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Inflation and Economic Development.

THESIS ABSTRACT

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After introducing the problem in Chapter I, the problem of inflation in Latin America is viewed from the perspectives of "orthodox" inflation analysis and structuralist analysis in Chapter II. In Chapter III the Monetarist position on the origin of Latin American inflations, and their effects on capital accumulation and resource allocation are examined. Sectoral imbalances implicit in the development process are advanced as a possible explanation of the inflations in Chapter IV on the Structuralist position. Policies of structural reform and monetary stabilization are discussed in Chapters V and VI. Chapter VII examines the "forced saving" arguments for inflationary finance. In Chapter VIII, the controversy is evaluated in its normative and positive aspects. Chapter IX contains a Bibliography of the subject.

INFLATION AND ECONOMIC DEVELOPMENT: A SURVEY OF THE MONETARIST - STRUCTURALIST CONTROVERSY

A Thesis

Submitted in partial fulfilment of the requirements for the Degree of Master of Arts in the Department of Economics and Political Science

by

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I. Introduction:

Since the Second World War, a dispute has grown among economists over the nature of inflation in Latin America. The so-called Monetarist-Structuralist controversy has focused the attention of analysts on the relationship between inflation and economic growth in low-income nations in Latin America that have experienced in recent years, a variety of combinations of stagnation and development, and of inflation and relative price stability. The technical ambiguity and political volatility of the central issues have led to a far-ranging debate over development theory and policy that ranges in style from academic to evangelical. Important international organizations have promoted conflicting theoretical systems, and have suggested differing economic management policies to deal with the problem~~s~~ of inflation.

Though a polarization of opinion continues and central questions remain, the dispute has refined itself considerably through the years, generating certain insights into the development process that have led to increased analytic rigour and empirical sophistication on the issue of inflation. While the controversy has a Latin-American setting, it clearly holds a wider relevance.

This paper will attempt to illuminate in particular the theoretical differences between the two schools of writers through a survey of important contributions to the dispute. In covering a diffuse and extensive literature it seems appropriate to order the work in a way that brings out the differences, as well as the similarities, within and between the two broad schools of thought on the issue, rather than imposing a mechanical coherence upon them. In addition to the diversity of the field, there is a pronounced assymetry in the characteristics of inflation that the two schools emphasize. For this reason, the device of "the Monetarist Position" and "the Structuralist Position" will be adopted, as it permits a "mean" case to be advanced and analyzed, without ignoring the variation and ambiguities within positions.

The positions of the two schools will be summarized and discussed against standards of INTERNAL consistency and ~~the~~ realism of assumptions and policy recommendations. Section 2 will first look to the state of inflation theory in developed economies for guidance on the key question of the relation of inflation to economic growth. (We will return to the state of modern theory in the Conclusions, particularly asking whether the concept of "structural inflation" is useful.) Section 2 will discuss the state of development theory in Latin America, where the writings of Furtado, Prebisch, et al., have built the intellectual framework for the structuralist position on inflation.

Section 3 will describe and analyze the monetarist position; Section 4 will advance the arguments of the structuralist reply. Section 5 and 6 will suggest the experiences of Latin American countries with inflation and stabilization, and summarize the policy conclusions of representative monetarists and structuralists. The ideological issues that frequently obscure the controversy over inflation will be discussed in Section 7, where inflation as a technique of development finance through forced saving is considered. The dichotomy between private and public investment mechanisms usually divides "monetarist" economists from "structuralist" economists in the intense political setting of Latin America. Section 8 will evaluate the central arguments of the two schools, and ask whether the controversy has contributed anything of lasting importance to the study of economic development in Latin America, or to the study of inflation as a general phenomenon.

II- The Monetarist - Structuralist Debate

In brief outline, the controversy between the monetarist and structuralist schools concerns the compatibility of inflation with optimal economic development and the priority to be given to the control of inflation. 1.

The shifting focus of the debate has been the policy of monetary restraint that the International Monetary Fund proposed for various Latin American countries since the war, and opposed by economists of the structuralist school. The argument has concerned the nature, causes, and consequences of inflation in underdeveloped countries and the ability of monetary and fiscal policy to control inflation.

The monetarists, who hold that monetary stability is a necessary condition for economic growth, assert that inflation in less developed countries is a phenomenon similar to inflation in developed countries, and no less serious a threat to the efficiency of the economy. These writers, frequently associated with the International Monetary Fund, find the cause of inflation in extravagent deficit finance, lax credit policies, ineffective incomes policies and price control systems that lead to inflationary distortions in the economy. Inflationary countries are

1. We will define inflation simply as a sustained trend of price increases.

attempting to live beyond their means. In addition to reducing the flow of internal and external saving, an inflationary economy distorts investment towards excessive inventories and luxury real estate. Inflation leads to chronic balance-of-payments problems and its control should be a major objective of economic development policy. Sharp stabilization programs are the most effective way of dealing with strong inflations.

The structuralists, often associated with the views of the United Nations' Economic Commission for Latin America, consider price increases a natural consequence of economic development in low income countries in Latin America. They trace the cause of inflation to sectoral imbalances and supply inelasticities (particularly in agriculture), to inadequate and unstable import capacity, and to a variety of rigidities in ecomomic and social structure that must be eliminated if growth with stability is to be secured. Structuralists occasionally make use of the forced saving arguments for inflation.

Excessive emphasis on price stability in less developed countries marked with serious structural weaknesses would reduce the rate of economic growth. The stabilization programs advocated by the International Monetary Fund are judged as paralytic and unacceptable in the context of Latin American social and economic realities.

A- The Problem of Inflation;

Inflation has been the subject of speculation and controversy among economists, political leaders and the general public in the development of every major economy. In developed countries the control of inflation has become an important objective of economic policy; despite this, inflation has been an ubiquitous companion of post-war growth. This has contributed to a heightened academic interest in the relation of inflation to economic growth, balance-of-payments viability, income distribution and other objectives and responsibilities.

This is not the place for a discussion of conflicting theories of inflation in developed countries. While the highly-charged disputes between Keynesians and Quantity Theorists, and among Cost-Push, Demand-Pull and Administered-Price combatants have considerably refined the basic concepts and problems of inflation analysis, many significant questions remain unresolved.

This is, perhaps, as much due to the size of the literature as to the complexity of the problems. Ralph Turvey wrote in 1951: "... the literature on the subject is now so extensive that only a specialist can hope to have more than a nodding acquaintance with it." 1.

1. Ralph Turvey, "Some Aspects of the Theory of Inflation in a Closed Economy." Sept.1951, P.531,<u>EJ</u>

Another writer said a few years later, "The theory of inflation is a vast and disorderly area of economic thought, partly because of the ambiguity of the word itself, and partly because, even when a strict definition is chosen, the ground covered is still extreme, and the choice of assumptions with which to build a model is enormously wide." ~~p~~. 1.

A variety of models have been constructed to investigate the nature of inflation and the efficacy of policy measures to deal with it, but they are highly diverse in content, partial in character, and untested. The familiar problems of discerning cause from correlation appear. One writer concludes "...although economists are agreed, by and large, on the type of forces which cause prices to rise and keep on rising, there is not as yet a complete and generally applicable theory of inflation. Nor are there substantive findings regarding the strength or importance of the various factors in initiating and sustaining inflationary processes." 2.

1. A. J. Brown's review of Hansen, A Study in the Theory of Inflation, Ec. Feb. 1951. See also Hagger, The Theory of Inflation (1964). Other recent, useful works on inflation include Ball, Inflation and the Theory of Money, (1964), Zawadzki, The Economics of Inflationary Processes, (1965)

2. H. S. Odeh, The Impact of Inflation on the Level of Economic Activity. (1966)

In recent years there has been a wealth of conflicting literary and mathematical treatments of inflation. In addition to the modern quantity theorists, who see movements in the price level as a result of the interaction between the supply of and demand for money, (the latter seen as a particularly stable form of asset demand) there is what might be called the supply and demand school, which sees price increases as depending on changes in the multitude of variables that determine aggregate demand and aggregate supply. One of these is the Swedish branch which distinguishes between the factor and goods markets, and which assures that inflation can arise in either of these markets. 1. The Anglo-American Keynesian branch considers primarily the goods market, the factor market entering the analysis only as a link in the chain of causation.

While the pure theory of inflation is in a somewhat ambiguous state, there is really much agreement on the most important feature of inflation. It represents an attempt by elements of an economy to secure more output than the resources of the economy can support. The way in which excessive and inconsistent monetary claims on resources are finally resolved, has important effects on income distribution: when one class gains, another must usually lose.

Although there is considerable uncertainty on the frontiers of the discipline, there is no lack of conclusive "impure" theorizing among those who influence or frame

1. B. Hansen: A Study in the Theory of Inflation.

economic policy.

Our chief interest is in the relation of inflation and growth, and a wide range of opinions have been expressed on this association. We will sample a few opinions to establish the diversity of professional judgments outside the Latin American setting.

On one hand, there are those to whom inflation is an unalloyed curse. Bresciani wrote of the German hyperinflation: "It annihilated thrift, it made reform of the national budget impossible for years, it obstructed the solution of the reparations question, it destroyed incalculable moral and intellectual values. It provoked a serious revolution in social classes; a few people accumulating wealth and forming a class of usurpers of national property, whilst millions were thrown into poverty. ...the sad years of 1919-1923 always weighs like a nightmare on the German people." 1.

In an OEEC report presented in the late Fifties called "The Problem of Rising Prices", six prominent economists (Fellner, Gilbert, Hansen, Kahn, Lutz and deWolfe) wrote, "We have concentrated, in this report, on the problem of price stability in accordance with our mandate. This does not imply that we wish to put a low priority on economic growth...It is rather that rising prices are not compatible with steady growth." 2.

1. C. Bresciani-Turroni. The Economics of Inflation (1937)p.404.
2. see Sidney Dell, Postwar Experience of Inflation in the Industrial Countries, p.189-190, in W.Baer and Isaac Kerstenetzky, Inflation and Growth in Latin America, the proceedings of an important conference on that subject in Rio de Janeiro, Jan.1963. N.B. Henceforth B. and K.

An IMF economist has called price stability "A pre-requisite to rapid economic growth. 1.

Other economists take a more sympathetic view of inflation. Arthur Lewis found redeeming qualities even in the German Hyper-Inflation. "Inflation increases fixed capital formation, even hyper-inflations like the German inflation of 1919 to 1923, have this effect. In the long run, it is an excellent effect, since it increases real output and the standard of living." 2. Criticizing the OEEC statement, noted above, Sidney Dell quotes the United Nations' World Economic Survey, 1957, which he maintains "shows that since 1870 rising production has more often than not, been accompanied by rising prices," for the developing countries. 2. Lewis has written, "I think the statisticians, once they stop chasing hares and come to the real point, will find that virtually all take-off periods, which by definition are short periods of rapid acceleration of the rate of growth, have been periods of self-liquidating inflation." 3.

Unsurprisingly, there are other analysts who hold there is no clear and simple relationship between multi-variable phenomena such as inflation and growth. Dell quotes a staff report of the Joint Economic Committee of the U.S. Congress, called Employment, Growth and Price Levels (1959): "The historical record ... casts considerable doubt on the view that inflation and growth are incompatible.

1. Dorrance; The Effect of Inflation on Economic Development. B. and K. p.68
2. Arthur Lewis, Theory of Economic Growth. P.223
3. Arthur Lewis, "Closing Remarks", B. and K., P32.

The data ...points to a single conclusion; there is no simple relationship between changes in output and changes in prices, just as periods of slow growth, or indeed, of no growth, have been marked by every manner of price behavior." 1.

Dell notes that Friedman and Schwarz in their monetary history of the United States reach the same conclusion, and that in studies based on shorter periods the Commission on Money and Credit (1961) find, at most, a slight inverse relation between growth and the rate of inflation or deflation, outside a modal range of zero to low rates of price change.

There is an equally broad range of experience and interpretation in post-war Latin America; one or two cases can usually be found to justify a variety of conflicting, simple associations of inflation and growth. Werner Baer writes, "...a number of countries have experienced high rates of inflation and slow rates of growth, other countries have experienced high rates of inflation and high rates of economic growth, and there have been examples of stability combined with high growth rates and stability combined with stagnation." 2. Baer notes the diverse record of three important Latin American economies during the 1950's. Argentina experienced a yearly average annual price increase of 25% and average annual growth of 2% per year, in GDP.

1. Sidney Dell, op. cit. P.190
2. W. Baer, "The Inflation Controversy in Latin America, A Survey," Latin American Research Review, Spring 1967, p.4.

Chile had an inflation rate of 38% and a growth rate of 3.2%. Brazil had an average inflation rate of 20% and a growth rate of nearly 6%.

In conclusion, there is clearly a variety of experience of inflation and growth in developed and less developed countries, and many interpretations of that experience. Historical evidence from other regions and the limitations of inflation theory are sufficiently persuasive to provide a prima facie case for approaching the Latin American inflations without prejudice as to their nature and consequences.

The problem in analyzing the monetarist-structuralist controversy is to determine whether specific conclusions are justified. There appears to be something of a tradition of politically motivated, universalist theorizing and casual empiricism in past studies of inflation; the short, rather dogmatic style of contributions to the controversy in question advances this danger. When broad generalizations are made, Harry Johnson's comment seems relevant; "The available historical and comparative evidence on this issue is fairly conclusive; There is no convincing evidence of any clear association, positive or negative, between the rate of inflation and the rate of growth." 1.

B. Development Theory in Latin America

To summarize our position so far, we have noted that during the last 15 years or so, a remarkable dispute has

1. Harry Johnson, "Is Inflation a Retarding Factor in Economic Growth?" Krivine, P.121

grown over the nature of inflation in Latin America. The monetarist-structuralist controversy has focused the attention of many analysts on the relationship between inflation and economic growth in Latin American nations that have recently experienced a variety of combinations of stagnation and development, and of inflation and relative price stability.

We cannot here do justice to the political and social conditions in Latin America that explain the intensity--even passion--of the inflation issue. It is however not a continent where the great political issues underlying successful socialist or capitalist development have been settled. Hirschman warns himself and other Western academics: "We are no longer ready to become partisans of systems, spoiling for a fight with our opponents over the minutest issue; rather we are now picturing ourselves as reasonable, sophisticated "incrementalists" bored with yesterday's ideological bouts...If this is so, we are seriously out of phase with the mood in Latin America (where)...ideologies are in their accustomed roles." 1. These forces have without doubt obscured the more subtle technical arguments about inflation, and prevent a neat resolution of the controversy.

After giving a brief summary of the structuralist philosophy in this section, we will turn directly to the monetarist and structuralist positions on the causes and consequences of inflation, and the policies that they would

1. A. Hirschman; Latin American Issues , P.35-36.

deploy against inflation. We will devote a separate section to the forced-saving issue, (using inflation as a form of capital accumulation) as viewed by monetarists, structuralists, and others. We will then draw some conclusions about the controversy.

C. Structuralism

The process of economic development in Latin America, which one writer has called "the most developed of the great underdeveloped regions of the world" 1., has been accompanied by a substantial controversy over the theory and design of development policy in the region. The catalyst in this dispute has been the emergence since World War II of a heterodox system of ideas called Structuralism.

The structuralist framework is a distinct combination of Keynesian and Marxian analysis within a liberal democratic political philosophy. It is strongly opposed to the landed elites of Latin America, suspicious of every economic contact with the developed countries, and an advocate pf a dynamic state role in economic development. One structuralist suggests the disagreement over inflation "is not just a technical issue in economic theory," it is based on "two completely different ways of looking at economic development, in fact two completely different attitudes about the nature of social change, two different sets of value judgments about the purposes of economic

1. J. P. Cole, Latin America, an Economic and Social Geography. P.441. (1965)

activity, and two incompatible views on what is politically possible." 1. 2.

The chief agent in the development and propogation of this new doctrine has been the Economic Commission for Latin America, a regional commission of the United Nations, founded in 1948 with its headquarters in Santiago, Chile. Through its history, the Commission and the many economists who have served it have been strongly influenced in their activities and analytic interpretations by the forceful Director of the Commission, Dr. Raul Prebisch. A.O.Hirschman writes, "The arresting feature of the ECLA is that it possesses attributes not frequently encountered in large international organizations; a cohesive personality which evokes loyalty from the staff, and a set of distinctive beliefs, principles and attitudes; in brief, an ideology." 3. The philosophy of the Commission is highly influential among Latin American intellectuals and policy makers. We shall discuss the structuralist philosophy primarily through an examination of ECLA doctrine.

1. Dudley Seers;"Inflation and Growth; the Heart of the Controversy" B. and K., P. 89

2. Needless to say, there are structuralists in North America, and monetarists in Latin America. While the former are mostly academics, the latter would include the liberal economists, businessmen and politicians who are skeptical and alarmed over the enhanced structuralist role of the state. See Hirschman, L.A. Issues, p. 24-25. It should also be emphasized that there is detailed disagreement among the proponents of both philosophies.

3. A.O. Hirschman, "Ideologies of Development in Latin America." in Hirschman, ed., Latin American Issues.

1. The Centre and the Periphery

In a combined attack on the theory of international trade and the liberal trade policies based thereon, Prebish wrote in an important early pamphlet; "In Latin America, reality is undermining the outdated schema of the international division of labour...under that schema the specific task that fell to Latin America, as part of the periphery of the world economic system, was that of producing food and raw materials for the great industrial centres. There was no place within it for the industrialization of the new countries." 1. Prebisch clearly belongs in the tradition of List and Manoilescu and Myrdal that suspects the free play of international economic forces, and proposes interference with market processes for purposes of national economic development. The familiar remedy is industrialization through protection.

Prebisch considers comparative advantage theoretically sound "but its assumptions ...proved false by facts." 2. The principal "reality" to contradict established theory is the contention that the gains of increased productivity have not reached the periphery, which has restricted the capacity of the periphery to accumulate capital for development. The solution to this constraint is industrialization which is said to be not "incompatible with the efficient development of primary production...(and the)...mechanization of agriculture...The solution is not in growth at the expense of foreign trade, but in knowing

1. ECLA, The Economic Development of Latin America and its Principal Problems. (1950)
2. Ibid, p.1,2.

how to extract from continually growing foreign trade the elements that will promote economic developments."1.

The mechanism whereby the "centres have kept the whole benefit of the technological development of their industries...(and) the peripheral countries transferred to them a share of the fruits of their own technical progress" 2. has been a systematic movement of the terms of trade against primary producing countries, the core of the controversial Prebisch-Singer thesis. Whether or not this movement is substantiated empirically - or the cyclical theory that backs it is corrected - it appears, as Hirschman suggests, that "ECLA found a fairly persuasive way of propounding a modern sophisticated version of the old idea that trade can be a vehicle for exploitation, rather than a means of increasing welfare all-round." 3.4. To ECLA the issue is settled; the ideas have been incorporated into the policy recommendations and statistical foundations of dozens of documents. "There is a tendency for the terms of trade to deteriorate and deliberate non-spontaneous industrialization offsets this trend." 5.

1. ibid, P. 1,2.
2. ibid, P.14
3. Hirschman, Latin American Issues, P.15
4. One of the most effective detailed criticisms of the thesis is M. J. Flanders, Prebisch on Protectionism, E. J. June,1964. The thesis remains alive in Chile, however.
5. ECLA, Economic Development Planning and International Co-operation. 1961, P.16

Another structural impediment to spontaneous development, discerned by ECLA and needing non-spontaneous policies to deal with it, is found "in a simple and well known fact; as per capita income rises, the demand for industrial goods tends to grow faster than the demand for primary commodities."1.This disparity between the income elasticities of demand between the centre and the periphery is caused by the declining relative demand for primary products in the centre (and aggravated by synthetic substitution) and the growing investment and consumption demand for manufactures in the periphery. It is suggested that this phenomenon contributes to the deterioration of the terms of trade and to chronic balance-of-payments problems.

ECLA opposes traditional reciprocity in the abolition of tariffs. The need for low tariffs in the centre is recognized, "The closed industrialization fostered by excessive protectionism, as well as unduly high customs tariffs applied to some staple agricultural commodities, have created a cost structure which makes it extremely difficult for Latin America to export manufactured goods to the rest of the world." 2. However, in the periphery, protection and closed industrialization are necessary to break down the structural characteristics of underdevelopment that have been the product of classical division of labour.

1. ibid, P.13
2. Towards a Dynamic Development Policy for Latin America. ECLA, 1963.

The Commission has promoted its explanation of underdevelopment in Latin America in a wide variety of publications and policy recommendations since its inception. In its concept of "programming" it has advised broad government responsibilities and instruments in economic affairs; it has strongly advocated the Latin American Common Market as a form of continental protectionism to solve individual export bottlenecks.

Hirschman suggests that ECLA saw its role as a dual one, "to alert the Latin American countries to the precariousness of their position, and to appeal for outside help to an area which has been buffeted and victimized by forces beyond its control."[1] The ECLA's theories have consolidated and systemitized middle class Latin American suspicion about foreign exploitation [2] and given arguments for government intervention as a solution for a variety of external problems. Though its emphasis has changed over the years, the basic ideology of international economics remains. While ECLA's conspiratorial picture of the developed world is not flattering to economists of liberal training, it is a symbol of great power to Latin Americans frustrated by the obstinacy of their economic development problems.

2. Economic and Social Structure in Latin America.

ECLA and others who would not object to being described as structuralists, emphasize internal as well

1. Hirschman, Latin American Issues, P. 16
2. A.G.Frank (Capitalism and Underdevelopment in Latin America), a Marxist sympathetic to structuralism, advances probably the limiting case of the theory that underdevelopment is the necessary product of capitalist development in the centre

as external "structural" factors inhibiting Latin American economic development. The argument proceeds from a deep and perhaps ~~occasionally~~ exaggerated dissatisfaction with the ability of the social and economic system "to achieve and maintain a rate of development consonant with the growth of population and with its demands for a speedy improvement in its level of living." 1. The economic and social structure is analyzed to detect those elements in its make-up which are inconsistent with rapid development. Then, reforms are suggested.

In a recent pamphlet, Prebisch criticized Latin America's social structure as constituting "a serious obstacle to technical progress and consequently to economic and social development." 2. The system, he suggests, hampers market mobility and prevents the emergence of dynamic risk-takers who could strenghhen the fabric of economic life. In addition, the existence of privilege in the distribution of wealth weakens incentives and permits extravagant patterns of consumption. It is suggested that Latin America must face the challenge of increasing equality in the distribution of income, and the level of capital formation by privileged groups. Technological progress will allow this "dynamic concept of distribution" to take place.

1,2. ECLA, Towards a Dynamic Development Policy for Latin America.

In addition to inadequate net capital formation, important bottlenecks can be found in the inefficient use of existing productive capacity. For instance, "there is no doubt that the most persistent bottleneck in the whole of the Latin American development process is generally to be found in agricultural production." 1. The current economic structure militates against the assimilation of modern techniques, against responsiveness to price signals, and against the efficient use of existing labour and land. Land reform is advocated to increase productivity and to reduce political tensions. A non-ECLA structuralist describes the land tenure issue as follows: "...enormous expanses of land are unavailable for cultivation, the introduction of modern techniques is delayed, the purchasing power of the peasants remains low, desirable re-allocations of rural population is prevented, and in general agricultural production lacks flexibility." 2.

Hirschman finds that ECLA is less forthright on domestic issues; "Problems such as those of agrarian reform and social security (not to speak of excessive military expenditures, have been shunned, partly because ECLA could not afford to prod and antagonize its members in these highly sensitive areas; partly, perhaps, because

1. ibid, P. 9

2. Victor Urquidi, The Challenge of Development in Latin America. 1964, P. 85

they felt they were in the competence of other international agencies..." 1. Nevertheless, the views of ECLA are clear on these matters.

Structuralists generally advocate a broad range of economic and political reforms to correct underdevelopment. These include tax reforms, educational reforms, and land reforms ranging from expropriation and collectivization to co-operatives, to fiscal measures to make the latifundia more responsive to price signals.

Whatever the particular configuration of policies, populist to Marxist, the reforms advocated by structuralists, (and the vigorous lobbying for their adoption) go beyond what economists in developed countries would regard as their area of technical competence and political action. For structuralists, economic and political structure and economic and political reform are indivisible in their approach to economic theory. It is clear that structuralists have joined a basic political battle in Latin America; niceties in economic analysis may be a casualty.

To underline the scope of the changes proposed by structuralists, and the style of their reforms, we close with a statement by Urquidi: "...it is not enough to produce without creating the requisite capacity to consume ...Latin American markets are narrow not only in a physical sense...there is almost no country in Latin America that

1. Hirschman, Latin American Issues, P.21

does not have striking inequalities of income due to the pattern of land distribution, concentration of industry in a few hands, urbanization, inadequate tax policies, and backward social conditions...A select group holds most of the purchasing power...a solution to this may be the key to economic development in Latin America." 1.

3.— Structuralism and Economic Theory.

We have seen that the logic of structuralism follows this sequence in elaborating and defending their economic development strategy. Historically, the trade relations between developed and less developed countries have deprived the periphery of spontaneous economic development. This historical process has left contemporary Latin American countries with a specific set of export industries and import needs that impede economic development. Internally, the economic and social structure are unsuited to economic growth. Reforms to achieve both efficiency and equity are advanced, with the state as the tool of change.

It is naturally impossible to evaluate here the structuralist system as a whole, or separate the bits and pieces of analysis that most closely resemble "pure theory". We shall, however, look at a cross-section of their world-view, theory, policy, and operational promotion sequence in dealing with inflation later in the paper. Here, though, we can identify some general characteristics of their theoretical position.

1. Urquidi, op. cit. P. 87

The common characteristic of structuralist theory is that it is largely amti-theoretical. First, there is a considerable suspicion of abstract analysis and, instead, an emphasis on historical and institutional factors in economic development. The distinguished structuralist, Celso Furtado, writes: "Economic development is a phenomenon with clear-cut historical aspects. Each economy faces a cluster of problems specific to itself... The complex of national resources, the migratory currents, the institutional order, and the relative degree of development singles out each historical phenomenon of development." 1. Recognizing this, structuralists try to place themselves between the poles of pure abstraction and institutional description in order to trace the sectoral character and sectoral interplay that stimulates or impedes economic development.

Structuralists generally show hostility toward the free market system, the private property values that propel it, and the liberal economic theories they believe have acted as ideological supports for the price system. Urquidi writes: "...the free pbay of economic and social forces, which in any case have never existed in a pure form, would only aggravate structural imbalances..the "invisible hand" ...is completely in applicable. 2. Prebisch shows

1. Celso Furtado, Development and Underdevelopment, P.4 (Furtado's economic history of Brazil represents structuralism at its best. See Bibliography.)

2. Urquidi, op.cit. P. 88

distaste for "the traditional propensity to introduce from abroad nostrums that are largely alien to the real requirements of Latin-America's situation." 1.

Furtado distrusts the universal value and applicability of "the great laws of the classical economists... free competition and free exchange. Both consisted in the ultimate analysis of logical constructions based on fragmentary observation, on simplistic psychological assumptions, on a given social structure, and on relations between expanding economies and others of a relatively stagnant type. Nevertheless, by dint of sheer repetition, these formulations become transferred into dogma." 2.

Like Gunnar Myrdal, Furtado suspects the normative content of "orthodox" economics, and finds in the perfected invisible hand of general equilibrium a wholly unacceptable political implication of utopian neo-classical automaticity. 3.

His own blend of classical, Keynesian, and Marxian thought attempts to define a markedly illiberal process of underdevelopment. At one point he states, "Underdevelopment is not a necessary stage in the process of formation of the modern capitalistic economies. It is a special process due to the penetration of modern capitalistic enterprises into archaic structures." 4.

1. Prebisch, Towards a Dynamic Development Policy...P.14
2. Furtado, op. cit. P. 5
3. It is interesting that many of the features that distinguished the debates over socialism and the market(Lange,Knight,etc) in the early part of this century in the West, are found in the monetarist structuralist controversy. When Furtado questions whether pure market theory is normative, he is aware of the practical power of ideas; he is not making the freshman error of questioning the value of "unrealistic" analysis; he is questioning unjustified extrapolations from pure theory.
4. Ibid, P. 138. FURTADO

To conclude, we cannot here judge the relative success of the structuralist school in explaining underdevelopment. But it is certainly a meaningful framework for many Latin American intellectuals and policy-makers, and structuralism represents their views on a wide front of social and economic affairs, reflecting the multi-perspective nature of structuralism. In this section, we have merely suggested its comprehensive, populist character, its hostility to something alien dismissed as "economic orthodoxy", and its emphasis on economic and social structures inhibiting economic development. It is particularly suspicious of the linkage between allegedly positive economic abstraction and capitalism in Latin America. Broad interventionist policy recommendations stem from institutional and historical analysis, and from a strong sense of political commitment. It represents the economic philosophy of much of the democratic Left in Latin America, promoting a broad if hazy program for political and social and economic change. The structuralist philosophy fills a wide canvas, of which the dispute with the monetarists over inflation is one corner. This is the structuralist perspective as we turn to that dispute.

III- The Monetarist Position

In this section we shall review the views of a number of important monetarists on the causes and consequences of inflation. After investigating their judgments on the origins of inflation, we shall look at their views on the association of inflation and growth in Latin America and other underdeveloped regions, at their views on the impact of inflation on capital accumulation, on resource allocation, and on the balance of payments.

One observer has suggested that structuralism runs "directly counter to the orthodox monetary policies urged by more developed countries and insisted upon by the International Monetary Fund." 1. The division does seem to evidence a preponderence of Latin Americans in the structuralist school, and of North Americans in the orthodox camp. Though there are important exceptions, the dichotomy is between economists from developed and less developed countries.

The division amounts to a difference of opinion as to whether the control of inflation should be a major objective of development policy. Probably the most consistent opponents of inflation have been IMF economists writing in the organization's journal, Staff Papers, reflecting - and influencing - the policies of the Fund.

1. J. P. Powellson, Latin America; Today's Economic and Social Revolution. (1964) P.178

"The IMF", one writer notes, "since Per Jacobsson became managing director in 1956, has expressed especial alarm concerning inflation and its undesirable repercussions. (In the late 1950's) the Fund became active in fostering stabilization programs in various Latin American countries as a condition for granting them financial assistance." 1.

In addition to IMF economists, we shall discuss the views of several prominent Latin-American economists, and try to discern differences of emphasis when they exist. However, some over-synthesis seems unavoidable when trying to assess the views of the monetarists. The same will apply to our treatment of the structuralists; the nature of the medium of the debate, a vast array of articles, chapters and speeches combining theory, observations, conclusions, and policy recommendations contributes to the problem of ordering the disorderly.

A. The Origins of Latin American Inflations:

For monetarists, the prime cause of inflation is government mismanagement of economic affairs.

At one extreme is a highly political explanation of the decline of fiscal discipline in government. Eugenio Gudin, a Brazilian academic, writes: "...post-war inflation in several of the most important Latin American countries, has its origin in the political revolution of

1. ibid, P. 178

the last twenty or thirty years, when the oligarchic type of government was replaced by governments truly elected by the people, that is to say, by the masses? Gudin writes nostalgically of the time when the President of the Republic was chosen by oligarchs and restrained by a Free Press. The President acted "...entirely free from pressure from demagogues or labour syndicates" and the "quality of the administrations...was much superior to that of the elected governments of today." The President of today, however, must make deals with other parties and groups, and this accounts for the "deterioration" of the quality of government.

Gudin suggests "the worth of a leader is often measured by his 'capacity to accomplish', that is, to complete, or at least start, the building of roads, stadiums, power plants, palaces etc., no matter what the price paid through the increased indebtedness, distortion and disorganization of the country's economy." 1. He suggests two other features that aggravate inflation are "nationalism and an exaggerated belief in industrialization as a cure-all." Nationalism inhibits foreign and private capital formation, and industrialization diverts resources from agriculture and exports to high-cost protected manufactures.

1. Eugenio Gudin, "Inflation in Latin America", P.343 in D. C. Hague, ed., Inflation. (IEA conference)

Other opponents of inflation take a less conservative view of the origin of deficit spending than Gudin, but all find the chief mechanism of inflation in the budget deficits and credit expansion that Latin American governments permit. Some monetarists show greater sympathy for the institutional problems and social pressures that make the governments of less developed countries more vulnerable to inflation than are developed countries today, or were developed countries during their process of economic growth.

Roberto de Olivera Campos, a prominent Brazilian economist, suggests there is a structural vulnerability: "...for the strong inflationary bias in most of the underdeveloped countries comes from the fact that their growth process often finds its motivation on the demand, rather than the supply, side. Theirs is not a Schumpeterian development arising from the entrepreneurs spontaneous production drive." 1. Rather, it is the pressure from the people to improve their standard of living that "prompts" governments to undertake responsibilities for economic growth that are unrealistic and hence inflationary. The consumption demonstration effect is said to aggravate this inflationary bias; in addition, Campos advances several structural arguments of a type we shall discuss later.

1. Roberto de Oliveira Campos, "Inflation and Balanced Growth", in H.S.Ellis, ed. Economic Development for Latin America, IEA Conference.

Thus, a central proposition in the monetarist case against inflation is the excess of aggregate demand over productive capacity in Latin American economies. Haberler has written, "...it is not surprising that poor and backward countries, when they wake up and set their minds to developing in a hurry and to catch up with the more developed countries, are continually tempted to overspend their meagre resources and to live beyond their means." 1. An IMF writer concurs, "...incomes are not rising as rapidly as the desires of the community." 2.

In addition to the profound political pressures on the governments of less developed countries for resources that do not exist, monetarists suspect that these governments may have been persuaded by the theoretical arguments for inflationary forced saving. Dorrance writes : "Under these circumstances, inflation may appear to be an easy method of providing finance to expand investment, and hence to be an easy way of obtaining capital for a more rapid expansion of output." 3.

In conclusion, monetarists view inflation as originating in the creation of excess purchasing power by the governments of less developed countries, and the inflation continues only through further expansion of the money supply, i.e, the implicit co-operation of the

1. see Gudin, P.345, for Haberler, in Stability and Progress in the World Economy, Hague, ed. IEA Conference.
2. Graeme S. Dorrance, "The Effect of Inflation on Economic Development", B. and K., P.37.
3. Dorrance, B. and K. , op. cit., P37

Central Bank. The political pressures on governments for high levels of expenditure, and their problems of financing them, are viewed with various degrees of alarm and sympathy.

Most monetarists would agree that shortages and immobilities common to less developed countries may lead to price increases, and "some rise in the average level of prices may be an unavoidable companion of economic progress." 1. But monetarists clearly put responsibility for excessive inflation on the managers of the national economy, and view tolerance of inflation as a serious error in policy, whether it originates in the political difficulties of monetary policy, or the implicit or explicit use of inflation as an instrument of development policy.

B. The Association of Inflation and Growth:

As noted above, there is very substantial disagreement about the significance of the historical and contemporary experience of inflation. Monetarists admit, "...the available simple evidence on the relation between inflation and growth is difficult to interpret." 2.

But monetarists eventually conclude the relationship is inverse between inflation and growth, and quote recent empirical studies to support their case. For instance, there is the international comparative study of Phelps-Brown and Brown, which concludes, "If there has been

1. Ibid. P. 40
2. Dorrance, Op. cit. P. 37

any predominent association, then, between the rates of rise of real income and prices...it has been inverse.. real income has risen more when prices have risen less; but there are significant exceptions; their rates of economic growth and rates of inflation are not invariably connected with one another in the short run." 1.

In an article which draws heavily on previous IMF studies, Dorrance provides the following summary of the evidence:

RELATIONSHIP OF RATES OF INFLATION TO ECONOMIC GROWTH IN RECENT YEARS*

	Annual Rates of Growth Per Capita (percent)		
	Stable Countries	*Mild Inflation Countries*	*Strong Inflation Countries*
Sample based on UN data	2	2	2
ECLA sample	3	..	2
U Tun Wai samples, based on			
Per capita national income			
Unadjusted	6	2	3
Adjusted for terms of trade	4	1	1
Per capita social product	4	3	..

Dorrance concludes from U Tun Wai's study, "...the less developed countries have, on the average, enjoyed annual increases in per capita output of approximately four percent during those periods when they maintained monetary stability."2. The paper found during periods of mild inflation, the increase in output in these countries was only half as great. During periods of strong inflation, the increases in output tended to be even smaller.

1. E.H.Phelps Brown and M.H.Browne, "Distribution and Productivity under Inflation," 1947-1957. Economic Journal, P.744
2. U Tun Wai, "The Relationship between Inflation and Economic Development: A Statistical Inductive Study", Staff Papers, October, 1959

However, one writer regards this procedure "wherein different countries in different periods are classified under three groups according to the rate of inflation experienced, the rate of inflation for each of the groups being compared, successively, with several other variables, one by one, as highly dangerous." Massad continues, suggesting that an alternate relation, inflation as a function of growth, should be tried; that the analysis combined a great variety of other factors; that the data are inconsistent, and that averages rather than movements within the periods are considered. Odeh has criticized the Tun Wai and Bhatia 1. IMF articles as econometrically naive: "Whatever its underlying merits, this approach takes no consideration of the role of other important variables which determine real output." 2.

Neverthless, monetarists feel the preponderence of evidence indicts strong inflations, and proceed to examine the characteristics of inflation that damage the progress of economic development.

C.-Inflation and Capital Accumulation;

Monetarists are generally skeptical about the ability of inflationary finance to increase the total flow of saving and resources to development purposes, and believe the long-run influence of inflation will be to reduce this flow from what it might be under stable conditions.

1. R. J. Bhatia, "Inflation, Deflation and Economic Development", Staff Papers, November, 1960
2. Odeh, op. cit. P.10

We shall follow the theoretical and empirical observations of Dorrance on this issue, in an article that may be taken as representative of the IMF position on inflation and capital formation. 1. In this section we shall note only the monetarist position of forced saving, for fuller treatment below. In any case, most monetarists stress the long-term effects of inflation on the whole spectrum of private accumulation techniques, due to the distortion of expectations that accompany sustained price increases.

Concerning the technique of forced saving, Dorrance says, "..it is true that individual units of investment, financed by bank credit, are likely to be created even in inflationary conditions." 2. When the monetary system's liabilities increase, unless the public is willing to finance the new investment by increasing the real value of their cash holdings, either prices will rise or foreign exchange holdings will fall. "This fall in the real value of money may be considered as a tax on money holdings." 2.3. Dorrance believes that, like a tax, the effect of inflation will be evaded if there is incentive and opportunity. A strong inflation "will lead to community reactions which have effects similar to those of widespread tax evasion." 2.

1. Dorrance, op.cit. who expresses debt to A.S.Shaalan, "The Impact of Inflation on the Composition of Private Domestic Investment", Staff Papers, 1962, Vol. IX.
2. Dorrance, P.39, op.cit.
3. For full discussion of inflation as a tax, see Friedman, Essays in Positive Economics, 254-7; Johnson, in Krivine, op.cit. 125-129, Summarized and criticized in Hagger, op.cit., P.144-146.

In other words, various sectors of the community will be able to protect themselves from the effects of the tax, perhaps to the extent of eliminating its role as a source of finance.

Of greater interest to monetarists is the effect of inflation on total private saving and investment. These broad effects require some analysis of the role of money in the economy.

During an inflation, money retains its function as a medium of exchange and a numeraire but it loses its function as a store of value and a standard for debt repayment. Dorrance suggests inflation has important effects on the community's desire for liquidity. 1. by increasing the value of effective liquidity, but weakening the usefulness of money as a liquid asset. This phenomenon will distort the direction of investment and reduce the flow of investment. The community's desire for liquidity will increase, because the future rate of investment is uncertain, increasing the element of unpredictability in business calculation, and thus increasing the need for effective liquidity. Because money and assets, denominated in money, lose value in an inflation, there will be a flight into non-monetary assets that increase in value as prices increase.

Assets denominated in money can form a large part of the voluntary savings of the community. The willingness to hold these assets naturally depends on the expectation of future price increases.

1. Dorrance, op. cit. P.40 ff.

Dorrance says: "Historically, the ratio of money to income has tended to rise in all but the wealthiest countries, but in recent years this ratio, on the whole, has declined in countries where inflation has prevailed." 1. He suggests that the decrease in holdings of financial assets other than money, can offset any saving brought about through saving forced by monetary authorities. "...a communal shift away from holdings of financial assets is almost certain to be associated with a decline in total savings." 2.

In addition to reducing personal saving, Dorrance suggests that inflation reduces business saving. In the first place, the increased demand for effective liquidity will reduce long-term investment as shareholders press management to distribute rather than re-invest current net income. Secondly, sophisticated long-run investors will press management to release dividends so that investments can be made abroad, rather than re-invested domestically. Thirdly, he quotes statistics for U.S.-controlled foreign corporations in less-developed countries for 1957-1960; in stable price countries, the corporations "tanded to re-invest half their disposable income. Similar companies operating in countries where prices were rising, tended to re-invest only half as much." 3.

1. Dorrance, op. cit. P 42.

2. ibid, P. 44
3. ibid, P. 45

These influences reduce investment in less-developed countries by business, whether domestically or foreign owned. Dorrance quotes the IMF annual report (1962), which deplores the movement of domestic, private saving to foreign investment: "a particularly unfortunate feature of the international financial scene in the last decade has been the large flow of private capital from those less-developed countries which have tolerated inflation, to countries, frequently wealthy, which have maintained stability."

Dorrance suggests that government saving as well will be reduced, if it attempts to finance investment by government deficit. Monetarists are suspicious of the secondary effects of inflationary investment as an instrument of development policy, if workers realize their real wage is being reduced by inflation, they may pressure governments to control the prices of important items, such as housing, food staples, and utility rates. If the supply of price-controlled goods and services is to increase, production must be subsidized. "The cost of these subsidies may well absorb substantial amounts of government expenditure,"1. and lead to greater budget deficits.

As an outflow of capital from a less-developed country is caused by inflation, so an inflow of portfolio investment is said to be discouraged by inflation.

1. Dorrance, op. cit. P. 46

The argument is that the volume of investment is a function of its expected return, and that exchange depreciations tend to be more severe than the price inflations that cause them: "The net return to non-resident equity investors may be expected to deteriorate in inflationary economies." 1.

In addition, one of the first candidates for restriction in periods of balance-of-payments difficulties, which accompany chronic inflation, are payments to non-residents. Dorrance quotes sources which suggest "that net private investment in all less-developed countries, by the United States, increased at a rate 20% faster than the comparable increase in investment in a group of mild inflation countries during the eleven years ending in 1961."2. The amount invested in strong inflation countries was equal to about a 4% re-investment rate on capital invested.

If governments of strong-inflation countries are to maintain an inflow of foreign capital they may import capital through the medium of public loans or guaranteed private investment, on conditions substantially more costly than those offered a stable country similar in other respects. This represents, according to Dorrance, a major cost of foreign uncertainty as a consequence of inflation.

In conclusion, most monetarists would hold that the influences of inflation will reduce flows of private resources for development, from home or abroad. As we shall

1. Dorrance, op. cit. P. 50-51

2. ibid. P. 53

see, they believe, in addition, that inflation distorts the direction of investment, reducing further the saving potential of the economy.

D. Resource Allocation:

One of the important distorting effects of inflation identified by monetarists is the propensity to accumulate salable inventories that will retain their value in the face of rising prices. As we have seen, "inflations may be expected to encourage investors to forgo the purchase of financial assets which could have financed long-term physical investment." 1. Dorrance suggests that the rate of inventory accumulation--or stable asset accumulation--can be expected to be at its highest in the early stages of inflation and will then decrease, but to a level greater than that accompanying stable prices. In his observations of the Latin American experience, he finds in Ecuador, a stable country, the ratio of inventory accumulation to total investment has been only slightly correlated with the rate of inflation. In Columbia and Mexico, two mild inflation countries, he finds a "clear correlation". In two strong inflation countries, Brazil and Chile, the rate of inflation seems to have had a "varied" effect on inventories. In Brazil, "when the rate of inflation rose, inventories were increased sharply. Thereafter, even though the rate of inflation might be rapid, the rate of inventory investment reverted to a more normal level...In Chile,

1. Dorrance, op. cit. p. 53

similar effects seem to have followed after a lag." 1.

Another distortion of investment patterns is said to be found in the flight to land and buildings as a protection against rising price levels. Gudin writes; "Land and buildings have largely taken the place of foreign currency as a hedge against currency depreciation... Buildings are the most striking sign of inflation in Latin America." 2. Dorrance says that investment in "luxury housing", a frequent target of inflation critics, is however a paradox "more apparent than real", but that owner-occupied residential property is attractive in an inflationary economy because it is easy to acquire, and investment in rental property is discouraged because of government control of rents. He reaches this conclusion, although he admits "...data on the distribution of expenditures between housing and other forms of investment are scarce, and data on investment in houses for owner-occupancy are practically non-existent." 3.

Gudin states that investment in basic industries is discouraged, because the long gestation periods and large amounts of capital required, increase risks in an environment of rising costs. 4. Dorrance agrees: "In an environment of unstable prices and rising costs, the long gestation period involved in fixed investment means that its eventual cost is indeterminate and hence the possibility of financing the total cost outlay may be

1. Dorrance, op.cit. P.54. For a dissenting view see W. Baer, EDCC, July 1963; "Brazil: Inflation and Economic Efficiency." also Baer, P. 501 of B. and K.
2. Gudin, op.cit. P.351
3. Dorrance,op.cit.P54
4. Gudin, op.cit. p.351

questionable." 1. An inflationary setting distorts expectations, and short-term projects allow a more frequent opportunity to evaluate investment choices.Because of this, the fixed-asset structure of an inflationary economy will not represent the most efficient use of resources through its bias to short-term projects.

E. The Consequences of Anti-Inflation Policies;Secondary Effects;

We have described above some of the "pure" distorting effects of inflation on market processes frequently cited by monetarists. A second major area of distortion is brought about by the selective controls used by governments to reduce the impact of inflation. These devices are particularly objectionable because they create bottlenecks, distribute resources inefficiently, and lead to further price increases by inhibiting the responses of suppliers of goods and services to price signals.

In his inflation survey, Baer writes: "In most major countries of Latin America (e.g. Argentina, Brazil and Chile), the government controls the prices of public utilities (both privately and publicly owned) and sets maximum prices for basic foodstuffs."

In the agricultural sector, there seems to be an almost irresistable temptation for governments to impose price controls on basic food products. This discourages the expansion of agricultural production by limited transfers of income to the agricultural sector. Though such

1. Dorrance, op. cit. P.53
2. Baer, op. cit. P. 5

controls may help governments restrain inflationary wage increase, "it is impossible to avoid inflationary breakthrough" 1. Campos suggests that whenever price controls have been effective (Argentina and Chile), agriculture has stagnated, and further inflationary pressures introduced; in Brazil, agriculture has expanded because the control of prices was ineffective. The shortages are aggravated by speculative hoarding of producers, distributors, and consumers who expect the controlled price to be raised. Thus controls inhibit the expansion and modernization of agriculture and further compound inflation.

In order to protect their foreign exchange reserves from depletion induced by inflation, less-developed countries often make use of exchange restrictions, such as multiple exchange rates and selective controls, to encourage import-substitution activities. Campos suggests that the export agricultural sector is inhibited when overvalued rates are maintained. He suggests that in many cases in Latin America, the overvaluation of exchange rates, in the face of internal inflation, has acted as a tax on agricultural exports, the proceeds of which have been used to subsidize industry through favourable exchange rates for imports of equipment and raw materials.2. This can lead to a decline in the quantum of agricultural exports--as has happened in Argentina and Brazil. Another

1. Campos, op. cit. P. 91
2. Campos, op. cit. P. 92

Monetarist says of inflation, "The primary effect (of inflation) has been to alter income distribution to the prejudice of the exposed subsectors of the export sector.."1. In addition, the exchange-rate system can encourage the irrational import of food stuffs. Dorrance concludes: "The favorable rates provided for the import of essential commodities serves to discourage domestic production and encourage activities (usually production of nonessential goods) which are given the greatest degree of protection. Often these are not the most appropriate use for the country's resources." 2. While inflation need not develop sectoral imbalances, the controls used to reduce the effects of inflation (rather than attacking the inflation), tend to have a serious cost-restraining effect and prove "self-defeating through a long-run supply disincentive effect." 3.

In the monetarist view, the government of a country experiencing inflation will be forced to regulate the prices of a variety of goods besides basic foodstuffs, but the political reasons for controls remain the same. Campos notes four factors that tend to decrease investment in utilities such as transport communications and electric power. First, historical costs are often used as a basis for valuing capital; during inflation rates based on underestimated value will reduce profits. Second, profits are often limited by statute. Third, the "unresponsiveness" of government administration may inhibit rapid rate adjustments. Finally, there is explicit political opposition to

1. Alexandre Kafka, "The Theoretical Interpretation of Latin American Economic Development", in Ellis, op.cit.
2. Dorrance, op. cit. P. 58
3. Campos, op. cit. P. 92

rate adjustments. (Baer notes "Raising the rates on railroads, buses, electricity, telephones, milk, meat etc. exposes the government to public criticism much more than producing a budget deficit." 1.) These influences, it is said, all traceable directly or indirectly to inflation, result in "the emergence of a wide gap between the relative profitability of investment in industry and agriculture, and investment in power and transportation."2. When the rates of privately-owned utilities are controlled, government may resort to subsidies to keep them in business; Campos does not believe these are a satisfactory alternative to the incentives provided by market-determined prices.

Several other aspects of controlled rates are noted by Campos: they act as a subsidy to consumption; during inflations, taxes based on rates increase less rapidly than the increase in prices; and finally, budget deficits financing utility deficits will clearly feed inflationary pressures. Investment will face disincentives in controlled-price industries and bottlenecks will appear. 3.

The final distortion we shall discuss is the use of interest-rate controls in financial institutions and markets. Baer notes that in Brazil the maximum bank interest rate that can be charged is 12%. When the rate of price increase is greater than the legal maximum interest rate, plus ubiquitous service charges, the real interest rate would be negative. Non-economic factors will frequently

1. Baer, op.cit. P.5
2. Campos, op. cit. P. 92
3. See Baer, op.cit. P.97 for reference to several studies involving controlled utility rates in Latin America.

be used to ration available credit, and once again the market mechanism for rational resource allocation will be impaired.

F. The Balance of Payments:

According to monetarists, inflation causes disequilibrium in the balance of payments. Dorrance writes: "The frequency with which inflating countries have had to resort to the IMF for assistance, together with the relatively small drawings by non-inflating countries, provides clear evidence of the relation between strong inflation and balance-of-payments difficulties." 1. He suggests that inflation will strengthen import demand, lessen export supplies, and encourage capital flight. Large exchange depreciations become necessary. Controls to lessen the consequences of periodic overvaluation can distort investment patterns, as noted in the section above, and reduce private foreign investment.

Campos states that "inflation will almost inevitably produce an external imbalance or aggravate an existing one." 2. He notes that as an inflation proceeds, aggregate demand exceeds productive capacity. First, this increases import demand. This will limit the demands impinging on the domestic economy, and will restrict the immediate effects of inflationary pressures on domestic prices. 3.

1. Dorrance, P. 59. op.cit.
2. Campos, op. cit. P. 97
3. ibid, P. 98

Second, inflation will decrease the supply of exports. In a section based on another IMF study, Dorrance concurs,1. rising domestic demand will absorb in sales, or stockpiles, a part of those exports which are suitable for domestic consumption. While increased coffee consumption in Brazil will have little effect on its coffee export quantum, inflation can bid away general productive factors which would otherwise have been used in coffee production. In the 1953-1959 experience of raw material exporting countries divided into three groups ranging from price stability to strong inflation, the volume of exports of the stable countries rose by one-quarter, of mild-inflation countries by one-fifth, and for the strong-inflation countries, by less than one-sixteenth. "The pressure of inflation led to a domestic absorption of resources in those countries where domestic prices were rising, preventing them from participating in the expansion of world demand for their products." 2.

Latin American countries have frequently chosen exchange controls and multiple exchange rates to deal with their balance-of-payments problems. These, of course, can have general economic development dimensions in addition to controlling the external imbalance. For various reasons, according to Campos, "...exchange controls have had the effect of maintaining overvalued export rates for the traditional

1. Dorrance, op.cit. P.64, and Gertrude Lovasy, "Inflation and Exports in Primary Producing Countries."Staff Papers, Vol. IX, (1962)
2. Dorrance, op.cit. P.61. The accompanying table in the Dorrance article shows a substantial fall in export prices and volumes. Structuralists would say this is the cause, not the result, of strong inflations.

exports, (combined at times with subsidies for new exports)"1. According to Campos, a major reason for following these policies in post-war Brazil, was to assure better terms of trade; a policy which succeeded for a time. Another reason, noted above, was to transfer resources to import-replacing industries; in fact, the multiple exchange rates were an export tax, subsidizing imports judged important for development purposes. Campos suggests this policy led to "a progressive decline in the quantum of exports", 2. though the sausal chain here is certainly open to question.

Dorrance suggests that when foreign exchange reserves are depleted and the inflating country is forced to devalue, the depreciation is likely to be greater than the rise in domestic prices. "The spillover of demand into the foreign market and the reduction of exports consequent on inflation, can only be offset by a greater rise in the domestic equivalent of foreign prices than of purely domestic prices."~~2~~.3. In a group of countries experiencing various inflation rates, the depreciation of the exchange rate was 15% higher than the rise in domestic prices in mild inflation countries, while in strong inflation countries, the excess was 75%. This process is said to take place in a jerky way, as governments try to peg rates and consolidate confidence.

1. Campos, op. cit. P. 98
2. Campos, P. 98 op. cit.
3. Dorrance, P. 63. op.cit.

When the rate is maintained overvalued, the effects of inflation are magnified, and speculative anticipation of devaluation leads to difficulties in the capital account.

In a more recent comment, Campos describes the effect of inflation on the mobilization of foreign resources. Regarding private direct investment, "other things being equal, the effect of an inflationary situation would be to discourage foreign direct investments."1, though windfall profits can come to foreign investors when there is exchange overvaluation, as profit remittances will be overvalued. But exchange risks, particularly relating to long-term investments,will discourage investors, especially those who lack the "peculiar gymnastics" of those who have long done business in an inflationary environment. We have noted earlier the discouraging effects of price controls on private investment in utilities. Campos suggests this will be particularly true for foreign investors, who may require a higher level of certainty than domestic investors.

Brazil, Campos notes, has defied his own monetarist postulation of a negative relation between inflation and the inflow of direct foreign investment. He suggest a number of possible counter-acting influences; the expanding internal market, the optimistic price expectations of an inflationary boom, and the encouragement of protected

1. Campos, comment, P. 458, B. and K.

industrial investment. Though exchange controls can be negative, in that they inhibit profit remittances, their protective effect can be positive, especially when combined with fiscal incentives to particular industries.

As a further balance-of-payments consequence of inflation, it "renders more difficult the securing of financing from international agencies, as well as from the United States government." 1. Campos suggests three reasons; the technical linkage that "is supposed to exist" between inflation and balance-of-payments disequilibria, effecting future ability to pay, (related to the discouragement of exports); there is secondly "a psychological barrier in the developed countries" which leads them to regard inflation as somewhat repulsive, even when accompanied by growth; finally, there is a sort of acceptance of "a determinate link between inflation and social and political instability." 2.

One form of foreign assistance that may be encouraged by inflation is the "involuntary financing" of the commercial arrears of inflationary less-developed countries. Suppliers' credits are available even in the face of severe inflations; if the inflationary country defaults, the exporting, advanced country may finance the private exporters' claim on the less-developed country. This may

1,2. ibid, P. 460

be one benefit of keeping imports at levels beyond "rational" import capacity.

But monetarists believe that, in the final analysis, inflation is decisively negative in its ultimate effect on the balance-of-payments and foreign-resource mobilization. Inflation, it is claimed, reduces the flow of resources for development from both domestic and foreign sources, and distorts the use of resources that are available, further impeding the growth of the economy.

IV The Structuralist Position.

Because of the diversity of their points of view, the structuralist position is perhaps more difficult to summarize than that of the monetarists. Aside from a mutual emphasis on sectoral imbalances as the initial cause of inflation and a common opposition to "orthodox" stabilization programs, there is considerable disagreement on the mechanisms of inflation and the policies to deal with it. This is particularly evident in the disagreement on the use of inflation as an instrument of forced saving; in a separate section, we shall discuss this controversy, and outline the ECLA synthesis on inflation and growth. In this section we shall discuss the internal and external bottlenecks that hold a central position in the structuralist argument, and review the broad intellectual setting of the debate, as seen by several prominent structuralists.

A.- Ideologies of Development;

It is essential to underline the suspicion with which many structuralists regard the economic theories that seem to justify the IMF policies of monetary stabilization. They believe the tone of academic, analytic neutrality in recommendations of anti-inflationary policy, really contain political value judgments with which they profoundly disagree. They do not believe that the object of development policy should be to provide a stable framework for private-sector growth.

This is what Dudley Seers means when he says that this "is not just a technical issue in economic theory". Seers considers that behind an emphasis on the monetary causes of inflation, lies the assumption that the goal of development is to establish an atmosphere in which "private enterprise responding to opportunities of profit" will save and invest in the best interests of economic growth. The call for a stable price level and exchange rate is really a call for a stable society, and development through the unimpaired mechanisms of classical liberalism. 1.

Seers continues to describe the decline of classical liberalism in the developed countries, suggesting this was caused by the discovery that the doctrine was based on unrealistic theoretical assumptions and unpleasant political realities. He suggests that the "invisible hand" has become irrelevant because perfect competition cannot exist, because the developed countries have reverted to protection, and that the quantity theory of money and "sound finance" have been overthrown by the Keynesian revolution. He also suggests, 2. that "the distributional tenets of the (liberal) school have never been attractive to thenpoor". Seers appears to believe

1,2. Seers, '...the Heart of the Controversy' B. and K. P. 89,92 that those who propose monetary stabilization are classical liberals; at the very least, orthodoxy is irrelevant, and its politics are suspect.

Baer notes that the structuralists in general state "that the problem of inflation in Latin America should be viewed against the broad sweep of socio-economic developments in the region." 1. Drawing on Seer's article above, and a less sweeping article, 2. we shall see how a representative structuralist perceives the Latin American economic reality. This reality both reflects and heightens their suspicion about "orthodox economics" in theory and as a practical remedy.

Seers sets out his "assumptions" as follows: In the foreign sector, each country relies on a few important primary exports, for which the home market is limited, and the world market is stagnant. Balance-of-payments crises, for these reasons, are chronic and severe. Most manufactured goods are imported. Internally, productive factors are weak; the majority of the population is rural, illiterate, and unskilled; land is privately owned and very unevenly distributed; capital markets are weak. The supply of enterprise is inelastic. Institutionally, transport is meagre and overloaded; agriculture

1. Baer, Survey, op. cit. P. 7

2. D. Seers, "A Theory of Growth and Inflation Based on Latin American Experience." OEP, June, 1962, frequently cited as the best example of rigourous, structuralist writing.

(except for export) is highly inefficient; manufacturing is monopolistic (often because of small markets); labour has some political power; public administration is limited by meagre tax revenues. Seers suggests that because of mounting population, aspirations, and urbanization, the economy must grow at least 5.5% per year, if discontent is to be contained.

Seers considers that development involves major inter-sectoral shifts of resources, if this is to be accomplished through the price system (1.2.) when prices are inflexible downwards, there will be strong upward pressures on prices.

The existing distribution of income means that consumption will bear little relation to need or economic development, as the affluent are not thrifty. The ill effects of income distribution are partially mitigated by taxation and import controls; "a policy of dispensing with devices of this kind, in the name of economic liberalism, in order to make prices more "realistic", may simultaneously impair the process of development and raise political tensions". 3.

Free-trade prescriptions are said to be the "most obviously unacceptable in Latin America". 3. Firstly,

1. Seers, ibid. P. 97 ff.
2. A. O. Hirschman, The Strategy of Economic Development, 156-166, emphasizes the necessity for price increases to resolve the sectoral disequilibria of the growth process.
3. Seers, op. cit.

Seers doubts, theoretically, that Latin America would benefit from a freely competitive international economy. Secondly, he sees Latin America facing a world filled with import restriction, and Latin America would never benefit by unilaterally opening its doors "to the full force of international competition". In addition, he suggests the doctrines of free trade are negated by the lack of factor mobility <u>into Latin America</u> as a way of lessening international disparities, and the amendments that must be made to comparative advantage specialization, when there is chronic, disguised unemployment. These international "realities", Seers contends, "make it really out of the question for a Latin American economist to be a thoroughgoing member of the classical school."

What is the implication of Seer's analysis of classical liberalism and Latin American realities? There is little original in showing that the assumptions of pure competition and free trade are somewhat unrealistic. His description of the realities of Latin American under development are not particularly controversial, despite his political reservations on income distribution. What is lacking is a linkage between his rejection of classical perfections and his rejection of market mechanisms as an economic reality. There is no evidence advanced that private enterprise <u>could not</u> be the medium of dynamic growth in Latin American development.

Seers seems to be saying that the anti-inflation policies of the IMF are based on the authority of discredited theories to impose an economic system with an unappealing social character. Unless the IMF has been guilty of some remarkable ex cathedra arguments, Seers' argument seems slightly incoherent. Neither developed mixed economies, nor the IMF, are based on classical liberal orthodoxies; the rejection of private-enterprise development (which functions despite imperfect competition etc.) for Latin America seems to be political, as the enthusiastic destruction of laisser-faire orthodoxies hardly amounts to the destruction of private enterprise as a credible development system.

Seers, like many structuralists, shifts ground with some facility. It does not follow that because neo-classical theories are incongruent with Latin American realities, contemporary IMF policies are unacceptable. It is possible, of course, to argue that private enterprise is not the most efficient agent of development for Latin America; many structuralists have made this point. It is insufficient, however, to prove this crucial point by analysis of Adam Smith.

It is correct, however, that the stabilization programs imply that the environment for private enterprise should be improved. David Felix, a non-structuralist, notes: "This may be inferred from the reduced role assigned in the programs to public investment...no dramatic increase of taxes is postulated either as part of the stabilization effort or of the subsequent development effort." 1. Structuralists are unambiguously opposed to this priority in development expenditure for a variety of economic and political issues beyond the specific question of inflation.

As Felix notes, the focus of the monetarist-structuralist debate is the package of policies proposed by the IMF for strong-inflation countries. 2. It is instructive to ask what questions structuralists feel they are answering in the controversy over inflation.

Firstly, there are several things the debate is not about. Structuralists do not deny that the money supply and prices are closely related, despite the complexity of the relationship. 3. They do not feel monetary factors are irrelevant. Secondly, the objectives of policy seem eventually the same; to end inflation. Seers says,"other things being equal, stability favours growth." Structuralists usually concur with the bulk of monetarist output when they list, and agree to the distorting effects of inflation.

1. D. Felix, "An Alternate View of the 'Monetarist-Structuralist Controversy', in Hirschman, L.A.Issues,P.82
2. D. Felix, "Monetarists, Structuralists and Import-Substituting Industrialization." B. and K. P.370
3. Grunwald, op.cit. B. and K. P. 290

To Seers, the debate is over the question of whether rapid growth can ever take place in the Latin American environment (without booming exports) without inflation. If it cannot, due to the structure of the economy, stabilization programs will stop price increases, but they will also stop economic growth, with dramatic political consequences. If governments are supporting inflation by increasing the money supply, it is for valid economic and political reasons, not fiscal irresponsibility. Grunwald writes, "the hands of the authorities are forced by exogenous circumstances". 1.

These pressures on policy are the substance of the structuralist position on inflation and growth, and we shall investigate them in terms of internal and external "bottlenecks". We have seen something of the intellectual setting of the structuralist position on inflation. After making certain judgments on the ends of Latin American development, structuralists deploy a variety of arguments on the means to attain them, and oppose those which would strengthen the status quo. We shall now turn to their specific analyses of inflation.

B. Internal Bottlenecks;

For the structuralist, inflation is a manifestation of imbalances in economic structure. It is their contention that policies of monetary stabilization only attack what

1. Grunwald, op. cit. B. and K. P.290

they designate as cumulative and propogating factors in the inflationary process. The cause of inflation, and the core of potential inflation that would remain even if stabilization were temporarily effective, are the "basic" factors, such as agricultural and import "inelasticities". As Grunwald suggests,(1.) structuralists seldom specify what concept of inelasticity is meant: roughly, they mean that the supply of goods does not meet changes in the quantity and composition of demand without powerful pressures on the price level. Internally, this "inelasticity" is a function of inefficient and immobile internal resources.

The internal bottleneck that first attracted the attention of structuralists was the "inelasticity" of agricultural production for domestic consumption. 2. Felix states their case formally: where money wages and industrial prices are rigid downwards, "prices will rise if the growth of per capita income, times the income elasticity of demand for food, exceeds the rate of growth of food production per capita." 3. (closed economy) As the income elasticity of demand for food in a less-developed country is likely to be high--perhaps 0.5 - 0.6--"a slow rate of growth of agricultural production per capita, (in Chile, the rate has been negative) limits the non-inflationary

1. Grunwald, "The Structuralist School on Price Stability and Development; the Chilean Case", L.A.Issues,P.110
2. The seminal structuralists on internal inelasticities are Anibal Pinto and Osvaldo Sunkel, with particular reference to Chile.
3. Felix, B. and K., P. 379 op.cit.

increase in aggregate output per capita to perhaps twice the rate of growth of food output per capita."

The structure of agricultural production inhibits the responsiveness of agriculture. In particular, the land tenure system--latifundia-minifundia--is said tobe counter-productive. Baer writes that the socio-economic structures "are dominated by either large non-capitalistic latifundios, which are not interested in profit maximization, or by minifundia which barely eke out a living and are scarcely integrated into the larger market economy." 1.

The workers in the cities are thus faced with rapidly increasing food prices as their incomes increase. Because food takes up a large part of the city worker's budget, (Baer says 45% in Brazil), the subsistence wage will increase. Monopolistic producers are said to pass on their increased wage costs to the consumers, raising the cost of living once again. To the extent that workers can protect their real incomes, they will demand higher wages, and as Felix says: "excess demand inflation in the agricultural sector becomes cost inflation for the rest of the economy." 2. The inadequate supply of agricultural produce--and a limited food import capacity--starts the inflation; it is sustained by a wage-price spiral.

1. Baer, "Survey", op. cit. P. 8

2. Felix, op. cit. B. and K. P. 379

Grunwald writes that the problem of inflation is compounded because of the "structuralist" factor of highly unequal income distribution. "Large sectors of the community, whose incomes are close to subsistence levels, must be protected by repressing inflation in essential goods and services. This means that some fundamental products will be subjected to price controls, which, in turn, constitute a disincentive for agricultural output." 1.

Another "structural" effect of income distribution is an inadequate saving rate because of "a completely disproportionate propensity to consume of the upper income classes." 2. Nicholas Kaldor has claimed that if the upper income classes of Chile had the same consumption-investment propensities as their counterparts in the more advanced countries, the saving rate could be doubled. 2. In addition, import substitution and industrialization catering to the demand of the upper classes are said to pre-empt investment in growth industries and social over-head capital.

Another internal "structural" factor is the instability and "inadequacy" of government revenues, and the rigidity of government expenditures. Export taxes

1. Grunwald, L. A. Issues, op. cit. P. 111
2. ibid. P. 114. (Kaldor un-cited) This is similar to Galbraith's diagnosis of Latin American realities: the extravagant consumption of classes who receive "non-functional (property, etc.) incomes.

are vital sources of revenue, and export prices vary greatly; government salaries and social security payments are incompressible. The tax system is said to be inadequate to the needs of government, as well as unstable, and an added inflationary influence because it is indirect: "whenever revenues have to be increased, resort to the tax system will have a direct effect on increasing the price level." 1. The instability of revenue causes inflation because when revenues fall, the government either cuts public investment, to the detriment of economic development, or runs a budget deficit to pay for the investments--thus creating inflationary pressures. (Government revenues seem to be called structural because governments expand their activities on the basis of high export prices and are unable to retrench when the revenues--as might be predicted--fall with export prices. This amounts to a "need" argument for inflationary forced saving, which we shall consider further below.)

C-External Bottlenecks:

Probably the most important "inelasticity" in the structuralist system is the import bottleneck. While the process of domestic economic development demands increasing inputs of foreign goods, the "purchasing power of exports", which consider both export volumes and movements

1. Grunwald, L. A. Issues, op. cit. P. 115

in the terms of trade, has grown very slowly. The slow growth of traditional exports has been caused by "a low income elasticity of demand for such products in advanced countries, partially due to the introduction of synthetic substitutes, and also due to the preferences that some African and Asian countries have obtained in the European market." 1.

The problem of slow continental growth of exports and growing development demand for imports, is magnified in the case of individual Latin American countries due to the fluctuations in prices and volumes of individual commodity exports. This means chronic and severe fluctuations in national incomes, government revenues, and the balance-of-payments of mono-product exporters.

Seers, in his formalization of structuralist thinking, 2. attempts to analyze the consequences of export trends that, in Latin America, "have meant a chronic and growing shortage of imports, exerting a chronic and growing pressure on the price level." 3.

In his model of an economy that must import its manufactured goods, it follows from his assumptions that the demand for manufactured goods will increase faster than GDP will increase. This leads to the conclusion

1. Baer, Survey, op.cit. P.9

2. Seers, OEP, op cit. We have discussed the assumptions of this model in an earlier section.

3. Seers, op. cit. P. 178

that exports must grow faster than national product if "dynamic equilibrium" is to be sustained. The concept of economic and social dynamic equilibrium is introduced where, $\frac{dY'}{dt} = \frac{dP}{dt} + \frac{dI'}{dt}$ Y' is minimum tolerable GDP, I' is minimum tolerable per capita product, P is population and t is time. From this formula, Seers deduces "the rate of expansion of exports in percentage terms must exceed the rate of growth of population by a substantial degree." 1. Export stagnation causes domestic inflation.

In a second case, Seers suggests, import substitution is followed in order to industrialize, despite the export bottleneck. But this accelerates the need for imported inputs even more at first: "...in the end, by the time a country is making its own equipment, import substitution will bring some decrease in the propensity to import, but this may not be achieved for two to three decades." 2. The various immobilities and inefficiencies involved in new domestic production lead to higher costs and pressures on domestic resources that, in turn, lead to inflation. A cumulative spiral is set in motion, which in turn reduces and distorts domestic investment.

1. ibid, P. 178

2. ibid. P. 179

In this way, lack of import capacity is said to lead to inflation. Grunwald quotes the ECLA study, "Inflation and Growth", 1. stating that the fundamental exogenous force,operating on Latin American economic development, has been "the collapse of export earnings in Latin America, after 1929." The study emphasizes the important, second step in the "import bottleneck" argument, which suggests that a process of import substitution has been forced upon them by the collapse of the capacity to import.

The steps that lead to import substitution, and the process itself, are said to have inflationary effects. The chronic balance-of-payments problems of Latin America, which are traced to structural discrepancies between the income elasticities of demand for imports in developed and less-developed countries, lead to chronic balance-of-payments problems and import and exchange restrictions. "Control of imports, implying the cutting down of imports to the size of export receipts, will create shortages of many formerly imported goods. The relative domestic prices of these goods will rise and thus contribute to the inflationary force." 2. Equally, devaluations will mean an increase in the domestic price of many imported goods.

Import substitution has both balance-of-payments and strategic dimensions. It circumvents the foreign-exchange constraint, and it is said to have valuable

1. Grunwald, op.cit. P. 290. The study is six volumes, mimeographed, and difficult to obtain.
2. Baer, Survey, P.9

domestic linkage effects. But structuralists also suggest that it is strongly inflationary, and "import substitution introduces rigidities so that sometimes the net benefit of the policy has been difficult to assess." 1. Firstly, the changing composition of imports to more finished capital goods and raw materials can make the economy even more sensitive to export fluctuations. It is more difficult to stop the production of a plant,because materials are blocked by foreign-exchange problems, than to reduce imports of finished goods. Secondly, "if the new industry is "inefficient" from the point of view of the international divisionnof labour, its productivity will be low, its prices necessarily high, and permanent protection will be needed." 2. Finally, small markets frequently imply a degree of monopoly, if minimum cost plants are to work in a protected economy.

In this way, both the import bottleneck and the principal policy deployed against it, are basic causes of inflation.

E. Additional Factors:

Besides these "structural" factors, structuralists distinguish several other types of forces in the inflationary process. They describe as "circumstantial" factors such as "exogenous price increases, political

1. Grunwald, op. cit. P. 113
2. ibid. P. 115

up-heavals, catastrophes, and, with special emphasis, irrational government interventionism." 1. Deficient public administration and incompetent controls all have influence on the price level.

In addition, structuralists denote "propagating factors", according to which various classes in the economy are able to defend their real incomes through credit expansion, cost-of-living wage and salary adjustment mechanisms, and government deficit spending. These are the factors that structuralists claim the stabilization programs are attacking, as we shall see in the discussion of inflation and policy. These propagating factors are of interest and importance in Latin American experience, where markets, factors of production and sectors have adapted to high, steady rates of price increase. Economic agents protect real income in this environment with policies that seem to sustain the inflation rate.

1. Grunwald, op. cit. P. 115

V- Structuralist Policies

Structuralists consider the stabilization programs, undertaken by some Latin American nations at the insistence of the IMF, to have been disaster in the economic development of the continent. The ECLA Economic Survey of Latin America (1967) notes, with as much restraint as can be expected from the organization, that the period of the fifties was marked by stabilization programs where "the sporadic nature of their measures, combined with the piecemeal and inconsistent character of the instruments used, helps explain why the results obtained were ephemeral.."1. Later programs put greater emphasis on wage and public-expenditure restraint, but "although these measures did serve to curb inflation, their social and economic cost was evidently high, and after the initial impact, and in part as a result of their undesirable repercussions, the trend towards monetary disequilibrium re-emerged with varying degrees of intensity." 1.

Osvaldo Sunkel is more outspoken in his condemnation of the programs; "the recent experiences show that classic stabilization programs are doomed to failure. ...complaints, resistance, violent criticisms, and complete failures met by stabilization programs in Latin America are basically due to the fact that they were

1. P. 40

presented as alternatives and substitutes for a legitimate and realistic policy of economic and social development."1. Structuralists complain that the programs failed because they cut public investment--and private investment--rather than increasing saving. Sunkel writes: "...investment was the more flexible element of public expenditures and its contraction caused a violent decline in the building industry." 2. The chief complaint of the structuralists is that an "orthodox" stabilization program damages just those dynamic sectors in the economy that are the potential vehicles of economic development.

As Seers says, inflation and growth is better than stability and stagnation, if stability and growth is not possible. As we shall see in the section on forced saving, some structuralists are strongly opposed to inflation on equity grounds: "If the system under which we live cannot develop without it, inflation will be an alternative that leads nowhere..for it corrodes the economy and dangerously disrupts society. Impossible, then, to deny the rationality of inflation as an instrument, not to infuse the system with dynamic vigour, but to sweep it inexorably onward to disintegration." (sic) 3. However, the remedy of stagnation is not acceptable as it reduces output, saving and investment, and brings about no fundamental reforms.

1.2. Comment, B. and K. P.423-427

3. "Ec. Dev. or Monetary Stability, the False Dilemma", Economic Bulletin for Latin America, March 1961, P.25

Most structuralists would recommend that stabilization should be a gradual process, with increases in taxation financing increased public-investment activity, and the public activities that previously were financed through deficit spending. But one observer has written: "...the substantial increase in taxes needed for stabilization would probably have led initially to a further curtailing of private consumption, reduced employment in some of the sumptory domestic industries, and an increase in the relative importance of the public sector, which would run counter to the economic philosophy of the stabilization program managers." 1.

The structuralist school holds that stabilization programs attack only the symptoms and propagating factors of inflation, resulting in a paralysis that reduces activity in sectors of the economy to their lowest common denominator to end inflation. For the structuralists, correction of the basic causes of inflation demands long-range structural reform. The solution is the wide policy package that is the answer to most structuralist problems.

Monetarists generally criticize the structuralists when they discuss their policy proposals. Campos, for instance, finds them incoherent and obscure. While there is a lack of specific policies 2. to deal with inflation,

1. Felix, op. cit. P. 377-378 B. and K.
2. Campos, L. A. Issues, P. 117

there is a fairly unified and certainly vehemently-held philosophy of structural reform, which, to the structuralist would meet a broad range of economic development needs, including the problem of monetary disequilibrium.

The first of these broad reforms is directed towards flexibility in internal production, particularly in agriculture. The government of an inflationary, less-developed country should increase the flow of resources to agriculture, through investment in transportation, irrigation and tachnical assistance. Price controls must be removed, as they contribute to the bottleneck, but the distribution of income must be improved of those in the community who buy the food. The burden of stabilization must be equitably shared. Land-tenure reform is an important part of structuralist reform, though there is considerable diversity of opinion on the exact configuration of policies. Some would propose outright expropriation and division on equity grounds; others would use the fiscal system to make production in existing hands more efficient. Increasing the purchasing power of the masses is an important part of agricultural reform: "...with a small agricultural market for the masses, there is little stimulus to innovate in the domestically oriented agricultural sector...we must avoid the error of thinking only in terms of obstacles from the supply side." 1.

1. A. Pinto, op. cit. P. 440. B. and K.

Structuralists consider that balance-of-payments problems cause inflation rather than the reverse, and structural reforms are again advocated. They advance several proposals to reduce the vulnerability of the economy to foreign vagaries and consequent limitations on domestic policy. Policies of import substitution would continue, but "must be such that maximum internal economic activity can be maintained when exports fall to their lowest point."1. Some simple but multiple system of exchange rates would be retained in order to diversify exports, through incentives. The government should finance both social overhead capital and directly productive activities, in order to minimize imports and diversify exports. The problem of unstable export fiscal revenues can be met through the use of contingency funds to stabilize total expenditures. The role of foreign aid is ignored by some structuralists and emphasized by others. 2. Foreign investment is generally ignored by structuralists. Currently, the Latin American common market is the focus of structuralist reform of the external bottleneck.

Monetary and fiscal policies would complement long-term structural reforms. More selective credit policies would accompany increased government intervention in the economy. Fiscal measures would finance greater government

1. "Inflation": Economic Development, Planning and International Co-operation. ECLA. P. 39
2. see Urquidi, op. cit., an alliance for progress" structuralist.

investment; as Seers says, "It should not be concluded that budgets ought to be left unbalanced, or credit should be liberally given away--The economic prospects of most Latin American countries would be considerably better if twice as much was collected in direct taxes and if credit was restricted for nonessential purposes." 1. The central point is that structuralists want to increase saving to the rate of investment, while monetarists are accused of reducing investment to saving through stabilization.

In his summary of the Rio conference, that produced the seminal Baer and Kerstenetzky volume, Richard Ruggles says, "there was general agreement that fiscal reform was required in Latin America." 2. It is doubtful, however, that members of the monetarist and structuralist schools were much in agreement on the scope and direction of the reforms and the use of the revenues. For structuralists, the government should be the dynamic and controlling element in the economy, and their structural reforms reflect this judgment. They seldom emphasize the role of private investment, domestic and foreign, and believe that stabilization programs are devices that implicitly place the reliance for economic development on private sources. The many dimensions of this economic and political bias, suggested above, are the key to understanding structuralist inflation--and development--policy.

1. Seers, B. and K., P. 103
2. Ruggles, Summary, B. and K., P. 18

Leaf 72 omitted in page numbering.

VI- Monetarist Policies; Stabilization Programs

Monetarists believe their analysis leads to the inescapable conclusion that " an economy experiencing inflation must be one where development is proceeding less rapidly than it would if the economy were stable, all other conditions being similar." 1. Though it is "one of the least pleasant operations facing a responsible government" 2. the distortions and balance of payments problems that ensue from inflation make stabilization of the economy a necessary condition of economic progress.

Monetarist stabilization programs attack the roots of inflation (as seen by monetarists) by reducing excess demand through elimination of budget deficits (expenditures by government down, tax revenues occasionally up), curtailment of inflationary credit expansion, inflationary subsidies, and inflationary wage increases. Exchange controls would be abolished. Baer notes that the control of wage increase has two justifications; it will reduce aggregate demand and increase the profit margins of entrepreneurs. The IMF and the IBRD provide assistance in the process of stabilization, making it more politically tolerable.

Dorrance suggest that the restructuring of the economy as a result of stabilization will mean a change in the

1. Dorrance, op. cit. P. 63

2. Baer, Survey, P. 7

composition of demand. The fact that some of the flows of resources suitable to an inflationary economy must be re-chanelled to be appropriate in a stabilized economy can lead to temporarily depressive influences. Investment will be cut back in industries that are non-economic in a non-inflationary economy, or were previously protected by exchange regulations; there will be some lag before new opportunities are perceived by entrepreneurs.

In addition there will be important dis-investment from inventories, and movement from real to financial assets. But these effects are said to be temporary; "the period of uncertainty must pass, and a new set of expectations should enable investors to make plans for future capital creation, with a consequent rise in their demand for resources." 1. The process of adjustment may cause a temporary reduction in output, but the enhanced rationality and quantity of domestic and foreign investment decisions will generate net long term benefits.

For monetarists these sacrifices of stabilization are temporary and purifying.

Monetarists generally argue that their programs should be introduced firmly and swiftly in order to be effective. Dorrance suggests that the community must be convinced that the government intends to stabilize the value of money. "The persistence of expectations as to the movements of

1. Dorrance, ibid. P.65

prices is a particular problem..."1. The community must be convinced that the government has the will to carry through the stabilization program, or there will be a lingering and damaging distrust of financial assets.

The opportunity cost of holding foreign financial assets and inventories is low even if the program succeeds; if it fails such asset-holders will gain substantially. Fredrich Lutz writes, "All the rapid inflations of which I Know have come to an end suddenly... experience as well as theoretical reasoning leads me to believe that a change in the public's attitude about the future movement of prices is a pre-requisite of stabilization. And this can only be brought about by administering a shock to the economy." 2. Impact and duration are thus seen of central importance to stabilization programs.

1. Dorrance, op.cit. P. 67

2. Lutz, op.cit. P. 484-485

The Monetarist Rebuttal

We shall briefly investigate the monetarist view of structuralism, to see if any concessions are made to the theoretical and practical challenge to the "conventional wisdom".

To one monetarist, the development of a new theory of inflation which regards changes in the money supply as "merely passive adjustments to irresistible autonomous pressures generated by bottlenecks.... an exercise in unnecessary originality."1. Campos, from his observations of Latin America, remarks that in heavy-inflation countries, the money supply has been expanded at such an order of magnitude so as to outstrip any possibility of growth of supply. At this rate, no economy could avoid inflation. Lutz says bluntly: "I can see how structural pressures can cause inflationary pressures, but I cannot see how they can explain an inflation of 60% per year." 2.

Two theses are suggested as to why monetary authorities are prone to such excesses in Latin America. The first that Campos suggests is that the pressures "are irresistible in the process of growth". He finds this unpersuasive, as some Latin American countries have achieved growth with little or no inflation; the gross-inflation countries have,in recent times, grown without inflation; and the irresistible demands for development

1. Campos, L.A. Issues, P. 71
2. Lutz, comment, B. and K. P. 483

programs can be met through other finance systems. In this way the passive adjustment of the money supply is not the necessary concomitant of growth in Latin America. Similar criticisms can be brought to the supply, institutional and capacity-to-import bottlenecks; some countries have been able to promote development and control inflation despite them--or without resorting to them as explanatory devices. In short, "the inflated countries are those that choose incompatible targets". 1.

Campos considers that the problem of bottlenecks has been generalized from the experience of Chile to the whole of Latin America by the ECLA. He does not believe they are autonomous and causal factors in the inflationary process. The half-hearted effort to control inflation in Chile repressed the inflation through controls which generated bottlenecks. In this sense, the bottlenecks are the creatures of policy, are open to correction, and should be the objective of policy. They contribute to the problem of inflation control, but are not autonomous and irresistible.

Balanced growth, as such, is impossible; there will always be leads and lags in development, according to Campos, but it is political policies "that convert self-correcting disequilibria inherent in the growth process into induced and cumulative ones." 2. A basic part of these policies is the use of controls: bottlenecks appear

1. Campos, op. cit. P. 73
2. Ibid. P. 74

in transport and electricity because rates are frozen, food supply is restricted because it is restrained by price controls; frozen interest rates force savers out of monetary assets; multiple exchange rates encourage consumption, perverse import substitution and discourages exports.

Of particular relevance is the structuralist idea that "capacity to import" has been an independent datum in Latin American economic development, and thereby an autonomous cause of inflation. Campos writes: "practically all of the inflated Latin American countries have biased their development programs in an anti-export direction." 1. While Argentina, Brazil and Chile discouraged exports, Mexico and Venezuala did not; equally, they did not suffer the same import "inelasticity". Campos has some sympathy for the Prebisch-Singer thesis, and believes it is possible that exports could grow at less than the required rate even with a rational development policy. The obvious solution in this case is the importation of foreign direct and loan capital, private and public.

Campos suggests that it is up to the structuralists to demonstrate that "the bottleneck has not gone beyond the normally expected gap, precisely as a result of inflationary policies and anti-export, biased development programs." 2. He considers the basic contradiction in structuralist thinking is their emphasis on the sluggish supply and import structures of less-developed countries.

1. Campos, op.cit. P.77
2. ibid. P. 78

"They ought to conclude logically that the only possible effective attack on inflation would be a contraction of excess demand; precisely what the "monetarists" have advocated all along." 1.

For the future formulation of stabilization programs, Campos notes some important lessons in the structuralist emphasis on supply inelasticities. They can exert a "derived causal role" usually as a result of controls; and "stabilization programs may have to adapt themselves to the fact that in its initial phases the repressed inflation may have to be converted into an open one", 2. as controlled prices are allowed to increase.

One positive contribution of the Monetarist-structuralist debate has been the recognition that purely monetary measures are inadequate to deal with strong inflations in less-developed countries. Some early monetarists and stabilization programs seemed to reflect this view. Clearly, "unscrambling" an inflation that has been going on for generations in a less-developed country, needs additional tools to those required in an advanced economy. Foreign assistance, sophisticated fiscal measures, an incomes policy, the moderation of direct controls, and perhaps specific re-orientation of investment patterns towards "bottleneck" sectors, whatever their initial cause,

1. Campos, op. cit. P. 79

2. ibid. P. 68

are part of "advanced" stabilization policies. But whatever the difficulties and dimensions of stabilization, monetarists would generally still agree, and structuralists would generally disagree, that sharp price stabilization "is a prerequisite to rapid economic growth". 1.

β The Experience of Stabilization:

From a neutral point of view, the stabilization programs of the fifties and sixties in Latin America have been rather unsuccessful. Some review of this experience seems in order (2.) as these programs have been the raison d'etre of the monetarist-structuralist controversy. Needless to say, the experience of stabilization was sufficiently ambiguous to allow wide latitude of interpretation. Here we shall briefly consider the stabilization efforts of Chile in the mid-fifties, Argentina in the late fifties, and Brazil in the period 1964-1966.

Baer notes that the stabilization program in Chile reduced inflation from 70% per annum in 1954, to 40% in 1956. The program used a range of wage, credit, foreign exchange and budgetary techniques, and all were, to some extent, successful. "As a consequence of the program, the per capita gross domestic product declined by 8% in 1956, and even by 1960 it had not recovered from that decline. Unemployment grew throughout the fifties." 3.

1. Dorrance, op. cit. P. 68
2. Baer, "Survey", op. cit. P. 15-18. This section draws on Baer's summary.
3. ibid

The Klein-Saks Mission, the private American consulting firm that recommended the program "was not able to sell the structuralist aspects of the program...such as tax reforms, budget policy, and others," 1. because of political difficulties. Poor harvests, rising food prices, a fall in the world price of copper and increasingly effective wage and credit demands, made the program increasingly vulnerable. "Rioting in April, 1958, led to the abandonment of both monetary and fiscal restraints." 2. Earthquakes and poor harvests overcame a second effort at stabilization in 1959 and 1960.

In Argentina, a stabilization program under the auspicies of the IMF was initiated by the Frondizi government, in 1958. Controls on trade, foreign exchange, and internal prices were removed; credit and subsidies were reduced; wages were controlled; attempts were made to improve government efficiency; and IMF loans helped the foreign-exchange position. "The rate of inflation declined and there was a decline of GDP of 5% in 1959." 2. Stagnation followed a brief recovery, exports of beef fell because of heightened domestic demand, and a Peronist labour vote, dissatisfied with wages, overthrew the government; the stabilization program was abandoned. Baer quotes Alejandro: "The stabilizers claimed their program was wrecked because of the poor showing of food production."

1. Grunwald, op. cit. P. 103
2. Baer, op. cit. P. 16

In Brazil, severe credit, wage, and government-expenditure restrictions were introduced by an authoritarian government to attack an annual inflation rate of 80% in 1966. The success of this effort, which was the "real world" focus of the important 1963 Rio conference, is not yet determined. The New York Times recently reported that the rate of inflation had been reduced from 41.1% in 1966, to 24.5% in 1967. However, "a recession crept up on Brazil early in 1967, mostly because of the stringent anti-inflationary policy of the "revolutionary" government of the late President Humberto Branco. By mid-year, business failures had reached record proportions and production in most sectors was lagging." 1. A strong recovery of output has apparently followed the relaxation of these policies by the new Costa e Silva government.

There is little doubt that the stabilization programs have produced stagnation, but there is doubt whether or not it has been therapeutic. Baer concludes : "the pro-stabilization forces will claim that their programs were never given a chance, that all sorts of extenuating circumstances impeded them, while the other side will claim that the stagnation already experienced was bad enough and could not be allowed to go on." 2.

1. P. L. Montgomery, "Brazil Inflation Down but not Out", New York Times, Economic Survey of the Americas, January 22, 1968.

2. Baer, op. cit. P. 16 ff.

Stabilization policies remain a critical economic and political issue in Latin America, as high rates of inflation persist. 1.

1. The issue is current and controversial in Colombia. The flavour is indicated in "Colombia Weathers a Monetary Crisis" NYT Jan. 1968. "The unusual contest between Colombia and the IMF began soon after President Hleras, himself an economist, was sworn in as chief of state in August, 1966. Citing Colombia's chronic imbalance of trade, the Fund said that the exchange rate of 13.5 pesos to the dollar was discouraging investment and was too high in relation to the country's reserves...it was broadly hinted that continued help from foreign lenders would be contingent on a "more realistic rate of exchange"...the President argued that devaluation had never helped in the past and... would stimulate inflation. The peso was freed and has risen to 16.5 to the dollar.

VII The "Forced Saving" Issue

A. Introduction:

In this section, we shall examine first the views of some authorities outside the specific framework of the Latin American economic development controversies on the usefulness of the technique in less-developed countries and the costs involved in its use. Secondly, with some tentative generalizations in hand we shall approach the views of monetarists and structuralists on the issue. The distinction between initiating and propagating factors is important in analyzing the Latin American inflation experience; the discussion of forced saving introduces some essentially political factors in the propagating factors, that helps to explain strong inflations in Latin America.

In this section, we shall discuss the validity of a deliberate policy of resource mobilization for economic development through inflationary credit manipulation. The political volatility of this type of policy sometimes inhibits its outright advocacy, but it certainly exists as an important "underworld" doctrine in some less-developed countries. We shall see that some structuralists perform conceptual gymnastics to justify what is simply a policy of forced saving, while others reject it on income-distribution grounds. Monetarists reject the system as inefficient.

J. G. Gurley describes inflation as a resource-mobilization system, akin to the fiscal method: "as a technique for mobilizing savings, inflation is designed to alter relative prices, and hence incomes, with the aim of increasing savings, and directing them to private investors." 1. Whether the ultimate investor is private or public, the saver is private: like a tax-subsidy system, the saving is involuntary. We shall investigate the conditions under which this sacrifice of consumption can be successfully imposed.

One important area of inflation as policy which we shall not discuss in detail, is the notion that some mild form of inflation is perfectly acceptable and valuable policy objective, in both developed and less-developed countries. Arthur Lewis writes of developed economies: "If people invest not primarily to innovate, but primarily because demand presses on capacity, the policy of keeping demand and supply exactly equal results in slow growth and low investment. The remedy is to keep the monetary tap slightly open--just 1% or 2% per annum--to keep order books slightly over full." 2. The monetarist-structuralist debate is not concerned with inflation of this magnitude.

1. J. G. Gurley, "Financial Structures in Developing Economies". David Krivine (ed.) <u>Fiscal and Monetary Problems in Developing States</u>. P. 106

2. Lewis, B. and K., P. 29

In underdeveloped countries, where it is generally agreed that immobilities are stronger and inter-sectoral shifts relatively more profound during growth, the permissible rate is perhaps higher. 1. Excluding external considerations, Harry Johnson writes: "thus one might expect that whereas tolerable price 'stability' in an advanced economy is frequently defined as a rate of inflation of no more than 1% or 2% a year, the tolerable degree of stability might be in the range of 4% to 6% annual rate of price increase." 2. These 'dynamic' arguments for inflation in countries with downward rigid prices, which imply a modest 'structuralism' do not justify strong inflation, or advocate inflation for redistribution and mobilization purposes. But some inflation can be accepted in developed and less-developed countries, as a consequence of growth.

β Theoretical Statement:

Though it has been debated in one form or another for hundreds of years, the popular version of the "forced saving" doctrine is now usually presented in Keynesian terms, deriving much from the Treatise and Tract as well as the General Theory.

When aggregate money demand is greater than aggregate supply at ruling prices, prices must increase.

1. This argument for pressure on entrepreneurial institutions is part of the Hirschman argument for inflation.
2. Johnson, Krivine, op. cit. P. 124

Aggregate money demand can be said, in the "ex ante" or Robertsonian sense, to consist of plans to expend, part on consumption and part on investment. A rise in prices without adjustment of income means a fall in aggregate real demand. Because consumption is subject to an income constraint, and not all consumers can protect their real expenditures by reducing savings. Though investment goods may increase in price, entrepreneurs can continue their plans, if provided with funds by the banking system.

Zawadzki writes: "The problem of forced saving in real and aggregate terms is perfectly clear. The reduction in real consumption expenditure frees resources engaged in the production of consumption goods and makes them available for the production of investment goods. A desired increase in investment can therefore be achieved." 1. He notes that the real forced saving must have a counterpart in money saving, in this case the increase in profits of the entrepreneurs, who are assumed to have a higher MPS than hired productive factors. Wage earners can escape forced saving by an upward adjustment of wages, but excess demand reappears, prices are pushed up, and forced saving recurs. He writes: "the purpose of inflation is a gradual re-establishment of a fully consistent structure of economic relationships, such that it satisfies, or at least is acceptable to, all those who possess economic power to disturb it." Forced saving increases the community's

1. Zawadzki, op. cit. P. 38
2. ibid. P. 40

Average Propensity to Save, and bridges the gap between voluntary investment and saving.

C - Conditions for Use:

Though forced saving is possible theoretically and politically, its effect is "unpredictable a priori", 1. "the possibilities of stimulating economic development by these means are quite limited",2, and at most, "it would appear that the circumstances justifying deficit financing as a deliberate choice, would be rather special, and the justified doses closely circumscribed." 3. We shall examine the conditions and limitations often suggested on the use of forced-saving techniques.

There is no doubt that the technique has certain "a priori" attractions. Arthur Lewis has written: "governments are tempted to obtain resources by printing money or creating credit because the political resistance which they encounter will be less than if they raise taxes instead. The result depends on how much money is created, how long inflation continues, what the money is used for, how people react, and how well the economy is managed." 4.

1. Nurkse, op.cit. P. 113
2. Johnson, Krivine, op.cit. P. 130
3. H. W. Singer, "Deficit Financing of Public Capital Formation", Social and Economic Studies, Sept. 1958. Meier, Leading Issues, op. cit. P. 183
4. Johnson, Krivine, op. cit. P. 126

It should first be established that there is no definite relation between money supply and G.N.P. that marks the frontier of inflationary finance. This raises the question of the amount of monetary expansion that can be allowed without monetary depreciation. Johnson writes: "The answer clearly, is that such financing can be safely pursued up to the limit of demand for money consequent on the expected growth of the economy at stable prices, plus the growth of demand for money associated with the monetization of the subsistence sector (where relevant), minus the portion of the growth in the money supply that must be credited against private debt."1.

Johnson further states that the restricted use of money in less-developed countries means that this method of finance could only be used to about o.5% of national income. Arthur Lewis suggests, "hardly beyond 1% of national income". 2. In addition, as noted above, the money supply can be increased if aggregate demand is deficient and there is unemployed capacity in the economy (as in an advanced country), but Lewis adds that idle labour is rarely enough to qualify as idle capacity. 3.

In the Theory of Economic Growth, Lewis writes: "inflations for the purpose of creating capital are self-destructive, since sooner or later they result in an

1. Johnson, Krivine, P. 126
2. Lewis, Theory, P. 221
3. Lewis, Dev. Planning, P. 130-131

increased supply of goods on the market." 1. We shall look at the conditions under which inflationary finance can be self-liquidating. Lewis says there is no doubt that if a government deficit finances for investment purposes, this primary purpose is usually achieved. What is uncertain is the effect of inflation on private investment and effects on future government revenues of continuing inflation.

An important "condition for success is that inflation should redistribute income to the right people". 2. If the government can set and enforce marginal rates of taxation greater than average rates of taxation, government revenues will automatically increase faster than incomes, and the transfer to government investment is accomplished smoothly. The transfer from consumption to investment is more involved within the private sector. Lewis writes, "the classes who normally benefit from inflation are entrepreneurs, peasants, and in some cases, the government..." 3. Wage earners are usually hurt; the voluntary savings of the middle class are not reduced "though the middle class speak and write more than other classes". 4.

If a transfer is accomplished through a lag between prices and wages, leading to increased private profits, the inflation will cease if the new equilibrium between

1. Lewis, P. 217
2. Lewis, op.cit. B. and K. P. 31
3. Lewis, Theory of Economic Growth, P. 222
4. ibid

wages and profits - consumption and investment - is accepted by the community. The same is true if a new stable relationship is formed between consumption and taxes financing government investment.

Whether or not this new equilibrium is stable, depends primarily on the ability of wage earners to defend themselves from forced saving. This depends, to a large extent, on institutional and psychological factors, but the intensity and duration of the inflation are directly related. The public can become increasingly efficient in evading the redistribution of income. Lewis writes: "The public tumbles to what is happening and insists on taking protective measures. Wage and salary earners arrange for their incomes to rise as fast as prices...This process can go on indefinitely, some countries have had price increases averaging 20% per annum for more than 50 years." 1. We shall discuss these inflationary spirals in a separate section.

Besides establishing a new equilibrium between wages and prices, inflation can come to an end when "an increased flow of consumer goods output catches up with the increased money supply". 2. Investment in industries which quickly yield increased capacity, produces a supply of consumer goods which stops the increase in prices. Through this mechanism, "consumers then get something, and, if their

1. Lewis, Closing Remarks.
2. ibid.

standard of living is rising absolutely, they are not so concerned that it is not rising as fast as productivity".1. In practice, it would be impossible to distinguish projects according to their source of finance--inflationary or non-inflationary--but the use of inflationary finance should make planners especially sensitive to future relative price movements of wage goods. Lewis, 2. contends that planners should emphasize projects with low-capital-output ratios, short gestation, and low import content, when contemplating inflationary finance.

There are clearly a number of vulnerable linkages in the argument for forced saving, and some broad criticisms of its usefulness as an instrument of forced saving. First, there is the possibility that the transfer of income will not be accomplished. Second, the transfer of purchasing can succeed, but the recipient will not invest, or NOT invest productively. This would apply to both public and private investors. Finally, there is the constant danger that the inflation will degenerate into a spiral that serves no useful purpose, and brings with its strong and erratic price increases a destruction of confidence in the currency and the host of distortions of resource mobilization and allocation that are discussed above, in the monetarist critique of inflation.

1. Lewis, Concluding Remarks, B. and K. P. 31
2. Lewis, Theory of Economic Growth.

There is also an objection based on the injustice of forced saving, an argument heard from all quarters. Lutz, a monetarist, writes: "I think there is no justification at all for squeezing investments out of the economy at the expense of the poor. Frankly, I am quite shocked by the equanimity,and even glee, with which these forced savings are contemplated by many economists." 1.)

Robert Mundell suggests that inflation could produce an inflationary tax yield of up to 3% of national income; 2 Harry Johnson considers that this is a highly optimistic estimate "and likely to exceed substantially the contribution that inflation could make even under the most favourable circumstances". 2. Though Arthur Lewis considered in the Theory of Economic Growth that there might be justification for forced-saving inflation "intermittently and in small doses", 3., he seems more dubious recently; the management of an inflation for forced-saving purposes requires both political authority and technical competence, if the inflation is not to degenerate into a spiral; if a government possesses these two qualities, it should increase taxes instead. Forced saving is politically painless only in its first stage. 4. Lewis concludes: "in an underdeveloped country, inflation is merely a substitute for

1. Lutz, B. and K. P. 483
2. Johnson, Krivine, P. 128
3. Theory...P. 224
4. Lewis, Development Planning, P. 138

taxation. From an economic point of view, it is an inferior substitute. " 1.

C- Inflationary Spirals

The inflationary spiral clearly holds a wider significance than the forced-saving argument, as exogenous shocks, besides inflationary finance, can initiate the spiral. These strong and erratic inflations, sustained by economic and political forces at rates of price increase far beyond those justifiable for sectoral transfer or forced-saving purposes, seem to pose a powerful threat to economic development, in Latin America and elsewhere.

The mechanism is essentially a struggle for economic power. Ralph Turvey defines inflation as "a process resulting from competition in attempting to maintain total real income, total real expenditure, and/or total output at a level which has become physically impossible, or in attempting to increase them to a level which is physically impossible." 2. The spiral - really any inflation greater than perhaps 10% per annum - indicates that the struggle for income has become explicit and political.

Lewis describes the process: "Every country in the world, including the Soviet bloc, has either experienced it or views it with apprehension. It has three contributing parts; wages, budgetary deficits, and devaluation." 3.

1. Lewis, Development Planning, P. 6
2. Ralph Turvey, "Some Aspects of the Theory of Inflation in a Closed Economy", EJ, 1951, P.534. See Zawadzki,op.cit. P. 20-24.
3. Lewis, Closing Remarks, B. and K. P. 21

The original cause can be a rise in the price of domestic food products, a rise in import or export prices, or an increase in the money supply. The cost-of-living increases and wages and prices start to cycle upwards. If government marginal rates of taxation are less than average rates of taxation, costs rise faster than revenues, and a budget deficit opens, unless the government is willing to cut back its activities. If there is a fixed-exchange-rate system, devaluation adds a third twist to the spiral by increasing import prices and, to a lesser extent, domestic prices. Lewis writes: "there are no unprotected contractual incomes any more...the spiral itself adds nothing and should be eliminated if this is at all possible." 1.

The budgetary deficit, Lewis suggests, is the result of tax revenues that increase more slowly than government revenues. He writes: "this seems to be of enormous importance in the bigger Latin American inflations. Without the budgetary deficits, the wage spiral by itself may raise prices by 5% or even 10% per annum. Increases of 20% per annum and more must mainly be due to the secondary effects of the budgetary deficit." 2.

This raises the vital question of why prices increase much more rapidly in Latin America than in Asian countries,

1. Lewis, B. and K. P. 23
2. ibid. P. 24. An econometric test of the influence of budget deficits in Chile, is found in "Some Notes on Inflation." Arnold Harberger, P. 319, B. and K.

where "inelasticities" are as severe. The difference, in Lewis's view, is the spiral mechanism, and the pivot of the process is the chronic government deficit. The explanations are "largely historical", Lewis adds: "all one can safely say is that in a number of Latin American countries the government gets away with printing money to an extent which is puzzling to visitors from any other continent and one cannot help feeling that the people deserve better governments than they get." 1. But this is a complex phenomenon--as is the failure of the stabilization programs. "Latin America is the most politically reactionary of all continents...and about the last place where the unions are likely to agree to any kind of wage control...the wage spiral cannot be eliminated without fundamental political change." 2.

This analysis of the spiral closely resembles J. K. Galbraith's explanation of Latin American inflation. After differentiating, controversially, "functional and non-functional" incomes, Galbraith suggests that in many countries in Latin America, there is an incomplete revolution where urban white and blue collar workers have not dis-established the old elites. There is a sort of economic civil war among the major interest groups. "The total of these (income) claims bears no necessary relationship to

1. Lewis, Closing Remarks, P. 24
2. ibid, p. 25

the income that is available. Since productivity is low, there is a strong likelihood that claims will exceed what is available, and this is invariably the case." 1. To reconcile these claims, each is granted his claim in money terms, and these groups then bid against each other in the market. The result is chronic inflation and the continued reward of "non-functional" social groups.

E. The Monetarists and Structuralists on Forced Saving.

The forced-saving argument is generally condemned by monetarists, while the structuralists present a mixed front. After noting the extremes, we shall discuss the ECLA synthesis of forced saving, inflation and economic development.

Monetarists frequently frame the forced-saving argument in inflation-tax terms, with the tax falling on money balances. Dorrance says, "it is true that individual units of investment are likely to be created even in inflationary conditions (but)...it is the over-all effect on progress which deserves consideration." 2. If the new finance, created by the government, is not to be inflationary, members of the community must be equally willing to increase their real money holdings; if they do not, prices will rise and the real value of eash holdings will fall.

1. J. K. Galbraith, "Underdevelopment, an Approach to Classification". Krivine, op. cit. P. 29
2. Dorrance, op. cit. P. 39

"Who benefits by these forced savings? Not the banks, but those who borrow from them." 1.

But the community will soon learn to evade the tax, and the source of finance will disappear as "dis-saving and waste" mount. 2. The familiar negative effects of inflation on private saving and investment and patterns of production intrude; in the minds of monetarists, the benefits clearly do not overcome the costs and the risks.

Structuralists who approve of forced saving, seldom go through the theoretical argument that shows forced saving is possible, or explicit identification of the classes who will be allowed to sacrifice consumption for the common good. Baer presents the argument in the usual, inverted structuralist form, and notes that "it has not received as extensive a treatment in the literature" as other inelasticity problems. 3. He argues that the process of urbanization and industrialization in Latin America has greatly increased the sphere of government activity in transport, power, schools, health services, housing, etc., in order to provide for growth in the industrial sector, and to alleviate social tensions in the cities. Despite the inept and inadequate tax system, "many Latin American governments have gone ahead with their investment projects, financing

1. Gudin, op. cit. P. 348
2. ibid, P. 349
3. Baer, survey, P. 10

them through deficits". 1. Needless to say, the issue is more complex than establishing the need for investment. Structuralists generally ignore the complications.

In Brazil, which has experienced both strong inflation and satisfactory growth, Baer suggests that "inflation did not have an obviously negative effect on the country's development and that it can even be argued, and partially shown, that it had a positive effect." 2. In the Brazilian case, he sees a positive effect on capital formation, and a "transfer of saving from the private sector, which usually saved more than it invested, to the government sector, which usually saved less than it invested." 2. He attributes this forced-saving process primarily to the weakness of trade unions in the fifties.

There can be no doubt that the Brazilian government in the early sixties attempts the same process, or at least tries to defend its share of real resources, in the inflationary spiral. Celso Furtado writes, as Minister of Planning, 3. that the inflation of the fifties has "its primary cause...in a deep disequilibrium of the public sector, which was called forth to take up concrete responsibilities in the process of capital formation, without regard to the fact that the fiscal apparatus had not undergone the necessary adaption...(now) we annually start the

1. Baer, op. cit. P. 10
2. W. Baer, Industrialization and Economic Development in Brazil (1965) P. 110-111
3. C. Furtado, comment, B. and K., P. 498

year with a planned public expenditure which amounts to 18% of GNP and we end the year with a public expenditure amounting effectively to 13 to 14% of GNP. This disparity between actual and planned expenditure causes a tremendous inflationary pressure." The attitude seems to be one of maximum public effort, and let the finance take care of itself.

Cyclical external revenues are also advanced by structuralists for inflationary finance. In Chile, about 25% of public income depends on the exports of one commodity, while government expenditures on salaries and social services are said to be relatively rigid. Public investment is a variable expenditure, but also the most important from the point of view of economic development. Thus, when revenues fall, inflationary finance "must" be used. Grunwald assesses Pinto's statement on the subject: "what is probably meant by calling the ups and downs a 'structural' factor, is that when there are windfall tax revenues due to, say, a good copper export price, the government immediately commits the increased revenues for ...expenditures which are difficult to reduce when revenues unexpectedly fall."[1,2]

Chile has also experienced one of the most prolonged price-wage spirals in Latin America, perhaps as part of this forced-saving ratchet. Several commentators remark how deeply engrained is inflation in the political

1. Grunwald, L. A. Issues, op.cit. P. 115, footnote
2. Furtado's excellent economic history of Brazil notes inflation has been used there to prevent the deterioration of coffee plantations during periods of low world prices.

life of the country, "each sector of the economy constructing its own defence mechanism." 1. Wage and salary earners, and pensioners, achieve the right to legal adjustments of their incomes in some formal relation to the cost-of-living index, and the 'right' to price controls of essential wage goods. The business sectors anticipate the wage adjustments by increasing their prices and demanding credit from the banks they frequently own; the government protects itself by providing itself with credit. Damaging as it may be, however, the Chilean inflation has never become hyper-inflation. Felix provides a political explanation: "stabilization programs are politically feasible only when it appears that inflation might conceivably 'get out of hand' but opposition reappears when the rate of inflation has been reduced to what historically seems to constitute safe levels." 2.

The complexity and duration of this sort of inflation makes it particularly difficult to identify a forced-saving process--or to hypothesize about the character of the economy without inflation.

ECLA lists forced saving as a "dynamic" effect of inflation. While inflation has its roots in the familiar structural imbalances of Latin America, inflation is also said to increase investment "to the extent that it

1.Grunwald, op. cit. P. 99
2. Felix, B. and K., P. 363

forcibly expands saving". 1. This is directly traceable, however, to a "regressive" cut in the potential consumption of the masses. When the "masses" try to remedy this effect "through their political or trade union power, the inflationary spiral is unleashed..." 2. The spiral may reduce the forced saving, but increases social tensions and introduces economic maladjustments.

Forced saving tends to reduce the income of the masses and transfer it to groups who frequently consume the surplus, rather than invest it. When unions and mass political forces begin to exercise their political power, "the capital-forming effects of inflation diminish or disappear. Some Latin American countries have already reached this stage, and others are nearing it. Inflation then moves in a vicious circle..." 3. The spiral is given further impetus by wage demands when productivity is stagnant, because of the external bottleneck, and further stimulated by the import substitution process that follows it. Controls will aggravate the cycle and further weaken the "dynamic" effects of inflation.

ECLA objects to forced saving on equity grounds, agreeing, perhaps, with Toynbee, that "inflation is an engine of social injustice by its very nature...a fertile mother of revolt and revolution, always and

1,2,3. Economic Development, Planning, and International Co-operation, Chapter 5, inflation, ECLA, P.35 ff. Similar to Prebisch's "Economic Development or Monetary Stabilization; the False Dilemma. EBLA, March, 1961.

everywhere." 1. ECLA does not regard inflation as an effective and durable instrument for economic development. But neither does it approve of monetary stabilization, despite the hypothesized inequities and iniquities of inflation: "it may be that in some cases the growth of average income among the broad masses of the population in Latin America, has been more vigorous than that induced by a policy of monetary stability alone." 2.

The ECLA solution is to increase non-inflationary capital formation, and discourage high-income consumption. This can be done by taxing the wealthy to stimulate their saving, or by the government taxing away their resources and investing it. International assistance is also granted a role. Whatever combination is chosen, it is vital "that the immediate consequences of anti-inflationary policy are shared by all social groups alike." 3. Only a vigorous policy of structural reform can assure the permanent defeat of 'basic' and 'propagating' factors in the inflationary process; import substitution and export diversification must continue. Whatever the details, saving must be increased, and "only if the structure of the economy is strengthened will it be possible to make monetary stabilization fully compatible with economic development." 4.

1. A. Toynbee, The Economy of Latin America, P. 43
2. Ec. Dev...op. cit. P. 36, 37
3. ibid. P. 40
4. ibid. P. 43

In a recent Economic Survey of Latin America, ECLA states its position on the ideal of stabilization. It discerns this synthesis of efficiency and equity in the most recent efforts of Brazil and Chile: "In all these programs, the countering of inflationary pressures is visualized as a gradual process of reduction in the rate at which prices increase, in such a way that it will not conflict with concurrent efforts to meet other development needs. It is made clear, moreover, that the process will be carried out, not only through immediate deflationary measures, but also by wholly or partly removing the underlying structural causes of disequilibrium." 1. Sudden deflation is not seen as a solution by ECLA.

1. Economic Survey of Latin America, 1965. ECLA,1967, P. 41

VIII - CONCLUSIONS:

We have attempted to provide a survey of some important features of the monetarist-structuralist controversy in Latin America. The content and style of the debate when combined with the theoretical difficulties of growth and inflation and the variety of their historical experience make final conclusions impossible.

In an introductory section we attempted to establish that there was a variety of historical and comparative recent data on the positive or negative association of inflation and growth, and that no generally acceptable formal, necessary theoretical relation exists between these two complex phenomena. From this we concluded that there was no clear and continuing association between the two, and that the completely incongruent <u>ex cathedra</u> statements of monetarists and structuralists on the relation,- and the generally combattive nature of the controversy - suggest forces at work besides a passion for scientific rigour. The two groups fundamentally differ in the development strategies - public versus private, planning versus free markets - that they promote in the highly-charged political atmosphere of Latin America.

This difference of political perspective helps explain the coherence of the two schools and the conflicts between them, but it reminds the reader of the unsupported conclusions so characteristic of the controversy, from brilliant insights to clearly polemical in content.

The structuralists generally propose that government take over the role of dynamic leading sector in Latin American development. Their emphasis is on government taking broader and more detailed responsibility for economic growth. When they advance the forced saving argument for inflation, government rather than private investment is enhanced. Structuralists are opposed to classical accumulation techniques because of its associated social consequences and the failure of private techniques that they find in Latin American history. They are highly suspicious of the national and international manifestations of private enterprise . On general theoretical grounds, structuralists distrust abstraction, emphasize historical and institutional factors, and find in the perfected invisible hand of general equilibrium theory a wholly unacceptable implication of utopian automaticity, in the real world. They often argue rather unsoundly that the unrealistic assumptions of "orthodox economics" imply that capitalism could not function successfully in Latin America.

The monetarists are less explicit in their philosophy of political economy, but only because their philosophy is - or has been - implicit in the activities of the IMF, the IBRD, and the aid policies of the United States in Latin America. They support, with some flexibility, private channels of development in directly productive activities. In their treatment of inflation, monetarists emphasize the effects of rapid price increases on the volume and quality of private investment, foreign and domestic, and efficient market allocation of resources. They consistently de-emphasize the use of trade, fiscal, and direct controls that in their view would discourage or disrupt private effort, though the controls may be justfied by others as a strategy of development.

The monetarists have a primarily political-historical explanation for inflation in certain Latin-American countries. They view with varying alarm and sympathy the pressures on governments to follow inflationary policies. Some emphasis is given to the vulnerability of less developed countries to inflation, but "bottlenecks" are frequently seen as the product of direct controls used to protect certain sectors from inflation, but in fact stimulating inflation. They conclude that purifying inflation is a necessary condition for maximum growth.

Structuralists see the cause of inflation in agricultural and export bottlenecks that initiate wage price spirals that governments as constituted are unable to halt. They agree with the monetarists that selective anti-inflationary measures can feed inflation, but hold that sharp stabilization has been and will be sufficiently paralytic to be inferior to inflation with some growth. Structural reforms led by the state are seen as the policy instrument for slowing inflation and achieving more equitable income distribution.

Most monetarist output is composed of cataloguing the distorting and damaging effects of inflation. They show little interest in defining the causes of inflation beyond belaboring governments for tolerating it, and tend to ignore the adaptions that economic agents can make to high but relatively stable rates of inflation, making the net effects of inflation on growth even more problematical. On the other hand, structuralists take ritual note of the damaging effects of inflation, but chiefly discuss broad problems of Latin American economic and social structure as the cause of inflation and hosts of other problems.

This dichotomy of emphasis represents the broad difference of development strategy that the two schools implicitly or explicitly advocate. The monetarists are not interested in the elaboration of complex problem areas that need interventionist polcies to deal with them; governments should be more concerned with providing a stable and congenial environment for private sector development. The "bottlenecks" are the result rather than the cause of inflation.

The structuralist position, perhaps, "is really an attempt to get some external economies out of the problem of inflation" 1. by drawing attention to other policy issues. Perhaps because of the charged political atmosphere that has surrounded the debate, the monetarist-structuralist controversy

1. A.O.Hirschman, B. and K., Comment, P.455

has generated little substantial agreement between the two schools of thought. There is some reason to believe that "at the level of theory, the monetarists had much the better of it" 1. Despite their plausible arguments that imbalances during rapid growth in less developed countries may be particularly severe, the structuralists cannot explain economically the inflationary spirals of Latin America, and why other less developed countries with similar "structural" problems have mastered inflation.

While the monetarists seem to sometimes overstate their case - as the IMF does when it treats the "soft" governments of Latin America as if they were endowed with the powers and mandates of advanced states - their objective of reasonable price stability seems desirable. There are no economic arguments for inflationary spirals, as the structuralists admit. The Latin American experience is a textbook of the "struggle for income" type of spiral inflation, where groups are ready and able to defend their relative positions. One lesson is the difficulty involved in slowing the spiral of expectation and gratification, once it has begun. The broad social context of economic policy and theory - the structuralist emphasis - must be considered for enduring remedies.

1. T.E.Davis, "Inflation and Growth in Latin America: Theory Performance and Policy," (Review of Baer and Kerstenetzky) EDCC, July 1966, P.511

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