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Part One

WORLD INFLATION AND LATIN AMERICA

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### 3. COLOMBIA

#### A. INTRODUCTORY NOTE

This study covers the period from 1971 to 1973 inclusive.

The period starts in 1971 because that year marked a spurt in the inflationary process, after several years in which price movements had been moderate. For the same reason, from that date onwards the government authorities attached increasing priority to the implementation of a large group of stabilization measures.

In 1972 and 1973, inflation accelerated owing to the effects on demand and prices of the rapid expansion of the external sector, which necessitated the adoption of new measures aimed at mitigating the growing inflationary pressures that were making themselves felt.

It was not considered advisable to extend the coverage of the study to include 1974, because the change in the administration which took place in the middle of the year and a significant modification of the country's external situation led to the introduction of important changes in the anti-inflationary policy in force. Thus, the inclusion of developments in 1974 would have affected the unified approach to the study and it would have been necessary to rectify the analytical method used.

#### B. MAIN FEATURES OF THE TREND OF THE COLOMBIAN ECONOMY

During the period 1971-1973, Colombia's economy was marked by the simultaneous appearance of a number of significant external and internal factors of a general nature, which were largely responsible for the development described below.

In the first place, and particularly in 1972 and 1973, the country was strongly affected by the demand and price levels deriving from the rapid and persistent expansion of the economy and of world trade.

At the same time, and for a number of reasons that will be analysed below, the country's productive system demonstrated a fair degree of flexibility in its reaction to external incentives.

Secondly, the combination of two mutually complementary factors was particularly important from the domestic standpoint. On the one hand, the management of government functions throughout the period under consideration was in the hands of the same political administration. On the other, a National Development Plan - generally known as "The four Strategies"<sup>32/</sup> - was introduced which defined and gave consistency to the economic policy measures applied during the three-year period.

The significance of these external and internal factors cannot be underestimated since it was they that gave the economic policy of the period its relative unity, consistency and homogeneity.

#### 1. Growth trends

In the early 1970s, the Colombian economy grew more rapidly than during the period 1965-1970 and during the 1950s and 1960s in general. The average growth rate of the gross domestic product, for example, was 6.5 per cent in 1970-1973 - and over 7 per cent in 1972-1973 - compared with 5.8 per cent in 1965-1970 (see table 1).

ECLA estimates indicate that, between 1970 and 1973, Colombia's per capita gross domestic product rose from about 509 dollars to 559 dollars (at constant 1970 prices).<sup>33/</sup> This growth rate (3.2 per cent per year) is about 30 per cent higher than that of the period 1965-1970 and twice that of the 1960s; it therefore represents a substantial change in the country's rate of economic expansion.

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<sup>32/</sup> These four strategies relate to: (a) urban development and housing; (b) rural incomes and agricultural productivity; (c) exports; (d) distribution of income.

<sup>33/</sup> During the same period, the average per capita gross domestic product for Latin America as a whole (19 countries) is estimated to have risen from 639 to 717 dollars at 1970 prices.



Table 1

COLUMBIA: TOTAL SUPPLY AND DEMAND

(Millions of pesos at 1970 prices)

	1970	Annual growth rate (percentages)					
		1965- 1970	1970- 1973	1970	1971	1972	1973
<u>Total supply</u>	151 230.4	6.3	5.6	8.2	5.5	4.6	6.8
Gross domestic product (at market prices)	130 590.8	5.8	6.5	6.6	5.5	6.8	7.3
Imports	20 639.6	10.6	-0.1	18.7	5.4	-8.6	3.3
<u>Total demand</u>	151 230.4	6.3	5.6	8.2	5.5	4.6	6.8
Exports	18 515.8	5.2	9.3	-2.5	5.1	13.4	9.5
Gross domestic investment	28 130.3	8.1	6.1	15.2	9.7	-0.9	10.0
Gross fixed investment	25 850.3	9.0	6.2	13.1	6.9	1.8	10.0
<u>Total consumption</u>	104 584.3	6.1	4.8	8.6	4.4	4.6	5.5
General government	9 961.6	6.9	3.8	14.0	23.6	-14.6	5.8
Private	94 622.7	6.0	4.9	8.0	2.4	7.0	5.4

Source: ECLA, on the basis of official statistics.

At the same time, the growth of the population has shown little change, remaining at about 3.2 per cent annually since the 1950s, - a fairly high figure in Latin American terms.<sup>34/</sup> At the end of 1973, the total population of the country was about 24 million.

(a) Overall supply and demand

The table illustrating overall supply and demand shows that this somewhat faster growth rate coincides with a fairly rapid expansion of exports which, at constant prices, registered an annual average increase of 9.3 per cent during the period 1970-1973, as opposed to 5.2 per cent in 1965-1970. As will be seen below, the export figures expressed in dollars at current prices show more clearly the fundamental change that took place from 1970 onwards.

Another striking feature of global demand was the increase in the rate of investment from 1970 onwards. In terms of the gross domestic product, the fixed gross investment coefficient rose from 17 per cent in 1965 to 19.6 per cent in 1971-1973; capital formation, however, continued to be below the level of the first part of the 1960s, when the coefficient was close to 20 per cent (see table 2).<sup>35/</sup> Moreover, this increase bears no relation to the increase in total public investment during the same period; according to the calculations of the World Bank, the coefficient for the latter rose from under 7 per cent of the gross domestic product in 1965 to approximately 12 per cent during the three years 1971-1973.<sup>36/</sup>

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<sup>34/</sup> It should be noted that the targets set in the International Development Strategy for the variables referred to are: about 3.5 per cent annually for the gross per capita product and at least 6 per cent annually for the overall product, allowing for an annual demographic growth rate of 2.5 per cent. Consequently, the figures for Colombia during the period 1971-1973 are close to the established targets, save in respect of the increase in population.

<sup>35/</sup> See ECLA, Tendencias y estructuras de la economía de Colombia en el último decenio (E/CN.12/915), 8 September 1971, pp. 21 and 22.

<sup>36/</sup> IBRD, Economic position and prospects of Colombia, Report No. 138-CO (15 May 1973), page 17.

Table 2  
COLOMBIA: STRUCTURE OF TOTAL SUPPLY AND DEMAND  
(Percentages)

	1965	Average 1969- 1970	1970	1973	Average 1971- 1973
<u>Total supply</u>	112.6	115.0	115.8	113.0	114.0
Gross domestic product (at market prices)	100.0	100.0	100.0	100.0	100.0
Imports	12.6	15.0	15.8	13.0	14.0
<u>Total demand</u>	112.6	115.0	115.8	113.0	114.0
Exports	14.6	14.8	14.2	15.3	14.8
Gross domestic investment	19.2	20.8	21.5	21.3	21.5
Gross fixed investment	17.0	19.3	19.0	19.6	19.6
Total consumption	78.8	79.4	80.1	76.4	77.7
General government	7.2	7.4	7.6	7.1	7.7
Private	71.6	72.0	72.5	69.3	70.0

Source: ECLA, on the basis of official statistics.

/Total consumption

Total consumption and its components fluctuated during the period 1971-1973, as a result of which their average growth rates, and especially that of consumption of the general government, were lower than in 1965-1970.

(b) The sectoral structure of the product and employment

An analysis of the sectoral structure of the gross domestic product during 1971-1973 shows that the acceleration of the overall growth rate coincided with, and was a consequence of, the fairly balanced development of the various productive sectors, with the sole exception of mining and quarrying whose share of the product declined. Consequently, although sectoral growth rates varied, given the increase in the overall product they were for the most part more or less consistent with the development requirements of a country such as Colombia (see tables 3 and 4).

The contribution of the agricultural sector to the gross domestic product increased somewhat more slowly in 1970-1973 than in 1965-1970. Nevertheless, the average growth rate for the last three years (4.3 per cent) was greater than the target set in the International Development Strategy and even compared favourably with the sector's usual rate of development in Latin American countries. Although it declined, the share of agriculture in the gross domestic product in 1971-1973 was still fairly high (27.8 per cent).

In 1970-1973, the manufacturing sector was more dynamic and stable than in the period 1965-1970 (an annual growth rate of 9.2 per cent in the former period compared with 6.4 per cent in the latter). As a result, the industrial growth rate in the last three years was higher than the 8 per cent minimum target set in the Strategy.<sup>37/</sup>

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<sup>37/</sup> Unfortunately, no industrial production indexes providing greater details regarding the growth of Colombia's manufacturing sector, particularly construction, are available in the country. However, some partial indicators show that, between 1970 and 1973, the consumption of electrical energy for industrial purposes rose by 15 per cent annually while the production of cement went up by 5 per cent annually and that of sugar by 7 per cent. (Source: DANE).

**Table 3**  
**COLOMBIA: GROSS DOMESTIC PRODUCT BY SECTOR OF ECONOMIC ACTIVITY**  
**(Millions of pesos at 1970 prices)**

	1970	Annual growth rate (percentages)					
		1965- 1970	1970- 1973	1970	1971	1972	1973
Agriculture	34 880.5	4.8	4.3	5.3	2.5	5.5	4.8
Mining	2 457.7	1.5	-4.9	-2.5	-4.6	-6.0	-4.2
Manufacturing	20 976.7	6.4	9.2	8.7	7.9	10.0	9.8
Construction	6 281.1	12.3	6.6	3.9	7.1	1.8	11.1
<u>Subtotal goods</u>	<u>64 596.0</u>	<u>5.8</u>	<u>5.8</u>	<u>5.9</u>	<u>4.4</u>	<u>6.2</u>	<u>6.9</u>
Electricity, gas and water	1 787.9	8.5	12.5	10.1	10.0	13.7	13.9
Transport and communications	8 881.1	6.6	6.7	10.8	6.4	7.3	6.5
<u>Subtotal basic services</u>	<u>10 669.0</u>	<u>6.9</u>	<u>7.7</u>	<u>10.7</u>	<u>7.0</u>	<u>8.4</u>	<u>7.8</u>
Commerce and finance	20 521.2	6.6	8.7	7.1	7.3	9.1	9.6
Ownership of dwellings	6 886.9	5.8	6.3	5.3	7.1	5.9	6.0
Government	8 283.5	4.9	5.6	9.5	6.8	4.2	5.8
Other services	9 069.7	4.7	7.3	6.0	7.4	7.9	6.7
<u>Subtotal other services</u>	<u>44 761.3</u>	<u>5.8</u>	<u>7.5</u>	<u>7.0</u>	<u>7.2</u>	<u>7.5</u>	<u>7.8</u>
<u>Total</u>	<u>120 026.2</u>	<u>5.7</u>	<u>6.5</u>	<u>6.6</u>	<u>5.5</u>	<u>6.8</u>	<u>7.3</u>

Source: ECLA, on the basis of official statistics.

Table 4

COLOMBIA: STRUCTURE OF THE GROSS DOMESTIC PRODUCT BY SECTOR OF ECONOMIC ACTIVITY

(Percentages)

	1965	Average 1966- 1970	1970	1973	Average 1971- 1973
Agriculture	30.4	29.7	29.1	27.2	27.8
Mining	2.5	2.2	2.0	1.5	1.6
Manufacturing	16.9	17.2	17.5	18.8	18.4
Construction	3.9	5.1	5.2	5.2	5.2
<u>Subtotal goods</u>	<u>53.7</u>	<u>54.1</u>	<u>53.8</u>	<u>52.8</u>	<u>53.0</u>
Electricity, gas and water	1.3	1.4	1.5	1.8	1.7
Transport and communications	7.1	7.2	7.4	7.4	7.5
<u>Subtotal basic services</u>	<u>8.4</u>	<u>8.6</u>	<u>8.9</u>	<u>9.2</u>	<u>9.1</u>
Commerce and finance	16.4	16.8	17.1	18.1	17.8
Ownership of dwellings	5.7	5.8	5.7	5.7	5.8
Government	7.2	6.9	6.9	6.7	6.8
Other services	8.0	7.7	7.6	7.7	7.7
<u>Subtotal other services</u>	<u>37.2</u>	<u>37.2</u>	<u>37.3</u>	<u>38.3</u>	<u>38.1</u>
<u>Total</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Source: ECLA, on the basis of official statistics.

As already pointed out, a notable feature of the trend of the other sectors producing goods and basic services during the period 1970-1973 was the absolute decline in the contribution of mining and quarrying to the gross domestic product, owing mainly to a drop in the production of crude petroleum from 1971 onwards. Moreover, the growth rate of construction was unsatisfactory compared with that of 1965-1970, especially considering the emphasis placed on its promotion in the National Development Plan. Only in 1973 was there any real signs of revival. Finally, the two basic services sectors (electricity, gas, water and sanitary services, and transport and communications) expanded more rapidly in 1970-1973 than in 1965-1970.

With regard to the services sectors, the rate of expansion was in every case greater in 1970-1973 than in the previous period. Altogether their share of the gross domestic product rose from 37.2 per cent in 1966-1970 to 38.1 per cent in 1971-1973.

Seen from the standpoint of employment of the labour force, there are other structural characteristics of the sectoral composition of the product that should be taken into account.

In the first place, although more or less recent information on the country's employment situation is fairly scarce, unemployment would seem to be a serious problem. It should be borne in mind that the average rate of visible urban unemployment at the end of the 1960s was reckoned to be around 10 per cent, and in general even higher in the larger cities of Colombia, excluding Bogotá. This situation would not appear to have improved or changed to any great extent during the period 1971-1973.<sup>38/</sup> The fundamental reason for this trend towards unemployment is that the urban labour force is increasing by over 5 per cent annually, and is obviously not all being absorbed into new employment opportunities in the cities.

Secondly, and related to the previous point, the proportion of the population employed in agriculture continued to decline fairly rapidly (from 42 per cent of the total in 1969 to about 38 per cent in

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<sup>38/</sup> See ILO, Hacia el pleno empleo, un programa para Colombia (Geneva 1970); ECLA, op.cit., pp. 29-32; and World Bank, op.cit., p.5.

1973);<sup>39/</sup> in fact, the absolute number of agricultural workers remained at virtually the same level or increased only very slightly. At the same time, considering the moderate increase in their share of the gross domestic product and certain figures for their capacity to absorb employment during the 1960s,<sup>40/</sup> the industrial sectors and sectors providing basic services are unlikely to have increased their relative share of total employment to any extent.<sup>41/</sup> The combination of these two factors led, on the one hand, to the appearance of serious employment problems in our urban areas, and, on the other, to an increasing need for new employment opportunities in the services sectors, thereby emphasizing a trend which was already very much apparent in the 1960s.

## 2. The external sector

The main features of the external sector during the period 1971-1973 were as follows. In the first place, the combined effect of internal and external factors, including the constant use of policy measures, brought about a substantial expansion and diversification of exports of goods; although there was in any case an increase in the unit value of exports (as much as 39 per cent between 1971 and 1973) there was also a substantial increase in the volume exported.

Secondly, the value of imports at current prices was on average 43 per cent higher during the three-year period than in 1966-1970, owing mainly to the application of rather liberal importation policies in 1971 and 1973. Because of the constant and increasing upward trend of the unit value of imports, however, the comparable increase at constant prices was 20 per cent.

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<sup>39/</sup> Estimates based on information supplied by DANE.

<sup>40/</sup> See ECLA, op.cit., pp. 12-16

<sup>41/</sup> According to the Plan of the Four Strategies, the generation of new employment opportunities should result from the rapid growth of construction and minor (non-traditional) exports. In the first case, the point has already been made that there was only any real increase in the sector's activity in 1973; as regards exports, the development of this sector will be examined below, although no data are available on its impact on employment.

/Third, the



Third, the considerable improvement between 1971 and 1973 in the goods trade balance was mainly responsible for the reduction in the balance-of-payment deficit on current account, which dropped from 449 million dollars to 57 million dollars.

Fourth, together with this sharp drop in the deficit on current account - and for accounting purposes, therefore, the lesser need for transfers of external savings to the country - the country's external financing policy enabled about 360 million dollars per year of medium and long-term non-compensatory external loans to be used during the three-year period under consideration.

Finally, the combination of this trend in the deficit on current account and of the use of external loans enabled the country's gross foreign exchange reserves to rise from about 200 million dollars at the end of 1971 to over 530 million dollars at the end of 1973 (see table 5, 6 and 7).

A further factor of a general nature that affected the external sector was the exchange system that was applied during the period. Following the policy introduced in 1967, a principal or unified exchange rate valid for the various foreign trade operations was applied throughout the period 1971-1973. At the same time, the unified rate of exchange was subject to moderate and periodic devaluations (mini-devaluations) which made it possible to keep the real value of the dollar fairly constant in terms of Colombian pesos, allowance being made of course for domestic inflation in the United States. Table 8 shows that, between 1969 and 1973, the real value of the dollar in pesos did not vary by more than 5 per cent.

An exception to this general rule was the existence of two special rates. One of these was used for exports of coffee and the other for the payment of purchases of crude petroleum for refining in the country.

The rate of exchange for coffee was also subject to mini-devaluations but throughout the period it stood at 80 per cent of the principal rate in peso terms. In other words, exports of coffee were subject to a proportional tax of 20 per cent.

Table 5

COLOMBIA: TREND OF EXPORTS AND IMPORTS OF GOODS

	Average 1966- 1970	1970	1971	1972	1973	Average 1971- 1973
1. Exports of goods (FOB, in millions of dollars)	632.2	788.0	755.0	958.6	1 334.1	1 015.9
2. Exports of goods (in millions of dollars, 1970=100)	80.2	100.0	95.8	121.6	169.3	128.9
3. Unit value index of exports of goods (1970=100)	85.8	100.0	90.0	98.0	125.0	104.3
4. Constant value index of exports of goods (2:3x100) (1970=100)	93.5	100.0	106.4	124.1	135.4	122.0
5. Imports of goods (FOB, in millions of dollars)	633.6	802.0	878.0	813.1	1 022.9	904.7
6. Imports of goods (in millions of dollars, 1970=100)	79.0	100.0	109.5	101.4	127.5	112.8
7. Unit value index of imports of goods (1970=100)	96.0	100.0	104.0	110.0	130.0	114.7
8. Constant value index of imports of goods (6:7x100) (1970=100)	82.3	100.0	105.3	92.2	98.1	98.5

Source: ECLA, on the basis of official statistics.

Table 6  
COLOMBIA: BALANCE OF PAYMENTS  
(Millions of dollars)

	Average 1966- 1970	1970	1971	1972	1973	Average 1971- 1973
<b>Current account</b>						
Exports of goods and services	806.6	1 000.0	984.0	1 198.4	1 626.0	1 269.5
Goods FOB	632.2	788.0	755.0	958.6	1 334.1	1 015.9
Services	174.4	212.0	229.0	239.8	291.9	253.6
Imports of goods and services	903.4	1 149.0	1 260.0	1 216.8	1 487.1	1 321.3
Goods FOB	633.6	802.0	878.0	813.1	1 022.9	904.7
Services	269.8	347.0	382.0	403.7	464.2	416.6
Net external investment income	-125.6	-180.0	-176.0	-197.7	-207.4	-193.7
Profits	-55.6	-91.0	-71.0	-69.5	-67.5	-69.3
Interests	-70.0	-89.0	-105.0	-128.2	-139.9	-124.4
Net private transfer payment	1.0	-1.0	3.0	10.9	12.0	8.6
Balance on current account	-221.4	-330.0	-449.0	-205.2	-56.5	-236.9
<b>Capital account</b>						
Net external financing (a+b+c+d+e)	221.4	330.0	449.0	205.2	56.5	236.9
a) Net external non-compensatory capital	266.8	405.0	383.0	281.2	193.5	285.9
Direct investment	45.8	43.0	43.0	18.4	26.4	29.3
Long- and medium-term loans	225.4	308.0	290.0	420.2	369.1	359.8
Amortization payments	-90.6	-121.0	-144.0	-165.0	-162.3	-157.1
Short-term liabilities	59.8	138.0	163.0	-16.3	-67.3	26.5
Official transfer payments	26.4	37.0	31.0	23.9	27.6	27.5
b) Domestic non-compensatory capital or assets	-9.6	-36.0	-12.0	-23.9	-39.7	-25.2
c) Errors and omissions	-5.4	-18.0	55.0	83.6	38.5	59.0
d) Allocation of SDRs	4.2	21.0	17.0	18.5	0.0	11.8
e) Net compensatory financing (increase -)	-34.6	-42.0	6.0	-154.2	-135.8	-94.7

Source: ECLA, on the basis of official statistics.

Table 7

COLOMBIA: FOREIGN EXCHANGE RESERVES

(Millions of dollars at current prices)

	1965	1966	1967	1968	1969	1970	1971	1972	1973
1) Total foreign exchange reserves at the end of the period	96	77	83	173	221	206	203	325	534
2) Imports of goods and services	653	867	696	866	939	1 149	1 260	1 206.3	1 541.6
3) Imports of goods and services (monthly average)	54.4	72.3	58.0	72.2	78.3	95.8	105.0	100.5	128.5
4) Number of months of imports financed out of foreign exchange reserves	1.8	1.1	1.4	2.4	2.8	2.2	1.9	3.2	4.2

Source: IMF, International Financial Statistics, September 1972 and August 1974.

Table 8

COLOMBIA: TREND OF THE "REAL" VALUE OF THE PRINCIPAL EXCHANGE RATE

Year	(1) Principal exchange rate (pesos per dollar - annual average)	(2) Implicit deflator of the gross domestic product of Colom- bia (1970 = 100)	(3) Implicit deflator of the gross national product of the United States (1970 = 100)	(4) (2):(3)x100 Ratio between the implicit deflators of Colom- bia and the United States (1970 = 100)	(5) (1):(4)x100 Trend of the "real" value of the prin- cipal exchange rate (base year, 1970) (pesos per dollar - annual average)
1969	17.37	90.7	94.8	95.7	18.15
1970	18.50	100.0	100.0	100.0	18.50
1971	20.02	111.6	104.7	106.6	18.95
1972	21.94	126.0	107.9	116.8	18.78
1973	23.69	155.1	118.7	130.7	18.13

Source: Banco de la República of Colombia and Department of Commerce of the United States, Statistical Abstract 1973.

In the case of petroleum, a fixed rate of exchange was applied which was not subject to moderate and periodic devaluations. In the middle of 1971, the rate was raised from 9 to 20 pesos per dollar - similar to the principal rate - and remained at this level up to and including 1974. Consequently, the gap between the rate of 20 pesos per dollar and the principal rate of exchange came progressively greater.

(a) Exports of goods

With regard to exports, the policy measures applied allowed for separate treatment of coffee sales and minor or non-traditional exports.

In the case of coffee, the policy throughout the period under consideration was designed to control the quantity of the product produced and exported in view of its important role in the national economy, the large share of Colombian exports in the international coffee market, the movement of prices and the terms of the International Coffee Agreement. In addition, the coffee-producing countries signed an international agreement in 1973 which led to the retention of 10 per cent of the volume of their sales in order to reduce world supply.

The volume of coffee exported by Colombia between 1968 and 1973 was fairly stable, fluctuating around 6,500,000 60-kilo bags. As regards prices, on the other hand, the situation was reversed: the average annual price per pound in New York, which had not varied greatly from 45 United States cents from 1965 to 1969, fluctuated widely in 1970, 1971, 1972 and 1973, in which latter year it reached a peak of 72.4 cents. Naturally, this fluctuation was reflected in the value of exports in current prices (see table 9).

The promotion of minor or non-traditional exports was one of the four strategies of the National Development Plan; what happened in practice was that a policy which had been applied since 1967 was maintained and strengthened. Briefly speaking, non-traditional exports were stimulated mainly by the following measures: (i) maintenance of a rate of exchange with a constant "real" value, as mentioned above;

Table 9  
COLOMBIA: EXPORTS OF COFFEE

	Average 1965- 1969	1970	1971	1972	1973	Average 1971- 1973
1) Exports of 60-kilo bags	6 071 347	6 506 278	6 569 291	6 528 000	6 769 000	6 622 097
2) Price per pound in New York (US cents)	45.09	56.42	49.27	56.70	72.35	59.44
3) Value of exports of unroasted coffee (millions of dollars)	338.0	466.7	399.7	430.4	600.0 <sub>a</sub> /	476.7

Source: Banco de la República of Colombia and FEDECAFE.

a/ Estimate.

(ii) issue of certificates of drawback (CAT) which, in several cases, represented as much as 15 per cent of the value exported;<sup>42/</sup> (iii) the preferential granting of fairly cheap bank credit (with negative real rates of interest); and (iv) the possibility of importing equipment and intermediate goods required for the production of minor exports without import control or customs duties. A study conducted by the International Monetary Fund calculated that the exchange subsidy on exports of manufactures resulting from the combined application of measures (ii), (iii) and (iv) represented 30 per cent.<sup>43/</sup>

It is not easy to make an accurate estimate of the real effect of the policy measures referred to above <sup>44/</sup> and of the generally favourable climate of recent years for all minor exports, but there can be no doubt that they expanded very rapidly and that they were further encouraged by the development of the Andean Common Market and, in general, by the large demand and high prices in the world markets. In the case of several export lines, particularly manufactures, the existence of production capacity which was not being utilized owing to the inadequacy of domestic demand was also an important factor.

For certain exports of food products, the substantial increase in international prices, which established a price differential in favour of exports as opposed to domestic sales, was decisive. Typical examples were meat, leather and cotton. This situation also led to an increase in the domestic price of these products, to temporary shortages on the national market and to the adoption of provisional measures forbidding their export. This aspect is dealt with in greater detail below.

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<sup>42/</sup> During the three-year period, this percentage changed and, moreover, showed some tendency to vary according to the characteristics of the merchandise exported. There was also some fluctuation in the redemption period of the GAT.

<sup>43/</sup> See, IBRD, op.cit., p. 27.

<sup>44/</sup> An analysis of this kind has been carried out by Carlos F. Díaz Alejandro in Las exportaciones menores colombianas, FEDESARROLLO, January 1973.



A look at the composition of exports of goods shows that, between 1966-1970 and 1971-1973, the combined share of coffee and crude petroleum dropped from 71.6 per cent to 53 per cent while that of non-traditional products rose from 28.4 per cent to 47 per cent (see table 10). This sharp increase was attributable to certain major products, particularly cotton, sugar, meat, emeralds, yarns and textiles, metal manufactures and machinery, electrical equipment, furs and leather, and chemical and pharmaceutical products.

(b) Imports of goods

The policy measures implemented during the three-year period had a decisive influence on imports. Basically, they involved the use of exchange and tariff instruments, lists of permitted or prohibited imports, prior deposits and monthly foreign exchange budgets.

By and large, the import policy was more or less liberal - in its application of the various instruments - according to the trend of exports, the country's import capacity and the level of foreign exchange reserves. Logically enough, it was found that the measures adopted took some time to affect the values and volumes imported. This delay was about six months and, in certain cases, close to a year.

The growth in imports of goods between 1970 and 1971 thus responded to a gradual liberalization of the policy applied as a result of the favourable trend of the foreign currency inflow between 1968 and 1970. Similarly, the drop in exports in 1971 led to the adoption of more restrictive measures which, the following year, caused a reduction in the volume imported. Finally, the improvement in the foreign exchange situation which began to take place at the beginning of 1972 brought about a progressive liberalization of import controls,<sup>45/</sup> which made possible a substantial increase in the value imported in 1973 and, to a lesser extent, in the corresponding volume, owing to the effect of the higher unit value of imports that year (see table 5).

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<sup>45/</sup> The provisions adopted were: (a) progressive increase in the monthly volume of import registration accepted by the Monetary Board (from 75 million to a 120 million dollars); (b) increase in the number of kinds of merchandise whose importation was permitted; (c) reduction of customs tariff; (d) reduction of prior deposits for import purposes.

Between 1965 and 1969, there had been similar variations in the import policy and in the value of imports brought into the country.

As regards the structure of imports of goods, between 1966-1970 and 1971-1973 there was a considerable increase in the relative share of imports of consumer goods and to lesser degree, of raw materials. By contrast, there was a marked reduction in the share of capital goods in the total (see table 11).

(c) Other aspects of the trend of the external sector

In view of the aforementioned reduction in the deficit on current account between 1971 and 1973, the generation of balance-of-payments surpluses in 1972 and 1973 - 154 million dollars and 136 million dollars, respectively - was largely attributable to the net inflow of resources deriving from the use of medium- and long-term foreign loans in greater volume than in previous years (see table 6).

Colombia has managed to devise an external financing strategy based on the permanent operation of an ad hoc consultant group, headed by the World Bank, and on the continuous and satisfactory formulation of investment projects which the international financial institutions and industrialized countries are keen to finance with loans granted on softer terms than private credits. This factor has also helped to improve the external debt-servicing situation - owing to the more favourable composition of the debt - with the result that the increase in the resources needed for the payment of amortization and interest on the debt has been moderate and compatible with the trend of exports.<sup>46/</sup>

The balance-of-payments figures show that 420 million dollars in medium- and long-term loans were utilized in 1972, the corresponding estimate for 1973 being 370 million dollars. It was also found that about 70 per cent of these amounts was used to finance the total investment of the public sector.<sup>47/</sup>

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<sup>46/</sup> See IBRD, Annual Report, 1974, table 6.

<sup>47/</sup> Including the national government and decentralized institutions, as well as direct and indirect investment. See CIAP, op.cit., table IV-VI.

Table 10  
COLOMBIA: COMPOSITION OF EXPORTS OF GOODS  
(Percentages)

	Average 1966- 1970	1970	1971	1972	1973	Average 1971- 1973
1. Coffee	61.9	62.7	54.9	47.5	47.4	49.3
2. Crude petroleum	9.7	8.0	7.0	3.4	2.0	3.7
3. Non-traditional exports	28.4	29.3	38.1	49.1	50.6	47.0

Source: ECLA, on the basis of official statistics.

Table 11  
COLOMBIA: COMPOSITION OF IMPORTS OF GOODS  
(Percentages)

	Average 1966- 1970	1970	1971	1972	1973	Average 1971- 1973
1. Consumer goods	8.8	10.7	10.4	12.4	14.1	12.3
Non-durable	4.0	5.6	4.9	5.8	6.6	5.8
Durable	4.7	5.1	5.5	6.6	7.5	6.5
2. Raw materials <u>a/</u>	45.2	44.7	48.9	46.7	48.4	48.0
3. Capital goods	45.3	43.9	40.0	39.5	36.1	38.5
4. Miscellaneous <u>b/</u>	0.6	0.7	0.7	1.4	1.4	1.2

Source: ECLA, on the basis of official statistics.

a/ Including construction material.

b/ Including fuels.

## C. THE RECENT INFLATIONARY PROCESS

### 1. Background

Following the four-year period 1967 to 1970 during which domestic price increases in the Colombian economy were below 9 per cent per year, the rate of inflation rose to approximately 14 per cent in 1971 and 1972, and to around 25 per cent in 1973.<sup>48/</sup> This acceleration in the rate at which prices increased contrasts with the pattern of the previous two decades, which shows a "current" rate of inflation of less than 10 per cent per year, upward variations in this trend taking place only in a few of the years (1957, 1963, 1965 and 1966) and being linked with substantial devaluations of the peso following fairly long periods with a pegged rate of exchange. In other words, the inflationary "tradition" of the country was relatively limited, in contrast with the turn inflation took in other countries of the region, while furthermore, the occasional upward variations which took place in the past seem to have had causes different from those of recent years, particularly as regards the problem of the exchange rate.

Similarly, as in other developing nations with a per capita income similar to that of Colombia, the item "food" exercises a very strong influence on the evolution of domestic prices, and this is reflected in the high weighting given to this item in the price indexes.<sup>49/</sup> Moreover, the variations in food prices - particularly those of staple foods - are those that have the clearest and most immediate effect on consumers as a whole.

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<sup>48/</sup> The figures refer to changes from December to December in the consumer price index. This index, which is considered to be a good indicator of inflationary trends, treats the situations of salaried employees and wage-earners separately, the calculations being made for seven cities (Bogotá, Medellín, Cali, Barranquilla, Bucaramanga, Manizales and Pasto) (see table 12).

<sup>49/</sup> In the national consumer price index for the country, the weighting of the item "food" is approximately 40 per cent for salaried employees and approximately 50 per cent for wage-earners.

Table 12

COLOMBIA: TREND OF CONSUMER PRICES

	Average 1965- 1969	1970	1971	1972	1973
<b>1. National consumer</b>					
Index (December to December, percentage variations) <sup>a/</sup>					
a) Salaried employees - total	10.2 <sup>b/</sup>	7.2	12.6	14.1	22.1
b) Wage-earners - total	9.8 <sup>c/</sup>	6.3	14.7	14.0	25.1
c) Salaried employees - foodstuffs	9.6	5.0	15.0	16.2	30.6
d) Wage-earners - foodstuffs	10.2	3.6	17.1	16.0	31.5
<b>2. National consumer</b>					
Index (average to average, 1970 = 100)					
a) Salaried employees - total	93.2 <sup>d/</sup>	100.0	110.9	125.5	150.2
b) Wage-earners - total	93.7 <sup>d/</sup>	100.0	111.8	127.3	155.2
c) Salaried employees - foodstuffs	94.4 <sup>d/</sup>	100.0	112.6	129.0	164.3
d) Wage-earners - foodstuffs	94.7 <sup>d/</sup>	100.0	112.6	130.0	167.5

Source: Departamento Administrativo Nacional de Estadística (DANE) and the National Planning Department.

a/ Includes the following cities weighted differently: Bogotá, Medellín, Cali, Barranquilla, Bucaramanga, Manizales and Pasto.

b/ Variations were 7.6% in 1967, 6.7% in 1968 and 8.5% in 1969.

c/ Variations were 7.0% in 1967, 6.4% in 1968 and 8.7% in 1969.

d/ Index value in 1969.

Over the three-year period 1971-1973 it was observed that food prices increased more rapidly than those for other goods and services. Thus, between 1970 and 1973 the relative consumer prices of foodstuffs increased by approximately 20 per cent compared with other items in the index (housing, clothing and miscellaneous items).<sup>50/</sup> A similar trend can be seen in respect of wholesale prices, if agricultural prices are compared with those for manufacturing industry and mining (see table 13).

Other notable relative price changes occurred between 1970 and 1973. With the exception of coffee,<sup>51/</sup> domestic wholesale prices for export products showed a marked upward trend, which coincided with that recorded by the unit values for exports mentioned earlier. On the other hand, the price indexes for capital goods and building materials showed relatively marked downturns; in both cases the drop was approximately 20 per cent with respect to agricultural prices, and 13 per cent with respect to the general index.<sup>52/</sup>

In the light of the foregoing it can be seen, put briefly, that in the period under study the acceleration in the growth rate of prices coincided with significant changes in the pricing system which, on the one hand, favoured agricultural and exporting activities, with the exception of coffee, and on the other operated to the detriment of manufacturing industry, especially of some branches of production such as building materials.

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<sup>50/</sup> See table 12 and figures for items for the consumer index published by DANE and the Bank of the Republic.

<sup>51/</sup> This upward trend was particularly strong in 1973, when the item in question showed an increase of 39 per cent, while the variation in the total wholesale price index amounted to 28 per cent.

<sup>52/</sup> See table 13.

Table 13

COLOMBIA: TREND OF OTHER PRICE INDEXES

	1969	1970	1971	1972	1973
1. Index of general wholesale prices (average to average, 1970 = 100)					
a) Total	-	100.0	111.5	131.9	168.7
b) According to economic end use					
i. Capital goods	-	100.0	107.8	124.8	146.0
ii. Raw materials and intermediate products	-	100.0	108.1	127.6	170.8
iii. Consumer goods	-	100.0	117.2	139.8	173.9
c) By branch of economic activity					
i. Agriculture, forestry, hunting and fishing	-	100.0	118.4	136.4	182.0
ii. Mining	-	100.0	112.3	126.9	148.9
iii. Manufacturing industry	-	100.0	109.5	126.0	155.2
2. Index of general wholesale prices (average to average 1970 = 100)					
a) Total	-	100.0	111.5	131.9	168.7
b) By origin of article					
i. Products consumed	-	100.0	112.6	134.1	170.6
ii. Imports	-	100.0	109.8	128.4	164.1
iii. Exports	-	100.0	102.6	126.1	171.7
iv. Exports (excluding coffee)	-	100.0	111.0	133.8	186.1
3. Index of prices for building materials in Bogotá (average to average 1970 = 100)	90.0	100.0	109.4	122.9	147.7
4. Coffee					
a) Average price in pesos in the country (1970 = 100)	75.3	100.0	95.5	115.0	148.6
b) Average price for conversion of dollars earned on exports (1970 = 100)	72.5	100.0	92.7	126.7	162.0

Source: Banco de la República and the National Planning Department.

2. Factors which influenced the acceleration of the inflationary process

In examining the intensity of annual price movements, two stages in the inflationary process stand out: 1971 and 1972 on the one hand, and 1973 on the other. However, examination of the elements which intervened in the process leads to a further subdivision: thus, the origins of price trends in 1971 seem to differ from those in 1972 and 1973. This makes it desirable to examine what occurred in the first year separately from that which occurred in the last two.

(a) The 1971 experience

Consumer food prices, which had increased by less than 5 per cent during 1970 in terms of the average for both salaried employees and wage earners, rose by more than 15 per cent in 1971. This substantial change in the rate of growth exercised a decisive influence on the overall acceleration of inflation, which rose from 7 per cent in the first year to approximately 14 per cent in the second.<sup>53/</sup>

Information available on the performance of the agricultural sector during the year shows that prevailing climatic conditions - particularly the extremely heavy rainfall in the early part of 1971 - caused a considerable drop in agricultural production, especially in some crop-farming items. Official figures put the loss of potential production at approximately 100 million dollars, so that the overall growth of the contribution of agriculture to the gross domestic product was only 2.5 per cent, or approximately half the rate recorded in the previous 5 years. Apart from coffee, the agricultural products which suffered most in the first half of 1971 were cotton, non-irrigated rice, beans, potatoes and soya, the shortfalls compared with a similar period for the previous year being between 10 and 30 per cent.<sup>54/</sup>

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<sup>53/</sup> See table 12. The approximate variations for both salaried employees and wage earners for the period December to December are taken together.

<sup>54/</sup> See, CIAP, op. cit., CIAP/591, p. 21 et seqq., and table AE-1.



A month by month analysis of the consumer price index shows that the change in the rate of inflation took place in the early part of the year and that, moreover, the rises in the prices of agricultural products which were in extremely short supply exercised considerable influence on the process.<sup>55/</sup> Other foods and other components of the index (clothing and miscellaneous items) continued to increase at a pace similar to that of the previous year.

In addition, the unexpectedness and the unprecedented size of shortfalls in certain products prevented the timely application of import and domestic policy measures to control, even partially, the supply and prices of the articles in short supply.

Another factor which had a considerable impact on the price increases was the exchange rate, in spite of the fact that, as already stated, a mini-devaluation policy had been followed since 1967. This impact was caused by the fixing in June 1971 of a new rate of exchange of 20 pesos to the dollar, applicable to purchases of crude petroleum for domestic refining.

Since September 1965 the rates had been fixed at 9 pesos per dollar, so this big difference rapidly had an effect on the prices of fuels and lubricants, and this was transferred, with varying intensity, to a range of goods and services whose inputs consisted to a significant proportion of petroleum products.<sup>56/</sup>

Examination of the trends of other variables which are of significance for the inflationary process suggests that during 1971, or in the immediately preceding months, no other factors were present which could have had an important impact on the evolution of prices. This general impression can be confirmed by examining the different indicators shown in table 14.

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<sup>55/</sup> For example, between September 1970 and September 1971 the prices of beans rose by 70 per cent and those of vegetable fat by 70 per cent. See DANE, Boletín Mensual de Estadística, November 1971, p. 72.

<sup>56/</sup> This even had an important impact on the cost of dwellings as calculated in the consumer price index, because of the weighting of fuels and services in this group. See DANE, Boletín Mensual de Estadística, November 1971, p. 68.

Table 14

COLOMBIA: RELATIONSHIP BETWEEN PRICE CHANGES AND SOME IMPORTANT VARIABLES

(Percentage variation)

	1969	1970	1971	1972	1973
1. National consumer price index (December to December)					
a) Salaried employees - total	8.5	7.2	12.6	14.1	22.1
b) Wage-earners - total	8.7	6.3	14.7	14.0	25.1
2. Index of unit value for imports of goods (average to average)	2.1	3.0	4.0	5.8	18.2
3. Index of unit value for exports of goods (average to average)	-1.2	23.4	-10.0	8.9	27.5
4. Main exchange rate (average to average)	6.0	6.5	8.2	9.6	8.0
5a. Unit value of imports by rate of exchange (2x4) (average to average)	8.2	9.7	12.5	16.0	27.7
5b. Unit value of exports by rate of exchange (3x4) (average to average)	4.7	31.4	-2.6	19.4	37.7
6. Money-total means of payment (at year-end)	22.3	15.5	11.9	27.1	30.7
7. Total Central Government expenditure b/	18.7	25.8	19.6	26.3	13.6
8. Total Central Government expenditure (as percentage of GDP at market prices)	9.4	10.0	10.2	10.7	9.2
8a. Central Government investment (as percentage of GDP at market prices)	3.9	4.2	3.9	4.5	3.5
9. Current Income of Central Government	16.9	24.7	20.6	11.6	24.8
10. Current Income of Central Government (as percentage of GDP at market prices)	8.6	9.2	9.4	8.7	8.2
11. Central Government Deficit (as percentage of GDP at market prices)	0.7	0.9	0.8	2.0	1.0
12. Investment and current expenditure of whole public sector	15.9	22.1	27.3	19.2	16.9 <sub>a/</sub>
13. Investment and current expenditure of whole public sector (as percentage of GDP at market prices)	24.0	24.8	26.9	26.6	23.5 <sub>a/</sub>
13a. Investment of whole public sector (as percentage of GDP at market prices)	9.8	11.5	12.7	12.3	10.9 <sub>a/</sub>
14. Nominal wages					
a) Minimum wages	-	-	-	30.0 <sub>d/</sub>	-
b) Industrial wages				14.8	15.0
c) Weighted nominal wage	3.4	9.9	6.6	10.6	

Source: Items to 5: ECIA, on the basis of official statistics; 6, 7, 9, 11; IMF, IFS August 1974; 12 and 13a: World Bank, *op.cit.*, Report N° 138-CO, Table II.2; 8, 10, 11, 13: GDP at current market prices, see Table 16; 14a: CIAP *op.cit.*, CIAP/591, Table AE-3; 14b: FEDESARROLLO, *Coyuntura Económica* April 1973 and 1974; and 14c: DANE, *Boletín Mensual*, April 1974, p. 118.

a/ As defined by IMF.

b/ Current expenditure plus investment.

c/ Estimates.

d/ About 30% from April; not adjusted since 1969, when it was adjusted by approximately 20% after remaining unchanged for 6 years.

/As regards

As regards the external sector, there was a drop of 10 per cent in the unit value of exports of goods, mainly as a result of the reduction in coffee prices, and there were no substantial increases on the international markets for any of the main products exported by the country.

The unit value of imports of goods increased by 4 per cent, compared with an increase in the principal rate of exchange of 8.2 per cent. The average increase in the cost of imports, expressed in terms of national currency, was therefore 12.5 per cent. This figure, although somewhat higher than that for previous years, is relatively moderate and does not seem to provide an explanation for variations of real importance, from the cost side, in the rate of increase of prices.

Although the available information on the evolution of wages is both limited and incomplete, the data are not indicative of any significant inflationary pressures coming from this area. The weighted nominal wage 57/ increased by 6.6 per cent, which would imply a drop, compared with 1970, of approximately 4 per cent in real wages. Furthermore the minimum urban and rural wages 58/ were not adjusted during 1971, in spite of the fact that the last increase had been awarded in August 1969.

From the point of view of other possible inflationary pressures, particularly those stemming from changes in a few of the principal financial variables, these did not seem to have any further relations with the change of the rate of price increases.

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57/ Calculated by DANE on the basis of data provided by the Instituto Colombiano de Seguros Sociales (ICSS). In June 1973 this institution had a membership of 1,173,000.

58/ These wages are fixed by decrees passed by the Government on the basis of studies prepared by the National Wages Council. There is no legal obligation to change them every year, and the records show that since 1950 they have been adjusted at intervals varying between one and six years.

/Thus, during

Thus, during 1971 the quantity of money increased by 11.9 per cent whereas in the previous year the increase was 15.5 per cent:<sup>59/</sup> these moderate and decreasing figures may be contrasted, for example, with the increase of 22.3 per cent recorded in 1969.

Nor were treasury operations one of the causes of inflation, since the rate of expansion of the national government's current income was faster than that of total expenditure, with the result that the Government deficit <sup>60/</sup> fell from 0.9 per cent of the gross domestic product in 1970 to 0.8 per cent in 1971. In addition, it was observed that the whole of this deficit was covered by using foreign loans, which did not have the effect of expanding the monetary mass owing to the overall situation of the balance of payments.

As a result of this, there was a drop in the country's international reserves between the end of 1970 and 1971.<sup>61/</sup>

It may be noted, it is true, that the anti-inflationary trend of fiscal policy coincided with a considerable expansion in central government expenditure - particularly current expenditure - and also in consolidated public sector expenditure, so that between 1970 and 1971 the share of these two variables <sup>62/</sup> in the GDP increased and thus maintained a trend that had been observed since the end of the 1960s. Notwithstanding, however, the simultaneous presence of the factors referred to - among which the deficit on current account in the balance of payments played a leading part - helped to offset to some extent the possible disequilibria that could have been generated by public sector monetary operations.

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<sup>59/</sup> The 1970 increase in the means of payment is also taken into account because in some interpretations of the variations in prices it is recognized that delays of up to six months could take place before the effect of the increase in the quantity of money on prices is felt.

<sup>60/</sup> Defined as the difference between total expenditure and current income. See table 14.

<sup>61/</sup> See tables 14, 15, and 16, and also tables 6 and 7.

<sup>62/</sup> See table 14. The government investment coefficient fell from 4.2 per cent in 1970 to 3.9 per cent in 1971, whereas that of public sector investment rose from 11.5 per cent at the end of the first year to 12.7 per cent in the second.

Table 15

## COLOMBIA: CENTRAL GOVERNMENT ACCOUNTS

(Millions of pesos at current prices)

	1968	1969	Percent age varia- tion	1970	Percent age varia- tion	1971	Percent age varia- tion	1972	Percent age varia- tion	1973	Percent age varia- tion
1. Current income a/	8 194	9 581	16.9	11 950	24.7	14 416	20.6	16 085	11.6	20 073	24.8
2. Current expenditure	4 902	6 061	23.6	7 649	26.2	9 747 <sup>b/</sup>	27.4	11 397	16.9	13 991	22.8
3. Surplus on Current account (1 - 2)	3 292	3 520	6.9	4 301	22.2	4 669	8.6	4 688	0.4	6 082	29.7
4. Investment	3 866	4 344	12.4	5 442	25.3	5 903	8.5	8 362	41.7	8 458	1.1
5. Total Central Government expenditure b/ (2 + 4)	8 768	10 405	18.7	13 091	25.8	15 650	19.6	19 759	26.3	22 449	13.6
6. Total Central Government deficit (5 - 1) or (4 - 3)	574	824	43.6	1 141	38.5	1 234	8.2	3 674	197.7	2 376	-35.3
7. Deficit financing c/ a) Foreign debt (net)	1 063	1 272	19.7	1 458	14.6	1 235	-15.3	3 290	166.4	3 051	-7.3
b) National debt (net) d/	-489	-448	-	-317	-	-1	-	34	-	-675	-
8. Share of investment financed by external borrowing (7a): 4 (percentages)	27.5	29.3		26.8		20.9		39.4		36.1	

Source: IMF, International Financial Statistics, August 1974, and ECLA, on the basis of data provided by the Tesorería General de la República.

a/ Excluding certificates of draw-back (CAT) and Tourist Development Certificates (CDT).

b/ Excluding certain special military purchases.

c/ Excluding amortization of the national and foreign debt.

d/ Including variations in cash holdings.

Table 16

## COLOMBIA: MONETARY TRENDS

(Millions of pesos at current prices; at the end of each period)

	1968	1969	Percent age varia- tion	1970	Percent age varia- tion	1971	Percent age varia- tion	1972	Percent age varia- tion	1973	Percent age varia- tion
I. Structure of monetary resources											
1. Money	15 858	19 396	22.3	22 397	15.5	25 064	11.9	31 854	27.1	41 647	30.7
2. Quasi-money	2 216	2 696	21.7	3 381	25.4	4 128	22.1	5 856	41.9	11 663	99.2
3. Deposits for imports	1 879	2 159	14.9	2 402	11.3	2 144	-10.7	2 496	16.4	1 163	-53.4
4. Long-term foreign debt	682	980	43.7	1 333	36.0	1 959	47.0	2 595	32.5	2 798	7.8
5. Other items (net)	1 971	1 788	-9.3	2 191	22.5	2 796	27.6	3 666	31.1	2 822	-23.0
Total	22 606	27 019	19.5	31 704	17.3	36 091	13.8	46 467	28.8	60 093	29.3
II. Monetary expansion and absorption factors											
6. International reserves (net)	-1 276	-1 198	-	-1 360	-	-3 054	-	527	-	5 502	-
7. Domestic credit	23 882	28 217	18.2	33 060	17.2	39 145	18.4	45 937	17.4	54 592	18.8
a) Central Government (net)	5 139	5 024	-2.2	4 696	-6.5	6 333	34.9	6 413	1.3	5 810	-9.4
b) Public institutions	647	935	44.5	1 265	35.4	1 540	21.6	2 009	30.5	3 628	80.6
c) Private sector	18 095	22 258	23.0	27 098	21.7	31 272	15.4	37 515	20.0	45 154	20.4
Total	22 606	27 019	19.5	31 704	17.3	36 091	13.8	46 467	28.8	60 093	29.3
8. GDP at current market prices <sup>a/</sup>	-	110 953		190 591		153 766		185 092		244 507	
9. GDP at market prices: Money <sup>b/</sup> (0:1)	-	5.7		5.8		6.1		5.8		5.9	
10. Direct issue (primary money) of the Banco de la República	14 766	18 739	26.9	20 573	9.8	22 522	9.5	27 505	22.1	35 950	30.7

Source: IMF, IFS, August 1974, and ECLA, on the basis of official statistics.

<sup>a/</sup> GDP generated over the entire year.<sup>b/</sup> This ratio as it stands does not reflect the true situation, since the GDP figure is for the entire year, whereas that of money was calculated at the end of each period.

(b) Trends in 1972 and 1973

The elements identified earlier which exercised some influence on the acceleration of prices in 1971 ceased, to a great extent, to have any effect either on the rate of inflation in 1972, or on the stepping up of the rate in 1973. During those two years, as has been pointed out, there was a tendency towards relatively balanced development in the various productive activities and, more specifically in agriculture, which grew at a satisfactory average rate of more than 5 per cent.<sup>63/</sup> In general, normal conditions prevailed as regards production and supply, and there was a marked improvement in the growth rate of the GDP.

The basic explanation of the inflationary trend in the two-year period 1972-1973 rested on developments in the external sector and the various impacts this had on some basic variables and situations. The impact impinged, on the one hand, on the government monetary position, as well as on the liquid resources in the hands of exporters and, on the other, on the extent of the influence of increased unit values for imports and exports on domestic costs and prices. To these two combined forces, which acted in the same direction, other supplementary factors were added, a notable one being the drop in imports in 1972.

(i) Financial over-expansion. The evolution of the means of payment showed clear signs of over-expansion, for they increased by 27.1 per cent in 1972 and by 30.7 per cent in 1973 (see table 14). These figures are much higher than those recorded in 1970-1971.

The behaviour of the public finances was the main factor which affected developments in the monetary field, as a result of the deficit financing by the national government (and by the public sector), the measures taken to cover it and the balance-of-payments situation during these years.

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<sup>63/</sup> Only some temporary problems in connexion with shortfalls in the production of certain foods were observed. In this respect, the most noteworthy case was that of potatoes, during the first half of 1973.

In 1972, a substantial increase in government expenditure (particularly in investment), which was not accompanied by similar growth in current income, resulted in a deficit of approximately 3,700 million pesos (2 per cent of the GDP) - three times the figure for 1971. In 1973, there was a sharp drop in the relative increase in government expenditure - in current values, investment remained practically at a standstill - and in spite of the fact that current income grew at a lower rate than the nominal GDP, the deficit was reduced to 2,400 million pesos (1 per cent of the GDP).

These deficits were financed through the use of net external credits, no use being made of domestic borrowing in the two-year period as a whole. Thus, in 1972 the national government used external loans in the amount of some 150 million dollars, whereas in the following year the figure for comparable operations was approximately 130 million. These figures may be compared with those for the period 1970-1971, when the average amount used was in the region of 70 million dollars per year (see table 15).

In addition, estimates for the whole public sector indicate that net foreign resources used also doubled between 1970-1971 and 1972-1973 (from an annual average of approximately 140 million dollars to one of some 300 million).

While the national government and the public sector were increasing their dependence on external credit, the balance-of-payments situation changed significantly, as reflected in the drop referred to in the deficit on current account. The result of this was, roughly, that foreign credit in 1972-1973 - which was more than 300 million dollars compared with the 140 million dollars for 1970-1971 - was put to better use by the public sector, and went in its entirety to swell the international reserves of the country (see table 7).

The monetary figures show that this increase in international reserves was the main factor behind the accelerated expansion of the quantity of money, and they also show that in 1972 and 1973 total domestic credit increased at a rate almost identical to that recorded in 1969-1971. As regards the components of domestic credit, only the loans granted to public institutions showed a higher average rate of growth (see table 16).

/Another factor



Another factor which exercised some influence on the evolution of the quantity of money was the development shown by the monetary absorption factors, as they are usually called. Thus, a moderating influence was exercised by the rapid increase of quasi-money resulting from the introduction of the system of readjustable savings and loans for housing.<sup>64/</sup>

Another aspect of the phenomenon of financial over-expansion to be taken into account is the rapid and substantial increase experienced in those years in the spending power of the exporting sectors. In this respect, a special feature of Colombian exports is that they are supplied by a large number of small national enterprises or economic units which pay a relatively low rate of taxation. A substantial portion of non-traditional exports and, to a lesser extent, coffee exports share this feature. Should exports increase, such a situation could lead to an increase in domestic demand - particularly for consumer goods - which may be more intense and sudden in Colombia than in those countries where the export sector is cornered by a small group of enterprises which are subject to higher rates of taxation and have to exercise a greater degree of restraint in their outlay, and/or in cases of total or partial government ownership of a major proportion of exporting enterprises.

Such a situation, together with the substantial increases in exports of goods which took place in 1972 and 1973 (27 and 39 per cent in dollars at current prices, respectively, and 39 and 50 per cent in their equivalent in Colombian pesos), leads to the assumption that demand pressures stemming from the increased capacity of exporting

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<sup>64/</sup> The system, introduced in May 1972, operates on the basis of units of constant purchasing power (UPAC), which are subject to daily readjustment in accordance with the estimated change in consumer prices. Towards the end of 1973, UPAC deposits amounted to the equivalent of 4,500 million pesos (this figure corresponded to 11 per cent of the quantity of money). However, by that date 3,400 million had already been spent on the construction of houses, so the net absorption effect of the system must have been a good deal smaller.

houses to incur greater expenditure may have had a considerable impact on the acceleration of the inflationary process under study.

(ii) External pressures on domestic prices. The most direct effects of external inflation (or "imported" inflation, as it is frequently called) on domestic prices were more marked in 1973, and were of special importance in the acceleration of inflation in that year, adding yet another dimension to the problem of financial over-expansion already examined. In 1972, the impact of these factors was not as strong.

It has also been observed that the increases in the international prices of commodities in the world market spread to the domestic economy through imports and, moreover, through their effects on the national prices of goods exported by Colombia.

As regards imports and exports, the price increases which had the greatest relative impact were related to the trade in agricultural products, more particularly foodstuffs. This is so for two main reasons. First, because these were the commodities which experienced comparatively higher increases in international prices.<sup>65/</sup> Secondly, because - as already stated - foodstuffs have the highest weighting in Colombian price indexes, and particularly in the consumer price indexes.

This relatively faster rate of growth of prices for agricultural products was also noted in the Colombian price structure in 1973, maintaining a trend which had begun in 1970. Thus, this feature was present both in consumer prices (foodstuffs) and in wholesale prices (agricultural commodities and others) (see tables 12 and 13).

In addition, one of the qualities of the Colombian economy which ought to be borne in mind when studying the impact of imported inflation

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<sup>65/</sup> In this connexion, it should be remembered that, on average, between 1972 and 1973 the international prices in dollars for agricultural food and non-food products on the world market increased by approximately 50 per cent, whereas the comparable rise for all commodities traded internationally was 20 per cent. See United Nations, Monthly Bulletin of Statistics, September 1974, pp. XIV and XV.

on the economy is its relative openness and flexibility in foreign trade operations.<sup>66/</sup> In practice, this means that the government lays down general guidelines for the operation of the external sector but, save in exceptional cases, participates only to a limited extent in fixing quantities, and particularly prices, for the various goods which are imported and exported.

Therefore, the effects of external inflation tended to be imported with some ease and speed, and in very few instances was any attempt made to isolate to any significant extent the domestic price situation from that prevailing in international markets. This was so in spite of the fact that there were certain important elements which could have helped in any attempt to ensure such isolation: first, the favourable balance-of-payments situation which existed from 1972 onwards and its further improvement in 1973, secondly, the fact that the country is self-sufficient in the majority of foodstuffs consumed, and thirdly, the relatively balanced and satisfactory growth of the GDP recorded in 1973 and in the previous year.

- The inflationary impact transmitted through imports. First evidence of the greater inflationary impact which the import trade had in 1973 is provided by the average variation in the dollar unit value of imports, which increased in that year by 18 per cent, or, in other words, more than three times as much as in 1972. However, the lower relative growth in the rate of exchange in 1973 caused the unit value of imports in national currency to rise by 28 per cent, or less than twice as much as in 1972 (see table 14). In any event, this higher rate of increase in the unit value of imports, in terms of national currency, may have meant an additional inflationary impact in 1973 of up to three percentage points over the 1972 figure.<sup>67/</sup>

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<sup>66/</sup> To this should be added a factor of no small importance, namely, the possibility, often put into practice, of indulging in contraband trade with neighbouring countries, particularly over the extensive frontiers which this country shares with Venezuela and Ecuador.

<sup>67/</sup> This calculation is based on 1972 estimates prepared by FEDESARROLLO. See Coyuntura Económica, Volume II, No 4, pp.2-3.

In addition to this general trend, the case of wheat and, to a lesser extent, that of maize deserve special consideration. As can be seen from table 17, during 1973 substantial quantities of these two products were imported, particularly wheat.<sup>68/</sup> The average prices in dollars paid by Colombia for wheat increased by 113 per cent while those for maize increased by 95 per cent, representing increases of 130 and 110 per cent respectively in terms of national currency. At the same time the domestic price of wheat rose by approximately 70 per cent and that of maize by 80 per cent, so that, in view of the widespread consumption of these products, this may have had an inflationary impact - and may have caused a cutback in the basic consumption of the country - not fully reflected in the more general calculations presented earlier.

Similarly, the difference between the variation in the international price of wheat and the domestic price resulted in losses for the Instituto de Mercadeo Agropecuario (IDEMA).<sup>69/</sup> This form of subsidy - which was intended to be temporary - was financed by loans granted to IDEMA by the Bank of the Republic. It is estimated that these funds brought about an additional expansion of the quantity of money of approximately 2 per cent.<sup>70/</sup>

Lastly, it is worth commenting on events in the field of edible oils. Although the country imported a limited quantity of inputs for the manufacture of this product in 1973, the sharp rise in the international price of soya and other oil seeds was a factor which exercised a decisive influence on the increase of approximately 75 per cent in its price on the domestic market during the year.

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<sup>68/</sup> This cereal is the only agricultural product traditionally imported by Colombia in significant quantities.

<sup>69/</sup> This is a decentralized official institution which markets both national and imported agricultural products.

<sup>70/</sup> See table 16. It is thought that in 1973 the cost of the subsidy may have exceeded 500 million pesos, notwithstanding the fact that domestic reserves of the cereal built up at the end of 1972 made it possible for 1973 imports to be lower than usual (see table 17).

Table 17

COLOMBIA: PRODUCTION, IMPORTS, AND PRICE FLUCTUATIONS  
OF SELECTED AGRICULTURAL PRODUCTS

	1971 (thousands of tons)		1972 (thousands of tons)		1973 (thousands of tons)		1972/1973		
	Produc- tion	Imports	Produc- tion	Imports	Produc- tion	Imports	Percent age price varia- tion in dollars	Percent age price varia- tion in dollars per ex- change rate	Estimate of percent- age varia- tion in domestic prices
1. Barley	112	68	106	12	94	15	-	-	
2. Beans	45	6	44	-	46	-	-	-	
3. Maize	915	47	872	21	824	94	95	110	80
4. Sorghum	219	-	238	21	398	37	103	119	-
5. Soya	83	23	102	-	99	14	153 <sup>a/</sup>	200 <sup>a/</sup>	-
6. Wheat	49	385	79	416	91	249	113	130	70

Source: ECLA, on the basis of DANE and National Planning Department statistics.

<sup>a/</sup> Variation between 1971 and 1973.

- The effect of the price increases of export products. The sharp increase in international prices for agricultural products also exercises obvious inflationary pressures on the Colombian economy, because of the relative openness and flexibility of the foreign trade operations of the country. Thus, when a price differential is established in favour of the export sales of a large proportion of national production, domestic prices tend to rise on a par with international ones, thus countering the attraction of the foreign market vis-à-vis the domestic one and avoiding the generation of internal problems of short supply.

This trend was strengthened for two additional reasons. Firstly, since a high proportion of the country's exports consists of products of agricultural origin, national exporters are quite familiar with the international markets for those products, and the opportunities open to them for expanding agricultural exports significantly and promptly are excellent. Secondly, no important economic policy measures were adopted during the year, nor in earlier periods, to reduce the price differential which was building up in favour of foreign sales.

In 1973 the dollar unit value of exports of goods increased by 27.5 per cent which, taken together with the variation in the main rate of exchange, gave an increase of 37.7 per cent in the unit value expressed in terms of national currency. This latter figure was double the increase of the previous year and provides one of the first indications of the inflationary pressure stemming from this area.

Furthermore, if coffee is excluded from the calculation of the unit value of exports in terms of national currency, it can be seen that in 1973 the increase was approximately 50 per cent in contrast to a comparable change of less than 10 per cent in 1972. This sharp change of pace had a most powerful impact on the domestic prices of certain agricultural products.

In this connexion, reference may be made to some opposite examples of the way prices developed in 1972 and 1973. Firstly, the wholesale prices of meat increased by approximately 45 per cent, the increase

/being even

being even higher for quality meats. Secondly, increases in domestic prices for other export products such as tobacco,<sup>71/</sup> were higher than 40 per cent. Lastly, as regards cotton, prices for the inland crop increased by 40 per cent during the year, and it was agreed that part of the coastal crop would be purchased at international prices, which increased by more than 100 per cent between 1972 and 1973.<sup>72/</sup>

(iii) Salaries and wages. In general, the available information does not seem to indicate that the evolution of salaries and wages was an important factor in the inflation which took place in the two-year period 1972-1973, and, in particular, in the acceleration which occurred in the second of these years.

In April 1972, minimum urban and rural wages were adjusted by an average of approximately 30 per cent - the first increase since August 1969. However, in 1972 the weighted nominal wage increased by only 10.6 per cent, which would mean a further drop in real wages of more than 3 per cent compared with 1971 (see table 14).

On the other hand, some data which it was possible to collect <sup>73/</sup> on the evolution of industrial wages in 1972 and 1973 show that the nominal increases in the manufacturing sector - which is probably one of the productive activities where conditions are more favourable to wage adjustments - amounted to 14.8 per cent in 1972 and 15 per cent in 1973. These figures imply that real wages in industry showed practically no change in 1972, while they decreased by more than 5 per cent in 1973.

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<sup>71/</sup> See DANE, Boletín Mensual de Estadística, September 1974, page 32.

<sup>72/</sup> See FEDESARROLLO, Coyuntura Económica, April 1974, page 55.

<sup>73/</sup> Calculated by the Fundación para la Educación Superior y el Desarrollo (FEDESARROLLO) on the basis of direct surveys carried out in 50 industrial enterprises. See Coyuntura Económica, April 1973 and 1974.

## D. MAIN FEATURES OF ANTI-INFLATIONARY POLICY

### 1. General remarks

The emphasis laid on anti-inflationary policy in the three-year period 1971-1973 was of course closely linked to the trends followed by price indexes and to the interpretations placed on the main factors that affected the inflationary process, especially as the foreign trade situation fluctuated. This meant, in practice, that concern for the problem of inflation grew steadily throughout the period and that an ever-higher priority was accorded to the formulation and implementation of stabilization measures. Influence in this direction was also exerted by the fact - to which attention has already been drawn - that the acceleration of price movements in 1971 was due, in essence, to temporary supply difficulties in respect of certain agricultural commodities.

Accordingly, the analysis of anti-inflationary policy presented in this section relates to what took place in 1972 and 1973, with emphasis on the latter year. Nevertheless, when it seems advisable, several features of the policy pursued in 1971 or in some of the preceding years are taken into consideration.

It should be noted that the gathering momentum of the inflationary process and the increasing priority assigned to measures for coping with it did not lead to the formulation of a single anti-inflationary programme as such, in which the action to be taken in the various fields of economic policy was established on a global basis and with some degree of precision. Thus, what is observable during the period is, in the main, the gradual emergence of several stabilization measures which were enacted and co-ordinated as time went by, primarily in the light of the course followed by Colombia's foreign trade.

/What, then,



What, then, were the main objectives, explicit or undeclared, of the stabilization measures applied?

The paramount aim was, of course, to keep the rate of inflation within "reasonable" limits, which implied adhering fairly closely to the rate at which prices had risen in 1967-1970, and, specifically, ensuring that price increases did not exceed 10 per cent per annum.<sup>74/</sup>

Concurrently, steps were taken to make stabilization policy compatible with the pursuit of other objectives. Outstanding among these were the growth of the domestic product at an annual rate of not less than 7 per cent and a gradual improvement in the existing state of affairs in respect of urban employment, rural levels of living and income distribution.

This definition of multiple objectives, although relatively general, should be assessed at its true value, inasmuch as it significantly influenced the authorities' choice of alternative stabilization policies. For example, it may be said at the outset that the measures applied were invariably prompted by the intention of mitigating the inflationary process or keeping it within reasonable or "functional" bounds, and not by any idea of abruptly curbing or completely eliminating the upward pressures that made themselves felt.

## 2. Stabilization measures

Following much the same arrangement as for the interpretative analysis of the latest inflationary trends, the study and evaluation of stabilization policy can be based on classification of the measures adopted in two broad and, of course, interdependent groups. Thus, on the one hand, it will be worth while to take a look at what happened in the monetary and financial fields, while, on the other, the action taken in the supplies, prices and income area will be reviewed.

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<sup>74/</sup> Some government officials have subsequently stated, however (in the course of 1974), that at the present time, in view of the worldwide spread and intensification of inflation, this target may be too ambitious. They think that in the new conditions prevailing - which were already largely present in 1973 - an annual rise in prices of 15 per cent or a little over would be admissible.

As a result of this classification by functions rather than by types of measures, relevant aspects of certain policies may be considered under the heads defined; one of the clearest cases in point is foreign trade policy, with reference to the handling of international reserves in the one context, and to regulations primarily relating to exchange rates in the other.

(a) The monetary-financial field

In the stabilization policy of the period paramount importance was assigned to the handling of monetary-financial variables, and especially to the control of the annual increase in the money supply. An attempt was made to programme the evolution of the means of payment and of other financial assets on lines which in turn would allow the liquidity of the economy to expand as far as was compatible with the anti-inflationary and development objectives already defined.

In quantitative terms, the basic target was to confine the annual rate of expansion of the means of payment to approximately 17 per cent. According to Planning Department experts, this increase was felt to be compatible with an annual growth rate of 7 per cent for the gross domestic product, and a price rise not exceeding 10 per cent per annum.

There are a number of justifications for the preponderance of such an aim by which the authorities were largely swayed in deciding upon their programmes of action.

In the first place, decisive weight was carried by the fact that the primarily "monetaristic" explanation of price variations appeared reasonable to a significant group of government technical experts. Furthermore, the management of monetary policy had a certain amount of tradition behind it, and institutional conditions in its favour - in particular the existence and co-ordinated operation of the Monetary Board (Junta Monetaria) and the Banco de la República.

Secondly, the assignment of priority to monetary-financial policy stemmed from a somewhat cautious evaluation of the possibilities of using other forms of economic policy, including, for example, more direct and generalized State action through fiscal policy and/or income

/and price

and price policies. This approach implied, from other standpoints, that the end in view was to regulate price movements without bringing about, at the same time, changes in the system of prices for goods and services and for the factors of production that were significantly different from those determined by market forces.

Lastly, an evaluation of the probabilities that an essentially monetary policy will be successful in controlling inflation may be based on another consideration. Price increases had quickened their pace, but without going too far or getting completely out of hand; and this suggests that the comparative absence of automatic adjustability mechanisms in the Colombian economic system detracts from the self-propelling power of the inflationary process. In Colombia, for example, wages, taxes and rentals are not automatically adjustable; and it may be added that only on the exchange front and in parts of the machinery for tapping savings are some procedures found which do display the characteristic of adjustability. Undoubtedly, the fewer the mechanisms which set up a direct and automatic chain reaction among the various price movements that may be taking place, the greater the possibility of making relatively easy and effective use of monetary instruments.

However, notwithstanding the precision with which the ceiling for the increase of the means of payment was set, and the grounds there were for according priority to the monetary-financial variables and assuming their potential efficacy, a study of the measures adopted reveals that the action taken to control the actual sources of the expansion of the money supply was relatively limited in scope and drive. In contrast, most of the measures enacted were designed to reduce the multiplier effect on the means of payment of an increase in the direct issue of currency.

(i) Measures relating to fiscal policy and management of international reserves. It will be recalled that the factor which decisively expedited the growth of the money supply between 1972 and 1973 was the size of the government deficit and the way in which it was financed through external credits, at a time when foreign-trade /trends had

trends had brought about a substantial reduction of the balance-of-payments deficit on current account. This led to an increase in international reserves and a parallel and equivalent expansion of the direct issue of national currency printed by the Banco de la República, since in practice, that institution absorbed the National Government's and the public sector's sales of foreign exchange deriving from the use of external credits.

In other words, the possibility of controlling the expansion of the means of payment at the source depended essentially upon the measures relating to fiscal policy and to the manipulation of international reserves which could feasibly be put into effect.

Faced with this situation, fiscal policy did little to reduce the government deficit and/or to change the method of financing it, which would have been the best way of lessening dependence on foreign credit.

Thus, in the first place, no really important moves were made - particularly in the field of taxation - to raise or maintain the share of the government's current income in the gross domestic product; on the contrary, between 1971 and 1973 the proportion it represented substantially declined, although the improvement in the economic growth rate and especially in foreign trade might have facilitated a possible increase in taxation. Secondly, where public expenditure was concerned, only in 1973 was some check imposed on its rapid rate of growth, mainly through severe restriction of fiscal and public investment.

Nor did any new provisions for dealing with the problem emerge in other areas of fiscal policy. With regard to inflows of capital in national currency, it has previously been shown that no net internal borrowing took place during the period. At the same time, in order to tap capital resources, the government continued to issue bonds of the traditional non-adjustable type, which became less and less attractive as the rate of inflation rose and as other competing instruments came to the fore, in particular the Constant Purchasing Power Units (Unidades de Poder Adquisitivo Constante - UPAC), which, in contrast, were adjustable.

/As far

As far as capital inflows in foreign currency were concerned, not only was the preceding years' rate of net external borrowing doubled, but also foreign commercial loans were contracted on a considerable scale (over 60 million dollars yearly in 1972 and 1973). These were used almost in their entirety to finance expenditure in national currency.

Concomitantly, the policy applied in respect of management of international reserves was unsuccessful, or insufficiently energetic, in slowing down the rate of accumulation of reserves and/or mitigating its monetary effects.

As has already been noted, it was only in 1973 that the gradual liberalization of import regulations, started in 1972, was stepped up and began to show results. In contrast, between 1971 and 1972 total imports of goods decreased in absolute terms by over 60 million dollars, in contradiction with the anti-inflationary measures that were being taken. It may be added that in 1972 reserves would not have increased as they did by 120 million dollars if in that year imports in terms of dollars at current prices had exceeded the 1971 figure by 5 per cent.

In the field of exports, the possibilities for action posed a more complex question, because - naturally enough - it was very difficult, and hardly advisable for the authorities, to launch a programme of reduction of export incentives, at a time when the original basic problem largely derived from public-sector financing, and when such a reduction would have been at variance with the export promotion strategy that had been pursued for several years past. Accordingly, until the end of 1973 no major changes were introduced in the system of incentives.<sup>75/</sup> The sole exception was that the practice of granting advances to exporters was done away with; and even so, this measure was offset by the allocation of additional resources to the Export Promotion Fund (Fondo de Promoción de Exportaciones - PROEXPO).

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<sup>75/</sup> It is true that other measures were adopted which did affect exports, such as, for example, the establishment of certain prohibitions and of export quotas. They will be discussed later, however, inasmuch as they were more directly prompted by price and supply problems.

An additional point of interest is that a conceptual alternative which was not mooted or which never took concrete shape, might have been adopted for the purpose of cushioning or rather regulating the immediate impact of expanding exports on liquidity. When exporters are profiting by increasingly favourable circumstances - inasmuch as they are simultaneously receiving the benefits deriving not only from larger export volumes and rising international prices but also from the continuance of the incentives they enjoy -, it would seem fairly logical that in certain cases there should be some curtailment of the liquidity of the national currency resources they obtain from the sale of their foreign exchange earnings. In other words, certain operational formulae might be established which would provide, for example, for a proportion of the foreign exchange liquidated by exporters to be paid for not in money but in government securities of some sort, with specific terms in respect of redemption periods, adjustability and interest rates.<sup>76/</sup>

To pass on to other questions related to reserves policy, it may be noted that during the period the monetary authorities were not empowered to influence the public sector's rate of external borrowing, even where commercial loans were concerned. On the other hand, they did take action with regard to foreign credits obtained by the private sector; so much so, that in 1973 the Monetary Board suspended the authorization of private persons to contract external loans.<sup>77/</sup>

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<sup>76/</sup> It seems out of place in the present report to go into much detail on this point, but it may be suggested that the proportion not payable in money could be increased monthly or quarterly in accordance with the gradual expansion - for the country as a whole or, alternatively, for some exporters of staple exports - of the monthly or quarterly amount of export earnings.

<sup>77/</sup> See Banco de la República, Informe Anual del Gerente a la Junta Directiva (Annual Report of the Manager to the Board of Governors), 1973, p. 46.

(ii) Monetary and savings policy measures. Essentially, it fell to monetary and savings policy to abate the multiplier effect on the means of payment produced by the central bank's direct issue of currency. It should be borne in mind that in 1972 and 1973 this issue increased relatively fast (by 22.1 per cent and 30.7 per cent, respectively, as compared with less than 10 per cent in 1970 and 1971). (See table 16.)

From the data available it can be seen that the task in question was successfully performed in 1973. In 1971 and 1972, as well as in 1970, the percentage increases in the means of payment were about one-fourth higher than the corresponding increases in the direct issue, whereas in 1973 the changes in these two variables were the same in relative terms. From a different point of view, the (marginal) multiplier of the Banco de la República issue decreased from 1.37 in 1971 to 1.16 in 1973.<sup>78/</sup>

In the achievement of this reduction decisive weight was carried by the monetary policy measures brought into force in the course of 1973. Among the main provisions adopted, mention may be made of the following:

- During the year two increases in the Bank's legal cash reserves were approved, with the result that the average rate for the system rose from 31.5 per cent in 1972 to 36.1 per cent in 1973;<sup>79/</sup>

- The policy of fixing ceilings, at quarterly intervals, for the growth of bank credits, which had been initiated early in 1972, was continued. The ceiling was set at 15 per cent for the whole of the year, and was virtually conformed to in the case of credits subject to control. The more rapid growth of other bank loans that were not directly controllable, however, boosted internal credit to the private sector by about 20 per cent;

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<sup>78/</sup> To make this calculation the absolute variations in the money supply are related with those of the Banco de la República issue.

<sup>79/</sup> See Banco de la República, op.cit., p. 157. Incidentally, between 1970 and 1972 the average rate in question had dropped from 35 per cent to 31.5 per cent. In other words, the trend it followed had been counterproductive in view of the speeding-up of the inflationary process which took place over that period.

- A new system of prepayments was established for import operations, under which importers were obliged to deposit 35 per cent of the national currency equivalent of the value of the goods to be imported. In practice, this mechanism completely cancelled out the expansionist effect produced by the gradual suppression of the system of prior import deposits which had begun a couple of years before;

- Two additional provisions were adopted, which were described earlier. On the one hand, external borrowing on the part of private persons was suspended - and steps were even taken to encourage the return of loans already brought into the country - and, on the other hand, advances were no longer granted to exporters.

No other significant changes were introduced in monetary policy. For example, the bank system continued to extend its credits at nominal and relatively stable rates of interest, which worked out as negative after the effect of inflation had been discounted.<sup>80/</sup> This meant, in effect, that demand for credit swelled, and became increasingly hard to meet with efficacy, as the higher rate at which prices rose enhanced the attractions of obtaining and using bank loans.

Savings policy underwent a reform which has already been discussed. The monetary adjustment mechanism was introduced with the establishment of a savings and loan system for housing purposes and of the UPAC, whereby large sums were channelled into the said system. A high proportion of these resources was used during the same period for the financing of urban construction.

The rest of the machinery for tapping savings, however, continued to operate on the basis of traditional-type instruments, with negative real interest rates - despite the raising of some of the nominal rates - with no clauses providing for monetary adjustment or automatic adjustability, and with a low degree of short-term liquidity. Even the Banco de la República itself held no securities of which the terms were such as to facilitate the transaction of open-market operations.

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<sup>80/</sup> Throughout the whole of the period 1970-1973, the Banco de la República's rediscount rate was 14 per cent per annum; and not until the beginning of 1974 was it raised to 16 per cent.



In short, savings policy as a whole probably made but a modest contribution to the task of slowing down the rate of expansion of the means of payment. Even the resources that were channelled into the savings and loan system for housing purposes may to some extent have reflected a reorientation of financial savings rather than a net addition to them.

(b) Policies for dealing with supply, price and income problems

The economic policy measures adopted to deal with problems in this area may be subdivided under three heads: (i) exchange policy; (ii) supplies and prices policy; (iii) income policy.

(i) Exchange policy. Here the anti-inflationary role played by exchange measures proper should be considered since other aspects of foreign trade policy will be examined in conjunction with supplies and prices policy.

A key feature of exchange policy derived from the application of a system of periodic "mini-devaluations", discounting the internal inflation in the United States, which enabled the "real" peso value of the principal exchange rate to be kept relatively stable between 1970-1973. Indeed, between 1971 and 1973 this value depreciated by little more than 4 per cent, which reflects a certain deliberately programmed slowness of pace in the average devaluations in 1972-1973 (see table 8).

It was decided that the policy of "mini-devaluations" initiated in 1967 should be maintained, since this course was thought to be consistent with the "functionalist" conception of anti-inflationary strategy and with other development policy objectives, especially in the fields of allocation of resources and export promotion. Moreover, Colombia's own experience in the operation of exchange rates with pegged foreign currency values afforded additional evidence of the risks of possible exchange "explosions" and of other undesirable secondary effects which may be precipitated by a policy of this type.

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It was also considered that by discounting the internal inflation in the United States <sup>81/</sup> it would be possible to offset, at least in part, the pressure on domestic prices exerted by the increase in the unit value of imports in terms of dollars. The pace of this increase, however, far outstripped that of inflation in the United States, <sup>82/</sup> especially in 1973, in consequence of two additional facts. In the first place, more than one-third of Colombia's imports come from industrialized countries whose currencies have undergone revaluations in relation to the dollar since 1971; and this must have led to a more than average increase in the dollar price of the goods imported. Secondly, although it has not been possible to verify the point in the present study, Colombian imports from the dollar area probably showed price increases higher than those reflected, on average, in the rate of inflation in the United States economy.

Another exchange measure which may have had net anti-inflationary effects in 1972 and 1973 - reversing the 1971 position - was the stabilization of the petroleum exchange rate, which was held firm at 20 pesos to the dollar.

Nevertheless, this policy generates several problems which cast some doubt on its advisability. For example, it involves subsidizing domestic consumption of petroleum and its derivatives, notwithstanding that in recent years domestic production of crude oil has been rapidly declining, and it is forecast that in 1974 or 1975 the country will become a net importer of petroleum. Moreover, a fixed exchange rate is at variance with a flexible exchange policy, and is bound, in the long run, as the peso values of the principal exchange rate and the petroleum rate move farther apart, to lead to "maxi-devaluations" of the exchange rate applied to imports of crude oil to be refined in Colombia.

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<sup>81/</sup> The implicit deflator of the gross domestic product of the United States increased by 4.7 per cent in 1971; by 3.1 per cent in 1972; and by approximately 10 per cent in 1973; in all, that is, by 18.7 per cent between 1970 and 1973.

<sup>82/</sup> The unit value of imports in dollars rose by 30 per cent between 1970 and 1973 and 18.2 per cent in the year 1973 taken by itself.

As regards other measures that affected import flows and costs, mention has already been made of the progressive liberalization which began in 1972 and led to a substantial increase in the current value of imports in 1973.

As a complementary measure, to bring down the domestic price of imported goods during 1972 and especially in the course of 1973, the customs tariffs for several import products were reduced. This reduction, however, was selective and limited - and, therefore, must have had only a restricted anti-inflationary effect - because the average level of the Colombian customs tariff is relatively low <sup>83/</sup> (about 40 per cent) and, furthermore, because no significant duties were payable on imported foods.

Likewise with the aim of making imports cheaper, throughout the period 1971-1973 the system of prior import deposits was gradually being abolished. In 1973, however, as noted above, the concern aroused by the rapid expansion of the means of payment led to the setting-up of the import prepayment mechanism. In global terms, therefore, at least in 1973, this line of action must have done virtually nothing to lower the cost of imports.<sup>84/</sup> Accordingly, the case under review clearly exemplifies the mutually contradictory effects that may be produced by the adoption of measures pertaining to different branches of economic policy, in this instance to monetary policy and to foreign trade policy.

(ii) Supplies and prices policy. The anti-inflationary policy pursued did not include the more or less generalized adoption of various forms of direct control of domestic prices. In this connexion

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<sup>83/</sup> Especially in comparison with the tariff in force in other countries signatories to the Cartagena Agreement.

<sup>84/</sup> At the end of 1972 the amount represented by prior import deposits was about 2,400 million pesos, while by the end of 1973 the cumulative total of prior deposits and prepayments was approximately 3,000 million (500 million in deposits and 2,500 million in prepayments).

it should be repeated that the keynotes of the stabilization programme were, on the one hand, the control and scheduling of the growth of monetary and financial variables, and, on the other, the promotion of the normal development of production and supplies, for which purpose the correct and flexible operation of the price mechanism was of vital importance.

But, within this general context, during the period considered, and especially in 1973, a number of more direct measures of supplies and prices policy were brought into operation.

In the first place, in those cases in which domestic production of certain foods fell short of requirements, the State undertook - through the Agricultural Marketing Institute (Instituto de Mercadeo Agrícola - IDEMA) - the importing and marketing of the volumes needed to satisfy demand. In 1973, for example, besides importing about 50 million dollars' worth of wheat - a product traditionally in short supply in Colombia -, the authorities allocated a similar sum to imports of maize, barley, soya bean and cocoa, in view of the sudden contradictions that took place in domestic production of those commodities.

Although between 1972 and 1973 world market dollar prices of these agricultural commodities rose, on an average, by about 100 per cent, it was only in the case of wheat - owing to the large scale on which it was imported and the diffused effect that an increase in wheat prices produces - that the decision was taken to subsidize domestic wheat prices, overtly although partially, a step which, as has been shown, caused IDEMA heavy operational losses. In other cases, the authorities preferred to allow domestic prices greater freedom of movement, taking advantage of the fact that imports were equivalent to a relatively low proportion of domestic production.

Secondly, in face of the rapid boom in the world prices of certain agricultural commodities exported by Colombia but widely consumed at home, the aim of the policy adopted was to prevent domestic prices of these goods from rising suddenly in the same proportion as world prices,

/and/or

and/or to forestall the generation of internal shortage problems. Thus, the upward trend of the domestic prices of a few selected products was regulated fairly flexibly, by limiting the volumes exported. The most representative examples of this tendency were constituted by the measures adopted in 1973 to establish beef export quotas, and by the total suspension of sugar sales abroad.

In any event, this is a complex field, in which the Colombian authorities themselves, rather than taking final decisions, settled for ad hoc solutions to the various problems arising. Thus, in practice the principles of freedom to export and of flexibility in respect of prices and production were counterpoised by more immediate needs to safeguard domestic supplies and to smooth out sudden violent upswings in the prices of agricultural commodities with a high incidence on the population's basic consumption.<sup>85/</sup>

An alternative measure, which was not adopted but which was discussed by some sectors in Colombia, might have served the purpose of reducing the price differential in favour of exports - besides producing other secondary effects - when world prices rose steeply. It could have consisted in the establishment of export duties at

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<sup>85/</sup> On this subject, the following opinion has been expressed:  
"It is reasonable that exports of goods which are in short supply in a given country, and in some cases in the world, should be prohibited, especially where the goods concerned, on account of their high costs, or because of natural disadvantages, or for any other reason, are unfitted to compete on the world market either today or in the foreseeable future. There are more than sufficient grounds for applying this norm to subsidized domestic consumer goods or goods whose processing is significantly dependent upon these, since in such cases the subsidy would become more burdensome without implying immediate or even remote benefits for export policy. Of course, with exceptions where advisable, the general principle of freedom to export should continue to prevail, since its application has produced very satisfactory results. This is particularly true of articles whose incidence on vital consumption is not great." See Banco de la República, op. cit., p. 61.

at rates varying in accordance with the levels reached by international prices.<sup>86/</sup> A policy of this type may, of course, have undesirable secondary effects - such as, for example, increased contraband in dutiable goods -, but from the standpoints of the more efficient operation of the economic system and of equitable taxation, its application may be advisable, especially when a favourable balance-of-payments position makes it permissible to run certain risks, and when, at the same time, it is necessary to augment the savings generated by the government.

Only the government authorities, however, can evaluate as a whole the merits and demerits of the adoption of provisions such as that suggested.<sup>87/</sup> Furthermore, any application of differential export taxes should be co-ordinated - and might even conflict - with other alternative measures, in particular with the possible mechanism (suggested above) for programming the liquidity of export earnings in accordance with the periodic fluctuations in their amount.

Thirdly, another important line of action in respect of prices and supplies pertained to IDEMA's normal function of marketing a number of agricultural commodities. This function included the establishment of support prices, at which the Institution regularly bought considerable quantities of agricultural commodities, and which were altered periodically as internal and external circumstances rendered it advisable.

Fourthly, it should be pointed out that the domestic price of coffee was also subject to internal regulation, as agreed upon between the Government and the National Coffee-Growers' Federation (Federación Nacional de Cafeteros). Thus, it was raised periodically, while at

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<sup>86/</sup> A variant of this formula may consist in the progressive elimination of export subsidies. In Colombia, however, the so-called Certificates of Drawback (Certificado de Abono Tributario - CAT) are of virtually no importance for exports of agricultural commodities as such; generally speaking, they are subsidies that have been vigorously operative in the case of exports of manufactured goods.

<sup>87/</sup> Similarly, instead of resorting to taxation, some governments may prefer a management of exchange policy based definitely on differential rates. Argentina's experience in recent years has largely reflected the application of this principle.

the same time this measure was co-ordinated - in the light of changes in the world market situation - with variations in other components of coffee policy. Between the beginning of 1971 and the beginning of 1973 the dollar price of coffee on the world market rose by about 45 per cent, while the variation in the domestic price in national currency was approximately 50 per cent.<sup>88/</sup>

It is worth while to add that the whole coffee policy pursued reduced the potential anti-stabilization effects that might have been produced by this export activity, especially in contrast with what happened in the case of a substantial proportion of non-traditional exports.

In addition to the fixing of the internal sales price, coffee was subject to other provisions, among which the following may be mentioned: (a) the regular stipulation of a reference price which closely followed world market coffee quotations; (b) the application of a special exchange rate for the liquidation of export earnings which, as indicated above, was about 20 per cent lower than the principal exchange rate; and (c) regulation of the quantities that could be exported, through the periodic adjustment of the "coffee retention quota". Between mid-1972 and mid-1973 - which was the period when world coffee prices soared most rapidly - the proportion of the quantity exported which was handed over by exporters to the National Coffee-Growers' Federation expanded from 23 per cent to 35 per cent. This led to a substantial increase in the stocks of coffee maintained in Colombia by the National Coffee Fund (Fondo Nacional del Café).

To illustrate the joint effect of the measures described, it is worth noting that according to World Bank estimates, between 1972 and 1973 the coffee-producers' net relative share in the world market sales price of coffee dropped from 40 per cent to 33 per cent.<sup>89/</sup>

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<sup>88/</sup> See Banco de la República, op. cit., pp. 71-73.

<sup>89/</sup> See International Bank for Reconstruction and Development (IBRD), op.cit., p. 20.

/Lastly, with

Lastly, with regard to price controls for other products, especially manufactures, the functions fulfilled by the Office of the Superintendent of Production and Prices (Superintendencia de Producción y Precios) deserve special mention. This agency was empowered throughout the period to monitor price trends, which in practice implied that after price increases had taken place studies could be undertaken and action initiated on the basis of their findings, with the aim of reconsidering the increases in question and/or deciding upon certain civil sanctions. Unfortunately, it is not easy to assess how far the application of such measures proved efficacious.

(iii) Income policy. As far as wage policy was concerned, free negotiation between employers and workers was the general rule. To begin with, as already noted, during the period under study there was no system of annual adjustment linked to price variations which covered broad sectors of the population. Not until 1972 was an increase in minimum urban and rural wages decided upon, on the lines and with the effects reviewed above.

Moreover, in the private sector the participation of the trade union organizations in wage negotiations was relatively small. It is estimated that about 30 per cent of the working population was grouped in trade unions and operated on the basis of discussion of lists of wage petitions. For the rest of the workers, much of the process of negotiating wage increases is still split up among small units, which often have little information and scanty power to secure wage adjustments that keep pace with the rise in prices.

Nor did any systems of periodic and automatic increases operate in the case of public-sector employees. What has been ascertained, however, is that in 1972 and 1973 their salaries were raised through several piecemeal decisions, by a yearly average of a little over 10 per cent, which must have implied that in real terms their remunerations were reduced.

In other fields of income policy, no specific anti-inflationary measures are known to have been adopted. For example, no significant provisions were brought into force to control the growth of the profits of enterprises (apart from the above-mentioned operation of the Office of the Superintendent of Production and Prices) and that of rentals.



#### 4. COSTA RICA

##### A. INTRODUCTORY NOTE

As far as the different forms and degress of inflation in Latin America in recent years are concerned, the case of Costa Rica is both interesting and illustrative. Its inflationary problem has very particular features, as regards its emergence and evolution and latter increase in pace.

The contrast between the long period of stability which characterized Costa Rica in the past, and the inflation of recent years constitutes one of the most outstanding peculiarities. The level and structure of the external trade of the country and the inflationary pressures imported combined with other factors of inflation to give rise to a very singular process.

Lastly, the features of its economic, political and social systems make up a picture in which inflation acquires fairly heterodox implications. It may be recalled that this is a country with a very homogenous population and whose peasants, generally speaking, are not living at subsistence level. The education and health indexes are the highest in the region and income distribution does not show the same degree of disparity as the majority of Latin American countries. The lack of armed forces not only affects the assigning of public resources, but also contributes to a fair measure of generosity in social development.

##### B. RECENT ECONOMIC TRENDS

Generally speaking, the economic activity of Costa Rica has shown considerable fluctuations over the last three years. It may be seen from different indicators that the cyclical movements which have been typical of this economy would appear to be continuing to function. It should be mentioned that this type of variation is not reproduced simultaneously in all the macro-economic variables; some action taken by

/the State,

the State, and some phenomena affecting the country's external sector, have changed the characteristic uniformity of the cycles.

An overall analysis shows that the dynamism present in the economy of Costa Rica in the 1960s may basically be attributed to such factors as its entry into the Central American Common Market, the evolution of world markets in certain agricultural products, the growth of public spending and the inflow of foreign capital. The combined action of these factors produced a frank expansion of the economy, despite the low price of coffee and the agricultural problems caused by the eruptions of the Irazú volcano.<sup>90/</sup>

The explanation of the drop in growth rates in the three-year period 1971-1973 would appear to lie in modifications of the above-mentioned factors and in their different arrangement. An examination of each of them shows its direct connexion with the external sector, which explains the great vulnerability of the economy to fluctuations in the international markets. It is thus possible to see from the analysis of the external sector the conditions and restrictions which affect economic activity in Costa Rica. It would therefore seem appropriate to begin the description of the economy as a whole during the three-year period 1971-1973 by pointing out the main movements in external trade and in Costa Rica's international financial relations. Once the most important events in this field have been identified, the evolution of total supply and demand and the structure of the product will be described. The description of the most important phenomena in this context will be useful for the subsequent interpretation of inflation in Costa Rica and the economic policy actions connected with it.

#### 1. The external sector

The influence of this sector in the economy of Costa Rica is doubly important. It consists of a core of activities directly involving a significant share of the functions of production and

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<sup>90/</sup> See Planning Office, National Development Plan of Costa Rica, Volume 1, "Diagnosis", 1973.

distribution. Unlike other countries, it is not a mere supplier and receiver of foreign exchange; the structure of its exports, in which agricultural items predominate, indicates a basic feature of this economy. The high export and import coefficients of Costa Rica reflect a very close link between the performance of the external sector and general economic activity.

On the other hand, the fluctuations in export prices and the persistent increase in import prices have severely affected the current movements of external trade. The fluctuations of the former and the increases in the latter took on the guise of delicate situations in the balance of payments, which, in view of the importance of the external sector, weighed considerably in a large part of economic activity.

(a) Export performance

Before going on to describe the evolution of exports and their basic components it should be made very clear that products of agricultural origin are of basic importance in their makeup. Three-quarters of the value of exports originates in this sector, and exports of coffee and bananas account for more than half. Although exports of industrial products reveal an increasing share in the whole (26.5 per cent in 1973), the predominance of agricultural products is a feature of the structure which it will be necessary to keep in mind both in the analysis of the economy as a whole and in the description of inflation in Costa Rica (see table 1).

The current value of exports of goods underwent significant variations in the three-year period 1971-1973. In fact, after recording a drop of 2.6 per cent in 1971 compared with the previous year, it showed annual increases of 24.7 per cent in 1972 and 20.8 per cent in 1973 (see table 1). These fluctuations are a result of very uneven variations in the export values of the different products; it may be noted that while there are items which underwent increases of 131.6 per cent in the three-year period described (cocoa, for example), there are others like coffee, which only increased by 28.6 per cent. Variations of this magnitude necessarily subject export activities, and those of the economy as a whole, to ups and downs which affect rates of growth.

/Table 1

Table 1

## COSTA RICA: STRUCTURE OF THE VALUE OF EXPORTS

(Millions of dollars at current prices)

Product	1969	Percent age	1970	Percent age	1971	Percent age	1972	Percent age	1973	Percent age	Percent age variation 1973-1970
Coffee	55.8	29.4	73.1	31.6	59.3	26.3	77.9	27.9	94.0	27.7	28.6
Bananas	51.5	27.2	66.8	28.9	64.4	28.4	82.8	29.5	93.3	27.5	39.7
Livestock and meat	15.1	8.0	18.0	7.8	20.5	9.1	30.3	10.8	32.7	9.6	81.7
Sugar	9.1	4.8	10.1	4.4	12.9	5.7	13.1	4.7	13.6	4.0	34.7
Cocoa	7.1	3.7	1.9	0.8	1.5	0.7	3.0	1.0	4.4	1.3	131.6
Other agricultural products	10.0	5.3	7.8	3.4	8.5	3.8	9.3	3.3	11.4	3.4	46.2
Industrial products	41.0	21.6	53.5	23.1	58.6	26.0	64.5	23.0	89.9	26.5	68.0
<u>Total</u>	<u>189.6</u>	<u>100.0</u>	<u>231.2</u>	<u>100.0</u>	<u>225.3</u>	<u>100.0</u>	<u>280.2</u>	<u>100.0</u>	<u>332.3</u>	<u>100.0</u>	<u>46.8</u>
Annual percentage variation	-	-	21.9	-	-2.6	-	24.7	-	20.8	-	-

Source: Dirección General de Estadística y Censos and Banco Central de Costa Rica. ECLA estimates for exports of industrial products and other agricultural products in 1969.

/The variations

The variations in the current values of exports may be explained by movements of consideration in prices and quantities. It may be seen from table 2 that different indexes showed relatively unfavourable changes; apart from the fact that there was a drop of 5 per cent in prices in 1971, the volume increased by a mere 3 per cent, with the result that there was a subsequent reduction in the value exported. These events were of great importance for the drop in the rate of general economic activity as from 1971. In 1972 and 1973 the indexes show asynchronisms which prevented a more vigorous growth of the value exported. When, as in 1972, the volume increased significantly, prices rose more slowly; conversely, when it was the prices which underwent significant increases, as in 1973, the volume went up less rapidly.

Table 2  
COSTA RICA: INDEXES OF PRICES, QUANTUM AND VALUES  
OF EXPORTS OF GOODS  
(Base: 1970=100)

	1971	1972	1973	1974
Price index	95	100	120	143
Quantum index	103	119	124	129
Export value index	97	119	148	184

Source: ECLA estimates on the basis of official data.

Detailed analysis of the main export products shows more clearly how variations in international prices and in the quantities exported affected the economy of Costa Rica. Tables 3 and 4 contain the above-mentioned information.

Table 3  
COSTA RICA: EVOLUTION OF THE AGRICULTURAL QUANTUM EXPORTED

Product	1970	1971	1972	1973	Percentage variations 1973-1970
Coffee (thousands of quintals)	1 500	1 390	1 871	1 585	5.7
Banana (thousands of bunches)	29 414	32 859	38 599	42 112	43.2
Livestock and meat (thousands of kilos)	17 475	18 617	26 131	21 763	24.6
Sugar (thousands of quintals)	1 465	1 807	1 683	2 438	66.4
Cocoa (thousands of quintals)	71	77	132	103	45.1

Source: Dirección General de Estadísticas y Censos and Banco Central de Costa Rica.

Table 4  
COSTA RICA: EVOLUTION OF PRICES OF AGRICULTURAL EXPORTS  
(Dollars at current prices)

Product	1970	1971	1972	1973
Coffee (per quintal)	48.66	42.67	41.60	59.31
Banana (per bunch)	2.27	1.95	2.15	2.22
Meat (per kilo)	1.03	1.10	1.16	1.50
Sugar (per quintal)	6.93	7.15	7.78	5.59
Cocoa (per quintal)	27.30	19.93	22.67	42.44

Source: Dirección General de Estadística y Censos and Banco Central de Costa Rica.

/Since coffee

Since coffee and bananas are the most important products, not only in exports but also in general production, the variations which they underwent in the last three years were factors which determined the evolution of the economy. The quantum of coffee exported underwent considerable changes - a drop of 7.4 per cent in 1971, an appreciable recovery of 34.6 per cent in 1972, and a further decline of 15.3 per cent in 1973. Furthermore, in 1971 the price of a quintal of coffee dropped by 12.4 per cent and in 1972, when production reached a maximum, the price dropped to a minimum.<sup>91/</sup> The sudden price increase in 1973 coincided with a drop in the production of coffee. In short, price and quantity both played a recessive role in 1971 and put up a compensatory performance in the next two years, with a reduction in the variations in export values.

As regards bananas, the sustained growth of the quantum exported was recorded at an annual average rate of around 13 per cent. Banana prices, however, showed an appreciable decline in 1971 (16 per cent), and the recovery of the next two years did not bring the price back up to 1970 levels.

The significance of the year 1971, a very critical period which had a decisive influence on the economic performance of the country at a later date should not be lost sight of. A large part of the loss of dynamism of the economy of Costa Rica is due to the related consequences of this decline, from the effects of which an open economy could hardly escape.

As far as exports of meat and sugar are concerned, it should be mentioned that a persistent increase in prices was not always accompanied by similar increases in the quanta exported. Livestock and meat showed a decrease of 17 per cent in 1973, and sugar a decline of 7 per cent in 1972, further aggravated by a drop of 22 per cent in price the following year.

<sup>91/</sup> As will be understood, the increase in production did not affect price changes, because of the small share of Costa Rican supply in the world market.

Mention should be made of the increase in the export values of industrial products; these increased by 68 per cent between 1970 and 1973, which meant that their share increased from 23 to 26.5 per cent in that period. Despite this increased diversification, however, the importance of export products of agricultural origin which are affected by the variations in prices and quantities has a decisive influence on the country's vulnerable external sector, and explains to a large extent the above-mentioned loss of dynamism in economic activities, which will be described in more detail below.

(b) The performance of imports

It is worth repeating that the economy of Costa Rica is strongly conditioned by imported supplies. The import coefficient which reached values of between 36 and 38 per cent during the three-year period 1971-1973 is an indicator which needs no further comment. In an economy as open as this the evolution of the actual material flows of imports and their financial counterparts have a considerable influence.

The current value of imports showed sharp increases in the first years of the 1970s (see table 5). The figures for 1973 and 1974 are particularly striking, when the growth rate was 18.6 and 50.0 per cent, respectively. The performance of the components, however, indicates that these increases in values are largely due to the increase in the prices of imported products and only a very small proportion can be attributed to increases in the quantities imported, except in 1974. In fact, the increase in the pace of the price rises is patent: 3 per cent in 1971, 8 per cent in 1972, 15 per cent in 1973 and 31 per cent in 1974; on the other hand, the quantum, following an increase of 7 per cent in 1971, decreased by around 1 per cent in 1972, showed a slight increase of around 3 per cent in 1973, and rose by 15 per cent in 1974. In other words, the financial counterparts in the form of payments abroad have increased much more rapidly than the actual physical entry of foreign products. Once again, the external sector, and this time through imports, is showing its influence and its adverse effects on the economy of Costa Rica.



Table 5

COSTA RICA: INDEXES OF PRICES, QUANTUM AND VALUES OF  
IMPORTS OF GOODS

(Base: 1970=100)

	1971	1972	1973	1974
Price index	103	111	128	168
Quantum index	107	106	109	125
Value index	110	118	140	210

Source: ECLA estimates on the basis of official data.

An analysis of the structure of imports confirms the foregoing considerations. The important influence of raw materials and capital goods and their increasing share in total imports may be seen in table 6. Imports of consumer goods, however, show fluctuations with a slight tendency to increase and a relatively decreasing share in the total, although they do in any case represent fairly considerable levels. Industry and construction are the sectors which most depend on imported supplies, and also have a significant share in imports of capital goods, while the transport sector is also included here with high absolute levels which tend to increase.

The features mentioned would appear to be enough to confirm that any change in import flows affects the base of the system of production and rigorously conditions the supply of final consumer products. In view of the international situation as regards price increases, it may be pointed out that inflation in Costa Rica is closely linked to the movements produced in the external sector, mainly in imports. The rising prices of imports mean higher production costs, while the slow growth of the quantum explains the economy's loss of dynamism.

Table 6

COSTA RICA: STRUCTURE OF IMPORTS OF GOODS

(CIF values in millions of dollars  
at current prices)

	1970	1971	1972	1973
Raw material for industry and mining	102.2	111.4	128.3	170.9
Raw material for agriculture	9.2	9.0	9.4	11.9
Construction material	17.3	16.8	15.2	18.3
Fuels and lubricants	6.3	6.9	7.5	12.4
<u>Total inputs</u>	<u>135.0</u> (42.6)	<u>144.1</u> (41.2)	<u>160.4</u> (43.1)	<u>213.5</u> (47.1)
Capital goods for industry and mining	25.7	25.4	26.7	42.4
Capital goods for agriculture	6.2	9.0	9.4	10.7
Capital goods for construction	10.2	13.1	14.6	13.5
Capital goods for transport	23.2	30.7	36.6	36.1
Other capital goods	13.4	15.7	20.5	21.6
<u>Total capital goods</u>	<u>78.7</u> (24.9)	<u>93.9</u> (26.9)	<u>107.8</u> (28.9)	<u>124.3</u> (27.4)
Non-durable consumer goods	69.7	74.1	71.9	76.9
Consumer durables	33.3	37.6	32.6	38.5
<u>Total consumer goods</u>	<u>103.0</u> (32.5)	<u>111.7</u> (31.9)	<u>104.5</u> (28.0)	<u>115.4</u> (25.5)
<u>Total imports</u>	<u>316.7</u> (100.0)	<u>349.7</u> (100.0)	<u>372.7</u> (100.0)	<u>453.2</u> (100.0)

Source: Dirección general de Estadística y Censos and Banco Central de Costa Rica.

(c) The balance of payments

The analysis of the current account brings out the size of the deficits in the trade balance (see table 7). In fact, the deficits recorded between 1971 and 1973 were much higher than those of the previous five-year period and their size accounts for most of the equally large deficits in the current account.

Although the trade deficit on goods and services declined to a significant extent during the last two years, especially compared with the deficit of 107 million dollars recorded in 1971, the increase in the payments of profits and interest on foreign capital expanded appreciably. It may be noted that in 1973 this item tripled as compared with the value recorded for 1970. The two imbalances thus combined to produce a deficit in the current account exceeding 100 million dollars during the three-year period under analysis (see table 7). A comparative examination of the deficit averages for the period 1971-1973, which double those of the five-year period 1966-1970, shows clearly the deterioration in the external sector in Costa Rica. This one indicator is sufficient to show, once more, that one of the main problems of the country's economy originates in the external sector. In this context it may be recalled that Costa Rica does not produce petroleum and that increased import costs of this commodity will have adverse repercussions on the trade balance. It is estimated that the cost of petroleum imports for 1974 will amount to 60 million dollars (more than twice the prepaid value in 1973), with easily foreseen consequences on domestic costs of production and distribution. Since the input in question is widely used, this will have repercussions on a large part of economic activity and certainly on the level of living of the population. If recent trends in the price increases of other imported products are included, it will be agreed that the prospects of disequilibria in external trade are not particularly encouraging. Exports of industrial products and the

Table 7  
COSTA RICA: BALANCE OF PAYMENTS

(Millions of dollars)

	Average 1966-1970	1970	1971	1972	1973	Average 1971-1973
<u>Current account</u>						
Exports of goods and services	210.3	280.1	283.8	346.3	416.5	346.9
Goods FOB	173.9	231.0	224.6	278.8	341.5	281.6
Services	36.4	49.1	59.2	67.5	75.0	67.2
Imports of goods and services	254.8	346.5	390.7	418.0	491.3	433.3
Goods FOB	207.6	286.8	316.3	337.1	399.3	350.9
Services	47.2	59.7	74.4	80.9	92.0	82.4
Payments of profits and interest on foreign capital (net)	-16.1	-13.6	-14.6	-34.7	-41.0	-30.1
Profits	-8.0	-3.8	-3.4	-21.0	-24.4	-16.3
Interest	-8.1	-9.8	-11.2	-13.7	-16.6	-13.8
Net private transfer payment	4.1	3.4	3.5	4.0	3.6	3.7
Balance of current account	-56.5	-76.6	-118.0	-102.4	-112.2	-110.9
<u>Capital account</u>						
Net external financing (a+b+c+d+e)	56.5	76.6	118.0	102.4	112.2	110.9
(a) Non compensatory foreign funds (net)	64.4	79.1	128.0	106.3	98.7	111.0
Direct investment	17.1	26.4	22.0	25.8	26.8	24.9
Long and medium-term loans	44.6	42.2	68.4	94.4	121.4	94.7
Amortizations	-23.9	-19.2	-30.6	-38.3	-58.0	-42.3
Short-term liabilities	22.7	27.2	64.3	21.8	9.0	31.7
Official transfer payments	3.9	2.5	3.9	2.6	-0.5	2.0
(b) National non-compensatory funds or assets	-9.1	-5.9	-19.8	-46.2	-38.0	-34.7
(c) Errors and omissions	6.9	-9.5	20.3	38.9	61.3	40.2
(d) Allocation of special drawing rights	0.8	4.2	3.4	3.7	0.0	2.4
(e) Net compensatory financing (- increase)	-6.5	8.7	-13.9	-0.3	-9.9	-8.0

Source: ECLA on the basis of official statistics.

/promising trend

promising trend in the prices of coffee, sugar, cocoa and meat apparently do not seem able to offset higher import costs. Estimates based on data for the first half of 1974 suggest that there will be increasing deficits in the current account of the balance of payments.

The analysis of the capital account draws attention to the extraordinary increase in long and medium-term loans (see table 7). These tripled in 1973 compared with 1970, in answer to a sustained trend in the intermediate years. Amortizations also show large increases and are clearly growing in volume, given the latest debt levels and will thus constitute a factor absorbing considerable quantities of foreign exchange.

At the end of 1973 the external debt amounted to 440 million dollars,<sup>92/</sup> which is moderate compared with the value of exports. However, it could become a serious problem if the deficits in the current account and the recent trends observed in the annual state of indebtedness are maintained.

Direct foreign investment also shows a tendency to increase (see table 7). The average for 1971-1973 was 46 per cent up on the five-year period 1966-1970, reaching 26.8 million dollars in 1973. The magnitude of transfers of foreign exchange abroad for the purposes of factor remuneration had already drawn attention. Remittances of profits, which in 1972 and 1973 nearly tripled those of the previous five-year period, were very close to balancing direct investment during those years. If the trend in the inflow of non-compensatory capital is maintained, the impact of profits on foreign investment on the deficit of the current account will be increasingly greater.

The magnitude of the figures in the item errors and omissions is noteworthy (see table 7). In 1973 this figure was 61.2 million dollars, more than half net external financing in that year. A minute investigation of the structure of this figure could make a distinct

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<sup>92/</sup> Central Bank of Costa Rica. The external public debt accounts for 228 million dollars, and the external private debt for 152 million.

difference in the balances of the other accounts. It is possible that no small part of this total is related to illegal exports and imports, or exports and imports not subject to official control.

The movements of accounts described above, especially the increase in indebtedness and the inflow of direct investment, not only financed the deficits of the current account during the three-year period but also meant that the country increased its international reserves between 1971 and 1973. Of particular importance were the increases in reserves in 1971 to 13.9 million dollars and in 1973 to 9.8 million dollars. It is estimated that total net international reserves at the end of 1973 amounted to 42.4 million dollars. As a point of reference, it may be noted that this amount is more than double that for 1969 and almost seven times that for 1970.<sup>93/</sup> Despite these increases, however, the 1973 level was only sufficient to finance one month's imports. Generally speaking, the level is considered to be adequate when it is equivalent to three or four month's imports; however, this is only a reference comparison, which in some cases may not be very meaningful.

To conclude the description of the most important features of the external sector as far as inflationary pressures are concerned, it is to be noted that the impact of the terms of trade has been adverse in recent years (see table 8). If 1970 is taken as the year of reference, it may be seen that in the last three years rather considerable losses were recorded in trade. In fact, the accumulated loss of the last three years is of the order of 91.3 million dollars at 1970 prices. If this figure is updated to dollars at 1973 prices, it would more than cover the deficit for the current account in that year. These figures are thus not insignificant and it is easy to forecast that they may increase significantly in 1974, in view of the trends of import prices.

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<sup>93/</sup> Source: International Monetary Fund, International Financial Statistics, November 1974.

Table 8  
COSTA RICA: INDICATORS OF EXTERNAL TRADE  
(Millions of dollars at 1970 prices)

	1971	1972	1973
Purchasing power of exports	275.5	310.4	331.3
Export quantum	298.1	348.5	361.9
Effects of the terms of trade with reference to 1970	-22.6	-38.1	-30.6
Index of terms of trade (1970=100)	92.2	90.1	93.7

Source: ECLA estimates on the basis of official data.

## 2. The evolution of total supply and demand

The state of these main variables of supply and demand shows up clearly the loss of dynamism manifest in the economy of Costa Rica. The real growth recorded in the three-year period 1971-1973 is a frank contrast to that of the period 1966-1970 (see table 9). As regards supply, both the product and imports grew much more slowly. A comparison of the annual rates for both periods showed that the growth of the product declined from 6.9 per cent to 4.3 per cent annually, while imports similarly slowed their growth rate from 10.1 per cent to 3.5 per cent annually between the two periods considered. This decline in the above-mentioned rates constitutes one of the factors which should be taken into account in a description of inflation in Costa Rica. It should, however, be pointed out that 1970, the period of reference in the evolution of the last three years, was an exceptional year as far as imports are concerned; the real growth rate recorded by this variable was 25.3 per cent. In any case, the drop in the annual rates in the last three years, both in imports and in the product show a loss of dynamism which can only be attributed, to a lesser extent, to the achievements of 1970.

Table 9

COSTA RICA: TOTAL SUPPLY AND DEMAND  
(Millions of colones at 1970 prices)

	1970	1971	1972	1973	Annual growth rates					
					1970-1965	1973-1970	1970	1971	1972	1973
<u>Total supply</u>	8 552.3	9 019.2	9 330.1	9 644.5	7.7	4.1	11.0	5.5	3.4	3.4
Gross domestic product at market prices	6 269.4	6 520.2	6 846.3	7 113.2	6.9	4.3	6.6	4.0	5.0	3.9
Imports	2 282.9	2 499.0	2 483.8	2 531.3	10.1	3.5	25.3	9.5	-0.6	1.9
<u>Total demand</u>	8 552.3	9 019.2	9 330.1	9 644.5	7.7	4.1	11.0	5.5	3.4	3.4
Exports	1 841.2	1 959.5	2 314.5	2 344.7	13.8	8.4	10.6	6.4	18.1	1.3
Gross domestic investment	1 522.6	1 545.1	1 413.7	1 496.0	5.8	-0.6	28.3	1.5	-8.5	5.8
Gross fixed investment	1 389.9	1 498.2	1 561.7	1 647.7	6.4	5.8	14.3	7.8	4.2	5.5
Public	266.3	322.3	338.4	362.1	2.7	10.8	11.0	21.0	5.0	7.0
Private	1 123.6	1 175.9	1 223.3	1 285.6	7.4	4.6	15.1	4.7	4.0	5.1
Total consumption	5 188.5	5 514.5	5 601.9	5 803.8	6.5	3.8	6.9	6.3	1.6	3.6
General government	873.0	944.5	1 005.9	1 066.3	7.6	6.9	8.0	8.2	6.5	6.0
Private	4 315.5	4 570.1	4 596.0	4 737.5	6.4	3.2	6.7	5.9	0.6	3.1

Source: ECLA, on the basis of official statistics.

/Taking the



Taking the structure of overall supply, the growing share of imports to the detriment of the gross domestic product may be observed (see table 10). Whether the two-year period 1969-1970 or a more distant period, such as 1965, as taken as reference, the relatively greater importance of imports in the last three years is outstanding. The import coefficient, which attained 31.6 per cent in 1965, reached 38.3 per cent in 1971, while the average for the period 1971-1973 was of the order of 36.7 per cent. However slow the evolution of the economy may have been in recent times, this change in the share of external supplies is extremely significant and constitutes another element which should be borne in mind when the re-emergence of inflation in Costa Rica as from 1973 is described.

Obviously, in the analysis of demand, the rates observed are rather slower for the last three years than in the five year period 1969-1970 (see table 9). Most of the components had much lower growth rates; while in the period 1966-1970 the annual rate of exports was 13.8 per cent, the rate of growth of investment 5.7 per cent, and the rate of consumption 6.5 per cent, in the last three years, these rates in the same order were 8.4 per cent, -0.6 per cent, and 3.8 per cent. Only fixed capital public investment showed an increase in dynamism in the latter period, when it increased from an annual rate of 2.7 per cent in the previous five-year period to an annual rate of 10.8 per cent in the last three years, with 1971 outstanding for its high growth rate (21 per cent, following the 11 per cent recorded the previous year). This fact should also be recalled when the appearance of inflationary pressures in Costa Rica is interpreted.

From the point of view of the structure of total demand significant changes may be observed (see table 10). If the 1973 structure is compared with that of the two-year period 1969-1970 and, better still, with a more distant period such as 1965, it may be observed that the most important changes were in exports and consumption. The export coefficient increased in the periods under consideration from

Table 10  
COSTA RICA: STRUCTURE OF TOTAL SUPPLY AND DEMAND <sup>a/</sup>

(Percentages)

	1965	Average 1969-1970	1970	1971	1972	1973	Average 1971-1973
<u>Total supply</u>	<u>131.6</u>	<u>133.8</u>	<u>136.4</u>	<u>138.3</u>	<u>136.3</u>	<u>135.6</u>	<u>136.7</u>
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Imports	31.6	33.8	36.4	38.3	36.3	35.6	36.7
<u>Total demand</u>	<u>131.6</u>	<u>133.8</u>	<u>136.4</u>	<u>138.3</u>	<u>136.3</u>	<u>135.6</u>	<u>136.7</u>
Exports	21.6	28.9	29.4	30.0	33.9	33.0	32.3
Gross domestic investment	25.7	22.3	24.3	23.7	20.6	21.0	21.8
Gross fixed investment	22.8	21.4	22.2	23.0	22.8	23.2	23.0
Public	5.2	4.2	4.3	4.9	4.9	5.1	5.0
Private	17.6	17.3	17.9	18.1	17.9	18.1	18.0
Total consumption	84.3	82.6	82.7	84.6	81.8	81.6	82.6
General government	13.5	13.8	13.9	14.5	14.7	15.0	14.7
Private	70.8	68.8	68.8	70.1	67.1	66.6	67.9

Source: Table 9.

<sup>a/</sup> 1970 prices.

21.6 per cent in 1965 to 28.9 per cent in 1969-1970, culminating in 33 per cent in 1973. On the other hand, consumption, especially private consumption, showed a decline in its share (see table 10).

It is worth pausing on the analysis of consumption and, in particular, on investment. The movements of these variables reflect crucial options in the allocation of resources. It is obvious that efforts made to maintain the growth rate of fixed capital formation were offset, from the domestic point of view, by a reduction in the share of consumption, accompanied by considerable external financing, as will be seen below.

The coefficient of fixed capital investment in the economy of Costa Rica reaches considerable levels. It in fact fluctuated within a narrow belt around 23 per cent and if the trend in the structure of investment manifested up to 1972 is maintained, by no means insignificant industrial base will be consolidated. Furthermore, the National Development Plan of Costa Rica assigns special priority to the inclusion of resources which have still not been exploited and their subsequent processing.<sup>94/</sup>

In the overall analysis of gross domestic investment a clear differentiation should be made between what has taken place in gross fixed investment and in inventory variations. Investment in fixed capital goods shows fluctuations, but reveals a growth superior to that of the product during the three-year period, and records annual rates well above those of consumption.

As regards inventory variations a characteristic fact may be observed. In 1970 the value of inventory variations accounted for 22 per cent of gross fixed investment while in 1971 it accounted for 15 per cent, but in 1972 it barely exceeded 1 per cent and in 1973 did not reach 2 per cent. This violent drop in inventories made up

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<sup>94/</sup> Summary of the National Development Plan of Costa Rica 1974-1978. The chapter on the strategy and overall plan observed that the inclusion of resources without their processing is not desirable since this would lead to the re-establishment of the classic international division of labour in which Costa Rica would continue to figure as an exporter of primary products.

in 1971 the difference between the growth of consumption (0.3 per cent) and that of the product (4 per cent); in 1972 it was to be explained by the extraordinary growth of exports (18.3 per cent), since consumption practically did not increase during that year (see table 9).

It is useful to mention that the greater part of investment is private sector investment while only around one-fifth is public sector investment (see table 10). It should, however, be mentioned that between 1970 and 1973 the share of public investment in capital formation increased appreciably: from 19.6 per cent it rose to 22 per cent, which is the more significant if it is borne in mind that the growth rate of total investment in the last three years did not decline as much as that of the other components. Furthermore, the data in colones at current prices given in table 11 indicates still more pronounced changes towards an increasing public share in investment.<sup>95/</sup> The most significant detail in this information indicates the type of investment which each sector prefers to make. It may thus be seen that private initiative was mainly concentrated in acquiring machinery and equipment, while state activity directed its priorities towards construction. In fixed capital formation as a whole, in view of the size of investment in each sector, machinery and equipment increased more rapidly than construction (see table 12).

Another aspect of great interest in the study of the accumulation process in the economy of Costa Rica concerns the destination of investment by sectors of economic activity.

The structure and trends of investment, are generally speaking, adequate reflections of the changes in the structure of production. In the case of the economy of Costa Rica, unmistakable signs of transformation in the structure of production may be observed, judging by the distribution of investment in the different sectors in 1971 and 1972 (see table 13). Industry, transport, ownership of dwellings

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<sup>95/</sup> This data differs from that of table 9 because the current values involve variations in prices and particularly in exchange rates which the conversion to real values attempts to eliminate.

Table 11

COSTA RICA: PUBLIC AND PRIVATE INVESTMENT

(Millions of colones at current prices)

	1970	Percentage	1971	Percentage	1972	Percentage
<u>Fixed public investment</u>	<u>287.6</u>	<u>22.7</u>	<u>408.2</u>	<u>25.9</u>	<u>562.3</u>	<u>31.2</u>
(a) Construction	228.1	18.0	304.2	19.3	430.3	23.9
(b) Machinery and equipment	61.5	4.7	104.0	6.6	132.0	7.3
<u>Fixed private investment</u>	<u>980.2</u>	<u>77.3</u>	<u>1 170.3</u>	<u>74.1</u>	<u>1 237.7</u>	<u>68.8</u>
(a) Construction	408.6	32.2	449.8	28.5	385.1	21.4
(b) Machinery and equipment	571.6	45.1	720.5	45.6	852.6	47.4
<u>Total fixed investment</u>	<u>1 267.8</u>	<u>100.0</u>	<u>1 578.5</u>	<u>100.0</u>	<u>1 800.0</u>	<u>100.0</u>

Source: Banco Central de Costa Rica.

Note: No data is available for 1973.

Table 12

COSTA RICA: STRUCTURE OF INVESTMENT

(Millions of colones at current prices)

	1970	Percentage	1971	Percentage	1972	Percentage
Investment in construction	636.7	50.1	754.0	47.8	815.4	45.3
Investment in machinery and equipment	633.1	49.9	824.5	52.2	984.6	54.7
<u>Total investment</u>	<u>1 269.8</u>	<u>100.0</u>	<u>1 578.5</u>	<u>100.0</u>	<u>1 800.0</u>	<u>100.0</u>

Source: Banco Central de Costa Rica.

Table 13

COSTA RICA: FIXED CAPITAL INVESTMENT BY SECTORS

(Millions of colones at current prices)

Sector	1970	Percent age	1971	Percent age	1972	Percent age
Agriculture	191.0	15.0	196.6	12.5	157.9	8.7
Industry	245.6	19.3	251.2	15.9	307.5	17.1
Construction <sup>a/</sup>	81.2	6.4	116.4	7.4	142.2	8.0
Electricity	79.1	6.2	142.5	9.0	172.2	9.6
Transport	190.7	15.0	232.2	14.7	304.1	16.9
Trade	86.1	6.8	93.0	5.9	88.6	4.9
Banking	24.8	2.0	16.6	1.0	27.9	1.5
Ownership of dwellings	173.0	13.6	248.2	15.7	221.1	12.3
Services	46.8	3.7	51.6	3.3	53.5	3.0
General government	151.4	12.0	230.2	14.6	325.0	18.0
<u>Total</u>	<u>1 269.7</u>	<u>100.0</u>	<u>1 578.5</u>	<u>100.0</u>	<u>1 800.0</u>	<u>100.0</u>

Source: Banco Central de Costa Rica.

<sup>a/</sup> Machinery and construction equipment.

/and general

and general government were the activities which most benefited. From the point of view of increases in allocations of resources in the period 1971-1972, of note are the electricity sector which grew by 118 per cent, construction which increased by 75 per cent, transport with 60 per cent, and general government whose growth rate was 115 per cent. Although these increases are for current values, they are not without meaning, since it was in that period that inflationary pressures began to appear, as will be seen below.<sup>96/</sup> In contrast to the increases mentioned the drop in investment in the agricultural sector is of note (see table 13).

The above data and the volume of investment in the industry and transport sector are, as has been said, clear indication of the transformation of the typical agricultural export model which characterized the economy of Costa Rica in the past. The industrialization process which gathered impulse in the second half of last decade, would seem to be continuing, although at a slower rate.

Lastly, it is also interesting in analysing investment to examine the preferences of the foreign private enterprise as regards in which sectors it places its investment. The data given in table 14 enables it to be concluded that agricultural and industrial activity attracted a major share of foreign investment, since the export capacity and the rate of economic viability of these sectors offer distinct advantages for foreign capital. It should also be mentioned that between 1970 and 1973 foreign capital increased by 33.3 per cent, although it still has not reached 10 per cent of total investment.

### 3. The product and its sectoral structure

The annual growth rates of the gross domestic product during the period 1971-1973 were, as has already been said, 4 per cent in 1971, 5 per cent in 1972, and 3 per cent in 1973, i.e., rather less than the rates recorded in the period 1966-1970, the annual average rate of which was estimated at about 7 per cent. It should not be lost sight of that

<sup>96/</sup> The increases in wholesale prices were approximately 6.7 per cent in 1971 and 5.4 per cent in 1972.

Table 14  
COSTA RICA: STRUCTURE OF PRIVATE FOREIGN INVESTMENT<sup>a/</sup>  
(Millions of dollars at current prices)

Sector	1970	Percent age	1971	Percent age	1972	Percent age	1973	Percent age
Agriculture	16.1	61.0	10.0	45.5	22.2	85.7	23.8	67.6
Industry	6.1	23.0	5.9	26.8	4.0	15.4	12.8	36.4
Transport	-0.5	-2.0	3.0	13.6	0.2	0.8	-0.2	-0.6
Services	0.5	2.0	0.7	3.2	0.2	0.8	0.2	0.6
Trade	1.0	4.0	-1.1	-5.0	-0.7	-2.7	-2.7	-7.7
Others b/	3.2	12.0	3.5	15.9	-	-	1.3	3.7
<u>Total</u>	<u>26.4</u>	<u>100.0</u>	<u>22.0</u>	<u>100.0</u>	<u>25.9</u>	<u>100.0</u>	<u>35.2</u>	<u>100.0</u>

Source: Banco Central de Costa Rica. Preliminary estimates.

a/ Data recorded in the balance of payments.

b/ Includes the finance sector.



the per capita product for Costa Rica is relatively high among the developing countries. In fact, different estimates for 1973 situate this indicator at levels of over 800 dollars.<sup>97/</sup>

An analysis of sectoral performance during the three-year period 1971-1973 enables it to be demonstrated that the loss of dynamism reflected in the growth rate of the product is the result of slow growth in all sectors, with the exception of construction. This is, therefore, a fairly widely generalized phenomenon in the economic activity of Costa Rica, contrasting with the considerable dynamism observed in the last decade, where the manufacturing and, to a lesser extent, the agricultural sector were of importance (see table 15).

The sectoral growth rates with the exception already mentioned, are, generally speaking, significantly lower than those of the five-year period 1965-1970; of special importance is the drop in the rate of growth of the agricultural sector, because of its influence on external trade, its capacity to absorb employment and its direct relationship with inflationary pressures.

It should be noted that the lower growth rate of economic activity was not merely limited to the production of goods, but that there were also appreciably lower rates in the production of services. It is common to observe in other countries that the sectors producing services take longer to show the crises which appear at the base of the economic system. In the case of Costa Rica, as has already been mentioned, economic activity in general is closely linked to external trade, so that the problems of the latter are directly and immediately disseminated throughout most of the system of production.

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<sup>97/</sup> The per capita product in dollars fluctuates to a significant extent depending on the exchange rates used for the conversion.

Table 15  
COSTA RICA: GROSS DOMESTIC PRODUCT BY BRANCH OF ECONOMIC ACTIVITY  
(Millions of colones at 1970 prices)

	1970	1971	1972	1973	Annual growth rates				
					1970-1965	1973-1970	1970	1971	1972
Agriculture	1 421.2	1 485.1	1 525.2	1 578.5	5.1	3.6	2.0	4.5	2.7
Mining	0.0	0.0	0.0	0.0	-	-	-	-	-
Manufacturing industry	929.0	984.8	1 039.0	1 111.7	9.5	6.2	8.4	6.0	5.5
Construction	279.5	301.9	323.0	333.4	4.8	6.1	12.8	8.0	7.0
Subtotal goods	2 629.7	2 771.8	2 887.2	3 023.6	6.5	4.8	5.3	5.4	4.2
Electricity, gas, water, sewage	109.6	120.6	133.8	138.1	9.8	8.0	8.0	10.0	10.9
Transport and communications	253.5	265.2	281.1	290.1	7.6	4.6	8.7	4.6	6.0
Subtotal basic services	363.1	385.8	414.9	428.2	8.2	5.6	8.5	6.3	7.5
Trade and finance	915.3	963.4	1 023.4	1 056.2	8.9	4.9	12.2	5.3	6.2
Ownership of dwellings	405.2	416.6	429.0	442.7	3.1	3.0	3.1	2.8	3.0
Government	681.9	719.4	766.2	790.7	7.8	5.1	6.8	5.5	6.5
Other services	559.6	570.8	593.7	612.7	6.5	3.1	5.0	2.0	4.0
Subtotal other services	2 562.0	2 670.2	2 812.3	2 902.3	7.1	4.2	7.6	4.2	5.3
Total gross domestic product	5 554.8	5 777.0	6 065.8	6 302.7	7.0	4.3	6.6	4.0	5.0
									3.2
									3.5
									-
									7.0
									3.2
									4.7

Source: ECLA, on the basis of official statistics.

On account of the slow growth in the sectors, the structure of the product suffered no modifications of importance in recent years (see table 16). The increased share of the manufacturing industry should, however, be noted, although the change which may be observed in the averages of the last two years and the period 1965-1970 is little more than 1 per cent. Exports by this sector to the Central American market explain this increase, despite the adverse effect of the price increase of its imported inputs; it may be observed that its share increased in each of the last three years although only to a small extent.

In describing the evolution of the economy of Costa Rica in the last three years, only the phenomena of most significance and use for the interpretation of inflation in the country were analysed. In view of this particular angle of interest, the most outstanding events were selected and the considerations with respect to them were examined in this perspective. There was no attempt to make an appraisal of the economic process, nor even an exhaustive description. The analysis of inflation, which follows, requires this general frame of reference, to be borne in mind.

Table 16

COSTA RICA: STRUCTURE OF GDP BY BRANCH OF ECONOMIC ACTIVITY<sup>a/</sup>

(Percentages)

	1965	Average 1966-1970	1970	1971	1972	1973	Average 1971-1973
Agriculture	28.0	26.6	25.6	25.7	25.1	25.0	25.3
Mining b/	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufacturing industry	14.9	16.2	16.7	17.0	17.1	17.6	17.3
Construction	5.6	5.0	5.0	5.2	5.3	5.3	5.3
<u>Subtotal goods</u>	<u>48.5</u>	<u>47.8</u>	<u>47.3</u>	<u>48.0</u>	<u>47.6</u>	<u>48.0</u>	<u>47.8</u>
Electricity, gas, water and sewage	1.7	1.9	2.0	2.1	2.2	2.2	2.2
Transport and communications	4.4	4.5	4.6	4.6	4.6	4.6	4.6
<u>Subtotal basic services</u>	<u>6.2</u>	<u>6.3</u>	<u>6.5</u>	<u>6.7</u>	<u>6.8</u>	<u>6.8</u>	<u>6.8</u>
Trade and finance	15.0	15.6	16.5	16.7	16.9	16.8	16.8
Ownership of dwellings	8.7	7.8	7.3	7.2	7.1	7.0	7.1
Government	11.8	12.3	12.3	12.4	12.6	12.5	12.5
Other services	10.3	10.3	10.1	9.9	9.8	9.7	9.8
<u>Subtotal other services</u>	<u>45.8</u>	<u>45.9</u>	<u>46.1</u>	<u>46.2</u>	<u>46.4</u>	<u>46.0</u>	<u>46.2</u>
<u>Total gross domestic product</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Source: ECLA estimates, on the basis of official data.

a/ 1970 prices.

b/ Mining and quarrying are included in manufacturing industry.

### C. APPEARANCE AND ACCELERATION OF INFLATION

One of the main features of the Costa Rican economy has been the relative stability of domestic prices, and it is within this context that the performance of its production agents evolved. In the whole period 1964-1970, for example, the consumer price index rose by 12.6 per cent (2 per cent annually). Clearly, there were no inflation problems and, more important still, problems of this kind do not seem to have been latent or kept under control by a direct policy of restraint. In view of the characteristics of its population, the distribution of income and the rates of economic growth during this decade, it is hard to believe that there were hidden inflationary pressures as occurred in other countries, where long periods of relative stability were sometimes achieved by curbing the growth of consumption of broad sectors of the population. On the whole, the steadily increasing demands of the social and productive process found a response in flexible supply, in which imports played a decisive role.

The prices situation changed radically in the 1970s. Already in 1970 and 1971 there were unusually large price increases, at rates which accelerated considerably in 1973 and 1974. The purpose of these pages is none other than to identify the most important characteristics of the emergence, spread and acceleration of the inflationary process.

In this connexion, two observations are necessary. First, given the fact that this is a recent phenomenon and in view of its characteristics, attention has been centred mainly on identifying the inflationary factors and considering them in order of importance. This is not intended to be a complete study. There are still some unknown factors, particularly as regards the expectations of producers and consumers and their conduct vis-a-vis a process which is beginning to affect them severely. The collection of relevant data and the choice and adaptation of a new set of analytical instruments will entail additional efforts in order to further clarify the problem.

/Moreover, it

Moreover, it must be pointed out that this is a partial attempt, since it excludes any analysis of the political process, which would no doubt have supplied additional criteria. Government action in this field, and the action of economic and political groups, make up a frame of reference which lies outside the scope of economic analysis. A task of that magnitude, however, apart from concentrating efforts which would have exceeded the scope of this study, requires information which is not generally compiled and for which the only substitute can be the most important day-to-day political developments.

### 1. The general context

In order to interpret the inflation which has recently affected Costa Rica it is necessary to identify the salient features of overall economic development and, in particular, the evolution of the external sector, which was attempted in the previous chapter.

Some facts which should be recalled here are the loss of dynamism of economic activity in the last three years, the public sector's increasing share in capital formation and the continuous nature of the industrialization process. Moreover, from the standpoint of the external sector, an important feature was the considerable rise in import prices and the fluctuations in volume and prices of the traditional export commodities. The effects of these movements, as described above, were reflected in sharp and persistent balance of payments deficits on current account, which is especially important because of their significant impact on a major part of economic activity. As will be seen below, it is in the external sector that many of the factors which have disrupted the basic equilibria and have led to changes in the system and rises in the level of domestic prices may be found.

### /2. Indicators

## 2. Indicators of levels of inflation

For an indication of the trend of inflation, among the price indicators generally chosen are consumer and wholesale price indexes and the implicit deflator of the product.<sup>98/</sup> Information has been collected on these indexes as a first criterion, which provides orders of magnitude of the price trends in Costa Rica. Table 17 shows the variations in these indexes.

The three indicators show that in the period 1966-1969 price increases were fairly small. In 1957-1969 the wholesale price index, apparently the most sensitive of the three, rose by less than 3 per cent annually, thus indicating virtual price stability.<sup>99/</sup> If this rate is compared with the movements of prices in other Latin American countries during this period, including those described as stable, the foregoing observation does not seem exaggerated.<sup>100/</sup>

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<sup>98/</sup> The implicit deflator of the product is generally defined as the harmonic mean of sectoral price indexes and is interpreted as an indicator of the general level of prices in the economy. It represents the ratio of the product at current prices to the product at constant prices.

<sup>99/</sup> The evolution of this index is shown in a study presented by Mr. Otto Kikut, Alternate Director of the National Planning Office (OFIPLAN), at the Seminar on Economic Policy held under the sponsorship of the National Planning Office of Costa Rica in October 1974.

<sup>100/</sup> The following annual rates of price increases for the same period in other countries of the region are useful for reference purposes: 29 per cent in Argentina, 5.4 per cent in Bolivia, 42 per cent in Brazil, 3.4 per cent in Mexico and 6.7 per cent in Peru.

Table 17  
COSTA RICA: PRICE INDEXES

Period	Wholesale price index <u>a/</u>		Retail price index <u>b/</u>		Implicit deflator of the gross product <u>c/</u>	
	Base 1966=100	Percentage annual variation	Base 1964=100	Percentage annual variation	Base 1967-1969 =100	Percentage annual variation
1966	100.0	-	99.5	-	97.9	-
1967	103.3	3.3	100.7	1.2	98.4	0.5
1968	108.4	4.9	104.8	4.1	99.3	0.9
1969	113.0	4.2	107.6	2.7	101.9	2.6
1970	120.0	6.2	112.6	4.6	107.7	5.7
1971	128.0	6.7	116.1	3.1	113.0	4.9
1972	135.0	5.4	121.4	4.6	119.6	5.8
1973	157.0	16.4	132.7	9.3	...	...

Source: a/ Banco Central de Costa Rica.

b/ National Planning Office.

c/ International Bank for Reconstruction and Development, Economic Report of Costa Rica, 15 March 1974, vol. II.

/In contrast



In contrast with this historical background of price stability, as already mentioned, the first few years of the 1970s show significant changes. The first inflection point was reached in 1970: the three indexes chosen show appreciably higher rates than in the immediately preceding periods, thus marking the start of inflationary pressures in Costa Rica. The other important milestone was in 1973, when the growth rates of the two indexes available tripled the annual rate of the period 1966-1972. Available data for the first half of 1974 indicate an acceleration which leaves no room for doubt regarding the persistence of the pressures on prices, constituting what can already be termed the recent inflationary process in Costa Rica (see table 18). A rate of increase in prices of 26 per cent over the past six months is a clear sign that the inflationary pressures evident in 1973 are gaining momentum.

Table 18  
COSTA RICA: RECENT DOMESTIC PRICE TRENDS

Period	Variation in the wholesale price index	Variation in the retail price index <u>a/</u>
December 1972 June 1973	9.3	6.9
June 1973 December 1973	15.7	8.5
December 1973 June 1974	26.0	18.1
June 1973 June 1974	45.8	28.2

Source: Banco Central de Costa Rica, Boletín Estadístico Mensual; and estimates of the United Nations Advisory Group in OFIPLAN.

a/ This index is no longer published officially because it is not regarded as truly representative. The wholesale price index is considered to be the most appropriate indicator for estimating price variations.

### 3. Disparities in price increases

It is interesting to note the uneven increase in wholesale prices according to the origin of the products. The sample of this index contains domestic and imported products, and the variations in both are useful for elucidating and studying the origins of inflation in Costa Rica (see table 19).

It will be noted that between 1971 and 1973 imported goods experienced appreciably higher price increases. If prices in June 1974 are compared with the average for 1973, the components show a similar growth (42 and 43 per cent). When an attempt is made to explain the causes of Costa Rican inflation, its first effects and subsequent spread, it will be useful to revert to this point.

A breakdown of this index by types of products also reflects disparities which help to discover other useful characteristics in diagnosing inflation. Table 20 contains a breakdown by groups of products.

The various groups of products show very uneven rates of increase. Obviously, the most spectacular rise was in fuel and electricity, i.e., one-and-a-half times the general index. Products of animal origin and miscellaneous products, mainly clothing, recorded the lowest rates. The effect of import prices is clear at the two extremes; the different import contents of the two groups and their respective prices are clearly reflected in the domestic prices. If consideration is given only to the last six months, the uneven rates of acceleration are seen to persist, and beverages and other foodstuffs, with a high import content, are included among the most dynamic groups.

It seems idle to go any further into a description of the inflationary situation in Costa Rica. The information given is sufficient to identify the period in which prices started to rise, the magnitude of the increases, their acceleration and disparities. Obviously it would have been more illuminating to analyse a larger group of price indicators, but a broader coverage would yield only marginal benefits and would not change the essence of this description.

Table 19

COSTA RICA: COMPONENTS OF THE WHOLESALE PRICE INDEX

(Base: 1966=100)

	1971	1972	1973	Percentage variation 1971-1973	June 1974	Percentage variation 1971-June 1974
Average general index of domestic goods	131.2	137.8	158.4	20.7	224.9	71.4
Average general index of imported goods	118.1	126.9	154.1	30.5	221.3	87.4
General index	128.0	135.0	157.0	22.7	223.7	74.8

Source: Banco Central de Costa Rica.

Table 20

## COSTA RICA: WHOLESALE PRICE INDEX BY GROUPS OF PRODUCTS

(Base: 1966=100)

	General index	Production of animal origin	Production of vegetable origin	Beverages and other foodstuffs	Fuels and electricity	Textile products and leather	Construction materials	Chemical products	Miscel- laneous products
June 1971	128.3	134.9	182.5	117.0	113.9	114.5	131.9	107.2	115.3
December 1971	130.3	136.8	187.8	117.7	114.1	120.3	127.0	106.1	123.9
June 1972	135.3	140.3	208.6	118.1	118.7	123.8	132.9	110.3	125.7
December 1972	140.4	142.7	209.2	121.1	119.9	134.7	143.9	114.9	132.9
June 1973	153.5	160.1	239.0	122.9	127.8	147.9	161.1	124.2	145.3
December 1973	177.6	170.3	267.6	162.6	143.9	189.9	185.6	136.1	159.4
June 1974	223.7	206.6	319.1	198.6	242.1	226.2	234.7	182.6	184.3
Variation between June 1971 and June 1974	74.4	53.3	74.8	69.7	112.6	97.6	77.9	70.3	59.8
Variation between June 1973 and June 1974	45.7	29.0	33.5	61.6	89.4	52.9	45.7	47.0	26.8

Source: OFIPLAN and Dirección General de Estadística y Censos.

#### D. THE FACTORS OF INFLATION

Contrary to what happens in other countries, especially those characterized by long-established inflationary processes, inflation in Costa Rica does not appear to have its main root in structural origins. Although obvious structural traits may be identified in the external sector, especially if it is recalled that bananas and coffee, with their traditional fluctuations in prices, continued to be decisive in the structure of exports, and that there is heavy dependence on imported supplies, this is not the case from the point of view of the function of production, the nature of the ownership system or in the perspective of the accumulation process. To put it in other terms, the whole panorama of structural inadequacies typical of other countries is not repeated here. The high rates of growth and capital formation recorded in the 1960s and the price stability which accompanied them and characterized the economy, suggest a situation in which economic growth was accompanied by a satisfactory degree of balance in the parts and variables of the system. The price rises of recent times, however, obviously indicate the presence of maladjustments in this coherent state of affairs.

To describe inflation in Costa Rica, two moments must be distinguished in its evolution - the initial impulses, and the speeding-up of the process. Each of these moments appear to fit in with one of two types of inflationary factors - those known as conjunctural factors and structural factors. As will be seen below, the moments and factors referred to may be clearly recognized in the two sub-periods into which the inflationary process is divided.

A reflexion of a general nature may, however, be included at this point. In other countries, the origins of the persistent price rises were generally to be found in the base of the economic system, and stemmed from structural disequilibria: existing economic phenomena explained the rapid dissemination and virulence of the inflation, and the interaction of the two types of disequilibria made up the classic pattern of inflation. The analysis of inflation in Costa Rica, both in

/its initial

its initial stage and in its re-emergence, suggests the possibility that the reproduction sequence of the inflation may have taken the reverse road: the price rises made their appearance basically motivated by domestic and external economic phenomena connected with the situation, while the structural features proper, especially as regards dependence on imported supplies, would explain the propagation of the phenomenon.

The above considerations tend to give State action as regards economic policy considerable manoeuvring space in steering the economic system. This is not the case in other countries, exhausted by generalized structural problems, where economic policy decisions only marginally modify the operation of economic activity.

#### 1. Inflation in 1970-1971

The data on the annual movements of prices showed a first change of pace at the beginning of the 1970s. The rate of increase in the period 1965-1969 was about 4 per cent; in 1970 this rose to 6.2 per cent and in 1971 to 6.7 per cent.<sup>101/</sup> Although these amounts may seem small, it is to be noted that they signify an increase of more than 50 per cent compared with the rate of the previous five years; they obviously constitute the beginning of recent inflation in Costa Rica. It would seem clear that these increases are directly related to the increase in the liquidity of the economy and its loss of dynamism. In the first part of the present document the drop in the growth rates of the product in the majority of the branches of economic activity was described. Consequently, other conjunctural variables require to be analysed since, as expected, they would appear to explain to a considerable extent the first advances of inflation. Table 21 sums up the monetary balance of Costa Rica, the outstanding features of which are variations in the monetary flows which coincide exactly with the increases in prices.

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<sup>101/</sup> Rates from the wholesale price index (see table 17).

Table 21

## COSTA RICA: MONETARY BALANCE

(Millions of colones at current prices: balances at end of each period)

	1969	Annual rate	1970	Annual rate	1971	Annual rate	1972	Annual rate	1973	Annual rate
Factors of monetary absorption	1 497.2	9.0	1 591.2	6.3	2 251.1	41.4	2 629.2	16.8	2 965.3	12.8
Money	1 014.5	14.5	1 099.1	8.3	1 416.0	28.8	1 617.3	14.2	2 007.7	24.1
Quasi-money	299.2	7.8	396.7	12.6	640.8	90.2	855.6	33.5	951.1	11.2
Long-term indebtedness	54.9	-27.5	40.5	-26.2	69.0	70.4	79.1	14.6	72.6	-9.2
Other items (net)	128.6	-4.9	114.9	-10.7	125.3	9.1	77.2	-39.4	-66.1	-
Factors of monetary expansion	1 497.2	9.0	1 591.4	6.3	2 250.8	41.4	2 629.3	16.8	2 965.5	12.8
Reserves	114.3	-65.5	42.2	-63.1	173.4	310.9	189.1	9.1	276.4	46.2
Domestic credit (net)	1 382.9	3.1	1 549.2	12.0	2 077.4	34.1	2 440.2	17.5	2 689.1	10.2
a) To the Government	258.5	-8.1	207.4	-19.8	251.7	21.4	379.0	50.6	274.8	-27.5
b) To official institutions	20.3	-43.8	29.3	44.3	73.5	150.9	83.3	13.3	163.3	96.0
c) To the private sector	1 104.1	7.9	1 312.5	18.9	1 752.1	33.5	1 977.9	12.9	2 221.3	12.3

Source: International Monetary Fund, International Financial Statistics, November 1974

/The changes

The changes in monetary resources are notable for their magnitude. It may be seen that money showed an increase of 8.3 per cent in 1970 and 28.8 per cent in 1971; quasi-money similarly recorded appreciable increases: 12.6 per cent in 1970 and 90.2 per cent in 1971. Although long-term indebtedness declined in 1970, it increased by 70.4 per cent in 1971.

As regards the factors of expansion, the increases in domestic credit at a rate of 12 per cent and 34.1 per cent in the first two years of the present decade indicates an appreciable increase in the liquidity of the economic system. The private sector figures as the main beneficiary of the increase in money. During 1970, the increase in the credit granted to it by the financial system was 18.9 per cent, while this increase was 33.5 per cent in 1971; this meant that its share in the absorption of credit exceeded 80 per cent of the total. The absolute figures of these volumes of credit nearly doubled the amounts of fixed capital investment which the private sector made during those years.

The structure of credits to the private sector has clear inflationary implications. While in the five-year period 1966-1970 nearly 90 per cent of this type of credit was devoted to financing industrial and agricultural activities, this percentage dropped to 54 per cent in 1971, giving way to personal type and service credits which reached increasingly large proportions.<sup>102/</sup> It is not difficult to see that this variation in the structure of the credit goes against the flexibility of supply and generates demand effects which put pressure on prices. The disparities observed in the price increases of different items may have a complementary explanation in terms of the product most in demand for the socio-economic groups benefiting from the credit policy.

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<sup>102/</sup> Inter-American Committee on the Alliance for Progress (CIAP), Sub-Committee on Costa Rica (18-22 September 1972), document prepared by the secretariat, p. 44.



Although the increased liquidity of the economic system tended to originate in the credit to the private sector, the liquidity which took its origins from the public sector did not cease to be important. If fiscal performance is examined, the remarkable increase in the budget deficit during 1971 stands out (see table 22). In fact, the deficit in 1971 was twice that for 1970, and amounted to 216 million colones, more than 40 per cent of which was financed with domestic credit. The magnitude of this budgetary imbalance may be explained by a slow increase in incomes (3.1 per cent) vis-à-vis the significant expansion of current expenditure (18.1 per cent) and capital expenditure (36 per cent). Consequently, fiscal performance in 1971 offered an additional boost to inflationary pressures, particularly if the increases in money are related to the magnitude of the deficit in the two-year period under analysis. These appreciations coincide with those which emerge from the analysis of the amounts of credit granted to the Government and other official institutions by the finance system (see table 21).

The other element which affected the expansion of the monetary system was the performance of international reserves. The decline noted in 1970 contrasted with the extraordinary growth of 1971, which increased 70 per cent compared with 1969 and 311 per cent compared with 1970. The increased liquidity apparent in the economy of Costa Rica found a major cause in the growth already mentioned, the magnitude of which in 1971 accounted for over 40 per cent of the increase in the money supply in 1971 (see table 21).

Table 22

COSTA RICA: FISCAL SITUATION OF THE PUBLIC SECTOR

(Millions of colones at current prices)

	1969	1970	Annual rate	1971	Annual rate
Current income of Central Government	719	883	22.8	910	3.1
Current expenditure of Central Government	685	769	12.3	908	18.1
Savings in current account	34	114	-	2	-
Savings of rest of public sector	133	191	-	262	-
Total public savings	167	305	-	264	-
Capital expenditure	352	361	2.5	491	36.0
Amortization of the debt	115	139	20.9	151	8.6
Gross deficit	298	195	-34.6	378	93.8
Finance	298	195	-34.6	378	93.8
External credit	83	174	109.6	216	24.1
Domestic credit	215	21	-90.3	162	671.4

Source: CIAP, Sub-Committee on Costa Rica (18-22 September 1972), document prepared by the Secretariat, table II-12.

/The description

The description in the foregoing pages of the main movements of the financial variables leaves no doubts as regards the impact of internal inflationary factors when inflation began in Costa Rica. Although during 1970 the influence of some factors was partially countered by others, in 1971 it is clearly to be noted that they all point in the same direction. The policy of re-activating the economy by granting increasing credits to the Government, to official institutions and, principally, to the private sector, did not have further violent repercussions on the level of prices, basically because imports increased by 7.1 per cent in real terms while stocks declined to a significant extent. Both variations constituted factors of flexibility in the supply of goods which in fact made it possible to mitigate the effect of the inflation. It is also necessary to take into account a further element which played its part against inflation during the period under analysis. The behaviour of consumers and producers was deeply rooted in the period of stability which previously characterized Costa Rica. Expansions like those observed in 1970 and more particularly in 1971, in countries whose agents are accustomed to defend themselves against inflation, would probably have had greater effect on prices.

Up to this point an attempt has been made to describe the main features of the first period of inflation in Costa Rica: conjunctural imbalances which later combined with structural factors and marked the beginning of inflationary pressures which are now hitting the economy of Costa Rica harder. The analysis of the main economic policy measures, particularly in exchange, which have certainly played a role of some importance, has deliberately been left for the last chapter.

## 2. Inflation during the period 1972-1973

The break-up of the basic stable aspects of the economic system, which was described in the analysis of the period when the first inflationary pressures emerged, does not seem to have improved in the years which followed, despite the Government's efforts. In 1973 a

/group of

group of new inflationary factors originating in the performance of the external sector appeared in this area which was in itself fertile ground for new price increases. The international markets showed unexpected price movements and influenced decisively the economy of Costa Rica. A description of the evolution of prices since 1972 to the present day requires the previous identification of the main factors of inflation which originate in the external sector, and their effects on economic activity.

(a) Imported inflation

The important increases in the prices of a large number of commodities involved in international trade first affects importing countries through the rise in prices of products from abroad, with clear repercussions on domestic prices. Although these repercussions vary according to whether the imports are of final goods or inputs, their multiplier effects on domestic prices are obvious. The increases in the costs of production and distribution constitute a direct response to this type of movement of external origin, and the effect of their manifestation is usually the unleashing of price rises in other products, including products which have nothing to do with external trade. The situation of international prices, however, does not only affect the levels of domestic prices through imports; increases in export prices, although they have an unquestionably favourable effect on the balance of payment, may give rise to inflationary pressures. Any unusual growth in the value of exports generates liquidity in national currency which does not always find an immediate response in increases in total supply; nor do imports, and even less production, react as rapidly as the increases in demand appear in the market. On the other hand, the structures of these two types of variation do not always coincide, and this produces maladjustments which may affect the system and the level of prices.

An increase of any size in export prices may also have inflationary effects when external market prices attract a growing share of production, causing shortages in the domestic market; this is the case of activities destined for export or aimed at satisfying the

/requirements of

requirements of the domestic market. It should be recalled that in countries where it has been attempted to rectify this situation by fixing export quotas in order to safeguard national supply, heavy flows of illegal trade have appeared and aggravated the problems of scarcity.

Increases of any size in international reserves, especially those which originate in conjunctural movements of export prices or inflows of foreign finance, also tend to have inflationary effects. Spending capacity on investment producing this type of surplus does not always stand at the same level as the consumer's spending capacity.

Lastly, it should be added that the behaviour of the agents of the socio-economic system, in the case of manifest inflation and even more so in an international situation of price rises, constitutes a factor of inflation which is by no means to be despised. In their haste to defend themselves and on occasion to profit from the inflation itself, they act in such a way that they promote new price increases. In such cases, the importer groups, when they introduce criteria for the cost of replacing imported merchandise in setting their selling prices, become in turn agents for the import of inflation.

(b) Factors of inflation

The main feature of the re-emergence of inflation in Costa Rica lies in the simultaneous presence of three factors of inflation: the slow growth of production, the persistent increase in the liquidity of the system and the violent impact of imported inflation.

The growth rates of sectoral production described in the first part make unnecessary any comment on the loss of dynamism in economic activity; it is, however, worth repeating that the slow growth of agriculture is one of the most significant facts.

As regards increases in liquidity, the persistent increase of the factors of monetary expansion may be observed. Credit grew by 17.5 per cent in 1972 and 10.2 per cent in 1973; similarly, international reserves showed growth rates which also signified a considerable monetary expansion, when they increased by 9.1 per cent in 1972 and 46.2 per cent in 1973 (see table 21).

/These increases

These increases in the factors of expansion may partly be explained by the growing deficit in the budget, as may be seen from table 23.

Table 23

FINANCING OF BUDGETARY EXPENDITURE  
(Millions of colones at current prices)

	1971	1972	1973
Total expenditure	1 250.7	1 433.4	1 892.3
Current income	908.4	1 040.3	1 386.6
Deficit	342.3	393.1	505.7
Financing			
With external credit	106.9	175.2	198.2
With domestic credit	174.0	232.3	302.6
With other resources	81.4	-14.4	4.9

Source: Ministry of Finance of Costa Rica.

The budgetary deficit shows appreciable increases, especially in 1973 (over 28 per cent) and it is financed for the most part by domestic credits.

The increases in credits to the private sector may be explained by an important transformation in the finance system stemming from the operation of new financial institutions, as will be seen when the main economic policy measures are described.

As from 1972 and especially in 1973, the external sector of Costa Rica underwent a fundamental change as regards prices. Import prices in this period showed unexpected increases (8 per cent in 1972 and 15 per cent in 1973) compared with an annual 3 per cent during the period 1965-1971. This sudden increase, together with the large share of imports in the country's economy, affected domestic prices

/as a

as a matter of course. In fact, as has already been observed, inflation speeded up after 1973 and its heavy dependence on imported supplies lessened the possibilities of cushioning the effects of imported inflation.

The indicators summarized below show clearly how the three factors of inflation already mentioned behaved compatibly with the speeding-up of inflation (see table 24).

Table 24

COSTA RICA: INDICATORS OF INFLATION  
(Percentage variations)

	Monetary expansion	Growth of the product	Import price index	Wholesale price index
1972	17	5.0	8%	5.4
1973	13	3.9	15%	16.4

Source: Tables 2, 12, 17 and 21.

Taking the analysis of inflation during the period in more detail, it may be seen that the indicators of inflation for 1972 give evidence of certain asynchronisms which have no convincing explanation (see table 17). On the one hand, the speeds of growth of the three indicators mentioned do not coincide. Both the retail price index and the deflator implicit in the product show increases greater than those recorded the previous year, while the wholesale price index shows a slower rate than in 1971. Attempts to reduce increases in monetary expansion would seem to have been successful in mitigating the rise in prices (see table 21), despite the extremely small increase in the quantum imported (1.1 per cent in 1972).

As has already been seen, the events of 1973 were very different. In this year the different factors of inflation acted in the same direction, forming an extremely clear picture in which the performances of these sectors were mutually complementary. There is no doubt that

/the initial

the initial impulse for the re-emergence of price increases came from imported inflation. Heavy dependence on imported inputs and final goods was a very vulnerable flank of the Costa Rican economy, and paved the way to the spread of the initial impetus. It is not easy to say what share the different factors analysed have in the process of inflation, since reciprocal interaction reproduces price increases the origin of which it is difficult to identify. Without recourse to simplifying expedients, it is difficult to make a strictly accurate dissection of the situation. However, during this last period the reasons given above tend to assign imported inflation a more decisive influence, and this opinion is confirmed by the detailed analysis of the price increases given below.

(c) The evolution of inflation

Tables 25 and 26 contain detailed information on the variations in wholesale prices during the two-half-year periods of 1973, and this makes possible a more authentic identification of the recent process of inflation. The items which show the largest price increase during that period and which, in view of their weighting within the whole, have a strong influence on wholesale price movements have been selected.

The data given in table 25, which refer to the first half of 1973, indicate the important influence of the price increases in agricultural commodities, such as meat, fresh fruit and vegetables and, following these in order of importance, the price of construction materials and various paper products. As regards meat and hides, which carry great weight in the economy of the country and in the general level of prices, the importance of the changes in their export prices should be underlined. The international price of beef rose during the first half of 1973 by approximately 65 per cent. This increase, of course, had a favourable effect on the balance of payments, but at the same time produced increases in domestic prices. It is usual for producers, faced with differently priced markets, to direct their sales so as to make maximum profits. If it is also borne in mind that exchange modifications were a further stimulus to exports, the pressure on domestic prices had of a necessity to find their expression by materializing in increases like those described (see table 25).



Table 25

COSTA RICA: VARIATIONS OF WHOLESALE PRICES DURING THE FIRST HALF OF 1973

(Percentages)

Item	Variation between December 1972 and June 1973	Weighting at 31 December 1972	Impact on the general index
Meat	27.9	7.5	2.1
Vegetables	19.2	5.5	1.0
Fresh fruit	31.8	10.5 <sup>a/</sup>	3.3
Textile products	15.4	1.1	0.2
Hides	21.3	0.7	0.1
Construction materials	12.0	13.3	1.6
Fertilizers	12.9	1.9	0.2
Clothing	9.5	4.4	0.4
Footwear	9.8	1.4	0.1
Articles for the household	9.7	1.4	0.1
<u>Various paper products</u>	15.0	3.0	0.4
Group of above items	18.7	50.7	9.5
Remaining items in the index <sup>b/</sup>	-0.4	49.3	-0.2
<u>General index</u>	<u>2.3</u>	<u>100.0</u>	<u>2.3</u>

Source: OFIPLAN, estimates of the United Nations Advisory Group.

<sup>a/</sup> The high weighting of this item does not fail to be remarkable.

<sup>b/</sup> There is a small difference in the estimate compared with the source used.

Table 26

COSTA RICA: VARIATIONS IN WHOLESALE PRICES DURING THE SECOND HALF OF 1973

(Percentages)

Item	Variation between June 1973 and December 1973	Weighting at 30 June 1973	Impact on the general index
Vegetables	35.4	6.0	2.1
Alcoholic beverages	18.5	3.7	0.7
Other foodstuffs	53.3	6.0	3.2
Textiles and wool yarn	208.3	0.3	0.6
Textiles and cotton yarn	23.0	3.8	0.9
Jute and hemp	25.0	0.3	0.1
Hides	19.0	0.8	0.2
Construction materials	15.2	13.6	2.0
Fertilizers	25.7	2.0	0.5
Various paper products	20.6	3.2	0.7
Group of above items	27.6	39.7	11.0
Rest of items in the index	7.9	60.3	4.7
General index	15.7	100.0	15.7

Source: OFIPLAN, estimates of the United Nations Advisory Group.

/Among other

Among other items where price rises cannot be attributed to seasonal variations, mention may be made of construction materials, fertilizers and various paper products. In such cases, the modifications in domestic prices are basically to be explained by price increases in imported inputs and final products, to which should be added the modifications in the exchange rate which will be analysed at a later stage.

Lastly, fresh fruit and vegetables showed surprising increases. In the case of the former there is a distinct problem with middlemen who take profit margins which are unreasonably excessive; the differences between producer prices and wholesale distribution prices are considerable.

As regards vegetables, the representative product is the bean, which is a basic element of the diet, four-fifths of which is imported. The price of importing this product underwent excessive increases: the cost of importing one ton increased from 270 to 970 dollars between the beginning of 1973 and April 1974.

The influence of the external sector in the increase of domestic prices in the first half of 1973 is therefore clear. It is, however, useful to point out once again that these movements of external origin were accompanied by significant increases in the liquidity of the Costa Rican economy.

It may be seen once again in table 26, which sums up the main price rises during the second half of 1973, that external inflation continued to have a decisive influence. Vegetables, other foodstuffs, textile products, fertilizers and various paper products are closely linked to some form of external supply and thus subject to international variations in their prices. Construction materials, experienced the effect of external prices, and also faced a growing domestic demand, which at times caused problems of shortage and gave impulse to the increasing trend.

### 3. Inflation in the first half of 1974

Data available for the first half of 1974 show clearly that the inflationary process is becoming stronger. The half-yearly rate recorded for the wholesale price index is 26 per cent, well above previous half-yearly variations (see table 18).

It would appear that the inflationary factors of importance during 1973 continued in full force during this period, since monetary expansion recorded a rate of increase of the order of 9 per cent and import prices increased by 31 per cent in 1974, according to data from the International Monetary Fund, International Financial Statistics, November 1974.

Some preliminary estimates of the current value of imports during the first half of 1974, which fluctuated around 300 million dollars - nearly 50 per cent up on imports for the same period in 1973 - show clearly the impact of import prices, while the quantum imported, using the same estimates, shows no significant increase.<sup>103/</sup>

The products which underwent the largest increases during this period confirm the above considerations (see table 27). The most important increases are, of course, in fuels, fertilizers, electricity and electrical articles for domestic use, soap, wax, insecticides and fungicides; important increases are also to be seen in milk products, sugar, bread, cereals, etc.

Although 15 items showed rises of over 20 per cent during the half-year, the most serious effects were concentrated in fuels, construction materials and sugar, bread and others. In that the price increases were 85.5 per cent for fuels, 26.5 per cent for construction materials and sugar and 35.6 for bread and others, their impact on the structure and level of prices was considerable. The extraordinary increase in the price of an input as extensively used as fuel causes very widespread and sometimes multiple repercussions in the price structure of an economy. Price increases in construction materials also have a great dissemination capacity. Price increases in sugar and bread are no less important, these two products being very closely linked to the cost of living. From this angle, the Government's intention to maintain the purchasing power of wages and pressures from the trade union sectors became part of the group of elements which affected prices.

<sup>103/</sup> Preliminary estimates of OFIPLAN.

Table 27

COSTA RICA: VARIATION IN WHOLESALE PRICES DURING THE FIRST HALF OF 1974

(Percentages)

Item	Variation between December 1973 and June 1974	Weighting at 31 December 1974	Impact on the general index
Fuel	85.5	3.9	3.3
Electricity	36.8	2.1	0.8
Milk products	38.1	3.2	1.2
Meat	16.7	8.2	1.4
Manufactured products of animal origin	20.4	1.8	0.4
Cereals	29.3	3.6	1.1
Dried fruits	23.5	2.3	0.5
Sugar, bread and others	35.6	8.0	2.8
Cotton fabrics	29.4	4.0	1.2
Construction materials	26.5	13.5	3.6
Fertilizers	57.4	2.2	1.2
Insecticides and fungicides	34.4	0.7	0.2
Soap and wax	41.1	3.3	1.4
Men's clothing	21.6	4.1	0.9
Electrical articles for domestic use	32.7	1.2	0.4
Group of above items	31.6	62.1	19.6
Rest of items in the index	16.9	37.9	6.4
General index	26.0	100.0	26.0

Source: CEIPLAN, United Nations Advisory Group.

/The rise

The rise in wholesale prices between June 1973 and June 1974 amounted to 45.8 per cent, and this could indicate the magnitude of the annual growth of wholesale prices during this past year. If recent trends should have continued during the second half of 1974, the increase in these prices could exceed the rate recorded between June 1973 and June 1974. It is not easy to estimate this, since it depends on phenomena of external origin and on the economic policy measures which could be introduced.

#### 4. The peculiarity of inflation in Costa Rica

The description and analysis of the above points enable inflation in Costa Rica to be qualified as a very special, and in some aspects a typical phenomenon. External inflation which determines the formation of domestic prices has direct repercussions on the base of economic system and filters into the rest of the economic sphere in some very curious forms. When it does not suffer the direct impact of import prices, it shows the indirect effects of the variations in export prices, which latterly also take the form of pressures on domestic prices. An example to illustrate this is that of milk products, which underwent a price rise of 38.1 per cent in the first half of 1974: international prices provided the incentive for livestock activity to produce beef, to the detriment of the production of milk and its products.

The basic elements of a price, when the system is stable, are given basically by the cost of production, the cost of distribution, taxes and the different profit margins in the various cases of intermediation between the producer and the consumer. The profit margins are in turn mainly a function of the supply and demand relationship of the product. In situations of manifest inflation, as in Costa Rica, these components undergo pressures both from costs and from demand. External inflation, as has been seen, increased the cost of imported inputs and final products on first impact, and this may be qualified as a case of inflation of costs of external origin; as has already been said, the high import coefficients of Costa Rica make the country very vulnerable to this type of inflation. This feature of the structure of the economy meant that the first impact was propagated and reproduced fairly freely in economic activity. The increase in import prices meant heavy deficits in the current account, while the inflow of external finance made  
/increased imports

increased imports possible and signified disequilibria in the monetary system which in turn gave rise to new inflationary pressures.

The different factors of inflation succeeded each other in time and finally as from mid 1973 made up a process in which the inflationary pressures were receiving internal and external stimuli, while their dissemination in the economic system was made easier by the structural disequilibria already described.

#### E. INFLATION AND MAIN ECONOMIC POLICY MEASURES

The purpose of the previous chapters was to examine the most important economic phenomena connected with the interpretation of the recent inflationary process in Costa Rica. Government measures affecting variations in domestic prices have been expressly excluded from this interpretation, since it would have been difficult to examine economic policy measures simultaneously with the factors of inflation. Now that the latter have been identified, it is easier to evaluate the effect of the principal measures and instruments, which shed additional and invaluable light on the subject.

It must be clearly understood from the outset that during the period under review there was no anti-inflationary policy of the kind adopted by other countries long affected by inflation, in which it is even possible to identify different attempts based on a variety of strategies. In the case of Costa Rica, inflation was a new phenomenon and the measures put into effect by the Government over the last three-year period were the result of pragmatic decisions rather than of an integral conception of stabilization policies. Moreover, the principal measures had other objectives, but inflation in some degree distorted the expected results, and thus triggered a different type of inflationary pressures.

##### 1. Public sector financing policy

The figures on total budget expenditure shown in table 28 indicate a trend towards the strengthening of the public sector's position. The growth of public investment at a rate of 36 per cent in the last three-year period confirms this view. The implementation of this policy was financed with funds from abroad and with domestic resources.

Table 28

COSTA RICA: TOTAL BUDGET EXPENDITURE AND FINANCING

(Millions of colones at current prices)

	1971	1972 <sup>a/</sup>	1973
Budget expenditure	1 242.9	1 409.3	1 865.4
Administration expenditure	718.2	853.0	1 023.6
Legislature	15.5	17.6	19.6
Executive	649.8	772.0	905.1
Judiciary	45.5	52.7	61.5
Elections tribunal	7.4	18.7	36.4
Current and capital transfers	314.3	326.0	460.2
Debt service payments	188.9	214.5	287.9
Investment in semi-public enterprises	-	-	69.2
Floating debt	-	-	12.0
Loans to public institutions	21.9	8.8	12.5
Adjustments 13th month and other	7.8	24.1	26.9
Total expenditure	1 250.7	1 433.4	1 892.3
Current income	908.4	1 040.3	1 386.6
Deficit	342.3	393.1	505.7
Financing of the deficit			
With external credit	106.9	175.2	198.2
With domestic credit	174.0	232.3	302.6
Other resources	81.4	-14.4	4.9

Source: Ministry of Finance of Costa Rica.

<sup>a/</sup> Some minor discrepancies in 1972 derive from the preliminary data available.

/The most



The most important measure from the standpoint of public sector financing and as an instrument for guiding the economic process was undoubtedly the tax reform of March 1972.<sup>104/</sup> principal changes introduced at that time relate to the general sales tax and selective taxes on consumption, and to taxes on income of private persons and enterprises.

With respect to the tax on transactions in goods and services, a distinction was made between the general sales tax and the selective taxes on goods according to the extent to which they were considered to be essential products. A general rate of 5 per cent was established on the price of transactions - a single rate payable at one stage only - and a supplementary group of rates ranging from 10 to 50 per cent, also payable in one stage, for a specific list of products. The Executive was authorized to alter the content of this list and the respective rates, so that this instrument would have the required flexibility.<sup>105/</sup>

As regards personal income tax, the main feature of the reform is that the rates are more progressive, although bigger deductions are made for dependants. The old scale comprising 30 income strata, with rates ranging from 1 to 30 per cent, was converted into a scale of 12 strata, the rates ranging from 5 to 50 per cent. In the same spirit, the minimum income for professionals, which was assumed to be 10,000 colones annually, was raised in accordance with a scale extending from 40,000 colones for professionals with studies of four years' duration to 70,000 colones for surgeons.

The reform of taxes on profits of enterprises also introduced more progressive rates; four strata were established with rates ranging from 5 to 40 per cent. As regards taxes on profits

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<sup>104/</sup> Banco Central de Costa Rica "Ley de Reforma Tributaria", Memoria Anual, 1972, vol. 3.

<sup>105/</sup> Banco Central de Costa Rica, "Ley de impuesto sobre ventas y ley de consolidación de impuestos selectivos al consumo", op.cit.

remitted abroad, on the whole, the rates were increased, and other single taxes were levied.<sup>106/</sup>

These reforms had a significant effect on the amount and structure of government income: table 29 shows the amounts collected in respect of the principal items.

A particularly striking fact in the analysis of inflation in Costa Rica is the extraordinary increase in indirect taxes on consumption. These taxes rose by over 400 per cent between 1971 and 1973, which raised their share in indirect taxes from 6.2 per cent to 21.4 per cent over those years. The transfer of these taxes to prices was legally authorized,<sup>107/</sup> so that their effect on price levels was an additional factor of inflation, especially if it is considered that the increased tax collections financed more public spending, with all its implications in terms of the growth of demand for goods and services.

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<sup>106/</sup> The following items are identified:

- (a) Public entertainment: the rate was raised from 5 to 10 per cent;
- (b) News service, records, etc.: the rate was fixed at 20 per cent;
- (c) Fees paid to members of boards of directors and for technical services and royalties: 20 per cent;
- (d) Dividends and shares: fixed at 15 per cent;
- (e) Interest on loans: fixed at 10 per cent;
- (f) Income from films for cinema, television, etc.: raised from 5 to 10 per cent.

Source: Inter-American Committee on the Alliance for Progress (CIAP), Sub-Committee on Costa Rica, report mentioned previously.

<sup>107/</sup> Tax Reform Law, chapter VIII, article 18. Price control: the Department of Internal Trade of the Ministry of Industry and Trade shall ensure that prices of goods not subject to selective consumer taxes are not adjusted as a result of the promulgation of this Law, and also that the prices of goods liable to tax are not increased unduly owing to the levying of these taxes.

Table 29

COSTA RICA: COMPOSITION OF TAX REVENUE

(Millions of colones at current prices)

	1971	1972	1973	Percentage variation 1971-1973
Tax revenue	826.2	934.5	1 254.2	51.8
Direct taxes	190.3	227.7	309.5	62.6
Income tax	182.8	213.0	291.1	59.2
Other direct taxes	7.5	14.7	18.4	145.3
Indirect taxes	635.9	706.8	944.7	48.6
Taxes on cigarettes and alcoholic beverages	79.4	85.0	99.9	25.8
Taxes on consumption	39.4	121.9	201.8	412.2
Taxes on sales	115.6	131.5	160.3	38.7
Taxes on gasoline consumption	56.9	62.5	68.6	20.6
Import taxes	192.0	159.4	196.8	2.5
Export taxes	4.8	5.6	6.7	39.6
Taxes on coffee	29.3	27.2	67.8	131.4
Stamp tax	11.1	12.9	17.3	55.9
Economic stabilization tax	62.7	50.4	64.8	3.3
Other indirect taxes	44.7	50.4	60.7	35.8

Source: Ministry of Finance of Costa Rica.

/It will

It will be recalled that the years 1972 and 1973, in particular, showed rising deficits, and the financing of these deficits, with external resources or domestic credit, led in one way or another to an increase in the money in circulation (see table 28). Capital expenditure, which expanded significantly, was not generally reflected in increases in the supply of goods and services which might have counteracted the pressures on prices. The maturity periods and rate of investment generated demand effects, and only marginally produced some indirect flexibility of supply. As may be observed, the higher taxes, which had already had some inflationary impact, financed an appreciable expansion of budget expenditure, which also affected price levels.

## 2. Private sector financing

As regards the financing of the public sector, it is useful to note that the establishment of a group of financial institutions in September 1972 marked an important change in the general system of financing. Up to that time it had been the exclusive prerogative of State banks to tap savings deposits and grant loans to enterprises and private persons; since then this right has been accorded to other financial intermediaries engaged in the following activities:<sup>108/</sup> provision of funds, working capital and general financing for activities performed by other enterprises, associations or physical persons; and purchase of shares, bonds, securities and other financial or credit instruments or securities issued by other enterprises or associations. Physical persons engaged in these activities were also included in this category of financial associations. The boom experienced by these institutions, which tapped an increasing amount of savings, is accounted for by the fact that they paid higher interest rates than the banks. They supplied operating capital to industrial and commercial enterprises, which in their turn were able to give

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<sup>108/</sup> "Ley de regulación de sociedades financieras de inversión y de crédito especial de carácter no bancario", La Gaceta, Nº 180, 22 September 1972.

credit to their clients, particularly for the purchase of durable consumer goods. This mechanism has obviously affected prices, both from the standpoint of the higher cost of money and from that of its faster circulation and the consequent increase in the propensity to consume which is generally the result of consumer credit.

In discussing the increases in liquidity in the economic system, it was noted that the private sector was the main beneficiary of the credit granted, since it obtained a consistently high proportion of it (see table 21). The figures for the monetary balance show that the policy of providing financial backing for private activities, basically those connected with exports of manufactures, has been the Government's constant concern in the period under review.

### 3. Foreign exchange policy

The balance of payments position in 1969 and 1970 was the cause of significant reductions in international reserves (65 per cent in 1969 and 63 per cent in 1970). Since projections for 1971 also indicated an unsatisfactory situation with regard to foreign trade, the Government decided to modify its foreign exchange policy.

As from the middle of June 1971, the Costa Rican monetary authorities introduced modifications involving the establishment of a dual system of foreign exchange.<sup>109/</sup> An official market was established for essential transactions for economic development purposes, with a rate of 6.65 colones to the dollar, and a free market for other operations. A month later a system of exchange surcharges was introduced whereby imports were grouped in three categories according to how far they were considered as essential goods. The first category of products was exempt, while the other two were liable to surcharges of 15 and 30 per cent. As in the previous case, the distinction was based on the nature of the imports in relation to development aims.

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<sup>109/</sup> See Banco Central de Costa Rica, "Exposición sobre medidas adoptadas para corregir el problema de la balanza de pagos", Memoria anual, 1971, vol. 3.

Although the dual and foreign exchange surcharge systems enabled a certain control to be exercised over the use of foreign exchange, they did not have the desired results since other items were gradually added to the preferential import list and operations on the official market amounted to about 90 per cent of the total. The main reason for enlarging the list was the difficulty of placing exports in the Central American market, in view of the rise in production costs as a result of the exchange surcharges.

At the beginning of 1972, Costa Rica returned to the dual exchange system, but the preferential list continued to have a decisive effect, since almost 80 per cent of the value of transactions was carried out on the official market. Since by the middle of 1972 the position with regard to the balance of payments and international reserves had not shown much improvement, in October of that year the preferential list was drastically cut down, only 85 items of the Central American Standard Customs Nomenclature (NAUCA) remaining out of the 450 on the previous preferential list.

These new restrictions in obtaining foreign exchange on the official market made imports more expensive, which raised the production costs of export industries relying on imported inputs. To offset the higher production costs and ensure that much exporters' possibilities of competing on the Central American market were not jeopardized, they were authorized to liquidate on the free market 50 per cent of the foreign exchange obtained from exports. This benefit was also accorded to exporters of non-traditional agricultural and fisheries products. The free market rate of exchange was 8.60 colones to the dollar, or 30 per cent higher than the rate on the official market. Although the list of 85 items was increased, operations on the official market came to represent 22 per cent of total imports, a proportion which rose to 30 per cent in 1973 when new import items were introduced in this market.

The concession of liquidating on the free market 50 per cent of the foreign exchange obtained from non-traditional industrial and

/agricultural exports

agricultural exports was also extended to the independent banana producers, up to 39 per cent of their total sales abroad.

The policy of discrimination in the use of foreign exchange slowed the growth of imports during the first half of 1973, an additional factor being the increased prices, mainly of raw materials for industry and, of course, fuels.

From the angle of interpreting the inflationary process, the exchange policy adopted in the three-year period concerned - whether through the dual foreign exchange market or foreign exchange surcharges - has in different ways made certain imports more expensive. It is even likely, from this point of view, that the efforts to solve the balance of payments problem have given additional impetus to the rise in production costs. A wide range of imported inputs, besides becoming more expensive in terms of foreign exchange owing to external inflation, underwent further increases in national currency owing to the rise in the exchange rate. The combination of these effects exerted pressure on domestic prices on the cost side.

Furthermore, the reduction in the amount of money in circulation which is attributable to the sales of foreign exchange at higher exchange rates, was more than offset by the increases in liquidity resulting from bank credit to the private and public sectors and the inflow of foreign capital, which also meant increases in the money in circulation. In addition, the possibility of a major part of the value of exports being liquidated on the free market at a rate of 8.60 colones to the dollar meant significant surpluses on that market, while the official market, in view of its exchange rate of 6.65 colones to the dollar, recorded a constant deficit. The Central Bank was compelled to purchase foreign exchange resulting from the surplus on the free market to cover the deficit recorded by the official market. The monetary expansion involved in this operation amounted to 87.8 and 193.7 million colones in 1972 and 1973, respectively.110/

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110/ Data supplied by the Banco Central de Costa Rica.

Costa Rica's foreign exchange policy should be evaluated within the general context of external inflation, in terms of the increasing liquidity which its economy experienced and taking into account that the rate of growth of most of the sectors of production declined. The exchange mechanism has not, of course, been the decisive factor of the inflationary pressures. The adjustments in the exchange rates took place throughout a period in which other inflationary factors were fully in operation and did no more than join forces with the other sources generating inflation. However, the maintenance of the exchange rate from 1973 onwards in the face of increasing domestic inflation undoubtedly lessened the effect of imported inflation.

The foreign exchange policy described above, owing to its flexibility and the appearance of the external factors indicated, does not seem to have had the desired impact on the balance of payments. The trends of imports of non-essential consumer goods have not changed, despite the increase in prices. On the whole, the inflationary processes stimulated a sometimes regressive redistribution of income owing to the differing capacity of the factors of production to transfer their increasing costs to the consumer and to benefit from the growth of demand for their products.

#### 4. Prices and wages policy

In a country which until a short while ago recorded constant indexes of stability, it would be difficult to find price policies which do not respect the basic equilibria of the economic system. The appearance of inflation in the last few years encountered a public apparatus which was not accustomed to this type of concern. Nevertheless, at the first signs of inflation, government action in connexion with prices had two basic aims: first, to control prices of essential goods in order to safeguard the level of living of the population and, secondly, to guarantee the possibilities of competition of non-traditional exports in the Central American market.

As regards the first point, it is only in the last few years, and basically as a result of tax reform, that the government decisions have had a more direct influence on the fixing of prices. In the



face of the new situation of changing costs and prices, the first government measures were aimed at containing speculation. It was not easy, however, to enter into a territory where there had formerly been no need for drastic action. The capacity for exercising the necessary control in this field was gradually formed. The Department of Internal Trade of the Ministry of Industry and Trade which is the agency mainly responsible for implementing the prices policy, has redoubled its efforts in terms of studies, costs and control programmes designed to improve the efficiency of this important aspect of general economic policy and give it a more organic structure.

One of the instruments used to guarantee competitive prices of non-traditional exports, as mentioned previously, was the exchange rate. The concession of liquidating 50 per cent of the foreign exchange obtained from these activities at a higher exchange rate on the free market was an important palliative in the face of the rising price of inputs and distribution costs.

Much the same observations as those made on the prices policy are applicable to the wages policy: the price stability during the past decade and the rapid growth of economic activity did not confer on this aspect the vitally urgent character which recent inflation has given it. A report of the Ministry of Labour and Social Security 111/ comments on the lack of any wages and employment policy, and points out that the institutional structure of the States does not permit any planned action in this respect. However, the wages policy found expression mainly in the establishment of minimum wages, which in some degree provides a frame of reference for determining the wages of other categories of labour. There is a system in force in Costa Rica for the establishment of minimum wages for the private sector, with the exception of workers in the banana companies.11

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111/ Antecedentes para una política nacional de salarios en Costa Rica, June 1974.

112/ "All workers shall have a right to a periodically readjusted minimum wage for a normal working day, which will ensure their livelihood and well-being. It shall always be an equal wage for equal work under equal conditions of efficiency. All matters related to the establishment of minimum wages shall be the responsibility of the technical body designated by law" (Political Constitution of 1949, article 57).

A National Wages Council, which is a permanent technical body, is responsible for establishing minimum wages for each branch of economic activity: agriculture; mining and quarrying; manufacturing and processing industry; trade; transport, storage and communications; services; and other activities. The National Wages Council is composed of nine members with equal representation of the State, employers and workers. The main criteria underlying the establishment of minimum wages are, first, to ensure for the worker and his family adequate food, housing and clothing, education for his children and any other needs established for the minimum level of families with the lowest purchasing power.<sup>113/</sup> Secondly, the payment capacity of the various activities is considered and their profit-making capacity safeguarded. In view of the conditions of price stability prevailing in Costa Rica, it was stipulated that the minimum wages should, generally speaking, be reviewed every two years.

The establishment of minimum wages is important not only insofar as the wages themselves are concerned, but also because the variations in the minimum wage is taken as a point of reference for settling other levels of remuneration.

The wages policy in the public sector, where the workers are covered by the civil service system, is based on the Law on Wages in the Public Administration.<sup>114/</sup> There are two mechanisms in this law for raising wages: on the basis of seniority and in terms of increases in the price index, provided it rises by at least 4 per cent annually.

Lastly, both individual and collective contracts may be freely entered into, provided the parties do not fix wages below the established minimum.

It is clear from the above account that mechanisms exist for maintaining the purchasing power of wages. When the price increases were small, these adjustment mechanisms usually served their purpose. In the three years 1971-1973, however, in the face of substantial

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<sup>113/</sup> Ibid.

<sup>114/</sup> Law No 2166 of 9 October 1957.

increases in the level of domestic prices and the loss of dynamism of economic activity, it is possible that the general increases, at least for a large sector of wage-earners, did not manage to maintain the purchasing power of labour remuneration.

Table 30 shows the minimum wages by sector of economic activity. As can be seen, there is considerable disparity between the increases in the minimum wages for the various activities, and between the wages in absolute terms. In view of the price increases in 1973 and the early months of 1974, in April of the latter year the Government decreed an extraordinary adjustment of all minimum wages, in accordance with the scale shown in table 31, before the expiry of the previous wage scale on 1 October.

The redistributive nature of this adjustment, which establishes higher rates for the lower wage levels, has basically benefited the agricultural worker. This adjustment has had repercussions on freely contracted wages; the workers organized in trade unions have based their petitions on the highest percentage adjustment in the minimum wages. Moreover, the Government granted an across-the-board adjustment of 200 colones a month for all workers in the public sector.

Despite the Government's plausible aims of maintaining the purchasing power of wages and basically of the lowest incomes, the recrudescence of inflation seems to be affecting the wage-earners' purchasing power. A report of the Integrated Working Groups for the restructuring of the Central American Common Market states that the level of wages in the lowest income sectors is not keeping pace with the increase in the prices of mass consumption goods. It further states that between May 1973 and May 1974 the cost of the basic basket for a family with a weekly income of 100 colones increased by 63 per cent, and that for families earning 200 colones weekly by 43 per cent. These two income strata comprise 65 per cent of the total Costa Rican labour force. To judge from these data, the prices and wages policy would seem to be one of the most delicate areas in the economic policy field.

Table 30

COSTA RICA: MINIMUM WAGES BY SECTOR OF ECONOMIC ACTIVITY

(Colones at current prices per day)

	1970- 1972	1972- 1974	Percentage variation
<b>Agriculture</b>			
Coffee (worker)	12.00	12.90	7.5
Bananas (worker)	18.50	20.80	12.4
Ice-cream factories (worker)	12.40	14.40	16.1
Bakeries (baker)	20.70	23.80	15.0
Textile factory (weaver)	15.00	17.25	15.0
Shoe factories (cutter)	16.15	20.40	26.3
Shirt factory (cutter)	16.10	18.05	12.1
Printing offices (type-setter)	38.50	41.20	7.0
Soap factory (worker)	13.60	15.25	12.1
Electrical workshop (skilled worker)	25.90	28.50	10.0
Construction (skilled worker)	27.75	28.50	2.7
Commercial activities (assistant)	15.80	13.70	12.0
Public transport (driver)	21.20	23.20	9.4
Laundries (various occupations)	14.80	17.00	14.9

Source: Ministry of Labour and Social Security, Wages Office.

Table 31

COSTA RICA: ADJUSTMENT OF MINIMUM WAGES, APRIL 1974

Minimum daily wages	Percentage adjustment
12.80 to 15.00	41.0
15.10 to 17.50	35.0
17.60 to 20.00	30.0
20.10 to 25.00	25.0
25.10 to 30.00	20.0
30.10 to 35.00	15.0
35.10 to 96.20	10.0
96.30 and over	-

Source: Ministry of Labour and Social Security, Planning, Programming and Statistical Department.

The conception and implementation of a wages policy which will benefit the broad masses and at the same time will not create inflationary pressures is hampered at present by two important obstacles. First, the persistence of imported inflation on whose effects State action, in the case of Costa Rica, has less room for manoeuvre and, secondly, the slow growth of production, which shows no signs of any significant improvement. To achieve consistency between the production and financial spheres, while respecting the purchasing power of wages within the context described in this study, constitutes a serious challenge in terms of the conception and implementation of an overall economic policy.

## 5. ECUADOR

### A. INTRODUCTORY NOTE

The review presented in this document of developments and policies connected with inflation in Ecuador covers a comparatively short period from about 1968 to 1973 and, in some instances, up to and including 1974 where sufficient data were available. This is because inflation is a recent development in Ecuador, which began to acquire some importance only in the late 1960s.

The domestic price distortions became definitely serious however, at the end of 1972 and in 1973-1974, when the Ecuadorian economy started to receive the full impact deriving from its newly assumed status as a petroleum-exporting country.

This resulted, on the one hand, in a very substantial increase in Ecuador's exports, international reserves and capacity to import and, on the other hand, in making its economy more sensitive to international market price fluctuations, which were intensified in those years.

Therefore, stabilization policies gradually took shape in what was, for various reasons, virtually an unknown context to the government officials concerned. In fact, the stabilization measures were determined and adjusted on the spot in the course of 1973 and 1974. This circumstance was as far as possible taken into account in preparing the present study.

### B. SALIENT FEATURES OF ECONOMIC TRENDS IN ECUADOR

During the period 1971-1973 and, as far as is known, in 1974 the development of the Ecuadorian economy was influenced by a number of predominant factors.

First, in mid-1972 the country started to export petroleum in significant quantities - which within a short time had reached over 200,000 barrels a day - as the culmination of the process initiated in 1967-1968 with the discovery of oil reservoirs, which in its turn led from 1969-1970 onwards to substantial direct investment by foreign companies.

The operation and, previously, the installation of this new mining activity had various far-reaching effects on the whole economy, which it is difficult to specify and examine briefly in summarized form. It seems evident, however, that the most important repercussions made themselves felt in the acceleration of the overall growth rate, in the expansion of external sector and public sector activities, and in different effects on price movements.

Secondly, the existence of two closely linked situations continued to be observed during the period under review. On the one hand, the trend recorded by the agricultural sector was far from dynamic, which resulted in low rates of growth for agricultural production. On the other hand, over the same period examined there was no eloquent decrease in the high proportion of the economically active population - estimated at 53 per cent of the total - which is excluded from the market for manufactures and which makes up what is normally called the marginal population of the country.<sup>115/</sup>

Thirdly, it is worth noting the increasing significance progressively acquired by the inflationary process, which culminated in 1973 and the first part of 1974 in periodical rates of price increases far higher than ever recorded before in Ecuador, and even similar to the parallel rates observed in other Latin American countries with a "tradition" of inflation.

The creation of this problem, the study of its origins and the review of the anti-inflationary policies formulated and put into practice - together with the relation between these aspects and the dominating factors mentioned above - constitute the central theme of this document.

Lastly, it is interesting to note that during the period under review, specifically in February 1972, a change took place in the country's political administration. The main economic policy

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<sup>115/</sup> See CIAP, Situación, principales problemas y perspectivas del desarrollo económico y social del Ecuador (CIAP/635), 19 October 1973, p. 17.

guidelines of the new administration were established in the Integrated Plan for Change and Development (Plan Integral de Transformación y Desarrollo) 1973-1977.

#### 1. Growth trends

Between 1970 and 1973 the rate of growth of the Ecuadorian economy - in terms of the growth of the gross domestic product - showed a rising trend, averaging 7.8 per cent annually, which meant a considerable acceleration over the rate of 5.5 per cent recorded in the period 1965-1970. The 1973 rate of 13.1 per cent and the 12 per cent reached in 1974 were outstanding (see table 1).

In view of the fact that since the middle of the 1960s the population growth rate had remained steady at around 3.4 per cent annually, this acceleration was even more evident in the trend shown by the per capita GDP (2 per cent in 1965-1970 and 4.3 per cent in 1970-1973). According to ECLA estimates, Ecuador's population - which at the end of 1973 was around 6.8 million - obtained for that year a GDP amounting to some 490 dollars per head compared with about 400 dollars in 1970, both values in terms of constant 1970 prices.<sup>116/</sup>

(a) Total supply and demand

A study of the total supply and demand situation reveals that, in the years 1970-1973, dynamic growth coincided with a rapid expansion of exports. These increased, in terms of constant prices, at an average rate of 21.2 per cent, or nine times the rate recorded in 1965-1970. As a result of this trend, the ratio of exports to the GDP rose from 15 per cent in 1970 to 21.3 per cent in 1973, which is undoubtedly a substantial change demonstrating the new outward-looking approach of the Ecuadorian economy (see table 2).

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<sup>116/</sup> It is estimated that the average per capita GDP for Latin America as a whole (19 countries) amounted, in dollars at 1970 prices, to 639 in 1970 and 717 in 1973. In other words, the value for Ecuador represented 63 per cent of the Latin American average in 1970, and 68 per cent in 1973.



Table 1

ECUADOR: TOTAL SUPPLY AND DEMAND

(Millions of sucres at 1970 prices)

	1970	Annual growth rate (percentages)					
		1970/ 1965	1973/ 1970	1970	1971	1972	1973
<u>Total supply</u>	<u>44 967</u>	<u>6.4</u>	<u>8.0</u>	<u>11.2</u>	<u>4.8</u>	<u>6.3</u>	<u>13.2</u>
Gross domestic product (at market prices)	37 338	5.5	7.8	7.9	2.2	8.4	13.1
Imports	7 629	11.9	9.3	30.7	17.7	-2.5	13.8
<u>Total demand</u>	<u>44 967</u>	<u>6.4</u>	<u>8.0</u>	<u>11.2</u>	<u>4.8</u>	<u>6.3</u>	<u>13.2</u>
Exports	5 590	2.5	21.2	9.8	8.3	25.7	30.8
Gross domestic investment	8 174	18.2	1.8	44.0	15.4	-5.1	-3.6
Gross fixed investment	7 463	19.5	-0.6	47.7	12.6	-7.6	-5.2
Public	1 857	9.4	10.1	9.2	24.9	-18.0	30.4
Private	5 606	24.4	-4.7	67.3	8.5	-3.7	-16.7
<u>Total consumption</u>	<u>31 203</u>	<u>5.0</u>	<u>6.9</u>	<u>5.2</u>	<u>1.4</u>	<u>6.0</u>	<u>13.7</u>
General government	5 348	8.2	14.3	3.6	22.8	14.4	6.2
Private	25 855	4.4	5.3	5.5	-3.0	3.8	15.8

Source: ECLA, on the basis of official statistics.

Table 2

ECUADOR: STRUCTURE OF TOTAL SUPPLY AND DEMAND

(Percentages; at 1970 prices)

	1965	Average 1969- 1970	1970	1973	Average 1971- 1973
<u>Total supply</u>	<u>115.2</u>	<u>118.7</u>	<u>120.4</u>	<u>121.3</u>	<u>121.9</u>
Gross domestic product	100.0	100.0	100.0	100.0	100.0
Imports	15.2	18.7	20.4	21.3	21.9
<u>Total demand</u>	<u>115.2</u>	<u>118.7</u>	<u>120.4</u>	<u>121.3</u>	<u>121.9</u>
Exports	17.3	14.8	15.0	21.3	18.7
Gross domestic investment	12.4	19.3	21.9	18.5	21.4
Gross fixed investment	10.7	17.4	20.0	15.7	18.6
Public	4.1	4.9	5.0	5.3	5.3
Private	6.6	12.5	15.0	10.4	13.3
<u>Total consumption</u>	<u>85.5</u>	<u>84.6</u>	<u>83.6</u>	<u>81.6</u>	<u>81.8</u>
General government	12.6	14.6	14.3	17.1	17.5
Private	72.9	70.0	69.3	64.5	64.4

Source: ECLA, on the basis of official statistics.

/Another important

Another important aspect was the trend of the investment rate. Up to the middle of the 1960s the ratio of gross fixed investment to the GDP declined steadily to values of around 11 per cent in 1965-1966, compared with an average for Latin America of about 13 per cent.

In 1967 this ratio started to rise rapidly and steadily, reaching a peak of 22 per cent in 1971. Investment in oil production activities was mainly responsible for this increase; in fact, in 1971 it represented over one-third of the country's total fixed capital formation.<sup>117/</sup>

In 1972 and 1973 the investment made by oil companies fell off abruptly upon completion of the necessary facilities for putting into operation the oil reservoirs so far exploited, so that the fixed investment coefficient dropped to 15.7 per cent in 1973. It should be noted that the fixed investment levels of the mid-1960s were not regained, because between that date and 1973 the public sector and the domestic private sector doubled their levels of capital formation, in terms of constant prices, while the GDP grew by about 50 per cent.<sup>118/</sup>

Total consumption and its components increased more rapidly in the period 1970-1973 than in 1965-1970, especially in the case of general government consumption.

Import trends were affected significantly by the purchase of materials and equipment necessary for the oil companies investments. This factor mainly accounts for the high growth rates of imports recorded in 1970 and 1971 and the decline observed in 1972 (see table 1).

(b) Sectoral structure of the product and employment

The accelerated growth of the GDP coincided with a fairly balanced development of the various production activities. Apart from mining, whose contribution to the GDP rose at an average annual rate of 81 per cent, other sectors - manufacturing, transport and

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<sup>117/</sup> See Central Bank of Ecuador, Memoria 1973, table 1-5.a - 1.

<sup>118/</sup> Ibid., table 1-5.b.

communications, and, in general services - grew at rates compatible with this acceleration. In contrast, agriculture, construction and, consequently, electricity, gas, water and sanitary services, recorded unsatisfactory rates of growth, lower even than the population growth rate (see table 3).

Between 1970 and 1973, agriculture grew at an average rate of barely 1 per cent annually, which was only slightly higher than the rate recorded between 1965 and 1970 (0.8 per cent). Thus the situation of evident stagnation in agricultural activity continued, and has been especially manifest since the mid-1960s. In this respect, it should be recalled that in the years 1960-1965 this sector's contribution to the product increased by about 3 per cent annually, compared with approximately 4 per cent annually in the 1950s.<sup>119/</sup> The trends described above caused the share of agriculture in the GDP to drop far more rapidly (from 33.3 per cent in 1965 to 22.3 per cent in 1973) than normally happens in the development process of countries with per capita income levels similar to Ecuador's (see table 4).

It seems clear that the basic problem consists in the typically low levels of productivity in the agricultural sector in general. This in its turn is a result, among other factors, of the prevailing system of land tenure - under which the latifundio-minifundio system still exists - of the scant capital formation in the sector, of the abundant unskilled manpower engaged in agriculture, and of the shortcomings of the prices, marketing and other policies affecting this activity.<sup>120/</sup>

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<sup>119/</sup> See ECLA, Tendencias y estructuras de la economía del Ecuador en el último decenio (E/CN.12/926), 9 March 1972, table 1.

<sup>120/</sup> See, for example, Situación, principales problemas y perspectivas del desarrollo económico y social del Ecuador, op.cit., pp. 121 et seqq.; and FAO/IDB Mission, Estudio del sector agropecuario del Ecuador, identificación de áreas prioritarias de inversión, 1973.

Table 3

ECUADOR: GROSS DOMESTIC PRODUCT AT FACTOR COST,  
BY SECTOR OF ECONOMIC ACTIVITY

(Millions of sucres at 1970 prices)

	1970	Annual growth rate					
		1970/ 1965	1973/ 1970	1970	1971	1972	1973
Agriculture	8 936	0.8	1.0	0.7	0.3	2.6	0.4
Mining	533	3.3	81.4	9.2	-20.6	157.7	179.2
Manufacturing	5 693	6.3	8.1	7.6	6.9	8.9	8.6
Construction	2 073	17.2	2.9	25.0	3.4	4.2	9.8
<u>Subtotal goods</u>	<u>17 235</u>	<u>4.0</u>	<u>8.2</u>	<u>5.7</u>	<u>2.3</u>	<u>7.9</u>	<u>15.0</u>
Electricity, gas, water and sanitary services	418	10.6	3.3	13.0	10.0	0.0	0.2
Transport and communications	2 091	7.8	8.1	10.5	5.2	11.9	7.4
<u>Subtotal basic services</u>	<u>2 509</u>	<u>8.3</u>	<u>7.4</u>	<u>10.9</u>	<u>6.0</u>	<u>9.8</u>	<u>6.3</u>
Commerce and finance	5 555	4.7	8.0	7.0	8.4	6.0	9.6
Ownership of dwellings	2 019	5.3	7.9	9.1	12.3	6.5	5.1
Government a/	-	-	-	-	-	-	-
Miscellaneous services a/	5 921	8.2	5.0	8.8	9.8	7.1	9.8
<u>Subtotal other services</u>	<u>13 495</u>	<u>6.3</u>	<u>6.7</u>	<u>8.1</u>	<u>4.6</u>	<u>6.5</u>	<u>9.0</u>
<u>Total</u>	<u>33 239</u>	<u>5.2</u>	<u>7.5</u>	<u>7.0</u>	<u>3.5</u>	<u>7.5</u>	<u>11.9</u>

Source: ECLA, on the basis of official statistics.

a/ Government included in miscellaneous services.

Table 4

ECUADOR: STRUCTURE OF GROSS DOMESTIC PRODUCT AT FACTOR COST,  
BY SECTOR OF ECONOMIC ACTIVITY

(Percentages; at 1970 prices)

	1965	Average 1969- 1970	1970	1973	Average 1971- 1973
Agriculture	33.3	27.7	26.9	22.3	24.3
Mining	1.8	1.6	1.6	7.7	4.2
Manufacturing	16.2	17.1	17.1	17.4	17.6
Construction	3.6	5.8	6.2	5.5	5.7
<u>Subtotal goods</u>	<u>54.9</u>	<u>52.2</u>	<u>51.8</u>	<u>52.9</u>	<u>51.9</u>
Electricity, gas, water and sanitary services	1.0	1.2	1.3	1.1	1.2
Transport and communications	5.6	6.2	6.3	6.4	6.5
<u>Subtotal basic services</u>	<u>6.6</u>	<u>7.4</u>	<u>7.6</u>	<u>7.5</u>	<u>7.7</u>
Commerce and finance	17.1	16.7	16.7	17.0	17.2
Ownership of dwellings	6.0	6.0	6.1	6.1	6.4
Government a/	-	-	-	-	-
Miscellaneous services a/	15.4	17.7	17.8	16.5	16.8
<u>Subtotal other services</u>	<u>38.5</u>	<u>40.4</u>	<u>40.6</u>	<u>39.6</u>	<u>40.4</u>
<u>Total</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Source: ECLA, on the basis of official statistics.

a/ Government included in miscellaneous services.

/Taken together,

Taken together, the goods producing sectors kept their share in the GDP comparatively stable between the years 1969-1970 and 1971-1973. The decline recorded by agriculture and, on a lesser scale, by construction were offset by a sharp rise in the share of mining, and a slight increase in that of manufacturing.

The sectors producing services and basic services, analysed on a global basis, also retained their share in the GDP with no major changes between 1969-1970 and 1971-1973. The purely service activities, which generate around 40 per cent of the GDP, continued to represent a fairly high proportion of the product, considering the per capita income levels in Ecuador and the coefficients observed in other countries of the region.<sup>121/</sup>

When, in addition, the sectoral composition of the product is examined from the standpoint of the distribution of manpower, other structural features are observable which are worthwhile taking into account.

First, available data on the sectoral composition of the labour force indicate that from the mid-1960s to the years 1971-1972 there were very slight variations in the relative absorption of manpower by the different economic activities. Thus, for example, agriculture continued to employ about 56 per cent of the labour force and manufacturing reduced its share of around 14 per cent to about 13.4 per cent.<sup>122/</sup>

These trends, considered simultaneously with the evolution of the GDP and its sectoral structure, accentuated the disparities noted between the average labour productivity in agriculture and that recorded in the rest of the economy, which already at the beginning of the 1970s stood at a ratio of 1 to 4. Similarly, the rapid economic development in 1972-1974 must have even further widened the gap.<sup>123/</sup>

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<sup>121/</sup> See ECLA, Trends and structure of the Latin American economy (E/CN.12/384), 4 March 1971, table 25.

<sup>122/</sup> Estimates based on data supplied by the Planning Board of Ecuador to missions of the International Monetary Fund.

<sup>123/</sup> See Situación, principales problemas y perspectivas del desarrollo económico y social del Ecuador, op.cit., pp. 8 et seq.

Secondly, some data on open unemployment trends indicate that the average unemployment rate after reaching a peak of 10 per cent in 1968 apparently descended to around 8 per cent in 1972-1973. This was still a relatively high rate - particularly in the towns - and was higher, for example, than that recorded in the first half of the 1960s. Of course, the degree of open unemployment in the towns depended essentially on the level and persistence of the disguised unemployment situation in the country.

## 2. The external sector

### (a) General aspects

The production and export of petroleum had a decisive effect on the balance of payments in the three years 1971-1973.

In the first place, the exports initiated in August 1972 meant an income of approximately 60 million dollars in 1972 and 270 million in 1973, the latter figure representing over 47 per cent of total exports of goods in that year.

Secondly, in the years 1971 and 1972 the investments made by oil companies in Ecuador averaged more than 120 million dollars annually. Deducting the direct imports effected by those same companies - which amounted to some 70 million dollars annually - the investments generated a net annual income of approximately 50 million dollars, or more than one-fifth of the normal level of exports at the beginning of the 1970s (see table 5).

Another salient feature of the external sector's development was the change experienced between 1971 and 1972-1973 in the overall balance of payments position.



Table 5  
ECUADOR: BALANCE OF PAYMENTS

(Millions of dollars)

	Average 1966- 1970	1970	1971	1972	1973	Average 1971- 1973
<u>Current account</u>						
Exports of goods and services	224.1	258.0	269.8	354.0	613.0	412.3
Goods FOB	205.4	234.3	242.9	323.2	574.1	380.1
Services	18.8	23.7	26.9	30.8	38.9	32.2
Imports of goods and services	274.0	375.5	459.7	473.8	627.5	520.3
Goods FOB	203.7	266.2	360.7	366.5	491.9	406.4
Services	70.3	109.3	99.0	107.3	135.6	114.0
Net external investment income	-26.9	-29.2	-35.7	-45.6	-100.4	-60.6
Profits	-19.6	-19.2	-25.2	-34.3	-93.4	-51.0
Interest	-7.3	-10.0	-10.5	-11.3	-7.0	-9.6
Net private transfer payments	5.1	7.5	7.7	6.3	16.8	10.3
Balance on current account	-71.7	-139.2	-217.9	-159.1	-98.1	-158.4
<u>Capital account</u>						
Net external financing (a+b+c+d+e)	71.7	139.2	217.9	159.1	98.1	158.4
(a) Net external non-compensatory capital	71.9	118.0	193.1	245.9	108.8	182.6
Direct investment	37.8	88.6	162.1	149.8	54.3	122.1
Long- and medium-term loans	42.1	49.2	49.0	111.7	60.3	73.7
Amortization payments	-17.0	-27.4	-29.8	-28.3	-33.7	-30.6
Short-term liabilities	1.2	-1.8	3.8	3.3	6.4	4.5
Official transfer payments	7.8	9.4	8.0	9.4	21.5	13.0
(b) Domestic non-compensatory capital or assets	-0.4	4.7	-3.2	-5.5	-10.4	-6.4
(c) Errors and omissions	2.7	16.2	-5.8	17.4	96.2	35.9
(d) Allocation of SDRs	0.8	4.2	3.5	3.8	0.0	2.4
(e) Net compensatory movements (increase -)	-3.4	-3.9	30.3	-102.5	-96.5	-56.2

Source: ECLA, on the basis of official statistics.

In 1971 the stagnation of exports and a sharp upturn in imports produced a large current account deficit (218 million dollars).<sup>124/</sup> The income on capital account - notwithstanding the increase recorded in foreign investment - was not enough to cover the current account deficit, so that a net sum of 30 million dollars had to be used of the international reserves.

In the years 1972 and 1973, on the other hand, the balance of payments showed surpluses of around 100 million dollars annually. The rapid growth of exports and a delayed increase in imports, which was only manifest in 1973, reduced the current account deficit by 60 million dollars annually compared with the figure for 1971 (from 218 million dollars in 1971 to 98 million in 1973). The income on capital account was bolstered in its turn in 1972 by a bigger influx of long- and medium-term loans, and in 1973 by a strong inflow of unidentified private external resources which are included in the balance of payments under the head of errors and omissions (see table 5).

Between end-1970 and end-1971, the level of gross international reserves dropped from 83 to 65 million dollars, the latter figure covering the equivalent of less than two months' imports. In 1972, on the other hand, the level rose to 143 million dollars and the following year to 241 million, the 1973 value being sufficient to finance imports for about 5 months. In other words, there was a fairly rapid and substantial increase in the country's international reserves (see table 6).

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<sup>124/</sup> This was the culmination of a trend begun in 1966-1967 towards a progressive deterioration of the country's trade balance and current account.

Table 6

ECUADOR: INTERNATIONAL RESERVES  
(Millions of dollars at current prices)

	1969	1970	1971	1972	1973	July 1974
(1) International reserves (totals at end of period)	65.0	83.2	64.7	143.4	241.1	444.4
(2) Imports of goods and services	281.5	375.5	459.7	473.8	627.5	-
(3) Imports of goods and services (monthly average)	23.5	31.3	38.3	39.5	52.3	-
(4) Number of months of imports financed by international reserves	2.8	2.7	1.7	3.6	4.6	-

Source: IMF, International Financial Statistics, September 1972  
and November 1974.

(i) The exchange system. Since November 1971 a dual system of exchange has operated in Ecuador, with an official and a free market.<sup>125/</sup> The official exchange rate was established at 25 pesos to the dollar in August 1970 and remained unchanged up to and including 1974, in line with the country's traditional policy of not making periodical adjustments in the exchange parity and of adjusting it only at intervals of a certain number of years.

During the period 1971-1973 the value of the free dollar came closer and closer to that of the official dollar, as the strong inflow of foreign exchange on the free market led the Central Bank to establish a permanent purchasing power, at a rate similar to the official, in order to absorb the foreign exchange surpluses generated in that market.

The prevailing exchange system meant - if the internal price variations in Ecuador and the United States are taken into account - that the real value of the Ecuadorian currency decreased by 11 per cent between 1971 and 1973, owing to the faster increase in its domestic prices (see table 7).

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<sup>125/</sup> Between August 1970 and November 1971 the free market was eliminated on a temporary basis only, and a single controlled market was established.

Table 7

ECUADOR: TREND OF REAL VALUE OF EXCHANGE RATE

(1) Average exchange rate a/ (sucres to the dollar)	(2) Implicit deflator of Ecuador's GDP (1970 = 100)	(3) Implicit deflator of the United States GDP (1967 = 100)	(4) (2)/(3)x100 Relation between implicit deflators of Ecuador and United States (1970 = 100)	(5) (1)/(4)x100 Trend of real value of average exchange rate (base 1970 - sucres to the dollar)
1969	19.16	93.4	94.8	98.5
1970	21.67	100.0	100.0	100.0
1971	25.71	108.8	104.7	103.9
1972	26.0	118.4	107.9	109.7
1973	24.85	133.9	118.7	112.8

Source: Central Bank of Ecuador, and United States Department of Commerce, Statistical Abstract 1973.

a/ Weighted average of exchange rates in force in the markets for current external transactions.

An additional feature of the prevailing exchange system during the period under review was the large-scale levying of taxes on ad valorem exports. These were designed, in particular, to generate fiscal revenue and to take the place of other possible forms of domestic taxes which did not already exist. Notable among the export taxes were those levied on bananas (31.4 per cent), coffee (26.5 per cent), cocoa (25 per cent) and sugar (23.75 per cent).<sup>126/</sup> The revenue obtained from all these export taxes in 1971 represented about one-tenth of the total current income of the central government. It should also be noted that a 15 per cent tax on petroleum exports was established in August 1972.

As regards import taxes, Ecuador's customs tariff provides average protection of 40 per cent and includes duties ranging, in general, from 30 to 50 per cent, the latter rate being levied on products with a lesser degree of processing. The existence of several development laws and special contracts, however, made it necessary to grant a great many exemptions, so that over one-third of the imports were not liable to customs duties. In any case, import taxes in 1971 accounted for about 30 per cent of the central government's total current income.<sup>127/</sup>

Lastly, with the purpose of establishing an additional control of imports, a system was adopted of classifying them in two schedules: those on schedule I were considered as essential and semi-essential products, and those on schedule II as less essential and luxury items. About one-fifth of total imports in the period 1971-1973 were products on schedule II, subject, on the one hand, to the payment

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<sup>126/</sup> Several of these rates were raised 10 to 15 percentage points as a result of the devaluation in 1970, but from 1973 onwards various pressures were created aimed at reducing the additional charges established. See Situación, principales problemas y perspectivas del desarrollo económico y social del Ecuador, op.cit., table VI-9.

<sup>127/</sup> Ibid., pp. 264 et seqq.

of relatively higher customs duties (including a 20 per cent surcharge) and, on the other hand, to the requirement in force up to the beginning of 1973 of making prior import deposits.

(b) Exports of goods

In terms of current values, exports of goods increased by 33 per cent in 1972 and by 78 per cent in 1973, while exports in 1973 were 145 per cent higher than in 1970. Up to 1972, the whole increment over 1970 was the result of a larger volume of exports (38 per cent), while between 1972 and 1973 there were simultaneous increases in the quantity exported and the unit value, each of about 34 per cent. Excluding petroleum and petroleum products, however, the increase in unit value in 1973 was 22 per cent (see table 8).

Petroleum exports alone accounted for rates of increase in total exports of 24 per cent in 1972 and 67 per cent in 1973, or about four-fifths of the total increase between 1971 and 1973.

In 1973 the volume of petroleum output averaged 210,000 barrels a day, or approximately 75 million barrels a year. Of this total, a little over 71 million barrels were exported at an average price of about 3.70 dollars a barrel.

As regards the trend of other exports, a significant feature, particularly in 1973, was the increase of 57 per cent in coffee exports, in response to improved world prices and also an increase in the volume exported. On the other hand, the export flows of cocoa and sugar remained at the same levels.

An average of 20 million dollars' worth of marine products was exported annually during the three years 1971-1973, although up to and including 1970 this item was virtually unimportant.

Table 8

EQUADOR: TRENDS OF EXPORTS AND IMPORTS OF GOODS

	Average 1966- 1970	1970	1971	1972	1973	Average 1971- 1973
(1) Exports of goods (FOB, millions of dollars)	205.4	234.3	242.9	323.2	574.1	380.1
(2) Exports of goods (millions of dollars, 1970 = 100)	87.7	100.0	103.7	137.9	245.0	162.2
(3) Index of unit value of exports of goods (1970 = 100)	92.8	100.0	96.0	99.9	134.0	110.0
(3a) Index of unit value of exports of goods, excluding petroleum and petroleum products	92.8	100.0	96.0	99.6	120.2	105.3
(4) Index of constant value of exports of goods $[(2)/(3) \cdot 100]$ (1970 = 100)	94.5	100.0	108.1	138.0	182.8	147.5
(5) Imports of goods (FOB, millions of dollars)	203.7	266.2	360.7	366.5	491.9	406.4
(6) Imports of goods (millions of dollars, 1970 = 100)	76.5	100.0	135.5	137.7	184.8	152.6
(7) Index of unit value of imports of goods (1970 = 100)	96.0	100.0	104.0	109.9	127.9	113.9
(8) Index of constant value of imports of goods $[(6)/(7) \cdot 100]$ (1970 = 100)	79.7	100.0	130.3	125.3	144.5	134.0

Source: ECLA, on the basis of official statistics.



The share of total exports represented by bananas, traditionally Ecuador's main export commodity,<sup>128/</sup> shrank progressively to 23 per cent in 1973, although their current value rose by 18 per cent between 1970 and 1973. As regards the trend in world banana prices, the average price in 1973 (7.5 cents per pound) was equal to the average for 1970 and similar to that recorded at the beginning of the 1950s.<sup>129/</sup>

Other changes which took place in the structure of exports in 1971-1973 were also due to the increase in the share of petroleum and the decline in that of other export items (see table 9).

Nevertheless, over and above the observations about the share acquired by exports of marine products, it is interesting to note that exports of a number of items increased by over 50 per cent in value between 1970 and 1973, reaching a total of 40 million dollars. These items include a wide range of manufactured and semi-manufactured products.

(c) Imports of goods

Between 1966-1970 and 1971-1973 the current value of imports of goods doubled, rising from an annual average of 200 million to 400 million dollars. Since during the same period, however, the unit value of imports rose 19 per cent, the increase in terms of constant prices is estimated at 68 per cent (see table 8).

Within the general fairly accelerated growth trend of nearly all import items, some salient features are worth considering (see table 10).

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<sup>128/</sup> At the beginning of the 1960s, exports of bananas represented 60 per cent of the country's total exports, and at the beginning of the 1970s their share was still over 50 per cent.

<sup>129/</sup> In fact, bananas are among the basic commodities which have suffered the sharpest cuts in terms of constant purchasing power on the world markets. See ECLA, Economic Survey of Latin America, 1973, Part One.

Table 9  
ECUADOR: STRUCTURE OF EXPORTS OF GOODS  
(Percentages)

	Average 1966- 1970	1970	1971	1972	1973	Average 1971- 1973
Petroleum	0.1	0.4	0.8	18.9	47.4	29.6
Bananas	53.0	51.8	50.4	40.5	23.1	33.8
Coffee	18.2	22.6	15.0	13.2	11.4	12.7
Cocoa	12.7	10.0	10.1	7.2	4.7	6.5
Sugar	4.0	3.6	5.5	5.3	2.1	3.7
Marine products	-	-	6.0	6.9	4.1	5.3
Miscellaneous	12.0	11.6	12.2	8.0	7.2	8.4

Source: ECLA, on the basis of official statistics.

Table 10

ECUADOR: STRUCTURE OF IMPORTS OF GOODS  
(Percentages)

	Average 1966- 1970	1970	1971	1972	1973	Average 1971- 1973
(1) Consumer goods	14.6	14.0	14.1	14.8	12.4	13.6
(a) Durable	5.2	5.1	4.0	3.8	3.6	3.8
(b) Non-durable	9.4	8.9	10.1	11.0	8.8	9.8
(2) Raw materials <u>a/</u>	42.5	41.1	42.4	42.5	48.1	45.0
(3) Fuels	6.7	7.6	7.6	7.0	4.5	6.0
(4) Capital goods	36.0	37.0	35.8	35.3	35.1	35.3
(5) Miscellaneous	0.2	0.3	0.1	0.4	0.0	0.1

Source: ECLA, on the basis of official statistics.

a/ Including construction materials.

First, up to and including 1972, and particularly up to 1971, substantial purchases were made of materials and equipment necessary for the installation of the new oil production activities in Ecuador. In 1971 these purchases may be estimated at over 80 million dollars, declining to less than 60 million in 1972, and to approximately 30 million in 1973.

Secondly, the period 1971-1973 marked a rapid growth of imports of food and similar items and of raw material inputs for the food industry. In terms of current values, these imports rose from 37 million dollars in 1970 to 97 million in 1973, i.e., by 163 per cent, while the increase in total imports was 85 per cent.

Lastly, between 1966-1970 and 1971-1973 imports of capital goods retained their share in the total at around 35 per cent, while the share of durable consumer goods and fuels declined, especially that of fuels in 1973.

## C. THE RECENT INFLATIONARY PROCESS

### 1. Background

Ecuador is one of the countries of Latin America where inflation and the accompanying preoccupation with combatting it constitute a relatively new phenomenon. During the 1950s, the annual average rate of increase in prices fluctuated around 1 per cent, while during the 1960s - up to 1968 inclusive - although higher it continued to be moderate, reaching an annual 3.5 per cent.

Only from 1969 onwards did annual price rises of more than 5 per cent begin to appear: this is the lowest figure usually considered to be indicative of the appearance of inflationary distortions of any importance.

However, since 1966-1967 food prices had been registering annual increases of more than 5 per cent, and were thus increasing more rapidly than domestic prices on average. Between 1965 and 1969 the prices of the food and beverages section of the Quito consumer price index increased at an annual average rate of 7 per cent, while the comparable annual increase in the housing and clothing sections was approximately 2.5 per cent. Thus, between the two years considered the relative price of food increased by 18 per cent.<sup>130/</sup>

In 1970 the rate of inflation continued to increase, rising to over 8 per cent but then dropping slightly to around 7 per cent in 1971 and 1972. In 1973, however, the inflation rate accelerated sharply to over 20 per cent. This increase continued to be in evidence during the early months of 1974, with the result that

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<sup>130/</sup> See Instituto Nacional de Estadística (INE), Indice de precios al consumidor (consumer price index). In addition to the monthly calculation of changes in the Quito index, the INE also prepares consumer price indexes for the cities of Guayaquil and Cuenca. In order to simplify our analysis, preference will be given to the price series for Quito in the present report. However, no wholesale price series were available to complement the analysis.

between April 1973 and April 1974, the price increase for the year was close on 30 per cent. After reaching this relative peak, however, there was a drop in July 1974 and throughout the second half of the year in general, so that the annual rate of inflation declined to slightly over 20 per cent - similar to that recorded at the end of 1973 131/ (see table 11).

As in the period 1965-1969, food prices increased between 1969 and 1973 at a faster rate than those of the other goods and services considered in the price indexes, particularly in 1972 and 1973. Thus, in the city of Quito, prices in the food and beverages section increased by 11 per cent during 1972, 31 per cent in 1973 and 45 per cent between April 1973 and April 1974.

Between 1969 and 1973 food prices increased by 10 per cent with respect to the housing and clothing sections. This increase, on top of the 18 per cent rise which took place between 1965 and 1969, meant that between 1965 and 1973 the total increase in the relative prices of foodstuffs was 30 per cent, which obviously meant a substantial advance in their position.

## 2. Factors which influenced the speeding up of inflation

As we have already seen, the country's past inflation shows two stages or levels in the acceleration of the growth rate of prices. The first stage covered 1969 and 1970, although its immediate origins went as far back as 1966-1967. The second stage was observed in 1973 and - according to the partial data available - in the first months of 1974, following some deceleration of inflation in 1971 and 1972.

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131/ In order to identify these changes in the rate, the figures used cover the period from one month of one year to the same month in the next year, since this is a more sensitive method for short periods than making estimates on the basis of averages.

Table 11

ECUADOR: TRENDS IN CONSUMER PRICES

		Average 1965- 1969	1970	1971	1972	1973	April 1973 to April 1974	July 1973 to July 1974
1. Consumer price index <u>a/</u> - Quito								
	(percentage variations)							
(a) General		5.9	8.3	6.8	6.9	20.5 <sup>b/</sup>	29.6	21.4
(b) Food and beverages	December to December)	8.5	5.0	6.3	10.7	31.1	45.0	28.2
2. Consumer price index <u>a/</u> - Quito								
	(percentage variations)							
(a) General		4.6	5.1	8.4	7.9	12.9	-	-
(b) Food and beverages	average to average)	6.9	3.3	6.5	11.1	20.3	-	-
3. Consumer price index <u>a/</u> - Quito								
	(average to average 1970 = 100)							
(a) General		95.2 <sup>c/</sup>	100.0	108.4	117.0	132.1	-	-
(b) Food and beverages		96.8 <sup>c/</sup>	100.0	106.5	118.3	142.3	-	-
4. Consumer price index <u>a/</u> - Guayaquil								
	(percentage variations)							
(a) General		3.9	12.5	5.1	5.4	15.6 <sup>b/</sup>	-	-
(b) Food and beverages	December to December)	5.1	9.9	6.6	4.8	20.7	-	-

Source: Instituto Nacional de Estadística (INE), Consumer price index.

a/ Of families with low and medium incomes.

b/ If a weighting of 40 per cent is attributed to Quito and 60 per cent to Guayaquil, the average rate is 17.6 per cent.

c/ Value of the index in 1969.

Examination of the factors which influenced the evolution of prices during the two stages identified shows that some common elements were present in both, together with others which were different; the intensity of their effects also varied.

Outstanding among these common elements, without any doubt, was the performance of the agricultural sector, both because of its intrinsic importance and because of its links with other economic variables. This, then, is one of the structural factors of inflation which has been most investigated, and the following section is devoted to analysing the phenomenon. The next two sections review the accessory elements in inflation which appeared, first during the acceleration of 1969-1970 and then in the re-acceleration of 1973-1974.

(a) The problem of agriculture

The slow growth of the agricultural sector, analysed above, is even more obvious when the trend of per capita agricultural output is taken into account. During the 1950s, this increased by approximately 1 per cent annually, dropped slightly between 1960 and 1965 and decreased by around 2.5 per cent annually between 1965 and 1973. This meant that in absolute and constant terms, the per capita agricultural product in 1973 was around 18 per cent less than in 1965.

Naturally enough, this substantial reduction in per capita agricultural output was a factor of great inflationary potential and significance, particularly in a country like Ecuador, where food accounts for 60 per cent or more of the expenditure of low- and medium-income families. The extent to which this inflationary potential materialized in actual pressures of varying intensity on domestic food prices, and indirectly on the prices of other goods and services, depended in its turn on several elements. These include the evolution of overall demand and demand for agricultural products and the evolution of imports of food and similar products aimed at reinforcing domestic supplies. The price relations existing between the prices of imported products and the prices of locally-produced products were also of consequence, as were the policy measures adopted as regards marketing and the fixing of food prices.

/As regards

As regards the evolution of local demand for foodstuffs, it was observed that this increased at progressively high rates as the economy's rate of development accelerated. Taking the annual rate of increase of the population as 3.4 per cent and an income foodstuffs elasticity of between 0.5 and 0.6, it may be estimated that between 1965 and 1970 the increase in domestic demand for foodstuffs was over 4 per cent annually, while in 1970-1973 the comparable rate was approximately 6 per cent, and in 1973 in particular the increase was more than 7 per cent.<sup>132/</sup>

In keeping with this trend, and in contrast to the annual variations in agricultural output, the rate of increase of the demand for foodstuffs exceeded the annual increase in domestic food output by around 3 per cent in 1965-1970, 5 per cent in 1970-1973 and 7 per cent in 1973 considered separately. The inflationary importance of this excess demand was particularly noteworthy, in view of its magnitude, persistence and continuing increase.

During the period 1966-1970 imports of food and similar products and inputs for food manufactures fluctuated without major variation around 35-37 million dollars, i.e., they did not offset the inadequate increase in the domestic output of agricultural products with respect to the increase in the demand for them.

Later, imports of food and other related items, expressed at constant 1970 prices, increased by around 40 per cent in 1971, remained stable in 1972 and again increased by around 40 per cent in 1973. It is estimated that during the period 1970-1973 these imports increased the local supply of foodstuffs by about 3 per cent annually over the levels provided by domestic output, so that the annual 5 per cent excess demand already referred to was reduced to less than half. In 1973, however, the shortfall would appear to have been greater than 3 per cent of agricultural output.

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<sup>132/</sup> See CIAP, op.cit., table IV-6.



In other words, taking into account the strengthening of domestic supply achieved through larger imports, agricultural output showed an annual deficit of around 3 per cent during the whole period 1966 to 1973, in the light of the evolution of demand.

In addition to these overall quantitative trends which influenced the process of inflation there were also, of course, partial disequilibria in the levels of specific food products and groups of products. Mention may be made, for example, of the inadequate domestic supply of rice and potatoes between 1972 and 1974.

As regards the ratio of the domestic prices of food products to their international prices, it was observed, generally speaking, that the prices in Ecuador were, and still are, distinctly lower than international prices, by as much as 50 per cent. Thus, with the increase in imports of food products, the relative expensiveness of such imports became increasingly glaring. This situation got even worse in 1973 and in the first part of 1974, when sizeable imports of foodstuffs coincided with large and continuing increases in the international prices of these products.

The inflationary pressures stemming from this difference in prices manifested themselves in the form of government subsidies granted in respect of imports of food effected and marketed by public institutions, mainly the Banco Nacional de Fomento (BNF), but also, as from 1973-1974, the Empresa Nacional de Almacenamiento y Comercialización de Productos Agropecuarios (ENAC) and the Empresa de Productos Vitales (EMPROVIT). It was thus frequent for imported products to be sold in the country below cost price, the losses so created being financed by credits granted by the Central Bank to the above-mentioned institutions.

Moreover, since the Government fixes and controls the retail prices of a large number of foodstuffs, it took the opportunity during the period under review, and particularly in 1973-1974 to increase the prices of several food products by varying amounts.

/This was

This was particularly the case when imports of such products from abroad increased considerably and made the price difference of the imported products bigger and more evident.

These and other aspects of the inflationary impact of the agricultural problem will be referred to again later, in the examination of the evolution of other variables of the economic system.

(b) The inflationary situation of 1969-1970: other explanatory factors

As already noted, from 1969 onwards the increases in domestic prices began to be significant and to warrant genuine concern, although food prices had already been showing increases of some magnitude since the mid-1960s.

Later, during the period 1968-1970, some other inflationary elements appeared in the economic situation in addition to the basic and longer-standing pressures deriving from the slow growth of the supply of agricultural commodities. These elements consisted of a more rapid increase in overall demand, and of considerable independent increases in the cost of some economic variables.

(i) The activation of overall demand. As from 1968, there was an increase in the growth rate of real demand for several simultaneous reasons.

The most noteworthy of these was the performance of gross domestic capital formation, which is analysed below. Its resurgence, which began in 1967, speeded up in 1969 and 1970, when investment in current values increased by 24.5 per cent and 53.4 per cent respectively (see table 12). Although it is true that during this period the imported element of investment would appear to have grown, the increase in capital formation in national currency was in any case substantial, and it is this which most directly influences the progress of domestic demand.

Table 12  
ECUADOR: RELATIONS BETWEEN PRICE MOVEMENTS AND SOME IMPORTANT VARIABLES  
(Percentage variations)

		1968	1969	1970	1971	1972	1973
1. Consumer price index - Quito	(December to December)	4.2	6.5	8.3	6.8	6.9	20.5
2. Index of unit value of imports of goods		0.0	3.2	2.0	4.0	5.7	16.4
3. Index of unit value of exports of goods		-5.5	5.8	9.9	-4.0	4.1	34.1
4. Exchange rate	(Average to average)	2.3	0.4	13.1	18.6	1.1	-4.4
5. Unit value of imports by exchange rate (2 • 4)		2.3	3.6	15.4	23.3	6.9	11.3
6. Unit value of exports by exchange rate (3 • 4)		-3.3	6.2	24.3	13.9	5.2	28.2
7. Money remunerations							
(a) Average monthly wage of workers in manufacturing industry		8.8	21.6	6.9	12.9	18.5	7.2a/
(b) Average monthly salary of employees in manufacturing industry		5.1	4.3	5.6	10.1	8.9	13.2a/
8. Agricultural output							
(a) Contribution to GDP of the agriculture, forestry, hunting and fishing sector		-1.3	0.5	0.7	0.3	2.6	0.4
(b) Contribution to per capita GDP		-4.6	-2.8	-2.7	-3.0	-0.7	-2.8
9. Per capita GDP (at market prices)		2.2	1.4	4.3	-1.2	4.9	9.4
10. January - total means of payment b/ (at end of year)		18.5	13.3	24.5	11.4	21.6	30.7
11. Total central government expenditure (at current prices)		25.0	11.0	25.3	17.0	4.1	29.7
12. Total central government expenditure (as percentage of GDP at market prices)		13.5	13.5	14.2	14.2	12.3	12.5
13. Current central government income (at current prices)		-3.6	15.3	26.2	19.0	24.7	46.7
14. Current central government income (as percentage of GDP at market prices)		9.2	9.5	10.0	10.2	10.6	12.2
15. Total deficit of central government (as percentage of GDP at market prices)		4.3	4.0	4.2	4.0	1.7	0.3
16. Gross domestic capital formation (at current prices)		15.9	24.5	53.4	28.4	4.0	11.0

Source: Items 1 to 6 and 10 to 15: ECLA, on the basis of official statistics; 7: INE, Estadísticas del trabajo; 8, 9 and 16: Banco Central del Ecuador, Memoria 1973.

a/ Variations between the first quarters of 1972 and 1973.

b/ According to IMF definition.

/During the

During the period 1968-1970, largely in keeping with the evolution of investment, the per capita GDP increased at a much higher rate than in previous years, and the growth rate of demand for foodstuffs gradually increased accordingly, as we have already seen.

Secondly, if the performance of the monetary variables is analysed, it will be seen that the rate of growth of the money supply was much higher during the period 1968-1970 than in the preceding years, more exactly during the three-year period 1964-1967. Thus, during the first-mentioned period, the annual average increase in the means of payment was 19 per cent, compared with a rate of only 9 per cent in the earlier period, which was similar to the rate observed during the early years of the 1960s (see table 13).

Naturally, this change in the growth rate of the quantity of money was of particular importance in an economy which was, generally speaking, not much "monetized"<sup>133/</sup> and which was also little accustomed to variations in the means of payments of 10 per cent or more per year. Moreover, during the period 1968-1970 the contrast between the rate of increase of the quantity of money and the average increase of the GDP was substantial, since the latter came to an annual average of only 6 per cent.

It may also be observed that 1968 marked the beginning of a new stage in the economy of Ecuador, characterized by frequent sizeable imbalances between the growth rate of real variables and that of financial variables. Previous to this date, the usual situation was a relative balance between the evolution of these two groups of variables.

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<sup>133/</sup> The GDP/money ratio is approximately 7 to 1, compared with ratios of around 5 to 1 frequently found in other countries of the region.

Table 13

## ECUADOR: MONETARY TRENDS

(In millions of sucres at current prices, at the end of each period)

	Per- cent age 1968	Per- cent age 1969	Per- cent age 1970	Per- cent age 1971	Per- cent age 1972	Per- cent age 1973	Per- cent age varia- tion
I. STRUCTURE OF MONETARY RESOURCES							
1. Money (means of payment)	3 830	4 341	5 404	6 020	7 320	9 568	30.7
2. Quasi-money	1 539	1 705	1 984	2 557	3 019	3 568	18.2
3. Bonds	1 332	1 409	1 456	1 619	1 844	2 135	15.8
4. Others (net)	64	507	947	-176	664	251	-62.2
Total	6 765	7 962	9 761	10 022	12 847	15 518	-
II. FACTORS OF EXPANSION AND CONTRACTION							
5. Domestic reserves (net)	963	1 042	1 401	696	3 199	5 874	83.6
6. Domestic credit	5 802	6 920	8 360	9 326	9 648	9 644	0.0
(a) to the Government (net)	929	1 514	1 911	2 233	1 821	211	-88.4
(b) to the private sector	4 873	5 406	6 449	7 093	7 827	9 433	20.5
Total	6 765	7 962	9 761	10 022	12 847	15 518	-
7. Direct issue (primary generation) by the Central Bank	3 537	5 067	7 046	6 768	9 418	12 219	29.7

Source: IMF, International Financial Statistics, August 1974.

A more detailed examination of monetary trends shows that the more rapid increase in the means of payment was originally due, especially in 1968 and 1969, to a large increase in the domestic credit granted to the Government (87 per cent in 1968 and 63 per cent in 1969). This expansion was aimed at financing the total deficit of the central government, which during those years amounted to around 1,200 million sucres per period, or more than 4 per cent of the GDP (see tables 12, 13 and 14). The excessive volume of the deficit originated in 1968, when total Government expenditure increased by 25 per cent, while its current income decreased by around 4 per cent.

It is worth noting that the lack of elasticity in the Government's current income system, especially as regards income from taxes on domestic activities, has been and continues to be a structural feature of the economy of Ecuador. It appears both in connexion with taxes and with the tariffs of the public enterprises. In addition, there is a high degree of specificity as regards tax yields, in that various percentages of the resources entering the Treasury have already been legally allocated in advance to specific functions.

In 1970 the growth of domestic credit to the Government continued to be substantial, and the Government continued to run a total deficit of more than 4 per cent of the GDP, but the balance-of-payments situation was such as to give an increase of 18 million dollars in the country's international reserves. This increase - due in particular to the flow of foreign investment already mentioned - caused a considerable expansion in the supply of money, unlike the situation in 1968 and 1969.

During the entire three-year period 1968-1970 placements in the private sector increased at relatively high rates. Thus, between 1967 and 1970 the average annual rate of growth was 16 per cent, while between 1964 and 1967 the rate had been only about 6 per cent.

Table 14

ECUADOR: CENTRAL GOVERNMENT FINANCE

(In millions of sucres at current prices)

	1967	1968	Per- cent age varia- tion	1969	Per- cent age varia- tion	1970	Per- cent age varia- tion	1971	Per- cent age varia- tion	1972	Per- cent age varia- tion	1973	Per- cent age varia- tion
1. Current income	2 649	2 554	-3.6	2 945	15.3	3 716	26.2	4 423	19.0	5 514	24.7	8 088	46.7
2. Total expenditure	3 027	3 785	25.0	4 200	11.0	5 261	25.3	6 156	17.0	6 407	4.1	8 313	29.7
3. Total deficit of the central government (2 - 1)	378	1 231	225.6	1 255	1.9	1 545	23.1	1 733	12.2	893	-48.5	225	-74.8
4. Financing of total deficit a/													
(a) External indebtedness (net)	34	66	94.1	17	-74.2	11	-35.3	-56	-	955	-	-67	-
(b) Internal indebtedness (net) b/	344	1 165	238.6	1 238	6.3	1 534	23.9	1 789	16.6	-62	-	292	-

Source: 1967-1971: IMF, International Financial Statistics, August 1974; 1972 and 1973: Banco Central del Ecuador, Memoria 1973, Tables V-1 and V-2.

a/ After deduction of amortization payments on the external and internal debt.

b/ Including variations of cash balances.

(ii) The "independent" increases in prices. The main element of inflation here was the 39 per cent devaluation of the sucre 134/ decided upon in August 1970 following a period of nearly a decade during which the exchange rate remained stable. This devaluation more or less coincided with the percentage increase experienced in domestic prices during the period in which the exchange rate remained unchanged.

The above-mentioned devaluation naturally caused several inflationary effects, but where it was most intensely felt was in the local prices for imported goods and goods produced in Ecuador but with a high import component.

In the case of exported goods, inflationary repercussions on the country were lessened to some extent owing to the export tax increases of 10 and 15 per cent decided upon at the same time as the devaluation. In practice, however, the effect of this adjustment was considerably reduced because in 1970 the unit value of exports increased by 10 per cent, which was a relatively big increase compared with the trends of previous years.

As far as the evolution of wages and salaries is concerned, the data which it has been possible to collect are scanty and partial.135/ It may be deduced from these data, however, that from the point of view of labour earnings, the inflationary pressure of greatest importance occurred in 1969, when the average remuneration of workers in manufacturing increased by more than 21 per cent compared with the previous period. In 1968 and 1970, however, the comparable increases were approximately 9 per cent and 7 per cent respectively (see table 12).

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134/ The official parity of the dollar increased from 18.18 to 25.25 sucres (seller).

135/ These data correspond to indexes of the average monthly remuneration, in sucres at current prices, of workers and salaried workers (taken separately) who work in manufacturing industry and in mining and quarrying. The indices are calculated by the Instituto Nacional de Estadística (INE).



(c) The speeding up of inflation in 1973-1974: some of the main elements which provoked it

In 1971 and to a lesser extent in 1972, the rate of inflation dropped because several factors which had fostered the significant price movements of earlier years were no longer present. Thus, the growth rate of overall demand declined on the one hand, while on the other the external sector did not have a destabilizing influence, since the exchange rate remained stable and the unit values of imports and exports did not undergo increases of any great consideration (see table 12).

As from the end of 1972, this situation was completely changed and inflation received a new impetus, which took on particular force during 1973 and the first part of 1974. The evolution of the external sector was of particular importance in this process, although other complementary aspects were also significant. It is therefore worth examining these two groups of causes, always bearing in mind the general and continuing influence of agriculture on the distortions caused by inflation.

(i) Evolution of the external sector. As already stated, as from mid 1972 the country's position as an exporter of petroleum had a decisive influence on the development of its external sector. It may be recalled that exports of goods increased from an average annual level of 240 million dollars in 1970-1971 to 320 million in 1972, 570 million in 1973 and over 1,200 million dollars in 1974. Imports of goods, for their part, which amounted to an annual average of around 310 million dollars, in 1970-1971, increased to 370 million in 1972, 490 million in 1973 and around 900 million in 1974.

At the same time, and especially in 1973 and the first part of 1974, there were important variations in the unit values of imports and exports, which also caused noteworthy repercussions.

Influences on the trend of overall demand. The expansive tendency of overall demand from the end of 1972, as a consequence of the external sector trends, was manifested in three main ways.

In the first place, taking the most generic indicator available, the increasing rate of growth of the GDP is worthy of note. Already

/in 1972,

in 1972, the increase in the per capita GDP was nearly 5 per cent - compared with a decline of 1.2 per cent in 1971 - while in 1973 and 1974 the annual average increase was around 8 per cent.

It is not necessary to expatiate further on the importance of this increase in the GDP growth rate and the inflationary pressures which arose from it, since a description has already been given of the effect produced on the demand for foodstuffs. However, attention should be given to the basic change, of a more general nature, which was felt throughout the system of production and supply when an economy which was "accustomed" to an annual growth of around 2 per cent in the per capita GDP found its rate of growth more than quadrupled.

Secondly, there was a rapid growth in the Government's current income - a rise of 47 per cent in 1973, with an estimated larger increase in 1974 - due in particular to the increase in foreign currency earnings coming from the participation revenue and taxes connected with the development of petroleum. At the same time tax revenue in national currency also rose considerably as a result, of the taxes on the growing imports. This did not occur with other current domestic income, however, because of the lack of elasticity of the system which has already been commented upon.

This relative abundance of current income, though it made it possible to bring the total debt of the central government down to practically insignificant figures, led at the same time to an expansion of Government expenditure which tended to be further intensified during 1974, when the Fondo Nacional de Desarrollo (FONADE)<sup>136/</sup> came into full operation. In 1973, then, total central government expenditure at current prices increased by 30 per cent, while public investment

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<sup>136/</sup> This agency, which is made up of the ministers and other high officials from the economic sector and is presided over by the Minister of Finance, operates independently of the budget. It receives the earnings from petroleum in excess of the reference price of 7.30 dollars per barrel and is aimed at financing only new investment projects not included in the budget. It is estimated that during 1974 more than 150 million dollars entered FONADE: i.e., rather more than the total public investment in 1973.

increased by 50 per cent.<sup>137/</sup> It is estimated that the two percentage increases may well have been higher in 1974 than in 1973.

Apart from the direct expansive effect of the increase in public activity, another important factor was the fact that the Government, because of the inadequacy of its current income in national currency, had to resort to selling foreign currency to the Central Bank to finance its increased expenditure. In other words, the form of financing the fiscal year had clear repercussions on the monetary system.

A third notable factor was the trend recorded in the means of payment. In 1971, these increased by 11.4 per cent, while in 1972 they increased by 21.6 per cent, and in 1973 by 30.7 per cent. The rate of increase in the first months of 1974 was equivalent to an annual growth of more than 30 per cent in the supply of money.

An examination of the monetary series shows that the accumulation of international reserves was the only factor behind this development since the total domestic credit in the system remained practically stable between the end of 1971 and 1973. The repayment of the Treasury's debts with the Central Bank had a decisive influence in the latter connexion, because domestic credit to the private sector increased by 10 per cent in 1972 and 20 per cent in 1973 (see table 13).

It should be added that in 1972 and 1973 the net purchases of foreign exchange by the monetary system amounted to a total of around 200 million dollars. This figure coincides approximately with the increase in international reserves reflected in the balance of payments and with the probable net sales of dollars by the Government to the Central Bank. The links existing between the operations on the external accounts, the fiscal accounts and the monetary variables were thus clear (see tables 6, 13 and 14).

More direct pressures on prices and costs. The first more direct influence of trends in the external sector on domestic prices was connected with the growing degree of openness in the economy of Ecuador and the consequent increase in its import and export coefficients

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<sup>137/</sup> See table 12 and Banco Central del Ecuador, Memoria 1973, op.cit., table 1-5a.

In the case of foodstuffs, in particular, this fact made the price difference of imported commodities increasingly more evident and significant. This introduced additional elements - quite apart from the slow increase in agricultural output - which impelled agricultural producers to press for and obtain an improvement in real prices.

Secondly, this process was accompanied by a large increase in the unit value of imports of goods, which rose on average by over 16 per cent in 1973. Furthermore, the increase in the international dollar prices of the agricultural commodities imported by Ecuador cannot have been less than 50 per cent on average, to judge by available data on this subject.<sup>138/</sup>

Despite government action involving the partially subsidized import and marketing of agricultural commodities, some selected examples show the local inflationary impact of the increase in the international prices of some foodstuffs imported by Ecuador.

Thus, in the case of wheat, the increase of over 100 per cent observed in 1973 in the dollar price of this product led to an increase of nearly 60 per cent in the price of bread in Quito between the end of 1972 and of 1973, while the 150 per cent increase in the international prices of soya beans in 1973 was a direct cause of the rise of over 50 per cent in local prices of oil and vegetable fat during that year.

As far as the repercussions of the change in the unit value of exports are concerned, it has already been mentioned that in 1973 this value increased by 22 per cent, without taking into account petroleum and petroleum products. From the structure of the country's exports, it may be deduced that this increase basically reflected increases in the international prices of sugar, cocoa and coffee, since the unit value of bananas did not change.

In the three cases identified, the domestic prices of the commodities or products in question rose in 1973 by amounts fluctuating around 50 per cent.

<sup>138/</sup> See United Nations, Monthly Bulletin of Statistics, September 1974, and Banco Central del Ecuador, Memoria 1973, op.cit.

Lastly, as regards the domestic prices of petroleum and petroleum products, it should be noted that the price increases at the international level had little influence on domestic prices because the Government decided to keep fuel prices stable. Agreements were therefore reached with the petroleum companies to regulate sales procedures for fuels in Ecuador.

(ii) Other inflationary factors. Among possible additional pressures on costs was the fact that the exchange rate fixed in August 1970 was not modified during 1973 and 1974. It may be noted, however, that between 1971 and 1973 the "real" value of the exchange rate dropped, so that no inflationary pressure came from this direction (see table 7).

Moreover, the trend of wages did not appear to have been an important inflationary factor either, at least in 1973. Between the first quarters of 1972 and 1973,<sup>139/</sup> the nominal remuneration of workers in manufacturing increased by 7.2 per cent, compared with increases of 12.9 per cent in 1971 and 18.5 in 1972 (see table 12).

At the same time it should be mentioned that the basic wage readjustments granted by the Government were relatively moderate. Thus, in March 1974 the Wages Commission fixed a compensatory adjustment of 250 sucres (10 dollars) per month for workers receiving monthly wages of between one thousand and five thousand sucres. It has been estimated that on average this was equivalent to a readjustment of 10 per cent, i.e., around one-third of the rise in prices during the 12-month period preceding the grant of the readjustment.

Naturally enough, the above information only gives an idea of the increases in remunerations in some sectors of the working population obviously not related with the active development of the external sector and other related activities. The qualitative data on this which it was possible to collect directly in Ecuador showed that the remunerations and readjustments in the petroleum sector

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<sup>139/</sup> No more recent data was available.

and other import, trading and construction activities connected with the sector were substantially higher than in the rest of the economy.

This brought about inflationary pressures not reflected in the available wage indexes, which influenced costs both directly (and also in terms of a rather limited demonstration effect) and through the actual demand exercised by the workers in the sectors already described.

In broader terms, the entire incorporations of the petroleum industry and the various related activities into the economy of Ecuador signified a rapid and intensive expansion of the most "modern" part of the system. Meanwhile, however, there was no outstanding progress in the most "primitive" part of the apparatus of production, which continued to employ more than 50 per cent of the economically active population.

Clearly, as the characteristic dual nature of the country's system of production became more extensive and more pronounced, substantial additional inflationary pressures which are difficult to quantify were let loose.

Thus, as the income receivers belonging to the modern sector became relatively more numerous and more significant in terms of their level of spending - particularly in some geographical areas - the fact that they were prepared to pay higher real prices to obtain the goods and services they required began to acquire greater importance, particularly when there were problems of inadequate supply of some goods. In other words, there was a tendency for corrections to be generated in a system of prices which, generally speaking, was consistent with low levels of productivity and per capita income.

Phenomena like that described, or similar to it, are of course inherent in development processes. Even so, they assumed particular importance in the recent evolution of the Ecuadorian economy because, on the one hand, the modernization of part of the economy was relatively widespread and very rapid, while the state of stagnation and low productivity per worker in the rest of it was deep-rooted and generalized.

/D. PRINCIPAL

## D. PRINCIPAL ASPECTS OF ANTI-INFLATIONARY POLICY

### 1. Background

In reviewing the anti-inflationary policy introduced by the Ecuadorian authorities one should not lose sight of some questions of a general nature whose impact on the bases, and on the framework in which the policy was to be carried out, was considerable.

First, it should be stressed that inflation is relatively new to the country and that, likewise, experience in the formulation and application of stabilizing measures is also limited and of recent date.

Secondly, the conditions which gave rise to the acceleration of inflation during 1973-1974 were also new, for the present world inflationary process, its intensity and the varied and far-reaching impact that it has on the peripheral economies have resulted in a situation hardly familiar to these economies, and even less so to Ecuador.

Finally, Ecuador's notable opening towards the exterior, initiated in 1972 with the launching of its petroleum exports, resulted - almost paradoxically and notwithstanding other beneficial effects - in the impact of external inflation being transmitted with great intensity throughout the country. A further contributory factor was the low flexibility of domestic supply - particularly of agricultural products - resulting from an economy in which relatively primitive forms of production continued to predominate.

Furthermore, it is worth pointing out that the granting of priority to and the application of anti-inflationary measures began, in practice, only in 1973 and coincided with the acceleration of inflation in that year, at the very time that the destabilizing effects provoked by the developments mentioned in the external sector were having their maximum impact. Similarly, although the anti-inflationary measures adopted were far-reaching in scope, they did not provide a framework for a stabilization programme as such, in which the actions to be taken in the various fields of economic policy could find comprehensive and precise expression.

/Bearing the

Bearing the foregoing in mind, this section will make a separate examination of the policies implemented, emphasis being placed on events which took place in 1973 and, when possible, during the first part of 1974.

First, the actions taken with a view to tackling some structural causes of inflation will be examined, followed by a review of measures aimed rather at dealing with the conjunctural factors which arose during the period under study.

## 2. Basic policies

### (a) Agricultural policy

Recognizing the seriousness of the problem caused by the limited growth of food production, the government authorities gave top priority to the programme for the agricultural sector, which was incorporated in the Plan Integral de Transformación y Desarrollo, 1973-1977.<sup>140/</sup> This programme laid down a number of quite detailed targets and measures aimed at achieving, during the period of the plan, an annual average growth rate of 5.3 per cent in the agricultural product, i.e., a rate five times higher than that recorded between 1965 and 1972.

Of course, in this document it is not feasible, for several reasons, to evaluate the degree to which the various measures envisaged in the programme mentioned contributed and are continuing to contribute to the gradual elimination of the causes of inflexibility in agricultural production. This task is beyond the scope of the study and, moreover, the agricultural programme covered a much longer period which, in general, did not coincide with the period of accelerated inflation referred to above.

Notwithstanding the foregoing, however, examination of the price aspect of agricultural policy - an aspect more directly linked with the subject dealt with in this report - reveals some important points.

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<sup>140/</sup> The plan for the agricultural sector is divided into 4 principal sub-programmes: (a) agrarian reform; (b) settlement; (c) the marketing of agricultural products, and (d) production.



(i) Price controls. It should be borne in mind that during the period under study a scheme aimed at fixing and controlling the price of a considerable number of foodstuffs (among others, milk, rice, sugar, coffee, several types of meat) was in operation and was being strengthened. Thus, in addition to action in the marketing of national and imported products already taken by the public institutions referred to, a Price Control Board was set up in April 1973 and given wide powers to supervise the enforcement of controlled prices.

It is difficult to judge the results obtained through the price control mechanisms, but it may be noted that some studies carried out by international institutions suggest that during 1973 the prices of controlled foodstuffs increased by much less than those of non-controlled goods. In several cases the control of prices was made possible because domestic supply was strengthened by subsidized imports and/or restricted exports, or because temporary shortages of some articles were accepted.

From another point of view, price control produced some contradictory effects. First, on some occasions, when there was a big difference with respect to the international prices, it was necessary to approve remarkably high increases in fixed prices. This provoked several adverse consequences - shortages in supplies and disincentives to production - which could have been avoided if smaller price adjustments had been authorized earlier.

Non-controlled foodstuffs, for their part, experienced considerable rises in prices which undermined the efforts and progress made in containing inflation through price control.

In addition, the distortions which arose between the prices of controlled products and those which were not controlled had some secondary effects. On the one hand, there was a tendency to intensify the production of non-controlled foodstuffs - to the detriment of controlled foodstuffs - and to sell controlled foodstuffs illegally in the country, or in neighbouring countries, at prices higher than those stipulated by the authorities. On the other, there were occasions

/when the

when the product concerned was not marketed in its original form, but processed and sold in other forms which were exempt from price control.<sup>141/</sup>

Lastly, the control of prices of some foodstuffs must have had negative repercussions on one of the basic objectives of the growth policy (and hence the anti-inflationary policy) of the country, because it failed to provide adequate price incentives to stimulate the production of several food items. Of course, this contradiction was even more marked in those cases where stricter controls were applied.

(ii) Other complementary measures. The agricultural policy also had limitations in other fields which were unfavourable to growth and anti-inflationary objectives. The best example of this was the absence of supporting price programmes and of programmes to provide complementary marketing facilities.

For all practical purposes the only supporting price programme effectively applied was that for wheat, and even in this case it was only in operation for a few months of the year. For other basic food products, such as rice and maize, no such programmes were in operation nor was suitable storage space available for temporary stocks of these goods.

As a result of this there were sharp and unnecessary fluctuations in the prices of some foodstuffs, since imbalances were created in the course of the year between the supply and demand for the product, while at the same time large portions of some harvests were lost, thus adversely affecting the growth possibilities of the agricultural sector.

(b) Fiscal policy

The greater the current income earned by the central government from the levying of taxes in the petroleum sector, the more marked was the situation mentioned earlier whereby the central government income in foreign currency was increasing rapidly, whereas income in

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<sup>141/</sup> This occurred specifically in the case of milk, a considerable part of the production of which was diverted to the manufacture of cheese which was exported as well as being sold in the country.

national currency was increasing at a slower pace. At the same time, the relatively rapid increase in government expenditure forced the Central Bank to liquidate foreign exchange holdings to meet such expenditure.

Two fundamental traits of the fiscal structure, which were not changed during the period under study, influenced this trend.

On the one hand, no important measures were adopted to strengthen the share in tax income of taxes levied on domestic activity. Outstanding in this respect is the limited influence which personal income tax and urban and rural property taxes continued to have.<sup>142/</sup>

Although the need to make important changes in these taxes was recognized,<sup>143/</sup> and such changes would have helped, moreover, to improve the elasticity of the system and to obtain other positive economic effects, in practice progress made in putting them into effect was limited.

On the other hand, although it is true that there was some partial progress in the field, the system of earmarking government income for a number of specific predetermined expenditures continued, thereby standing in the way of a more flexible fiscal system, more in line with an anti-inflationary strategy.

The foregoing is further compounded by the fact that the rising oil income was also affected in different ways by specific allocations, so that a new element was introduced into the automatic income-expenditure relation. Of course, the inflationary potential of such a situation tended to be still greater when, on account of the balance-of-payments and the monetary account situations, income in foreign currency was used to finance expenditure in national currency.

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<sup>142/</sup> In 1972-1973 the yield from these taxes amounted to less than 20 per cent of total current income (2 per cent of the GDP).

<sup>143/</sup> See CIAP, op. cit., CIAP/635, pages 227 et seqq.

It may be noted also that the role played by the State in attracting domestic funds through the sale of government bonds was relatively moderate. The sums involved in this type of operation amounted to approximately 500 million sucres per year (20 million dollars). Furthermore, no substantial changes were made in the terms of issue of public bonds in order to improve their real yield, and the nominal rates of interest earned lagged behind the inflation rate.

As regards the policy followed to control and channel government expenditure, the substantial increases in 1973 and 1974 in total government expenditure and the public investment thus made possible are worthy of note. In general, although expenditure policy was expansive, the information available indicates that the growth in current expenditure was subject to greater restrictions than that of investment.

### 3. Complementary policies

#### (a) Monetary policy

The measures adopted by the monetary authority were dictated principally by the need to curb the rate of growth in the money supply, since the direct issues by the Central Bank had grown rapidly, spurred on by the purchases of international reserves which the institution had to make. Nevertheless, during the period 1972-1974 no overall quantitative targets were set or announced for the annual variation in the means of payments.

In 1972 and 1973 the relative increase in the direct issue were 39 and 30 per cent respectively, while the comparable increases in the means of payment amounted to approximately 22 per cent and 31 per cent. In other words, in 1972 a greater degree of success was achieved in the proposed task (see table 13).

Of particular note among the provisions introduced was the application of "portfolio growth ceilings" which limited the expansion of the total placements of the banking system to 3 per cent per quarter.

/During 1973

During 1973, this measure does not seem to have been very effective, for the portfolio holdings subject to the growth ceiling increased by approximately 22 per cent: i.e., they almost doubled their growth figure for the previous year.<sup>144/</sup>

Another measure aimed at reducing the multiplier effect of the direct issues by the Central Bank was a modification of the system of minimum legal cash requirements. Thus, through regulations adopted in June and December of 1973, it was stipulated that the legal cash requirements for banks must actually be held in cash. The aim, of course, was to make this instrument of monetary policy more restrictive.

It should be noted that it was not possible to obtain adequate information on changes in liquidity ratios during the period under study. However, it is felt that the way they were handled and the continued increase in these ratios was not a major element in the monetary policy followed.

From 1973, onwards, the Central Bank began to carry out open market operations, and through the placing of short-term Stabilization Bonds it managed to withdraw substantial sums of money from circulation. Thus, in the first year of operations, it tapped off 400 million sucres - a figure equal to one-fourth of the increase in quasi-money recorded in 1973 and not much lower than the figure for the sale of government bonds referred to previously.

In addition to these quantitative monetary policy guidelines, some complementary qualitative aspects are worthy of note.

On the one hand, the system of funds set aside for special development applications was strengthened and widened, with the purpose of intensifying the selective credit control policy being carried out by the Central Bank. Of special importance in this connexion is the volume of funds channelled through the National Development Bank, an institution which received an extra 700 million sucres in credit from the banking system between the end of 1972 and of 1973. This figure

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<sup>144/</sup> See Banco Central del Ecuador, Memoria 1973, pages 63 and following.

corresponded to approximately 40 per cent of the expansion in bank placements for the year, and a fair share of this sum was used to finance the imports of foodstuffs effected by the National Development Bank.

On the other hand, there were no important changes in interest rate policy. The banking system continued granting credits at nominal rates of interest, which were maintained without variation during the period 1972-1974. These rates became increasingly negative, in real terms, as inflation accelerated. An indication in this respect is the fact that the discount rate of the Central Bank remained steady up to and including 1974 at 8 per cent per year, after having risen in 1970 from 5 to 8 per cent.

(b) International reserves management policy

It is not surprising that the international reserves in the hands of the monetary authority increase rapidly when the exports of a country grow, in a relatively short period, at the pace and to the extent they did in Ecuador. For this reason, the main objective in circumstances like those of the years 1972-1974 would normally be to achieve both a relatively gradual and continuous increase in reserves and a reduction in the intensity of the monetary impact of the accumulation of reserves.

As regards the first aspect, total reserves amounted to 65 million dollars at the end of 1971, reached a relative maximum of 444 million by mid-1974, and then diminished after this date.<sup>145/</sup> In other words, in the space of two and a half years the level of reserves increased seven-fold (see table 6).

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<sup>145/</sup> Between August and December 1974 reserves fluctuated around approximately 360 million dollars.

Within this trend, the most rapid increases took place during 1972 and in the first half of 1974. In both cases, but particularly in 1972, the import policy did not manage (and to some extent did not even endeavour) to bring about a more rapid rise in imports. Thus, the measures for the liberalization of imports which were introduced during 1972 did not have any effect in that year, and in practice the imports of goods in 1972, while almost equal to those of 1971 at current values, were 4 per cent lower at constant values.

In the first part of 1974 the situation was different, because the strong and unforeseen increase in the price of petroleum which took place towards the end of 1973 and early in 1974 prevented the flow of imports from following more closely the month by month trends in exports. However, the new import liberalization measures introduced towards the end of 1973 and in the early months of 1974 resulted, in 1974 in the high level of 900 million dollars of imports, a good deal more than half of this amount being imported during the second half of the year.

From another standpoint, it may be borne in mind that so rapid an increase in the imports of the country could have stemmed from an increase in the quota of capital goods due to the needs of the imported component of new investment projects. This possibility was restricted, however, by the fact that there was a scarcity of projects and, moreover, a greater generation of domestic savings would also have been required to finance the greater investment which, theoretically, could have been made.

In the field of exports, the policy for handling international reserves was subject, in the main, to the use the Government made of the foreign exchange provided by its share in the petroleum industry. As stated earlier, the greater the Government's need to sell foreign currency to the Central Bank to meet its expenditure in national currency, the more intense and direct were the repercussions on the monetary supply.

(c) Exchange policy

The policy of a pegged rate of exchange which was followed and the drop in the real value of the dollar exchange rate which took place, as mentioned earlier, between 1971 and 1973 and continued during 1974, acted as an anti-inflationary factor.

Thus, for example, between 1971 and 1973 the unit dollar value of imports of goods increased by approximately 23 per cent, whereas the average real value of the rate of exchange fell by 11 per cent. In this way the inflationary effect which changes in import prices might have caused was reduced, for it would have been much greater if the real value of the dollar in sucres had been kept constant through periodic devaluations.<sup>146/</sup>

An alternative exchange policy which was considered and discussed by the government authorities and by international agencies consisted of the revaluation of the sucre. By this means the reduction in the real value of the rate of exchange would have been greater, as would the anti-inflationary effect on imports as well as on the domestic prices of exported goods, while the monetary situation would also have been improved by the growth in reserves.

Apart from the anti-inflationary aspect, other grounds for the proposed revaluation included the low cost of petroleum production and the relative abundance of foreign exchange in the country.

Finally, however, it was decided not to revalue the sucre, since it was felt that the need to plan the medium-term and long-term development of the country on the right lines and to promote the export of non-traditional products must be taken into account, as well as the need to ensure more lasting equilibrium in the balance of payments. Furthermore, it was felt that as a possible anti-inflationary measure it was full of risks, and that it was preferable to have recourse to the use of other economic policies.

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<sup>146/</sup> It should be remembered that in calculating this "real" value, domestic inflation in both Ecuador and the United States was taken into account (see table 7).



Considering another aspect of exchange policy, it is interesting to note that in 1973 and particularly in 1974, with the aim of reducing the domestic price of imports, customs tariffs for a large number of imports were reduced. In this connexion, note should be taken of the reduction from 20 or more per cent to zero of the tariff on agricultural inputs and implements. The reductions approved for several industrial inputs and products were also considerable.

In spite of the foregoing, however, in the case of foodstuffs the reduction in customs tariffs had little anti-inflationary impact, owing to the fact that the duties on such items were already quite insignificant.

In keeping with this target of cheaper imports - and also to liberalize their inflow - the system of prior deposits was abolished in 1973. At the end of 1972 the accumulated balance of these deposits amounted to 1,150 million sucres: quite a large figure, when it is considered that it was equivalent to 15 per cent of the money supply.

Of course, the abolition of the measure referred to had a bad effect as regards monetary expansion, for it contributed to the acceleration experienced in the growth of the means of payments in 1973.

As far as exchange measures aimed at making foreign sales of national products less attractive by raising their prices were concerned, no new provisions of particular importance were introduced during the period under review. Indeed, as already mentioned, several measures were being proposed in 1973 aimed at reducing the export surtax, introduced at the same time as the 1970 devaluation, on bananas, coffee, cocoa and sugar. More specific information is not available on the turn events have taken in this respect.

(d) Wages and salaries policy

In the private sector, free bargaining between employers and workers was the general rule, with only limited participation by trade unions.

/During the

During the period under study no annual adjustment system linked to price movements was in operation for really substantial sectors of the population. Only at the beginning of 1974 was an adjustment in minimum wages approved, under the arrangements and with the effects mentioned previously.

It is interesting to note, furthermore, that the active population working in the most "primitive" sector of the economy were practically left out of the provisions adopted on wages.<sup>147/</sup>

Public servants were not given periodic or automatic readjustments either, but they did receive the compensatory bonus granted in March 1974.

Finally, it should be noted that the wages and salary policy failed to fix any more or less definite targets regarding the evolution which the real income of workers should follow.

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<sup>147/</sup> However, it is possible that inflation affected this sector of the population to a lesser extent, since the majority of them practise a system of production whereby they supply their own needs.

## 6. URUGUAY

### A. INTRODUCTORY NOTE

The review contained in this document of developments and policies in connexion with inflation in Uruguay has been structured differently from the rest of the country studies included in the present chapter, in view of the special features of Uruguay's experience.

Thus, the first part of this study deals with the development of the inflationary process since its beginnings in the mid-1950s, in order to identify the links existing between the stagnation of the economy and the creation of basic inflationary pressures, and to analyse the role played by the propagating mechanisms in the spread and multiplication of those pressures.

For various reasons, the period covered in the first part of the study extends up to and including 1971, since it is considered that this year closes an important phase in the course of inflation in Uruguay.

The second part examines events in the three years 1972-1974, taking into account that this more recent experience called for special consideration, in view of the general lines of this chapter of the Economic Survey.

Moreover, 1972 was the logical point of departure for the sub-period considered, because that year marked a change in the position of the government authorities regarding the problem of inflation and the need to adopt stabilization programmes to curb it, and because from that year onwards the impact of imported inflation began to make itself felt in Uruguay.

## B. LONGER-TERM PROSPECTS: STAGNATION AND INFLATION

### 1. Background

Inflation in Uruguay has its own particular features which distinguish it from inflation in other countries of the region. Thus, in addition to being a fairly longstanding, continuing and virulent process, its main feature has been the clear association existing between economic stagnation and the creation of pressures which are a threat to price stability.

Concurrently with the arresting of growth, the start of the inflationary process may be placed almost exactly in 1957, when the rate of price increases, which had fluctuated around 6 to 7 per cent annually over the whole period 1939-1956, rose to about 20 per cent annually. Since 1957 there have been successive periods of acceleration and deceleration of the rate of price increases,<sup>148/</sup> in keeping with the evolution of some basic variables and of the economic and stabilization policies put into practice, but the strong inflationary trend of the country's economy and the great difficulty or impossibility of achieving relative price stability for several consecutive years predominated.

The characteristics and roots of the complex phenomenon of Uruguay's economic stagnation have been studied in depth in a number of studies undertaken by national and international institutions.<sup>149/</sup> In view of its nature and scope, however, the present study does not seem to be the place to consider this aspect; it is more important here to identify the main links between lack of growth and inflationary pressures.

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<sup>148/</sup> See table 1. Roughly, the periods of acceleration were 1957-1959, 1962-1967 and 1970-1974, while the rate of inflation decreased in 1960-1962 and 1968-1970.

<sup>149/</sup> See, for example, Investment and Economic Development Committee (CIDE) - which in 1967 became the Planning and Budget Office - Estudio económico del Uruguay - evoluciones y perspectivas, Montevideo, 1963; and Plan Nacional de Desarrollo Económico y Social 1965-1974, Montevideo, 1965; and OAS, Evaluación del Plan Nacional de Desarrollo Económico y Social de la República Oriental del Uruguay 1965-1974, Washington, D.C., 1967.

Table 1  
URUGUAY: TREND OF PRICES AND RELATED VARIABLES  
(Percentages)

	Consumer price index			Wages and salaries			Liquidity coefficient	Variation in money supply December to December	Total Government deficit as a percentage of GDP	Relative prices in agriculture a/ (December 1963=100)
	Variation between annual averages	Variation December to December	Variation in the dollar for imports (between annual averages)	Variation between annual averages	Index of real wages and salaries 1957=100	Money supply GDP				
1957=100										
Average 1939-1949	6.0	-	-	-	-	-	-	-	-	-
Average 1949-1954	6.6	-	-	-	-	-	-	-	-	-
1955	7.5	10.3	5.6	-	-	-	-	5.0	-	-
1956	6.7	6.0	14.6	-	-	-	-	12.8	-	-
1957	14.7	18.5	20.8	-	100.0	-	-	6.1	-	118.0
1958	17.5	19.5	15.8	15.3	98.1	15.6	-	30.8	-	90.0
1959	39.5	48.5	48.5	25.2	88.0	15.4	-	43.0	-	161.0
1960	38.8	36.3	102.0	44.3	91.5	13.6	-	30.6	-	121.0
1961	22.5	10.3	11.1	27.7	95.4	13.1	-	21.8	-	108.0
1962	10.9	11.2	0.0	14.7	98.6	12.7	-	1.0	-	112.0
1963	20.6	43.6	29.6	18.6	97.0	12.6	-	28.8	-	100.0
1964	43.2	35.4	16.7	35.6	91.9	11.4	-	42.0	-	94.0
1965	56.5	88.0	90.4	48.6	87.2	12.0	-	102.7	3.6	86.0
1966	73.5	49.4	103.6	93.5	97.2	10.7	-	40.1	0.3	93.0
1967	89.3	136.0	64.0	78.0	91.4	9.9	-	110.4	2.8	99.0
1968	125.4	66.3b/	121.1	114.2	87.4	9.0	-	53.5	1.1	82.0
1969	20.9	14.5	0.0	28.5	92.4	10.0	-	61.3	2.3	86.0
1970	16.5	20.9	0.0	11.4	88.4	12.0	-	15.0	1.6	87.0
1971	23.9	35.7	4.0	27.4	90.8	14.0	-	51.1	5.6	106.0
1972	76.5	94.7	117.6c/	48.5	76.4	13.0	-	52.1	2.4	126.0
1973	97.0	77.5	61.3d/	90.3	73.8	13.0	-	74.5	1.1	116.0
1974	77.2	107.3	29.0e/	75.0d/	79.2d/	12.0	-	62.2	3.0	92.0e/

Sources: Statistics and Census Department, Índice de los precios del consumo; Central Bank of Uruguay, Índice de precios al por mayor de productos nacionales; and ECLA estimates based on official statistics.

a/ Calculated by dividing the price index for agricultural products by the price index for manufactured products.

b/ Between December 1967 and June 1968 the increase was 63.7 per cent; between June and December 1968 it was 1.6 per cent.

c/ Variation from June to June.

d/ Average value calculated for the period January-September.

e/ Value for September.

/In any

In any case, in order to have in view some of the magnitudes identifying the size of the problem of stagnation, the trend of some representative indicators may be observed (see table 2: figures have been compiled for several years of the period 1950-1974).

Although the annual population growth rate was reduced from 1.5 per cent at the beginning of the 1950s to 1.2 per cent so far in the 1970s, the per capita gross domestic product reached a peak value of 960 dollars (at 1970 prices) in 1956, 10 years later it had dropped to below 900 dollars, and up to and including 1974 it fluctuated around this figure.<sup>150/</sup>

As regards the goods producing sector, two outstanding facts are that the per capita agricultural production reached at the beginning of the 1950s has not since been exceeded,<sup>151/</sup> and that per capita manufacturing production reached its peak in 1956, when it was more than 10 per cent higher than the figure recorded in 1973-1974.

The trend of external variables indicates that it was not until 1973 that exports of goods expressed in dollars at current prices exceeded the value of exports in 1950-1951, while over the whole period 1957 to 1968 export levels were about 40 per cent (or 100 million dollars annually) lower than those recorded at the beginning of the 1950s.

The trend of imports was similar to that of exports, although the biggest reduction occurred in the period 1964-1968, when the value of imports of goods was 40 per cent lower than in the early 1950s.

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<sup>150/</sup> While between 1956 and 1974 Uruguay's per capita gross domestic product fell by about 8 per cent, the average value for Latin America rose by over 60 per cent.

<sup>151/</sup> On the whole, the growth of livestock production has been slower and less subject to annual fluctuations than crop production, but it still accounts for nearly 70 per cent of total agricultural output.

Table 2

URUGUAY: SOME INDICATORS OF ECONOMIC TRENDS

	1950	1951	1956	1961	1966	1971	1972	1973	1974
Total population (thousands of inhabitants)	2 193	2 227	2 397	2 590	2 754	2 921	2 956	2 990	3 025
Gross domestic product (1970 = 100)	68	74	87	86	91	99	98	99	100
Per capita gross domestic product (dollars at 1970 prices)	827	883	962	911	898	907	884	883	883
Exports of goods (millions of dollars)	254	296	216	175	190	197	242a/	328	370
Per capita exports of goods (dollars)	116	106	90	68	69	67	82	110	122
Imports of goods (millions of dollars)	184	237	159	183	132	203	179	249	420
Per capita imports of goods (dollars)	84	106	66	71	48	69	61	83	139
Index of unit value of exports (1970 = 100)	114	159	101	90	98	101	131	190	204
Index of unit value of imports (1970 = 100)	82	98	102	90	91	106	111	133	209
Terms of trade (1970 = 100)	139	162	99	100	108	95	118	143	98
Export quantum index (1970 = 100)	99	66	95	87	87	87	82	77	74
Import quantum index (1970 = 100)	111	119	76	100	71	94	79	92	141
Agricultural production index (1970 = 100)	72	79	86	86	95	99	96	99	101
Per capita agricultural production index (1970 = 100)	95	102	104	96	100	98	94	96	96
Manufacturing production index (1970 = 100)	59	65	87	84	89	98	98	97	99
Per capita manufacturing production index (1970 = 100)	78	84	105	94	93	97	96	94	95

Sources: ECLA estimates based on official statistics.

a/ Including 28 million dollars' worth of non-monetary gold.

The course of the unit value of exports - which reflects the international prices of goods exported by Uruguay, mainly meat and wool - played a decisive role in the evolution of the external sector. Thus, the favourable situation in the first half of the 1950s as regards world prices of these commodities did not occur again until 20 years later,<sup>152/</sup> when world inflation spurted. Because of the impact of inflation on the unit value of Uruguay's imports, however, the terms of trade failed to regain in 1973 the levels recorded in 1950-1951 and in 1974 they reverted to a level comparable with that registered in 1970.

The trend of capital formation was consistent with that of the economy in general and the availability of foreign exchange for imports. The rate of investment in relation to the gross domestic product, which had reached around 20 per cent at the beginning of the 1950s, declined steadily from then onwards to levels of 15 per cent in the early 1960s and 10 per cent in the middle of that decade. Subsequently, the investment coefficient recovered slightly, remaining at around 11 per cent.

Among other circumstances, this reduction in the investment rate took place concurrently with an absolute decrease in domestic saving, particularly that generated by the public sector. In fact, since the end of the 1950s, the Treasury and the public sector have frequently shown deficits or very small surpluses on current account. Over the past 15 years, private saving has remained at or below the levels reached before 1960.

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<sup>152/</sup> The index of the unit value of exports (in dollars at current prices), with base year 1970 = 100, reached 135 in 1950-1954, fluctuated around 100 throughout the period 1958-1970, and soared to an average of over 190 in 1973-1974.



## 2. Origins of inflation: structural factors and propagating mechanisms

A study of the factors contributing to inflation in Uruguay and of the relationships between the growth and inflationary processes sheds light on some basic and more lasting features of the problem under review and, in particular, makes it possible to distinguish between those usually called structural factors and those identified as propagating factors of the basic disequilibria.

On this question, the Economic Survey of almost 10 years ago 153/ contains several observations which are still relevant today.

On the one hand, it was stated that:

"The various analyses of Uruguay's economy show the structural background of the present situation, which seems to be attributable to two basic factors. Firstly, the relative stagnation - and recently the recession - of agricultural production, which has ceased to fulfil its two traditional functions: to provide food and inputs for the domestic market and to create an exportable surplus that would make it possible to import the supplementary capital goods, primary products and consumer goods required if the national system is to develop properly. The general result of this trend has been the low growth rate of the domestic product, which, allowing for population growth, shrank in absolute terms by about 12 per cent between 1957 and 1965.

This circumstance is at variance with the second basic factor: social resistance to a decline in real income, a phenomenon which takes a highly individual form in Uruguay, which has a well-integrated and highly organized society. The population is thus fighting a rearguard action with a wide range of devices and instruments that enable each group to defend its own interests with some measure of success. "154/

In addition, the unfavourable course of agricultural production coincided with a situation where the relative prices for agriculture were actually quite encouraging for the sector. Thus, for example, a series covering real agricultural prices calculated on the basis of 1935-1937 = 100 shows that throughout the post-war period up to and

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153/ See ECLA, Economic Survey of Latin America, 1965 (United Nations publication, Sales No.: 67.II.G.1), pages 43-45.

154/ See Economic Survey of Latin America, 1965, op.cit., page 44.

including 1963 the index values fluctuated around 140.155/ In other words, the evolution of the agricultural sector acted as a structural factor of inflation, both because of the slow growth of production and because of the pressures it brought to bear on the general level of prices with the improvement in its relative position.

In connexion with the propagating mechanisms, on the other hand, the 1965 Economic Survey affirms that:

"One such factor derives from the most vulnerable point of Uruguay's present economy - its trade balance. The inadequacy of the agricultural sector has led to persistent disequilibrium in Uruguay's external accounts, which in turn has prompted periodical devaluations of the national currency, both as a response (usually belated) to the basic maladjustment and as a means of curbing the demand for imports by raising their relative prices.

Devaluation, which has raised the official rate of the dollar from approximately 11 pesos in 1961 to nearly 60 at the end of 1965, is another "propagating" factor of inflation, inasmuch as the consequent adjustment of the prices of imported goods provoke a defensive reaction on the part of those affected by such changes, changes, whether wage-earners, who in the face of these price increases will try to obtain wage adjustments, or entrepreneurs, who will try to meet the higher cost of their imported inputs by raising the prices of their products. Simultaneously or successively, these two mechanisms of the inflationary spiral have set in motion the mechanisms involved in the fiscal and monetary sectors. The government machine, which in Uruguay employs a sizable proportion of the labour force, has had to satisfy to a greater or lesser extent the petitions of its active or retired personnel, and for that purpose it has had to raise taxes or resort to financing by the currency issuing institution. It is worthwhile noting the contradiction underlying public sector decisions on devaluation. On the one hand, devaluation opens the way to obtaining funds from additional export or import charges or from the credit expansion made possible by the increase in the value of the reserves. On the other hand, devaluation has the effects alluded to above, with the resulting increase in expenditure. This contradiction has also occurred or is occurring in other countries beset by the same type of problems, but it is especially significant, perhaps, in Uruguay because of the scale of employment in the public sector and its high level of organization.

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155/ See Evaluación del Plan Nacional de Desarrollo Económico y Social de la República Oriental del Uruguay 1965-1974, op.cit., page 269. The real price series was obtained by deflating the agricultural price index by a representative index of general price trends.

Thus, the various factors of fiscal disequilibrium - from the standpoint of both receipts (increases in taxes or currency issues) and expenditure (increases in wages and in transfers to other public sector agencies) - constitute the third important mechanism responsible for the spread of inflation.

To use a simplified approach, the above-mentioned factors might be said to affect a fourth determinant of inflation - the monetary sector. It is a well-known fact that, theoretically at least, it is this sector which gives way to or resists the pressures that originate from various sources and require an increase in the money supply to meet the higher levels of nominal income and consequently of prices."<sup>156/</sup>

It was also noted that in the course of the inflationary process the structural factors gradually lose part of their original significance, particularly in the more accelerated bursts of inflation, while the more immediate or propagating mechanisms acquire more importance.

With a view to illustrating the behaviour of the propagating mechanisms in the period 1955-1974 and its relationship with price trends, several indicators which have been considered useful for the purpose are presented in table 1. Some main conclusions may be drawn from these figures.

First, it is not easy to establish well-defined causal links or the order of importance of the various propagating mechanisms and the sequence in which they operated, since this is a circular process of interaction which, in addition, is constantly changing.

Secondly, the devaluations of the Uruguayan peso, according to their frequency and intensity, seem to have constituted the most active and direct of all the propagating mechanisms, which tends to confirm a hypotheses put forward in the above-mentioned Economic Survey. Moreover, the periods of decline in the rate of price increases (1959-1962 and 1968-1970) followed periods in which drastic devaluations in one or several consecutive years had made it possible temporarily to manage the economy with fewer financial and material pressures and with a slower rate of devaluation of the national currency.

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<sup>156/</sup> See Economic Survey of Latin America, 1965, op.cit., page 44.

Thirdly, wage adjustments were primarily a defensive mechanism in response to price variations. In this respect, the series on wages and salaries in manufacturing 157/ reveals that the nominal wage adjustments lagged at least a year behind the changes in the rate of inflation. Thus, during spurts of inflation there were significant decreases in real wages and salaries, which were usually compensated for, often only in part, when adjustments were obtained to offset former price increases, or the rate of increase in prices slackened, or both.158/

Fourthly, the behaviour of the monetary mechanism was different before and after 1968. Before that year it was a passive rather than an active factor, which gave way to the pressures originating outside it, and the periodical percentage variations in the money supply were consistently lower than those recorded in prices. This trend contributed to the decrease in the liquidity coefficient (money supply/gross domestic product) from values of over 15 per cent in 1950-1959 to less than 10 per cent in 1967-1968. This trend was reversed after 1968 and the liquidity coefficient rose to levels of around 13 per cent in the last few years.

Lastly, the government finances have generally been an element contributing to financial and price instability, first because there have frequently been fiscal - and public - deficits 159/ which have

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157/ The Statistics and Census Department also calculates wage and salary indexes for other sectors, but the manufacturing series was used here, since the available data cover a longer period and it has been subject to less frequent changes in the method of preparation.

158/ Although the limitations of the real wage and salary series are recognized, it may be noted in terms of broad trends that the relevant index, with base year 1957 = 100, dropped to below 90 in 1959, recovered to about 100 in 1962, fell again to less than 90 in 1968, recovered slightly up to 1971 and dropped to around 80 in 1974. This point will be dealt with again later.

159/ Fiscal deficits are defined as the difference between total expenditure (current and capital) and current income.

been covered, to a great extent, with issues by the monetary authorities and, secondly, because the size of the deficits has fluctuated widely.

Some available data suggest that in 1956-1957 the fiscal deficit began to have some relative importance upon reaching 2 per cent of the gross domestic product.<sup>160/</sup> In subsequent years up to and including 1961, the deficit was maintained or reduced, but started to rise in 1962 and by 1965 it was over 3.5 per cent of the gross domestic product. From that year until 1974, the deficit decreased in one year and increased again in the next - except in 1973 - the highest relative values being recorded in 1967, 1969, 1971 in particular, and 1974 (see table 1).

Two supplementary observations on the size of the fiscal deficit and its fluctuations are called for here. As regards its origin, a predominating role was played by the greater or lesser annual revenue obtained from export taxes, which increased substantially in periods when the devaluations were most drastic.<sup>161/</sup>

As regards financing the deficit, there was an obvious link between the greater fiscal disequilibria and the higher rates of increase in the money supply. This was partly due to the fact that other sources of financing to cover the deficit, such as external loans and the sale of government bonds - as distinct from direct issues by the monetary authorities - were of little relative importance and had a small range of compensatory flexibility.

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<sup>160/</sup> See Evaluación del Plan Nacional de Desarrollo Económico y Social de la República Oriental del Uruguay 1965-1974, op.cit., page 514.

<sup>161/</sup> Frequently, in those periods, there was the twofold effect of higher revenue resulting from the devaluation itself and that resulting from the rise in export taxes.

### 3. Stabilization efforts up to 1971

#### (a) Experience prior to 1968-1971

Within the context of this long history of inflation, as the annual price increases became more violent and the adverse economic and social effects of the problem snowballed and spread, more importance and priority were attached to the framing and implementation of anti-inflationary policies, which became progressively more complex and more difficult to define.

Thus, "at the outset, when inflationary pressures had but a moderate and somewhat intermittent effect on prices, the remedies adopted were piecemeal and sporadic so far as the range of instruments used was concerned. Various expedients to curb the demand for imports were combined with others aimed at stepping up exportable surpluses (for example, by endeavouring to reduce domestic consumption), while at the same time, or at other stages, more importance was attached to tightening the money supply or to increasing public revenue".<sup>162/</sup>

At a later date, other more integrated stabilization systems were formulated; in some instances these were applied in their entirety, but not in others, or only to a partial extent. Among the latter was what was known as the Annual Programme (referring to 1965), the anti-inflationary project which formed part of the National Development Plan 1965-1974, prepared by CIDE. This programme constituted the beginning of a rather longer-term stabilization plan - consistent with the development plan - and favoured a "gradualist" approach to containing inflation. It also defined a group of measures and institutional arrangements aimed at simultaneously getting rid of the structural factors and the propagating mechanisms which were causing inflation.

Among the measures considered, mention should be made of the proposal to draw up a Social Agreement between the Government, the entrepreneurs and the wage workers, which would allow a periodic

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<sup>162/</sup> See Economic Survey of Latin America, 1965, op.cit., page 45.

definition and co-ordination of the general norms which should govern wage policies and some basic prices and the remuneration of the capital factor.

For various reasons, particularly of a political nature, the Annual Programme and subsequent programmes, and the Development Plan were implemented to only a small extent. However, many of the ideas and lines of action proposed in them materialized as specific measures in later years.<sup>163/</sup>

It should also be borne in mind that up to 1966 inclusive, the anti-inflationary policies introduced were affected by the restrictive terms of reference and the institutional limitations which characterized the power of the Government of Uruguay.

This situation underwent a basic change in March 1967, with the beginning of the administration of a new Government, elected in November 1966, and the adoption at the same time of constitutional reforms introducing a presidential system and granting the Government broader terms of reference and powers.

During 1967 and the first half of 1968, however, the rate of inflation increased, particularly as a result of the violent fiscal and monetary shock of the readjustment of over 100 per cent in public sector salaries,<sup>164/</sup> which came into force at the beginning of 1967, and because of the repercussions from an external trade situation in which low export levels and sharp devaluations of the local currency coincided (see tables 1 and 2).

At the same time as the rate of growth of prices increased, the opinion was gaining consensus in Government circles that it was essential to introduce an energetic stabilization programme which

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<sup>163/</sup> Notable examples of these which may be mentioned were the creation of the Central Bank in 1967, and the Planning and Budget Office and the priority given as from this date, to the substantive and financial programming of the economy and also to the co-ordination between the two.

<sup>164/</sup> For constitutional reasons, the 1966 readjustment had not been granted, since it was just previous to the elections.

would enable the increasingly imminent risk of hyperinflation to be avoided. Finally, in June 1968 - in circumstances in which it was estimated that if the price trends of the first half of the year were to continue throughout the year a possible annual rate of growth of prices of not less than 200 per cent would be reached - the Government decided to go forward with an anti-inflationary policy, clearly differentiated from those which had been applied previously.

(b) The stabilization policy 1968-1971

The strategy followed as from the second half of 1968, was aimed at bringing inflation to an abrupt halt, i.e., the type of stabilization usually known as shock treatment, as opposed to the gradualist approach, was selected.

(i) The programme and its results. A central element of the policy was the prices, wages and incomes freeze - to their June 1968 levels - which was brought into force as from July of that year.

In order to make the freeze effective, a system of almost total centralization was established for determining prices and wages, while previously existing machinery was done away with, principally such machinery as was outside the direct radius of action of the Government. Thus, the tripartite wages councils disappeared together with the freedom to fix wholesale and retail prices for the main products handled in the economy of Uruguay. In order to carry out these new functions, a Productivity, Prices and Income Commission (COPRIN), was set up, where, despite tripartite representation, it was the Government which carried the decisive weight in the making of decisions.

With the creation of COPRIN - and the ample powers granted it - the State took control of practically all the prices, merchandise and factors of the economy, in both the public and private sectors. The fixing, control and very occasionally the revision of prices and wages, ranged from the most general and relatively most important cases to other more specific cases which were less important to the functioning of the production and marketing system.



A second basic element of the stabilization policy followed consisted in maintaining a fixed rate of exchange (of 250 pesos to the dollar) applicable to commercial and financial operations with the exterior, while at the same time existing controls for regulating the inflow and outflow of foreign exchange in the commercial and financial markets were tightened up.<sup>165/</sup>

The maintenance of a fixed exchange rate was considered feasible for a relatively long period, because the authorities were of the opinion that the sizeable devaluations agreed upon towards the end of 1967 and in the second quarter of 1968 had led to a possible over pricing of foreign exchange, which was a situation which had not made its appearance in the country for a long time. This over-pricing in turn would enable incentives to be applied to agricultural production and exports and fiscal financed to be reinforced, -- through increased yields from withholdings -- especially if the prices and wages freeze decree were successful.

Lastly, by means of the careful manipulation of fiscal and monetary instruments, it was hoped to maintain a reasonable balance between the evolution of financial and substantive variables, so that a situation of an overgrowth of liquidity would not be produced, particularly in an economy where prices and wages ought to remain stabilized.

The measures indicated and other secondary measures which it does not seem necessary to review in the present document, were applied during a period of approximately three years which lasted till the second half of 1971.

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<sup>165/</sup> Even so, the so-called "parallel" market continued to function, although in a limited and illegal form.

Without going into detailed considerations of the probable repercussions of the anti-inflationary strategy on growth and its structure and on income distribution,<sup>166/</sup> it seems obvious that this strategy succeeded in containing the growth of prices, especially in the second half of 1968 and in 1969.

In fact, the consumer price index, which had increased by 136 per cent between December 1966 and December 1967 and by 63.7 per cent between December 1967 and June 1968, increased by only 1.6 per cent between June and December 1968, and by 14.5 per cent during 1969. The rate of inflation in 1970 reached 20.9 per cent and 35.7 per cent in 1971 (see table 1).<sup>167/</sup>

(ii) The breakdown of the programme. Time passed, and especially in 1971, the numerous pressures generated were eating away at the base of the anti-inflationary programme. This was basically in response to the fact that the traditional propagation mechanisms of inflation in Uruguay were regaining strength, combined in 1971 with an adverse economic situation and increasing operational complications in the implementation of the stabilization programme.

In the first place, it should be observed in connexion with these propagation mechanisms, that there was a progressive accumulation of various elements which made it increasingly difficult to maintain the rate of exchange established in June 1968. Local prices continued to rise, although to a moderate extent, and the over-pricing of foreign currency recorded in mid-1968 disappeared; it became increasingly

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<sup>166/</sup> Between 1967 and 1971 the gross domestic product increased by around 3 per cent annually. Real wages in industry - and the average for the economy as a whole - remained at stable levels throughout the whole period 1967-1971. See, Banco Central del Uruguay, Indicadores de la actividad económico-financiera, published monthly.

<sup>167/</sup> The wholesale price index for national products recorded a trend very similar to that of consumer prices. The variations in the wholesale index were: 124.7 per cent in 1967; 63.7 per cent in the first part of 1968 and 1.4 per cent in the second half; 7.5 per cent in 1969, 17.9 in 1970 and 40 per cent in 1971. See Banco Central del Uruguay, op.cit.

more complicated to contain the demand for imports, in a situation in which there was at one and the same time a sizeable decrease in local prices of imported articles and a significant increase in overall demand, in real and financial terms; local exporters, particularly of meat, wool and hides, began to accumulate stocks and postponed selling abroad as they waited for a more favourable exchange rate,<sup>168/</sup> while in 1970 and 1971 equilibrium was achieved in the balance of payments following a decrease of approximately 30 million dollars per year in net international reserves (see table 3).

In response to these tensions, the peso was devalued from 250 to 370 pesos to the dollar, in the last quarter of 1971, and this gave a renewed impulse to a propagation mechanism which had remained inactive for more than three years.

Secondly, money supply - at times under pressure mainly from the growth of credit to the public sector (in 1969 and 1971) and at others, from the increase in placements in the private sector (in 1970) - grew more rapidly than prices and economic activity with the result that the liquidity coefficient increased steadily and significantly between 1968 and 1971 (from 9 per cent to 14 per cent; see table 1).

Although it may be argued that this increase in liquidity was to be expected since inflationary expectations were slumping, it is also true that it made for greater dynamism - perhaps too great - in total demand, including imports, and also determined a relatively larger supply of financial resources, which was a potential risk, should other factors tend to destroy price stability, as was the case in 1971.

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<sup>168/</sup> Or sold a percentage of their goods outside legal channels within the country and/or in boarder countries.

Table 3  
URUGUAY: BALANCE OF PAYMENTS  
(Millions of dollars)

	Average 1966-1970	1971	1972	1973	1974
<u>Current account</u>					
Exports of goods and services	250.6	252.7	310.8	409.8	463.4
Goods FOB	190.5	196.8	242.0	327.6	370.1
Services	60.1	55.9	68.8	82.2	93.3
Imports of goods and services	233.7	302.9	279.3	366.3	566.4
Goods FOB	157.5	203.0	178.7	248.6	419.7
Services	76.2	99.9	100.6	117.7	146.7
Net external investment income	-23.2	-21.6	-23.5	-25.1	-39.5
Profits	-1.0	0.0	0.0	0.0	0.0
Interest	-22.2	-21.6	-23.5	-25.1	-39.5
Net private transfer payments	-0.2	-0.6	-0.2	-0.2	-0.0
Balance on current account	-6.5	-72.4	7.8	18.2	-142.5
<u>Capital account</u>					
Net external financing (a+b+c+d+e)	6.5	72.4	-7.8	-18.2	142.5
(a) Net external non-compensatory capital	26.3	83.1	69.8	47.4	85.3
Direct investment	0.0	0.0	0.0	0.0	
Long-and medium-term loans	21.1	57.0	59.9	31.6	
Amortization payments	-14.8	-19.3	-25.1	-47.2	
Short-term liabilities	10.5	36.5	23.1	44.0	
Official transfer payments	9.5	8.9	11.8	19.0	57.2
(b) Domestic non-compensatory capital or assets	-0.6	-2.6	0.6	-25.7	
(c) Errors and omissions	-16.6	-44.8	-56.8	-82.4	
(d) Allocation of SDR units	1.8	7.4	8.1	0.0	
(e) Net compensatory financing (-increase)	-4.4	29.3	-29.4	42.5	

Source: ECLA, on the basis of official statistics.

/Thirdly, in

Thirdly, in 1971 the fiscal situation deteriorated notably because total Government expenditure increased by around 60 per cent while the increase in current earnings was 24 per cent (see table 4). The increase in expenditure basically reflected the large increase in public sector wages in that year. The slow growth of current incomes was influenced by the fact that the yield from withholdings was adversely affected by the stability of the exchange rate and by the decrease in exports.

As a result of this development, the fiscal deficit increased its percentage of the gross domestic product, from 1.6 per cent to 5.6 per cent, and had to be financed almost entirely by direct issues by the Central Bank in favour of the Government. In 1971, fiscal activities were thus of great importance as a factor of monetary growth, in a situation in which the increase in the quantity of money which had been 15 per cent in 1970 was 51 per cent in the following year (see tables 1 and 5).

In the fourth place, the role of wage readjustments as a propagation mechanism was not of outstanding importance, except as already noted for fiscal returns in 1971. It should be recalled that real wages in the private sector, more exactly in industry, remained relatively stable between 1967 and 1971.

As far as circumstantial factors were concerned, it should be recalled that 1971 marked the end of a Government and a year of presidential elections. In the circumstances, the outgoing Government implemented the stabilization programme which it had set for itself, rather less energetically than in previous years.

Lastly, in connexion with the increasing operational complexity of centralizing wage and price control, in the course of time the work of COPRIN became unquestionably more complicated and overloaded, putting a drag on the efficient functioning of the stabilization system. A factor which affected this was the increase in the number of requests for the review of prices and wages which reached COPRIN, and the fact already commented upon, that the field in which this institution was empowered to act and exercise control was very wide and very diverse.

Table 4

## URUGUAY: CENTRAL BANK FINANCES

(Thousands of millions of pesos at current prices)

	1969	1970	1971	1972	1973	1974 <sup>a</sup>	Per- cent- age varia- tion
(1) Current income	61.8	82.9	103.1	167.6	370.2	606.1	63.7
(2) Total expenditure	73.5	91.2	145.2	199.4	406.4	734.7	80.8
(3) Total central government deficit (2-1)	11.7	8.3	42.1	31.8	36.2	128.6	255.2
(4) Financing of the total deficit b/	-	8.3	42.1	31.8	36.2	128.6	-
(a) External credit	-	1.1	0.8	2.9	8.1	5.0	-
(b) Domestic credit	-	7.2	41.3	28.9	28.1	123.6	-
(1) Monetary authorities	-	(3.2)	(36.4)	(24.8)	(20.9)	(102.3)	-
(ii) Other sources (including Treasury bonds)	-	(4.0)	(4.9)	(4.1)	(7.2)	(21.3)	-

Sources: IMF, International Financial Statistics, February 1975; and ECLA, on the basis of official statistics.

a/ Estimates.

b/ After deduction of amortization payments on the domestic and external debt.

Table 5

URUGUAY: MONETARY TRENDS

(Thousands of millions of pesos at current prices)

	1969	1970	Per- cent age varia- tion	1971	Per- cent age varia- tion	1972	Per- cent age varia- tion	1973	Per- cent age varia- tion	1974 <sup>a/</sup>	Per- cent age varia- tion
I. <u>Composition of the monetary resources</u>											
(1) Money	72.0	82.8	15.0	125.1	51.1	190.3	52.1	331.9	74.5	538.2	62.2
(2) Quasi-money	28.8	38.7	34.4	56.5	46.0	96.6	71.0	164.3	70.1	-	-
II. <u>Factors of expansion and contraction</u>											
(3) Domestic credit	76.8	104.4	35.9	173.8	66.5	337.2	94.0	510.3	51.3	950.0	86.0
(a) to the public sector	18.7	20.3	8.6	42.5	109.4	76.8	80.7	84.3	9.8	-	67.0
(b) to the private sector	58.1	84.1	44.8	131.3	56.0	260.4	98.3	426.0	63.6	-	94.0
(4) Net international reserves	-1.8	-10.5	-	-7.0	-	-	-	-	-	-	-

Sources: IMF, International Financial Statistics, February 1975; and ECLA, on the basis of official statistics.

a/ Estimates.

C. THE PERIOD 1972-1974: REACTIVATION OF THE MOVEMENT  
OF PRICES AND IMPORTED INFLATION

1. The general setting

The evolution of inflation and the economy in Uruguay during the period 1972-1974 has some main features.

The first aspect of note is the rapid reactivation of inflation, after the breakdown of the stabilization policy brought in during the three-year period 1968-1971 had become more pronounced at the end of 1971.

In any case, after annual price increases of around 100 per cent were reached in 1972, the rate of inflation remained about this level in 1973 and 1974, with no indications of any later increase or, conversely, any decrease in its rate (see table 6, which gives data on trends in consumer and wholesale prices).

Secondly, during the last three-year period, not only was the strategy applied in the previous period abandoned as far as stabilization policies and measures are concerned, but a scheme of action different to that of 1968-1971 progressively took shape.

The shock treatment alternative which had been followed was replaced by another system characterized by the flexibility of its price mechanism and the functional nature of movements in the level and system of prices. The rates of inflation considered acceptable by the authorities largely took second place to other economic policy priorities, especially as regards the direction and requirements of growth.

In the third place, to the endogenous factors which affected the existence and duration of disequilibria in domestic prices, was added an exogenous influence as from 1972 - imported inflation - which has remained in existence to the present time and which acquired more force with time.



Table 6

URUGUAY: RECENT PRICE TRENDS

	1970		1971		1972		1973		1974	
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
	Between December to annual averages		Between December to annual averages		Between December to annual averages		Between December to annual averages		Between December to annual averages	
(1) Consumer price index	16.5	20.9	23.9	35.7	76.5	94.7	97.0	77.5	77.2	107.3
(2) Index of wholesale prices of domestic products - general	13.7	17.9	20.4	40.0	89.9	114.6	114.9	91.7	-	51.0a/
(a) Manufactured products	13.2	17.5	17.1	32.1	80.4	102.8	118.0	97.2	-	62.1a/
(b) Agricultural products	15.3	19.1	29.7	61.6	113.9	141.0	108.4	81.3	-	28.3a/

Sources: Statistios and Census Departuamt, Indice de los precios del consumo; and Central Bank of Uruguay, Indice de precios al por mayor de productos nacionales.

a/ Variation between December 1973 and September 1974.

It should be noted that the rebound of inflation from abroad found the process of penetration assisted by the intensive increase in international prices; by the fact that the country was undergoing a process of domestic inflation of some consideration; and by the policy being followed of bringing national and international prices up to the same level, especially in circumstances in which food prices in the world market had increased substantially.

Lastly, another outstanding feature of the period 1972-1974 was the re-emergence of the old tendency for the Uruguayan economy to stagnate following a brief interruption of this trend, as has already been observed, in the years immediately preceding this period, especially during 1968-1970.

In fact the data given in tables 7 to 10 show that between 1971 and 1974 the gross domestic product showed an annual average growth rate of 0.5 per cent, i.e., the annual per capita product decreased by 0.7 per cent.

It may also be seen from an examination of the trend of the sectors of economic activity that the gross domestic product generated by agriculture remained static, measured in absolute values, between 1971 and 1974, and that industry grew during the same period at a slower rate than the population. Only construction continued to develop at a speed similar to that of previous years, at an annual rate of around 4 per cent. (see table 9).

As regards the evolution of total supply and demand in this general setting of stagnation, the further drop in the investment coefficient during 1972-1974, following its recovery in 1968-1971, is of note.

## 2. Internal factors of inflation

In the reactivation of inflation which took place as from late 1971, the role of the propagation mechanisms was again decisive. However, it is noteworthy that owing to special conditions some of these propagation mechanisms proved to be more persistent or more intensive than in previous periods, or showed both these characteristics.

Table 7

URUGUAY: TOTAL SUPPLY AND DEMAND

(Thousands of millions of pesos at 1970 prices)

	1970	1974 a/	1970- 1965	1974- 1971	1971	1972	1973	1974 a/
<u>Total supply</u>	688.7	680.7	3.2	0.3	-2.0	-2.4	1.8	2.5
Imports	76.6	65.1	12.8	-1.7	-10.6	-11.9	9.4	8.2
Gross domestic product	612.1	615.6	2.3	0.5	-1.0	-1.3	1.0	1.9
<u>Total demand</u>	688.7	680.7	3.2	0.3	-2.0	-2.4	1.8	2.5
Exports	71.6	64.6	-3.0	2.9	-17.1	10.8	-9.9	8.9
Gross domestic investment	70.0	64.0	7.2	-5.3	7.7	-12.0	-3.0	-0.5
Gross fixed investment	68.5	...	7.1	...	2.6	-17.9	-4.6	...
Total consumption	547.1	552.1	3.7	0.8	-1.3	-2.5	3.8	2.2
General government	92.1	83.2	5.7	-1.0	-6.8	-6.0	3.4	-0.3
Private	454.9	468.9	3.3	1.1	-0.2	-1.9	3.9	2.6

Source: ECLA, on the basis of official statistics.

a/ Preliminary figures.

Table 8  
URUGUAY: STRUCTURE OF TOTAL SUPPLY AND DEMAND<sup>a/</sup>  
(Percentages)

	1965	Average 1969- 1970	1970	1971	1972	1973	1974
<u>Total supply</u>	<u>107.7</u>	<u>111.8</u>	<u>112.5</u>	<u>111.3</u>	<u>110.1</u>	<u>110.9</u>	<u>111.6</u>
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Imports	7.7	11.8	12.5	11.3	10.1	10.9	11.6
<u>Total demand</u>	<u>107.7</u>	<u>111.8</u>	<u>112.5</u>	<u>111.3</u>	<u>110.1</u>	<u>110.9</u>	<u>111.6</u>
Exports	15.2	11.8	11.7	9.8	11.0	9.8	10.5
Gross domestic investment	9.1	11.1	11.4	12.4	11.1	10.7	10.4
Gross fixed investment	8.9	11.1	11.2	11.6	9.6	9.1	-
<u>Total consumption</u>	<u>83.4</u>	<u>88.8</u>	<u>89.4</u>	<u>89.1</u>	<u>88.0</u>	<u>90.4</u>	<u>90.7</u>
General government	<u>12.8</u>	<u>14.6</u>	<u>15.0</u>	<u>14.2</u>	<u>13.5</u>	<u>13.8</u>	<u>13.5</u>
Private	70.6	74.2	74.4	74.9	74.5	76.6	77.2

Source: ECLA, estimates based on official statistics.

a/ At 1970 prices.

Table 9

URUGUAY: GROSS DOMESTIC PRODUCT,  
BY SECTOR OF ECONOMIC ACTIVITY  
(Millions of pesos at 1970 prices)

	1970	1974 <sup>a/</sup>	1970- 1965	1974- 1971	1971	1972	1973	1974 <sup>a/</sup>
Agriculture	67 164	66 600	2.8	0.1	-1.2	-3.4	3.1	0.8
Mining	0	0	-	-	-	-	-	-
Manufacturing	128 760	129 995	2.4	1.0	-1.8	-0.3	-0.4	3.6
Construction	20 182	24 084	4.3	4.1	5.8	5.5	-2.0	9.1
<u>Subtotal goods</u>	<u>216 106</u>	<u>220 679</u>	<u>2.7</u>	<u>1.0</u>	<u>-0.9</u>	<u>-0.7</u>	<u>0.5</u>	<u>3.3</u>
Electricity, gas, water and sanitary services	7 919	8 749	5.0	1.7	5.1	4.2	5.2	-4.1
Transport and communications	45 496	45 917	0.1	-0.7	3.0	-6.3	0.6	3.9
<u>Subtotal basic services</u>	<u>53 415</u>	<u>54 666</u>	<u>0.7</u>	<u>-0.3</u>	<u>3.3</u>	<u>-4.7</u>	<u>1.4</u>	<u>2.5</u>
Commerce and finance	91 603	87 201	0.9	-0.2	-4.1	-4.5	1.2	2.6
Ownership of dwellings	27 436		1.9		1.5	1.5	0.7	
Government	76 734	170 263	4.3	0.3	-2.2	0.0	0.7	-0.4
Miscellaneous services	66 336		2.3		-1.0	1.2	0.7	
<u>Subtotal other services</u>	<u>262 109</u>	<u>257 464</u>	<u>2.3</u>	<u>0.1</u>	<u>-2.2</u>	<u>-1.1</u>	<u>0.9</u>	<u>0.6</u>
<u>Total gross domestic product</u>	<u>531 630</u>	<u>534 560</u>	<u>2.3</u>	<u>0.5</u>	<u>-1.0</u>	<u>-1.3</u>	<u>1.0</u>	<u>1.9</u>

Source: ECLA, on the basis of official statistics.

<sup>a/</sup> Preliminary figures.

Table 10  
URUGUAY: STRUCTURE OF GROSS DOMESTIC PRODUCT,  
BY SECTOR OF ECONOMIC ACTIVITY<sup>a/</sup>

(Percentages)

	1965	Average 1966- 1970	1970	1971	1972	1973	1974
Agriculture	12.3	12.2	12.6	12.6	12.3	12.6	12.5
Mining	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufacturing	24.0	24.1	24.2	24.0	24.3	23.9	24.4
Construction	3.4	3.7	3.8	4.1	4.3	4.2	4.5
<u>Subtotal goods</u>	<u>39.8</u>	<u>39.9</u>	<u>40.6</u>	<u>40.7</u>	<u>40.9</u>	<u>40.7</u>	<u>41.5</u>
Electricity, gas, water and sanitary services	1.3	1.4	1.5	1.6	1.7	1.7	1.6
Transport and communications	9.5	8.9	8.6	8.9	8.5	8.4	8.6
<u>Subtotal basic services</u>	<u>10.8</u>	<u>10.3</u>	<u>10.0</u>	<u>10.5</u>	<u>10.1</u>	<u>10.2</u>	<u>10.2</u>
Commerce and finance	18.4	16.9	17.2	16.7	16.2	16.2	16.3
Ownership of dwellings	5.3	5.3	5.2	5.3	5.4	5.4	31.9
Government	13.1	15.2	14.4	14.3	14.5	14.4	
Miscellaneous services	12.4	12.6	12.5	12.5	12.8	12.8	
<u>Subtotal other services</u>	<u>49.2</u>	<u>50.0</u>	<u>49.3</u>	<u>48.7</u>	<u>48.9</u>	<u>48.8</u>	<u>48.2</u>
<u>Total gross domestic product</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Source: ECLA estimates based on official statistics.

a/ At 1970 prices.

In the first place, during the last few years an endeavour was made to channel inflation along corrective lines, the main aim being to make sure of relatively better prices for exports and agricultural products on a systematic basis. With this in view, two mechanisms or guidelines of great importance for the operation of the system were introduced.

One of these was the introduction, early in 1972, of the exchange procedure which consists in periodically determining minidevaluations of the national currency. Thus, after the two maxidevaluations adopted at the end of 1971 and the beginning of 1972 (which raised the import dollar quotation from 250 to 500 pesos), movements of the exchange rate continued to take place at intervals.

Another was the acceptance - or rather the pursuit - of an improvement in the relative prices of agricultural products. Influence in that direction was exerted by exchange policy itself, by a more liberal approach to the determination of agricultural prices, to which end the number of food products subject to official price-fixing was considerably restricted; and by the exposure of domestic industry to external competition, in consequence of the elimination of quantitative import controls.

In line with this orientation, between the end of 1970 and the year 1972, wholesale prices of agricultural commodities, in relation to those of manufactures, rose by about 45 per cent, thus becoming a major factor in the propagation of inflation. Subsequently, once the overall annual growth rate of prices had attained 100 per cent, during the years 1973 and 1974 prices of manufactures increased faster than those of agricultural products (see again tables 1 and 6).

Secondly, the role played by the monetary system as a propagating mechanism reflected, in reality, contradictory lines of conduct. Generally speaking, in the three-year period 1972-1974 the percentage variations in the money supply were smaller than those in prices,

/which led

which led to a gradual reduction of the liquidity coefficient of the economy and, up to a point, relegated the monetary instrument to a mainly passive function.<sup>169/</sup>

On specific occasions, however, the authorities endeavoured to prevent the decrease in the liquidity coefficient, which was exercising a moderating influence on inflationary trends, from being carried too far and consequently producing depressive effects. For example, action was taken to that end at the beginning of the last quarter of 1973, when the contractionist monetary programme that had been applied during the rest of the year was adjusted and expanded with the aim of adapting the growth of the money supply to the needs of the economy.

Thirdly, wage adjustments did not play a very active part as a mechanism of inflationary propagation. During the period 1972-1974, they fell short of price increases. Thus, between 1971 and 1974 the index of real wages in manufacturing industry showed a decrease of about 10 per cent (see again table 1). The average index of wages in the economy as a whole declined in a similar proportion.<sup>170/</sup>

Lastly, the action of the fiscal sector as a factor of propagation - especially on account of its linkage with monetary expansion - was particularly important in the year 1974. Since current expenditure increased faster than current income,<sup>171/</sup> the total Central Government deficit rose by over 250 per cent, and, in order to finance it, the monetary authorities had to quintuple the volume of resources that they had earmarked for the purpose in 1973 (see again table 4).

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<sup>169/</sup> It is worthwhile, however, to bear in mind an earlier remark to the effect that the reduction noted is consonant with increases in expectations of inflation and in the speed of circulation of the means of payments.

<sup>170/</sup> See the Central Bank of Uruguay, Indicadores de la actividad económico-financiera, March 1975. The nominal series are deflated by the consumer price index.

<sup>171/</sup> Compensatory wage and pension adjustments covered by the national exchequer, and a slower increase than had been expected in revenue from export taxes largely account for this trend.



### 3. Imported inflation

Imported inflation was brought into Uruguay in a context which allowed its repercussions to spread through the internal economy intensively and with ease, combining with the expansionist pressures generated on the domestic side.

Indeed, when the external impact began to make itself felt, the reacceleration of inflation had already gained impetus on its own account, and, complementarily, the economic policy which gradually took shape during the period aimed more and more unequivocally at approximating internal to international prices. Naturally, this approximation could be most rapidly achieved in the case of agricultural products, with the ensuing inflationary effects. On the other hand, it was necessarily a slower business where manufactures were concerned, despite the fact that in their case the resulting repercussions might ultimately have proved anti-inflationary, in view of the high relative costs of domestic industry.

In accordance with the classification suggested in the analysis of inflation in Latin America made elsewhere in the present study, the direct influence of imported inflation will first be considered, and its indirect repercussions will then be examined.

#### (a) Direct effects

In 1972 the increase in the unit value of exports of goods, in terms of dollars at current prices, was already substantial, amounting to 30 per cent (see table 11). Basically, given the structure of Uruguay's exports, this variation derived from the rise in the world market price of beef, which in that year exceeded 30 per cent, and had been as much as about 80 per cent between 1970 and 1972 (see table 12).

Table 11  
URUGUAY: TRENDS IN SELECTED FOREIGN TRADE INDICATORS

	Average 1966-1970	1971	1972	1973	1974
(1) Exports of goods (FOB, millions of dollars)	190.5	196.8	242.0	327.6	370.1
(2) Exports of goods (millions of dollars, 1970 = 100)	85.0	87.8	108.0	146.0	165.1
(3) Index of unit value of exports of goods (1970 = 100)	93.6	101.0	131.0	190.0	203.7
(4) Index of constant value of exports of goods (1970 = 100) (2:3 x 100)	90.8	86.9	82.4	76.8	81.1
(5) Imports of goods (FOB, millions of dollars)	157.5	203.0	178.7	248.6	419.7
(6) Imports of goods (millions of dollars, 1970 = 100)	77.6	100.0	88.0	122.4	206.7
(7) Index of unit value of imports of goods (1970 = 100)	95.4	106.0	110.9	133.0	208.5
(8) Index of constant value of imports of goods (1970 = 100) (6 : 7 x 100)	81.3	94.3	79.4	92.0	99.1
(9) International reserves (millions of dollars, at close of period)	175.0	181.0	198.0	232.0	170.0a/

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

a/ Corresponding to month of October.

Table 12  
URUGUAY: PERCENTAGE COMPOSITION OF EXPORTS OF GOODS

	Average 1969-1970	1971	1972	1973	1974a/
Wool	20.8	21.6	15.4	17.7	5.6
Meat and meat products	34.6	33.6	48.1	39.2	25.4
Live animals	1.1	1.4	0.9	0.4	-
Hides and bristles	11.1	10.4	10.7	8.0	2.3
Yarns and textiles	14.5	12.2	12.7	15.4	2.3
Unprocessed agricultural products	4.5	6.8	0.6	5.4	3.5
Processed agricultural products	6.5	4.7	5.2	3.2	19.8
Mineral products	1.8	1.5	0.6	1.0	5.1
Miscellaneous	5.0	7.8	5.8	9.7	36.0b/
<u>Total</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Source: ECLA, on the basis of official statistics and data supplied by the Organization of American States (OAS).

a/ Exports effected in January-August 1974.

b/ Corresponding to chemical products (22.3 million dollars) and products of miscellaneous industries (80.6 million dollars).

/This movement

This movement was paralleled by the upswing in the average domestic price of beef, which, having already increased by over 75 per cent in 1971, soared by an additional 130 per cent, approximately, in 1972 (see table 13). Price variations such as these in the case of a product like meat are of special significance in Uruguay, where meat consumption is of high relative importance in the structure of diet. Furthermore, as regards supplies of proteins, meat substitutes are relatively scarce and costly, and, likewise, their price trends closely follow those of meat.

In 1973 the direct effects of imported inflation grew broader and more marked, since, on the one hand, the unit value of exports in terms of dollars increased by 45 per cent - that is, even more rapidly than in 1972 - and, on the other hand, the index of import prices rose by 20 per cent, which meant that the rate recorded in the preceding years was approximately quadrupled.

Among staple export products, world meat prices rose by 70 per cent, while those of wool doubled. In both cases, the higher quotations were reflected in domestic price trends, although these were to some extent offset by the export taxes known as "detracciones", which, in terms of national currency, were periodically and significantly raised during the year. This subject will be reverted to at a later stage.

The rise in the unit value of imports was essentially due to substantial increases - ranging as a rule from 30 per cent to 50 per cent - in the prices of several agricultural commodities of which Uruguay is an importer: for example, wheat, maize, sugar, coffee and tea. The domestic prices of these goods tended to reflect the upward movement of world prices, as well as the devaluations affecting the exchange rate.

Probably one of the most representative cases in point was that of wheat; domestic prices of wheat flour shot up in 1972 and 1973 at an annual rate of about 140 per cent.

Table 13

URUGUAY: VARIATIONS IN CONSUMER PRICES OF SELECTED GOODS

(Annual rates)

	1971	1972	1973
Beef	75.5	128.9	108.4
Rice	2.5	107.9	123.9
Wheat flour	7.1	139.3	135.0
Edible oil	18.0	64.5	151.9

Source: Consumer Price Index prepared by the Department of Statistics and Censuses of Uruguay.

a/ December to December.

Table 14

URUGUAY: PERCENTAGE COMPOSITION OF IMPORTS  
OF GOODS, BY MAJOR ECONOMIC GROUPS

	Average 1969-1970	1971	1972	1973	1974 <sub>a</sub> /
Consumer goods	8.0	8.8	6.5	7.1	6.5
Raw materials	51.0	51.3	59.2	62.5	51.5
Construction materials	2.0	2.0	1.3	2.1	2.0
Fuels	13.7	14.5	20.4	19.3	32.1
Capital goods	24.6	21.9	11.2	8.3	7.3
Miscellaneous	0.7	1.5	1.4	0.7	0.6
<u>Total</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

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

a/ Imports effected in January-August 1974.

/In 1974,

In 1974, the direct effects of imported inflation were intensified, but in contrast to what had happened in the previous years, the pressure deriving from world prices of exports decreased, and that originating in the external prices of imports was stepped up.

The unit value of exports of goods rose by only 7 per cent, owing to an interruption of the upward trend of world prices of wool and meat. Moreover, difficulties in exporting meat, in particular to European Economic Community (EEC) countries, left large surpluses for disposal which had to be sold to Brazil or marketed at home.

In contrast, the average unit value of imports increased in 1974 by 57 per cent, which gives a first rough idea of the inflationary pressure introduced through this channel.

In the case of certain products, however, the pressure exerted on domestic prices far exceeded the average. The most obvious instances were afforded by petroleum and petroleum products, of which the country is not a producer, and which showed price increments of approximately 200 per cent or over; and by some agricultural and industrial raw materials whose international prices rapidly increased (see table 14).

Similarly, prices of manufactures and capital goods - especially those expressed in terms of dollars - were pushed up by the effects of world inflation on the corresponding international quotations.

(b) Indirect diffusion: some repercussions

One of the indirect effects observable in 1973 resulted from the expansion of the monetary authorities' international reserves. Thanks to the thriving growth of exports, in particular, between the end of 1972 and the close of 1973 gross reserves climbed from 193 to 232 million dollars (see again table 11).

Although the series compiled on the evolution of the means of payment give no separate indication of the monetary effect of the variation in net international reserves, it can be deduced from table 5 that in 1973, for the first time in many years, this variation acted as an expansionist factor. The money supply increased by 74.5 per cent, and quasi-money by 70 per cent, while the growth rate of total domestic credit was 51 per cent (see again table 5).

/The effect

The effect in question ceased in 1974, when a loss of reserves occurred; and the relative increase in domestic credit (86 per cent) was greater than the increment in the money supply (62 per cent).

Another indirect repercussion of some importance also made itself felt in 1973, when the Uruguayan exporters' capacity for spending increased rapidly and substantially, inasmuch as the value of their exports rose by 35 per cent in terms of dollars at current prices.

The expansionist effect of this trend was lessened, however, by the fact that the revenue obtained by the Government in 1973 from export taxes ("detracciones") exceeded its 1972 level by the national currency equivalent of about 20 million dollars.<sup>172/</sup> Thus, the net returns accruing to meat and wool exporters - discounting export taxes - increased from about 120 million dollars in 1972 to 140 million in 1973, while the gross value of the exports in question rose from about 150 million in the first of these years to 190 million in the second.

Although exports of hides were also subject to the export tax ("detracciones") régime, the data available were insufficient for the preparation of an estimate similar to that made for meat and wool.

#### 4. Additional aspects of anti-inflationary policy

During the period 1972-1974, the formulation and implementation of stabilization measures was subordinated, as has already been pointed out, to certain basic lines of action laid down by overall economic policy, which were pursued with gradually increasing vigour as time went by.

It should be borne in mind that before the effects of imported inflation began to make themselves felt, the strategy determined on had implied acceptance of a functional modicum of inflation, while

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<sup>172/</sup> According to approximate estimates, the yield of these taxes on exports of meat and wool amounted to the national currency equivalent of 30 million dollars in 1972 and 50 million in 1973.

at the same time, by virtue of the flexibility of the price mechanism, internal prices for domestic production were to be progressively equalized with the corresponding external prices.

Moreover, the decision taken with regard to imported inflation itself and its internal repercussions was that its "internalization" should be tolerated - with a few minor and temporary exceptions that may have occurred - both in relation to domestic prices of goods exported by Uruguay and in respect of internal prices of imported goods or domestically-produced goods using inputs from abroad.

Accordingly, the various types of economic policy that may be differentiated evolved along lines consistent with the general orientations described.

Exchange policy operated on the basis of the existence of two markets, one commercial and the other financial.

In the former, which is the more important, since it comprises export and import operations, the system applied was one of periodic minidevaluations of the national currency, which closely followed internal price trends. Only in the early months of 1974, for reasons not clearly identified, was the rate of devaluation slower than that of internal inflation, but a radical change took place in this respect in the second half of the year.<sup>173/</sup>

Uruguay also opted for the progressive liberalization of its import trade, to which end certain restrictions and bans on imports were eliminated. At the same time customs duties were gradually reduced, although in this last direction the authorities acted with caution. In 1973 and 1974 the result of the application of these measures was a rapid rate of increase of imports of goods.

The financial market - whose operations were subject to certain limitations and which mobilized relatively small quantities of resources - was broadened and liberalized in September 1974, when

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<sup>173/</sup> Between December 1973 and June 1974 the national-currency value of the dollar increased by 20 per cent, whereas between June and December 1974, the comparable increase amounted to 41 per cent.

the determination of foreign currency quotations was left to the free play of supply and demand. From the time of this reform onwards, the so-called "parallel" market diminished greatly in size.

Fiscal policy was aimed at reducing the inflationary repercussions of the Government's financial operations. With this end in view, various measures were adopted during the period under study, with the aim of restricting the growth rate of fiscal expenditure, strengthening mechanisms for tapping the sources of current income and financing the sector's deficit by means of non-inflationary expedients.

Nevertheless, the evolution of government finances continued to show considerable fluctuations, according to whether the Government had to grant larger or smaller compensatory wage adjustment to its employees, and/or, in view of the weakness of the system of taxation on internal activity, according to the variations in the yield of export taxes and import duties brought about by export and import trends. In any case, throughout the whole period under study the fiscal sector generated deficits on current account.

In 1974, when the fiscal situation notably deteriorated, for the reasons set forth above, investment acted as a factor of adjustment, since it was frozen, in nominal values, at the same level as in 1973.

At all events, when the total fiscal deficit increased rapidly - as happened in 1974 - the only feasible form of financing it in significant amounts continued to be an issue of currency by the monetary authorities. There were two reasons for this: on the one hand, external credit played little part in the structure of capital inflows,<sup>174/</sup> and, on the other hand, it was impracticable for the sale of official securities to mount spectacularly from one year to

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<sup>174/</sup> This state of affairs, was, due, inter alia, to the low relative level of public investment in Uruguay (in 1974 it amounted to about 33 million pesos, i.e., the equivalent of less than 30 million dollars).



the next.<sup>175/</sup> Nevertheless, measures were adopted, particularly in 1974, with the aim of ensuring positive returns on such documents in real terms.

Significant progress was made in the financing of autonomous institutions. Through a realistic policy in relation to public utility tariffs, which were periodically adjusted, the negative rate of savings usually shown by such bodies was successfully eliminated, and they even succeeded in generating an increasing surplus on current account, which, in the last two years, seems to have financed approximately half their investment.<sup>176/</sup>

Monetary policy operated on the basis of flexible annual programmes, which were revised several times in the course of each year, and were designed to make the increases in the money supply compatible with the estimated - and also the actual - variations in prices and in economic activity.

Generally speaking, monetary policy played a passive role, in the sense that no attempt was made to resort to a major restriction of the rate of expansion of the means of payment as a decisive weapon in the battle against inflation.

The policy in question might rather be said to have been concerned mainly with ensuring that the increases in the money supply which were considered acceptable should be compatible with the fluctuations of demand for greater credit resources on the part of the public and private sectors.

Lastly, with regard to price and wage policies, some indication has already been given of the principal lines followed, especially in respect of prices.

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<sup>175/</sup> To give some idea of the position, it should be noted that in 1974, sales of Treasury bonds amounted to 20,000 million pesos, while the monetary authorities' issue of currency reached 100,000 million (see again table 4).

<sup>176/</sup> See Inter-American Committee on the Alliance for Progress (CIAP), El Esfuerzo interno y las necesidades de financiamiento externo para el desarrollo del Uruguay, CIAP/584, 1973, Vol. I; and International Bank for Reconstruction and Development (IBRD), "Economic memorandum of Uruguay", August 1974.

In relation to instruments influencing prices, it should be recalled that in the course of the three-year period the previously-established mechanisms for the centralization and control of commodity and factor prices were gradually eliminated, giving place to a régime of increasing freedom in pricing and the assignment of greater relative importance to internal and external competition in the operation of the economic system.

The wage policy applied was based on the granting of adjustments every six months, the aim of which was to ensure that during each half-year real wages should be maintained at much the same level as in the immediately preceding period.

Subsequently, towards the end of 1974, this formula was replaced by a non-periodic system of wage adjustments designed to relate average real wages to their 1968 levels for the various sectors.

In any case, the result of these wage policy variants depended, once the nominal adjustments had been granted, upon whether the rate of inflation increased or decreased during the period over which the new wage was in force.



