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A Comparative Analysis of Economic
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THE WORLD ECONOMIC SLOWDOWN
AND THE ASIAN AND LATIN AMERICAN ECONOMIES:
A Comparative Analysis of
Economic Structure, Policy and Performance.

I INTRODUCTION

Since the world economic growth began to slow down in 1973, there are two outstanding features of the developing countries economic experience which deserve attention. First, the developing countries were able to withstand the first oil shock and the consequent upheavals in the world economy reasonably well. As Table 1 shows, whereas the rate of economic growth of industrial countries fell sharply from 4.9 per cent in 1960-73 to 2.8 per cent in 1973-79 (i.e. it was nearly halved), the developing countries suffered only a relatively small decline in their pace of economic expansion: from 6.3 per cent in the period 1960-73 to 5.2 per cent in the period between the two oil-shocks.¹ However, the impact of the second oil price increase and the associated changes in economic policy in the advanced countries on the third world have been devastating. At the bottom of the recession in 1982 and 1983, the average rate of economic growth in the developing countries fell to a mere 2 per cent, below the rate of growth of population. 1982 was in fact the first year

¹ There is no suggestion here that the oil shocks were the 'cause' of the deceleration in world economic growth in the 1970s and 80s. For full analysis of the reasons for the world economic slowdown, see Glynn, Bughes, Lipietz and Singh 1986.

Table 1. population, G.D.P. and G.D.P. per capita in 1980, C.D.P. Growth Rates 1960-73, 1973-79 and 1980, 1981, 1982 and 1983. Various Country Groupings.

Country Group	1980 GDP (billions of dollars)	1980 population (millions)	1980 GDP per capita (dollars)	GDP growth rates (Average annual percentage changes)						
				1960-73	1973-79	1980	1981	1982	1983	1984 ^a
Developing countries ^b	2,118	3,280	650	6.3	5.2	2.5	2.4	1.9	2.0	5.4
Low income	349	2,174	250	5.6	4.8	5.9	4.8	5.2	7.8	9.4
Asia	497	1,971	250	5.9	5.2	6.3	5.2	5.6	8.6	10.2
China	284	980	290	8.5	5.7	6.1	4.8	7.3	9.6	14.0
India	162	675	240	3.6	4.3	6.9	5.7	2.9	7.7	4.5
Africa	52	204	250	3.5	2.1	1.3	1.2	0.5	0.3	0.7
Middle-income oil importers	915	611	1,500	6.3	5.6	4.3	0.9	0.7	0.8	4.1
East Asia and Pacific	204	183	1,110	8.2	8.6	3.6	6.7	4.2	6.4	6.4
Middle East and North										
Africa	28	35	800	5.2	3.0	4.2	-2.4	5.5	2.9	4.1
Sub-Saharan Africa ^c	37	60	610	5.6	3.7	5.5	3.9	1.1	-1.4	-1.1
Southern Europe	201	91	2,210	6.7	5.0	1.5	2.3	0.7	0.9	2.7
Latin America and Caribbean	445	241	1,840	5.6	5.0	5.8	-2.3	-0.4	1.7	3.7
Middle-income oil exporters	654	494	1,320	6.9	4.9	-2.4	2.4	0.9	3.1	2.5
High-income oil exporters	228	16	14,250	10.7	7.7	7.4	0.0		-7.1	1.3
Industrial market economies	7,463	715	10,440	4.9	2.8	1.3	1.3	-0.5	2.3	4.6

a. Estimated

b. Data for 1982 are based on a sample of ninety developing countries.

c. Does not include South Africa.

Source: World Development Report (1984) and (1985)

since World War II when per capita GDP in the developing countries actually fell. Although with the recovery in the US economy and the pick-up in OECD economic growth, the developing countries were able to attain a much higher growth rate in 1984, the available data indicate that economic expansion in the third world has slowed down again in 1985 and in the first half of 1986.²

The second important aspect of the third world's economic experience is the differential performances of the different parts of the third world, particularly since 1979. As Table 1 indicates economic growth did not slow down in the 1980s in all parts of the South. China, India and other low income Asian countries have on average managed to maintain their pace of economic expansion. Although there appears to be some trend decline in economic growth in the middle-income East Asian and Pacific countries in the 1980s compared with the 1960s and 1970s, they still have a respectable growth record. However it is the economies of Latin American and Sub-Saharan African countries which have performed particularly poorly in the 1980s. In the Latin American and Caribbean countries, GDP per capita fell at a rate of more than 4 per cent per annum for three consecutive years, 1981, 1982 and 1983. For the region as a whole, per capita GDP levels in 1983 were lower than in 1977, and in some countries as low as in the 1960s. Similarly in the Sub-Saharan African countries, per capita GDP has contracted at a rate of almost 5 per cent per annum in each of the years 1982, 1983 and

² World Bank (1986).

1984. Reduced economic growth has not surprisingly been accompanied by large falls in levels of consumption and employment, and in a number of African and Latin American countries by enormous under-utilisation of industrial capacity and massive de-industrialisation.

The reasons why the third world countries as a whole were able to withstand the first oil shock and the associated turbulence in world economy relatively well, are not far to seek. Firstly, they were able to borrow on the private capital market at an unprecedented scale, at real interest rates which were extremely low. Secondly, the recession in the industrial countries which followed the 1973 oil price rise was of short duration. The GDP in industrial countries rose by 6.1 per cent in 1973; in 1974, it increased only by 0.8 per cent and fell by 0.4 per cent in 1975. In 1976, the GDP growth in industrial countries was 4.7 per cent, almost back to its trend level. In comparison, the recession the advanced economies following the oil price rise of 1979 and the contractionary economic policies in these countries, was less sharp but it lasted much longer. The rate of growth of GDP in industrial market economies was 3.3 per cent in 1979, 1.3 per cent in 1980, 1.3 per cent in 1981, -0.5 per cent in 1982 and only 2.3 per cent in 1983. Furthermore, the availability of private foreign capital which had permitted many third world countries to maintain economic growth between 1973-79 declined sharply after 1981.

This paper is concerned with the other main aspect of the South's economic experience outlined above, i.e. the question of differential economic performance. In

particular, the question asked is why did the Asian economies apparently cope with the world economic crisis in the 1980s so much better than the Latin American countries?³ Is it a mere coincidence, a matter of good luck or are there more systematic forces deriving from economic structure, initial conditions or economic policy at work which can help explain the differences in economic performance in the countries in the two continents? In view of the obvious analytical and policy significance of these issues, they have recently been investigated by a number of scholars. (See for example Balaasa [1984], Madison [1985], Sachs [1985], Singh [1985]). Section II briefly reviews this literature and outlines the competing hypotheses. Section III examines comparative economic performance for a more comprehensive group of Asian and Latin American economies than has been attempted in the earlier studies. Differences in economic structure, initial conditions and the nature of the economic shocks suffered by the two groups of countries are considered in Sections IV and V. Section VI offers some comments on economic policy differences between the countries. Section VII briefly analyses the individual economic experience of the large semi-industrial countries in the two continents - China and India in Asia, Brazil and Mexico in Latin America. The main conclusions are summarised in Section VIII.

3 The differential economic performance of the Sub-Saharan African countries is not considered in this essay because the initial level of economic development and the structural characteristics of these economies are rather different than those of Latin American countries. For a study of the Sub-Saharan African countries, see Singh (1986).

II The Reasons for Superior Asian Economic Performance:

Alternative Hypotheses

The mainstream views on the reasons for the superior economic record of the Asian countries relative to those in Latin America are best contained in the works of Balaasa, Kruegger and Sachs. Basically these economists argue that the Asian economies have done better than the Latin America ones because they have had more open and export -oriented trading regimes and have followed exchange rate policies which maintain if not enhance the competitiveness of their tradeable sectors. Thus Sachs (1985): 'The most important differences seem to centre on exchange rate management and on the trading regimes. Latin American and Asian countries have differed not only in the amounts borrowed, but also the uses to which the loans were applied. Simply put the Latin American countries did not use the foreign borrowing to develop a resource base in tradeable goods, especially export industries, adequate for future debt servicing.' Overvalued exchange rates, it is argued, not only reduced competitiveness but also encouraged capital flight. 'Foreign borrowings by Latin America governments (particularly Argentina, Mexico and Venezuela) often went to finance the private sector's accumulation of foreign assets rather than an increase in export capacity'. In an extended analysis of political economy, Sachs goes on to ascribe the superiority of the trading and exchange rate regimes in Asian countries to the relatively greater dominance of rural interests in their polities.

Maddison's (1985) fascinating historical study has compared the economic performance of the Latin American and Asian countries during the decade (1973-83) of the present slow-down in world economic growth with that during the decade 1929-39. In contrast to the current situation, during the Great Depression of the 1930's, the Latin American countries achieved a much higher rate of economic growth than the Asian countries. Maddison suggests that this was 'because the sharp experience of recession in the independent countries of Latin America induced a change in attitudes towards the liberal international economic order, and (fostered) an inward-looking developmentalism...' He goes on to argue that "in the conditions of 1930's, the verdict must be in favour of the import-substitution policies, for openness to the world economy of the type Cuba was compelled to follow meant large scale unemployment of productive resources" (p. 23). The economic performance of the Asian countries in the 1930's was poor despite the fact that they were subject to smaller exogenous shocks than the Latin American countries. Maddison blames this on the orthodox contractionary economic policies and financial of the colonial governments in Asia.

However, the position is reversed in 1973-83. Maddison believes that the less favourable record of the Latin American countries during this decade is essentially due to the poor quality of their domestic policies. He writes: "In Latin America, most governments still rely on inflation as a way of raising revenue... In Asian countries (fiscal), monetary and exchange rate policies were more cautious, trade deficits and foreign borrowings were much more modest... Because of better

domestic policy, these countries have not been plagued by massive capital flight by their own nationals, as Latin America has been."

Singh (1985) provides a rather different analysis of the comparative economic performance of the Asian and Latin American countries during the 1980's. His study was restricted to the large semi-industrial countries, Brazil and Mexico in Latin America and India, China and S. Korea in Asia. Contrary to Sachs, Balaasa and others, he argues that India and China have performed better than Brazil and Mexico during the current turbulence in the world economy precisely because they were less closely integrated with it. They had long followed the path of 'self reliance' and import-substitution industrialisation; they also depended relatively little on foreign debt. In contrast, the two large Latin American countries chose to follow outward-looking industrial strategies based on multinational investment and foreign debt. Singh concludes: 'When the world economy was growing rapidly, these countries benefitted from their greater integration with it in much the way orthodox economics extols the virtues of increased trade and specialisation. However, their industrial structures which were suitable for an expanding world economy and world trade also left them vulnerable to prolonged economic disruption when the international economy ceased to grow'. As for South Korea, whose economic structure is different than that of any of the other four countries, Singh ascribes its exporting success less to the exchange rate policies than to the direct state promotion of exports.

The foregoing account of the various theories for explaining the differential economic performance of Asia and Latin America during the last decade raises two analytical issues. First, how is 'openness' or 'the degree of integration with the world economy' to be defined? Does the concept simply refer to foreign trade as a proportion of GDP, or does it also encompass foreign investment and foreign debt? Secondly, and more importantly, what is the relationship between 'economic vulnerability' and the 'degree of integration with the world economy'. It may be inferred from Singh's analysis above that, *ceteris paribus*, greater a country's integration with the world economy, the greater its vulnerability to international economic fluctuations.¹ However, Sachs (1985), Balaasa (1981) among others propose that the contrary may be true. Thus Balaasa (1981) observed:

At any rate, one should not exaggerate the vulnerability of an economy with a high export share. Thus, during the 1974-75 world recession, export-oriented developing countries in general, and Korea in particular, fared relatively well, since they had more of a margin to spare as far as imports are concerned. By contrast, countries which went the farthest in import substitution, and limited imports to what appeared to be absolutely necessary inputs, suffered serious production setbacks because of their inability to procure these inputs as their balance-of-payments situation deteriorated.

Finally, as the author has elsewhere noted, the degree of instability of the world economic system should not be overstated. "This is because other confluence of the circumstances existing in 1974 - the quadrupling of oil prices and the doubling of grain prices, together with a deep world recession, partly caused by reactions to the sudden oil price increase and partly the

¹Singh (1985), however, specifically noted that a country's vulnerability is not just a function of the size of its trading sector but depends on the nature of the country's exports and imports as well as a host of other factors.

consequence of the super boom of the years 1972-73 - cannot be expected to recur." [Balaasa (1981), pp. 355-356].

Balaasa's second point above need not detain us: the post-1979 experience of the world economy has shown him to be conclusive wrong on this issue. However, on the first point, leaving aside for the moment his empirical assertion, he has a more reasonable a priori case. The theoretical argument is very well put by Williamson (1985) as follows: 'A country with a very small trade sector generally has limited range of exports based on resource-intensive products that are exploiting some local comparative advantage bestowed by geology or climate. These products tend to exhibit both inelastic supply and inelastic demand, so there is a very little possibility of export expansion at the margin. Import capacity tends to be entirely preempted in importing intermediate goods, including oil, that are necessary to keep industry going for the domestic market. Hence, there is minimal elasticity in the trade structure to permit adjustment to trade shocks. This is the basic, though not the only, reason why the size of the trade sector is significant in enabling countries to overcome external shocks.'

There are thus plausible a priori grounds for positing either a positive or a negative relationship between trade 'openness' and 'vulnerability'. Moreover, as the following analysis will show the issue is much more complex; the relationship between 'openness' and 'vulnerability' also depends on the precise nature of the external shock.

III The Comparative Economic Performance of Asian and Latin American Economies

In order to carry out a systematic comparison of structure, policy and performance in the Asian and Latin American countries, the present study uses a much larger sample of countries than the previous investigations.

Table 2 compares the economic performance of 19 countries in the two continents - 10 Asian and 9 Latin American - in terms of the long-term rate of growth of g.d.p. recorded over the years, 1963-73, 1973-79 and 1979-84, the time periods being chosen to reflect the varying conditions in the world economy. The superior record of the Asian countries during the post-1979 period stands out. Both groups of countries more or less maintained their trend rate of economic growth in the period between the two oil shocks, the so-called inter-shock period - 1973-79. However, after 1979, the median¹ rate of economic growth in Asia fell only slightly, from 6.7 per cent p.a. to 5.5 per cent p.a. whilst in Latin America, the median growth rate plummeted from about 5.0 per cent p.a. during the 1960s and 1970s to a negative figure of -0.5 per cent in 1979-84.

The economic performance of two Asian countries, India, and Sri Lanka, raises a significant issue. Both these countries not only maintained their rate of economic expansion

¹ Since economic policy is carried out at an individual country rather than at a continental level, and the focus of the study is inter-country comparisons, median is a better summary measure of central tendency than the weighted average (weighted by GDP) used by Sachs (1985). The latter measure will simply reflect much more the experience of the larger economies.

T A B L E: 2

Growth Rate of GDP (1975 prices) in Asian and Latin American Countries1963-73, 1973-79, 1979-84

(percentage per annum)

<u>ASIA</u>	<u>1963-73</u>	<u>1973-79</u>	<u>1979-84</u>
China	8.6	4.9	8.2
India	3.4	4.3	5.4
Indonesia	6.9	7.1	5.6
Korea	9.6	9.8	5.8
Malaysia	6.6	7.3	6.6
Pakistan	6.2	5.0	4.4
Philippines	5.2	6.4	1.9
Sri Lanka	4.5	5.0	5.3
Taiwan	10.7	9.2	6.4
Thailand	8.0	7.7	5.5
Median	6.7	6.7	5.5
<u>LATIN AMERICA</u>			
Argentina	4.8	1.8	-1.7
Bolivia	4.7	4.7	-4.4
Brazil	8.3	6.9	0.8
Chile	3.6	2.7	-1.1
Colombia	5.9	5.0	2.0
Ecuador	7.2	6.8	1.7
Mexico	7.8	5.7	2.0
Peru	3.9	2.4	-0.5
Venezuela	5.2	5.6	-1.8
Median	5.2	5.0	-0.5

Source: The World Bank Data Bank

the last
during \bigwedge decade of turbulence in the world economy, they actually managed to increase it: much more so in the case of India than Sri Lanka. It is arguable that by appreciably increasing its trend rate of growth, India has been more successful in coping with international economic fluctuations than even Korea whose trend rate of growth fell by more than forty percent over the period 1979-84.

Another Asian country which deserves comment, but for the opposite reason, is Phillipines. Alone among the ten Asian countries, it has suffered a very sharp fall in its rate of economic growth over the period 1979-84 compared with the 1960's and 70's. Otherwise the remarkable feature of table 1 is the extraordinary uniformity of experience of countries in each continent ^{in the 1980s} \bigwedge Leaving aside Phillipines and Pakistan (with a growth rate of 4.4 percent), eight of the ten Asian countries managed to register a growth rate of more than 5 percent p.a during 1979-84. On the other hand in Latin America, not one country out of nine achieved a corresponding grow rate of g.d.p of more than 2 percent p.a. This continental uniformity in economic performance is all the more significant in view of the wide inter-country differences in economic structure, economic policy and even in the basic economic system. This is particularly true in Asia where countries like China, India and South Korea not only have different economic systems, but the two market economy countries (India and South Korea) have traditionally followed very different economic strategies.

Table 3 records the comparative experience of the Latin American and Asian countries with respect to inflation. There are significant inter-country differences in inflation rates and their evolution over time. The median inflation rate in Asia doubled in the decade 1973-84 compared with the period 1963-73. In Latin America, however, the median inflation rate increased from 8.2 percent p.a in 1963-73 to 23.7 percent p.a in 1973-79 and to 53.7 percent p.a in 1979-84. During the last decade, the worst inflation performance in Asia was recorded by Philippines and Sri Lanka and in Latin America by Argentina and Bolivia. By Latin American standards, the Philippines inflation rate of less than 20 percent p.a during 1979-84 is quite modest. Only one Latin American country (Venezuela) managed to achieve a lower inflation rate than that of Philippines in the period since the second oil-shock. Finally, the first row of the table shows that compared with its average inflation rate during the 1970's, China's inflation increased six-fold during 1979-84; however, it was still only 3 percent during the latter period.

Tables 4 and 6 provide investment and savings rates respectively in the countries on the two continents. Table 3 indicates that despite the world economic slow-down, there has been a marked trend increase in the average rate of investment in the Asian countries, from less than 20 percent of g.d.p in 1965-72 to nearly 30 percent of g.d.p in 1979-83. Malaysia invested 33 percent of its g.d.p during the last period and Sri Lanka's rate of investment increased from 16.3 percent in 1965-72 to nearly 29.6 percent in 1979-83. However, the increase in Sri Lanka's investment performance is largely due to a single

T A B L E: 3

Rates of Inflation in Asia and Latin America, 1963-1984

(average annual rates of growth of consumer price index, in percentages)

<u>ASIA</u>	<u>1963-73</u>	<u>1973-79</u>	<u>1979-84</u>
China	-0.5(a)	0.6(b)	3.0
India	8.3	6.3	10.0
Indonesia	42.1(c)	19.7	12.5
Korea	13.2	17.9	12.1
Malaysia	2.1	6.2	6.0
Pakistan	5.1	14.8	9.2
Philippines	7.9	13.3	19.8
Sri Lanka	4.3	7.3	17.0
Taiwan	3.5	12.0	12.9(d)
Thailand	3.2	9.7	8.3
Median	4.7	12.0	10.0
<u>LATIN AMERICA</u>			
Argentina	NA	181.5	222.8
Bolivia	8.2	17.4	195.6
Brazil	31.4	38.6	121.6
Chile	NA	167.9	22.1
Colombia	11.2	23.7	22.8
Ecuador	5.9	14.5	23.6
Mexico	4.5	19.8	53.7
Peru	9.9	38.2	82.8
Venezuela	2.2	8.9	13.0
Median	8.2	23.7	53.7

NOTES: (a) 1965-70
 (b) 1970-79
 (c) 1966-73
 (d) 1979-82

Source: World Bank Data Bank

T A B L E: 4

Investment Performance of Asian and Latin American Economies(Gross domestic Investment/GDP; percentages)

<u>ASIA</u> (a)	<u>1965-72</u>	<u>1973-78</u>	<u>1979-83</u>
China	23.0	30.0	30.0
India	18.3	21.7	24.6
Indonesia	12.6	20.6	23.0
South Korea	24.1	29.0	30.0
Malaysia	19.6	25.7	33.4
Pakistan	16.3	15.9	15.8
Philippines	20.9	28.6	29.6
Sri Lanka	16.1	16.2	29.9
Thailand	23.8	25.4	25.3
Median	19.6	25.4	29.6
<u>LATIN AMERICA</u>			
Argentina	20.4	24.6	20.5
Bolivia	17.5	21.1	9.0
Brazil	25.8	28.1	22.5
Chile	15.3	15.3	17.2
Colombia	19.0	18.8	20.0
Ecuador	18.6	26.4	24.2
Mexico	21.3	23.4	26.1
Peru	16.7	18.0	17.0
Venezuela	29.1	35.4	26.2
Median	19.0	23.4	20.5

Source: World Development Report, 1985(a) The figures for Taiwan are not reported in the World Development Report.

irrigation project financed by foreign aid (see Taylor (1986)). As table 6 shows Sri Lanka's domestic savings rate actually fell in 1979-83 compared with the earlier periods.

The Latin American investment performance during the last decade is much better than its record of economic growth. The median rate of investment has if anything increased slightly since 1973. However, compared with 1973-78 when there was a marked increase in the rate of accumulation, the rate of investment has declined in almost every Latin American country during 1979-83. The decline would be even greater if the data for 1984 and 1985 is considered.

If the investment and growth records of countries are considered together, they imply an increase in the average incremental capital-output ratio in both continents. Table 5 indicates that there was in fact a rise in ICORs during the 1970's for almost every group of countries in the world economy the largest increase being for the developed market economies. Because of the severity of the balance of payment constraint and consequent low capacity utilisation, the average ICOR in the Latin American countries during the 1980s is bound to be considerably higher than that reported ^{for the 1970s} in table 5.

Table 6 shows that there has been a marked increase in domestic savings in the Asian countries during the decade 1973-83. Gross national savings as a proportion of g.d.p increased from less than 15 percent during 1965-72 to over 20 percent in the period 1979-83. Indonesia's savings rate increased from 6.9 percent of GDP in 1965-72 to 20.1 percent in 1979-83, India's from 13.4 percent to 21 percent. The Latin

Table 5: Incremental Capital-Output Ratios in World Market Economies at 1975 Prices

	1960-65	1965-70	1970-75	1975-80	1960-70	1970-80
World market economies	4.1	4.7	7.1	6.4	4.4	6.7
Developed economies	4.3	5.1	8.3	6.7	4.7	7.4
Developing countries	3.2	2.9	3.8	5.4	3.0	4.6
Developed economies						
North America	4.1	6.9	7.9	5.7	5.4	6.6
Africa, Asia and Oceania	3.3	3.1	8.1	7.0	3.2	7.5
Europe	4.8	5.2	8.8	7.6	5.0	8.1
Major industrial economies	4.2	5.2	8.4	6.4	4.7	7.2
Other developed economies	4.4	5.0	7.8	8.8	4.8	8.2
European Economic Community	4.9	5.2	9.2	7.3	5.0	8.1
Developing countries						
Latin America and the Caribbean	3.5	3.4	4.1	5.5	3.5	4.9
Africa	2.7	2.5	6.2	4.8	2.6	5.2
West Asia	1.6	1.7	2.0	10.7	1.6	4.5
Asia and the Pacific	4.5	3.3	4.1	4.1	3.7	4.1
High-income	2.8	2.6	3.6	6.1	2.7	4.8
Medium-income	2.8	3.3	3.8	4.4	3.1	4.2
Low-income	6.1	3.5	4.9	4.6	4.3	4.7
Least developed	4.1	6.1	5.2	4.0	5.1	4.4
Capital-surplus energy exporting	0.9	1.0	1.9	13.3	1.0	5.2
Other net energy exporting	2.8	3.0	4.1	4.5	2.9	4.4
Net energy importing	4.2	3.5	4.2	5.1	3.8	4.7
Petroleum-exporting	1.9	2.0	3.2	6.0	2.0	4.7
Newly-industrialised	3.7	2.7	2.9	4.4	3.1	3.7
Agricultural product exporters	4.8	3.8	5.2	5.7	4.2	5.5
Mineral product exporters	2.8	3.7	7.1	6.3	3.3	6.6

Source: U.N. Reproduced from Raj (1984).

T A B L E: 6

Domestic Savings in Asian and Latin American Countries(Gross National Savings/GDP; percentage)

<u>ASIA</u> (a)	<u>1965-72</u>	<u>1973-78</u>	<u>1979-83</u>
China	23.0	30.0	30.0
India	13.4	19.2	21.0
Indonesia	6.9	18.8	20.1
Korea	14.9	24.9	23.7
Malaysia	20.8	27.2	26.3
Pakistan	10.2	10.0	12.1
Philippines	17.1	23.9	23.3
Sri Lanka	11.3	11.9	10.9
Thailand	21.3	23.6	20.5
Median	14.9	23.6	21.0
<u>LATIN AMERICA</u>			
Argentina	20.3	26.2	17.9
Bolivia	12.9	16.1	-7.2
Brazil	24.0	24.0	17.6
Chile	13.0	11.9	17.0
Colombia	15.4	19.1	17.2
Ecuador	11.3	20.4	20.5
Mexico	19.2	20.2	24.2
Peru	15.2	11.4	13.5
Venezuela	29.8	36.1	29.3
Median	15.4	20.2	17.6

Source: World Development Report, 1985(a) The figures for Taiwan are not reported in the World Development Report

American savings record is relatively much better than its growth experience during the last decade. Largely because of increased savings of the oil countries (Ecuador, Mexico and Venezuela), the median savings rate in Latin America increased from 15.4 percent in 1965-72 to over 20 percent in 1973-78; it was, however, still 17.6 percent during the period 1979-83. Bolivia and Chile have the poorest domestic savings record during the 1980's, with Bolivia registering sizeable dissaving.

Table 7 provides data on the current account balances of the countries on the two continents. During 1965-72, the median current account deficit in Asian countries was considerably greater than in Latin America. This could be due to the fact that Asian countries are much poorer than those in Latin America and may therefore have been recipients of greater amounts of foreign aid. In 1973-78, the current deficits were broadly similar in the two groups of countries. However, in the period since 1979, the Asian deficits are on average greater than those in Latin America. This does not reflect superior international performance of the Latin countries but simply that the debt crisis obliged many of them to sharply and often precipitately reduce their deficits. The comparable Chinese figures are not available in table 7, but as will be reported in Section VII. the Chinese ran a current account surplus for much of the period and had accumulated enormous reserves by the early 1980's. In Latin America, Venezuela also registered on average a current account surplus in all the three periods; yet because of capital flight it contracted enormous debts. The question of capital flight will be considered in Section VI.

TABLE: 7

Current Account Balances in Asian and Latin American Countries; 1965-1983Current Account Balance/GDP (percent)

<u>ASIA</u> (a)	<u>1965-72</u>	<u>1973-78</u>	<u>1979-83</u>
China	n.a.	n.a.	n.a.
India	-4.9	-2.5	-3.6
Indonesia	-5.7	-1.8	-2.9
Korea	-9.2	-4.1	-6.3
Malaysia	1.2	1.5	-7.1
Pakistan	-6.1	-5.9	-3.7
Philippines	-3.8	-4.7	-6.3
Sri Lanka	-4.8	-4.3	-19.0
Thailand	-2.5	-1.8	-4.8
Median	-4.85	-3.0	-5.6
<u>LATIN AMERICA</u>			
Argentina	-0.1	1.6	-2.6
Bolivia	-4.6	-5.0	-16.2
Brazil	-0.8	-4.1	-4.9
Chile	-2.3	-3.4	-10.2
Colombia	-3.6	-0.3	-2.8
Ecuador	-7.3	-6.0	-3.7
Mexico	-2.1	-3.2	-1.9
Peru	-1.5	-6.6	-3.5
Venezuela	0.7	0.7	3.1
Median	-2.1	-3.4	-3.5

Source: World Development Report 1985(a) The figures for Taiwan are not reported in the World Development Report.

To sum up, the Asian countries since 1979 have had a far better record in terms of growth and inflation than those in Latin America. In these respects the uniformity of experience of the countries in each continent is quite remarkable. The two groups of countries, however, differ much less in terms of their rates of accumulation, savings behaviour and the current accounts of their balance of payments.

IV INITIAL CONDITIONS: ECONOMIC STRUCTURE AND DEBT IN ASIA
AND LATIN AMERICA

Tables 8 and 9 summarise the main characteristics of the economic and industrial structure in 1980 in the Asian and Latin American countries respectively. The tables show firstly that the share of agriculture in GDP tends to be much higher in the Asian countries than in Latin America (Columbia being an exception). In many Latin economies agriculture accounts for less than 10 per cent of g.d.p. Secondly, as one would expect, large countries in both continents have a relatively smaller foreign trade sector than the small countries. Thus the share of exports of goods and non-factor services in GDP is just 6 to 7 per cent in India and China, and only slightly higher in the larger Latin economies of Argentina and Brazil. At 14 per cent in 1980, it was however, considerably greater in the large Mexican economy. Thirdly, the smaller Asian countries tend to have a relatively larger exporting sector than the smaller Latin economies.

Fourthly, in almost all economies, large and small, in Latin America as well as Asia, primary commodities still constitute the bulk of merchandise exports. In the large Latin countries, the share of primary commodities in exports is 77 per cent in Argentina and over 60 per cent in both Brazil and Mexico. In Asia, the primary commodities' share is somewhat smaller in China (but still over 50 per cent) and India (a little over forty per cent). The outstanding exception in both continents is South Korea where primary commodities constitute only 10 per cent of merchandise exports. In this respect, that country's economic structure resembles that of an advanced industrial country.

Table 8: Indicators of Economic and Industrial Structure in Asia 1980

	China	India	Indo- nesia	Republic of Korea	Malay- sia	Paki- stan	Philip- pines	Sri Lanka	Taiwan	Thai- land
GNP per capita (dollars)	290	240	430	1,520	1,620	300	690	270	N.A.	670
Distribution of GDP (percent)										
Agriculture	31	37	26	16	24	31	23	28	"	25
Industry	47	26	42	41	37	25	37	30	"	29
Manufacturing	N.A.	18	9	28	23	16	26	18	"	20
Services	22	37	32	43	39	44	40	42	"	46
Distribution of Value Added in										
Manufacturing	N.A.	13	29	17	22	N.A.	39	N.A.	"	N.A.
Food and Agriculture	"	19	8	22	8	"	11	"	"	"
Textile and Clothing	"	20	7	17	17	"	10	"	"	"
Machinery & Transport equip ^m	"	13	11	12	6	"	8	"	"	"
Chemicals	"	35	45	32	47	"	32	"	"	"
Others										
Share of Export of Goods & Non-Factor Services in GDP	6	7	31	37	60	13	20	31	"	25
Share of Primary Commodities in Merchandise Exports	53	41	98	10	81	50	63	75	"	71

Source: World Bank (1982), and 1983

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Table 9: Indicators of Economic and Industrial structure in Latin America in 1980

	Argentina	Bolivia	Brazil	Chile	Colombia	Equador	Mexico	Peru	Venezuela
GNP per capita (dollars)	2,390	570	2,050	2,150	1,180	1,270	2,090	930	3,630
Distribution of GDP (percent)									
Agriculture	9	18	13	7	28	13	10	8	6
Industry	38	29	34	37	30	38	38	45	47
Manufacturing	25	14	27	21	22	8	24	27	16
Services	53	53	53	56	42	49	52	47	47
Distribution of Value Added in									
Manufacturing, %	12	N.A	14	15	32	29	19	27	25
Food and									
Agriculture	11	N.A	9	5	15	14	9	14	7
Textile and									
Clothing	27	N.A	28	16	12	10	19	10	8
Machinery and									
Transport equip ^m	13	N.A	11	11	12	7	12	11	9
Chemicals	37	N.A	38	53	29	40	41	38	51
Others									
Share of Export of Goods & Non-Factor Services in GDP, %	7	17	9	21	17	24	14	24	33
Share of Primary Commodities in Merchandise Export, %	77	97	61	80	80	97	61	84	98

Source: World Bank (1982), and 1980.

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Turning to the structure of industry in 1980, in the industrially most advanced Latin economies, machinery and transport equipment accounted for more than a quarter of manufacturing production in Brazil and Argentina and a little under twenty per cent in Mexico. The share of these manufacturing branches tended to be smaller in the industrially most advanced Asian countries of India and S. Korea.⁽¹⁾ It is also worth noting in table 8 that the share of manufacturing in India's g.d.p. is relatively low. However, as reported in Singh (1985), the absolute size of India's manufacturing industry is very large and on a number of important indicators, India is one of the most advanced industrial countries in the third world. (See further Section VII).

Tables 10 and 11 report on two indicators of debt burden for the two groups of countries - the debt/g.d.p. ratio and the debt service to exports ratio. The debt figures for each country refer to the gross external liabilities and includes both short and long term debt. Table 10 shows that in the intershock period (1973-79), the average debt to g.d.p. ratio in the Asian countries was greater than that in the Latin American economies. Several Asian countries (Korea, Indonesia, Pakistan, Sri Lanka and Phillipines) had higher debt as a proportion of g.d.p. than countries like Mexico and Brazil. However, as table 11

(1) The comparable data for China's industrial structure is not available in the World Bank Data Bank. However, a detailed comparison of the Chinese industrial structure with that in India and South Korea was made in Singh (1985). This comparison showed that in the late 1970's the share of machinery and metal products in the Chinese manufacturing sector was higher than the corresponding share of these industries in the Indian and S. Korean manufacturing production.

Table 10

TOTAL EXTERNAL DEBT / GDP RATIOS IN ASIA AND LATIN AMERICA
(average annual ratios ,in percentages)

	1973-79	1980-83

Latin America		
Argentina	17.8	46.2
Bolivia	NA	NA
Brazil	21.3	33.8
Chile	43.1	64.5
Colombia	21.6	25.2
Ecuador	NA	NA
Mexico	26.7	45.1
Peru	53.1	55.8
Venezuela	24.9	48.2
Median	24.9	46.2
Asian Countries		
China	NA	NA
India	14.2	13.5
Indonesia	35.5	30.8
Korea	31.9	50.6
Malaysia	NA	NA
Pakistan	52.5	38.7
Philippines	31.1	58.2
Sri Lanka	46.7	55.3
Taiwan	NA	NA
Thailand	15.2	30.6
Median	31.9	39.7

Source: Original data from World Bank Data Bank

Table 11

FOREIGN DEBT SERVICE / EXPORT RATIOS IN ASIA AND LATIN AMERICA
average annual ratios in 1973-79, 1980-83, in percentages

	1973- 1979	1980- 1983

Latin America		
Argentina	19.5	22.4
Bolivia	NA	NA
Brazil	22.9	36.7
Chile	26.3	24.4
Colombia	12.0	17.4
Ecuador	NA	NA
Mexico	38.8	34.8
Peru	27.1	34.3
Venezuela	4.6	15.6
Median	22.9	24.4
Asian Countries		
China	NA	NA
India	13.7	9.3(1)
Indonesia	10.0	10.2
Korea	11.5	13.0
Malaysia	5.0	4.6
Pakistan	19.3	20.5
Philippines	9.4	13.3
Sri Lanka	13.9	9.1
Taiwan	NA	NA
Thailand	3.1	8.4
Median	10.7	9.8

(1) Data for 1990-92

Source: Original data from World Bank Data Bank

indicates, despite the greater debt to g.d.p. ratio of the Asian countries, their average debt service to exports ratio during 1973-79 was about half that of the Latin economies. This was partly due to the softer loan conditions (the greater role of ODA) for the Asian countries. More significantly, it was due to differences in economic structure: the Asian countries with large debt to g.d.p. ratios also typically displayed greater trade openness (i.e. had relatively large exports to g.d.p. ratios) than those in Latin America.

During 1980-83, the debt to g.d.p. ratio increased appreciably in both continents, much more so in Latin America than in Asia. In the Latin American case this is likely to reflect more a fall in the rate of growth of g.d.p.; in the Asian countries it is more due to an increase in debt due to somewhat greater current account deficits in the 1980s (see tables 2 and 6). However, the debt service to exports ratio increased only slightly in 1980-83 in Latin America and fell slightly in that period in Asia.

Finally, it should be emphasised that in both Tables 10 and 11, the intercontinental differences are as important as the inter-continental differences. In Asia, countries like India and China⁽¹⁾ continued to have relatively very small debt burdens throughout the 1970s and 1980s. This was, however, not fortuitous but a deliberately act of economic policy as will be discussed in section VII.

(1) The comparable figures for China's debt are not available in the World Bank Data Bank. However, see Section VII below.

V. THE COMPARATIVE IMPACT OF EXOGENOUS SHOCKS

Next we consider the nature of exogenous shocks which the countries in the two continents were subject to. To begin with there is an elementary conceptual issue here which is often overlooked in the literature but which deserves attention. The impact of an exogenous shock to an economy depends on the size of the shock and the structure of the economy. Thus the larger the share of imports in the GDP of a country the greater would be the impact on its real income of a decline in its terms of trade. However, a country's economic structure is determined at least in part by its economic policy and long-term strategy. In order, for example, to avoid or to minimise the effects of fluctuations in its terms of trade, the country may choose to have a relatively low level of imports or foreign trade. This argument has a significant implication for the Balaasa-Williamson view referred to in Section III that the more open an economy, the better it is able to cope with exogenous shocks. Even if one were to accept their notion of greater flexibility of the open economies, the adverse initial effect of a given terms of trade shock is clearly greater for such economies.

The movements in the terms of trade during 1979-83 (relative to 1975-78) and their impact on the Latin American and Asian economies are shown in Table 12. The Table indicates that there is a wide variation in the changes in the terms of trade experienced by countries in each continent. Despite the slippage in oil prices in 1982 and 1983, over 1979-83 as a whole, the terms of trade of the oil exporting countries greatly improved - in the case of Indonesia by a huge 98 per cent.

As there are a large number of oil exporting countries in

Table 12

TERMS OF TRADE SHOCK, 1979-1983

	(1) Percentage change in terms of trade from 75-78	(2) Imports as percentage of GDP, 75-78 average	(3)=(112)/100 Real Income effect of terms of trade change

Latin America			
Argentina	-8.2	8.6	-0.7
Bolivia	-9.4	24.1	-2.3
Brazil	-20.9	9.4	-2.7
Chile	-2.1	23.4	-0.5
Colombia	-12.8	14.7	-1.9
Ecuador	22.1	27.4	6.1
Mexico	29.7	9.8	2.8
Peru	30.8	18.7	5.9
Venezuela	42.4	32.5	13.8
Median	-2.1	19.7	-0.5
Asian Countries			
India	-13.4	6.8	-1.9
Indonesia	93.8	21.5	21.3
Korea, Republic of	-6.4	34.7	-2.2
Malaysia	11.7	44.3	5.2
Pakistan	-6.7	20.9	-1.4
Philippines	-4.1	24.1	-1.0
Sri Lanka	-4.5	29.9	-1.4
Thailand	-17.0	24.7	-4.2
Median	-5.4	24.3	-1.2

Source: Original data from World Bank Data Bank

Latin America, on average the terms of trade moved more against the Asian countries than against the Latin American. Moreover, because of the greater trade openness of the Asian countries, the adverse impact on real income was also on average greater in Asia than in Latin America.

Over the period 1979-83 Brazil suffered the greatest decline in its terms of trade (nearly 30 per cent) of any country in the two continents. In Asia, the Indian terms of trade worsened by 13 per cent but its effect on real income was only 0.9 per cent of g.d.p. Korea suffered a terms of trade loss of half the size of India's, but because of its much more open economy the effect on Korea's real income was more than twice that for India.

Another exogenous shocks which both Asian and Latin American economies suffered following the second oil price increase and the adoption of highly restrictive monetary policies in the US and the other advanced countries was the enormous increase in nominal and real interest rates. Measured as the London Interbank Offer Rate (LIBOR) on three month US dollar deposits less the rate of change of GDP deflator in the US, the real interest rates increased from an average of only 0.5 per cent during 1974-78 to more than 7 per cent in 1981 and 1982 and 5 per cent in 1983. If the real interest rates are defined more appropriately in terms of the differences between LIBOR and the rate of change of export prices of developing countries, the recorded increase in these rates is astounding. As Table 13 shows the average real interest rate on developing country floating-rate debt increased from -11.8 per cent in 1977 to 15.9 per cent in 1983.

Table 13.

Average real percentage interest rate on developing country
floating-rate debt: 1977-83

1977	-11.8
1978	-7.4
1979	-9.7
1980	-6.0
1981	14.6
1982	16.7
1983	15.9

Source: H. Reisen, Key Prices for Adjustment Towards Less
External Indebtedness, OECD, Development Centre, 1985.

This rise in interest rates had a much greater effect on the economies of Latin American countries than on those in Asia. A larger proportion of the Latin American debt was of the floating rate variety. Further, the World Bank data on the average terms of new loans (e.g. maturity, the grace period, the grant element) during the period 1972-87 show the Latin American countries faced by far the worse loan conditions. Sachs (1985) suggests that with a few exceptions the impact of the rise in interest rates on the developing countries economies was not particularly significant. He writes "At the peak, the measured US real interest rate rises by about 10 percentage points and is multiplied by a debt/g.d.p. ratio of the order of 20 per cent, producing a peak annual loss of about 2 per cent of GDP and an average annual loss of about 1 per cent of GDP". However, this is not a valid argument. Since as seen in Table 6 the median current account deficit in the Latin American countries was only about 3 per cent of g.d.p. in the late 1970's, the impact of the increase in interest rates (whether measured in nominal or real terms) on the current balance of these economies was highly significant. The dynamic consequences (particularly in terms of capital flows) of an increase (or decrease) in the current account deficit by nearly a third for a balance of payments constrained economy cannot be exaggerated.

This issue also has an important bearing on the general question of the vulnerability of an economy to international fluctuations. Of two countries with the same debt to g.d.p. ratio, a rise in interest rates, other things being equal, will have a more serious impact on the less rather than the more 'open' economy (where 'openness' is defined in terms of the share

of exports or imports in g.d.p.). This is because the less 'open' economy will be obliged to increase its exports or reduce its imports by a greater proportion to compensate for the increase in interest rates than the more open economy. Thus compared with the Asian countries, the Latin American economies suffered far more from the interest rate shock not only because of the worse terms and conditions of their loans, but also because of the structure of their economies which were less 'open'.

There are two other exogenous shocks which need to be considered and which could help explain the intercontinental differences in growth rates and inflation in Asia and Latin America in the 1980s. First is what Williamson (1985) calls the 'contagion effect' whereby following the Mexican debt crisis in 1982, voluntary private capital flows to most Latin American countries were greatly reduced if not stopped altogether. Williamson rightly notes: "Korea got close to the brink in 1980 as a result of overexpansionary policies in 1979 and large external shocks; had it been in South America and therefore subject to contagion, it might well have succumbed" (p.569). The important point is that because of the 'contagion effect', capital flows are likely to have been reduced much more to the Latin American than to the Asian economies. This in turn will have worsened the balance of payment constraint in the Latin American countries more so and more suddenly than in the Asian economies. In that context, the effects in terms of lower

economic growths and higher inflation in Latin America in the 1980s are not surprising⁽¹⁾.

This point is best illustrated by considering the case of Mexico itself. The Mexican economy expanded rapidly during the oil boom years 1978-81. As table 14 shows, the rate of growth of g.d.p. during these four years was more than 8 per cent per annum. More detailed data⁽²⁾ indicate that even the non-oil g.d.p. increased at an extraordinary rate of nearly 8 per cent per annum at a time of significant deceleration in world economic growth. Instead of increasing unemployment which most industrial countries experience during this period, in Mexico, on average, at a conservative estimate, half a million new jobs were being created each year. Towards the end of the period, revised figures indicate that nearly a million new jobs were being created annually. Similarly investment in plant and equipment recovered strongly. From 1977 to 1980, gross fixed capital formation as a proportion of g.d.p. rose from less than 20 per cent to nearly 25 per cent.

However, as Tables 14 and 15 also suggest, the health of the financial economy was not so robust. After a sharp fall from its 1977 level of 29 per cent to 17.5 per cent in 1978, the rate of inflation in 1980 was again 26.4 per cent and in 1981, 27.9 per cent. But the most important indicator of the deterioration of the financial economy was the continuing increase in the current account deficit which by 1981 had reached a colossal figure of \$11.7 billion or 5.9 per cent of GDP (Table 15). This

(1) For a discussion of the effects of the balance of payments constraint on all spheres, real and financial, of developing country economies, see Singh (1986).

(2) See Ros (1986), Brailovsky and Barker (1983), Singh (1985)

Table 14

MEXICO, Main Economic Indicators, 1972-1984

	1972	1973	1974	1975	1977	1978

GNP, real growth rate, %pa	6.5	8.5	6.1	4.2	3.5	8.2
Inflation rate, %pa	4.3	12.1	23.9	15.7	29.0	17.5
Trade balance / GDP, %	-2.2	-2.7	-4.2	-4.0	-2.5	-2.3
Current balance / GDP, %	-2.1	-2.6	-4.1	-3.9	-2.4	-3.2
Total debt, US\$b	7.9	9.0	11.9	20.5	31.1	35.7
of which short term, US\$b	.0	.0	.0	.0	5.5	4.9
Total debt / GDP, %	15.6	16.3	16.6	23.1	38.0	34.7
Debt service / Exports, %	23.5	23.3	19.7	32.6	45.4	59.4

Terms of trade, index	100.0	99.9	107.4	110.9	101.9	104.6
Export volume, index	100.0	101.8	75.0	78.6	91.1	128.6
Exports / GDP, %	8.9	9.7	8.4	7.7	9.5	10.4
Imports / GDP, %	8.9	9.5	10.6	9.3	9.4	11.0
Workers remit / Exports, %	NA	NA	NA	NA	NA	NA

	1979	1980	1981	1982	1983	1984

GNP, real growth rate, %pa	9.1	8.3	7.9	-1.5	-5.3	3.5
Inflation rate, %pa	18.1	26.4	27.9	59.0	101.9	65.5
Trade balance / GDP, %	-4.2	-4.5	-6.0	-2.9	3.5	2.0
Current balance / GDP, %	-4.1	-4.5	-5.9	-3.7	3.6	2.1
Total debt, US\$b	42.8	57.1	77.9	85.8	93.7	97.3
of which short term, US\$b	9.0	16.2	25.0	26.1	10.1	7.4
Total debt / GDP, %	31.8	30.7	32.5	51.4	65.6	55.5
Debt service / Exports, %	65.8	33.5	29.4	35.9	40.4	36.9

Terms of trade, index	114.0	147.6	158.0	154.6	107.5	103.3
Export volume, index	151.8	178.6	219.6	241.1	260.7	NA
Exports / GDP, %	11.2	12.6	12.0	15.7	19.1	17.1
Imports / GDP, %	12.4	15.8	14.0	11.8	8.9	9.2
Workers remit / Exports, %	NA	NA	NA	NA	NA	NA

Source: Original data from the World Bank Data Bank

Table 15

Mexico: Current Balance of Payments 1976-81

(All figures in thousands of millions of U.S. dollars except where stated otherwise)

	1976	1977	1978	1979	1980	1981
Balance of payments current account	-3.069	-1.623	-2.693	-4.856	-6.761	-11.7
a) Balance of goods and non-factor services	-1.190	0.360	-0.310	-1.542	-1.808	-4.1
b) Balance of factor payments	-1.879	-1.983	-2.383	-3.314	-4.953	-7.6
<u>Memorandum</u>						
Interest on external/public debt	1.266	1.542	2.023	2.888	3.958	5.5
Oil exports	0.543	1.029	1.799	3.861	10.305	14.4
Merchandise imports	5.427	5.150	7.376	11.380	17.174	23.1
%change unit value in dollars of manufactured imports	7.4	8.0	10.5	12.7	15.2	17.0
%change in unit value in dollars of oil exports (dollars)	8.4	6.7	0.5	47.2	55.2	8.2

Sources: Sistema de Cuentas Nacionales de Mexico, SPP, Informe Annual de Banco de Mexico, various years.

was despite the nearly 30 fold increase in oil revenues, which rose from \$0.5 billion in 1976 to \$14.4 billion in 1981. This disjuncture between the financial and the real economy was directly responsible for the economic crisis which followed in 1982.

There were three main reasons for the huge increase in the current account deficit during the years of the oil boom: (a) a massive increase in manufactured imports which quadrupled in nominal value and tripled in terms of volume over the five years 1976 to 1981; (b) relatively poor performance of non-oil exports, which was in important part due to the US and world recession; (c) interest payments on public debt which increased very rapidly (see Table 15). Of the three, (a) was an avoidable act of public policy while (b) and (c) were less so since they depended to a large extent on the USA and world economic activity and interest rates. The government's programme of liberalization of imports which it vigorously pursued between 1977 and 1981 played a significant role in the surge of imports.⁽¹⁾

However, the important point is that up to 1981 Mexico had little difficulty in financing these increasingly large current deficits from foreign borrowings. Thus from 1978 to 1981, while international bank loans to developing countries as a whole increased by 76 per cent, they rose by 146 per cent to Mexico, already a large debtor in 1978. To meet the Mexican government's increased demand for foreign loans to finance the current account deficit, the international banks accelerated their lending to Mexico in 1981, albeit with an increasing shortening of the term structure of the new loans. [Ros (1986)].

(1) See further Brailovsky and Barker (1983)

In that year, the capital account of the balance of payments indicates, Mexico's net public short term liabilities rose by \$12.7 billion (compared with \$6 billion in 1980 and \$1.7 billion in 1979). However in the crisis year of 1982 these capital flows were abruptly halted and the capital account shows that Mexico's net public external short term liabilities actually decreased by \$614 million.

Brailovsky and Barker (1983) rightly observe in this context: "Although the conditions for a balance of payments crisis were present, the extent to which it actually took place in 1982 was certainly out of proportion with the underlying disequilibria. These were hugely amplified by capital movements that, under the system of free exchange convertibility then prevailing, could not be brought under control, even when domestic interest rates were risen dramatically. The situation was made untenable when the international banking system imposed a freeze borrowings by Mexico. In fact, this means that Mexico was forced to reduce in absolute terms the debt outstanding during the second half of 1982, a quite unprecedented action by international standards. This action, moreover, served no good purpose: it hindered the Mexican economy to an unnecessary extent and it endangered the international financial system. Were it not for these aggravating circumstances, the 1982 crisis could have had much less damaging effects on the Mexican economy, an economy that despite policy mistakes, ended this period (1976-82) with a strengthened productive potential after having created sizeable new resources and employed a growing proportion of its working population. ²⁾

Following the Mexican crisis, serious 'contagious' interruptions in normal capital flows occurred in a number of other Latin American countries. As Fishlow's paper in this volume suggests such capital supply shocks were much more significant for the Latin American than for the Asian economies and had a far greater impact on the former.

Apart from the interest rate and the capital supply factors, there is another exogenous shock which is likely to have had an important differential impact on the Asian and Latin American economies. Reduced world economic growth and world trade during 1980-82 is unlikely to have led to a uniform contraction of the normal markets for countries in the two continents. In particular, the Middle Eastern market which continued to expand during this period was much more significant for many of the Asian countries than for Latin America. There are two important channels by which the South Asian (India, Pakistan and Sri Lanka) and South East Asian countries have benefitted from the economic prosperity in the Middle East; (i) workers' remittances and (ii) the growth of merchandise and construction exports.

By 1975 there were 1.6 million migrants working in the Arab oil producing countries, which comprised as much as 17 per cent of the total labour force of these countries. Although most of the migrants came from the other Middle Eastern countries, a little over 20 per cent were from South and South East Asia. It is estimated that by 1980, the number of migrants to the Middle Eastern oil producing nations increased to 3 million of whom more than a quarter came from South and South East Asia. [Talal (1984), Burki (1984), Singh (1985a)].

In view of the size of the migration, the scale of the remittances and their impact on the balance of payments for a number of Asian countries has been highly significant. The World Bank data show that workers' remittances constituted a little over 28 per cent of the exports of goods and non-factor services in Pakistan in 1975; in 1982, their share had increased to over eighty per cent. The size of the remittances in 1982 was four times as large as Pakistan's debt service in that year. Similarly in India workers' remittances as a proportion of exports increased from a little over 5 per cent in 1974, to nearly 15 per cent in 1978 and to about 25 per cent in 1980. The corresponding figures for Sri Lanka are 1.4 per cent of exports in 1974, 4.1 per cent in 1978 and 22 per cent in 1982. In Thailand, remittances constituted less than 1 per cent of exports in 1976 and over 10 per cent in 1983; the corresponding increase in Thailand's debt service over this period was from 2.5 per cent to 11.5 per cent of exports.

Apart from workers migration and remittances, the Asian economies were able to greatly expand their exports to the oil countries. Since 1973, the high income Arab oil producing countries (Oman, Libya, Saudi Arabia, Kuwait, United Arab Emirates) have been by far the fastest growing market in the world. Between 1973 and 1984 the imports of these countries increased at a rate of 18.3 per cent p.a.; the corresponding growth rate of imports in the industrial market economies was 3.2 per cent and in the middle income developing countries less than 5 per cent. [World Bank (1986)]. Pakistan's share of high income oil exporting countries in its total exports increased from only 4 per cent in 1965 to 22 per cent in 1983; India's share of

exports going to the oil-rich countries increased from 2 to 7 per cent over the same period. The corresponding increase in Korea's share was from almost zero in 1965 to 10 per cent in 1983.⁽¹⁾

To sum up this discussion, the last two sections have examined the differences between the Asian and Latin American countries in terms of economic structure, the initial conditions in the 1970s particularly with respect to the size and the terms of their debt, and the nature of the exogenous shocks which the countries in the two continents were subject to. Since there are large and small countries in both continents, the intra-continental differences in economic and industrial structure were found to be more important than the inter-continental ones except that the share of agriculture in g.d.p. tended to be generally higher in Asia than in Latin America. More significantly the smaller Asian countries displayed greater trade openness (i.e. had a higher ratio of exports to g.d.p.) than the smaller Latin American nations; the reverse was true in the case of the larger countries in the two continents (India and China in Asia, Mexico and Brazil in Latin America). In the inter-shock period, 1973-78, the median debt service ratio of the Latin American countries was twice as large as that of the Asian economies. This was largely due to two factors: (a) the much better terms on which the Asian loans had been contracted and (b) the greater exports to g.d.p. ratio of the indebted Asian countries. With respect to exogenous shocks, the terms of trade shock during 1979-83 was if anything more severe for the Asian economies than for those in

(1) See World Bank (1985), Table 12, pp.196-197.

Latin America, but again there were very important inter-continental differences. The increase in the nominal and real interest rates following the monetarist shock had a greater impact on the Latin American than Asian countries. This interest rate effect was particularly significant in relation to the current account balances of the Latin American economies. The balance of payments position of the latter group also suffered from the 'contagion effect' which led to a sharp reduction in capital flows to that region following the Mexican debt crisis in 1982. Finally it is suggested that the recession in the world economy during 1980 to 1982 is likely to have had a differential impact on the export markets (including the market for migrant labour) of the two groups of countries. The increased workers' remittances arising from the economic prosperity of the Middle East had an important role in easing the balance of payments position of a number of Asian countries.

VI EXPORTS, CAPITAL FLIGHT AND THE EXCHANGE RATE.

Sachs (1985) has singled out the exchange rate changes as one of the most important determinants of the differential economic performance of the Asian and Latin American countries. It is argued that the Asian group owe their trading success to the more sensible exchange rate policies followed by the governments of these countries. The overvalued exchange rates of the Latin economies, it is asserted, not only hampered their exports but were also responsible for the massive capital flights which these countries suffered. Some evidence bearing on this issue will be briefly reviewed in this section.

Table 16 provides information on the growth in the volume of merchandise exports of the Latin American and Asian countries during 1973-79 and 1979-83. In the first period, the Asian group increased its exports volume at a slightly faster rate on average than the Latin American countries; in the latter period, the Asian performance has been considerably better. Table 17 gives UNIDO data on the export performance in manufactures alone (rather than in total merchandise exports) for selected developing countries over the period 1970-80. The Table shows that over the decade as a whole Brazilian manufactured exports expanded at much the same rate as the Korean exports. Thus despite the lack of 'openness' of the Brazilian economy relative to Korea's. Brazil's exporters did extremely well in the foreign markets. During 1970-78, Mexico and Argentine's manufacturing exports grew faster than India's. However, Malaysia, Phillipines and Thailand all had strong export performance in manufactures in the 1970s.

Table 16

VOLUME OF EXPORTS OF MERCHANDISE IN ASIA AND LATIN AMERICA
average annual rates of growth in percentages

	1977-79	1979-80

Latin America		
Argentina	10.9	1.0
Bolivia	-3.7	-3.0
Brazil	5.1	7.7
Chile	15.0	.9
Colombia	3.2	-2.0
Ecuador	-0.9	-10.5
Mexico	6.9	14.5
Peru	15.7	-9.5
Venezuela	-6.3	-9.6
Median	3.2	0.0
Asian Countries		
China	NA	NA
India	7.4	1.3
Indonesia	2.1	-2.2
Korea	15.2	13.7
Malaysia	1.7	5.0
Pakistan	2.3	12.3
Philippines	7.4	-5.2
Sri Lanka	.0	5.9
Taiwan	NA	NA
Thailand	8.3	6.4
Median	4.9	5.4

Source: World Bank Data Bank

Table 17

Exports of manufactures (SITC 5-8 less 68) by selected developing countries or territories, 1970-1980

Countries or territories ^d	Average annual growth rate ^b (percentage)		Share in total (percentage)		
	1970-1973	1974-1980	1970	1974	1980
Republic of Korea	43.1	18.3	6.0	16.1	14.2
Hong Kong	19.9	25.2	18.5	12.0	11.9
Singapore	34.3	41.3	4.0	6.5	8.2
Brazil	35.9	33.4	3.4	6.1	6.3
India	17.2	10.0 ^c	9.3	5.4	...
Mexico	20.2	...	3.7	2.5	...
Argentina	27.1	5.4	2.3	2.4	1.7
Malaysia	37.1	32.8	1.0	2.0	2.2
Kuwait	36.9	38.4	0.9	1.6	1.9
Thailand	50.7	36.8	0.3	1.2	1.5
Pakistan	9.6	22.7	3.8	1.2	1.1
Philippines	31.4	31.3	0.7	1.0	1.1
Other countries	25.2	...	45.6	42.0	...
All developing countries ^d	26.5	26.0	100.0	100.0	100.0

a Ranked by the value of their exports of manufactures (SITC 5-8 less 68) in 1978

b Compound growth rate

c Annual growth rate in 1979 over 1978

d Seventy countries

Source: UNIDO (1984)

The essential question is to what extent, if any, the differential exporting records of the various countries can be explained in terms of their exchange rates policies. Is exporting success simply a function of the exchange rate as is often implied in the orthodox literature in this area or does it also depend on other factors which may be more important? There are few studies where the effects of the exchange rate changes on exporting performance are isolated from those of other factors (e.g. the growth of world demand). Moreover there is contrary evidence, particularly striking for the advanced countries, which is simply overlooked. It will be useful to examine this evidence.

Table 18 provides data on exchange rates, relative costs (as measured by labour costs per unit of output measured in a common currency) and exporting performance (indicated by the share of manufactures in industrial country exports) for the leading advanced economies over the period 1956-76. The Table shows 'perverse results' as far as the relationship between the exchange rate, relative costs and export performance is concerned. Over the period 1956-76, UK's exchange rate depreciated by nearly fifty per cent whilst its share of industrial country exports was halved. Similarly West Germany and Japan's currency appreciated significantly over this period and yet these countries greatly increased their export share. The relationship between relative costs and export share is also perverse for these countries as well as for the US and Italy. Such perverse results hold not only over the long period 1956-76 but also over the shorter period such as 1970-76.

Table 18

Index Numbers of Trade-Weighted Exchange Rates and of Unit Labour Costs in Dollar Terms and Percentage Export Shares of Manufactures (Selected Years 1956-76).

	1956	1960	1965	1970	1975	1976
<i>United Kingdom</i>						
Exchange Rate ¹ (1956=100)	100	106	105	89	68	59
Relative Costs ² (1956=100)	100	110	109	101	101	94
Export Share of manufactured goods ³	13.7	13.9	13.5	10.3	9.3	8.7
<i>United States</i>						
Exchange Rate	100	106	105	100	87	94
Relative Costs	100	104	105	80	51	55
Export Share	23.3	21.7	20.5	18.5	17.7	17.3
<i>West Germany</i>						
Exchange Rate	100	106	113	126	178	185
Relative Costs	100	116	135	146	165	163
Export Share	16.5	19.7	19.2	19.8	20.3	20.6
<i>Japan</i>						
Exchange Rate	100	105	104	106	111	119
Relative Costs	100	87	87	105	132	136
Export Share	5.7	6.9	9.4	11.7	13.6	14.6
<i>France</i>						
Exchange Rate	100	71	70	62	69	66
Relative Costs	100	79	75	67	80	79
Export Share	7.9	9.7	8.6	8.7	10.2	9.3
<i>Italy</i>						
Exchange Rate	100	105	104	106	85	68
Relative Costs	100	94	107	104	119	103
Export Share	3.6	5.2	6.3	7.2	7.5	7.1

1 For each country an index of average exchange rates was divided by a trade weighted index of the average annual exchange rates of the other five countries, weighted by 1970 export shares.

2 For each country unit labour costs in dollars (manufacturing earnings divided by indices of trends in productivity) are divided by the weighted average of the unit labour costs of the other five countries - the weights in each case being determined by the export shares of each country in 1970.

3 Each country's share of the value of manufactured exports of major developed market economies, in US dollars. "Special category" exports are excluded in the case of the US.

Source: Kaldor (1984)

There is a large literature which attempts to explain these observations in terms of the importance of investment and a host of non-price factors which influence a country's exporting performance. (See, for example, Kalder (1978), Stout (1979)). It may perhaps be argued that such considerations do not apply to developing country manufacturing exports.⁽¹⁾ However, Brailovsky (1981) carried out a similar exercise for a sample of both developing and developed countries and arrived at much the same results.⁽²⁾ The developing countries included in his sample were Argentina, Brazil, Hong Kong, Korea, Mexico and Singapore. He found on the whole no relationship between real exchange rate changes and foreign market penetration for either the developed or the developing countries over the entire period 1960-77 or over the four sub-periods which he studied.

Brailovsky notes that Singapore's real exchange rate appreciated over two periods; in one it gained and in the other it lost its share of world markets. Singapore's real exchange rate depreciated over the two remaining periods, but in one of these it had negative penetration. Korea and Hong Kong had persistent large gains in their market shares, although in two out of four periods their real exchange rate rose. Similarly Mexico's share in the world market decreased during 1964-68 although it maintained an almost constant exchange rate. In the next period, the peso had a small real appreciation, yet a substantial market penetration was achieved.

(1) In view of the low price elasticity of primary commodities, there are good grounds for not expecting a significant positive relationship between currency depreciation and exports of these commodities. See Branson (1983).

(2) See also Fishlow's paper on this volume

Let us consider the Korean example further. Between 1974 and 1978, the volume of Korean exports more than doubled. This was one of the most important factors in ensuring that Korea's trade deficit which had risen to 11.9 per cent of g.d.p. in 1974 following the first oil shock had practically vanished by 1977-78. However, this enormous increase in Korean exports during this period could not simply be ascribed to 'getting the prices right'. On the contrary, over these years, Korea's real exchange rate (corrected for inflation) had appreciated by nearly 20 per cent. Much more important to the country's export drive were two institutional mechanisms which had been established: the system of setting export targets and the practice of holding national trade-promotion meetings. As World Bank (1983) noted: "These two mechanisms helped translate political resolve into bureaucratic and corporate resolve. They also provided up-to-date information on export performance by firm, product and market and enabled the government to analyse the reasons for any discrepancies between targets and performance. The government then adjusted its export incentives and targets accordingly".⁽¹⁾

The alleged positive relationship between capital flight and currency overvaluation is also a more complex phenomenon. It is true that countries like Mexico, Venezuela and Argentina, suffered massive capital flights in the early 1980's. In economies where there are few exchange controls, currency depreciation, to the extent that it leads to wage-price increases and consequent financial instability, may encourage rather than discourage capital flight. This is what happened in Mexico when in February 1982, because of the shortage of reserves, the

(1) World Bank (1983), page 68.

Government instead of imposing exchange controls floated the currency. At that time the peso/US dollar nominal exchange rate was 26 and the Mexican rate of inflation was about 28 per cent. It was argued at the time that because of Mexico's higher inflation rate than that of its trading partners (chiefly, the U.S.), the equilibrium exchange rate for the peso was 35. However, the currency soon overshot to 50 peso per dollar. This in turn led to wage-price increases, financial instability, capital flight and further devaluation. By August 1982, the peso/dollar exchange rate had depreciated to 120, the rate of inflation had increased to nearly 100 per cent and the differential between the Mexican and the trading partners' rate of inflation had widened further. It was at this point that the Government decided to impose exchange controls. The exchange controls did not totally stop the capital flight, but they greatly reduced it.

Under the new administration of President De La Madrid which came into office at the end of 1982, the Government accepted an IMF programme and embarked on orthodox economic and financial policies. These policies, even before the earthquake and fall in oil prices, were showing clear evidence of failure. By 1985 the peso/dollar exchange rate had depreciated to 500, the rate of inflation at over 60 per cent was still much greater than the world rate of inflation and the capital flight continued. Ros (1986) estimates that as a proportion of the net real private financial savings, the capital flight in 1983 and 1984 was

greater than in 1981 and 1982.⁽¹⁾

The important question is why did the Mexican Government not impose exchange controls in 1980 or 1981 to forestall the financial crisis and capital flight.⁽²⁾ The answer lies in the nature of the class bargain which had long prevailed in the Mexican polity. Just as the working class were able to recoup price rises with wage increases, albeit with a lag, it was the privilege of the bourgeoisie to have more or less free convertibility of currency. Whereas Mexico's upper classes had always accepted import controls, it required a major financial and political crisis for exchange controls to be introduced. However, in other developing countries (e.g. Korea, India, Brazil) exchange controls have long been accepted and these countries had relatively little capital flights.

(1) Ros (1986) notes: "since, from 1983 onwards, the change in the real value of the private sector holding of Mexican public debt has actually been negative and thus the whole of its net real savings has been invested abroad. At present, the latter are financing the current account deficit of the rest of the world (with respect to Mexico) as well as through the intermediation of foreign banks, the [nominal] borrowing from abroad by the Mexican public sector. This borrowing is, thus, a consequence of the need to balance the external accounts in the face of a major alteration in the asset composition of the private sector's net financial savings".

(2) Exchange controls had been proposed throughout 1981 by economists at the Ministry of Oil and Industry to forestall an impending balance of payment crisis. At the time, these proposals were totally unacceptable.

VI NOTES ON LARGE SEMI-INDUSTRIAL ECONOMIES IN ASIA AND
LATIN AMERICA.

In the context of the debate about 'openness' and vulnerability, it will be useful to examine in some detail the experience of the largest Asian and Latin American economies: India, China, Brazil and Mexico. These four countries account for the bulk of the third world's industrial production. More significantly, they have for long followed rather different development strategies and economic policies.

In terms of absolute size, Brazil's manufacturing sector in 1980 was about twice as large as that of Mexico's. Mexico and India's manufacturing industries were of more or less the same size. UNIDO (1984) estimates that in absolute terms China's manufacturing economy in 1980 was twice as large as that of Brazil's. Other relevant indicators such as technology exports, the sophistication of the machine tools and capital goods industries suggest that these countries were also among the most advanced in the third world in terms of the quality of their industrial development. [Singh (1984)].

With respect to economic policy for the last four decades, India and China have long followed inward-oriented import substitution industrialisation strategies. Direct foreign investment has played a very small role in the Indian economy and hardly any in China.

Brazil had an inward looking trade regime until the early 1960's, but then in 1964, following the military coup, it started a fundamental switch towards 'outward orientation' by

encouraging exports and foreign investment (by instituting important changes in tariff structure, exchange rate and export promotion policies). Krueger (1977), which is based on a study of trade regimes in a group of developing countries until 1973, regarded Brazil (along with Korea) as an exemplary case of a switch towards outward orientation. Balaasa (1981) also notes that in the mid-1960's, Brazil changed its policies towards outward orientation.

The Mexican case is more mixed. The country had implemented strong import substitution policies in the 1950's and the 1960's. However, in the late 1960's, it too initiated steps to change its trade regime towards 'outward orientation'. Imports began to be liberalized and various export promotion measures were instituted, [Balaasa, (1981)]. However, the balance of payments crisis of 1974 led to a reversal of import liberalization measures. Nevertheless, with the coming of oil and the improvement of the balance of payments situation, the government again embarked on strong import liberalization policies between 1977 and 1981. Brailovsky (1980).

Further in contrast to the large Asian countries the two large Latin American countries share one important structural characteristic: the foreign multinationals play a major role in their industrial economies. [Singh (1984)].

It was noted in Section III that during the world economic slowdown of the 1980's, India and China have performed considerably better than Brazil or Mexico. As Table 2 showed, between 1979-84 the two Asian countries have been able to maintain, if not improve on their long-term trend rates of growth whilst the two large Latin American economies have suffered a sharp break in their development momentum. How can these differences in economic experience of these countries be explained?

Consider first the case of India. In the wake of deceleration in world economic growth in the 1970s and 1980s, the Indian economy was subject to all the shocks which emanate from such world economic crisis, i.e. there was a sharp adverse movement in India's terms of trade, the growth of export markets slowed down, the country was exposed to higher real interest rates and there was also (relative to the g.d.p.) a reduction in capital inflow.⁽¹⁾ Table 19 which gives summary data on the Indian economy for the period 1972 to 1984, shows that India's terms of trade declined by 40 per cent between 1972 and 1976 and by 33 per cent between 1977 to 1979. This adverse movement in the Indian terms of trade in the 1970s was greater than that recorded for S. Korea. Nevertheless during 1977 to 1979, the country had moved into a significant current account surplus. India's debt service to export ratio at a little over 9 per cent in the 1980's was less than half that recorded in the early 1970s.

(1) The following discussions summarise the information contained in Singh (1985) to which the reader is referred for a fuller analysis.

Table 19

INDIA, Main Economic Indicators, 1972-1981

	1972	1973	1974	1975	1977	1978

GDP, real growth rate, %pa	-1.7	3.6	1.2	1.0	3.3	6.6
Inflation rate, %pa	27.6	20.8	26.9	-3.3	7.8	2.2
Trade balance / GDP, %	-1.7	-1.1	-1.3	1.6	1.5	-1.9
Current balance / GDP, %	-1.5	-1.9	-1.0	1.3	1.7	1.2
Total debt, US\$b	9.9	10.5	12.3	14.1	15.5	16.4
of which short term, US\$b	1.0	1.0	1.0	1.0	1.4	1.7
Total debt / GDP, %	15.9	13.9	14.2	15.7	14.9	13.3
Debt service / Exports, %	22.8	19.9	17.7	11.7	10.9	11.7

Terms of trade, index	100.0	85.1	61.4	60.7	76.2	72.2
Export volume, index	100.0	106.0	109.0	156.7	159.7	156.7
Exports / GDP, %	4.3	4.3	4.2	7.2	7.2	6.9
Imports / GDP, %	4.6	4.9	5.8	6.4	6.3	7.4
Workers remit / Exports, %	4.9	5.4	5.6	9.9	12.3	14.4

	1979	1980	1981	1982	1993	1994

GDP, real growth rate, %pa	-5.1	6.7	5.8	2.9	7.6	4.5
Inflation rate, %pa	8.8	11.4	12.5	7.8	12.6	6.2
Trade balance / GDP, %	-1.5	-3.2	-3.4	-3.2	NA	NA
Current balance / GDP, %	-1.4	-1.5	-2.1	-1.7	NA	NA
Total debt, US\$b	16.2	19.2	20.7	24.9	29.3	30.7
of which short term, US\$b	1.7	1.9	1.2	1.8	1.6	1.7
Total debt / GDP, %	12.7	11.9	12.5	14.6	14.9	16.7
Debt service / Exports, %	10.7	9.4	9.1	9.5	NA	NA

Terms of trade, index	52.7	60.1	59.0	59.0	58.6	56.0
Export volume, index	162.7	149.3	156.7	173.1	173.1	NA
Exports / GDP, %	7.3	7.0	6.8	7.2	NA	NA
Imports / GDP, %	9.0	10.5	10.5	10.3	NA	NA
Workers remit / Exports, %	14.8	24.5	20.4	21.5	NA	NA

Source: Original data from the World Bank Data Bank

How did this successful economic adjustment come about?

Singh (1985) refers to three medium term factors. One, a decline in food imports made a substantial contribution to the balance of payments compared with the situation in the late 1960's and early 1970's. Two, there was an enormous increase in migrants' remittances as a consequence of the economic boom in the middle eastern countries (see Table 19). Three, there was a rapid expansion of India's own oil production and impressive progress in oil-conservation measures. Between 1980-81 and 1982-83, the volume of oil imports declined by 30 per cent as a result of increasing domestic production and conservation.

The oil production programme, and associated programmes of conservation and development of alternative energy sources, required a big investment effort. This investment was carried out by increased domestic savings rather than by foreign borrowing. India's domestic saving rate increased from 14 per cent of g.d.p. in 1965-72, to 19 per cent in 1973-78 and nearly 25 per cent in 1984.

One of the most important reasons why India has been able to weather the world economic storm so well lies precisely in this factor: that the country did not borrow in the world capital markets in the 1970s. India had a very high credit standing and could easily have borrowed extensively from the international banks in the mid-1970's, but it was a deliberate act of policy on the part of India's economic managers not to do so. India did obtain a structural loan from the IMF in 1981 - a three-year extended arrangement. However, this loan amounted to a relatively small sum of \$5 billion, not all of which was drawn; as a part of the arrangement with the IMF, there was also a relatively small amount of borrowing from the private capital market to cover specific investment projects. The total amount

of such borrowing - multilateral as well as that from private sources - has been miniscule compared with the large scale foreign indebtedness of Mexico, Brazil and Republic of Korea.

The other main reason for India's successful economic record in the midst of the world economic crisis lies in the country's long-term economic and industrial strategy. This strategy which India has followed more or less intact over the last three decades has led to an impressive build up of the country's scientific and technical infrastructure, training of high-level technical cadres as well as a diversified capital goods industry.⁽¹⁾ It has brought about not only a deep development of the country's technical know-how, but also of 'know-why' (to use Lall's (1984) expressive phrase). An important consequence of the development of these supply-side capabilities is that India did not need to borrow as much abroad to finance large investment projects as was the case with the other countries.⁽²⁾

We turn now to China. China has a rather different relationship with the world economy from that of most other developing countries including large economies like India. The main difference is that China has normally maintained a trade and current account surplus. Table 20 provides data on aggregate trade balances and growth of Chinese exports and imports since

(1) There is a very large literature on these subjects; for a recent review and discussion of the main issues, see Lall (1982) and Lall (1984).

(2) The argument here is in terms of supply-side capabilities. Had such capabilities not been available, the foreign exchange requirements of the investment programme would have been much greater.

Table 20

China: Aggregate Trade Balances and Growth of Exports and Imports, 1970-83 (US\$ million)

	1970	1975	1976	1977	1978	1979	1980	1981	1982	1983
Visible trade balance:										
Yearly balance, FOB	112	303	1,697	1,564	-161	-906	-305	3,547	6,868	5,584
Cumulative total since 1950*	1,260	2,985	4,682	6,264	6,103	5,197	4,892	8,439	15,307	20,891
Exports:										
Total, FOB	2,163	7,121	7,269	8,178	10,170	13,458	18,875	21,496	23,501	23,983
Real growth % p.a.+		10.1	12.7	-1.9	23.9	17.6	21.4	n.a.	n.a.	
Imports:										
Total, FOB	2,051	6,818	5,572	6,614	10,331	14,364	19,180	17,949	16,633	18,399
Real growth % p.a.+		11.6	-4.4	32.3	51.0	21.0	14.2	n.a.	n.a.	
of which:										
Capital goods#:										
Total	411	1,996	1,671	1,165	1,994	3,705	5,131	4,343	3,068	
Real growth % p.a.+		19.2	-11.1	-33.0	58.1	76.3	n.a.	n.a.	n.a.	

Notes

* Figures for 1970 and 1975 are calculated from data given in John L. Davie and Dean W. Carver, "China's international trade and finance." Joint Economic Committee, US Congress, China Under the Four Modernizations, Pt 2 (Washington D.C.: US Government Printing Office, 1982), p.40.

+ The price deflators are taken from ibid. p.44.

These cover machinery [Standard International Trade Classification (SITC) 71, 722-24], transport equipment (SITC 73) and precision instruments (SITC 861).

Sources

CIA, China, International Trade Annual Statistical Supplement, March 1984; and Fourth Quarter, 1983, March 1984, for 1970, 1975 and 1978-83; other earlier issues for 1976-77.

Source: As quoted in Kuch and Howe (1984).

1970. The second row of the table also shows China's cumulative visible trade balance since 1950; in 1983, this stood at a figure of nearly \$21 billion. As a consequence in 1983, China had the seventh largest gold and foreign exchange currency in the world. Its external debt is miniscule. In 1984, it stood at \$6 billion, compared with China's foreign assets in that year of \$26.9 billion and foreign exchange reserves of \$22.1 billion.

Thus the disruptions of the world economy during the last decade have had relatively little impact on the pace of Chinese economic expansion. Essentially, the Chinese economy has not been balance of payments constrained during this period. The central long-term factor responsible for this happy situation is that the Chinese over the last 30 years have built up their own industrial capacities and capabilities which enables them to have sustained high rates of economic growth without being affected by the state of the world economy.

There are, however, two points about China's recent international economic relationships which deserve attention. First, Table 20 shows that in 1978, 1979 and 1980, China sustained deficits in her visible trade, particularly in 1979 when the deficit was nearly one billion US dollars. Since then, there has been a remarkable turnaround and in the 1980's the Chinese have achieved impressive surpluses on visible trade. As China also usually has a surplus on invisibles in 1983, the Chinese current account surplus was of the order of \$14 billion. The main reason for the deficits in the late 1970s was the large rise in imports: as Table 20 indicates, in real terms, imports increased by 32 per cent, 51 per cent and 21 per cent respectively in 1977, 1978 and 1979. Plant and technology imports for fertiliser, steel and other industries played a major

role in the rise in imports. Subsequently such imports were sharply curtailed basically for reasons of domestic absorptive capacity. In addition to the reduction in the rate of growth of imports, the other main factors responsible for the large turn around in trade balance since 1979 have been the rapid growth of manufactured exports and the oil exports.

The second point to note is that particularly since Chairman Mao's death, the Chinese have been making vigorous effort to increase China's economic relations with the world in order to modernise various sectors of the Chinese economy. For this purpose, since the mid-1970's, they have been rapidly expanding their exports as well as imports especially of technology; they have also been encouraging direct foreign investment in various forms, notably in oil exploration. Further, the Bank of China has also been borrowing abroad in order to finance imports of plant and technology. However, unlike the East Europeans who borrowed heavily for similar reasons in the late 1960's and in the 1970's and subsequently found themselves in serious difficulties when the world economic situation changed, the Chinese normally take a conservative and rather cautious approach to these foreign economic entanglements. The pace and degree of integration of China with the world economy seems to be firmly dictated by the absorptive capacity of the domestic industry.⁽¹⁾

(1) In 1985, there has been a large increase in imports reminiscent of the late 1970s. This is likely to lead before long to a similar corrective as occurred in the early 1980s.

We shall now briefly examine the cases of Brazil and Mexico. As seen in Table 2 in Section III, both countries were high growth economies during the 1960s and 1970s. Both of them were also able to maintain fast growth between 1970 to 1980. However, in the 1980s both countries have been in serious economic crisis. The following points may be made in a summary form with respect to the experience of Brazil and Mexico in the context of the crisis of the international economy during the 1970s and 1980s.⁽¹⁾

First, both countries borrowed heavily on the international market to adjust their economies in the wake of the 1973 oil shock. It will be appreciated that the market signals were particularly favourable for such borrowing: not only the private banks were ready and able to lend, the real rates of interest during the period 1974-79 were negative.⁽²⁾

Secondly, it is important to emphasise that contrary to what is often alleged, the foreign borrowings were used not for increasing consumption but for investment and structural change in these economies. In Brazil, gross domestic investment as a proportion of g.d.p. increased from 25.8 per cent during the period 1965-72 to 28.1 per cent in 1973-79. In Mexico, the corresponding increase was from 21.3 per cent to 23.4 per cent. (See Table 4 in Section III). However, the latter figure understates the increase in the Mexican rate of investment since it includes the years 1975-77 when the economy was experiencing a recession. Gross fixed capital formation as a proportion of g.d.p

(1) For a fuller discussion, see Singh (1985) and the references contained therein.

(2) See IMF (1984), chart IV.5, p.67. The real interest rate is defined as LIBOR less rate of change of non-oil developing countries export unit values. The earlier discussion in section IV also refers here.

rose in Mexico from 19.6 per cent in 1977 to 21.2 per cent in 1978, to 23.2 per cent in 1979 and 24.7 per cent in 1980. Similarly gross national savings as a proportion of g.d.p. increased in that country from 16.03 per cent in 1960-70, to 16.8 per cent during 1970-76 and to 19.9 per cent in the period 1976-82.⁽¹⁾

Thirdly, in addition to foreign borrowing, both countries sought greater integration with the world economy to cope with the post-1973 world economic conditions. As Table 16 in Section VI showed the Brazilian manufactured exports grew at a phenomenal rate of nearly 35 per cent p.a. in the decade 1970-80, a rate almost equivalent to that of Korea's. Based on the huge expansion of oil exports, Mexico's total exports rose more than threefold between 1976 and 1981. Further, as noted earlier, in Mexico there was a determined effort to liberalise imports after 1977.

Fourthly, the main consequence of the very large foreign borrowing and the greater degrees of integration with the world economy was that when the world-market conditions abruptly changed after 1980 both Mexico and Brazil were thrown into a deep and prolonged economic and social crisis. Under the present institutional parameters of the Mexican and the Brazilian economies, the resolution of their crisis (in the sense of resumption of their normal trend rates of economic growth) depends crucially on international factors: the rate of growth of the world economy and world trade, the world interest rates, the exchange rate for the U.S. dollar and the terms of trade for the primary commodities. All of these factors clearly lie

(1) See Singh (1985).

outside the control of Mexico and Brazil: they are essentially determined by economic interactions among the U.S. and other OECD countries.⁽¹⁾

In contrast it can be reasonably asserted with respect to India and China that their rate of economic growth is essentially independent of the world rate of economic growth: the former basically depends on the internal dynamism and domestic factors in these economies.

(1) For a fuller discussion of this issue, See Singh (1984a); Taylor (1982).

VII CONCLUSION

The main conclusion of this paper is that theories which attempt to explain the differential economic performance of the Asian and Latin American countries during the 1980s in terms of the greater openness of the Asian economies or their superior exchange rate policies do not fit the evidence. The far from open Asian countries like China and India were able to cope at least as effectively with the world economic recession as the more open East Asian economies. These theories also do not give adequate attention to the greater impact of the interest rate shock on the balance of payments position of the Latin American countries. Nor do they consider the full implications of the 'contagion effect' whereby normal capital flows to all Latin American countries were sharply curtailed as a consequence of Mexico's debt crisis in August 1982. It has been argued here that the contraction of the world economic activity is likely to have had a differential impact on the markets (including the market for migrant labour) of the two groups of countries. The paper also suggests that the relationship between the exchange rate, export performance and capital flight is much more complex than is envisaged in the mainstream analyses of these issues. Finally, it has been emphasised here that the intracontinental differences between economic structure and policy are at least as important as the intercontinental differences.

With respect to the question of economic vulnerability, it has been argued here that compared with India and China, the poor economic performance of the two large Latin American economies, Mexico and Brazil, during the 1980s may be ascribed to their large foreign borrowings and their greater integration with the world economy. However, it may be objected that despite similarly large borrowings relative to g.d.p. and even greater integration with the world economy, the Korean economy has continued to perform well in the 1980s. A main reason for this phenomenon, this paper suggests, lies in an important structural difference between Korea and the two Latin American countries at the onset of the debt crisis. Brazil and Mexico had relatively much smaller exports to g.d.p. ratios which made them much more vulnerable to interest rate and capital supply shocks and to financial disruption. In order to reduce their vulnerability to international economic fluctuations, countries with relatively low exports to g.d.p. ratios, other things being equal, should also have correspondingly low debt to g.d.p. ratios. This would help towards insulating them not only from financial market disruptions but also from trade fluctuations.

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