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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

WORLD ECONOMIC GROWTH - RETROSPECT AND PROSPECTS

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World Economic Growth -- Retrospect and Prospects

I

The purpose of this paper is to review the trend of economic growth of the last ten years in the three most important parts of the free world: the countries of Western Europe and North America, of Latin America and of Southeast Asia. It focuses on the factors bearing most directly on long-run economic growth in these areas, including the volume of savings and investment, the role of international trade and capital movements, and the effects of price changes. An attempt is made to assess the prospects for growth in the years ahead and to draw some general lessons from the experience of the last decade.

Since this paper is primarily concerned with discerning the long-run trend, year-to-year changes and differences as between individual economies and particular sectors of the economies could not be treated in more than a cursory way. For the same reason, it does not purport to present an economic survey of the three regions; nor does it constitute a world economic survey, since it does not cover the countries of the Far East, the Near East, the South Pacific and South Africa or, excepting Malaya, any of the dependent territories. Developments in these areas differed so much from country to country, and from those of the areas discussed in this report, that most of the findings of this study presumably do not apply to them, although the growth trends of the North Atlantic area, of Latin America, and of the countries of Southeast Asia obviously have an important bearing on the growth of economic activity in all other regions.

This paper is based on three regional studies prepared by the Economic Staff which may be circulated at a later date.

II

In retrospect, and in comparison with any other period in the last 40 or 50 years, including the years of sustained growth in the twenties, the last ten years were a period of unprecedented accomplishments for the United States, Canada and most of the countries of Western Europe and Latin America. They were, by and large, poor years for almost all

1/ The member countries of the Organization for European Economic Co-operation (OEEC), the United States and Canada, the twenty Latin American Republics, and Burma, Ceylon, India, Indonesia, Malaya, Pakistan and Thailand.
Southeast Asian countries, although there are strong indications that in the last two or three years the area as a whole — perhaps with the exception of Indonesia — has moved off "dead center" and has achieved a sustained increase in income in excess of population growth. It is this movement off dead center in India, and perhaps in other countries of Southeast Asia, rather than the slowness of their recovery from the dislocations of the war and the postwar disturbances which emerges as the most important finding. This is not to say with any degree of certainty that continued economic growth is assured, but the experience of the last few years does suggest that growth is possible on the existing resource base and within the existing social and political framework.

Western Europe, the United States and Canada

These are the salient features of the achievements of the countries of Western Europe and North America:

(1) Notwithstanding the greater degree of destruction and disloca-
tion after World War II, Western Europe had reached its prewar level of agricultural and industrial output by 1949, four years after the war, whereas Europe's comeback after World War I had taken six years. In the United States and Canada, industrial production had almost doubled and agriculture output had risen by one-half during the war. The rise continued after the war. In the United States by the end of 1954, industrial and agricult-
ural output were higher, by 45% and 20% respectively, than at the end of the war. In Canada the volume of production had risen one-third in industry and two-fifths in agriculture.

(2) In long-run perspective, the postwar decade has been a period of reasonably full to over-full employment in all European and North American countries, except in Germany and Italy; in Germany, the inflow of repatriates from Eastern Europe was only gradually absorbed, and in Italy unemployment is a structural phenomenon rather than a reflection of under-utilization of physical capacity. The transition from wartime to peacetime production, after both 1945 and the Korean War, was remarkably smooth in comparison with the experience of 1919-20, and much smoother than had been anticipated. There were of course repeated "crises" affecting all of Europe, such as the convertibility and balance of payments crisis of 1947-48 and the much milder post-
Korean downturn of 1952-53, and several "emergency" situations, national in character, such as the intermittent payments diffic-
culties of individual countries. And there were the brief though severe inventory cycle of 1949 and the industrial setback of 1953-54 in the United States and Canada. But in all instances, corrective forces inherent in the economies, coupled with correc-
tive policy measures — and, perhaps, fortuitous circumstances — prevented the downturns from becoming cumulative.
(3) The countries of Western Europe started the postwar decade with a balance of payments deficit on current account of about $10 billion. By 1951 the over-all European dollar gap, which many observers had thought to be "chronic" and permanent, was closed. It remained closed in the face of a decline in American imports during the 1953-54 recession. Aid under the Marshall Plan and an expansion of European export by more than one-half permitted the European countries as a whole to rebuild their hard monetary reserves from a postwar low of $7.9 billion in 1947 to $14.8 billion by the end of 1954, and current forecasts indicate a further increase in 1955. This is not to say that a blissful state of balance has been reached by all European countries. There still remain national balance of payments problems, particularly in intra-European payments relations, and even the over-all balance is somewhat precarious, since it rests in part on the unstable props of U.S. military expenditures and off-shore purchases. But the balance of payments problem has been brought under control, in the sense that its dimensions have been so curtailed as to make it readily amenable to measures of monetary and fiscal discipline. The achievement of balance on international account is the more remarkable since it was reached despite a deterioration of Europe's terms of trade by about 10% compared to prewar, the curtailment in East-West trade, the loss of a large proportion of investment income from overseas, the debt service burden incident to large borrowings from the United States and Canada, and an expansion of the volume of imports by 10% compared with prewar. Europe has now to export approximately 40% more than before the war to balance its international accounts. There has been a steady revival of intra-European trade which now exceeds prewar volume by two-thirds. Efforts toward equilibrium in the dollar accounts were helped by the fact, frequently overlooked, that the United States' terms of trade deteriorated more than 30% -- much more than those of Europe. Although the countries of Latin America were the chief beneficiaries of this change in the relation between export and import prices, a significant share of the benefits accrued also to the dependent territories of the Western European countries and this has helped to strengthen the gold and dollar position of Europe.

(4) The second half of the last decade has seen the revival of the use of monetary measures as instruments of control over the functioning of the economy. After the spectacularly successful German monetary reform of 1948, one European country after another began to rely more heavily on monetary and credit controls to correct deviations from internal and external equilibrium. Contrary to what many observers expected, the return to "sound" money did not result in curtailed investment and a slowing down of the rate at which output and income were growing. This was a reflection of the growth of private voluntary savings available to finance investment expenditures both at home and abroad; Europe has again become a source of savings large enough to assure
its own development and to permit the contribution of some resources for investment in underdeveloped countries.

(5) The success of monetary and fiscal controls is revealed by the high degree of price stability which has prevailed in Western Europe in the last five years. In spite of the price disturbances brought on first by the devaluations of 1949 and later by the Korean boom, and an uninterrupted high level of investment, the over-all European price level (as reflected in cost-of-living indices) increased between 1948 and 1954 by about 30% (by less than 20% relative to the price level of the United States). In four of the 17 OEEC countries (Belgium, Germany, Portugal and Switzerland), prices rose less than in the United States, while in only four other countries (Austria, Greece, France and Iceland) did price rises exceed 50%. But, with the exception of Greece, even in the last group of countries price movements have been decidedly minor in the last two years.

(6) In the postwar decade as a whole the output of Western Europe has grown at an average rate of almost 6% per year, compared with an American growth rate of 4 1/2%. On a per capita basis the corresponding figures are 5% and 2.4% respectively. If Germany and Austria are not taken into account in computing the European growth rate, because of the extraordinarily high rates which prevailed in those countries, the European growth rate declines to 4 3/4% in the aggregate, and to 3 3/4% per capita. It should be noted that even these adjusted rates exceed the corresponding rates for United States by considerable margins, and that the high rates of capital formation and growth continue even after reconstruction has been completed and American aid has come to an end.

Latin America

For the countries of Latin America as a whole, the last decade was probably the most prosperous period of their recorded history. The advances during that time, together with those made during the war, almost doubled the aggregate real income of the area. The greatest gains were achieved immediately after the war and during the Korean boom; since then growth has become noticeably slower.

Note on Terminology: Throughout this paper the terms output, income product, etc., denote "real" quantities, i.e. they have been corrected for price changes. The term output (or aggregate output) is used interchangeably with "gross domestic product in real terms". The term income (or aggregate income) denotes real gross domestic product plus gains (or losses) through changes in the terms of trade; that is to say, exports are valued at their "real" purchasing power over imports. Gross national product is equal to gross domestic product adjusted for income accruing to non-residents and residents' income received from abroad.
5.

(1) Since the end of the war, real output grew at a rate of 4 3/4% per year; real income -- taking account of the improved terms of trade which the area enjoyed -- at 5 1/2%. These rates of growth were smaller than those of Western Europe but since Latin American output had increased throughout the war, Latin American total gains over prewar are relatively greater than those of Western Europe. The per capita rate, however, is smaller than Europe's, because a considerable proportion of the growth in output was "eaten up" -- in many countries literally -- by a high rate of population growth; for the area as a whole the latter came to 2.4%.

(2) The usefulness of average figures for Latin America is limited, however, because they conceal important country-by-country differences. For example, growth in real output varied from 2% per year for Chile to 5% for Mexico. Between 1945 and 1953, agricultural production rose one-third on the average, but declined by 15% in Argentina and by 11% in Cuba.

(3) Latin America's gains in output consisted in the main of the following: a moderate increase (33%) in agricultural output, a very large rise in industrial production and construction (64%) end a somewhat smaller, though very respectable, increase in mining (50%). Aggregate income was further enhanced by the great improvement in the terms of trade, which made the purchasing power of Latin-American exports one-third higher in 1953 than in 1945, having been even more favorable in intervening years. The improvement in the terms of trade, which were not only much more favorable than prewar but also considerably better than in the 'twenties, enhanced Latin America's real income by 6%. But this figure fails to take into account the fact these gains enabled Latin America to acquire additional imports which could otherwise have been obtained only at a much higher real cost in terms of additional export production. To some extent, the favorable terms of trade were the result of the fact that the volume of Latin American exports has remained virtually unchanged since 1947 although its composition has changed considerably. Total agricultural exports declined, largely due to a fall in volume of wheat and meat exports; on the other hand, exports of products of the extractive industries, particularly oil, increased. The failure of exports to expand probably also reflected fiscal, monetary and general economic policies which, although such was not their purpose, made expansion of output in export industries less attractive than expansion in other sectors of the economy. To a lesser extent, the stationary level of exports was also attributable to an increased domestic demand for export commodities.

(4) The fact that food production for domestic consumption expanded less than did production of other goods and services does not indicate that agriculture as a whole was neglected in Latin America. Rather it may be taken as a reflection of the fact that in a number of countries in the area a level of income has been reached (at
At least by the income groups benefiting most from the rise in income) at which an increasing proportion of additional income is spent on goods and services other than foodstuffs. This also explains the sharp increase in manufacturing production and the continuously strong demand for imports of manufactures, both for consumption and industrial purposes. The volume of such imports rose by one-half between 1947 and 1953, and almost doubled compared with prewar. It was financed in part by an inflow of private capital of approximately $2 billion. This was, however, partially offset by a net outflow through public capital movements in the early postwar years, when several countries, notably Argentina, purchased foreign-owned investments.

(5) The proportionately greater increase in imports than in exports was also reflected in the movement of gold and dollar reserves, which at the end of the war stood at a level of $3.8 billion. By the fall of 1948, they had been drawn down to $2.7 billion. Since then they have grown again to $3.7 billion. However, in view of the price changes of the last ten years, this sum represents a much smaller volume of purchasing power than did the reserves available at the end of the war. Moreover, the distribution of international reserves among the various Latin American countries has significantly changed, with the result that some of the most important countries of the area now lack sufficient exchange reserves and are unable to meet even temporary payments deficits.

(6) The balance of payments difficulties of some of the leading Latin American countries, which mar their record of economic advancement and the outlook for the future (discussed below), is but one aspect of the broader problem of fiscal and monetary management in a period of rapid economic growth. As indicated above, price rises in Western Europe over the last five years were on the average not greater than 30%; they exceeded 50% in only four countries. In Latin America, the average price increase, as reflected in cost of living indices, came in the same period to about 50%. Only in five of the 20 Latin American republics -- in Cuba, the Dominican Republic, Ecuador, Haiti and Panama -- were price increases 10% or less. In the five southernmost countries of the hemisphere -- Argentina, Bolivia, Brazil, Chile and Paraguay -- price increases of 200 to 1,500 per cent occurred, accompanied by exchange depreciation, and at the end of 1954 the end of these inflationary movements was not in sight. A comparison of growth rates and rates of investment on the one hand, and price movement on the other, indicates that countries with moderate price increases were able to transfer some resources from consumption to investment use, at least for short periods. On the other hand, in the countries with the greatest price increases, the growth record is poor for four of the five countries where inflation has been rampant, and in the remaining country, Brazil, there are definite indications that the end of the period of most rapid advancement coincided with the beginning of sharp and continuous price increases.
Southeast Asia

The picture which emerges from the analysis of the economies of Southeast Asia is substantially different from that of the countries of Western Europe and of the Western hemisphere. By and large, the years up to the Korean war were bad years for Southeast Asia as a whole. Because of physical destruction and distortions in the organization of the economies during the war, but primarily as a result of the political changes and civil disorders in the postwar years, the recovery of the economies of the Southeast Asian countries was painfully slow and discontinuous, with advances interrupted by periods of retrogression. Since 1951, however, considerable progress has been made in several of the countries, and there are indications that the development of the area is gaining momentum.

However, the economic history of the Southeast Asia area over the last ten years differs so much from country to country that it is difficult to discern a common pattern, and virtually impossible to form anything more than highly tentative views about the outlook for the future.

Thailand, for instance, enjoyed an uninterrupted export boom from the end of the war until 1951 and real income rose far above the prewar level; in the last two years, however, balance of payments difficulties arose requiring a slackening of the growth. In neighboring Burma, on the other hand, civil strife and economic disorganization kept output substantially below prewar despite high growth rates between 1950 and 1954. The experience of Indonesia has been similar. The country recovered very slowly from the war and postwar disturbances. Although the volume of rubber and tin exports had reached prewar level by 1948, aggregate output, and particularly food production, lagged behind so that national income was barely above prewar in 1952, and food production in 1953-54 was only slightly above the 1938 level. For Ceylon, the available data show that the last ten years were a period of moderate growth, interrupted by a marked setback in 1951. The postwar developments in Malaya were much more erratic, with the Korean boom accounting for a very sharp upswing, and the years 1952 and 1953 reflecting lower rubber and tin prices.

In all these countries the attainment of a satisfactory rate of income growth depended to a large extent on developments in the export sector of the economy. Since, by and large, the demand for the principal exports was strong, the growth rates demonstrated the ability of the various countries to cope with the twofold problem of organizing (or reorganizing) export production and of utilizing export proceeds to raise the level of investment or consumption.

The development problems of India and Pakistan were fundamentally different. Since the export sectors play a lesser role in the structure of the economies of these two countries, the stimulus to increased production and investment had to come from within the countries themselves.
The dislocations caused by the war were compounded by the disruptive effects of the partition and by adverse weather conditions which curtailed food production and made emergency assistance necessary. The consequence of all these factors was a virtually static volume of total output until 1950-51 and a decline in per capita income and consumption, presumably below prewar levels. Since 1951, however, a remarkable acceleration in the rate of growth has taken place and for the last three years total output has grown substantially faster than population in India, and perhaps also in Pakistan. As already stated, the achievements of the last three years may be taken as an indication that India, and to a more limited and uncertain extent Pakistan, have moved off dead center. This, together with the consideration that a relatively low level of investment "pays off" well in the form of additional output (see below, page 11), and that in India monetary stability has been maintained throughout the postwar period, permits the expectation that in the next few years a more satisfactory rate of growth of output and income may be attained. The same may be true as to Indonesia, although information is too sketchy to permit more than a superficial judgment.

As to the monetary and balance of payments developments in the Southeast Asia area, country-by-country differences again prevent any general observations. However, if proper weight is given to size of population, it may be said that the over-all performance was remarkably good in the maintenance of monetary stability, and rather uneven on the balance of payments side. In India, the cost of living was the same at the end of 1954 as during 1948. In Pakistan, an upswing in the price level during 1953 raised the cost of living index by 11%, but as of the end of 1954 the cost of living had risen less since 1948 than it had in the United States. In Ceylon and Burma, likewise, the price level rose by less than 10%. Price stability in Ceylon was artificial, however, since it was achieved by means of heavy food subsidies. Malaya experienced rapid price increases during the Korean boom but since 1953 the price level has receded. In Thailand, government borrowing from the banking system resulted in inflationary price movements through 1953, and it is still uncertain whether the recent attempts to restore stability were successful. Indonesia was the only country in the area to experience violent price movements. Between 1948 and 1954, prices rose by more than 130% while the money supply increased about fourfold and the rupiah depreciated to one-third for exports and one-sixth for imports.

The over-all foreign exchange position of the countries of Southeast Asia is now worse than it was at the end of the war. To some extent the drawing down of foreign exchange holdings was intentional, since several of the countries, particularly India (and Pakistan and Ceylon) had accumulated large sterling balances during the war on the understanding that these assets would be available to finance imports after the war. In other countries, an accumulation of foreign exchange holdings occurred partly because of delays in carrying out development programs (Burma), and partly because exchange earnings were unexpectedly high during the Korean boom (Indonesia, Thailand, Malaya). From 1952 and 1953 on, however, foreign exchange holdings were depleted at a rapid rate as a
result of capital expenditures abroad, and because monetary expansion caused balance of payments deficits. Only in India did international reserves remain virtually unchanged in the last three years. Through a tightening of import controls (which in turn, however, reinforced inflationary pressures in some countries), an adjustment of exchange rates (Indonesia, Thailand), and foreign assistance, balance of payments equilibrium was restored in most countries and the depletion of foreign exchange reserves was halted. This is not to say that inflationary pressures and balance of payments difficulties have been eliminated and that monetary and exchange problems will not arise again in the years ahead. But it seems to indicate a growing awareness of these problems and the recognition that their solution is a prerequisite to continued growth.

III

Throughout the period, the level of gross fixed investment was almost uniformly high in Western Europe, the United States and Canada, and in the countries of Latin America. The investment rates differed substantially from country to country and, in the case of Latin America, from year to year, but the over-all performance was remarkably good -- probably better than for any other ten-year period in the past. For Western Europe as a whole the gross rate of fixed investment amounted to 16% of the gross national product, and for Canada and the United States it was slightly higher.

The high rate in the United States was the result of many forces. Immediately after the war, reconversion and modernization of industrial plant and equipment was the strongest factor in raising the rate of private fixed investment well above prewar levels; more recently, housing construction expanded rapidly and additions to productive industrial capacity helped to maintain the investment rate -- contrary to the views of many observers who had not anticipated that the high level of investment could be maintained for so long. Throughout the last decade, public investment played a relatively subordinate role; it accounted for less than one-third of total fixed investment. In Canada, a considerable proportion of fixed investment was financed by inflows of foreign capital, mostly from the United States. But since Canada at the same time made loans and grants to Europe, repaid foreign obligations, increased its foreign exchange holdings and acquired investments in the United States, the net increase in resources available for investment from abroad was negligible and, for the period as a whole, domestic investment was financed almost entirely through domestic savings.

In Western Europe, the high level of investment was due to a large volume of savings and foreign assistance in the form of grants and loans. Assistance given to European countries, at first primarily through loan operations and later through grants and loans under the Marshall Plan and related programs, made it possible to devote a large proportion of
total available resources to the reconstruction, and subsequently to the expansion, of productive capacity. Thus, until 1948 foreign assistance financed almost one-third of total European investment. But, as indicated above, the level of investment did not decline when foreign economic aid tapered off, and Europe as a whole managed to finance its gross investment (and an increase in its gold and dollar holdings) almost entirely from domestic savings. There was, however, one significant difference between the methods of financing investment in the United States and in Western Europe. In the latter, public investment accounted for almost one-half of total investment (if public funds used to finance private investment are considered as "public investment"), while in the United States public investment (so defined) came to considerably less than one-third of total investment. In the last few years, however, the proportion of public investment in total investment in Western Europe has declined while private savings and private investment have increased. This may be taken as a further indication of the growing strength and self-reliance of the economies of Western Europe.

In the Latin American countries, during the entire postwar period, gross fixed investment absorbed about 15.5% of the gross national product, only slightly less than in Europe. As in Europe, a large proportion of total fixed investment was public. However, the investment performance of Latin America differed from that of Western Europe in two important respects. In the first place, total investment was very unevenly distributed among countries. In several, the rate of investment for the entire period was less than 10% while in others it approached 20%. Secondly, there was a pronounced change in the rate of investment in the course of the period. In most countries gross investment rose quickly between 1945-46 and 1948-49, when it reached a peak of almost 18% of gross income; from then on it receded gradually to a level of 14% in 1953. This cyclical movement probably is related to the availability of public and private savings and of foreign exchange resources to cover the import content of investment expenditures. As already stated, Latin America disposed of large foreign exchange reserves at the end of the war, a high proportion of which was used to finance imports of investment goods on public and private account, to some extent to take care of the backlog of replacement requirements accumulated during the war. At the same time, rapid improvements in the terms of trade and a brisk foreign demand for most Latin American exports raised incomes, making many private investment opportunities attractive and a large volume of public investment necessary. Inflows of public and private capital resumed, although inward movements of public capital were more than offset, for Latin America as a whole, by purchase of foreign investment and by loans to foreign countries. By 1949, however, improvements in the terms of trade had slowed down. The demand for imported consumers goods had caught up with increased foreign exchange earnings and had eaten into exchange reserves; moreover, purchasing power of the latter was reduced because of the higher costs of imports. From 1949 on, despite the renewed strength of Latin American exports during the Korean boom, the volume of investment declined, partly as a result of conscious retrenchment policies, but mainly because the export sectors of the economies and the industrial sectors which produce
substitutes for imports were caught in the squeeze of domestic price increases, and lower prices and greater availability of import goods abroad. In other words, savings through windfall profits in the export sector and high profits in import-substitution industries gradually disappeared, leaving fewer resources available for investment both in the private and the public sectors.

In the countries of Southeast Asia the level of domestic gross investment was of course much lower than in Europe and in the Western Hemisphere. For the area as a whole, it probably came to 8% or 9% but this figure has little meaning in view of the wide divergence among countries of the investment rate. Burmese statistics reveal gross investment rates as high as 19% (in 1954), while gross investment in Indonesia appears to have been about 5% of the gross national product -- barely enough to take care of replacement requirements. The low rate of investment is in part a consequence of the low level of income, which in most countries does not permit a high rate of savings. But other factors seem to have compounded this difficulty, inherent in the state of underdevelopment itself. Political uncertainties militated against inflows of foreign capital and even against the reinvestment of earnings of foreign capital, which in the past played a major role in the growth and investment process of the area. A temporarily more important factor inhibiting investment, particularly in the public sector, was the lack of investment programs and plans. This, in conjunction with huge foreign exchange earnings, resulted (in Burma, Thailand and Malaya) in substantial increases in foreign exchange holdings in the earlier years of the period and during the Korean boom.

But there is now some indication that the factors delaying full utilization of domestic savings and of foreign capital, to the extent to which the latter is available, are being overcome. In India the volume of investment has substantially increased in the last two or three years. In Burma, investment has increased to the point at which stability has been threatened, particularly in view of the deterioration in the balance of payments.

A further aspect of the investment picture in Southeast Asia is worthy of notice. The level of total investment is apparently closely related to the volume of public investment (and public savings); in the countries in which public investment is high, private investment is likewise high. This may permit the conclusion that in the present state of underdevelopment of these countries a high level of public capital expenditures not only does not interfere with the flow of private investment but may be a prerequisite for its expansion.

The most significant conclusion which emerges from a comparison of the investment and output figures of the countries in the three areas is the fact that where income and rates of investment are low, the "yield" of investment in the form of additional output is proportionately greater than in countries with higher income and higher rates of investment. The limited period for which data are available and the doubtful precision of the data make this conclusion rather tentative. But nevertheless, it
is probably significant that the capital-output ratio -- the relationship between net investment and additional output -- is 2:1 or slightly higher in India, where both income and investment are low, while it averages around 3:1 for Latin America with higher income and investment, and comes to approximately 4:1 for most countries of Western Europe. In a number of countries, capital-output ratios did not conform to this average but in all instances plausible and even obvious reasons can be advanced for an "abnormally" favorable or "abnormally" unfavorable ratio.

This finding, even though tentative, is important if for no other reason than that it casts serious doubt on the frequently held view that in underdeveloped countries the capital-output ratio for the economy as a whole is likely to be higher than in advanced countries. This position is commonly based on two arguments. One is that the amount of social overhead capital in underdeveloped countries is low and that therefore in order to increase production, more capital outlays are required in underdeveloped countries than in advanced countries to provide power, or transportation, or repair facilities or training for personnel. The second is that certain kinds of investment, primarily in the public sector, are bound to be initially under-utilized in underdeveloped countries, while in advanced countries their utilization is high from the beginning. Roads of the same carrying capacity, for instance, more or less equally expensive in all countries, are less fully utilized in underdeveloped countries than in advanced countries because traffic densities are lower.

These findings with respect to capital returns do not invalidate the reasons for expecting high capital-output ratios in underdeveloped countries. But they indicate that the relative importance of these reasons is not as great as has been assumed on general grounds (rather than on the basis of empirical evidence), and that other considerations such as the ready availability, at low cost, of productive factors other than capital, and the fact that the low volume of investment brings about a concentration of capital outlays in uses with high and immediate yields, may be more important. It may well be that a large proportion of investment in underdeveloped countries is "bottleneck investment" which brings a relatively large increase in output and in many instances also high monetary returns.

IV

The summary observations of the preceding pages permit a few general conclusions regarding the outlook in the three areas. But before advancing them, it may be useful to recall once more that the observations themselves are confined to a relatively short period of time, and that in many instances the basic data would not pass rigorous tests of reliability.

Moreover, the recital of facts and their analysis presented here have been confined to such broad aggregates as the rate of investment and savings, the total output and income, and the volume of foreign trade.
The impersonal forces behind these magnitudes, which have influenced their movements in one direction or another, and the more personal policy decisions which have modified these forces, have hardly been touched upon. Therefore, the experience of the last ten years, as described here, does not lend itself as a basis for a forecast of developments. These are determined by price movements of individual commodities or groups of commodities, by decisions of individual economic units such as firms or households, and, above all, by public authorities whose policy decisions are bound to be influenced by such extra-economic factors as requirements of defense, exigencies of foreign relations and political considerations. Therefore, the conclusions that emerge from this account of postwar developments must be limited to an appraisal of what is possible and, more hesitantly, what is likely. They cannot indicate what will happen.

To take the last point, regarding the differences in the size of capital-output ratios, first: if the capital-output ratios of the last few years can be considered as "typical" and, over a period of years, as reasonably stable, one may conclude that one of the chief problems of development, i.e. to attain a sufficiently high rate of domestic capital accumulation (supplemented by foreign loans and grants) assumes manageable proportions, or, at any rate, more manageable proportions than it would if in underdeveloped countries a one-unit increase in aggregate output required as much, or more, investment than in advanced countries. It means, for instance, that a relatively small increase in private or public savings, or moderate amounts of foreign loans or grants, could bring about an acceleration of the rate of growth in India and neighboring countries to 3% or 3.5%, even if the capital-output ratio of additional investment turned out to be somewhat larger than it has been in the last few years. It also may be taken as a refutation of the proposition that in many underdeveloped countries the precondition of any growth is a massive injection of foreign capital. On the other hand, it confirms the view that even relatively small additions from abroad to total resources available for investment significantly enhance the growth rate. A satisfactory growth rate in turn makes servicing foreign loans easier.

This brings us to the next point. The very fact that several countries in the Southeast Asia area, and many countries in Latin America, in recent years experienced rates of growth of output substantially in excess of population growth, may be taken as an indication that a reduction of absolute consumption levels as a means of freeing resources for investment is not necessary for the maintenance and gradual raising of the current rates of growth. With the exception of those countries which "live beyond their means", by drawing down foreign exchange reserves or failing to discharge their current foreign obligations, the growth rates of recent years can be gradually raised or, in the face of worsening terms of trade, at least maintained by "saving" a growing proportion of the annual increment in total output. In countries with acute balance of payments problems, however, a temporary cut both in consumption and investment is of course unavoidable.

It does not appear likely, however, that in the next few years a persistent reversal of the strong growth trends observed in the three
areas will take place or, to put it more cautiously, that localized setbacks -- which are bound to occur -- will bring about a general slowing down of development. As already indicated, the economies of Europe have staged a remarkable comeback. Their continued rise in output and per capita income lends an important element of strength to the free world economy. It makes it easier for their authorities to adopt, and pursue with more vigor, policies which will prevent the spreading of temporary difficulties from one country to another, and to continue the dismantling of exchange restrictions and discriminatory controls, thus making for a more rational utilization of resources. The revival of private savings (of business firms and individuals) makes their economies more resilient, so that the shocks of technical innovations and changing market conditions which are the price -- and the danger -- of dynamic growth can be more easily absorbed.

The expansionary trend of the countries of Western Europe plays also an important role in the growth prospects of primary producing countries, among them the countries of Latin America and Southeast Asia. As the experience of the American downturn of 1953-54 has shown, the export proceeds of primary producers are not determined solely by conditions in the American market; these producers can rely more and more on the demand for many of their exports in Western Europe. Moreover, the foreign exchange reserve position of the European countries is now such that there is less likelihood that a downturn in the level of economic activity in the United States will spread with full force to Europe. This is not to say that the occurrence of cyclical fluctuation in the United States is more likely than in other industrialized countries. In the years since the war the American economy has shown an unexpectedly high degree of flexibility and adaptability, and the forces making for expansion have easily and rapidly overcome whatever deflationary tendencies were generated in the economy. Moreover, the government policies have lent support to the public pressures for maintaining a high level of employment and are likely to do so in the future.

Another aspect of the completion of European recovery has an importance beyond the borders of Europe. In several of the Western European countries capital formation has risen to a level at which domestic investment requirements can be met without strain, and marginal amounts can be used to finance capital investment overseas. Thus the countries of Latin America and Southeast Asia may be able to attract European capital, to supplement the savings generated in their own economies and capital from the United States. Even now, Europe is supplying overseas countries with a considerable flow of credit, although in most instances it is short- or medium-term in form. But given a continued high rate of savings in the countries of Western Europe, and reasonably stable balance of payments conditions, it would seem reasonable to expect an expansion of capital flows in the form of direct investments and long-term loans from Western Europe to overseas areas.

As to the growth prospects of Latin America, it seems certain that the area can no longer expect "windfall" income through further improvements in the terms of trade. Rather, a downward adjustment of prices of
exports of some of the Latin American countries is in the making, which is bound to necessitate painful adjustments of monetary and fiscal policies. On the other hand, if full employment and high rates of investment continue in the advanced countries -- and, as the preceding paragraphs attempt to show, indications are that they will continue -- Latin America as a whole may confidently expect expanding markets for its principal export products and therefore, terms of trade which, though lower than at present, would be as good as those during the prosperous 'twenties and considerably better than those which prevailed before the war. But in order to maintain the rates of growth of output and income that prevailed in recent years, it will be necessary vigorously to pursue policies designed to stimulate private domestic and foreign investments and to husband public resources, while at the same time maintaining stable monetary conditions and equilibrium in the balance of payments. There is, however, one additional negative aspect of the problem of Latin American development which may become of growing importance in the future. That is the high rate of population growth which, if it continues unchecked, is likely to have an adverse effect on the growth of per capita income. Fortunately, the pressure of population on resources is acute in a few Latin American countries only. But even where the pressure is not extreme, the high rate of population increase is likely to strain investment resources and make more difficult the achievement of a satisfactory rate of per capita income growth.

In the countries of South East Asia the conditions for further economic advancement are similar to those for Latin America. With one or two exceptions, the countries can no longer rely to the same extent as before on accumulated foreign balances to finance their domestic capital formation, but must generate savings out of current earnings and finance capital goods imports out of current export proceeds. This, of course, makes the task of economic development harder. On the other hand, there are several countervailing factors. One is the previously mentioned favorable capital-output ratio. Another is the progress that has been made in the planning and administration of public investment projects. There is also, in the countries which recently were plagued by inflation or balance of payments deficits, a growing awareness of the necessity of "playing it safe" in the field of monetary and foreign exchange policies. And there is finally the fact that some progress has been made in the last two or three years which in itself is an important stimulus to further advancement.

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