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LATIN AMERICAN ECONOMIC DEVELOPMENT: 1950-1980

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ABSTRACT

The paper stresses the evolutionary and adaptive experience of Latin American growth between 1950 and 1980, and provides a synthetic view by considering the sources of growth within a simple production framework. Regressions use quinquennial panel data for 18 Latin American countries. They provide an estimate of the net return to investment, of the elasticity of output to labor and of the contribution of other variables with influence on efficiency. The regressions show that Latin American growth varied systematically with trade performance.

The paper provides information on the effects of inflation upon per capita income growth in the region. There is a negative correlation: an inflation rate of even 20 percent reduces the per capita growth rate by 0.4 percentage point, or almost 15 percent of the regional mean of 3 percent growth between 1950 and 1980. This result does not hold, however, once high inflation observations are excluded.

Finally we call attention to the persistent problems of income distribution and poverty.

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I. INTRODUCTION

In the thirty years between 1950 and 1980, Latin America experienced rapid growth. During this period, output as measured in adjusted purchasing power terms, expanded at an annual rate of 5.8 percent, with per capita increases averaging 3 percent a year. Table 1 provides country detail. The clear star performer is Brazil, whose share in regional product increased from less than a quarter to more than a third. At the other extreme are two groups. One is the Southern Cone, Argentina, Chile and Uruguay, whose 1950 leading position in the region was eroded by much less than normal performance. The other laggards include a variety of smaller countries, several in Central America.

The average Latin American record, viewed from immediate post-World War II perspective, is impressive. The target of the Alliance for Progress, implemented in 1961, was an annual rate of 2 percent per capita. European per capita income growth in the aftermath of the Industrial Revolution was 1.3 percent from 1850 to 1900 and 1.4 percent between 1900 and 1950. Long term United States economic growth has been at 1.8 percent.

Yet two factors combine to make the 1950-1980 Latin American growth performance seem less positive. One is its dramatic reversal in the 1980s. Latin America has retrogressed in this decade, with product falling at a rate of 1.4 percent, as recorded in table 1. This is a generalized regional

Table 1 : Per Capita Gross Domestic Output and Growth Rates of Latin American Countries[a]
(percent and dollars of 1975)

	Share in Total Population (percent)	Share in Regional GDP (percent)		GDP per Capita Dollars of 1975		Growth Rate of GDP per Capita (percent per year)	
	1980	1950	1980	1950	1980	1950-80	1980-88[c]
Brazil	35.6	22.2	34.2	637	2,152	4.2	0.2
Mexico	20.2	18.5	23.1	1,055	2,547	3.0	-1.3
Argentina	8.0	21.2	11.8	1,877	3,209	1.8	-1.9
Colombia	7.5	7.2	6.3	949	1,882	2.3	1.4
Venezuela	4.3	7.2	7.1	1,811	3,647[e](3,310[f])	2.4[e](1.5[f])	-1.8
Peru	5.1	4.9	3.9	953	1,746	2.1	-1.7
Chile	3.2	5.7	3.4	1,416	2,372	1.8	0.2
Uruguay	0.8	3.1	1.2	2,184	3,269	1.4	-1.2
Ecuador	2.3	1.4	1.6	638	1,556	3.1	-0.9
Guatemala	2.0	1.6	1.2	842	1,422	1.8	-2.4
Dominican Rep.	1.7	1.1	1.1	719	1,564	2.6	0.2
Bolivia	1.6	1.4	0.8	762	1,114	1.3	-3.3
El Salvador	1.3	0.8	0.5	612	899	1.3	-1.9
Paraguay	0.9	0.8	0.7	885	1,753	2.4	-0.4
Costa Rica	0.6	0.5	0.6	819	2,170	3.3	-1.1
Panama	0.5	0.5	0.5	928	2,157	2.9	-3.0
Nicaragua	0.7	0.5	0.4	683	1,324	2.3	-3.4
Honduras	1.0	0.6	0.4	680	1,031	1.4	-1.8
Haiti	1.6	0.8	0.2	363c	439	0.7	0.0
Latin America[b]						3.0[e](2.7[f])	-1.4

[a] Countries ordered by average share in regional GDP between 1950 and 1985;
[b] Latin America except Cuba; [c] 1960; [d] preliminary;
[e] Venezuela data adjusted for changes in the terms of trade; [f] Venezuela data not adjusted for changes in the terms of trade.

Note: The growth rate of Venezuela's per capita GDP between 1950 and 1980 is 1.9 percent per year in IMF: IFS. For Chile and Honduras, the average growth rate per capita per year from Summers and Heston is 0.004 higher than in IMF: IFS, and for Nicaragua it is almost 0.01 larger. The average for Latin America is practically unaffected by the growth rates of Honduras and Nicaragua due to their small share in the population of the region.

Sources: Robert Summers and Alan Heston, "Improved International Comparisons of Real Product and its Composition: 1950-1980," Review of Income and Wealth, June 1984; and ECLA, Preliminary overview of the Latin American Economy, 1988.

phenomenon. By 1988, with the exception of Brazil, Chile, Colombia and the Dominican Republic, per capita GDP had fallen below its 1980 level. At the extreme, Venezuela, Nicaragua and El Salvador show levels below those attained in 1960. The 1980s have truly been a lost decade, and one underestimates earlier achievement.

The second circumstance diminishing the accomplishment from 1950 to 1980 has been the surging performance of the Asian countries. Led by the four newly industrializing countries of South Korea, Hong Kong, Singapore and Taiwan, but extending to many others, Asia has vaulted ahead in the 1980s at an average annual per capita rate in excess of 5 percent. This contrast has now been widely interpreted as proving the errors of the import substitution strategy favored by Latin America through much of the post-War period. Two of the pillars of that strategy were emphasis upon industrialization through governmental intervention and barriers to trade.

Commentators have recently argued forcefully against both. Angus Madison(1985) contends:

> "The economic growth performance of Latin America since 1973 has been abysmal...there has...been a certain continuity in economic policy attitudes since the 1930s and the liberal international order which was created by OECD countries and has influenced policy in Asia has left them virtually untouched."

Deepak Lal's (1985) rejection of state intervention is another that many now find attractive:

> "The most serious current distortions in many developing countries are not those flowing from the inevitable imperfections of market economy but the policy induced, and thus far from inevitable, distortions created by irrational <u>dirigisme</u>."

Understanding the post-war experience is thus important for policy prescriptions that are currently being debated within Latin America. In this paper we re-examine these three decades to provide a context for discussion of the future. In section II, we analyze the sources of growth, stressing the evolutionary and adaptive experience of the region over these three decades. In section III, we take a closer look at the inflationary process within the region and its determinants. In section IV, we call attention to the grave and persistent problems of income distribution and poverty that these three decades of overall growth failed to eliminate. Inequality and a significant part of the population with inadequate nutrition, health care and housing reflect another side of the failure of the Latin American development process that has received too little attention in recent years. The last section briefly considers the implications of our conclusions for the present policy discussion.

II. SOURCES OF GROWTH

During the 1950s, most Latin American countries moved toward an import substitution strategy.[1] They chose this path because it seemed to fit. After the Great Depression of the 1930s and the disruption of the second world

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[1] There is a vast literature on the economic development of Latin America. See, for instance, Baer (1977), Corbo (1988), Dietz (1987), Fishlow (1972), Foxley (1976), Hirschman (1987, 1968), Klaren (1986) and Sheahan (1987).

war, followed shortly thereafter by the Korean War boom and bust, the international economy did not seem to be a propitious engine of growth. Nor did the United States place economic development and Latin America high on the agenda; the Marshall Plan instead gave priority to Europe and the Cold War.

Latin American economic writing and practice, influenced but not determined by a group of economists working at the Economic Commission of Latin America in Santiago under the leadership of Raul Prebisch, emerged against this backdrop. These contributions amended the orthodox view of economic growth through comparative advantage and capital accumulation in three ways: the specification of macroeconomic adjustment, the identification of microeconomic distortions and, following from the above, a strong role for government intervention.

Attention to the foreign exchange constraint rather than savings as the determinant of growth in peripheral countries was the principal macroeconomic novelty. In a world where the terms of trade moved against traditional primary export products,[2] domestic production would have to substitute for non-essential imports, leaving the foreign exchange for the needed inputs. Moreover, while technical progress in agriculture would leave labor unemployed, dynamic industry could absorb the growing population with increasing productivity and incomes. Domestic production required protection

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[2] See Grilli (1988).

against imports and deliberate bias against exports of resources that move into industry.

In the microeconomic sphere, there was stress on imperfections and discontinuities, both of which impeded effective operation of price signals. Whether in agriculture, where land concentration was notorious, or in industry where new privileges provided shelter from market forces, the competitive model was flawed.

These macro- and microeconomic conditions militated in favor of a strong state presence. Regulation and direction were needed. Development was a consequence of policy, not a natural evolution. Conscious and comprehensive planning was desirable; the Economic Commission of Latin America pioneered in the application of input-output models in the region.

Import substitution was a disequilibrium development strategy. It confronted three limitations that increasingly impacted upon performance toward the end of the 1950s. One was deterioration in the balance of trade, the second was sectoral imbalance, and the third was deterioration of the public sector accounts.

Protection led to overvalued exchange rates and hence taxes on exports. The consequence was an eventual reduction in export supply. Industrialization in turn required increased inputs of capital goods and intermediate imports. As trade deficits increased, foreign investment became a critical requirement, not only for its modern technology but also its provision of foreign exchange. This was an ironic and unanticipated

consequence of a strategy deriving its strong political appeal from its emphasis upon national productive capability.

In sectoral terms, import substitution policies exaggerated industrial growth at the expense of agriculture, with three consequences. First, food prices were kept artificially low, benefiting urban incomes at the expense of rural incomes. Second, relatively capital intensive manufactures absorbed only a diminishing fraction of the increment in the labor force, swelling the service sector and placing pressure on government to serve as an employer of last resort. Third, physical targets dominated cost effectiveness calculations; it was as though the higher shadow price of foreign exchange justified any project.

The third disequilibrium was fiscal. As the initial real resources taxed away from primary exports began to give out, subsidies to industrial investment had to come from explicit taxes. At the same time, government responsibilities had increased, placing new pressures upon the budget from the expenditure side. Monetization of the deficit was an irresistable lure and one with nineteenth century precedent in Latin America. Inflation and need for stabilization began to lurk as a problem in several countries toward the end of the 1950s.

These disequilibria were temporarily averted by the Alliance for Progress. New inflows of official capital simultaneously helped with the external accounts and public sector deficits, while PL 480 imports eased supplies of food. Governments also attempted to correct some of the policy excesses by more realistic exchange rates and greater promotion of exports.

These efforts were not enough. By the mid-1960s, the Alliance was itself faltering, the victim of changing policy perceptions in the United States and Latin America alike. Reforms were not easy nor were resources unlimited. More orthodox policies became the order of the day, frequently under military tutelage, setting the stage for a new phase of economic expansion.

The limits of the import substitution strategy were recognized. Important modifications to commercial policy were introduced in the 1960s. Tariffs were frequently reduced, especially in the highest categories. Crawling peg exchange rate systems accommodated to high domestic rates of inflation and averted the overvaluation earlier so predominant. Explicit concern for inducing non-traditional exports produced special export subsidy programs in many countries during the period after 1965. In the context of a more bouyant international market, such reinforcements produced positive results and export growth and diversification in the region increased.

At the same time, larger private capital inflows were an option for which several countries of the region were eligible. From the end of the 1960s and reinforced by the oil surpluses after 1973, the Euro-dollar market was in pursuit of new takers and found many of them in the region. Governments could finance both more imports as well as larger public sector deficits.

Domestic policies tended to retreat somewhat from regulation and prices were given greater scope to direct resources. Still, the commitment to industrialization remained. And that meant an intrusive role for the public

sector even under the "orthodox" policies pursued by military governments. The Brazilian "miracle" was a clear lineal descendant of import substitution, not to be confused with an outward orientation. The large domestic market still dominated production decisions.

This period of adaptation and relatively successful adjustment of the earlier model (growth rates showed improvement generally and not only in Brazil) was brought to an abrupt end by the international disequilibrium ushered in by the oil price rise in 1973.

The post-oil shock experience in the region was substantially conditioned by mounting indebtedness and deterioration of domestic policy in a more difficult external environment. This period saw the rise of international monetarism as a means of reducing inflation in the Southern Cone countries, at the expense of a substantial increase in external liabilities. It saw growing indebtedness of oil producers based upon the new greater value of oil in the ground. Finally, it saw Brazil labor under its progressively larger service payments and domestic pressures to sustain its exhilarating pace of industrial expansion. For the region as a whole, output growth slowed in the 1970s, but remained at satisfactory levels.

The precariousness of the Latin American economies only became fully apparent when a new oil price rise, an abrupt increase in real interest rates and an OECD recession coincided in the early 1980s. Countries of the region had badly chosen their adjustment style after 1973. It was not simply that they blindly followed the original import substitution bias of the 1950s,

as Maddison has argued. Rather it was their specially asymmetric opening to the world economy, featuring vast financial flows with much more limited trade penetration. And new fiscal distortions reduced the room for maneuver. To make growth continue in the late 1970s, government deficits were incurred that could no longer be so easily financed. Stop-go macroeconomic responses could be found in a much larger number of countries during this period. They were but prelude to the stop-stop policies that ultimately came to be necessary in the 1980s.

A useful synthetic view of this period as a whole is provided by considering its sources of growth within a simple production framework. Table 2 summarizes the regression results. The regressions use quinquennial panel data for 18 Latin American countries.[3] They provide an estimate of the net return to investment and the elasticity of output to labor as well as of the contribution of other variables with potential influence on differential efficiency. Thus, a higher rate of increase of exports might be expected to provide externalities over and above the direct contribution to output; that is, of course, one of the central tenets of the argument in favor of a more outward development strategy. The same kind of externalities might be expected from imports in a structuralist foreign exchange constrained situation.

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[3] All Latin American countries except Cuba and Haiti, for lack of data. The countries are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, Venezuela.

Two key results emerge from table 2. First, a straightforward two factor approach, here labeled neo-classical, is markedly inferior to an augmented definition of the production function that includes other variables reflecting the degree of success in integration into the international economy. Latin American growth required more than increased capital formation. It also varied systematically with trade performance.

Both export expansion and the growth rate of imports clearly mattered. Exports were significant not only for their contribution to productive efficiency, but also because higher earnings could avert recurrent stabilization crises with adverse effects on output growth. More novel is the finding that availability of imports exerted an independent influence. Import substitution, successfully pursued, required imported inputs. Countries, unable to obtain them and forced to curtail their foreign purchases excessively, suffered. This access to imports, both through export earnings and foreign finance, differentiated the successes from the failures. This is where Brazil and Mexico diverged from the Southern Cone experience.

Second, the evidence in table 2 strongly suggests that three different sub-periods corresponding to different internal policies and external conditions can be distinguished. The dummy variables are highly statistically significant. The differences among these three periods are clarified in the following three tables. Table 3 summarizes the sources of growth for the 1950-65 period, table 4 shows the equations for the decade 1965-75 and table 5 presents those for 1975-80.

Table 2: Growth, 1950-1980
Latin America[a]

	Neoclassical			Augmented		
Constant	0.79	0.54	-0.97	-0.13	-2.50	-0.48
Investment Share in GDP	0.09 (1.94)	0.11 (2.42)	0.11 (2.45)	0.07 (2.22)	0.11 (3.36)	0.10 (3.19)
Growth Rate of Labor Force	0.98 (3.22)	1.02 (3.39)	1.06 (3.45)	0.69 (3.06)	0.80 (3.75)	0.73 (3.41)
Growth Rate of Exports Volume				0.22 (6.47)	0.21 (6.85)	0.22 (6.88)
Growth Rate of Imports Volume				0.14 (5.00)	0.16 (5.99)	0.15 (5.69)
Dummy 1			1.49 (2.31)		1.97 (4.36)	
Dummy 2			1.15 (1.76)		1.32 (2.90)	
Dummy 3		-1.33 (-2.22)				-1.65 (-3.91)
R^2	0.19	0.23	0.23	0.57	0.64	0.63

[a] 18 countries; all Latin American countries except Cuba and Haiti; N = 108.
Each observation corresponds to a five-year average. t-statistics in parentheses
Dummy 1 = 1 for 1950-1965, and 0 otherwise.
Dummy 2 = 1 for 1965-1975, and 0 otherwise.
Dummy 3 = 1 for 1975-1980, and 0 otherwise.
Data from ECLA, Statistical Yearbook, 1983 and 1986; and investment ratios from Summers et al., opus cit.

Table 3: Growth, 1950-1965

	Neoclassical	Augmented
Constant	-1.45	-2.22
Investment Share in GDP	0.13 (2.55)	0.20 (4.71)
Growth Rate of Labor Force	1.77 (4.14)	0.95 (2.95)
Growth Rate of Exports Volume		0.13 (3.61)
Growth Rate of Imports Volume		0.16 (5.09)
Government Share in GDP		0.02 (0.66)
R^2	0.43	0.74

18 countries; all Latin American countries except Cuba and Haiti. N = 54.

Table 4: Growth, 1965-75

	Neoclassical	Augmented
Constant	0.99	0.39
Investment Share in GDP	0.11 (1.14)	0.06 (0.73)
Growth Rate of Labor Force	0.82 (1.60)	0.44 (1.23)
Growth Rate of Exports Volume		0.28 (4.42)
Growth Rate of Imports Volume		0.21 (3.86)
Government Share in GDP		-0.02 (-0.25)
R^2	0.16	0.64

18 countries; all Latin American countries except Cuba and Haiti. N = 36.

Table 5: Growth, 1975-80

	Neoclassical	Augmented
Constant	0.73	-2.72
Investment Share in GDP	0.07 (0.48)	-0.03 (-0.33)
Growth Rate of Labor Force	0.81 (0.94)	1.51 (2.77)
Growth Rate of Exports Volume		0.33 (3.38)
Growth Rate of Imports Volume		0.16 (1.63)
Government Share in GDP		0.01 (0.09)
R^2	0.11	0.74

18 countries; all Latin American countries except Cuba and Haiti. N = 18.

In each period, the augmented formulation performs much better than the neo-classical formulation in its explanation of output growth. In each period, the interface with the international economy provides essential information. By contrast, sheer size of the current purchases of the public sector -- estimates of its investment are included in the investment ratio -- does not seem to matter.

There are also differences between periods. Especially noteworthy is the increasing contribution of export performance over time. Latin American exports until the mid-1960s were almost exclusively primary exports. Although world trade prospered in the 1950s, it was newly oriented to the exchange of manufactured products among industrial countries. Primary prices were quite weak between 1955 and 1965: real export volume growth of 5 percent per year until 1963 for all non-oil developing countries translated into growth of purchasing power of only 2 percent per year. In the following two periods, and especially after the oil price increase in 1973, export capability played a much greater part in determining aggregate growth.

At the same time, successful import substitution enabled the larger and more rapidly growing economies to compress import requirements. After 1975, policy was already consciously addressed to this objective in most countries of the region, and new protective barriers were erected. In contrast to the coefficient for exports, imports exhibit a decline in importance in the last sub-period.

The disaggregation also points to a falling significance of investment. The estimate of the rate of return declines from not always

productive, accumulation of capital under the impulse of increased foreign savings. Many of the projects were longer term, moreover, and did not have a principal impact in the shorter term. Later adjustment difficulties meant that much investment never contributed.

The statistical analysis thus confirms an important association between the level of output growth and successful Latin American integration into the international economy.

III. INFLATION

Another special feature of Latin American development is the ubiquity of inflation. Table 6 presents the Latin American record of inflation over this 30 year period. Two inferences are direct. One is a clear distinction among countries; the other is the tendency for price increases to accelerate over time.

Some countries in the region are recurrent offenders, while others, because of the discipline of fixed exchange rates, have largely avoided highly inflationary episodes. Among the former, Argentina, Chile, Brazil and Uruguay stand out. The small countries of Central America largely fall into the latter camp; at an extreme is Panama, without its own currency issue. Virtually alone among countries of the region, Colombia has managed to avoid surges of runaway inflation while sustaining a moderate average.

Table 6: Inflation Rates in Latin America
(Consumer prices; percent per year, average in the period)

	1950-1980	51-55	56-60	61-65	66-70	71-75	76-80	81-85
CHILE	76.9	43.1	28.6	26.8	26.4	265.9	82.5	21.5
ARGENTINA	63.0	19.5	39.6	23.3	19.7	72.0	211.0	382.4
URUGUAY	41.6	11.8	23.6	30.7	65.1	71.2	56.7	45.9
BOLIVIA	33.9	70.6	83.2	5.2	5.9	22.5	18.0	2692.4
BRAZIL	33.2	16.8	25.7	62.3	27.7	21.2	52.0	153.9
PARAGUAY	18.7	54.7	12.3	5.4	1.3	11.8	15.0	15.9
PERU	16.2	7.3	8.4	8.9	9.8	12.8	51.1	104.9
COLOMBIA	13.9	5.7	9.4	12.9	10.1	18.1	24.5	22.4
MEXICO	9.0	9.3	5.9	1.8	3.6	12.3	21.4	62.4
ECUADOR	6.0	2.9	-0.1	4.0	5.0	13.6	11.7	28.1
EL SALVADOR	5.2	5.9	0.4	0.2	1.1	8.9	12.8	14.7
COSTA RICA	4.8	2.2	1.5	2.1	2.6	14.1	8.2	37.4
DOMINICAN REP.	4.4	1.5	0.1	2.8	1.3	11.0	10.0	16.9
HONDURAS	4.2	7.4	-0.6	2.7	2.0	6.4	9.8	7.0
GUATEMALA	3.9	1.9	-0.1	0.1	1.5	8.7	10.7	7.7
VENEZUELA	3.7	1.3	2.4	0.4	1.6	5.7	11.3	11.1
PANAMA	2.7	0.6	-0.1	0.9	1.6	7.3	6.9	3.3

Sources: IMF, International Financial Statistics, except for 1960 and 1961 in Chile.

With the oil price shock in 1973 came a new set of inflationary pressures. Higher international prices of imports were magnified by nominal devaluations in several countries. Despite slower growth, inflation showed a tendency to increase. But, as Table 6 indicates, much larger effects were to be felt after 1980. In the midst of real declines in per capita output, inflation attained much higher levels than ever before in the post-War period.

Monetarism and structuralism are the two basic interpretations of inflation in Latin America and two corresponding programs for stabilization are derived from them. According to monetarism, inflation is the result of overspending: inflation in Latin America is thus caused by large budget deficits financed by money creation. The private sector, while crowded out, seeks to sustain its position. To stop inflation, budget deficits must be cut.

Structuralism, the opposing view, maintains that budget deficits are not at the heart of the matter. The basic causes of inflation lie in supply shortages, bottlenecks and inconsistent claims of different groups in society trying to get a larger share of the pie. Fiscal and monetary policy are accommodating. For structuralists, administered controls on prices and wages become the central component of stabilization policy. This is the only way to stop inflation.

Both diagnoses of inflation are incomplete and thus their remedies have consistently failed.[4] From the 1950s to the 1980s Latin America suffered

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[4] See Cardoso (1989) for a brief summary and references.

from the application of numerous stabilization programs.[5] These three decades have seen more inflation acceleration than successful reduction. Within this period, the most effective deceleration was the Chilean in the 1970s. It was, however, associated with special political circumstances and a flawed reliance on fixed exchange rates that helped trigger a massive decline in income in the early 1980s.

The results from stabilization attempts were, in general, unsatisfactory. Most typically, temporary reductions in inflation and external deficits were combined with large increases in unemployment and a reduction of the labor share in output. Pastor's (1987) empirical analysis of the International Monetary Fund programs in Latin America in the period 1965-81 finds that Fund programs had mixed impacts on growth rates, led to rising inflation and were associated with declines in the wage share. Equally important, and for these reasons, the programs could not be sustained in their implementation. Reaction against the IMF in Latin America has a long history; it is not merely a product of the debt crisis.

The Brazilian experience in the mid-sixties is now often cited as an example of a successful orthodox program. There are two caveats. First, it should be recognized that the stabilization program of mid-1960s in Brazil was not strictly orthodox, as it did make use of price and wage policy. Real wages

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[5] Stabilization programs were implemented, for instance, in Chile (1956-58, 1973-78), Argentina (1959-62, 1976-78), Bolivia (1956), Peru (1959, 1975-78), Uruguay (1959-62, 1974-78), Mexico (1983) and Brazil (1964-68, 1982-83).

were supposed to be maintained at their previous average level. Instead they became the residual factor when inflation proved to be resistant to application of restrictive fiscal policy. Prices were subject to some controls as well as held in check by the incentive of favored access to credit. As a consequence of these efforts inflation did decline between 1964 and 1966; in a final stage, a further reduction was facilitated by renewed growth and productivity increases.

Second, there was a high cost borne by the wage earners whose residual claim on income helped to make stabilization possible. The objective is not only to reduce inflation, but at minimal expense. In this case, the burden fell not so much upon output as upon real wages and a deterioration of the income distribution. Such wage compression was enforced, as in Chile, by political repression.

In the late 1970s, in part because previous policies had not been effective, a new and more radical policy direction became popular in the Southern Cone. Restoring the role of free markets became the dominant ideology of neoconservantism. Its strategy consisted of: 1) freeing prices, 2) eliminating quantitative restrictions on trade and reducing tariffs, 3) promoting a domestic capital market by freeing interest rates and eliminating controls over the allocation of credit, 4) promoting the free entry and exit of capital and 5) reducing the participation of the public sector in production.

Ramos (1986) offers an excellent guided tour through the ups and downs of the neoconservative experience in Argentina, Chile and Uruguay.[6] What distinguishes the neoconservative programs in the Southern Cone in the late 1970s from other orthodox programs is the reliance on the exchange rate to achieve disinflation. The neoconservative approach is based on global monetarism. This theory maintains that a fixed exchange rate determines the prices of tradables and becomes the central price around which price expectations can be formed. A fixed exchange rate is thus the basic vehicle of disinflation, while fiscal discipline restricts demand and avoids undermining the program.

Theory diverges from practice because of significant lags and a limited degree of import competition. So long as there is inflation inertia, non-tradable prices are not frozen and domestic tradable prices are not set by international prices, overvaluation will occur. Overvaluation in turn implies large current account deficits and stimulates capital flight. The accumulation of debt, and its service, becomes so great as to force a policy reversal. An inevitable devaluation provokes another round of inflation.

The Argentine experience is prototypical. At the beginning of 1976 in Argentina, inflation had reached 400 percent when, once again, the military took power. Martinez de Hoz was in charge of the economic team for five years.

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[6] See also the special issues of Economic Development and Cultural Change (1986) and World Development (1985).

The first phase of the disinflation program relied on wage controls. At the same time, the fiscal deficit was gradually reduced. These policies brought about favorable results on the inflation front. In December 1978, a new price-stabilization program was instituted. The resultant reduction of inflation was bought at the price of a huge overvaluation. By 1981, the overvaluation had precipitated massive capital flight and external debt. The collapse of the exchange rate that followed brought about a new inflationary surge. Using the exchange rate as a principal tool to combat inflation can lead to highly unstable outcomes.

The most recent experiences of Argentina, Brazil and Mexico in the 1980s afford an interesting continuity despite their new dimension of a large external debt. They help underline the key role played in Latin American inflation during the last thirty years by the external balance. Just as output growth in the region must take into account external integration, so must the circumstances of internal macro-economic disequilibrium. Easily financed current account deficits made for relatively low inflation. Balance of payments crises translated into higher interest rates and credit rationing as well as inflationary pressures generated by realignment of exchange rates. What counts is not only the size of the public deficit but the capacity to finance it. In the 1980s, one sees the salience of this point in the context of increasing debt service. Countries financed the purchase of foreign exchange not through taxes but by issuing domestic debt or printing money. As a consequence, inflation rates more than doubled in the 1980s. (See table 6).

A second aspect of Latin American inflation is the prevalence of indexation. The pervasiveness of high inflation has created mechanisms of institutional defense. All key prices in the economy -- the exchange rate, interest rate and wage rate -- tend to have automatic adjustments in response to price level changes. Indexing averts the large changes in relative prices that typically occurred in the 1950s in Latin America. It does so, however, at the expense of building additional rigidities into inflation and making disinflation, particularly from high levels, virtually impossible under orthodox programs. Inertia matters.

But the special kind of incomes policy established by indexing is also far from neutral. Certain groups benefit and others lose depending upon the choice of index and the degree to which adjustment is forward or backward looking; a special case earlier discussed was Brazil in the mid-1960s. Heterodox programs which take the current relative prices as equilibrium because of high inflation can err. Return to an average real wage will not necessarily prove a guarantee that structural and distributional components of inflation are eliminated. Incomes policy has to do more than coordinate the responses of different price setters.

Table 7 provides information on the effects of inflation upon per capita income growth in the region. The regressions use quinquennial panel data for 17 Latin American countries.[7] For the period as a whole, there is a

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[7] Cuba, Haiti and Nicaragua are excluded from the sample because of the lack of data.

negative correlation. This result is replicated for each of the sub-periods, with the coefficient being largest and most statistically significant in the interval 1950-65. The average impact is not trivial: an inflation rate of even 20 percent reduces the per capita growth rate by 0.4 percentage point, or almost 15 percent of the regional mean of 3 percent growth between 1950 and 1980.

This result does not hold, however, once high inflation observations are excluded. (See lower panel of table 7). If the sample is limited to all 5-year averages less than 50 percent, there is no systematic effect of inflation upon growth. And in the period 1965-75, the effect is actually positive, reflecting the degree to which spreading indexing facilitated adaption to inflationary pressures of modest levels. The appropriate conclusion, therefore, and consistent with the experience after 1980, is that moderate inflation was not a serious handicap, but that much higher rates exert a palpable cost. At rates of 20 to 30 percent a month, one cannot avoid a high degree of variance in relative prices and attendant uncertainty, not to speak of instability.

Much of the empirical analysis of Latin American inflation in recent years has been in test of the implications of rational expectations theory for the effects of unanticipated money growth on real output growth and the price level. Conclusions have not been uniform, but are sensitive to model structure, country sample and period of observation. A recent study by Canarella and Pollard (1989) explores the relation between money, the price

level and growth in 16 Latin American countries between 1950 and 1983. While the empirical results conform broadly to the view that unanticipated money growth has positive effects on output and negative effects on the price level, they are hardly decisive. Consistent with our emphasis upon external factors, the coefficient on money growth is generally not of unitary elasticity as predicted. The pattern of output response, moreover, is quite sluggish and highly variable across countries; the price level effect is equally far from uniform, nor are the cumulative coeficients consistent with those in the output equation.

While at one time structuralists were prone to argue in favor of a favorable inflation-output relationship in the region, few defend such a position at the exaggerated rates now being recorded in many of the countries of the region. More sophisticated financial markets registering daily expectations and indexing at more and more frequent intervals leave little scope for unanticipated price increases, let alone a positive impact. The old debate between monetarists and structuralists has given way to generalized recognition of the need for better macro-economic policy and return to much lower inflation rates.

Table 7: Inflation and Growth, Latin America[a]

	1950-80	1950-80	1950-80	1950-80	1950-65	1965-75	1975-80
Constant	2.54	3.00	2.34	2.49	2.48	3.04	2.53
Inflation Rate	-0.02	-0.02	-0.02	-0.02	-0.04	-0.02	-0.01
	(-3.01)	(-3.42)	(-3.10)	(-3.11)	(-3.56)	(-2.63)	(-0.40)
Dummy 1		-0.83					
		(-2.21)					
Dummy 2			0.64				
			(1.62)				
Dummy 3				0.43			
				(0.85)			
R^2	0.08	0.13	0.11	0.09	0.21	0.18	0.01

[a] 17 countries; all Latin American countries except Cuba, Haiti and Nicaragua.

Latin America[b]

	1950-80	1950-80	1950-80	1950-80	1950-65	1965-75	1975-80
Constant	2.50	2.80	2.27	2.51	2.40	1.65	2.66
Inflation Rate	-0.01	-0.01	-0.00	-0.01	-0.03	0.14	-0.02
	(-0.36)	(-0.57)	(-0.27)	(-0.27)	(-1.39)	(2.73)	(-0.38)
Dummy 1		-0.53					
		(-1.18)					
Dummy 2			0.64				
			(1.38)				
Dummy 3				-0.12			
				(-0.19)			
R^2	0.00	0.02	0.03	0.00	0.05	0.24	0.01

[b] 13 countries; excludes Argentina, Bolivia, Chile, and Uruguay from previous sample.
Dummy 1 = 1 for 1950-1965, and 0 otherwise.
Dummy 2 = 1 for 1965-1975, and 0 otherwise.
Dummy 3=1 for 1975-1980, and 0 otherwise.
t-statistics in parentheses.
Data: Income per capita growth rates from Summers et al., opus cit, and inflation rates from IMF, International Financial Statistics.

IV. POVERTY AND INCOME DISTRIBUTION

Perhaps the biggest limitation of Latin American development in the post-War period has been its modest social achievements in the process of economic growth. Growth is essential for achieving social goals. But growth is not enough. Economic growth and industrialization in Latin America blended with mass poverty, social tensions, regional imbalances, widespreadpolitical instability and acute injustice.[8]

Who are the poor?

Altimir (1982) develops a widely used definition of poverty for ten Latin American countries in the 1970s on the basis of available household surveys and population censuses. His poverty lines (annual household consumption per capita ranging from 150 to 250 dollars of 1970) are country specific based on the cost of a nutritionally adequate diet multiplied by two. According to Altimir's estimate, in 1970, 40 percent of Latin American households were poor and had an average purchasing power from 40 to 55 percent below the poverty line. Only in Argentina the income gap was as low as 25 percent. The extent of poverty was higher in rural than in urban areas in all Latin American countries. Even in Argentina, Chile and Uruguay, the most heavily urbanized countries in the region, the extent of rural poverty was not less than 20 percent of rural households. In Mexico, the three bottom deciles

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[8] Cardoso and Helwege (1989) provide a survey of the literature on poverty in Latin America.

of the income distribution were entirely rural. In Brazil, 70 percent of the lowest four deciles in the mid-1970s were rural households. The poorest are usually landless laborers who purchase all or a large part of their food. In the urban areas the poorest are self employed (rather than wage earners), workers in construction (the most likely entry point for immigrants) and persons working in public make-work programs such as those in Chile.

In 1970, the extent of destitution (risk of severe nutritional deficiency) varied quite substantially from 1 percent of the population in Argentina to 45 percent in Honduras. About one fifth of all households in Latin America had incomes that were insufficient to pay for an adequate diet. Musgrove's (1985) study of nutrition in 10 Latin American cities in 1966-69 confirmed the high levels of destitution poverty, ranging from 18 percent in Caracas to 56 percent in Quito. Table 8 shows different estimates of the percentage of population living in poverty in 1970 for 12 Latin American countries.

The basic survey data from which the indices of poverty are drawn present many problems. These surveys undercount disproportionately poor groups and those in surveys underreport their incomes (as shown by comparisons with independent sources of data). One therefore has more confidence in the measurement of trends than in figures for any one year. Molina (1982) published an update of Altimir's work, based on the assumption that poverty lines grew at one-fourth the rate of average income in any country. Despite

Table 8: Percentage of Population Living in Poverty
Latin America, 1970

	Kakwani	Altimir		
		A Destitution	B Poverty	C Relative Poverty
Brazil	17.3	25	49	54
Mexico	4.2	12	34	48
Argentina		1	8	28
Venezuela	4.6	10	25	38
Colombia	13.1	18	45	48
Peru	25.3	25	50	48
Chile	0.9	6	17	39
Uruguay	6.1	4[a]	10[a]	25[a]
Costa Rica	1.5	6	24	36
Honduras	27.5	45	65	58
Ecuador	21.5			
El Salvador	20.8			

Notes: Kakwani's poverty line is 150 dollars of 1970.
Altimir's poverty lines for 1970: the national averages of the line of destitution, A, vary between 87 dollars for Honduras and 151 dollars for Argentina. The national averages of the line of absolute poverty, B, vary between 162 dollars for Honduras and 296 dollars for Argentina. Relative poverty, C, is defined as less than half the average per capita income of all households.
[a] urban poverty.

Sources: Kakwani, opus cit.; Oscar Altimir, The Extent of Poverty in Latin America, World Bank Staff Working Paper Number 522, Washington D.C., World Bank, 1982.

Table 9: Incidence of Poverty in Latin America
1970- 1981

	1970		1981	
	Head Count[a]	Poverty Gap[b]	Head Count[a]	Poverty Gap[b]
Argentina	8.0	0.5	8.0	0.5
Brazil	49.0	8.2	43.0	4.2
Chile	17.0	1.9	16.0	1.6
Colombia	45.0	7.7	43.0	5.3
Costa Rica	24.0	3.6	22.0	2.7
Honduras	65.0	23.1	64.0	21.8
Mexico	34.0	3.9	29.0	2.6
Panama	39.0	6.8	37.0	5.7
Peru	50.0	13.4	49.0	12.8
Venezuela	25.0	2.8	24.0	3.6
All 10	39.0	5.3	35.0	3.6

[a] Percent of population below the poverty line.
[b] Shortfall of the average income of the poor from the poverty line as a proportion of GDP.

Source: Sergio Molina, "Poverty: Description and Analysis of Policies for Overcoming It," CEPAL Review, no.18, December 1982.

considerable growth in the 1970s, the consequences are disappointing. Table 9 shows only a slight drop in the percentage of the population living in poverty in most countries in 1981 compared to 1970, with substantial progress in Brazil and Mexico. Because of their weight in regional total, the incidence of poverty in Latin America dropped from 39 percent to 35 percent. Nonetheless, the numbers of poor increased.

Although the number of poor increased, they undoubtedly saw some improvement in their standard of living between 1950 and 1980 as health and schooling improved. Growth of the urban population brought expanded opportunities. Life expectancy in Latin America increased from 55 years in 1960 to 63.7 years in 1980 and infant mortality declined 107 per thousand to 69 per thousand. Access to literacy rose. The data in table 10 show a strong positive correlation between incomes per head and life expectancy, as well as between incomes per head and life expectancy. There is no correlation between incomes per head and infant mortality rates.

Aggregates may overstate. Merrick (1989), for instance, asserts the existence of a dual population structure in Brazil. He shows a modern demographic elite passing through the mortality transition and into controlled natality at a pace similar to late industrializing societies. This southeast-urban sector coexists with the northeast-rural sector where high fertility and mortality rates correspond to the level of traditional underdeveloped societies.

Table 10: Economic and Social Indicators
Latin America[a], 1980

	GDP per head[b] (index)	Urban Population (% of total)	Infant Mortality (per thousand)	Life Expectancy (years)	Population per physician (1981)	Literacy Ratio (1978)
Y > $2,000 in 1980						
1. Venezuela	100.0	83	41.7	67.4	1,000	82
2. Uruguay	98.8	84	39.7	70.9	500	94
3. Argentina	96.9	82	45.2	70.4	540[g]	93
4. Mexico	76.9	67	56.0	65.2	1,210	82[h]
5. Chile	71.7	81	43.2	67.1	1,930	89[i]
6. Costa Rica	65.6	43	27.5	72.2	1,440	90[h]
7. Panama	65.2	54	21.7	70.4	1,010	82
8. Brazil	65.0	68	83.3	63.1	1,300	76
Y > $1,000 in 1980						
9. Colombia	56.9	64	56.4	62.9	1,710[g]	81[h]
10. Paraguay	53.0	39	46.8	64.6	1,750	84
11. Peru	52.7	65	87.7	57.7	1,440	80
12. Dominican Rep.	47.3	51	68.3	61.4	1,400	67
13. Ecuador	47.0	45	81.6	61.2	760[g]	77
14. Guatemala	43.0	39	65.9	58.5	8,610[g]	46[j]
15. Nicaragua	40.0	53	90.5	56.4	2,230	90
16. Bolivia	33.7	44	131.3	50.2	2,000	63[k]
17. Honduras	31.1	36	88.5	58.2	3,100	60
Y < $1,000 in 1980						
18. El Salvador	27.2	41	77.9	63.0	2,550	62
19. Haiti	13.3	28	114.6	53.2	9,200	23[h]

[a] Latin America except Cuba, countries ordered by size of GDP per capita in 1980.
[b] Indices of GDP per capita in 1980, Venezuela = 100. Venezuela GDP per capita not corrected for changes in the terms of trade = 3,310 dollars of 1975.
[g] 1980; [h] 1980; [i] 1970; [j] 1975; [k] 1976.

Sources: Summers and Heston, opus cit. ; World Bank, World Tables; IMF, International Financial Statistics, PREALC, and ECLAC.

Relative shares of income also count. They are relevant not only to issues of equity, but to the assessment of policies to overcome absolute poverty. Average income per capita in most Latin American countries exceeds that in the majority of African and Asian countries, yet extreme poverty persists as a result of unequal income distribution. In the Latin American context it is impossible to look at poverty without considering redistribution as a potential solution.

Table 11 presents the share of the richest quintile as a multiple of the poorest quintile, as well as Gini indices for 13 Latin American countries. The levels of inequality depicted by these indices are striking as they exceed those found in most other parts of the developing world. There is little indication that the situation has much improved after 1970. Moreover, there is reason to believe that the 1980s has shown an increased share of income going to capital and declines to labor, thereby leading to further deterioration. While efforts to eradicate absolute poverty appear feasible in resource cost, although difficult to implement, relative inequality may prove much more stubborn. From the standpoint of politics, extreme relative inequality may create a discontent that hampers effective economic policies.

What can be done?

Between the 1950s and 1980s different strategies to attack poverty became fashionable. From an emphasis upon economic growth, focus shifted to the basic needs approach and now back again to the belief that only growth can reduce poverty. But despite the limited aggregate resources needed to reduce

Table 11: Income Shares and Gini Indices
14 Latin American countries, circa 1970

	Income Share of bottom 20% (percent)		Income Share of top 20% as multiple of bottom 20%			Gini Index	
	a	b	a	b	c	a	c
Brazil	3.0	2.0	21	33	15	.574	.500
Mexico	3.7	2.9	15	20	16	.524	.567
Argentina	6.9	4.4	7	11	7	.437	.425
Venezuela	2.7	3.0	24	18	18	.622	.531
Colombia	3.5		17		15	.557	.520
Peru		1.9		32	26		.591
Chile	4.8		12		14	.506	.503
Ecuador	3.5		16		24	.526	.625
Dominican Rep.	4.3		13			.493	
El Salvador	3.2		18		11	.539	.532
Costa Rica	5.0	3.3	11	17	9	.416	.466
Panama	3.0		20		24	.557	.558
Uruguay					13		.449
Honduras					21		.612
For comparison: Developed Countries							
Average	5.5		9			.380	

Sources:
a Manek Kakwani, Income Inequality and Poverty: Methods of Estimation and Policy Implications, New York: Oxford University Press, 1980;
b World development report 1988, Washington D.C.: World Bank.
c Jacques Lecaillon et al., Income Distribution and Economic Development: An Analytical Survey, Genva: International Labor Office, 1984.

destitution poverty, projects have failed successfully to target the poor. They have increased as fast as population. And the promise of growth has given way to a lost decade of development in the 1980s.

Peasant leaders and leftist politicians claim that land reform is the solution to poverty and inequality in the rural areas of Latin America. History shows that it succeeded politically only when imposed by revolutionary governments committed to breaking the power of the landed oligarchy. But in four countries in the region where it took place (Mexico, Cuba, Peru and Nicaragua) it achieved neither social justice nor economic efficiency. The Bolivian outcome seems to have been somewhat more successful. Agrarian reform has tended to recede as an option since the Alliance for Progress, in favor of urban migration and agricultural credit as a solution to rural poverty.

In the absence of a revolution (and even that does not appear to be sufficient) what can be done? Glewwe and van der Gaag (1988) divide policies to assist the poor into three types: relative price changes, direct transfers and changing the characteristics of the poor.

Changing relative prices remains the most common strategy despite compelling criticism. The costs of this policy include significant leakages as well as large efficiency costs. Their appeal is their immediate, if only nominal, consequences. These are deceptive. One valid conclusion from the Latin American experience is that government ordered nominal wage increases as a tool of redistribution do not work.

Direct transfers have a big advantage: they directly benefit the poor. Their limitation derives from the difficulty of targeting and the

absence of a vocal constituency. The poor are seen as undeserving of special efforts and there is concern that no permanent gains will be realized. The fiscal constraint faced by most Latin American governments precludes much advance on this front. Indeed there has probably been retrogression as expenditures in behalf of the poorest may have suffered proportionally larger cuts.

Changing the characteristics of the poor remains the most appealing strategy because it removes one of the most important causes of poverty. The most general characteristic of the poor in Latin America is an inferior educational background in both formal schooling and skills training.

There are significant externalities for growth itself from expenditures on publicly provided education and health services. Primary education is an important means for raising productivity and hence growth. This also holds true for health expenditures. Correa (1970) has argued that improvements in health and nutrition added 0.12 to 0.93 percentage points to the rate of economic growth in nine Latin American countries between 1950-62. Norman Hicks (1980) has estimated that a 10 year increase in life expectancy raises per capita GDP growth rates by 1.1 percentage points and a 10 percentage points increase in literacy rates raise per capita GDP growth by 0.3 percentage points. David Wheeler's (1980) findings indicate significant impact on growth rates from increases in calorie intake and in literacy rates. Robin Morris's (1982) study found that primary education enrollments had a favorable effect on growth rates of per capita income.

In the end, the stark poverty and income distribution problem in Latin America measure the failure of the post-War development process. No exclusive strategy can work. Restored economic growth, more attention to absolute poverty and basic needs as well as a continuing commitment to increased capability and mobility are necessary. As significant as technical design is the inability politically to reconcile attention to poverty and inequality with policies that sustain macro-economic equilibrium and economic growth.

V. CONCLUSIONS

Latin America now faces the 1990s. The experience during the thirty years from 1950 to 1980 provides bases both for optimism as well as caution. Countries in the region have demonstrated a capacity for sustained expansion at relatively high rates over an extended period of time. In so doing, they have also demonstrated a degree of adaptability and pragmatism. Ideology has not dominated economic policy-making over extended periods in the face of poor performance.

On the debit side, countries have failed to establish a record of credible and consistent policy. The public sector stands out as a major weakness. Instead of a progressive strengthening, one sees accelerating debility in many countries. Recovering the ability to lead the development process is necessary but not easy. Several political leaders have tried without much success, as inflation barometers sadly register.

Most fundamentally, poverty and distribution problems loom as powerful obstacles to the required increases in investment ratios that virtually all countries must undertake in order to resume growth at satisfactory rates. The prospects for zero-sum perspectives seem more probable than cooperative solutions. The proliferation of capital flight creates even more diversity of interest and unequalizing claims on wealth.

Technocratic solutions, predominant in many countries from the mid-1960s, do not seem to be an answer that will hold in the future. For one, in many instances it was the technocrats that papered over the fragilities of the 1970s and provoked a much worse reaction in the 1980s. For another, the opening of politics precludes such a reversion. Instead one will have to rely on more limited areas of regulation and intervention and more decentralization and use of market signals. Perhaps by focusing on social policy, the great failure of growth until now, and by providing scope for more, but not exclusive, private initiative, a more appropriate Latin American model will begin to unfold.

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