 9 countries accounting for 86 per cent; for 1945 and subsequently on all countries.

/Table 13

Table 13

SELECTED COUNTRIES: PARTICIPATION OF IMPORTS OF GOODS IN TOTAL SUPPLY, BY VOLUME 1928-4, 1938-9, 1950-1 AND 1957-8

(Imports as percentage of supply at 1950 prices)[a/]

Country	1928-9	1938-9	1950-1	1957-8
Group U				
Brazil	15	9	12	8
Argentina	21	14	10	9
Mexico	17	9	10	10
Colombia	22	14	13	10
Chile	28	19	12	12
Peru	...	...	15	17
Group O				
Venezuela	...	11	17	17
Costa Rica	...	...	22	25
Ecuador	...	10 b/	11	14
El Salvador	...	...	15	19
Guatemala	...	...	15	18
Honduras	15 c/	13	16	20

Source: ECLA Economic Bulletin of Latin America, Vol V, No.2, and published and unpublished estimates by ECLA.

a/ 1928-9 and 1938-9 statistics of imports and supply were obtained by linking series at 1955 prices to 1950 estimates.

b/ 1939.

c/ 1929.

/1939, but

1939, but the demand also expanded very quickly, so that imports continued to climb except in Argentina. Nevertheless, because of shortage of equipment, there was growing pressure on capacity in several key industries, especially electric power production,[20] and the railways.[21]

One consequence of this series of developments was that the heavy industries had to be expanded rapidly. Thus, in Mexico the number employed in metallurgy, machines and vehicles rose from under 10,000 in 1930 to 173,000 in 1955.[22] The impact was, however, wider than this: industrial expansion on this scale means changes in many other industries, in fact a transformation of the whole economy. Another consequence was that the composition of imports changed greatly. While consumer goods accounted for almost half of all imports in 1928, by 1957-58 this proportion had fallen to 7 per cent in Brazil, 10 per cent in Argentina, and only slightly more in Colombia, Chile and Mexico.[23] On the other hand, capital equipment, which had accounted for about 20 per cent of imports of 1928 in countries of Group U, constituted more than a third in 1957-58 (over 40 per cent in Chile and Mexico). The only exception was Argentina, where the shortage of foreign exchange was especially acute. The share of petroleum in total imports also grew considerably in Argentina, Brazil and Chile, though not in the traditional producers such as Colombia, Mexico and Peru. Finally, there were fast increases in imports of materials - of

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20/ The growth of capacity of electric power production slowed down after 1955 in Brazil, Mexico and Chile, although it accelerated in Argentina and most countries of Group O. The consequence was that reserve capacity had fallen to very low levels by 1959 in many countries. (See Estado actual y evolución reciente de la Energía Eléctrica en América Latina, ECLA).

21/ Argentina is a striking instance. The physical equipment of the rail system changed little between 1928 and 1954. The number of seats available for passengers rose by 19 per cent and the freight capacity grew by 4 per cent in these 26 years. (Effective capacity fell because of the time lost whilst rolling stock was under repair.) By 1956 the total of goods awaiting shipment amounted to 2 months' loading. (See Economic Development of Argentina, Vol. V, ECLA).

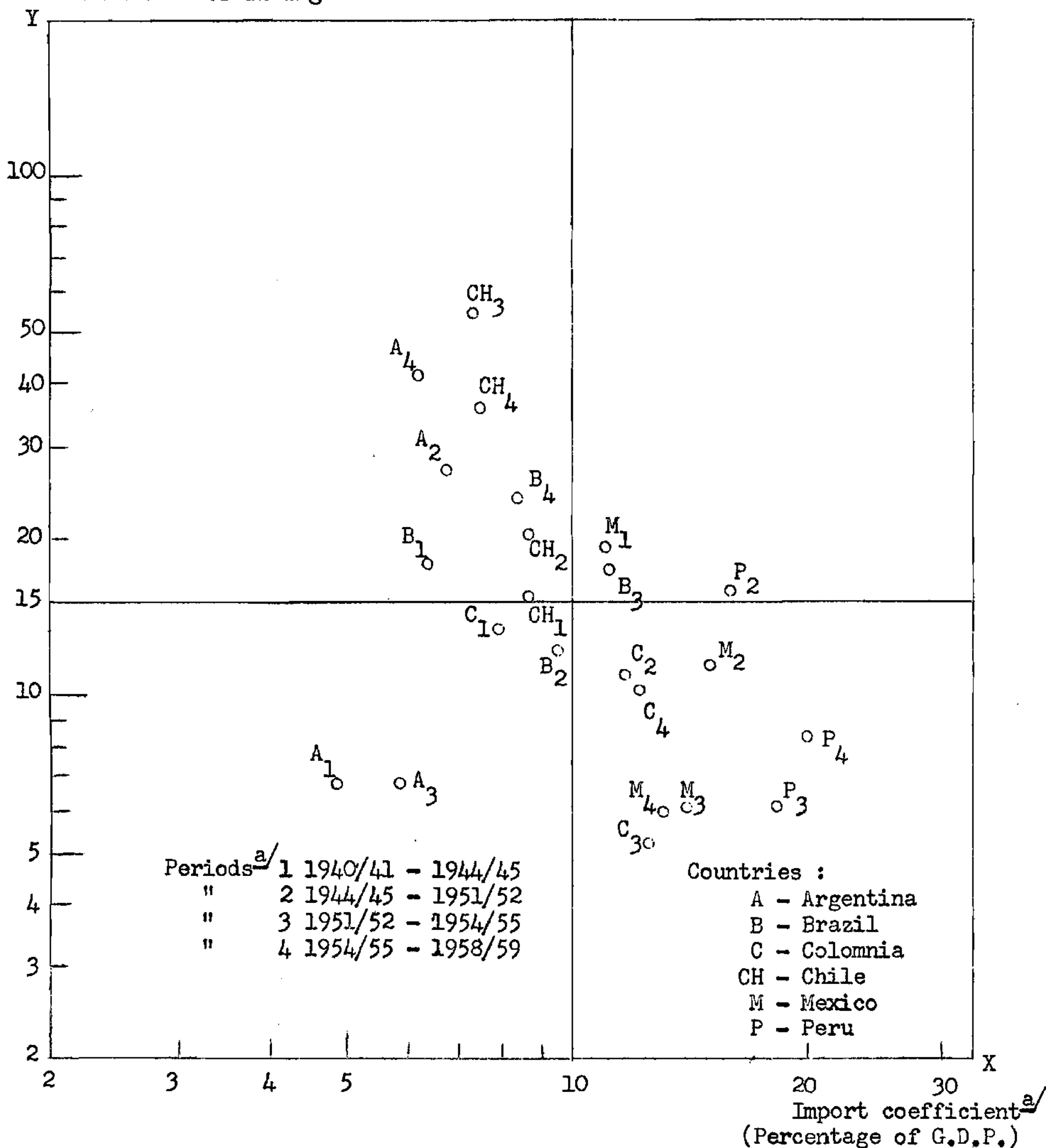
22/ Industrial Census, 1956.

23/ It was still near 40 per cent in Group O countries such as Ecuador and El Salvador.

FIGURE VI

LATIN AMERICA : RELATION BETWEEN AVERAGE INCREASE IN COST OF LIVING AND IMPORT COEFFICIENT a/ IN SELECTED COUNTRIES OF GROUP U

Logarithmic scale



a/ The change in the cost of living is related in the figure to the average import coefficient over a period starting and enging one year earlier than those shown here.

metals in Argentina, because of the need for ore, scrap and steel products, and of non-metals elsewhere.

This forced shift in the pattern of imports indicates the strain caused in several countries by the attempt to grow rapidly in a period of foreign exchange shortage, especially where, notably in Argentina, the necessary acceleration in output in key sectors had not been achieved. Although the deterioration in export markets was less dramatic in the second half of the 1950's than in the first half of the 1930's, the impact was nevertheless comparable in some countries, because it came at a time when it was difficult to make further economies in imports, whereas the import structure in 1929 had afforded room for economies.

Figure VI indicates there is a close relation between the import coefficient in various periods and the rate of price increase. One obvious exception is Argentina. Before 1945, plentiful supplies of food and a fairly well-equipped economy meant that structural problems were only of limited importance in Argentina and in the early 1950's price and wage controls were being used to suppress inflation. But in general it appears that, in the countries of Group U, an import coefficient of less than 10 per cent has been associated with inflation. At levels below this, there is little possibility of using foreign exchange to buy imports that would relieve internal structural problems.

/IV. THE

IV. THE SIGNIFICANCE OF POLICY, 1929-59

Any historical account can impart a somewhat misleading appearance of inevitability to economic developments. In order to see the picture as a whole account must be taken of the effect of decisions of economic policy. Whether circumstances have been propitious or otherwise, the whole climate of economic development and the success with which a country's problems have been faced depend in some degree on the way in which decisions of the authorities and of those with economic power have, perhaps unintentionally, influenced events. Policies can greatly aggravate or greatly improve the current situation, and they can make the problems of future policy-makers either easier or more difficult to solve.

Before trying to summarize briefly some of the principal lines of policy followed in various fields and their relation to inflationary pressures, it must be emphasized that measures are not adopted in a social vacuum by a group of men in a position to choose freely from the whole range of alternatives. On the one hand, given the rapidly changing economic environment of Latin America, those who take decisions have been continuously facing new and serious problems and finding that they lack either previous experience or adequate machinery for dealing with them. On the other hand, conjunctures of social forces and interests impose certain boundaries on the scope for policy and may at times inhibit the adoption of necessary measures, or hamper their execution or cause other and inconsistent policies to be put into effect.

1. Weakness of available instruments

With respect to the first point, sight should not be lost of the quality and the appropriateness of the mechanisms and instruments which have been available in the region for dealing with the tasks which emerged out of the depression and out of the subsequent need to transform the traditional economic structure. The central political task in these decades can be summarized as that of achieving a rupture with the previous system of externally-oriented growth.

The situation was far from favourable in many important respects. Public administrators, for example, had to leave a world of limited and conventional functions for one in which there were heavy responsibilities, of a type unknown in the old régime of _laissez-faire_ and incompatible with the old organizational structure and the traditional limited status of the public servant. The intractability of this problem is evidenced by the widespread attempt to solve it by the creation one after another of new organizations, autonomous or nearly so, which could contribute to the solution of particular administrative problems,

/but represented

but represented *in toto* a series of makeshifts instead of a fundamental reform of the organization and methods of the public service, such as was needed in the new situation. Secondly, the key instruments of economic policy could only be used to a limited extent. Apart from the fact that their efficiency depended ultimately on the competence of those who used them, their operation was also hindered by serious institutional defects and by certain of the characteristics of the typical economic structure. Monetary policy, for example, faced the following obstacles: the lack of scope for open market operations in Government bonds; the size and independence of the external sector; the importance of credit arrangements outside the banking system; the relatively small amount of cash in bank tills; the limited or non-existent experience of the management and staffs of central banks, which had to face novel situations and to shoulder unconventional responsibilities.

An analogous set of defects hampered fiscal policy. Apart from any question as to the competence and impartiality of those administering policy, the extent of the increase in their responsibilities is indicated by the great changes which took place in a mere couple of decades in the structure of Government accounts, on the sides of both income and expenditure. Treasuries were obliged to turn to new sources of taxation and find additional financial resources of a non-budgetary nature, often in economic conditions which were far from favourable. They also had to devise ways of carrying out the social and economic initiatives appropriate to the circumstances of the new era.

2. The role of political interests

Turning to the second element mentioned above, the most significant point is that only in a few countries was there a definite and irreversible decision on the need to follow a new path. Political power groupings which had been created in the course of the old scheme of development could at times be relegated to a plane of secondary importance, but in most of the countries of the region they never entirely lost their former power. Accordingly, whenever the political climate became helpful to them once more or whenever it was possible - as it was bound to be on occasion - to point the obvious failures in the new lines of policy, these traditional forces found themselves in a position not only to affect the details of policy but also to change its orientation. On the other hand, the appearance on the scene of new interests, such as the growing groups of manufacturing entrepreneurs and the associations of their employees, represented forces which had at times to be conciliated, and the customary exclusion of these interests from decision-making meant that the expression of their influence was often spasmodic and irresponsible.

/In brief,

In brief, there was in nearly every country a lack of widespread agreement on what constituted the national interest and an unwillingness to subordinate individual or sectional claims to it. Yet this seems something of an oversimplification, when individual countries are considered. In one or two cases, at some point along the road of economic development, a social and political decision became widely accepted about the main objectives of policy, and those who were adversely affected by this decision remained subsequently in an undoubted, even if important, minority. In this respect, the history of such countries reflected what had occurred at various stages of development in countries already industrialized (for example, Germany, the United Kingdom or the United States), when forces which favoured a break with the traditional economic way of life imposed their will.

By contrast, in most countries of the region, either because the new trends were not powerful enough or because they were diverted by mistaken decisions, the basic political orientatation remained essentially unresolved. In such circumstances, which are characteristic of countries in a period of transition, what appears as weaknesses in the instruments of policy, or as incompetence in their use, may really be in great measure an expression of the incoherent and unstable way in which political pressure groups affect the formation of policy, each bound and committed to certain fundamentally incompatible economic aims.

This may help to explain the fact that only in a very few countries has economic policy clearly played a key role in the elimination, or even the moderation, of the basic economic disequilibria. As a general rule, the measures adopted have been, at least in some degree and on some occasions successful in dealing with short-term problems, but not in creating a sound and sufficient basis for the new patterns of economic growth.

3. The change in orientation after the war

Although no clear distinction can be made between the 15 years that ended in 1945 and the 15 years that followed, the latter period is more interesting, as well as more topical, because some of the main features of the picture have changed considerably, affecting the overall balance of considerations. As a generalization, the relative importance of policy

/has increased

has increased somewhat since the end of the war. Governments have acquired, albeit in some cases despite themselves, the power to influence events over a wider range, and there has been a considerable increase in what is expected of them. The immediate post-war period brought an improvement in foreign exchange supplies which, apart from stimulating the growth of income, created opportunities for correcting some of the more obvious existing defects in the economic structure. Moreover, the adjustments which had been forced on Latin America's economies by the depression had been at least in some degree completed. These adjustments had been carried out under extremely unfavourable conditions and had severely strained the equilibrium of nearly every economy, but they did provide both the physical basis and the human experience which were necessary preconditions for further advances towards economic independence. Developments in the institutions and instruments of economic policy, although incomplete, had changed the whole approach as to what it was feasible to expect from official policy. There was now, for example, factual knowledge about the effects of policy and the risks involved in its operation. So the new period involved a challenge which, though by no means simple, was less overwhelming than had previously faced the Governments of Latin America.

Nevertheless, as has been seen, the symptoms of disequilibrium, such as inflationary pressures, tended in general to increase rather than diminish during the post-war period, at least in countries attempting a diversified development of their economies. The analysis of the policies adopted in this period is therefore of special interest. 24/

An examination of the field of public finance in certain countries reveals, first, a steady growth of the proportion of public expenditure in the domestic product, and secondly a persistent imbalance in the public accounts (see tables 14 and 15). Some countries, it is true, like Mexico, do not show this relatively fast rise in public expenditure, but the general

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24/ Various fields of policy are discussed in more detail in the full study. Here only some general aspects which are of major significance will be dealt with and the examples limited to one or two representative countries for which data are available.

/Table 14

Table 14

RELATION BETWEEN PUBLIC EXPENDITURE AND GROSS DOMESTIC PRODUCT

(Current values in percentages)

Country	1947-48	1952-53	1956-57
Group U			
Brazil	18	22	27
Argentina	30	28	26
Mexico a/	7	8	8
Colombia b/	16	15	17
Chile	23	24	23
Group O			
Venezuela c/	(12)	26	28 d/
El Salvador	9	13	11

Source: ECLA, on the basis of official national statistics.

a/ The figures given are those of the Federal Government. However, in the case of public expenditure, the figure obtained for consolidated expenditure bears the following relation to the gross domestic product:

1947-48	1952-53	1956-57	1958
11	12	12	12

In this study, the comparisons are made on the basis of the Federal Government figures, since the consolidated figures for the sector were not available in every case.

b/ Gross national product.

c/ The fiscal year covers the period 1 July - 30 June in every table.

d/ Expenditure in 1956-57 is undervalued, since capital debts existed which were paid in 1958 and subsequent years.

/Table 15

Table 15

DEFICIT IN TAX REVENUE WITH RESPECT TO PUBLIC EXPENDITURE

(Percentages)

	Group U				Group O	
	Brazil	Argentina	Mexico	Chile	Venezuela	El Salvador
1947	13	48	41	30		4
1948	14	105	50	18		17
1949	22	47	21	47		5
1950	25	37	5	67	31	8
1951	9	30	+6	53	50	11
1952	16	25	17	64	12	13
1953	25	32	19	40	13	8
1954	11	39	25	30	3	0
1955	15	34	3	38	13 a/	3
1956	28	11	8	27	8 a/	8
1957	24	24	19	30	+23 a/	+4
1958			27		36 a/	8

Source: ECLA, on the basis of offical national statistics.

a/ In Venezuela, debts contracted in earlier years were paid in 1958 under the head of capital expenditure.

/tendency is

tendency is unmistakeable. 25/ The fiscal problem was aggravated in most cases by the performance of exports - either by their fluctuations or by their relatively slow growth. 26/ Still, even those countries which were less dependent on foreign trade for revenue, or which had a more favourable experience with exports, show the same tendency for a deficit to develop. There has been, throughout the region, a general failure to introduce the fiscal reforms which were necessary, especially those which would impact a greater flexibility to revenue and reduce widespread tax evasion. In the absence of these reforms, fiscal systems have suffered from two serious defects: they are regressive 27/ and they increase inflationary pressures in the economy through their tendency to deficit. 28/

The analysis of monetary developments is not more encouraging. Even if allowance is made for the structural limitations on the operation of traditional instruments of control, limitations which have already been mentioned, there was surprisingly little attempt to use them, even on a modest scale, to control the inflationary pressures arising in foreign trade or

25/ In some cases, such as Venezuela and also Mexico, the budget deficit was covered wholly or partly by foreign borrowing, but otherwise it was financed by central bank advances, leading in turn to currency issue.

26/ In some countries of Group U - Mexico, Colombia and Chile, for example - the proportion of revenue obtained from the external sector was significant (including import duties). In 1956 it was 34 per cent, 15 per cent and 27 per cent respectively for each of these countries. In Venezuela and El Salvador, the corresponding figures were even higher: 87 per cent and 56 per cent.

27/ In the period 1953-57, the percentage contribution of indirect taxes to revenue was as follows:

All taxes		Excluding taxes paid by big mineral companies	
Brazil	75	Chile	67
Argentina	60	Venezuela	77
Mexico	42		
Colombia	57		
Chile	57		
El Salvador	56		

28/ There have also been well-known cases of political power being used for personal enrichment.

/those deriving

those deriving from forces at work in the private and public sectors. [29]

In the field of foreign economic policy, a more coherent rationale is evident. Objectives which were followed included the conservation of foreign exchange, the reservation of scarce exchange for essential imports, the protection of existing local industries and the promotion of new ones. Unfortunately, however, these measures were often adopted without reference to their effects in other spheres of economic policy. At times they affected unfavourably the promotion of exports, especially new products, and they caused an explosive upward movement in prices when exchange rates were adjusted belatedly, after having been held unchanged and overvalued for years. Table 16 shows how during the war and the immediate post-war years the domestic value of some currencies became completely divorced from international price patterns, as exemplified by those current in the United States. In Argentina, for example, while the index of wholesale prices (1939 = 100) rose to 927 in 1953, the exchange rate increased in the same time by only 85 per cent; in Chile, and to a lesser extent in Brazil, similar discrepancies can be seen. Some countries, like Mexico, kept their exchange rates more closely in line with the relative purchasing power of their currencies. [30]

With very few exceptions, wage policy does not seem to have had in Latin America the significance attributed to it in the analysis of inflation in the industrialized countries of the Northern Hemisphere. The reasons are not hard to find. Most of the active population is employed in the agricultural sector; trade unions are not very powerful; employment incomes are relatively small, as a proportion of national income; and there has been in most countries little or no official action to promote wage increases, although there have been conspicuous exceptions to this last generalization, as will be seen.

Nevertheless, wage movements could still play a significant role in the development of inflation. There have always been certain groups of

29/ A more comprehensive analysis of monetary factors will be included in the final version of the study.

30/ Naturally the exchange rate policy cannot be appraised independently of developments in other fields and the special characteristics of the economy concerned.

/Table 16

Table 16

ARGENTINA, BRAZIL, CHILE AND MEXICO: PRICES AS A PERCENTAGE OF UNITED STATES PRICES ON THE BASIS OF OFFICIAL EXCHANGE RATES

(1939 = 100)

	Wholesale price index	Exchange rate index	Price index in terms of dollars $\frac{A}{B}$	United States price index	Prices as a percentage of United States prices $\frac{C}{D}$
	(A)	(B)	(C)	(D)	(E)
Argentina					
1939	100	100	100	100	100
1950	520	133	390	210	186
1953	927	185	501	222	226
June 1955	1 100	196	561	223	252
December 1955	1 170	400	293	224	131
1958	1 990	756	263	240	109
Brazil					
1939	100	100	100	100	100
1946	275	109	252	155	163
1950	440	111	396	210	189
1953	630	215	293	222	132
1955	920	464	198	223	89
1956	1 150	495	232	230	101
1958	1 490	691	216	240	90
Chile					
1939	100	100	100	100	100
1950	522	135	386	210	184
1953	950	285	333	222	150
1956	2 749	2 378	116	230	50
1958	4 618	4 260	108	240	45
Mexico					
1939	100	100	100	100	100
1946	225	94	239	155	154
1949	261	160	163	199	82
1953	365	160	228	222	103
December 1954	398	241	165	223	74
1958	513	241	213	240	89

Source: ECLA, on the basis of national price statistics and data from the International Monetary Fund, International Financial Statistics.

/wage or

wage or salary-earners quite highly organized, whose achievements in wage claims have constituted incentives and provided targets for the other weaker sections. And while wage-earners have at times been powerless to achieve increases, they have consistently been able to prevent a reduction in their remuneration.

Argentina is the outstanding case among countries where wages policy has at various times, among other factors, played a significant role in the process of inflation. It is true that the increase in the level of wages, which started in 1943, did not at first affect the cost-of-living index. One reason was the pressures which unexported surpluses of foodstuffs exercised on the price level. But, from 1944 until 1949, the general salary level was readjusted annually, by substantial amounts, as can be seen from the following figures:

Percentage annual increase from average of previous year

	Wage bill	Cost of living
1944	17	-
1945	14	19
1946	36	19
1947	42	12
1948	36	13
1949	34	32
1950	20	25
1951	30	37
1952	23	39
1953	11	4
1954	15	4
1955	13	12
1956	19	14
1957	22	25
1958	45	32
1959	62	114

Source: Central Bank, Producto e ingreso de la República Argentina, 1935-54 and Boletín Estadístico.

/An increase

An increase in wage rates which merely equalled that in prices could not be considered an autonomous source of inflation. Indeed, because of improvements that always occur in productivity, it would permit the rise in prices to slow up. But as the data show, the movements of wages and prices have been far from parallel in the last fifteen years in Argentina. 31/

This has meant that real wages have fluctuated violently. An increase in real wages in a sector which paralleled the upward trend in productivity could be considered in a sense 'neutral'. 32/ So the fluctuation which occurred in Argentina meant that the influence of wage increments, predominantly a result of policy decisions in this period, were far from neutral in their effect. Figure VII compares the movements in hourly real wages and in productivity in the manufacturing sector. From 1946 to 1950, real wages climbed much the quicker of the two, but in 1950 the picture was reversed. Then after another climb in real wages, climaxing in the general wage increase of 1958, there was once more a sharp reversal, and real wages in this sector finally fell back to about the same relation vis-à-vis productivity as in 1943.

It might therefore be concluded that over the whole period the influence of wage changes has been neutral. In fact, however, apart from any other element - and certainly there were others of importance in Argentine experience - this sequence of events militated against the stability of the economy. Wage policy, particularly in the later years of the 1940's, pushed up costs of production and helped initiate a chronic inflationary condition.

The characteristics of policies in various fields which have been outlined, apart from the general considerations mentioned at the beginning of this section, bring out some of the fundamental weaknesses of policies followed by countries in the region, especially those most affected by inflationary pressures.

31/ The figures given refer to total wages, but they reflect movements in wage rates.

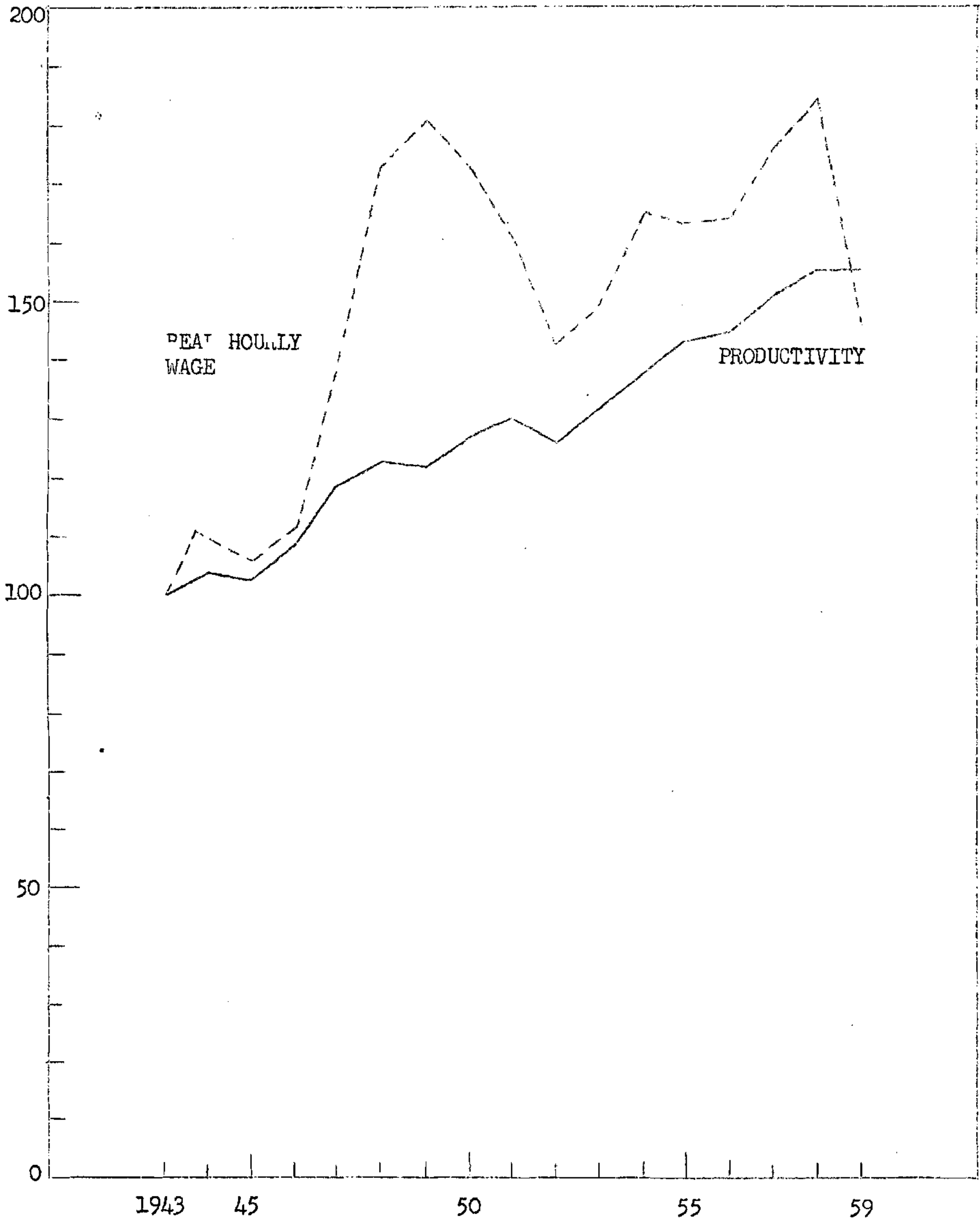
32/ If it occurred in all sectors it would imply, ceteris paribus, a constant share of wages in national income.

/4. Failures

FIGURE VII

ARGENTINA : COMPARISON BETWEEN REAL WAGES AND PRODUCTIVITY IN MANUFACTURING, 1943 - 59
(Indices 1943 = 100)

Natural scale



<u>Sources:</u> <u>Statistical Bulletin</u> (Central Bank).
<u>Monthly Statistical Summary</u> (Ministry of Trade).

4. Failures of co-ordination

One is the consistent failure to relate different types of policy to each other. Decisions on import controls, exchange rates, development projects, rates of taxes, credit, wages, and so on, have been taken without consideration of their mutual implications. It seems that individual ministers often take decisions on the economic issues that face them without consulting their colleagues. In a tight situation, like that of most Latin American countries since the depression, a major decision in any one field changes the balance of considerations in all the others. Thus the extent of a wage increase in the economy will affect what tax rates need to be levied, what exchange rate will be viable, and so on. This lack of co-ordination has greatly aggravated inflationary tendencies. Where it has proved impossible for the proposals of various authorities to be reconciled by one or more of them agreeing to take action that would be politically unpopular, the final result has been that the demands on the economy have exceeded its resources. A second failing which helps to explain the first, is the lack of overall economic development plans. If these had existed, it would have been easier to see the significance of policies in particular fields, and to have kept to certain priorities. In particular, import substitution would then have followed more consistent and more rational lines.

5. Relevance of foreign examples

Another weakness, evident from the history of the past three decades, is that there have been "fashions" in the objectives of policy. Moreover, these fashions have mostly been imported - often with some time-lag - from overseas. The "demonstration effect" can be seen in official attitudes in peripheral countries, as well as in patterns of consumption. The attempt to ensure stability by keeping the currency on a conventional gold standard was followed by a period of increasing recourse to deficit finance. In the war years, efforts were made to suppress inflation by price control, and subsequently doctrines of full employment and social welfare had their impact on the region.

It can hardly be over-emphasized that these ideologies were developed to solve the problems of industrial countries, and subsumed the structural features of such countries. Thus the theoretical case for stimulating an

/economy by

economy by deficit finance rests on the assumption of elastic supply conditions throughout the economy, so that expenditure could be increased without either raising production costs or causing a big increase in imports. This is true of highly developed countries at times when demand in nearly all sectors is less than would fully employ the labour and capital available. But the same assumption is hardly valid for countries like those of Latin America: even if there is spare capacity locally to satisfy increases in certain types of demand, there are limits to the expansion of output in some sectors, and a wide range of products can only be obtained from abroad. The consequence, therefore, is inflation and/or a payments deficit.

Similarly, those drawing up schemes for price control seem to have ignored the fact that they would only work if the public service was organized to administer them. Experience abroad shows that prices have to be fixed on the basis of careful study and judicious criteria; that they have to be comprehensive (otherwise excess demand spills over on to uncontrolled items), that they have to be backed by extensive rationing of supplies; and that they require the full support and co-operation of all sections of public opinion, especially trade unions and business men.

Raising the levels of living of the masses can naturally go further in economies which are more highly developed, and better balanced. A condition for extensive schemes of social security is that incomes should exceed consumer needs by a sufficient margin to provide the means for financing both development and welfare. It is also implied that the fiscal machinery is effective enough to collect the finance which is needed for all forms of government expenditure, and that there are spare resources of administration available to cope with all individual cases under welfare legislation.

6. General appraisal

How much damage did misguided policies do? The first thing to make clear is that however bad the policies of Governments in the region were, the originating causes of Latin America's problems were the world depression, the Second World War, and the slowing-up in the growth of the industrial countries in the 1950's. Really, therefore, the question is rather this: given the adverse developments in world markets, to what extent have the

/difficulties undergone

difficulties undergone by Latin American economies been due to the failure of Governments' policies or coherent development plans?

The most obvious possibility would have been to increase export earnings. The difficulty was that, in each period, the total sales of primary products depended on the needs of the industrial countries. All primary producing areas suffered more or less severely from these developments. It would of course have been possible for Latin America to gain markets from other areas, though the discrimination by France and the United Kingdom in favour of suppliers in the franc and sterling areas, together with the heavy subsidies and protection given by the industrial countries to their own primary producers limited what could be done in this respect.

It would also have been possible for individual countries in the region to gain ground at the expense of others. In fact, it can be seen from table 4 that the countries of Group O did very much better than those of Group U in the 1950's.

It cannot be concluded, however, that the whole region could have done as well as Group O. Their performance was due in part to the strong markets for two products, petroleum and bananas. Moreover, a small producer can push higher exports on to the market without drastically affecting the price. This special advantage is reflected in the international coffee agreements. Thus, in the first agreement of the current series (1958), Brazil accepted the responsibility of keeping 40 per cent of its exportable coffee out of traditional export channels, while the proportion applicable in the case of Colombia was 15 per cent, and the countries of Central America and the Caribbean had to retain less than 10 per cent. It is also interesting to note that even among dollar-standard countries, a large sugar producer - Cuba - fared much worse with its exports in the 1950's than small ones, such as the Dominican Republic.

Attempts by major exporters to force the pace of exporting, would probably have brought about a fall in prices for many exports, and almost certainly a decline in the foreign exchange earnings of competitors, including those in the region. So the total value of Latin America's exports would have been more likely to fall than to rise.

/It is

It is true that policies in Group U countries were often such as to discourage exports, in some cases needlessly so. To the extent that price or exchange policies hampered exports, or industrialization reduced exportable surpluses (as it did for Brazilian cotton), or income taxes discouraged the exploitation of minerals, export stagnation must be attributed to these policies. But it is difficult to believe that with different policies the export performance of the whole region would have been so much better that it would have induced by itself a satisfactory rate of growth. The purchasing power of all the primary product exporters in the world rose by less than 20 per cent in the 1950's.

Some action was therefore necessary to enable the income of the partially industrialized countries of this group to increase at a faster rate than their exports. The growing realization of the nature of the challenge to the region led to the appearance of economic doctrines which took as their starting-point the need for development and industrialization, and which were therefore more specifically Latin American in their orientation. A shift of emphasis was taking place, in favour of Governments' accepting the responsibility for economic growth, expressed in programmes to achieve certain necessary targets. The acceptance of this responsibility was not, however, matched by the realization that all aspects of policy had to be judged in the light of their contribution to the end in question. The necessity for policy to be expansionist was on occasion interpreted as meaning that it need not be disciplined or guided by strict principles.

In the last two or three years, trends in opinion overseas have made their influence felt once more. This time they tended in the opposite direction, towards restrictive and deflationary policies. Partly as a reaction to the sharp inflation that had developed, and partly because of the need for financial assistance, this shift too was reflected in Latin American policies.

In Western Europe and North America, the expansionist and egalitarian attitude of the early post-war years was already, in the early 1950's giving ground before the twin targets of price stability and balanced external payments, implying a quite different balance of economic policy. Direct controls had fallen out of official favour, and the main policy

/instruments used

instruments used were fiscal and monetary. This was, in fact, the reappearance of the gold standard in a modified form. In some countries of Latin America, too, stabilization policies were adopted. [33] Major attempts were started on the recommendations of foreign missions in Chile and Peru, and by the end of the decade, similar programmes were being carried out in Argentina, Bolivia, Colombia and Uruguay. In Chile and Peru further stabilization programmes were being put into force.

Once again, it is not clear that the differences between the developed countries and the countries of Latin America have been fully taken into account. Monetary policy is only likely to be a successful regulator of the economy where the following conditions apply: an integrated economy with competition in the markets for the factors of production and products; responsiveness of both investment and savings to changes in the rate of interest; a distribution of income that reflects human needs; full employment of labour; and exports which can be promoted or discouraged by changes in home consumption. Merely to list these assumptions is to indicate that they are not particularly applicable in the countries of the region. Moreover, the financial systems of Latin America are not at present very suitable for the administration of policies of financial restraint. As has been shown, there is not the range of monetary devices (such as open-market operations and consumer credit control) which would enable monetary policy to be both balanced and flexible, and they cannot easily be developed so long as the habits of inflation prevail.

The immediate cost of stabilization programmes has generally been a lowering in the level of economic activity, with declines in both investment and consumption. The attempt to remove the excess of demand from all sectors implied a great reduction in its total, leading to inadequate demand in some of them. At the same time, the removal of price distortions, which were certainly in many cases severe temporarily accelerated the rise in prices.

33/ These are discussed in a paper by Raúl Prebisch in Economic Bulletin for Latin America (Vol. VI, 1), entitled: "Economic development or monetary stability: the false dilemma".

/Stabilization policies

Stabilization policies have usually failed to include, as an integral part of the programme, measures to stimulate the lagging sectors of the economy, and to achieve import substitution of the right type. Indeed, policies of this sort have not always been put into effect with a careful assessment of their likely effects on investment in various sectors, and of whether these effects correspond to the country's needs. There is therefore no assurance that growth will be resumed in the near future or that when it is resumed it will be free from further inflation, and renewed balance-of-payments pressures.

It seems that opinion is changing again in the industrial countries themselves. Confidence in monetary policy as the main instrument of economic strategy has weakened somewhat. Thus, the Staff of the Joint Economic Committee of the United States Congress point out that prices have continued to rise slowly, despite the firm monetary policy followed from 1953 to 1958. "Given rapid shifts in demand, with an excess now in one sector, now in another, but with total demand not in excess, and the prevalence of market power and downward rigidities, monetary policy can stabilize the price level only if used in such drastic measure that a high level of unemployment is also generated". 34/ Moreover, the ultimate test of policy in the industrial countries is increasingly whether the rate of growth is adequate to the country's needs. Although the balance of emphasis in policy, and the machinery for carrying it out, would naturally have to be very different in Latin America, this criterion is of course particularly appropriate for countries beset by poverty and by a rapid rate of increase in population.

34/ Congress of the United States, Staff of the Joint Economic Committee, Report on Employment, Growth and Price Levels, December 1959. See also Report of the Committee on the Working of the Monetary System (Her Majesty's Stationery Office, 1959), for rather similar conclusions on experience with monetary policy in the United Kingdom.