The Relationship Between Monetary, Fiscal, and External Policies and Their Effects Upon Income and Prices in Latin America.

Dale Louis Cramer

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THE RELATIONSHIP BETWEEN MONETARY, FISCAL, AND EXTERNAL POLICIES AND THEIR EFFECTS UPON INCOME AND PRICES IN LATIN AMERICA

A Dissertation

Submitted to the Graduate Faculty of the Louisiana State University and Agricultural and Mechanical College in partial fulfillment of the requirements for the degree of Doctor of Philosophy in The Department of Economics

by Dale Louis Cramer
M. A., Bradley University, 1951 January, 1958
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ABSTRACT

The problems associated with economic stability and rising income among the nations of the world are numerous and complex. These problems consist of short run and long run difficulties, and pertain to all countries regardless of the extent of economic development.

This paper presents the relationship between monetary, fiscal, and external policies as they were employed in some of the Latin American countries during the five-year period, 1952-1956. These policies reveal, in large measure, changes in income, the price level, and external practices of these relatively underdeveloped countries.

For the purpose of determining to what extent monetary, fiscal, and external policies should be applied, the requirements necessary for a nation to realize a condition of international equilibrium are given. This concept explains that a stated national income may be maintained at a given exchange rate, provided that changes in saving and investment are offset by variations in imports and exports (the current account of the balance of payments). If there are differences between the two accounts, then lending (the capital account of the balance of payments) would be required to create a balance.

It is suggested that an additional requirement is
necessary before a condition of international equilibrium may be established. The requirement is that monetary, fiscal, and external policies must be so employed that they may fill the gap between saving and investment and imports and exports should capital movements fail to do so.

The concept of international equilibrium is applied to Mexico and Venezuela in order to determine if these two countries realized a state of international equilibrium. Monetary, fiscal, and external policies are then observed for the purpose of relating their contribution toward creating such a desirable objective.

It was found that those in charge of carrying out these policies in the nations considered were unable to obtain the objective of international equilibrium. It is suggested that the desire to develop the countries was considered to be of greater importance than was that of acquiring a condition of international equilibrium. The effect has been to relegate the aforementioned policies to some extent in order to stimulate economic development.

These findings suggested a need for various measures to be undertaken by underdeveloped nations which may provide for a greater degree of economic progress and stability. The measures suggested are (1) the relationship between gold and international reserves and the money
supply, (2) a comparison between the money supply, national product, and price level, and (3) changes in current account balances and long-term capital movements.

If utilized, these measures could contribute to a greater degree of monetary stability; express the relative effectiveness of the internal policies—monetary and fiscal policies—and, therefore, suggest variations in their employment; and provide a basis for estimating the need and effectiveness of capital movements.

These measures, as applied to six Latin American nations, appeared to justify their use in achieving a better balanced growth.
INTRODUCTION

A sizeable portion of the vast store of economic literature in recent years has been devoted to studies on an international level. Some of the writings have emphasized the adaptation of older ideas while others have presented the application of newer theories, some of which pertain directly to the underdeveloped countries.¹

Although the larger portion of this literature is concerned with the responsibilities of the more highly industrialized nations and emphasizes the theme of full employment, steady but rising incomes, and relatively stable price levels, a growing body of economic writings is related to the problems of the lesser developed countries. A few of the major problems are discussed under such topics as the pent-up postwar demand for goods and services, the inadequate supply of many commodities, the mal-allocation of resource factors, economic development, a lack of saving and investment, disequilibrium

in the balance of payments, and so on. The subjects are of immense importance from both the standpoint of raising the apparent low plane of living in the underdeveloped areas and of explaining how these nations may fit into a pattern of expanding world trade and co-operation.

This paper is to deal with some of the economic problems of Latin America as a part of the general group of countries which are referred to as the underdeveloped areas of the world. Specifically, the contention of this paper is that the problems associated with fluctuating incomes, general high prices and inflation, and imbalances in the balance of payments could be ameliorated to a great extent if monetary, fiscal, and external policies were applied with greater effectiveness. The effectiveness allows for the application of these policies primarily through the present means now available in the countries. It further suggests a change in the manner

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2The term underdeveloped area is construed to mean a nation or group of nations with a low per-capita income but having the basic prerequisites for material improvement. For a more authoritative definition of underdevelopment refer to N. S. Buchanan, and H. S. Ellis, Approaches to Economic Development (New York: Twentieth Century Fund, 1955), p. 4; and E. M. Bernstein, and I. G. Patel, "Inflation In Relation To Economic Development," International Monetary Fund, Staff Papers, Vol. II, No. 3, November, 1952, p. 363.

3There are numerous articles treating these general problems. For an interesting account of the instability
of their employment only if the policies are inflexible, or have little or no effect on the functioning of the economy as they are used. In addition, it makes little sense if the policies are employed without proper co-ordination.4

The approach to the solution of the above indicated problems begins with a logical hypothesis. It is assumed that those in charge of directing the economic growth of the lesser developed nations hold a condition of international equilibrium as their major objective. This objective may not be attained, or if it becomes a reality, the nations may not be able to maintain such a condition. From a more practical viewpoint, it is not so important as to whether or not a condition of international equilibrium is maintained as long as it remains the chief


4Among several good articles on this subject refer
objective of these countries. Thus, it is realized that there are factors at work which constantly tend to disturb an otherwise balanced pattern of growth. It is important, therefore, that these nations attempt to readjust to the altered conditions. Monetary, fiscal, and external policies have a definite role to play in helping to mitigate the adverse effects of these disturbances.

The concept of international equilibrium explains that a nation could maintain a given national income at a stated exchange rate provided that realized saving equated realized investment and imports equated exports (a current account balance). Furthermore, that the above condition could be maintained if the balance between the internal accounts of saving and investment are different from that of the external accounts of imports and exports, provided that the movement of international capital is equal to the difference.\(^5\)

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\(^5\)The writer drew heavily on the work of Professors
It is further suggested that capital, the balancing factor, may not be of sufficient magnitude—whether the balancing result requires an inflow or outflow of capital—to provide a balance between the internal and external accounts. If capital should be exactly sufficient to close the gap, it still must be directed into channels which would react on saving and investment and imports and exports in a balancing fashion, otherwise income or the exchange rate, or both, would be subject to change.

On the other hand, the flow of capital is subject to decisions made by foreign residents, firms, and governments. Since these foreign groups must give sanction to capital movements, the lesser developed nations are not always in a position to influence the directional flow of capital.

From the reasons stated in the above paragraphs, it is likely that capital movements are normally unable to accomplish a condition of international equilibrium in the open economies of the underdeveloped countries.

A final contention of this paper is, then, that monetary, fiscal, and external policies must complement the movement of capital in order to close the gap between the internal and external accounts of these nations to achieve, if not maintain, a state of international equilibrium. A more exhaustive treatment of the concept of international equilibrium and the role of monetary, fiscal, and external policies is reserved for the first part of Chapter I.

To get closer to the more practical implications in the employment of the three aforementioned policies, the last part of Chapter I is concerned with some of the numerous variable factors which influence the implementation of monetary, fiscal, and external policies. Some of the factors considered are foreign exchange reserves, depreciation of the currency, individual and business savings, the character of the banking systems, taxation, the role of governmental agencies, exchange systems, and so on.

No effort is made to separate the variable factors into a dependent or independent status. Income is considered to be the only independent variable factor. All other elements are dependent on one another and on income itself. Furthermore, each factor is introduced and analyzed individually. Also, little effort is expended
in associating the influence of other factors upon a single factor under consideration. This method seems to be justifiable since the purpose of our analysis at this stage is to probe into the nature of these factors as they would appear to be employed in the lesser developed economies. To state the matter a little differently, one wants to know more about what to expect from the influences that these factors create in the underdeveloped countries. Perhaps the variable factors introduced in this survey produce different effects than the same factors at work in the more highly developed nations. In addition, there may be some factors evident in the underdeveloped nations that are of minor significance in the more industrialized countries. Finally, some of the factors which exist in the lesser developed nations may not be evident at all in the advanced countries.

After having examined the theory of international equilibrium and the anticipated influences exerted by the variable factors, subsequent chapters deal with the practical application of these forces. Chapter II is

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6 Although important, such elements as cultural and political factors are not considered within the realm of this study.

7 For instance, an increase in the tax rates applicable to individual incomes may tend to stimulate production in the developed nations, whereas a similar rise
devoted to a study of Mexico, while Chapter III is concerned with a study of Venezuela. In this manner, one is given an opportunity to apply the concepts developed in Chapter I.

These two nations are chosen on the basis of their dissimilar characteristics; that is, Mexico is primarily a domestic economy, and Venezuela is chiefly an export economy. Also, the external portion of their economies functions on a different basis. Mexico employs a flexible exchange rate system, and Venezuela utilizes a form of exchange control. Recent experience in these two underdeveloped countries should present one with an opportunity to test the concept of international equilibrium; to observe the influences generated by the variable factors; and to examine the extent to which monetary, fiscal, and external policies contribute, or fail to contribute, toward a more balanced economic growth.

With the results produced after examining the two

in tax rates is likely to depress production in the lesser developed countries. A change in interest rates normally has the effect of determining the direction of investment expenditures in the industrialized nations. Yet, a variation of interest rates in the underdeveloped countries may provide very little inducement in the employment of capital. Also, the latter countries may occasion an immediate capital flight in response to external pressures on their exchange rates. These pressures may be evident only after long intervals in the highly developed nations, and the probability of anticipated capital flight is likely to be remote.
above nations, the first part of the last chapter, Chapter
IV, offers several measuring devices which should be use­ful in describing the effectiveness of the above internal
and external policies. The measuring devices include (1)
the relationship between gold and international reserves
and the money supply, (2) a comparison between the money
supply, national product (income), and the price level,
and (3) changes in current account balances and long-term
capital movements.

These devices are applied to six Latin American
countries, three of which represent domestic economies
in opposition to export economies. They include Argentina,
Brazil, and Mexico. The remaining three nations are prima­
arily export economies and consist of Chile, Peru, and
Venezuela.

The six nations are taken as representative samples
of the numerous countries referred to as the Latin American
area. Of course, the list could be expanded. Yet, the
number of countries chosen should be sufficient for these
purposes, and may serve as a basis for judging whether or
not the nations are directing their policies so as to
achieve a condition of international equilibrium. In
addition, the measuring devices may yield some information
with respect to the requirement of foreign capital and
the ability of the countries to absorb it. Finally, they
should suggest the need for a change in the use of one or more of the internal or external policies, or a shift in emphasis in applying the policies, to provide a more continuous pattern of growth.

The second part of Chapter IV is reserved for drawing up the general conclusions.

The theoretical portion of this paper is largely confined to Chapter I Conceptual Relations Among Variable Factors. Chapter II The Case of Mexico, Chapter III The Case of Venezuela, and the first part of Chapter IV Some Concluding Observations are primarily devoted to observing and describing events as they take place.

Chapters II and III follow a similar sequence of development. The earlier sections of these two chapters are concerned with the concept of international equilibrium and, therefore, deal with the influences exerted on the national income and price level by the forces of saving, investment, imports, exports, and lending (capital) over a five-year period, 1952-1956. A discussion of the internal and external influences which give rise to changes in the above factors is presented on a year-to-year basis. This approach gives one an opportunity to check on the application and co-ordination of monetary, fiscal, and external policies, and to determine their effectiveness, or lack of effectiveness, in maintaining
the national income for the period.

In connection with Venezuela, an attempt is made to measure the approximate state of international equilibrium by excluding, as far as possible, the impact of the petroleum industry, and then incorporating the contribution of the oil firms into the analysis. By excluding this external element in the first instance, it should give one a chance to estimate the internal growth of the nation.

This paper is subject to perhaps many limitations. A few of the more important limiting factors pertain to the number of countries included in this study and the time element. Besides being a monumental task, the inclusion of a larger number of Latin American countries would perhaps alter the findings to only a minor extent. Yet, because they are not included, the above statement is open to valid criticism. Nevertheless, some of the countries are in such an early stage of development that the type of analysis used in this paper would yield ineffective results. Also, the kind of information which is required in a study of this nature would probably be lacking.

With respect to the time factor, the period under study is of short duration. It includes only five recent years, 1952-1956. At best, this short time span allows
one to only touch on the edges of the intermediate period. Nevertheless, whenever there are definite indications of the more pronounced long run forces exerting their weight, they will be brought to the reader's attention.
CHAPTER I

CONCEPTUAL RELATIONS AMONG VARIABLE FACTORS

Certainly many of our present day economic problems dealing with nations hinge upon the outcome of the working of numerous variable forces. There is still room for more analytical treatment of these forces, especially as they apply to nations carrying on trade with one another. Furthermore, the underdeveloped areas have particular problems which may be alleviated somewhat through a better understanding of the interplay of variable factors.

This chapter is to deal with some of the variable factors as they affect the functioning of an economy. In other words, the question posed is: what effects can one expect from the working of these variable factors? Of utmost importance are the possible effects to be realized in the functioning of an open economy, and particularly as the factors are applied in underdeveloped nations.

To get underway, it would seem prudent to establish the conditions which provide for an equilibrium situation of a nation engaged in trade. After such a setting is accomplished, variable factors will be introduced and analyzed. The variable factors will be treated under two general headings: (1) monetary and fiscal variables and (2) external variables. There will be an overlapping
between these two categories; nonetheless, a general categorizing is attempted for clarity.

Emphasis is to be placed upon the monetary effects of the variables rather than their effects upon the flow of goods. This distinction is of more importance when the external factors are treated.

The subject matter in this chapter will pertain mostly to general short-term problems rather than long run adjustments, and, therefore, should be considered as supplemental to the more fundamental long run processes.

I. THE SETTING

The income approach will be utilized to establish the necessary requirements for international equilibrium of a nation engaged in trade. At the outset, the various symbols must be defined.¹ NI is to refer to a given national income; E is to represent intended exports; M is to indicate intended imports; S is to represent intended saving; A is to explain intended investment, that is, the

net accumulation of real capital by residents; $L$ is to represent the rate of lending; $MB$ is to refer to monetary and banking policies; and $F$ is to relate to fiscal policy.

$E$ and $A$ tend to increase income while $M$ and $S$ tend to reduce income, other things remaining the same. There is no assurance, however, that $E + A$ equals $M + S$ since either or both factors on one side of the equation may rise or fall to an extent greater or less than one or both of the factors on the opposite side of the equation at any given point in time. For example, a rise in intended exports is not likely to be associated with an exact rise in intended imports. And it is further unlikely that the difference between these two amounts will be exactly offset by a rise in intended saving and a fall in intended investment to accomplish an equality between the two sides of the equation.² The same reasoning may be applied to any other situation in respect to these factors. In other words, in order to establish national equilibrium two balancing factors must come into play. They are (1) the intended rate of lending ($L$) and (2) monetary and fiscal policies

²As observables, saving and investment are equal. However, at any given point in time, either factor may be larger or smaller than the other. In this connection see Alvin Hansen, Monetary Theory and Fiscal Policy (New York: McGraw-Hill Book Co., 1949), Appendix B, pp. 219-225.
The center of attention will first be directed upon lending. The following conditional requirement for the establishment of national equilibrium is stated in the following equation.\(^4\)

\[ E - M = L = A - S \]

Lending plays the important role of creating a balance between the two sides of the equation \((E - M)\) and \((A - S)\).\(^5\) In doing so it connects the national economy, at a given income level and exchange rate, through the intended saving and intended investment account, and the international economy through the external accounts of intended exports and intended imports.

The result is that the excess of intended saving over intended investment may be offset by positive lending. If the opposite situation existed, negative lending (borrowing) would be instigated in order to balance the account.

Similar reasoning may be applied to the external account witnessing an excess of intended exports over

---

\(^3\)These two forces are briefly discussed by Professor Kindleberger. Refer to Kindleberger, *op. cit.*, pp. 438 and 448-450.

\(^4\)Enke and Salera, *op. cit.*, p. 233.

\(^5\)Lending here includes the usual capital account items.
imports or vice versa. The former would provide a balance by positive lending, and the latter through negative lending. The outcome is explained in a somewhat different light by Professors Enke and Salera in the following statement: "... When equilibrium has been attained, intended exports minus intended imports will equal intended saving minus intended investment because both differences will be equal to lending."^6

The above discussion may be augmented by pointing out individual conditions emphasizing the direction of lending.

If:

\[ E > M, \text{ L should be positive, } (-) \text{ effect in the balance of payments, or lending, takes place.} \]

\[ M > E, \text{ L should be negative, } (+) \text{ effect in the balance of payments, or negative lending (borrowing), takes place.} \]

\[ S > A, \text{ L should be positive, } (-) \text{ effect in the balance of payments, or lending, takes place.} \]

\[ A > S, \text{ L should be negative, } (+) \text{ effect in the balance of payments, or negative lending (borrowing), takes place.} \]

Lending in its balancing role may be either a cause or effect factor.^7 From a causal viewpoint, lending

^6Enke and Salera, op. cit., p. 234.

^7Enke and Salera, op. cit., p. 233.
would involve contracts for the movement of funds based upon decisions of individuals, government, and private or quasi-public institutions.

Lending as a resultant concept may occur when exporters decide to place their earnings in a bank of the importing country. There is a transfer of purchasing power as would be occasioned by a movement of short-term funds.

Since lending and borrowing involve two nations, which means that the flow of funds must be sanctioned by both sides, except for similar transactions as mentioned at the end of the above paragraph, lending may fail to close the necessary gap between the equation factors. For instance, intended lending may fail to close the gap registered by an excess of intended exports over intended imports; or, a surplus of intended investment over intended saving may not be reduced by the necessary amount required through intended (negative) lending.

In such a case as given, there would be a tendency for the national income to change, or the exchange rate would have to be modified.

The possible failure of lending as a balancing factor to provide a given national income and rate of exchange may be compensated for through the interaction of the second balancing factor(s)—monetary policy (MB)
and fiscal policy \( (F) \). A second equation may be conceived and expressed as follows:

\[
E - M = MB \quad \text{and} \quad F = A - S
\]

In this equation monetary and fiscal policy replace lending in the former equation.\(^8\) This attempts to explain that if lending— involving other nations— doesn't achieve the necessary balance between the accounts, the money and banking system and the government could provide enough flexibility to achieve the desired balance.

Monetary and fiscal policy could play an important part in achieving equilibrium. Some of the measures available are applied to individual situations below.

If:

\( E > M \), \( MB \) should provide for an increase in the international exchange reserve fund to act as a "buffer."

\( F \) should allow for an increase of export taxes or a reduction in subsidies, if granted.

\( M > E \), \( MB \) should utilize the "buffer" of international exchange reserves.

\( F \) should include a rise in import taxes or a reduction of import subsidies, if granted.

---

\(^8\)The term replacement is employed here only as an explanation of the new balancing factor(s) \((MB \text{ and } F)\). Actually, the factor(s) supplement rather than replace lending.
A, MB should grant a selective downward revision of quantitative and qualitative controls; a reduction of commercial bank interest rates.

F should produce a decrease in taxation; an increase of transfer payments; a rise in government lending to the public.

A, MB should incorporate a selective upward revision of quantitative and qualitative controls; a rise of commercial bank interest rates.

F should sanction an increase in taxation; a reduction of transfer payments; stepped-up government borrowing from the public.

The types of measures and the extent of their use would depend a great deal upon the experience of the nation involved. The maintenance of a supply of exchange reserves as a result of an international sales increase is an accepted means today of providing for future declines in export sales or for changes in relative imports. International reserves may be used as a first line of defense to close the gap if negative lending fails to do so.9

Variations in tax levies may not register the desired effects within a reasonable period of time. On the other hand, a highly efficient tax system could provide the necessary directional change in saving, exports, and imports, especially if commodity taxes and

9Venezuela has accumulated approximately $350 million of gold and foreign exchange between the years 1952 and 1956. See the International Monetary Fund, International Financial Statistics, any recent issue.
similar excise taxes constitute an important segment of income. Export and import tax levies may be changed in short-order if the Executive branch of the government has been granted authority to vary these imposts.\textsuperscript{10}

Governmental borrowing from the domestic sector could be carried out in connection with tax policy and other fiscal measures to insure the filling of the gap not closed through lending. The decision to use this measure would hinge upon the desirability of creating a temporary debt and the extent of prior debt outstanding. The smaller the gap to be closed between the two sides of the equation, including lending, the more likely would be the possibility of employing government borrowing from the public.\textsuperscript{11}

Borrowing from the banking system creates additional reserves for commercial banks and makes possible larger

\textsuperscript{10}Decree number 2602 allowed the Acting President of Columbia to establish import duties for all commodities in the Tariff Schedule. Refer to United States Department of Commerce, \textit{Business Information Service, World Trade Series}, number 177, February, 1952; \textit{Laws} 1502 and 53 of 1935 and 1939, respectively, gave the President of Paraguay the power to increase import duties in an amount equal to revenue losses from changes in the official rate of exchange. See United States Department of Commerce, \textit{Investment in Paraguay}, December, 1954, p. 90; and Presidential decree number 11 issued on October 18, 1955 exempted certain industries from paying Nicaraguan import duties on various products. Refer to United States Department of Commerce, \textit{Foreign Commerce Weekly}, December 19, 1955, p. 8.

\textsuperscript{11}James Maxwell, \textit{Fiscal Policy} (New York: Henry
loans. However, this action by itself may reduce saving only slightly. This depends primarily upon psychological stimulation and anticipation of future economic conditions by the public in general.

A change in the flow of transfer payments could be so altered as to contribute somewhat toward closing the gap between the equation factors. Perhaps the most serious obstacle connected with this measure is the time element. Generally, a change in the directional flow of transfer payments takes too long to accomplish desirable results.

Probably the most flexible measure would be the altering of quantitative and qualitative controls of the banking system. Timing is of immense importance. In the case in which intended saving is in excess of intended accumulation and positive intended lending does not close the gap, a lowering of the general and selective monetary controls should reduce the evident high liquidity. Lowering bank interest rates would also contribute something toward the accomplishment of the same objective, because it would tend to entice idle funds into investment channels. A reverse application

Holt and Co., 1955), pp. 115-117. This is a good although brief discussion of the merits and demerits of spending and taxation.
of these monetary measures would serve to close the gap if intended accumulation were greater than intended saving and intended lending fell short of absorbing the difference.

In the above discussion monetary and banking measures were causal factors directly instigated to create a balance between the equation factors. One may inquire as to whether these measures could be effectual factors, i.e., applied for some other given purpose yet indirectly aiding in closing the gap. This appears entirely possible. Quantitative and qualitative controls are tightened when the authorities feel that there is too much money and credit in circulation or when prices begin to rise. This is normally a period when intended accumulation is in excess of intended saving. A general loosening of controls would take place when there is too little money and credit in circulation or when prices start to fall. This is usually the time when intended saving is in excess of intended accumulation.

The varying of monetary controls in an attempt to deal effectively with the supply of money and credit in circulation would tend to produce changes in the direction required to help offset the excess of intended saving over intended investment and vice versa.

At present monetary and fiscal policies are
probably more in the realm of effect factors than they are cause factors so far as they pertain to the balancing of the equation. In other words, these policies are applied mainly to the domestic problems of money, credit, and prices rather than as measures instigated to fill a gap in order to achieve a given national income.¹²

So far it has been shown that a nation could realize a national equilibrium condition through the alteration of the rate of lending and monetary and fiscal policies. International equilibrium could not be achieved, however, without taking into account the rate of exchange. There would be only one exchange rate and national income level that would provide an equilibrium, given the rate of lending and the sum of the monetary and fiscal influencing devices.

The national income level may rise or fall, but there is only one exchange rate at each income level that would provide equilibrium, given the rate of lending and the influence of monetary and fiscal factors. Conversely, there may be different exchange rates, but there is only one income level at each exchange rate that would assure equilibrium, given the rate of lending and the influence

¹²The recent experience of Brazil and Chile indicates that monetary and fiscal policies were quite unsuccessful in relieving the above domestic problems. Refer to Table III, page 309, and 310 of this paper.
of monetary and fiscal measures.13

If there is a tendency for the rate of lending to be positive, recording a (-) in the balance of payments, when intended exports exceed intended imports and \((S > A)\), there will be pressure exerted to raise the exchange rate unless this tendency is offset by monetary and fiscal policies. The opposite reaction would be expected if there is a tendency for the rate of lending to be negative, causing a (+) in the balance of payments, when intended imports exceed intended exports and \((A > S)\). There will be pressure exerted to lower the exchange rate unless this tendency is offset by monetary and fiscal policies.

The influence of intended saving and intended investment will affect the exchange rate mainly in an indirect manner. The extent of the influence may be very slight, depending upon the importance of trade in relation to national income.

If monetary policy is chiefly relied upon to close the gap when intended accumulation is excessive, the dampening effect via discouraging loans in order to accomplish a higher liquidity may actually create a desire on the part of individuals to spend abroad. The transferring of purchasing power has the effect of

13Enke and Salera, op. cit., p. 234.
turning saving into spending and relieving the downward pressure upon the exchange rate.\(^{14}\) The reverse effects would be expected should intended saving be larger than intended investment.\(^{15}\)

This discussion should point out the extreme difficulty that a nation would encounter in order to achieve an international equilibrium relying primarily upon the tedious task of balancing the several factors. In addition, this short run balance does not include many factors that actually bear great weight. The general level of prices, for example, may change with income, move in the opposite direction, or remain constant depending upon the relative elasticities of those two factors. It is possible that the income elasticity of demand may be greater than the price elasticity of demand. This would mean that a greater than proportionate increase

\(^{14}\)The result of this action depends in great measure upon the initial group that carried out the negative lending. If this group were the government, the above result is possible. If individuals were the recipients of borrowing, monetary policy may or may not accomplish this result.

\(^{15}\)This analysis assumes that the multiplier effect is neutralized; e. g., autonomous exports would bring forth autonomous imports with the accompanying results of induced exports and induced imports. In line with the above reasoning either the exports and imports achieve exact proportions—which is highly unlikely—or their effects are offset through the operation of the two balancing factors. Professor Brainard discusses the
in income would be spent upon certain classes of goods. These products, however, may be occasioned with a relatively inelastic demand with respect to price. Further purchases may not be forthcoming unless the price falls. In other words, the incentive to buy which is created by additional income may be offset by high, rigid prices. In another case, the price elasticity of demand may be quite high along with income elasticity of demand. This condition may bring about a lower price level since a given increase in income in certain lines of goods could stimulate purchases to such an extent that total revenue accruing to businessmen would be greater at the lower price, and, hence, cause pressure toward a lower general price level. Of course, in both instances above, the movements would depend upon whether the goods involved loom heavy in the public's budget. The state of employment would also have an impact on these two forces.

There is a good deal of emphasis placed upon such a precarious balancing of these factors today.\(^{16}\) The

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operation of the multiplier according to four sources of income: new gold, use of foreign bank deposits, foreign loans, and government grants. See Brainard, \textit{op. cit.}, pp. 164-166.

\(^{16}\)The income approach would require the utilization of the two balancing factors in order to maintain equilibrium at a given national income.
camps are divided on this score. Advocates on the one side argue that international equilibrium is the primary responsibility of the individual nation. Each country must keep in step or be ostracized by the others. The opposing forces feel that international equilibrium is basically an international co-operative responsibility rather than an essentially domestic one. This interesting problem is, however, outside the scope of this study.

The remainder of this chapter is to be concerned with some of the monetary, fiscal, and exchange variables. Disequilibrium and imbalance are terms often referred to in discourse concerning the economic problems of nations. Special significance is attached to these terms when discussion is directed toward the underdeveloped areas.

Before discussing the variable factors and disequilibrium, the concept of equilibrium should be defined. According to Professor Kindleberger, international


equilibrium means: "... that state of the balance of payments over the relevant time period which makes it possible to sustain an open economy without severe unemployment on a continuing basis."¹⁹ Equilibrium, from the rate-of-exchange approach, is explained by Professor Nurske "... as one that maintains a country's external accounts in equilibrium without the need for wholesale unemployment at home."²⁰ A synthesis of these two definitions yields several points as conditions for international equilibrium. They are: (1) an equality in the balance of payments, (2) a relatively high state of employment at home, and (3) a rate of exchange suitable to maintain (1) and (2) over a period of time.

II. SOME VARIABLE FACTORS²¹

The above problems of international equilibrium have not been solved. No doubt part of the difficulty

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¹⁹ Kindleberger, op. cit., p. 397.


²¹ The variable factors as referred to here mean those factors which in the short run and intermediate period would cause a disruption to the otherwise smooth flow of economic activity unless offset, or at least mitigated, through monetary, fiscal, or exchange practices.
lies in the realm of the reaction of variable factors. Many economists would agree that not enough is known about these various influences, one way or another, upon internal and external complexities.

It is hoped that some benefit may be realized from probing into the nature of their working. This investigation will be undertaken from a conceptual viewpoint. Subsequently, in later chapters, a pragmatic analysis will be made of their application and effects in selected countries.

A. Monetary and Fiscal Factors

In the discussion of monetary and fiscal policies it will be anticipated that central banks are more or less free to carry out monetary policies which appear feasible to offset the probable adverse results of variable factors. From a realistic standpoint this is not always the case.\(^2\)\(^2\)

To the extent that this condition is not true, monetary

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policy would succumb to the dictates of the federal government, or the dominance of fiscal policy over monetary policy would prevent proper co-ordination between the two areas of policy determination. 23

1. Income Changes

The plane of living in a nation is dependent in part upon the ability of that nation to cope with income changes primarily through the facility of monetary and fiscal policy. Particularly is this true in countries which are subject to great resiliency in the income pattern. The inability of the above policy to deal adequately with such problems as changes in export income or the presence of too little saving, prolongs the period of adjustment for a nation grasping for greater development.

The remainder of this section will consider some of the variable factors which tend to give rise to changes in income and, therefore, produce serious problems for monetary and fiscal control. These factors will consist of export income, personal savings, taxation, and government borrowing.

23 A study of Venezuela yields evidence of this result. See Chapter III of this paper, pp. 260-262.
a. Export Income

The preferred position of monetary policy with respect to changes in export income is usually considered as passive; that is, banks serve importers by making exchange available, while they serve exporters by converting foreign exchange earnings into local currency.

As foreign sales rise and exporters receive more income, their earnings would have a natural, beneficial effect on the country as a whole. A portion of the increased income earned would spur domestic production and income; a part of the income would be used to import more goods; and the remainder would be held for near-future investment. If foreign income should fall, these situations would be reversed. Monetary policy, even in this instance, would be passive, at least to a certain extent, with changes in production and the distribution of income providing the necessary adjustment.

This passive attitude concerning monetary policy has blended into a more active one in many nations. The main reasons for this change are the desire by many countries to increase post-war production, the emphasis upon greater industrialization, and the over-all concept that each nation is to maintain a high rate of employment and income within the nation regardless of so-called
temporary external maladjustments.\textsuperscript{24}

The answer to the question of how important is export income in relation to total income seems to depend much upon the relative degree of industrialization in most nations. The lower the degree of industrial development, the greater is the importance of export income to total income, and vice versa.\textsuperscript{25}

This source of income constitutes an exceptional problem for monetary authorities in underdeveloped areas. Exports are subject to sudden change and, from a monetary standpoint, banks are subject to rapid deposits and withdrawals.\textsuperscript{26} To bring in the other side of the picture,

\textsuperscript{24}Professor Hansen questions this approach in terms of long run cost or price-level disparities, but supports it when it is made to refer to a short run cyclical disturbance. See Hansen, Monetary Theory and Fiscal Policy, pp. 210-211. According to Professor Nurske, adjustment should occur through varying the exchange rate. See Ragnar Nurske, The New Economics, edited by Seymour Harris, (New York: Alfred A. Knopf, 1948), p. 273. Professors Despres and Kindleberger state that a guiding principle in post-war equilibrium policy is one which explains that the pursuit of domestic policies of full employment should not be hindered through balance of payments difficulties. See Emile Despres and Charles Kindleberger, "The Mechanism for Adjustment in International Payments--Lessons of Post-war Experience," American Economic Review, Papers and Proceedings, May, 1952, p. 332.

\textsuperscript{25}There are exceptions to the above statement. For example, Venezuela is further advanced industrially than the majority of Latin American countries, yet export income amounted to approximately 37.9 per cent of national product (income) between 1952 and 1956. See the International Monetary Fund, International Financial Statistics, January, 1957.

\textsuperscript{26}The Central Banks of Columbia, Ecuador, Mexico,
there is also a tendency for nations which depend upon exports for a relatively large share of total income to possess a relatively large thirst for imports. Once again this explains the situation of underdeveloped nations with respect to their anxiety to industrialize.27 Because of this situation, it is likely that commercial banks will tend to hold larger liquid reserves than would otherwise be the case. The outcome may be fewer loans and less investment on the part of banks, or at least a tendency to channel funds into more selective areas.

The more cautious attitude of bankers resulting from the dominance of exports and imports could serve to some extent as a means of braking the inflation. However, a deleterious effect may be encountered in the form of loans and investment directed predominantly toward old well-established firms rather than toward the growth industries.

Total bank deposits may fail to register a decline even when imports rise sharply. The reduction of deposits

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Salvador, Uruguay, and Venezuela utilize foreign exchange reserves as part of the minimum reserve against note issues or deposit liabilities, or both. One of the reasons given to explain the employment of international reserves in this way is that they tend to create confidence in the currency no longer backed by gold. See M. H. DeKock, Central Banking (London: Staples Press, Ltd., 1954), pp. 88-89.

by importers may be matched by an increase of deposits on the part of foreign exporters. Of course, the small local banks are not likely to handle sizeable deposits from foreign exporters; nonetheless, the larger commercial banks and the central banks may often be in this position. There is a strong possibility that the money supply will not be reduced as importers withdraw funds according to orthodox banking, and inflation might therefore be prolonged.

The rise in export income provides additional income in both the private and public sectors. In the private sector of the nation's economy, expenditures on consumption and investment would normally be greater. Spending might rise at a faster rate than the increase in export income, since bank credit would tend to be easier to obtain. The probable result would be a rise in prices and a fall in real income.

As for the public sector, government revenues would rise as a result of a prior increase in exports. This would create an incentive for additional consumption and investment expenditures in this area. The difficulty here lies in the fact that a temporary

increase in income because of a rise in exports may be comprehended as a permanent improvement in economic activity. The error in judgment would be realized when export income suddenly declines; but the government may find that the only way to relieve the situation will be to increase federal expenditures. Sooner or later this may call for deficit financing.

Since imports are one of the most flexible factors, it has been proposed that the authorities stabilize them. This kind of policy would pertain only to nations depending upon exports and imports to a relatively large extent. By holding imports quite steady, erratic movements in export income would be expected to produce less


The banking system of Uruguay attempts to mitigate internal disturbances created by the gain or loss of export income. When exchange reserves accumulate the banking system reduces its lending. It does this by refusing to issue new currency against its larger reserve balance. A comparison is made between the annual expansion in bank loans and the changes in bank reserves of gold and foreign exchange with the money supply. If the percentage rise in bank loans is much greater than the increase in reserves in terms of the money supply, the banking system reduces credit expansion. Ibid., pp. 272-273.

The author would consider this as a proposal for medium-term policy.
adverse results for monetary policy. It would be known that a certain amount of export income would be required to pay for a given amount of imports. At a time when export income is larger than that required to pay for the imports, the excess amount could be set aside for periods when export income would fail to equate the necessary payment for imports. Even if the surplus export earnings were not held for future depressing periods, there would be less disturbance to the present money supply since only a portion of the total export income would be channeled into the monetary system. On the import side, the stabilization of imports would require that the greater portion of the limited amount of imports would consist of necessities. In other words, import stabilization would tend to prevent wasteful spending upon semi-luxury and luxury items which the nation could not afford.

Serious disadvantages might result from a policy aimed at stabilizing imports. The over-all program would place in the hands of the authorities the decision as to what would and would not be imported into the country. Furthermore, a policy geared to limit imports would fail to register the changing needs for goods coming into the nation. In establishing the basic commodity import unit, the authorities would have to
consider the contribution of export income. Since there is little internal control over exports, this would be difficult to do. The longer the time period considered, the more likely is the probability of error of judgment from the standpoint of both exports and imports.\(^32\)

The rise or fall of export income not accompanied by a proportionate change in the same direction of imports and not offset through opposite changes in investment or similar changes in saving would cause pressure upon the price level unless the banking system were able to provide enough flexibility to counter the price movement, or unless fiscal policy could provide larger revenue through taxation, or both.\(^33\)

Since in many nations structural changes and the mobility of factors are not free to adjust to the new situation in a hurry, a resort to deficit financing at home and abroad serves as a temporary avenue of escape. It would appear that this latter action only prolongs a much needed adjustment.

How would other forms of income affect monetary


\(^{33}\)The multiplier would be expected to accentuate the directional pressure on the price level.
and fiscal policy in a nation, especially one that is considered to be underdeveloped? The answer would depend in great measure upon the alternative means used to accumulate capital. These methods would include personal savings, taxation, government borrowing from banks, the public, and foreign countries.

b. Personal Savings

Personal savings would normally constitute the major source of capital funds. However, in some nations the supply of personal savings either does not exist or the amount is too small to be effective. In this connection, consumption expenditures constitute nearly all the national income. To the extent that such is the case, part of the blame must rest upon the monetary and banking system. Individuals who accumulate small amounts of saving may either hoard the funds or spend a little more than they otherwise would, in part, because of the failure of the monetary system to provide people with saving institutions.

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34 This general classification was taken from Professor Kindleberger. Refer to Kindleberger, op. cit., pp. 384-387.

35 An opposing comment to this popular contention is offered by Professor Rozenthal. See Alek Rozenthal, American Economic Review, Book Reviews Section, March, 1956, pp. 183-184.

36 Some of the countries in Latin America have
The voluntary aspects of the problem of saving may be partially explained by the tendency of those who have relatively large amounts of funds available to place their money in land or imported luxury items rather than in productive enterprises. Again, the failure of bank development would account for the lack of systematic personal savings.

The development of several types of banking institutions within a given area probably contributes to the disparagement of banking services from the standpoint of individual savers. For example, it is pointed out that the development of banking systems in Latin America follows no consistent pattern. Foreign branch banking is common in some of the nations, commercial (unit) banking characterizes other countries, and central banking alleviated this problem to some extent. For instance, Mexico had two savings institutions in 1921. By 1951 there were 739 savings institutions including banks and branches, credit unions and other financial institutions. Refer to Senate Committee on Banking and Currency, Interim Report, Study of Latin American Countries (Washington: United States Printing Office), 1954, p. 354.


38 Other factors are important in this connection, such as: the moulding of the saving habit and faith in the government.

39 Triffin, op. cit., pp. 96-103.
is important in still others. Furthermore, the kinds of controls and their effectiveness may vary a good deal. Foreign branch banking, for instance, is likely to extend its services predominantly to traders, or it may encourage the investment of funds in other countries rather than for domestic utilization. Of course, any one type of banking system may serve a nation better than other forms. A nation should be free to choose the kind which serves its purpose best.

In the more industrialized countries an active stock market serves as an important outlet for money not spent on consumption. Failure in the development of security exchange markets appears to be a characteristic feature of the lesser developed nations.

The instability of the governments and the lack of industrial development in many nations have been leading factors explaining the failure in the development of security exchange markets. In addition, the problem of the technical development of capital markets has prevented the accumulation of saving for investment.41

40 The desire for more government control over banking functions may be a partial explanation of the recent trend in central banking development, especially in Latin America. Refer to Buchanan and Ellis, op. cit., p. 338.

41 A good discussion of this problem may be found in Professor Hanson's book. Refer to Simon G. Hanson, Economic
It would probably be prudent to first establish a very narrow market in securities and gradually expand it as it comes to meet with general acceptance. In this connection, the government could be of valuable assistance in propagandizing the program. It could also develop a market for the distribution of its own bonds.

As for the encouragement of personal savings of the small income earners who are unfamiliar with security exchange markets, the development of small local industries on a community basis may be utilized for this purpose.\(^42\)

Instead of concentrating upon alternative ways to encourage personal saving, some countries attempt to acquire funds through forced savings; that is, through printing additional quantities of paper. As more money is printed and spent, inflation arises and this tends to reduce the real income of wage earners since their wages fail to keep pace with rising prices.\(^43\)

The selective control over imports has some

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\(^{42}\) Buchanan and Ellis, op. cit., pp. 304-305.

influence on the saving function. Certainly the small savers would be forced to purchase less. Those with larger incomes are likely to spend more of their higher incomes in buying other domestic products or to increase their saving accounts abroad. However, it is difficult to conceive of a nation deliberately reducing its imports for the prime purpose of encouraging personal savings.

Deposit insurance in those nations which have no comparable service would be of special importance to the people. Countries with a good record of political stability could provide this service through the government if no private concern were willing to do so. Banking legislation could be modified to provide more flexibility with respect to capital requirements for banks desiring to serve the rural areas. The government and private businesses could do something toward familiarizing the public with the banking institutions by paying workers with checks and encouraging payments by checks.44

c. Taxation

A good deal of concerted agreement is expressed

by writers who feel that much may be accomplished in the area of taxation as a part of fiscal reform.\footnote{This is one of the most promising spheres of independent policy action, according to Professor Hanson. Refer to Hanson, \textit{op. cit.}, pp. 472-473; a similar viewpoint is expressed by Professor Triffin. See Robert Triffin, "Exchange Control and Equilibrium," \textit{Foreign Economic Policy for the United States}, edited by Seymour Harris, (Cambridge: Harvard University Press, 1948), p. 414.}

Taxes imposed upon commodities would normally be quite regressive for the majority of the people in nations with relatively low income and saving. It may be well to reduce, as far as possible, this type of taxation, at least for an interim period. Selectivity may be exercised in such a way as to reduce or exclude taxes imposed upon necessities. A dual advantage may be realized from such action; more funds would be made available for investment, and the banking system would be used more intensely.\footnote{It should be recognized that the saving made possible by the reduced tax rate may not be shared in its entirety with consumers.}

Because exports and imports play a substantial role in various nations, customs duties are of considerable importance.\footnote{Wendell Gordon, \textit{The Economy of Latin America} (New York: Columbia University Press, 1950), p. 368.} If carried too far, import levies might deter domestic purchases to a serious extent. While there is some justification for preventing the importation of
luxury goods, these duties, at the same time, tend to reduce the effect of comparative advantage in trade. Importers may maintain their usual mark-ups, or even increase them, rather than share in the increased duty. 48

Imposts applied to exporters may force factors and suppliers to assume a larger share of the tax. Yet, a graduated custom levy on imports starting with items of necessity and ascending with semi-luxury and luxury products could have a beneficial effect. The higher income groups would be encouraged to invest more of their idle income at home. At the same time, the larger number of lower income earners would be able to purchase a greater volume of imported goods should home production fail to satisfy domestic demand.

A tax on exports may produce a sizable share of total tax revenue. So long as the tax is not greater than the cost-price differential, it would not interfere with sales or hinder international specialization. 49

48 Customs duties constitute a major portion of total government receipts in nearly all the Central American countries including Mexico. No doubt these duties are an important source of revenue in nearly all of the Latin American nations. See the United States Department of Commerce, Investment in Central America (Washington: United States Printing Office, 1956), p. 30; and Bank of Mexico, Annual Reports, 1955 and 1956.

49 Buchanan and Ellis, op. cit., p. 328.
This type of tax is easy to administer, and it may contribute to stability by raising and lowering the duties during prosperity and depression.

Government monopolies which are quite common in some countries may also be made a source of tax income. The imposition of a tax on such monopolies may create a desire for efficiency. Their ability to withstand a tax may be used as one measure for comparing their efficiency with that of private producers. Sometimes they plead non-tax payments on the basis that they offer commodities and services at exceedingly low prices. If this defense is valid, their tax contributions should be lowered proportionately. No doubt there are numerous examples to show that such is not the case. Though there may be some justification for their temporary existence, it would appear to be advantageous not to include government monopolies in a country's long run planning.

The progressive income tax so popular in some nations has not been successful as a major source of income in many of the lesser developed countries.  

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50 One recent case is that of Argentina's monopoly agency called the I. A. P. I. which purchased farm commodities at low prices and sold them at the higher world market price. See Gordon, op. cit., pp. 253-254.

51 Individual income taxes provided only 13.9 per cent of total government revenues of Costa Rica in 1955. Similarly, taxes on income yielded 7.7 per cent of the
The chief explanation for this is that the higher income groups hold a good deal of political power. Tax administrators often wink at the flagrant abuses of the income tax of this group. And as for the much larger group, perhaps one of the chief reasons explaining the lack of popularity with respect to the progressive income tax has been the inability of the larger masses to earn enough taxable income, and the expense involved in collection.

A tax levied upon real property has been suggested as a means to be used for recouping revenue lost through individual income levies. This may be a commendable measure if applied to unused property, but it is doubtful that it should be used as a substitute for a sound progressive income tax. The trend toward a more even


52 Gordon, op. cit., pp. 208-210 and 213; for an explanation of comparative burdens of high income taxpayers refer to Hanson, op. cit., pp. 466-467; Professors Buchanan and Ellis point out some of the difficulties of income tax levies; such as, illiteracy and inadequate record keeping. See Buchanan and Ellis, op. cit., p. 324.

53 Gordon, op. cit., p. 213. Mr. Adler defends this type of tax, since the distribution of property is more uneven in some countries than is the distribution of income. Refer to Adler, op. cit., p. 594.
distribution of land may reduce the incentive toward developing costly real property tax programs.

A good tax system, particularly in the underdeveloped nations, should be highly flexible; that is, as the structure of production changes, new tax sources may be tapped while others may become of lesser importance. For example, in a few Latin American countries the severance tax has begun to yield more revenue. Perhaps the sales tax and other types of taxes will take a more important place as a source of revenue as more productive facilities are created or existing ones are expanded.

d. Government Borrowing

The remaining portion of this section is concerned with government expenditures made possible by borrowing. The types of borrowing to be considered are borrowing from banks, the public, and foreign countries. In addition, an attempt is made to integrate monetary and fiscal policies to show how they may contribute toward a more effective borrowing program.

The well-known Keynesian concept of closing the investment gap through government spending is probably

emphasized more in the monetary and fiscal policies of underdeveloped nations than elsewhere. It is supported on the basis of full employment and economic development.\(^5\)

The full employment concept is supported on a somewhat different basis than it is in the more industrialized nations. It is generally agreed that nearly full employment already exists in most underdeveloped countries. Of course, inefficiencies may be evident because of the poor factor distribution. Yet, this may establish a foundation for the justification of the more effective use of monetary and fiscal policy. If this reasoning can be inculcated, then there is a firm basis established for more public control in order to bring about a stronger economy.

Development, or the desire to industrialize, further supports the more extensive employment of monetary and fiscal measures. Development may proceed at a slow or rapid rate. Because of the desire to compete more successfully with other nations and to raise the domestic plane of living, the latter is more likely to

\(^{55}\)Full employment is usually considered as an objective, while economic development is a means-to-end concept. For a discussion of the meaning of economic development in this connection see Harold F. Williamson, Economic Development, edited by H. F. Williamson and John A. Buttrick, (New York: Prentice-Hall, Inc., 1954), p. 6.
Monetary and fiscal controls should be much easier to employ in countries in which the people are accustomed to a good deal of government activity. The underdeveloped nations are, as a rule, in this general situation; therefore, it is likely that monetary and fiscal measures may be utilized on a larger scale than would be possible in the more developed nations.

Personal savings as the major source of capital accumulation may not provide sufficient funds for growth. Even a change in the tax rates or in the structure of the tax system may fail to yield a high state of employment or to support a desirable developmental policy. The final area of domestic policy lies within the sphere of governmental expenditures.

The type and amount of borrowing on the part of the government may be determined by several factors. The amount of borrowing may be quite small if the government were to attempt to balance the budget at the end of each year. On the other hand, a cyclical balancing

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57 The yearly budget appears to be giving way in favor of some type of cyclical budget balancing. Refer to Charles Prather, Money and Banking, 5th edition, (Homewood, Illinois: Richard D. Irwin, inc., 1954),
of revenues and expenditures would allow more time for balancing to become a reality according to predetermined plans.\textsuperscript{58}

It is known that if aggregate expenditure exceeds the national output at full employment, inflation will arise; and if national output is larger than aggregate expenditure, unemployment will come about. The responsibility of the government tends to lie within the limits of the above concept, the prevention of inflation and the prevention of serious unemployment. The current problem of the underdeveloped nations, however, is explained primarily in terms of inflation rather than unemployment as such.\textsuperscript{59}

The experience of the depression of the 1930's has shown that monetary policy is less effective in the downswing than in prosperity.\textsuperscript{60} However, even in the

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\textsuperscript{58}Cyclical budget balancing is at least suggested in the various development programs in Latin America. For example, Argentina and Guatemala have adopted five-year programs. For a survey of the economic development plan for Guatemala, refer to the Government of Guatemala, Desarrollo Económico de Guatemala 1955-1960, (Economic Development of Guatemala), Guatemala, C. A., 1956.

\textsuperscript{59}This is not to say that unemployment (underemployment) is a basic factor partially responsible for inflation.

\textsuperscript{60}George Halm, Economics of Money and Banking
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latter instance, the success of monetary policy was none too bright because of poor timing, psychological motivations, and so on. Is it possible then that government borrowing may be successful if monetary policy stands ready to cope with any adversity affecting the economic system? The answer seems to be problematical.

The effect of government borrowing upon the economy depends upon the way in which it is created. Borrowing from the banking system allows for the expansion of commercial bank reserves. If newly created money is spent by the government, private expenditures need not decline since banks are in a position to provide more funds, and total spending may become favorable to further output and income. Yet, the newly created reserves provide for the likelihood of too much spending and constitute a threat to the price level.  

The responsibility of the banking system requires that it is so organized that it has sufficient funds available to loan, and it has proper machinery at its disposal to loosen or tighten the money supply as it sees fit. It is entirely possible that this is not the case


in an underdeveloped nation. The banking system may not be so highly organized, or the government may dominate monetary policy. If this is true, monetary policy would be quite ineffective as a weapon to ward off inflation or to prevent deflation.

Government borrowing may come from public saving. Although this form of borrowing would be expected to be quite small, it has an effect similar to an increase in taxation and represents a transfer of existing funds from the public to the government. The income effect of such borrowing depends upon the way in which the government would utilize the funds obtained.

The operation of government enterprises may take an active part of a negative monetary policy. Government owned firms serve as an important source of revenue in some nations as well as an item of expenditure. The government may borrow from its enterprises at most any time, and at increasing amounts as the firms become more vast and numerous. Moreover, repayment is not such an important problem. At the same time, this borrowing action would restrain or prevent any outward action by

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62 Even in an industrialized nation such as the United States, banking and government policy sometimes conflict. Evidence of this is found in the Federal Reserve-Treasury rift.
the monetary authorities. This clandestine operation might well be an alternative to the printing or borrowing of money, since the latter is frowned upon by the authorities and other (creditor) nations too.

The expenditure of borrowed funds may have different results depending upon the action taken by the monetary authorities. Even in the case in which expenditure of the funds is carried out by the government, monetary policy could help assure the most useful application of those funds by establishing the terms on loans. Loans from government funds could be channeled into the most deserving sectors by the adoption of different loan terms for each sector. A large portion of the funds would go where they would be the most productive. Of course, that part of the funds which was borrowed and spent directly by the government would circumvent this action to some

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63 Of course, the functioning of an economy may be hindered through such action.

64 In this connection, the policy of the Central Bank of Mexico accomplishes a similar result. Instead of channeling funds on the basis of loan terms, the Central Bank does this by deposit reserves. It requires the commercial banks to maintain a 100 per cent cash reserve behind their demand liabilities, but it reduces the reserve percentage if the commercial banks make loans in definite sectors on a stipulated long-, intermediate-, and short-term basis. See B. H. Beckhart, editor, Banking Systems (New York: Columbia University Press, 1954), pp. 585-586.
The government has one other borrowing alternative remaining. Besides borrowing from the public or banks, it may have access to foreign capital.

A nation plagued with fundamental problems such as are usually connected with mal-distribution of resources, with being a primary producer, or a nation which is over-emphasizing industrial production may be faced with a persistent deficit in its current account.

Generally, it is explained that short-term funds will move out of the country primarily for safe-keeping. Yet, it is likely that some short-term funds will be moving into the nation. This is natural since foreign importers will place deposits in banks for present or future purchases from the country in question, and because there is always the possibility of making a high return on capital invested for short periods of time. One may inquire if it is possible for the nation to receive an

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65I. G. Patel, "Selective Credit Controls in Underdeveloped Economies," International Monetary Fund, Staff Papers, Washington, D. C., September, 1954, p. 87; Mr. Adler points out the importance of diversified investment. See Adler, op. cit., pp. 588-591; Professor Kindleberger suggests that price distortion may channel government funds into areas that cannot be supported after inflation, i. e., hotels, etc. This is likely unless monetary measures act quickly enough to dispel the threat. Refer to Charles Kindleberger, International Economics, p. 386.
income benefit from short-term funds when the account may show a net outward movement of such capital. That possibility depends much upon the monetary policy of the country. If banks are operating with a fractional reserve policy, the additional external deposits placed in the domestic banks would allow for a multiple expansion of loans and investment, provided these funds are not sterilized in the name of the foreign owner.

The funds moving out or "in flight" may be composed mainly of accumulated saving rather than the withdrawal of deposits. The net effect in the nation concerned would be an expansion of money and credit through the banking system to an amount greater than the net outward movement of funds as indicated in the balance of payments. In other words, as long as there is a rather consistent amount of short-term capital in the banks of the country, it could experience a net income gain even though short-term capital is moving out at a rate faster than it moves toward the nation.

It would not be common practice, however, to expect the short-term movement of funds to be employed for the purpose of attempting to deal successfully with a persistent import surplus. Gold exports, grants or gifts directed into the country, or capital investment moving in constitute the major means of solving the current
account deficit. The most important of these items would be the capital movement. Gold cannot be drained away over long periods of time, and a nation cannot count upon other countries' grants or gifts.66

Both monetary policy and fiscal policy could play an important role in connection with capital inflow. The monetary role would affect the employment of the funds. As mentioned earlier (see page 54), the monetary authorities could channel the funds into their most productive uses through the terms on capital. This would help to assure repayment by stimulating exports and, at the same time, providing for the growth of basic industries.

Fiscal policy would be responsible for determining the necessary amount of capital needed. This would involve the co-ordination between the balance of payments deficit or surplus and the internal need for funds, including judgment with respect to the probable debt or surplus encountered.

B. External Factors

Only a few nations today, if any, can afford to neglect the impact of external trade upon their national income, output, and employment. Even in the case of the

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United States in which exports contribute but a small proportion to total national income, it is becoming increasingly evident that changes in exports and imports along with other items making up the balance of payments have profound international results. A small change in our decisions to export and import may have tremendous effects in other nations, primarily in those of the more underdeveloped areas.

Earlier in this chapter it was stated that lending (L) could be employed in order to create a balance between imports (M) and exports (E). At the same time monetary and fiscal policy (MB) and (F) could be so applied that they may bring an equality between saving (S) and investment (A). By reason of their complementary nature, these two forces would normally spill over into each other's area. As an example, monetary and fiscal policy might be concerned to a certain extent with income derived externally for the purpose of maintaining a given national income. On the other hand, lending would tend to affect saving and investment decisions within the nation.

The working of the above forces as indicated

67 It is explained that though export income represents a small contribution of total income in America, this may mean the difference between profits and marginal returns. Refer to Paul V. Horn, International Trade Principles and Practices (New York: Prentice-Hall, Inc., 1951), p. 29.
assumed the existence of a stable exchange rate at a
given national income. But from a more practical view-
point, there will be pressures exerted which will tend
to influence the rate of exchange. These pressures may
be caused by internal or external factors. Now our
problem hinges upon the question of what effect an
exchange rate has upon national income. This calls for
our immediate attention.

1. The Rate of Exchange

The rate of exchange refers to the price of one
currency in terms of another. This broad definition
infers that the exchange rate, the national price level,
and national income tend to influence one another.

A monetary disequilibrium could occur because of
an unequal degree of variation in national price levels,
that is, because of changes in the price levels of two
nations, with the exchange rate remaining the same;68
or whenever a variation in the exchange rate occurs,
national price levels remaining constant or moving less
proportionately.69

68A shift in foreign demand may raise the price of
one export product and lower that of another leaving the
national income unchanged. Refer to Enke and Salera, op.
cit., p. 193.

69Snider, op. cit., p. 167.
The movement of the exchange rate could lead to a monetary disequilibrium since it would influence the national income. A rise in the exchange rate would normally increase the national income, that is, a greater increase in exports relative to imports. Conversely, a drop in the exchange rate would produce a fall in the national income, for imports would then exceed exports.

A fluctuation in national income accompanied by a given exchange rate could create a monetary disequilibrium which might call for an adjustment of the exchange rate. This would be the probable outcome if lending and monetary and fiscal policy should fail to be effective. On the other hand, the exchange rate might not need to be tampered with if the national price level should fail to move along with the national income variation.

The national income and national price level may not move with the same degree of variation and in the same direction. For example, the national price level may move slowly or not at all until a state of nearly full

\[\text{\textsuperscript{70}}\text{Mexico realized an increase in exports in 1955 and 1956 caused, in part, by a rise in the domestic rate of exchange in 1954. Refer to the Bank of Mexico, \textit{Annual Reports}, 1954-1956.}\]

\[\text{\textsuperscript{71}\text{The final result depends upon the regulators of demand and supply. For an analysis of these complex forces see P. T. Ellsworth, \textit{The International Economy} (New York: The Macmillan Co., 1950), pp. 555-572.}\]
employment is realized. Also, such factors as wage rigidity and monopoly may slow down or prevent price movements from occurring as national income changes.

It is further conceivable that a change in the national price level, the exchange rate remaining stationary, could cause a monetary disequilibrium, in as much as the national income may not respond to the same degree of change as the price level. This is most likely to occur after full employment has been reached, and it depends to a great extent upon the distribution of income.72

So far as adjustment to equilibrium is concerned, both price and income changes are involved.73 Price variations are probably least applicable when a good deal of unemployment is present and when prices and costs are inflexible since a change in the money supply and bank

72 The export sector may suffer less than the domestic sector because of more favorable terms on loans, subsidies, an inelastic demand for major export products, etc., especially if this sector normally contributes a large share to total income.

73 The income approach tends to relegate price changes to a secondary position. This is emphasized by Professor Nurske as follows: "... in the adjustment process, price changes work generally in the right direction for the restoration of equilibrium. But, insofar as they occur at all they are essentially a byproduct of the changes in the volume of employment and productive activity. These latter changes are therefore to be regarded as the primary equilibrating factors." Ragnar Nurske, "Domestic and International Equilibrium," in The New Economics, edited by S. E. Harris, p. 269.
reserves affect the general level of prices only to a small degree. However, rising production during a business slump will tend to raise prices or, at least, keep them from falling.\textsuperscript{74}

Income variations affect production through changes in employment. As production and employment rise, the increased income tends to maintain a larger supply of money. This has the effect of keeping interest rates down as the demand for money strengthens with a rising output.\textsuperscript{75}

2. Exchange Control

Income analysis as applied to an open economy generally requires that cyclical and monetary adjustments (short-term) should come about through internal changes rather than by exchange rate variations. In the long run period, however, the structural pressures would require an adjustment in the exchange rate.\textsuperscript{76}

\textsuperscript{74}Snider, op. cit., p. 234.

\textsuperscript{75}Ibid.

\textsuperscript{76}Mr. Bloomfield points out that Keynes, Harrod, and other followers expressed this attitude. Refer to Arthur I. Bloomfield, "Foreign Exchange Rate Theory and Policy," \textit{The New Economics}, edited by S. E. Harris, pp. 300-301, including footnotes on page 300; also see Ragnar Nurske, "Conditions of International Monetary Equilibrium," in \textit{Readings In The Theory Of International Trade}, p. 34.
Many of the present problems of the underdeveloped nations depend upon the application of monetary and fiscal policies for their solution. A few of these problems pertain to investment, development, social security and union activities, inflation, and price controls. In order to solve these types of problems the responsible authorities may desire to prevent external pressures from upsetting their domestic goals. Exchange controls are often employed in such cases.

The ultimate effect of exchange control is to allow monetary and fiscal factors to make their full contribution toward establishing and maintaining full employment at a high income level while the balance of payments may be held in equilibrium. It is assumed that after these adjustments have been made exchange control would no longer be necessary, and a free or flexible exchange system would take its place. The time required to solve these basic problems may, however,

77 Professor Mikesell criticized the United Nations reports for overemphasizing planning, controls, etc. which tend to divert attention away from the relative price structure, comparative advantage, and so on. Refer to Raymond F. Mikesell, "Economic Doctrines Implied In United Nations Reports," American Economic Review, Papers and Proceedings, May, 1954, pp. 570-582.

78 Professors Buchanan and Ellis stated that the danger in the use of exchange controls is that they put no correctives to work. It is essential, therefore, that
extend over many years.

Exchange control may not contribute to the maintenance of a high national income, since it would tend to reduce both imports and exports over a period of time.

The underdeveloped nations would generally be pressed with inflation since capital facilities cannot expand as rapidly as the money supply in the first instance, and the national income would fall because of later retaliation on the part of the outside world.

A higher domestic price level would tend to stimulate imports and reduce exports, provided that the price levels in other trading nations do not rise at the same time. If the higher price level were extended to the open economy, it would tend to lower the nation's exchange rate. Imports would tend to rise, for importers would be willing to give up more units of currency for imported goods than before. But the authorities would not allow the increased imports to upset the balance of payments. The result is that the imposition of exchange control will prevent the rate from falling.

Exports would decline if the exchange rate were lowered, because foreign buyers would have to give up more units of their currency for their imports. Since monetary and fiscal policies are successful. See Buchanan and Ellis, *Approaches to Economic Development*, p. 402.
exchange control prevents the lowering of the exchange rate, exports would not be expected to show much decline.

The actual effect of exchange control upon the balance of payments also depends upon the relative volume of imports and exports.

Should the inflation not be overcome within a reasonably short period of time, the nation might stand to lose much more than it could gain. The blocking of external forces also prevents the utilization of comparative advantage. It does this by forcing the nation to use high priced domestic resources and commodities which could be imported cheaper, and by preventing it from exporting resources and goods produced cheaper at home.\textsuperscript{79}

The final outcome would depend upon the severity of the general inflation, the adaptability of monetary and fiscal policies to this situation, the relative price inflation in the various domestic sectors which may cause price control, and the probability of appreciating the

\textsuperscript{79}The rather extensive use of multiple exchange rates is an outward manifestation of this reasoning. Rates other than the official rate are employed to attract certain imports and to assure the sale of selected exports. At least six countries in Latin America employed multiple exchange rates in 1952. They were Columbia, Costa Rica, Ecuador, Nicaragua, Peru, and Venezuela. See R. F. Mikesell, \textit{Foreign Exchange In The Post-war World}, p. 315.
exchange rate in order to bring the nation's price level into line with those of other trading nations. After about twenty-five years, exchange control continues to be used for the purpose of rationing imports. It is usually explained that this is necessary in order to prevent a decline in the national income. Nevertheless, the reduction in imports would normally lead to a future decline in exports.

The immediate effect of this phase of exchange control activity would be a rise in income following the lowering of imports. Gold and foreign exchange would flow into the nation. But if the period were prolonged, the gold and foreign exchange reserves of foreign countries would become seriously reduced or even exhausted.

Under the circumstances just described, it is possible that short-term loans could be made to foreign nations. The consequent outflow of its capital might be expected to provide for an equilibrium in the balance of payments of the import-restricting country. Yet, for several reasons, such is not likely to be the result.

80 The domestic alternative adjustment would be deflation. This could lead to unemployment if prices, wages, etc. are inflexible. The economic and social cost may be too high. Refer to Snider, op. cit., p. 257.

81 This would depend upon the volume of import reduction and the type of demand for the country's exports.
The exchange control authorities would probably prevent the outward movement of capital. Again, capital may be more profitably employed within the country not necessarily because of a higher return but because greater opportunities now exist. Furthermore, the restrictions upon imports may indicate that the general price level of the nation restricting imports is relatively higher than those of other trading nations.

The close of the interim period is realized when exports decline to the extent of the lower import level. The national income cannot be maintained with a lower scale of imports and exports unless monetary and fiscal policy are successfully adapted to that purpose. The role of these two policies is next to be traced.

On the basis of the experience of many nations the following chain of efforts and results would probably follow under a newly launched system of exchange control. Since the control is likely to be imposed to reduce imports, exports would become excessive. Saving would then be required to exceed domestic accumulation by an amount equal to the excess of exports over imports. This could be realized in part by raising quantitative and qualitative controls and increasing commercial bank interest rates. Additional remedies would include higher taxes, more emphasis upon government bond sales,
and smaller transfer payments.

The monetary and fiscal factors at work to maintain an excess of saving over investment would probably be moderated, since exports would be constantly reduced until finally exports equated the lower import level to create equilibrium. This does not appear to be the correct solution to the problem, however, since now both exports and imports have declined. In order to maintain the original national income at a level which existed before controls were imposed to reduce imports, both saving and investment would have to rise to the same extent at which imports and exports have fallen.

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82 This does not take account of the fact that the domestic price level may be influenced and that imports not controlled could amount to a sizable proportion of total imports.

83 Symbolically the explanation would be as follows:

If:

If:

- \( E - M = A - S \), or
- \( E + A = M + S \), then
- \( M > E \), and
- \( A > S \), exchange controls are imposed to restrict imports, then
- \( E > M \), monetary and fiscal policies are applied to increase saving, then
- \( S > A \), exports are reduced to equate the lower import level, then
- \( E = M \), monetary and fiscal policies are employed to reduce saving, then
- \( S = A \), but, \( M \) and \( E \) are at a new low level which indicates that monetary and fiscal policies should have allowed for a rise in both \( S \) and \( A \) in order to maintain the original income level.
Theorizing can be carried to a point which often has a humorous side. On the other hand, one's sober but practical application to current problems, without due regard to sound theory, can be so over-controlled as to require hourly or "minutely" decisions looking toward the solution of the problems. In this connection, too, the administration involved in such minute control may become too costly in terms of accomplishments. The chain of developments described above serve to indicate briefly the vast complexities which would confront the authorities responsible for carrying out monetary and fiscal policy in the presence of an exchange control system.

3. Flexible Exchange Rates

The flexible exchange rate system represents a middle-of-the-road condition with respect to external policy.\textsuperscript{84} The rate of exchange is allowed to fluctuate according to the dictates of demand and supply, except that extreme fluctuations are prevented through the operation of a stabilization fund or some other similar government agency.\textsuperscript{85} During the post-war era, the

\begin{footnotesize}
\begin{enumerate}
\item Snider, op. cit., p. 159.
\item Mexico is a good example of a Latin American country which utilizes a flexible exchange rate system. The United States supports, in part, the Mexican stabilization fund.
\end{enumerate}
\end{footnotesize}
International Monetary Fund has been attempting to modify extreme exchange rate movements on an international basis. Since the exchange rate can vary, part of the shock may be absorbed through this external means rather than placing full reliance upon domestic changes alone as would be necessary under exchange control.

The fluctuating rate places great reliance upon the demand and supply forces at work within nations and among the trading countries. The market rate as determined through trading is responsible for establishing an official rate of exchange.

The official rate of exchange is destined to express an equilibrium condition in the balance of payments of a nation with other trading countries. This rate, expressed in terms of prices, tends to link the average price levels of the periphery.

As the market prices change in accordance with the forces of the market, the official rate would be "flexible" too. Speculation would be of lesser importance than under a freely fluctuating system largely because variations in the official rate are usually carried out only periodically and in secret. This result could be expected as long as the change in market prices are of moderate intensity.86

86Halm, op. cit., p. 478.
Foreign exchange reserves would flow out if the average market prices of a nation's goods rose temporarily above those of its trading partners. The official rate would not need to be altered if the situation corrected itself within a reasonable period of time. On the other hand, the balance of payments could be maintained at equilibrium should the reverse occur as the nation accumulates foreign exchange.

If market prices fluctuate to great extremes, the stabilization fund would be required to buy or sell foreign exchange until the market straightened itself out. The problem is that this may take a long time, and the Fund may be exhausted. The other alternatives would be the inflow of funds or capital, monetary and fiscal measures, or a change in the official exchange rate. The most likely to occur is a mixture of all three.

Yet, an important problem would still wait for solution. How could internal measures (monetary and fiscal policy) be combined with external measures (exchange policy) in order to maintain a price and income level consistent with such a level in other trading nations? Probably no general answer can be given here since the emphasis in each country would depend upon its own situation.

It would seem worthwhile to discuss the alternatives
in terms of the more common problems evident today in the
underdeveloped areas. These are inflation and disequilibria
in the balance of payments.87

Since inflation is often so glaringly evident in
the underdeveloped areas, deflation appears to be the
method necessary to solve the internal monetary problem
and, thereby, reduce the pressure exerted upon the
exchange rate.

If there is a redundancy of money and credit which
brought on the inflation in the private sector, either
because of a desire on the part of authorities to induce
the people to consume and invest more or because pro-
duction fails to rise proportionately with the larger
supply of funds, a tightening of monetary and fiscal
policy would contribute to the reduction of the excess
of money and credit.

87 In Latin America eight of the twenty nations
are virtually free of exchange controls. These are:
Cuba, Dominican Republic, El Salvador, Guatemala, Haiti,
Honduras, Mexico, and Panama. These countries finance
their trade with the rest of the world almost exclusively
in dollars and maintain a high percentage of gold and
dollar reserves behind their currencies. However, for
our purposes the eight-country classification is not
sufficiently exact, for some of the countries exercise
varying degrees of control by means of payments agree-
ments and other devices. Refer to R. F. Mikesell,
Foreign Exchange In The Postwar World, pp. 305-306.
The amount of deflation necessary to stabilize the economy is of great importance. As deflation takes hold and costs and prices begin to fall, prices usually fall faster than costs. This tends to lead to unemployment. But unemployment is directly opposed to the objective of full employment. Also, the rigidity of prices and wages and the possibility of widescale monopoly would not allow deflation to do its job.

Increased borrowing on the part of the government to finance various projects may lead to inflation. Deflation as a means of correction may be turned down because it would be thought of as an impediment to development. In other words, the social cost may be considered less if inflation prevails primarily for the purpose of increasing developmental projects. Whether such action is justifiable or not, the pendulum may swing in favor of a short-term expediency (inflation) for a long-term anticipated gain (a diversified industry and larger production). Furthermore, deflation as an element of policy in many underdeveloped areas is likely to be opposed because of its tendency to reduce imports which may otherwise be too great a cost in terms of development.

Underemployment is a more likely situation in the underdeveloped areas. People usually are not thrown out of work, but they move to less productive employment. See Seymour Harris, Chapter I, "Some Major Issues," in Economic Problems of Latin America, pp. 8-9.
Foreign exchange earnings derived from exports may not aid a deflationary policy if such earnings are allowed to infiltrate into the monetary system. This form of income is subject to wide and unpredictable movements which could upset a broad deflationary policy.

Prestige may even enter into the explanation of the failure of deflation. Underdeveloped nations like to imitate the more industrialized countries. This is a defensive type of situation in which the feeling among the lesser developed countries is that they must match the rising income of the industrial countries or at least to see to it that their income moves in the same direction that is being taken by that of the more fully developed, industrial countries, even at the cost of inflation.

Loan funds may be moving toward the underdeveloped areas, and this movement may explain, in part, the original equilibrium exchange rate. Nevertheless, the domestic economy may feel the inflationary effect of such loans as they are spent in unproductive endeavors.89

Inflation may present a problem even when the funds are being utilized productively. For example, the government may use the funds to import capital goods which are

89No doubt the above is a partial explanation as to why the World Bank restricts its loans to governments. Generally, the government or agencies of the governments in Latin America take a large share of the responsibility for channeling funds into the more productive sectors.
sold to domestic firms. The firms would probably pay for these goods with savings or borrowed funds. Income would rise to the extent of the loan plus the income velocity which it generates. The result would be a greater supply of money. Individual purchasers would have to refrain from spending for other customary non-capital items until the new savings are equal to the foreign loan. Since this deferral of expenditure is unlikely, inflation would prevail. A deflationary policy, on the other hand, may reduce the incentive to expand.

The desire for development which loan funds could help support, accompanied by the determination to maintain an equilibrium in the balance of payments, may be stronger a force than that of deflation. In such event, the price level would remain quite high, with income varying in accordance with the more dominating factors. Depreciation of the exchange rate is an alternative means available for coping with inflation. Its

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90 Buchanan and Ellis, op. cit., p. 388.

91 Export income may rise or fall in comparison with domestic income, including that derived from imports; at one time or another its rise or fall will be affected by such factors as the distribution of income through monetary and fiscal policy which could cause income to rise or fall; the extent and results of price control, if applied; the stimulative effect of the multiplier which would also influence the actual income; the psychological determination on the part of the public via co-operation in order to alleviate an undesirable condition.
effect upon the price level and national income may have mixed results.

If the general market prices of a nation's commodities rise, the authorities may be willing to raise the official rate of exchange to conform with them. This will have the effect of reducing imports, in view of the probability that domestic traders will need to surrender more of their home currency for a given amount of imports than they did previously. An increase in the domestic rate would also tend to increase the exports of the nation, for traders of other nations would now give up less units of their currency for purchases from the depreciating country.

The average price level in the nation depreciating its exchange rate would tend to fall or, if rising, to ascend at a slower rate than those of its trading partner. This being the case, a nation could maintain its price level and income would rise. Many perplexities could arise, however, and lead to a different solution.

If at the outset a deficit balance accrues in the

92 After the 1954 depreciation of the Mexican peso, the wholesale price index (1953 = 100) rose to 125 at the end of 1955. Yet, between January and October of 1956 the price index revealed a three point rise to 128. Using the same base year, the wholesale index of the United States showed a five point increase between January and October of 1956. Refer to International Monetary Fund, *International Financial Statistics*, January, 1957.
balance of payments, depreciation could remedy the situation within a short period of time.\textsuperscript{93} Thereafter, retaliation in kind by other nations is likely to prevent a continuation of the earlier benefits attaching to depreciation.

Furthermore, exchange depreciation may actually foster inflation through its effectiveness in preventing imports from entering the nation. The larger supply of money would probably result in the bidding of prices at home. At the same time, rising export income would create additional funds for domestic expenditures. This may, in turn, lead to a policy of further depreciation which could make the problem nearly unbearable.\textsuperscript{94} Speculation and

\textsuperscript{93}This assumes that the elasticities of demand and supply are high enough to bring about greater than proportionate changes in imports and exports. For a good discussion of these effects, refer to Jacob Viner, \textit{International Trade and Economic Development}, p. 91-93; also see James Meade, \textit{The Theory of International Economic Policy} (London: Oxford University Press, 1951), I, 309-310. According to Mr. Bloomfield depreciation may not work rapidly enough in a short period of time, especially if the country is a primary producer faced with a relatively inelastic demand for its exports. Refer to Arthur Bloomfield, "Foreign Exchange Rate Theory and Policy," \textit{The New Economics}, p. 309.

\textsuperscript{94}Chile presents a good example of this process. The wholesale price index rose in the following manner: 1953-100, 1954-157, 1955-277, and August, 1956-485. On the other hand, the exchange rate changes were as follows (pesos per dollar): 1953-110.0, 1954-200.0, 1955-300.0, and August, 1956-497. See the International Monetary Fund, \textit{International Financial Statistics}, January, 1957.
capital outflow would probably occur, and this would again assert itself upon the balance of payments in the form of a deficit.

Internally, inflation may raise the domestic price level to an extent greater than that in the periphery. In this case, too, exchange depreciation would fail, since the price rise may encourage imports. 95

Consideration should also be given to the point that if inflation is greater in one sector than another, e.g., the export sector, exports may remain stable or possibly decline.

Under such circumstances, monetary and fiscal policy would have a definite place in helping to bring about a tolerable situation. Tightening of monetary controls would be essential as would also the raising of taxes in the fiscal area. Intended saving (S) would become a key factor, for both investment (A) and exports (E) would have risen while imports (M) would have declined, except in the case of hyperinflation as was indicated in the last two paragraphs above. 96 National income would probably fall, at least in some sectors, as a result of the operation of these measures.

95 Snider, op. cit., pp. 257-258.

96 Professor Viner recognized similar measures. See Viner, loc. cit.
Professor Snider suggests an intermediate proposal of disinflation plus exchange depreciation. Inflation would be reduced through the appropriate monetary and fiscal measures but would stop short of an actual downturn of prices. After prices are stabilized, presumably under conditions of full employment and high national income, then exchange depreciation may be instigated in order to bring costs and prices at home into equilibrium with those prevailing in the trading nations. This appears to be an excellent policy proposal, but the exactitudes required would be extremely difficult to ascertain and implement.

SUMMARY

In this chapter an attempt has been made to bring together some of the internal and external factors whose functioning with respect to a nation's economy may contribute to serious fluctuations in income and the general price level, and may threaten the exchange rate. Monetary and fiscal policy and exchange policy are the measures suggested to offset their otherwise adverse effects.

Primary emphasis is placed upon these factors as

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they relate to the lesser developed countries. These nations are quite generally characterized today by inflation and by disequilibrium in their balance of payments. At least a partial explanation of their present-day problems lies in the realm of factor influences and the inability of these nations to cope with the reverberations which originate so largely in those influences.

The approach is primarily in terms of income analysis, and from a theoretical standpoint. The temporal sequence of developments is kept within the realm of short-term problems. Accordingly, a very considerable emphasis is given to the monetary aspect of changes and to the methods employed to deal with such changes as opposed to the physical or output analysis.

Monetary and fiscal measures are regarded as desirable and necessary forces for establishing an equilibrium situation. The addition of these measures to the general balancing factor of lending is considered appropriate, because lending, operating alone, may fail to close the gap in the balance of payments, especially within the short run period of time. Monetary and fiscal policy has an important role to play in helping to reduce the impact of variable factors, external as well as domestic.

It appears that much may be accomplished by a
nation confronted with short-term shocks which tend to affect its national income or price level and its balance of payments through a better co-ordination between external and internal policy. Here again, monetary and fiscal measures have an important part to play.

It was found that changes in the external sector, such as variations in income, depreciation, etc., have an impact upon the domestic sector which tends to alter the national income or price level. The decision with respect to the type of external policy which seems most desirable to produce an equilibrium in the balance of payments requires a varying degree of monetary and fiscal implementation. As an example, the use of exchange controls, with periodic changes in the exchange rate, seems to create an unusually important role for monetary and fiscal policy while, on the other hand, these measures are of lesser importance if a nation is pursuing a flexible exchange rate policy. In the latter case, the external forces are taken into account through the variability of the exchange rate rather than by monetary and fiscal policy. Of course, if extreme fluctuations occur in the external sector, then monetary and fiscal policy may play a stellar role in moderating the problem. Deflation or exchange depreciation rely to a very considerable extent upon the latter policy.
As a step toward the more effective co-ordination between internal and external policy, it was suggested that perhaps disinflation along with some exchange depreciation may be employed to help prevent too great a burden in either area. Yet, such synchronization of policy as may be required might create more problems than it could solve.

Since there are many varying factors which bring about change, both monetary and fiscal policy and external policy should be of a flexible nature in order to successfully deal with the problems which that change precipitates.

Subsequent chapters will present individual country analyses in order to find out how some of the more representative nations are coping with these concepts through practical application. An effort will be made to determine the extent to which that practical application supports, and is supported by, certain theoretical expectations and conclusions in this area of international trade study.
CHAPTER II

THE CASE OF MEXICO

Mexico was selected for this study because it represents one of the more economically advanced countries of Latin America. Its specific position would be subject to change relative to the other nations in this area depending upon the classification one chooses to employ. Using the dual criteria of domestic economic progress and freedom from external control, Mexico should be classified as one of the more favorably situated nations of Latin America.

Domestically, the gross national product and national income have continued to rise in a consistent manner in recent years.¹ No doubt part of Mexico's ability to cope creditably with domestic problems is because the people have an opportunity to observe and to employ many policies successfully used in the United States. On the other hand, Mexico is an underdeveloped country faced with

¹The gross national product has risen from 58,300 millions of pesos in 1952 to 92,400 millions of pesos in 1956. The devaluation of the peso by about 30.8 per cent in 1954 is responsible, in part, for the rise in the gross national product figures from 1954 to 1956. See the Banco de Mexico, S. A., Trigesimatercera Asamblea General Ordinaria de Accionistas (Thirty-third Annual Report of the Bank of Mexico), 1955, p. 149; also the International Monetary Fund, International Financial News Survey, November 16, 1956, p. 162.
inflation and numerous other domestic problems found in a typical developing nation.  

It is contended that Mexico has no balance of payments problem as such. This explains why the country does not practice exchange control. Nevertheless, there is a tendency for Mexico to import more than it exports.

The purpose of this chapter is to analyze some of the theoretical concepts developed in Chapter I from a more practical viewpoint. The topics to be presented for observation will be the international equilibrium of Mexico and the internal and external policies of the country during the last five years, 1952-1956. Variable factors which present numerous problems will be treated as they influence monetary, fiscal, and external policies. As mentioned earlier, attention is to center around recent experiences of the nation and, therefore, covers a relatively short period of time.

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2 A recent report of the National Bank of Mexico states that Mexico's economic position is comparable to that of the United States in the last quarter of the nineteenth century. Refer to Banco Nacional de Mexico, S. A., Review of the Economic Situation of Mexico, July, 1955, pp. 3-4.

I. INTERNATIONAL EQUILIBRIUM: SOME FACTS

The concept of international equilibrium assumes that the necessary factors of saving, investment, imports, exports, and lending are so adjusted that equality among these factors is a probability, and that they will maintain such a relationship over a more or less prolonged period of time. From a more practical viewpoint, it is unlikely that such a situation would occur in an underdeveloped nation, or if it did exist, it would not last for an extended period of time.

The latter explanation seems reasonable because international equilibrium is subject to human discretion. For example, an international equilibrium balance could be disturbed whenever groups of importers decide to alter the quantity of goods imported, while the decisions on the part of savers, investors, exporters, or lenders do not change accordingly to offset the prior dictates of the importers.

Furthermore, a nation which would realize a state of international equilibrium would be constantly on the defense to maintain its favorable position because many of its trading partners probably would have not achieved such a desirable goal.

A majority of the lesser developed nations are
subject to the economic diversities of foreign industrial countries with which they trade. Such may be the case even if their foreign trade represents a minor portion of total income. The reason for this is that they must import certain basic foodstuffs not available within the country or not produced in sufficient quantities, and their urgent need to acquire capital goods produced by other nations. The import of foodstuffs is essential to maintain their plane of living while the inflow of capital goods provides for future growth.

Mexico is no exception to this kind of reliance upon other countries. The major part of its foreign trade is with the United States. Although its foreign trade accounts for about 13 per cent of its total trade, the types of goods imported are crucially important for the maintenance of the nation’s plane of living and for economic growth.

On the other hand, the extensive participation on the part of the government may serve to check large deviations away from an equilibrium position. Again, Mexico

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4In 1954, 83.6 per cent of Mexico’s import trade and 79.7 per cent of its export trade was carried on with North America, principally the United States. The import and export trade was 83.1 per cent and 80.2 per cent, respectively, for the year 1955. See the Banco Nacional de Comercio Exterior, S. A., Comercio Exterior de Mexico 1955 (The National Bank of Foreign Commerce, Foreign Commerce of Mexico 1955), March, 1956, p. 217.
is an example of an underdeveloped nation in which the government takes an active role in economic development.

The following section on saving and investment emphasizes the relative contribution of the private and government sectors to the total product of the nation. Unless specifically stated, the terms national product and national income will be used interchangeably. The national product figures are to be used in describing relationships. This seems to be the best way of making comparisons since both the private and public sectors are being considered. Furthermore, the national product is equal to national income if it is recognized that the former takes account of depreciation, indirect business taxes, and subsidies. Unfortunately, existing information with respect to these factors is lacking in the case of Mexico. The national product data are given, therefore, in gross figures.

A. Saving and Investment

Table I, page 88, presents the saving and investment picture of Mexico from 1952 to 1956. The national product for the years 1953 and 1955 show exceptional directional changes.5 In addition, the 1953 national product figures for the years 1952-1954 were taken from the Bank of Mexico, Annual Report, 1955,
TABLE I

SAVING AND INVESTMENT OF MEXICO
(in millions of pesos)

<table>
<thead>
<tr>
<th>National Producta</th>
<th>As a % of Total</th>
<th>Saving</th>
<th>As a % of Total Saving</th>
<th>Private Savingb</th>
<th>As a % of Total Saving</th>
<th>Private Savingb</th>
<th>Public Savingb</th>
<th>As a % of Total Saving</th>
<th>Private Savingb</th>
<th>Public Savingb</th>
<th>As a % of Total Saving</th>
<th>Private Savingb</th>
<th>Public Savingb</th>
<th>As a % of Total Saving</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>58,300</td>
<td>100.0</td>
<td>5,222c</td>
<td>9.0</td>
<td>3,394</td>
<td>65.0</td>
<td>1,828d</td>
<td>35.0</td>
<td>8,168</td>
<td>14.0</td>
<td>4,732</td>
<td>57.9</td>
<td>3,434</td>
<td>42.1</td>
</tr>
<tr>
<td>1953</td>
<td>56,200</td>
<td>100.0</td>
<td>6,573</td>
<td>11.7</td>
<td>4,000</td>
<td>61.0</td>
<td>2,573</td>
<td>39.0</td>
<td>7,540</td>
<td>13.4</td>
<td>4,600</td>
<td>61.0</td>
<td>2,940</td>
<td>39.0</td>
</tr>
<tr>
<td>1954</td>
<td>66,478</td>
<td>100.0</td>
<td>8,056</td>
<td>12.1</td>
<td>4,815</td>
<td>59.8</td>
<td>3,241</td>
<td>40.2</td>
<td>9,428</td>
<td>14.2</td>
<td>5,400</td>
<td>57.3</td>
<td>4,028</td>
<td>39.0</td>
</tr>
<tr>
<td>1955</td>
<td>84,000</td>
<td>100.0</td>
<td>10,742</td>
<td>12.3</td>
<td>6,505</td>
<td>60.6</td>
<td>4,237</td>
<td>39.4</td>
<td>11,611</td>
<td>13.8</td>
<td>7,600</td>
<td>65.5</td>
<td>4,011</td>
<td>34.5</td>
</tr>
<tr>
<td>1956e</td>
<td>92,400</td>
<td>100.0</td>
<td>11,817</td>
<td>12.8</td>
<td>7,156</td>
<td>60.6</td>
<td>4,661</td>
<td>39.4</td>
<td>12,774</td>
<td>13.8</td>
<td>8,360</td>
<td>65.4</td>
<td>4,414</td>
<td>34.6</td>
</tr>
</tbody>
</table>


aGross figures.

bPublic sector includes decentralized government organizations, state owned businesses, government of the Federal District, and states and municipalities.

cPartially estimated.

dEstimated at 35% of total saving.

eAll figures are estimated on the basis of a ten per cent increase.
income fell by 1,800 millions of pesos from the preceding year, while the national income in 1955 rose by 15,420 millions of pesos over 1954.\(^6\)

The decline in the gross national product for 1953 was 3.4 per cent. Several reasons can be offered to explain, in part, this decline in the national product. Inflation had been a problem for several years, and the Korean War further aggravated the situation. Credit expanded by nearly 20 per cent between 1952 and 1953.\(^7\)

On the other hand, prices actually declined in 1953.\(^8\)

The fall of less than three percentage points was not unusual when compared to the prior year's price rise. In 1952 the price level rose by about 35 per cent; furthermore, in the following year, 1954, the price level ascended by approximately 37 percentage points.

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\(^6\) National income figures for the years under study were as follows: 1952, 52,000 millions of pesos; 1953, 50,200; 1954, 59,180; 1955, 74,600; and 1956, 82,060. The sources of national income data are the same as those used for the national product figures (see footnote 5, p. 87), except for 1956. National income for 1956 was estimated at ten per cent greater than 1955.

\(^7\) Bank of Mexico, Annual Report, 1954, p. 58. This figure excludes inter-bank accounts.

\(^8\) Ibid., p. 123. The wholesale price index was 392.5 at the end of 1953 (base 1939 = 100).
Positive action, primarily by the governmental sector, halted the rise in output and income for the year. Realized public investment fell by 494 millions of pesos (14.4 per cent) while private investment expenditures dropped by 132 millions of pesos (3.0 per cent). Over-all total realized investment expenditures declined by 7.7 per cent at the end of 1953. In contrast, the national product dropped 3.4 per cent.

Table I further reveals that total saving rose 25.9 per cent during the year. Realized private saving increased 17.1 per cent; thus it accounted for approximately 45 per cent of the total rise.

To sum up the internal factors, the decline in government investment expenditures and the rise of public savings played a vital role in explaining the economic situation at the year's end. Saving rose by a much greater extent than investment fell; however, the effect upon the fall in the national product was not very pronounced. Two major reasons explain this condition. They are the abundance of credit and the time element. The extent of available credit has already been stated, but some attention should be given to the latter factor. During the first half of 1953 the government carried out various conservative measures to deal effectively with the inflation. The conservative attitude, expressed mainly
through a brisk reduction of investment spending, spread to the general public. The result was larger saving. The government was forced to change its policy in the middle of 1953 because national income was expected to fall rapidly. Government investment spending then rose; nevertheless, the desired expansion on the part of the general public failed to mature. The final end-of-the-year result was an actual decline in the national product and income.

These events were expressed by an authoritative report:

... Two distinct phases were apparent during 1953. In the first half of the year, official policy was aimed at balancing the fiscal budget and containing the threat of inflation, which also coincided with a deterioration in the balance of payments. The measures for financial austerity mainly led to a slackening of public investment. ... Nevertheless, the private sector enjoyed credit which was more readily available and more abundant, loaned with the objective of encouraging private investment and of thus reconciling the need for financial and monetary equilibrium with the desire to avoid restricting economic development.

The consequent tendency towards depression led during the second half of the year to a change in fiscal policy, while public investment was raised. But the influence of the initial contraction, which was partly psychological, could not be neutralized. ... 9

The high liquidity on the part of the general public had become too firm to be pried loose. The general price level followed pretty much the course of events. The wholesale price level in December, 1952 was 392.7. By February, 1953 it had declined to 383.9 while it stood at 387.4 at the end of April. Finally, the year ended with the December, 1953 price index at 395.6.\(^\text{10}\)

On the international scene, the normal trend of import surpluses was realized again in 1953.\(^\text{11}\) This fact plus the fear of the public's inclination to save for later spending upon imports brought about the decision by the government to devalue the currency in 1954.\(^\text{12}\)

Foreign exchange reserves declined from 2,163 millions of pesos in 1952 to 1,886 millions of pesos at the close of 1953. From the commodity viewpoint, the reason for the smaller exchange balance was not because of a rise in imports, the latter actually declined, but because of the pronounced fall in exports earnings as is demonstrated by the balance of payments schedule.

Mexico's short-term obligations with American

\(^{10}\) National Bank of Mexico, S. A., Review of the Economic Situation of Mexico. See the following issues: February, April, and June, 1954.

\(^{11}\) See the Balance of Payments of Mexico, Appendix A, p. 174.

\(^{12}\) Devaluation took place in April, 1954.
banks, principally loans and acceptances and draft indebtedness, rose by 34.6 millions of pesos (4 millions of dollars) while American Banks' obligations to Mexico, mainly deposits and United States Government bonds maturing within one year, fell by 380.6 millions of pesos (44 million dollars).\(^\text{13}\)

The second of the two years of exceptional directional change in the national product was 1955. The sharp rise in the national product was brought about in several different ways. Perhaps the most significant event was the devaluation of the peso in mid-1954. Export income swelled by about 1,937 millions of pesos (154.9 millions of dollars).\(^\text{14}\)

Total investment for 1955 was 23.1 per cent larger than in 1954. Government investment did not increase, but actually fell. This result came about after a large injection of government investment in 1954. The official attitude was to place the burden of rising investment on the shoulders of the private sector. The result was a fortunate turn of events; private investment was greater by approximately 41 per cent over 1954, as Table I


\(^{14}\) Calculated at the new rate of exchange of 12.51 pesos to the dollar.
Another factor of utmost importance was the official concern of higher costs and prices attributed in part to the 1954 devaluation. This problem led once again to a more conservative policy with respect to government spending.

The policy of the Bank of Mexico was to encourage private investment. Although this policy will be discussed under the internal and external policy heading, it should be pointed out that commercial banks were enticed into channeling loans to those various sectors of the economy in which economic development would yield the greatest returns.

Private saving expansion during 1955 represented a 36 per cent increase over the preceding 12 months. The share of private saving to total saving maintained a rate of approximately 60 per cent; the remainder consisted of public saving.

The physical output was larger by some 26 per cent at the end of 1955; that is, a rise from 66,478 millions of pesos in 1954 to 84,000 millions of pesos in 1955, calculated in terms of gross figures.

Table I shows that the figures for 1956 were estimated. The national product and income represented a 10
per cent increase over 1955. The figures for investment and saving have also been increased by 10 per cent. No doubt these are conservative estimates, but they seem to be indicative of the general conservative viewpoint expressed during the first part of the year.

On the basis of information made available during the first half of the year, it would seem reasonable to expect the balance of payments of Mexico to continue its favorable condition. Nevertheless, it is difficult to predict just how and to what extent the devaluation will affect Mexico's international relations.

It is quite clear that the volume of saving has failed to maintain a volume of investment capable of supporting a high level of production and employment. Table I indicates, however, that the saving gap has narrowed over the past five years.

Table II, page 96, takes account of the monetary influences by attaching prices to a base year. The general commodity index of 210 commodities was employed as a guide for measurement. The index based upon 1939 was rebased for 1950 in order to obtain a more current trend in price changes.

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16See the Index of Wholesale Prices in Mexico City, Appendix B, p. 176.
TABLE II
REAL SAVING AND INVESTMENT OF MEXICO
(in millions of pesos)

<table>
<thead>
<tr>
<th>Year</th>
<th>National Product</th>
<th>Saving</th>
<th>Investment</th>
<th>Prices^a (1950 = 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>46,014</td>
<td>4,122</td>
<td>6,445</td>
<td>126.7</td>
</tr>
<tr>
<td>1953</td>
<td>44,647</td>
<td>5,213</td>
<td>5,979</td>
<td>128.1</td>
</tr>
<tr>
<td>1954</td>
<td>48,207</td>
<td>5,842</td>
<td>6,837</td>
<td>137.9</td>
</tr>
<tr>
<td>1955</td>
<td>52,239</td>
<td>6,618</td>
<td>7,221</td>
<td>160.8</td>
</tr>
<tr>
<td>1956</td>
<td>55,797</td>
<td>7,135</td>
<td>7,714</td>
<td>165.6^b</td>
</tr>
</tbody>
</table>

Source: Table I, p. 88.

^aPrices are computed from data issued by the Bank of Mexico, S. A., Annual Reports, and the National Bank of Foreign Commerce, Foreign Commerce of Mexico, December, 1956.

^bThe price index for 1956 consists of the average price of consumer and producer goods for the first ten months of the year.

Table II shows that inflation has been something more than of passing importance. The national product rose in terms of 1950 prices by 21.3 per cent, or it averaged a little more than 5 per cent per year. In contrast, investment expenditures increased by 19.7 per cent or approximately 3.95 per cent for each of the five years. The data also shows that investment expenditures for the period as a whole failed to maintain the given level of national income. Nevertheless, the last two years, 1955 and 1956, indicated that investment expenditures rose by 6.6 per cent per year while the national product increased by 7.6 per cent per year. In other words, investment has
improved its position with respect to the national income.

Saving has risen at a rapid rate, although it still falls short of investment expenditures. The rate of increase in 1955 and 1956 was about 11 per cent for each year based upon 1950 prices. The rise in saving paints a somewhat optimistic picture; nevertheless, there are several reasons that help to explain why saving consistently falls short of investment. It is said that only a small proportion of the population have funds available out of their income for saving. Although statistical proof is lacking, Mr. Antonio Flores, Director of the National Financiera (National Industrial Financing Corporation) states that:

... the distribution of income results in a situation which has a marked influence on the structure of the capital market. There is on the one hand a small population group whose high income gives it a wide margin of saving, and on the other millions who can hardly satisfy their most pressing needs.17

It is recognized too that hoarding is a continuous problem in Mexico; however, there is no way to determine to what extent hoarding could contribute to greater investment. There is good indication that hoarding is not so

serious a problem today as it was in the past. Banking institutions have spread to nearly all parts of the country. In 1951 there were 739 depositories of cash including banks and branches, credit unions, and other financial organizations. This figure is in contrast to the two savings institutions which existed in 1931. The growth in the number of all types of financial institutions follows the phenomenal rate of the savings banks.

The rise in the national product and income during recent years has surely contributed to a larger number of people realizing some savings. On the other hand, the rise in income is not nearly so impressive when expressed in real terms as shown in Table II. Nevertheless, investment expenditures have made it possible for more people to save a portion of their income.

The degree of government influence into the working of the economic system is of particular interest. Table I, page 88, shows that government investment varied between 34.5 to 42.7 per cent of total investment for the years under study while public saving ranged within similar percentage points. In other words, government participation accounts for a large portion of total income and

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employment. Also, it accounts for a sizable portion of total saving. Public works and public enterprises are evidently the foundation for economic development. The basic industries and external economies are primarily a governmental responsibility.

The saving public does have access to two stock exchanges in Mexico. Although individual participation on these exchanges is greater at present than ever before, there is still a good deal of apathy on the part of the general public.

Inflation has been a leading factor in holding back further utilization of the exchanges. Inflation is, nevertheless, a partial explanation for the recent upsurge in stock exchange activity. Private holders of bonds have suffered through their investment in this type of fixed return paper; therefore, many people have changed their portfolios to the purchase of stocks.¹⁹

The public is being further stimulated in putting its saving to work through the efforts of the investment bankers. In addition, the National Financiera sells securities to individuals. Evidently the general public is becoming more accustomed to the purchases of the latter institution's securities since it is now offering its

paper without the usual repurchase guarantee. This guarantee has been used in the past in order to encourage individuals to buy more securities. Nevertheless, a recent issue was offered by the National Financiera without this additional prop. In other words, the officials of financial institutions must feel that the general public is so conditioned with respect to the purchase of securities that it will take them off the market without an additional incentive.  

Table I reveals the rapid rise in saving during the five-year period. Total realized saving increased approximately 126 per cent, but public saving over-shadowed private saving. The percentage figures were 155 per cent for the former and 111 per cent for the latter.

No doubt part of the public saving consisted of forced saving of the private sector. On the other hand, another unverified portion of public saving represented the inflationary influence. Nonetheless, aggregate saving has risen at a rapid rate even though it did fall short of investment expenditures.

The question may be posed: why is it that investment spending was larger than saving? A partial explanation is that the creation of money allowed for greater investment.

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expansion. The expansion was of a dual nature. Credit itself made it possible for private investment to rise. The second feature is that the government provided vast investment expenditures. Furthermore, rising export income and the tightening of import restrictions both stimulated domestic investment. In reference to Table I, total actual investment increased 56.4 per cent during the five years under consideration. Private investment expenditures rose 76.7 per cent while the public sector accounted for a 28.5 per cent increase. Perhaps of greater significance is the fact that public investment has averaged 38.6 per cent of total investment for the period. Both private and public investment expenditures have advanced rapidly in the last few years; however, the inflationary impact must be kept in mind. Certainly it should modify such optimistic overtones.

Traditionally, a low propensity to save creates a large multiplier effect.\(^{21}\) The result should stimulate consumption and, in turn, induce further investment. In Mexico part of the multiplying effect is reduced because the improvement in consumption is confined to a very narrow base; that is, only a small portion of the

\(^{21}\)Table I indicates that the maximum autonomous multiplier effect, notwithstanding import leakages, would average about 7.
population share in the returns from investment via higher incomes sufficient to accumulate savings for investment. Some part of the funds that would be available for further investment are directed into conspicuous consumption, the acquisition of more land, increased imports, or it goes abroad as flight capital.

Reference to Table I again shows that saving, as one leakage factor, would reduce the multiplier somewhat. The marginal propensity to save in Mexico is approximately 0.14. However, the inclusion of the marginal propensity to import estimated at about 0.20 reduces the multiplier to a great extent.\textsuperscript{22} At the minimum, the two leakage factors amount to 0.34. This means that 34 centavos (100 centavos per peso) out of every additional peso of income would be saved and spent for imports.

Only a rough estimate is possible in determining the influence of capital outflow. The balance of payments indicates that capital outflows were especially prominent in 1952, 1954, and 1955.\textsuperscript{23}

Import restrictions have been tightened in each of

\textsuperscript{22}The estimate of the import leakage is taken from Mr. Flores. Refer to United Nations, Department of Economic Affairs, \textit{Domestic Financing of Economic Development}, pp. 175-176.

\textsuperscript{23}See the Balance of Payments of Mexico, Appendix A, p. 174.
several recent years. In 1954 the government took action to reduce the inflow of luxury and non-essential goods.\textsuperscript{24} An effort was made in 1956 to regulate import licenses of some commodities in accordance with the value of the surpluses of major export products.\textsuperscript{25} A new Mexican import tariff schedule went into effect in the latter year.\textsuperscript{26} The new schedule involves a complete revision of the tariff classification for imported goods.

A further treatment of saving and investment will be presented under the subsequent heading of monetary, fiscal and external policies. At this stage it is quite clear that realized saving and investment decisions have not provided for an equality between these two factors in any of the years under study; investment expenditure has been larger than saving in every year. Table III below gives the amounts of excess investment over saving.

\begin{table}[h]
\centering
\caption{THE EXCESS OF REALIZED INVESTMENT OVER SAVING \hfill (in millions of pesos)}
\begin{tabular}{ll}
1952 & 2,944 \\
1953 & 967
\end{tabular}
\end{table}

\begin{flushright}
\textsuperscript{25} International Monetary Fund, \textit{International Financial News Survey}, September 21, 1956, p. 95.
\textsuperscript{26} United States Department of Commerce, \textit{Foreign Commerce Weekly}, February 20, 1956, p. 6.
\end{flushright}
B. Imports, Exports, and Lending\textsuperscript{27}

Chapter I explained that if an international equilibrium condition were to be obtained whenever investment expenditures exceeded saving, as is the case in Mexico, imports should be larger than exports by an amount equal to the investment surplus. If this balance were not realized, then lending would be the factor responsible for creating the balance.\textsuperscript{28} This section will inquire into Mexico's import and export relations to find out whether or not an international equilibrium exists, and if it does not, to see if lending fills the gap.

The current account section of the balance of payments explains whether a nation is balancing its current transactions (receipts and expenditures) in its trade with other nations. If an imbalance is present, the difference must be reconciled through the capital account,

\textsuperscript{27}Imports include all the current account minus items while exports represent the sum of all the current account plus items. Lending constitutes the (net) capital account balance.

\textsuperscript{28}Refer to Chapter I, pp. 15-17.
unilateral account, or the gold account.

Some interesting relationships may be drawn from Table IV. Mexico has realized an import surplus in its commodity trade for every year included in this survey. Nevertheless, the import surplus has declined in every year with the exception of 1953. Among the more important factors which have contributed to the narrowing of the import gap were the success of import controls as mentioned on pages 102 and 103, the devaluation in 1954, the stimulation of exports, and good harvest years.

### TABLE IV

**IMPORTS AND EXPORTS OF MEXICO***

( in millions of dollars )

<table>
<thead>
<tr>
<th>Item</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956^a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports, f.o.b.</td>
<td>619.6</td>
<td>589.2</td>
<td>655.3</td>
<td>810.2</td>
<td>454.9</td>
</tr>
<tr>
<td>Imports, c.i.f.</td>
<td>-830.9</td>
<td>-807.6</td>
<td>-788.7</td>
<td>-885.7</td>
<td>-518.3</td>
</tr>
<tr>
<td>Nonmonetary gold</td>
<td>2.0</td>
<td>14.0</td>
<td>11.7</td>
<td>14.2</td>
<td>2.4</td>
</tr>
<tr>
<td>Foreign travel</td>
<td>275.1</td>
<td>302.3</td>
<td>336.8</td>
<td>364.8</td>
<td>223.6</td>
</tr>
<tr>
<td>Foreign travel</td>
<td>-113.3</td>
<td>-140.1</td>
<td>-173.2</td>
<td>-164.6</td>
<td>-104.1</td>
</tr>
<tr>
<td>Investment income</td>
<td>-123.5</td>
<td>93.6</td>
<td>85.7</td>
<td>93.3</td>
<td>57.9</td>
</tr>
<tr>
<td>Other (net)</td>
<td>28.7</td>
<td>28.6</td>
<td>23.3</td>
<td>20.8</td>
<td>9.1</td>
</tr>
<tr>
<td>Balance</td>
<td>-142.3</td>
<td>-107.2</td>
<td>-20.5</td>
<td>68.4</td>
<td>9.7</td>
</tr>
</tbody>
</table>

Source: Balance of Payments of Mexico, Appendix A, p. 174.

*Minus items denote debits or a reduction in purchasing power.

^aIncludes the first six months of 1956 only.

The receipts of foreign travel expenditures are of particular importance to Mexico's current account.
balance. The major components of this item consist of dollar earnings brought into Mexico by seasonal workers (braceros) in the United States and foreign tourist expenditures in the country. Table IV reveals that the foreign travel item amounted to between one-third and one-half the value of exports.

The investment income account was characteristic of a nation in a debtor stage of economic progress; that is, income earned abroad consistently falls short of income earned in Mexico by foreign individuals, firms, and governments.

Mexico had an over-all debit balance on current account in the first three years of the five-year period. Yet, the amount of the debit balance was lowered in each of the successive years. The decline in 1953 was about 35 millions of dollars. Although total commodity trade fell, imports declined to a greater extent than exports and nonmonetary gold taken together. No doubt the conservative measures carried out by the government in the first half of the year contributed to the fall in imports (see pages 90 and 91). The "wait-and-see" attitude of the general public, the possibility of devaluation, and the general business decline in the United States were significant factors accounting for the reduction in exports.

The foreign travel items offset one another between
1952 and 1953 while the miscellaneous account declined by only 100,000 dollars. The principal factor explaining the reduced deficit balance in 1953 was the investment income item, which although still unfavorable, fell by some 29.9 millions of dollars.

The deficit on current account in 1954 was 20.5 millions of dollars. The devaluation of the peso in April, 1954 was perhaps the chief reason for the small unfavorable balance. Table IV shows the effects of devaluation with a large spurt in export sales and a reduction in imports.

In 1955 the current account turned favorable. Exports rose by 154.9 millions of dollars. This large increase of exports is indicative of the results to be expected during the first full year after devaluation. On the other hand, imports surged upward by the amount of 95 millions of dollars. Perhaps the main reasons for the rise in imports were the accumulation of foreign exchange reserves and the rapid rise of the domestic price level (see Table II, page 96). Both were influenced in the first instance by the devaluation of the previous year.

Another important factor which helped to produce a favorable current account balance in 1955 was the large increase of foreign travel receipts in Mexico accompanied by a decline of Mexican foreign travel expenditures.
Since the data for 1956 included only the first six months, it is difficult to predict the changes which may have occurred in the last half of the year. Nevertheless, it is normal for exports to rise markedly in the last part of the year when a large portion of the crops are harvested for shipment.

By way of summation, the current account has shown a deficit balance for the years 1952, 1953, and 1954. The only complete year which yielded a favorable current account balance was 1955, while the information for 1956 presents an incomplete picture.

A survey of the capital account should throw some light upon the directional flow of lending (positive or negative). Table V shows the capital account items and

### Table V

**CAPITAL ACCOUNT OF MEXICO**

<table>
<thead>
<tr>
<th>Item</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term</td>
<td>64.3</td>
<td>21.7</td>
<td>115.9</td>
<td>179.0</td>
<td>84.5</td>
</tr>
<tr>
<td>Private</td>
<td>42.8</td>
<td>21.3</td>
<td>98.0</td>
<td>139.5</td>
<td>69.8</td>
</tr>
<tr>
<td>Official</td>
<td>21.5</td>
<td>.4</td>
<td>17.9</td>
<td>39.5</td>
<td>14.7</td>
</tr>
<tr>
<td>Short term</td>
<td>-51.2</td>
<td>65.5</td>
<td>-95.6</td>
<td>-121.9</td>
<td>48.2</td>
</tr>
<tr>
<td>Private</td>
<td>-2.4</td>
<td>20.1</td>
<td>-20.2</td>
<td>29.0</td>
<td>13.5</td>
</tr>
<tr>
<td>Official</td>
<td>-48.8</td>
<td>45.4</td>
<td>-68.4</td>
<td>-150.9</td>
<td>34.7</td>
</tr>
<tr>
<td>Balance</td>
<td>13.1</td>
<td>87.2</td>
<td>20.3</td>
<td>57.1</td>
<td>132.7</td>
</tr>
</tbody>
</table>

*Source: Balance of Payments of Mexico, Appendix A, p. 174.*

<sup>a</sup>Includes the first half of 1956 only.
their directional movements. It is inferred that all the positive items represent inward movements of capital or negative lending (borrowing), or returns on loans made and, consequently, the minus items indicate outward flows of capital or positive lending, or the repayment of previous borrowings.

Long-term movements of capital into Mexico showed a constant rise except for the year 1953. The reasons for the fall of capital imports were two-fold. First of all, the government of Mexico was deeply concerned with the presence of inflation. As mentioned earlier, measures were taken in that year to prevent further loss of purchasing power. Furthermore, the adverse psychology as expressed by the private sector contributed to the smaller amount of long-term capital inflow.

The 400,000 dollars of official capital import were evidence that foreign governments and other official bodies were inclined to reserve their decisions to make funds available to Mexico.

Private long-term capital inflow accounted for the greater portion of Mexico's total long-term foreign capital resources; nevertheless, some caution should be read into these figures. A large portion of the private direct investments consisted of the reinvestment of the profits of foreign owned firms in Mexico rather than new investments
by a larger number of foreign residents.

The amount of official capital flows represents capital actually consumed, not authorized. In addition, the figures include repayments made each year. The constancy of repayments along with the favorable balance of payments in the past few years has provided Mexico with a high international credit rating. 29

Total short-term capital movements have been quite erratic during the period covered by this survey. Table V indicates a debit balance existed for three out of the five years. On the whole, official short-term capital movements have been larger in amount than the private short-term capital movements. The private short-term capital account consists of the changes in national and private banks' assets which include gold holdings of these banks, but it excludes the foreign assets of the Central Bank. 30

The short-term account totals represent net balance figures. 31 A minus means that either non-residents


30 The Bank of Mexico's foreign assets are included with "other foreign assets" of the "official short-term" capital account item. Private transactions also fall within the classification of the latter account item. See the Balance of Payments of Mexico, Appendix A, p. 174.

31 The lone exception is the "use or repayment of International Monetary Fund resources" item.
have—on balance—drawn down their bank deposits in Mexican banks; or the banks have acquired stocks, bonds, or other assets of foreign countries, including foreign currency, bank deposits, and brokerage balances; or the banks have received gold on balance.

The minus balance of the short-term capital account in 1952 seems logical because internally the economy was characterized by inflation. Externally the situation gave rise to foreign skepticism which resulted in a decline of American banks' short-term claims on Mexico and a rise in United States banks' short-term liabilities to Mexico. In other words, American short-term balances were being withdrawn while Mexican nationals were increasing their deposits in American banks and purchasing United States securities. The favorable capital account balance was possible in 1952 because of the inflow of long-term capital.

At the end of 1953 the short-term capital balance turned positive. This suggests that a high state of liquidity was desired on the part of both the private and official sectors.

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The debit balance on short-term capital account was 
re-established in 1954 and continued through 1955. 
Devaluation played a star role in bringing about the minus 
balance.

A more thorough investigation of the balance of 
payments accounts will be undertaken in the subsequent 
section dealing with monetary, fiscal, and external 
policies.

It is now possible to bring together the internal 
factors of saving and investment and the external factors 
of imports, exports, and lending in order to arrive at an 
approximate international equilibrium of Mexico.

Table VI combines the above factors to show their

TABLE VI

THE INTERNATIONAL EQUILIBRIUM OF MEXICO
(in millions of pesos)*

<table>
<thead>
<tr>
<th>Year</th>
<th>National Product</th>
<th>Saving(S)</th>
<th>Investment(A)</th>
<th>Lending Balance</th>
<th>Import(M) Balance</th>
<th>Export(E)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>58,300</td>
<td>A&gt;S 2,944</td>
<td></td>
<td>← 113</td>
<td>M&gt;E 1,231</td>
<td></td>
</tr>
<tr>
<td>1953</td>
<td>56,300</td>
<td>A&gt;S 967</td>
<td></td>
<td>← 754</td>
<td>M&gt;E 927</td>
<td></td>
</tr>
<tr>
<td>1954</td>
<td>66,478</td>
<td>A&gt;S 1,372</td>
<td></td>
<td>← 254</td>
<td>M&gt;E 257</td>
<td></td>
</tr>
<tr>
<td>1955</td>
<td>84,000</td>
<td>A&gt;S 869</td>
<td></td>
<td>← 714</td>
<td>E&gt;M 856</td>
<td></td>
</tr>
<tr>
<td>1956</td>
<td>92,400</td>
<td>A&gt;S 957</td>
<td>← 1,660a</td>
<td>E&gt;M 121a</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Table I, page 88; Table III, pages 103-104; Table IV, page 105; Table V, page 108; and the Balance of Payments of Mexico, Appendix A, p. 174.

*Monetary conversions were made at the following rates of exchange: 8.65 pesos per dollar, 1952-1955; 12.51 pesos per dollar, 1954-1956.

aIncludes data for the first half of 1956 only.
balancing relationships. An over-all appraisal of the table yields some important facts. Investment was in excess of saving for each year. In the first instance, this relationship presents a gratifying situation. Nevertheless, it is possible that productivity has not risen so much as the figures indicate. An increase in the supply of money and credit could constitute a part of this seemingly tremendous increase in investment and output.

According to theory, an excess of investment over saving should be offset through negative lending if international equilibrium is to be realized, i.e., there should be an inflow of capital in an amount equal to the investment surplus. Table VI reveals the above condition. Lending was negative on balance; an inflow of capital took place in every year. This fact indicates that some portion of the rise in investment and national product was caused by inflation. The year 1953 would seem to bear this out, because income and output fell while investment was still much greater than saving.

Table VI further indicates that external policy was of prime importance since the lending balance was moving in the desired direction for the first three of the five years surveyed. In other words, lending should be negative whenever imports exceed exports. In addition, a major correction was made through external policy via
devaluation in 1954.

Within the general framework of events, each year presents its own unique set of factor relationships. The remainder of this section will be devoted to observing the influences exerted by the various factors during the five-year period under consideration.

I

In 1952 investment (A) exceeded saving (S) by some 2,944 millions of pesos. This would indicate that lending (the capital account of the balance of payments) should show an inflow of capital by this amount. Accordingly, negative lending took place to the extent of 113 millions of pesos.³² Therefore, the lending function contributed to a decline in the imbalance in a theoretical sense, which when deducted from investment totaled 2,831 millions of pesos.

Since investment was in excess of saving, the surplus must have been generated through an increase of money and credit and government spending. The supply of money in circulation and demand deposits increased by 278 millions of pesos while credit extended by the banking institutions was greater by some 770 millions of pesos.

³²See Table VI, column 4, p. 112.
during 1952. Money and credit accounted for 1,048 millions of pesos out of the total investment balance of 2,831 millions of pesos, including the lending factor. Although data were not available, the remainder must have been financed through the government by use of various direct and indirect methods.

Negative lending failed to close the gap between imports and exports. The year 1952 ended with an import balance on current account to the extent of 1,231 millions of pesos. Although negative lending took place, there remained a gap of 1,118 millions of pesos. This gap was covered through the unilateral, gold, and errors and omissions accounts of the balance of payments and the change in international reserves. To sum up: Mexico received donations amounting to 27 millions of pesos, lost gold to the extent of 551 millions of pesos, increased its foreign exchange reserves by 519 millions of pesos, and assigned 21 millions of pesos as a credit to the errors and omissions item. These figures total 1,118 millions of pesos, and this sum is equal to the original gap between the import surplus and the capital or lending balance.

34 Refer to Money and Credit of Mexico, Appendix C, p. 177.

35 Refer to Table VI, columns 4 and 5, p. 112.

36 The figures for the donations and gold items—converted into pesos—are taken from the Balance of...
The national product realized an increase of 6,500 millions of pesos at current prices. This amounted to a 12.5 per cent rise in national product (income). However, in constant pesos the rise was only 1,127 millions of pesos, or 2.5 per cent. In either case the rise in output appeared satisfactory. It would seem logical that productivity could rise by a larger amount since the establishment of a new firm, for example, would convert the operators of, say, shoe-shining booths into steel handlers or auto assembly workers. In other words, the immediate effect of even a small capital investment in a country in which productivity is exceptionally low would make possible a large percentage rise in production.

On the other hand, the constant creation of money and credit may be too great even though a rise in national product is evident. This year seemed to be the end of a culmination period; that is, inflation was getting too far out of hand. Since 1950 the total money supply has risen 18.2 per cent or from 5,989 to 7,078 millions of pesos. Furthermore, at the end of 1952 the banking system had extended 7,639 millions of pesos worth of credit. These figures reveal the fact that the national product probably

Payments, Appendix A, p. 174. The foreign exchange figure was obtained from the International Monetary Fund, International Financial Statistics, January, 1957, p. 156, line 12.

Money and Credit of Mexico, Appendix C, p. 177.
could not have been maintained at its existing level without even more extreme penalties imposed on the economic system.

Externally, the top-heavy import balance consisting mainly of capital goods failed to reap immediate benefits while the gold-foreign exchange balance indicated a reverse directional movement, that is, a net loss of gold amounting to 32 millions of pesos.

II

The next year, 1953, ended with an actual decline in national product (income). This was the only year in this survey in which the national product fell. Yet, in referring back to Table VI, page 112, one finds a pattern in the trend of saving and investment, lending, and imports and exports similar to that of the preceding year, except that the figures were smaller in amount.

Investment exceeded saving by 967 millions of pesos in 1953. This figure would indicate that lending should have been negative by the amount of the investment balance in order to establish an equilibrium at the new, lower national product figure. Thus, borrowing took place as lending revealed an inward flow to the extent of 754 millions of pesos. Internally, then, there was an investment accumulation of 123 millions of pesos after considering the effect of the lending inflow.
Even though saving rose by an amount greater than investment fell, investment was still in excess of saving. Money and credit in circulation increased in 1953 by a large amount. Money in circulation was 575 millions of pesos greater than at the end of 1952. In addition, the banking system allowed credit to rise by 1,514 millions of pesos.38 This total of 2,089 millions of pesos was much larger than the investment excess. Accordingly, this fact would seem, at first, to indicate a large rise in the price level. However, the price level did not rise, but fell slightly. The events explaining these results were given earlier; however, it would seem expedient to mention them once again.39 The government decided to reduce the apparent inflation at the beginning of the year. Investment spending was curtailed and credit controls were made more stringent. By mid-year it was observed that the national income was headed toward a sharp decline; therefore, governmental policy was reversed. Government spending began to rise while money and credit were made more plentiful. Yet, the private sector failed to be stimulated through governmental and banking policy. The result was that the price level fell during the first four or

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38 Ibid.

39 Refer to pp. 91-92.
five months of the year under the government's "austerity" policy, but as credit rose during the last half of the year, the price level increased too, and finally settled on a plane nearly equal to that at the beginning of the year. 40

On the international scene, imports were larger than exports by 927 millions of pesos. Negative lending once again was in the right direction to close the import gap. Nevertheless, the amount of capital inflow was 173 millions of pesos short of covering the import excess. Other balance of payments accounts provided the desired flows to create a balance. Gold inflow totaled 119 millions of pesos while donations amounted to 37 millions of pesos. Foreign exchange reserves declined, however, by 389 millions of pesos. Finally, the errors and omissions absorbed the remaining 644 millions of pesos in the form of a credit balance.

Economic development suffered a blow in the year 1953 as output declined 3 per cent in real terms. It appears that the authorities were rudely awakened to the fact that saving and investment were not strong enough to support the previous high level of income and output. Furthermore, the abundance of money and credit could not

40 See Table II, column 5, p. 96.
be relied upon to sufficiently stimulate the private sector.

Evidently the authorities gave serious consideration to the probability of an inappropriate exchange rate, which is the predominate factor influencing the national product (income) in the external sector. Upon reviewing the gold and foreign exchange items for the first two years of this study, it is evident that a net loss occurred. In 1952 there was a net gold loss of 32 millions of pesos while at the end of 1953 foreign exchange drained away to the extent of 270 millions of pesos. Taking both years into consideration, the total net loss of these two items was approximately 302 millions of pesos.

III

The problem to be faced squarely at the beginning of 1954 seemed to be one with two alternative solutions. The first was to moderate economic development primarily through stringent monetary and fiscal measures; the second, to maintain an abundance of money and credit internally and to take drastic measures in the external portion of the economy. The decision to be rendered at this time was further influenced, no doubt, by the possible reaction of the private sector to either proposal. Although the decision was not as clear-cut as the two
above alternative solutions indicate, the second of the two choices dominated.

What was the result? Investment rose to about 1,372 millions of pesos over saving, and the lending balance resulted in an inflow of capital, which failed to close the saving-investment gap. Investment less the lending balance totaled 1,118 millions of pesos.41 It is of special interest to note that although private saving and investment figures were larger in 1954, they rose by nearly the same amount—800 millions of pesos. Government investment spending increased by 1,088 millions of pesos while saving rose less in 1954 than it did in 1953.42 The result was that the excess of investment over saving was attributed to larger government spending.

The abundance of money and credit appeared to make it rather easy for the governmental sector to increase investment expenditures. The money supply was made larger during the year by some 1,071 millions of pesos, and bank credit increased in an amount of 3,670 millions of pesos according to assembled data.43

Lending almost fulfilled its theoretical purpose

41 Refer to Table VI, columns 3 and 4, p. 112.
42 See Table II, p. 96.
43 Refer to Money and Credit of Mexico, Appendix C, p. 177.
in the international sector, i. e., the inward movement of capital nearly equaled the import surplus. As shown in Table VI, page 112, the import surplus was 257 millions of pesos while (negative) lending amounted to 254 millions of pesos. The difference of 3 millions of pesos was accounted for in the following manner: foreign exchange reserve holdings rose 976 millions of pesos and (net) donations flowed inward to the extent of 71 millions of pesos. The outward movement of gold totaled 1,206 millions of pesos. The summation of these figures (2,253 millions of pesos) was offset by a debit balance in the errors and omissions account amounting to 2,250 millions of pesos. The difference of 3 millions of pesos was equal to the imbalance between the import-lending items.

The result of these forces made possible, in part, a rise in national product amounting to 10,176 millions of pesos. At current prices, this figure represented an 18.1 per cent increase over 1953. However, at 1950 prices the percentage rise amounted to 8.0 per cent.

The rise in money and credit during 1952, and the last half of 1953, and for a portion of 1954 brought about the creation and modification of several monetary, fiscal, and exchange measures during this and the following year.

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44 See Table I, column 2, p. 88.
Some of these factors included a new tariff, a new income tax law, and restrictions upon the granting of credit. A discussion of these measures will be forthcoming in the subsequent section dealing with monetary, fiscal, and external policy.

The outstanding change during 1954 was the devaluation in April. The peso rate was lowered from 8.65 to the dollar to 12.51 to the dollar, a decline of 45 percent in terms of dollars. The devaluation surely contributed to the higher price level. One source of information states that: "The monetary devaluation provoked a rapid upturn in prices, the level of wholesale prices rising by 15 per cent during the period March to December 1954. . . ."45 Another result of devaluation was the rise of exports and the fall of imports. Nevertheless, because the new, lower exchange rate was in effect for only about seven months in 1954, the real impact of devaluation was more clearly recognized in 1955.

One other factor should not be overlooked, as observed from the experience during the year. This factor was government investment. It was earlier stated that the investment-saving excess was financed almost entirely by

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the government. The productivity of government investment in general is indirect and quite slow in realizing a greater output. This type of capital addition may make possible a larger future output, but the immediate effect would be quite moderate. In evidence of this result, the real national product was only about 2 millions of pesos larger than that of 1952.46

IV

Two main events took place in 1955. The first was that government investment declined, and the second related to the influence on the external sector brought about by the devaluation of 1954. On the domestic scene, investment exceeded saving for the fourth year in a row. This year's excess was 869 millions of pesos. The lending factor could have contributed to an equilibrium situation if capital would have moved inward to the extent of the investment surplus. However, this inflow was not sufficient to equate saving and investment. As Table VI, page 112, shows, capital flowed inward on balance to the extent of 714 millions of pesos. Furthermore, money and credit in circulation rose by approximately 2,975 millions of pesos. Yet, it was not the government sector which increased its investment spending. Investment

46 See Table II, p. 96.
expenditures in this sector actually declined by 17 millions of pesos. It was, therefore, the private sector's additional spending which led to an investment surplus. Even though total investment was larger than total saving, the latter increased by more than the former.

It would seem that from this experience an optimistic trend was developing via increased private and decreased government spending while saving in both areas continued to rise. Nevertheless, the distribution of income was probably on a very narrow basis. It was the export sector that seemed to gain the most. Importers were in a favorable situation, too, since the domestic price level shot upward again this year. 47

The international sector contributed a good deal to the rise in national product amounting to 17,522 millions of pesos at current prices. This is the first year of the survey in which exports were larger than imports. Devaluation did its job from this standpoint. However, this is not to say that devaluation produced only favorable results. The export excess called for the outward movement of capital to the extent of this surplus if equilibrium were to be accomplished in the external sector. But as stated above the capital flow was inward

47 Refer to Table II, p. 96.
instead. The result was a gap amounting to 1,570 millions of pesos, if the export surplus and the lending balance are taken into account. The gap was closed by the inflow of 1,000 millions of pesos of gold, a (net) outward movement in the donations account of 55 millions of pesos, and a rise of foreign exchange reserves amounting to 1,652 millions of pesos. The remaining balance was absorbed by a debit of some 2,167 millions of pesos in the errors and omissions account.

Gold and foreign exchange reserves produced a net gain for the first time in the last four years. The receipt of these two factors totaled 2,652 millions of pesos; hence, there is a strong indication of the large increase of money in circulation. Referring to Appendix C, Money and Credit of Mexico, page 177, it is observed that of the total additions to money and credit in 1955, money in circulation accounted for 2,049 millions of pesos of the total 2,975 millions of pesos created by both money and credit.

The financing of the excess investment of 869 millions of pesos, the surplus of exports amounting to 856 millions of pesos, and the accumulation of gold and foreign exchange reserves noted above, all of which contributed to an increase of the national product of some 17,522 millions of pesos, would seem to have exerted some
influence upon the general level of prices. Table II on page 96 supports the above statement by showing that the price level rose 22.9 points at the close of 1955. The result was that the national product rose 8.4 per cent at 1950 prices. This rise is considered highly favorable if compared to the experience of industrialized nations, but it was much lower than the current figures indicated.

The estimated rise of 10 per cent in saving and investment for the year 1956 provided an investment surplus of 957 millions of pesos. According to mid-year figures, capital inflow amounted to 1,660 millions of pesos. Information during the year gave no indication that one could expect a reverse flow of capital at the year's end; nevertheless, it would be expected that the mid-year figure was much larger than that anticipated at the close of the period. Taking the first half-year figure as representative for the period, capital inflow more than provided for the excess of investment over saving.

On the other hand, total money and credit in circulation declined for the first time in the last five years. Credit was reduced by 1,265 millions of pesos and money in circulation fell some 514 millions of pesos. This result was brought about by new banking requirements which included higher reserves behind demand and savings deposits.
and the refusal on the part of the Bank of Mexico to grant rediscounts as freely as in the past.\textsuperscript{48}

Exports exceeded imports by 121 millions of pesos. The export surplus added to the inflow of capital, which amounted to 1,660 millions of pesos, indicated that the export-import gap would not be closed through lending. At mid-year the gold-foreign exchange items together showed a net gain of about 126 millions of pesos.\textsuperscript{49}

Should there be no adversities during the remainder of the year, the balance of payments will be favorable once again.

Perhaps the outstanding event of this year was the determination on the part of the authorities to maintain a tight money and credit policy. The real national product rose by approximately 7 per cent. Although estimates were employed in determining saving and investment for this year, a recent report states that at the end of July the real national product rose 10 per cent above that of the previous year.\textsuperscript{50} Furthermore, the conservative monetary


\textsuperscript{49}Foreign exchange figures were obtained from the International Monetary Fund, \textit{International Financial Statistics}, January, 1957, p. 157.

\textsuperscript{50}International Monetary Fund, \textit{International Financial News Survey}, September 21, 1956, p. 94.
policy was applied with a good deal of success as compared with prior years. The general price level rise was held to less than five points.

Before passing on to the final sections of this chapter, a few general statements seem to be in order. The national product (income) rose during four out of the five years included in this survey. Nevertheless, the rise in prices was greater than that of the national product. This rise indicates that the majority of people with low incomes must have suffered to a great extent.

Lending as a balancing factor did not serve its purpose of closing the gaps between saving and investment and imports and exports. For this reason, it would be natural to expect variations in the national income. Mexico realized an inflow of capital in every year under consideration. Since realized investment was larger than realized saving throughout the period, it was stated that capital should have moved inward in order to provide a balance between the factors. The effect of a capital inflow would be to raise saving. Saving did rise according to the experience of Mexico. It is true, nevertheless, that investment was two or three steps ahead of saving, but the principle was at work. In other words, with a more vigorous application of monetary and fiscal measures, the gaps between saving and investment probably could have been closed.
The relationship between lending and the external sector produced a rather consistent pattern at least for the first three of the five years under investigation. The inward capital flows, though insufficient, contributed toward the closing of the import surplus gap. It appears that external policy—particularly that of a fiscal nature—was not applied with enough force. During the last two years of this survey, Mexico encountered export surpluses. Devaluation made this possible, but, at the same time, the lower exchange rate which helped to produce a larger national product also raised prices and influenced the distribution of income. It would seem that the necessary corrections would have been possible through the combined efforts of monetary, fiscal, and exchange policies. The review of the year 1956 revealed that some measures were instigated in order to reduce the two-pronged effects of the investment and export balances.

The foregoing analysis has shown that many changes have occurred in Mexico even though a relatively short period of time was considered. Although some attention has been given to various measures adopted to cope with these changes, a more systematic treatment of these devices will be undertaken in order to visualize more clearly how this nation handled such problems. The following discussion will center around internal and external policies.
II. SOME OBSERVATIONS ON MONETARY, FISCAL, AND EXTERNAL POLICIES

Banking operations in Mexico are carried out through a central banking system. The Bank of Mexico is the central bank which is endowed with all the traditional functions of a central bank.⁵¹ Although the methods employed to control the supply of money and credit in circulation are described as being similar to that of our Federal Reserve System, the association between the Bank of Mexico and the government is much different than that of the Federal Reserve System and the United States government. The Mexican government owns 51 per cent of the stock of the Bank of Mexico, and it enjoys the right to appoint five of the Bank's nine directors.⁵²

The types of controls consist of open market operations, rediscounting, and reserve requirements. The first two kinds of controls have not been very effective. With reference to open market operations Professor Myers states that:

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⁵² Ibid.
Open-market operations, which are often used in order to force banks to rediscount and thus make the rate effective, are of little avail in a country like Mexico where the securities market is rudimentary. . . .

The rediscounting process has likewise been quite ineffective in most recent years. It seems that many banks have access to sources of funds other than the Central Bank. The favorable balance of payments occasioned in the last few years indicates that deposits received from external trade are one of the most important sources of funds.

Reserve requirements include both demand and savings deposits. These requirements differ according to the three types of banking institutions. For example, the flexible reserve requirements in 1949 consisted of a 50 per cent reserve against deposits for banks located in Mexico City; a 45 per cent reserve for all branch banks; and a 40 per cent reserve against deposits for all non-branch city banks. Modifications were made at various times as to the use of government securities and private reserves. The latter were not used until 1948, when the banks in the Federal District were given permission to include government-approved securities and private issues up to limited amounts of their total reserves. The idea was

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53 Ibid., p. 581.
54 Ibid., pp. 584-585.
to increase the amount of loans to productive enterprises.

Finally, in September, 1949, a more drastic action was taken because of the threat of continued inflation. The Bank of Mexico subjected all increases in demand liabilities of the deposit banks to a 100 per cent reserve. However, an exception allowed deficits in reserves up to 70 per cent without penalty, provided that the deficit sums were invested in equipment loans of a short-term character, securities of two years' maturity, or capital loans up to five years' duration. In addition, the total long-term loans for any bank were limited to an amount equal to 20 per cent of its demand liabilities. The effect of the latter was to limit the banks' ability to take advantage of the escape clause in the new reserve requirement and to make banks invest up to 20 per cent of their deposits in long-term loans, with the remaining increases in deposits placed with the Bank of Mexico.55

Bankers were critical of the elaborate reserve program; so a revision was made in 1950. The 20 per cent of total deposits in long loans was maintained, but increases in deposits had to be offset in the following manner:

55 Ibid., p. 585.
30 per cent by an increase in deposits at the Bank of Mexico; 20 per cent by investment in productive activities, at medium-term and long-term; 20 per cent by investment in securities, private or government; 30 per cent (the remainder) unrestricted. 56

The above requirements were established for the banks in Mexico City; however, similar requirements were imposed on branch and non-branch banks. The former were allowed 35 per cent of the increase in cash deposits as unrestricted while the non-branch banks were given the right to employ 40 per cent of their increases in deposits as they wished.

The concluding requirement of this complex reserve procedure took effect in 1951. Because the expansion of bank credit became so large, all banks whose deposits exceeded an amount equal to 10 times their capital and reserves were required to deposit the total amount of such new cash deposits with the Bank of Mexico. 57

Other restrictions were placed upon special banking institutions including the agricultural and investment banks.

There is a distinction between national and private banks. However, from a practical standpoint, their

56 Ibid., p. 586.
57 Ibid.
operations and regulations are similar. For example, all private commercial banks are associated with the Bank of Mexico. They must subscribe to the stock of the Central Bank, and their reserve requirements are almost identical with those of the national banks, as stated above.

This short review of the complex banking operations reveals the sincere effort of the monetary authorities to reduce money and credit in circulation on the one hand, and to stimulate economic development on the other. Nonetheless, the latter effort seemed to predominate over the former because, even with the imposition of the stringent monetary measures as applied in 1951, total money and credit rose from 13,669 millions of pesos at the end of 1951 to 14,717 millions of pesos at the close of 1952. In addition, the Central Bank held 1,614 millions of pesos worth of government securities. This figure represents a large portion of the Federal Government's debt. The significant point to be stressed is that the Bank of Mexico was being forced to help finance the program of industrialization carried out by the government.

The following discussion relating to monetary, fiscal, and external policies will be presented on a year-to-year basis in a manner similar to that employed

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58 Refer to the Balance Sheet of the Bank of Mexico, Appendix D, P.
in the preceding portion of this chapter.

I

Total government expenditures were greater than total income in 1952. The deficit of 231.6 millions of pesos included public debt retirement, which accounted for 16.9 per cent of total expenditures. Although the data are incomplete as given by function, the difference between the sum of the items shown (3,381.0 millions of pesos) and the total expenditures of 5,657.7 millions of pesos consisted of transfer expenditures. A Department of Commerce report which listed expenditures by type under the heading of current, capital, and transfer expenditures for the year presented a breakdown of these expenditures in the following manner, all in millions of pesos.

<table>
<thead>
<tr>
<th>Expenditure Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price and other subsidies</td>
<td>688.7</td>
</tr>
<tr>
<td>To public institutions</td>
<td>678.7</td>
</tr>
<tr>
<td>To private institutions</td>
<td>10.0</td>
</tr>
<tr>
<td>Social security payments</td>
<td>123.9</td>
</tr>
<tr>
<td>Acquisition of real property</td>
<td>6.4</td>
</tr>
<tr>
<td>Acquisition of securities including investments</td>
<td>1,500.0</td>
</tr>
<tr>
<td>Other transfers</td>
<td>30.6</td>
</tr>
<tr>
<td><strong>Total transfers</strong></td>
<td><strong>2,249.6</strong></td>
</tr>
</tbody>
</table>

The total transfers figure less social security payments accounted for 2,225.7 millions of pesos. This

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59 See the Federal Government Accounts of Mexico, Appendix E, p. 180.

figure added to the actual expenditures computed by function totaled 5,606.7 millions of pesos. Thus, if transfer expenditures are taken into consideration, it is possible to account for nearly all of the expenditures for 1952, even though the use of different sources and the ever-present possibility of overlapping are taken into account.

The transfer expenditure item yielded some important information with respect to the government's participation in economic activity. Subsidy payments were as large as expenditures for public education and culture, and greater than expenditures encountered for agricultural development. Furthermore, nearly all of the subsidies granted were directed into publicly owned facilities.

Government purchases of securities had a substantial effect upon the amount of money in circulation and the extension of government ownership. The portion of corporate and public enterprise securities purchased by the government expanded its ownership and control over the economy, and perhaps the larger portion of the purchase of securities resulted in a greater supply of money in the possession of business firms and other holders.

Total government income consisted in large measure of direct taxes levied upon income or profit.61

61 National income taxes are divided into five
Approximately 43.3 per cent of total federal revenue was obtained by means of direct taxation. The usual criticism of the underdeveloped nations' failure to employ direct tax levies does not apply in the case of Mexico. However, this statement is not meant to be construed as indicating the attainment of maximum satisfaction in connection with taxation procedures.

There is probably some doubt as to the rather small deficit encountered by the Federal Government. Yet, one must keep in mind the fact that the public sector includes much more than just the Federal Government. Unfortunately, income and expenditure figures realized by these other groups were unavailable. A United States Department of Commerce report makes the following statement in referring to the public sector: "... The principal deficits in

schedules as shown below. See the Senate Committee on Banking and Currency, Interim Report, Study of Latin American Countries, p. 394.

Schedule I includes individuals or corporations engaged in commerce, industry, or agriculture for a profit.

Schedule II applies to income received from interest, dividends, leases, patents, royalties, and so on, from foreign enterprises.

Schedule III represents income from subsoil operations or government concessions.

Schedule IV includes salary, wages, bonuses, pensions, and annuities.

Schedule V covers professions, arts, and sports.

Direct taxes specifically included those levied upon income, excess profits, exports, and mineral production.
recent years have been incurred by the autonomous public agencies. At any rate, one may conclude at this stage that both the banking system and the government failed to prevent inflation during 1952.

The next area of interest is that of the external sector. In this connection, an important question may be asked: were there any factors in this area which influenced the national product and contributed to the apparent inflation? One article reviewing the money supply of Mexico contains a statement which reads: "... During periods when our imports predominate, for instance, there is a contractionist tendency in the offer of money whereas the opposite phenomenon manifests itself when the country's exports exceed imports." Construed literally, this statement means that banks will witness a withdrawal of deposits and, therefore, loans and investments will contract during those periods in which imports are excessive. Although imports were excessive in 1952, the tendency toward contraction did not materialize. The rather small net loss of gold and foreign exchange, amounting to about 32 millions of pesos, was more than offset through the

63 United States Department of Commerce, Bureau of Foreign Commerce, Investment in Mexico, p. 87.
operation of monetary and fiscal policy.

The only serious problem created in the external sphere was that of a sizeable long-term capital inflow which could cause an exceptional burden in subsequent years if not properly utilized.

The terms of trade remained favorable at the end of 1952.\(^6^5\) However, the figure .483 for 1951 revealed more favorable terms of trade than in 1952 (.654). According to the latter figure, for each unit of imports received .65 units of exports were given in return. In terms of the volume of imports and exports, a less satisfactory relationship prevailed. In 1951 the volume of exports, in tons, declined by 2 percentage points from the base year of 1950.\(^6^6\) Nevertheless, the volume in 1952 rose to 3 points above the base year; it was larger than that in 1951 by 5 points. Since the Korean War was partially responsible for both the increases in price and volume, the administrative authorities probably felt that this favorable export condition would not last. The volume of imports, measured in tons, stood at 37 points above the

\(^{65}\) The general index of the price of imports rose 19 points (base 1950 = 100) while the price of exports increased 29 points. The computation is: \(\Delta (M) - \Delta (E) = 19 - 29 = .654.\) Refer to the National Bank of Foreign Commerce, *Foreign Commerce of Mexico 1955*, pp. 55-58.

base year. This index number was 1 point lower than in 1951, but it revealed the effects of the higher income and prices of the domestic economy; that is, a larger portion of the national income was being spent for imports in 1952 than in 1951. The result of price and volume changes in 1952 showed that what Mexico lost in terms of volume it gained through price changes.

II

At the outset of 1953 the government decided to reduce the inflationary pressure. As already stated, it did curtail some of its own spending. However, it was felt that the private sector should maintain or, better still, increase its expenditures. In February, 1953, the Bank of Mexico felt it necessary to introduce some reforms for the purpose of stimulating private spending and encouraging productive loans. At the outset of 1953 the government decided to reduce the inflationary pressure. As already stated, it did curtail some of its own spending. However, it was felt that the private sector should maintain or, better still, increase its expenditures. In February, 1953, the Bank of Mexico felt it necessary to introduce some reforms for the purpose of stimulating private spending and encouraging productive loans. 67 It encouraged agricultural banks to rediscount their paper by allowing them to present an amount up to 20 per cent of their paid-in capital and surplus for rediscounting purposes. In order to stimulate other loans, commercial banks were given the privilege of increasing their demand deposits up to 12.5 times their capital and surplus. Furthermore, banks in the Federal District were permitted to invest up to 10

per cent of their cash reserves in government and other securities. The Bank of Mexico nearly doubled its loans and discounts during the year. It was evident too that the Central Bank increased its holdings of Federal Government securities. Total holdings amounted to 1,717.5 millions of pesos as shown by the balance sheet of this Bank.

The less stringent banking requirements facilitated the purchase of government securities by most of the banks; consequently, the expansion of loans took place on a large scale. Although demand deposits constitute about 50 per cent, on the average, of the total money supply, the proportionate rise of demand deposits was larger in 1953. Money in circulation rose 215 millions of pesos while demand deposits increased 360 millions of pesos.

On the other hand, Federal Government expenditures in 1953 were lower than those in 1952 by approximately 1,000 millions of pesos. Slightly lower too was the government's budget deficit of 161 millions of pesos. Expenditures, by function, totaled 3,474.9 millions of pesos, as shown in Appendix E, page 180. Because some of

68 Ibid.
69 Refer to the Balance Sheet of the Bank of Mexico, Appendix D, p. 178.
70 See Money and Credit of Mexico, Appendix C, p. 177.
the data were unavailable, this figure was 1,043.2 millions of pesos less than the total expenditures by the government for the year. However, the difference between the two above figures is narrowed if one considers the transfer expenditures which, fortunately, were available for 1953. They were utilized as follows (in millions of pesos): 71

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsidies</td>
<td>420.2</td>
</tr>
<tr>
<td>To public institutions</td>
<td></td>
</tr>
<tr>
<td>To private institutions</td>
<td>391.1</td>
</tr>
<tr>
<td>To individuals</td>
<td>29.1</td>
</tr>
<tr>
<td>Social security payments</td>
<td>93.2</td>
</tr>
<tr>
<td>Acquisition of real property</td>
<td>3.6</td>
</tr>
<tr>
<td>Acquisition of securities</td>
<td></td>
</tr>
<tr>
<td>including investments</td>
<td>965.0</td>
</tr>
<tr>
<td>Other transfers</td>
<td>30.1</td>
</tr>
<tr>
<td>Total transfers</td>
<td>1,512.1</td>
</tr>
</tbody>
</table>

The deduction of the social security payments already accounted for would give a total transfer figure of 1,418.9 millions of pesos. Since a portion of the transfer payments was probably included in the expenditure-by-function figures, a discrepancy occurred between the sum of the actual total expenditures by function amounting to 3,479.9 millions of pesos, plus the transfer payments of 1,418.9 millions of pesos. The total expenditures of the Federal Government amounted to 4,518.1 millions of pesos.

Total subsidy payments in 1953 were slightly less

than one-half those of 1952. Furthermore, the authoritative figures indicated that government owned enterprises received none of this aid. Finally, the government helped to reduce the amount of money in circulation somewhat by purchasing less corporate and public enterprise securities and by making fewer investments with transfer funds.

An analysis of the Federal Government expenditure accounts for 1953 reveals no extreme shifts in expenditures. An additional 243.1 millions of pesos were spent for communication and transportation, while the agricultural sector received an increase of about 100 millions of pesos for development. However, the banking system and perhaps some of the autonomous government enterprises made available a large amount of money and credit for expansion.

Although total tax revenue was less this year than in 1952, direct taxes represented approximately 42.8 percent of the total revenue. The chief reason for the smaller total of tax collections was the general business recession which took place rather than changes in tax laws. The reduction of income from taxes further reflected the more conservative attitude on the part of the government, especially during the first six months of the year.

The Federal Government decided that it had to do something in the latter portion of the year with respect to stimulating the economy since its anti-inflationary
policy during the first half spilled over into the private sector. Firms and individuals adopted the same attitude as the government with respect to spending, and the national product (income) was falling. The government could have imposed a higher income tax in order to combat the private sector's apparent demand for higher liquidity. But such action probably would have discouraged the private sector. It was also possible to increase expenditures via public works and other developmental projects already planned through foreign financing. This alternative was not employed either. A major reason for not accepting this choice was because the time necessary to reap physical benefits from such projects would be too extended, and foreign capital required the acceptance of other nations. Perhaps Mexico could have obtained additional funds from official sources to carry out these projects. However, the authorities did not attempt to seek a solution to its problem in this manner. The balance of payments of Mexico reveals that in 1953 the repayment of official loans ($31.2 million of dollars) was nearly as large as official loans obtained during the year ($31.6 million of dollars).

A third recourse involved government deficit spending along with import restrictions. Although such a policy would tend to place a good deal of pressure on the
external sector unless applied rigidly, this was the alternative chosen by the authorities to solve their state of depression. Nevertheless, the second part of the program—imposing import duties—was not made effective in 1953. Imports did decline somewhat, as the balance of payments of Mexico reveals, principally because of the reduced business activity. Yet, the difference between imports and exports was greater in 1953 than in 1952, imports being larger in both years.

The terms of trade turned unfavorable this year. The index of import prices remained the same as in 1952, that is, 19 points higher than in the base year, 1950. However, the export price index was 16 points lower than the previous year, but it was still 13 percentage points higher than in 1950. Measured from the base year, the terms of trade was unfavorable at 1.1. A given unit of imports was exchanged for every 1.1 unit of exports. On the other hand, the volume of exports rose 15 points over the base year in 1953 while the index volume of imports was 49 percentage points larger than in 1950. To summarize on the basis of these figures: the increase in the volume of exports was slightly larger than the rise in


price of exports; the relative increase in import prices was much less than the relative volume of increase in imports; and once again a portion of the national income leaked away through the purchase of imports.

Foreign exchange reserves were reduced by about 389 millions of pesos. However, the inward flow of gold helped offset the loss of foreign exchange in part, leaving a net loss figure of approximately 270 millions of pesos.

The resolute determination on the part of the authorities was quite clear at the end of this year. Economic development was to be stimulated even though it created more inflation. Moreover, the authorities were willing to allow a disequilibrium and subsequent depreciation of the monetary unit in order to protect the domestic economy. However, depreciation occurred in the following year, 1954. Attention will now be focused upon some of the internal and external policies put into effect during this latter year.

III

There were no new banking reforms enacted in 1954; nevertheless, there was great emphasis placed upon the channeling of funds into the various sectors of the economy. Agricultural loans were encouraged during the major portion of the year by continuing the policy of
allowing agricultural banks to rediscount paper up to 20 per cent of their paid-in capital and surplus, and by establishing a limit upon such banks loans of 10 per cent of their paid-in capital and surplus.  

Of the total credit made available during the year, approximately 58 per cent was directed into industry, about 25 per cent was channeled into agriculture, and the remainder was shared between commerce and mining.  

Industrial and agricultural credit together amounted to 83 per cent of the total credit expended. In the preceding year, total credit for these two sectors amounted to 75 per cent. The effect was to reduce the amount of commercial credit this year for the purpose of stimulating, as far as possible, the production of commodities. Furthermore, commercial credits have had a poor repayment record. According to a banking source, "Approximately 35 to 38 per cent of commercial paper presented for payments is returned uncollectable..."  

It is apparent from the above discussion that the

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74 Bank of Mexico, Annual Report, 1955, p. 34.
banking system tried to channel funds into production as opposed to commercial credit and speculation. The latter was evidently a serious problem in the first three or four months of the year because of the high liquidity preference attaching to such uses of funds. The Bank of Mexico introduced several measures to deal with speculation. In April new banking institutions were required to place a 50 per cent down-payment on speculative security purchases. However, the margin requirement was lowered to 25 per cent in June. The Bank also refused to provide funds for speculation in stocks of private enterprises. Furthermore, the Central Bank suspended the authorization of long-term bonds by public enterprises in order to prevent the saturation of the market for such issues. 78

Loans and discounts granted by the Bank of Mexico increased at such a rapid rate that by the end of the year they had nearly doubled. 79 In addition, the balance sheet reveals that loans to the Federal Government rose sharply while loans and discounts to national banks increased 170 per cent.

Government spending was at a high level in the early months of 1954. In fact, it was anticipated that

78 Bank of Mexico, Annual Report, 1955, p. 35.
79 See the Balance Sheet of the Bank of Mexico, Appendix D, p. 178.
should spending be maintained at such a level, the govern-
ment would witness a budget deficit of about 1,000 millions
of pesos at the end of the year. 80 It was realized by
April of this year that a firm policy requiring serious
adjustments was necessary. The problems of utmost
importance in addition to abundant government spending
were: a large supply of money and credit in circulation
causing prices to turn upward, a liquidity which is
attractive to the general public with the probability of
huge capital outflows, and the continuance of a strong
demand for imports while exports were moving downward
accompanied by an unfavorable terms-of-trade situation
which had appeared at the close of 1953.

The attempts to make adjustments which these
problems called for were of a mixed nature. From the
discussion of banking activity during the year, it was
found that conservative measures were not forthcoming.
Nevertheless, a major adjustment took place in the external
sector via depreciation. Internally, fiscal policy was
the primary device employed to bring about a healthier
economic situation. In other words, it was the govern-
ment which attempted to relieve the ensuing problems,
with little or no reliance upon a co-ordination of banking

80 United Nations, Economic Survey of Latin America
1954, p. 175.
(monetary) and fiscal policy.

In December, the import duties which were in effect in 1953 were selectively raised while a 15 per cent ad valorem tax on exports was removed. A new ad valorem duty of 25 per cent was put into effect for the dual purpose of reducing exporters' profits and increasing the income of the Treasury. Obviously, these measures were instigated because of the depreciation.

These levies on exports and imports resulted in increased income for the Federal Government. Together they contributed 1,611.3 millions of pesos, which was 201.2 millions of pesos more than similar levies yielded the preceding year.\footnote{See the Federal Government Accounts of Mexico, Appendix E, p. 180.}

There was no marked change in the income tax law, although a few modifications were made primarily for the purpose of creating a greater incentive toward production. The most important modification concerned Schedules I and III which allowed greater reinvestment of profits and larger depreciation reserves.\footnote{United Nations, \textit{Economic Survey of Latin America 1954}, p. 176. The various tax schedules applicable in Mexico are given on pp. 137-138, footnote 61 of this paper.} Income tax revenue was nearly 200 millions of pesos greater this year than in 1953. A larger number of persons were subject to income
taxes this year, and, at the same time, administrative efficiency reduced collection costs.

In order to stimulate consumption, federal employees were given a 10 per cent wage increase. Most industries followed suit; in fact, the general industrial wage increase averaged slightly higher than that given to federal employees. The problem of wage increases in Mexico is that the general purchasing power fails to rise because the larger number of potential consumers are employed in agriculture. These individuals do not share in enhanced wage benefits; therefore, consumption is augmented to only a small degree, if at all. Furthermore, wage increases have lagged far behind the increased living costs. Statistics indicate that from 1939 to June 1954, the cost of living index rose 379.4% whereas during this same period wages lagged behind registered a rise of only 280%. . . .

Federal Government expenditures exceeded those of 1953 by approximately 300 millions of pesos. By observing the Federal Government Accounts in Appendix E, page 180,

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83 National Bank of Mexico, Review of the Economic Situation of Mexico, June, 1954, p. 3. In July, 1954 the minimum wage law raised wages in the Federal District to 9.50 pesos ($.76) and 7.50 pesos ($.60) outside the district. See the August, 1954 issue, p. 3.

84 Ibid., issue of August, 1954.
one finds larger spending figures for every functional item with the exception of the public debt. This year the payment on the debt was reduced by about 300 millions of pesos. Nevertheless, this was the first year in which the Federal Government realized a surplus in its accounts.

The immediate causes leading to the depreciation in April were explained in the following terms: "... the activities of speculators buying dollars during March and April of this year, and falling exports gave rise to fears that our reserves would soon become exhausted. ..." 85

In January the foreign exchange reserves held by the Bank of Mexico were reported as 243 millions of dollars (approximately 2,102 millions of pesos). At the end of April the reserves amounted to 157 millions of dollars (about 1,358 millions of pesos). 86 One of the most rational guides for determining the effects of the loss of foreign exchange is a comparison of the reserves with the amount of money in circulation. Such a comparison for the two months mentioned above reveals that foreign exchange reserves represented nearly 27 per cent of the money in circulation in January while the reserves fell

85Ibid., issue of May, 1954, p. 4.
to 17.5 per cent in April. The authorities felt that the fall in exchange reserves was sufficient reason to depreciate the currency. Furthermore, the depreciation was sanctioned by the officials of the International Monetary Fund.

Exports were on the decline and imports were steady in the first quarter of 1954, but depreciation was expected to reverse this tendency. The result at the end of the year was that the general price index of exports, in pesos, rose to 145 above the base year. At the same time, the price index of imports increased to 153. Therefore, the terms-of-trade was 1.2 which meant that a given unit of imports exchanged for every 1.2 units of exports. In terms of volume, exports rose to 117 points above the base year. The result was that the higher peso price (lower foreign currency price) of exports did not create a corresponding increase in the volume of sales. With respect to imports, the higher peso price maintained an index volume at 148 points above the base year. A comparison of the higher index price of imports, as given above, revealed that the volume of imports was nearly as large as the rise in the price index. The general

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87 Ibid., issues of March and July, 1954, pp. 9 and 14, respectively. Money in circulation in January was 7,859 millions of pesos while in April it was 7,760 millions of pesos.
conclusion, then, is that at the end of the year appreciation had provided only a small improvement in commodity movements.

Compared with 1953, the price index of exports rose 32 points, from 113 to 145, while the volume index of exports increased from 115 to 117, or by only 2 points. On the other hand, the price index of imports at the end of 1953 was 119, and it rose to 153 at the end of the following year. The rise amounted to 34 points. However, the volume index of imports fell by 1 point during the same period; from 149 in 1953 to 148 in 1954. The tax levies on both imports and exports were imposed to make possible a more even distribution of income, and to supply the government with additional revenue. No doubt the tax levies helped to achieve both results.

In summary, the rise in internal prices was immediate and direct. Government investment spending alone increased during the year by 1,068 millions of pesos while money and credit in circulation was greater by some 4,741 millions of pesos. It appears that the basic error in the adjustment technique was the failure to apply a more stringent monetary policy in conjunction with

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89 See page 121.
fiscal policy. The result was that internal prices rose 11.8 points.\textsuperscript{90} This rise of the price level was larger than the 10 per cent increase in wages which was granted during the year. Moreover, the largest consumer group, the farmers, did not participate in higher wage benefits. Internal expansion was not as responsive as the authorities evidently hoped it would be. It should have been realized that depreciation puts no corrective to work, and in Mexico the co-ordination and flexibility of monetary and fiscal measures are of special importance in order to deal effectively with the results of adjustment factors such as depreciation.

IV

One of the first measures undertaken in 1955 was a banking reform. Its purpose was to check the excessive expansion of the circulating media. Circular 1279 of January 10, 1955 affected all deposit banks. The decree stated that increases in demand deposits in national money must be deposited with the Bank of Mexico or applied in the following manner:\textsuperscript{91}

\begin{itemize}
  \item Banks in the Federal District
  \begin{itemize}
    \item 30 per cent in cash in the Bank of Mexico
    \item 20 per cent in government bonds
    \item 15 per cent in financiera bonds
    \item 10 per cent in securities approved by the Ministry
  \end{itemize}
\end{itemize}

\textsuperscript{90}Refer to Table II, p. 96.

\textsuperscript{91}Bank of Mexico, \textit{Annual Report}, 1956, p. 48.
of Finance
10 per cent in equipment bonds
15 per cent (remainder) unrestricted

A further condition stipulated that out of the
total loans extended by the above banks 70 per cent must
be channeled into production and the remaining 30 per cent
may be directed into commercial production.

Banks outside the Federal District
20 per cent in cash in the Bank of Mexico
30 per cent in securities approved by the Ministry
of Finance
35 per cent in equipment bonds
15 per cent (remainder) unrestricted

The quantitative and qualitative aspects of govern­
ment regulation are revealed once again in the new banking
decree. From the quantitative viewpoint, it is clear that
the authorities now intend to restrict the circulation of
money to a greater extent than was evident in the older
law. Perhaps even greater emphasis is placed upon the
qualitative provisions. The amounts and direction of loans
and investments are quite specific.

The financiera bonds are explained as securities
issued primarily by the Nacional Financiera, the largest
government investment bank, and they consist of issues for
an industrial enterprise. The backing consists of a
mortgage on the assets of the firm plus a general guaranty
of the Financiera institution. These bonds were to be

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purchased from the Bank of Mexico. By handling the
securities in this manner, the effect was an automatic
open market sale by the Central Bank. Equipment bonds
mentioned above, "... are credits granted for a par-
ticular business purpose and secured on the equipment
and/or product. ...".

The disposition of deposits held in foreign
currency were included in Circular 1279. It was stated
that increases in deposits of foreign money would be
handled as follows:

- 25 per cent in cash with the Bank of Mexico
- 75 per cent invested in bonds of the International
  Bank for Reconstruction and Development and in
  securities of the Nacional Financiera

In August, Circular 1287 was issued, affecting
deposits in savings banks and savings departments of com-
mmercial banks. It explained that 100 per cent of the
increase in savings deposits must be deposited in full
with the Bank of Mexico. However, an escape clause
relieved the banks from penalty payments of up to 90 per
cent of such deposits provided the funds were invested
accordingly:

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93 Ibid., p. 9.
94 Ibid., footnote 2.
95 Bank of Mexico, loc. cit.
96 Ibid., pp. 48-49.
10 per cent in national and foreign currency in
short-term loans
5 per cent in plant expansion and equipment loans
37.5 per cent in intermediate loans approved by the
Department of Interior and Public Credit
37.5 per cent in government securities

In addition, when total loans and investments of
these institutions were equal to 20 per cent of their
deposits in national and foreign coins, new deposits were
to be treated as given below:97

10 per cent in cash in the Bank of Mexico
5 per cent in short-term plant expansion and
equipment loans
10 per cent in short-term industrial securities
10 per cent in government securities
65 per cent (remainder) unrestricted

It is apparent that safety of deposits was the
chief factor in the strict allocation of savings deposits.
Liquidity and safety are excellent criteria for such
deposits, but it would seem that the administrative
expenses and particularly inspection costs would be exceed­
ingly high.

At least two other banking changes which occurred
during the year should be mentioned. The Bank of Mexico
liquidated its holdings in the Nacional Financiera and
reduced its ownership in the National Bank of Foreign
Commerce.98 The securities were sold to private banks

97Ibid., p. 49.
98Ibid., p. 50.
and individuals. Total credit of the Bank was reduced because of the liquidation. Furthermore, a more general distribution of these securities was expected to encourage a greater interest in stock market activity as well as a withdrawal of hoarded funds from their hiding places.

The Central Bank curtailed its rediscounting privilege for the National Agricultural Banks and Ejidal Institutions. The latter provided funds for farmers with small landholdings.

An important monetary reform was passed by Congress on September 15, 1955. It was, in effect, a coinage act. New silver coins were issued in various denominations, with their intrinsic and market values equal. Hence, they were 100 per cent representative coins. Some older coins were demonetized at the current value of their silver content while others were to circulate but would be no longer minted. In addition, the new coins possessed limited legal tender qualities while the older issues were to become subsidiary coins.

The purpose of this reform was to present the public

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99 Refer to Money and Credit of Mexico, Appendix C, p. 177.

100 Bank of Mexico, op. cit., p. 50.

with coins of constant value and, therefore, to encourage savings. If the public were to accept the new coins on this basis, the reform could represent an important deterrent to inflation. Yet, the past experience of coin circulation in Mexico casts a shadow of doubt as to the accomplishment of the above objective.

These rather lengthy changes in banking and monetary operations emphasized the determination on the part of the authorities to employ a more co-ordinated attack upon the problems associated with inflation. Nevertheless, the inelastic nature of such reforms could not cope with the excessive demand for funds, particularly the demand of the private sector. Furthermore, the banking system was unable to restrict or demonetize the receipt of foreign exchange reserves which began to flow inward in large amounts.

The government was evidently aware of the probable inflationary consequences which often follow depreciation, for public investment declined. Total government spending did increase somewhat this year, however, as the Federal Government Accounts of Mexico, Appendix E, page 181, reveal. Total revenue rose to slightly more than 7,000 millions of pesos. This rise in income was large enough to create a surplus in the government accounts for the second consecutive year. The amount of the surplus
in the current year was 486.1 millions of pesos.

Again this year, every revenue item showed a gain. Significant increases were noticeable in income, export, and taxes on trade. On the expenditure side of the ledger, communication and transportation accounted for 26.3 percent of total government spending. This percentage represents the largest relative and absolute amounts for this particular item to date. The remaining items received their normal share of government expenditures.

Even though the Federal Government showed a surplus in its activities, other government owned enterprises were not usually so fortunate. A report at the beginning of the year indicated the need for economy in the functioning of these firms by stating that the prospect for economic growth in 1955 will brighten a good deal if the deficits of some of the government owned entities could be reduced.\textsuperscript{102}

There were no new fiscal policy measures instigated this year except for the reduction of government investment expenditures, and an additional 300 millions of pesos expended on the public debt.

As was mentioned earlier, money and credit in circulation rose by some 2,975 millions of pesos (see page 124). Demand deposits rose by approximately 1,500 millions

\textsuperscript{102} Ibid., issue of January, 1955, p. 5.
of pesos. This was the first year of this survey that demand deposits represented more than 50 per cent of the money supply. This is a healthy trend which indicates that the private sector is making greater use of the banking system. The exceptionally large increase in private investment this year revealed that the business slump and high state of liquidity during 1953 had ended. Also a portion of the rise in demand deposits could be attributed to the accumulation of foreign exchange reserves.

Credit rose by slightly more than 1,000 millions of pesos. The private banking institutions increased their loans by a much larger amount than the national institutions while the Bank of Mexico actually reduced its lending during the year.\footnote{Money and Credit of México, Appendix C, p. 177.}

In the external sector, the price of exports rose to 164 (fell in terms of foreign currency) of the base year while the volume index ascended to 141. In other words, the peso price rise was larger than the increase in volume exported. However, in order to visualize the influence of depreciation, a comparison with last year's figures is essential. This comparison reveals that the price index of exports in 1955 was 19 points higher than 1954. On the other hand, the volume index of exports stood at 24 points
higher in 1955. This yearly comparison meant that export income should have increased by a large amount in the latter year.\textsuperscript{104} The Balance of Payments of Mexico in Appendix A, page 174, does verify this trend.

Imports also rose in 1955. However, the increase of the price index was larger than the volume index expansion. The trend is in the same direction whether compared to the base year or during the last year. The price index of imports was at 168 compared with 1950, and it was 15 points greater than the index at the end of 1954. The volume index change recorded 155 above the base year while it was 7 points greater than last year.\textsuperscript{105} The result has been a larger rise in price than volume change. Nevertheless, the total expenditures for imports were less than the income received from exports, including the taxes in both categories.\textsuperscript{106}

Since money and credit in circulation increased during the year and the current account of the balance of payments registered its first surplus balance since 1950, one would expect that foreign exchange reserves had

\textsuperscript{104}National Bank of Foreign Commerce, \textit{op. cit.}, pp. 55 and 59.

\textsuperscript{105}Ibid., pp. 56 and 59.

\textsuperscript{106}See the Balance of Payments of Mexico, Appendix A, p. 174.
accumulated during the year. It was found earlier in this paper (page 126) that the rise of foreign exchange holdings amounted to 1,652 millions of pesos. Adding the gold inflow (1,000 millions of pesos) to these foreign exchange reserves gives a total of 2,652 millions of pesos. This accumulation would normally lead to monetary expansion within the country unless monetary policy were flexible enough to cope with this new inflationary pressure.

How successful was the monetary policy of Mexico in dealing with this problem? Fortunately, quite successful. On page 126 of this paper it was pointed out that, of the total additions to money and credit of some 2,975 millions of pesos, 2,049 millions of pesos represented an increase in the money supply. Since the rise in gold and foreign exchange was less than that of the money supply, it would appear that the rise in prices could hardly be explained in terms of an increase in the exchange factor. A better explanation of the rise in prices would be one that relates to internal pressures such as higher wages, more social benefits, taxation, and the increased costs of imported goods. Such pressures were created in 1954 and continued throughout 1955.

In reviewing the final year of this study, 1956, various estimates were employed. At the present writing,
figures representing external activity are available only through the first half of the year. Nonetheless, a general appraisal with respect to the application of monetary, fiscal, and external policy can be presented.

Although no new monetary reforms were evident in 1956, the extensive modifications in banking requirements undertaken last year began to produce more favorable results. By referring to the Money and Credit of Mexico in Appendix C, page 177, it will be observed that the money in circulation declined by 514 millions of pesos, and credit was reduced by 1,265 millions of pesos. In addition, figures indicated that saving had been rising in a consistent fashion. In order to further stimulate savings in national money, the Treasury Department increased the interest rate from 4 to 4.5 per cent in February. 107

The Bank of Mexico continued its policy of refusing to grant rediscounts to banks except when they showed a severe decline in their deposits.

Gold and foreign exchange holdings through August increased by only 225 millions of pesos. This factor, which usually is a source of monetary instability, posed no problem for the authorities.

107Council for Inter-American Cooperation, Inc., Noticias, March 27, 1956, p. 4.
A major change in fiscal policy took place this year. The Mexican income tax law was modified in several respects. One of the major provisions raised the tax rates on earnings of: "... income from commerce and industry (tax schedules I and II) will be subject to proportional and progressive tax rates as high as 39 per cent in place of the former top rate of 33 per cent. . . ."108 Also, the excess profits tax was reduced for the purpose of stimulating development. The old law provided:

"... that part of net taxable excess profits amounting to a sum greater than 15 per cent of invested capital was subject to excess profits taxation at rates of up to 25 per cent. Under the new amendments, ... the excess profits tax may not, under any circumstances, exceed 10 per cent of the amount of net taxable excess profits income. . . ."109

In addition, foreign branches or agencies of foreign business organizations were required to pay a higher excess profits tax. Other changes were incorporated into the new law which, in general, raised tax levies as applied under schedules I through V.

The effect of the tax changes were beginning to be felt at the end of the year. Income tax revenue was approximately 40 millions of pesos larger than in 1955. However, the force of the tax modifications should be

109 Ibid.
even greater in 1957 than in 1956.

Other forms of tax revenue declined somewhat in 1956. Smaller export tax income was attributed to a selectivity which was accomplished by adjusting rates in such a way as to encourage shipments of those goods which had been moving slowly in trade. Import tax levies also brought in less revenue this year because tariffs had restricted the inflow of commodities to capital goods and certain basic foodstuffs. However, this is the first year under study in which export tax income exceeded that of import revenue.

It was anticipated that the Federal Accounts would be in balance at the end of the year. Available information on this matter is scanty, but it does indicate that over one-half the total expenditures were divided among three items. These were Communications and Transportation, Agriculture, and Public Education and Cultural Services.

The year 1956 was, no doubt, the most prosperous one of the five years covered in this study. Internally, money and credit in circulation declined; the Federal Government budget was heading toward a balance, if not a surplus; real production and income rose along with saving; and the price level rose only 5.2 points. Externally, foreign exchange reserves were rising as of August but not enough to disturb the money in circulation, and the current
account tended toward a surplus. Finally, relative economic stability in foreign countries, particularly in the United States, helped to contribute toward a most economically successful year.

SUMMARY

International equilibrium in Mexico was not realized during the five years included in this study. Nevertheless, one could hardly conceive the possibility of an international equilibrium situation occurring within a nation that is characterized with underdevelopment. Lending as a balancing factor does not seem to possess enough flexibility to help offset internal and external fluctuations. At least this study reveals that such was the case with respect to Mexico. Capital tended to move into the country, but in none of the years surveyed did capital move outward on balance. Historically, capital would flow to the lesser developed areas. On the other hand, investment spending via inflation ultimately leads only to a more serious adjustment problem. Furthermore, should exports exceed imports, as they did in the final two years of this study, capital would tend to move out of the country, especially if the lending function were to create international equilibrium. Once again, there is a conflict between the historical movement of capital and
international equilibrium created through the lending function. In any event, lending was unable to create a condition of international equilibrium.

It was a contention in Chapter I that, if lending were to fail to bring about a condition of international equilibrium, monetary, fiscal, and external policy could help bring about that desirable situation. Although those policies were applied, in varying degrees, they did not establish international equilibrium during the rather short period covered in this survey.

By briefly reviewing the five years, one finds that monetary and fiscal policy were applied with little success in 1952. Inflation was rampant during the year. Fiscal policy was the dominant force put into effect during the first half of 1953. At the same time, some monetary encouragement was forthcoming in order to maintain private expenditures. But private expenditures declined too, and this forced the government to increase its spending in the last half of the year. The Bank of Mexico was forced to contribute to the expansion through the purchase of government securities.

The most important policy change in 1954 occurred in the external sector. The justification of depreciation is still doubtful. One should consider, however, that economic development is the basis for almost all policy
procedures. Since there was a good prospect that foreign exchange reserves would be drained away, action was taken to preserve the country's holdings. Fiscal policy was intermixed with external policy; monetary policy was, however, neglected.

A change toward a more effective monetary policy characterized 1955. Fiscal and exchange policy found negligible expression, except for taxes levied upon imports and exports.

Some modifications of the various controls were evident in 1956. In the monetary area, the rates on savings accounts rose; the general policy, however, was marked with conservatism. The major fiscal policy change involved a new income tax law and external policy provided for export and import taxes and tariff modifications.

From a policy standpoint, perhaps the two factors which contributed most to the failure to solve the problem of international disequilibrium were lack of co-ordination and improper timing. The failure to co-ordinate policy measures is evident from the facts which have been presented in this chapter. Better timing, though difficult to accomplish, could have smoothed out the fluctuations in the national product and income. As an example, conservative policy measures really should have gone into effect early in 1952, but when they were finally applied
in 1955, the reverse directional change was abrupt and turned into a sharp depression.

The Federal Government in Mexico is the leading decision-making body. It has control of the banking system and thus directs monetary policy to a great extent. Furthermore, it makes decisions as to external policy adjustments. In numerous instances it has been observed that the decisions made by the government created a psychological stimulation on the part of the general public, at one time, and a spirit of dejection at another time. Nevertheless, there appears to be a sincere desire to encourage private individuals and firms to take a larger part in helping to direct economic activity.

Judging from the rapid changes that have occurred within a short period of time, there appeared to be forces of a fundamental nature at work which will produce long-term adjustments. The abrupt changes in income and prices are indicative of the inability of the country to increase and to diversify its production. The development of external economies and the spreading of firms and industries require an extended period of time.

The key factor in decision-making was an urgent desire for economic development. It seems that those responsible for policy measures were willing to accept the harmful effects of inflation and rising prices for the
sake of channeling large amounts of funds into long-term development projects. The anxiety to industrialize can be appreciated, yet moderation is necessary in order to prevent the evils of inflation and high prices.

International equilibrium will probably not be achieved in Mexico for some time. In this connection, it would be well for those who are in a position to formulate policy in Mexico, to keep in mind a suggestion offered by Mr. Flores, a countryman, which reads:

It would seem that the best policy, suggested by the experience of Mexico during recent years, is to limit economic development to the point where balance of payments is attained, so long as this is compatible with the continuation of that progress...

To this, one should add a final note to the effect that monetary and fiscal policy must be co-ordinated and be made to possess the sort of flexibility that will help realize simultaneously the success of an economic development program and the achievement of external equilibrium.

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## APPENDIX A

### BALANCE OF PAYMENTS OF MEXICO

(in millions of dollars)

<table>
<thead>
<tr>
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<th></th>
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<td><strong>Current Account</strong></td>
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<td></td>
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<td></td>
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<td>620.6</td>
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<td>655.3</td>
<td>810.2</td>
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<td>14.0</td>
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<td>2.4</td>
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<tr>
<td>Foreign travel</td>
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<td>302.3</td>
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<td>364.8</td>
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<td>28.6</td>
<td>23.3</td>
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<td>9.1</td>
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<td>Long term</td>
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<td>72.5</td>
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<td>179.0</td>
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<tr>
<td>Direct investment</td>
<td>45.5</td>
<td>31.0</td>
<td>65.3</td>
<td>40.9</td>
<td>104.6</td>
<td>111.8</td>
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<td>Other private (net)</td>
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<td>-20.5</td>
<td>-19.6</td>
<td>-6.6</td>
<td>27.7</td>
<td>9.4</td>
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<td>Official</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Export-Import Bank, IBRD, and other loans</td>
<td>28.6</td>
<td>34.2</td>
<td>55.3</td>
<td>31.6</td>
<td>58.2</td>
<td>113.3</td>
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<td>Official repayments</td>
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<td>-38.9</td>
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<td>National and private banks' assets (net)</td>
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<td>20.2</td>
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<tr>
<td>Payments agreements (net)</td>
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<td>-14.8</td>
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<td>- .1</td>
<td>.6</td>
<td>8.5</td>
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<td>Use or repayment (-) of IMF resources</td>
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<td>---</td>
<td>22.4</td>
<td>22.4</td>
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<td>Other foreign assets (net)</td>
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<td>10.4</td>
<td>60.2</td>
<td>45.5</td>
<td>98.4</td>
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<td>45.6</td>
<td>13.1</td>
<td>87.2</td>
<td>20.3</td>
<td>57.1</td>
<td>132.7</td>
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### APPENDIX A (continued)

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<td>Unilateral Account</td>
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<td>Private donations</td>
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<td>Errors and Omissions</td>
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<td>29.5</td>
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aIncludes gold holdings.

bIncluded under "Other foreign assets."

cOther "short-term" assets include assets of the Bank of Mexico and private transactions such as loans and claims on United States banks and banker balances. The account includes $37.0 million on United States Stabilization Fund Loan for 1950.
APPENDIX B

INDEX OF WHOLESALE PRICES IN MEXICO CITY

<table>
<thead>
<tr>
<th>Year</th>
<th>210 Commodities</th>
<th>Consumers' Goods</th>
<th>Producers' Goods</th>
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<tr>
<td>1939</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
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<td></td>
<td>O</td>
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APPENDIX C

MONEY AND CREDIT OF MEXICO

Money in Circulation
(in millions of pesos)

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<th>Year</th>
<th>Total</th>
<th>Currency</th>
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<tr>
<td>1950</td>
<td>5,989</td>
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<td>3,075</td>
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<tr>
<td>1951</td>
<td>6,300</td>
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<td>4,637</td>
<td>4,087</td>
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<td>1955</td>
<td>10,773</td>
<td>5,244</td>
<td>5,529</td>
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<tr>
<td>1956</td>
<td>10,259</td>
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*Information not available.

Distribution of Credit by Type of Bank
(in millions of pesos)

<table>
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<tr>
<th>Year</th>
<th>Total</th>
<th>Private Institutions</th>
<th>National Institutions</th>
<th>Bank of Mexico</th>
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<td>1951</td>
<td>6,869.1</td>
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<td>b</td>
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<td>1952</td>
<td>7,639.1</td>
<td>4,183.9</td>
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<td>9,152.6</td>
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<td>1955</td>
<td>13,749.2</td>
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<td>1956</td>
<td>12,483.5</td>
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*Excludes inter-bank credit.

bInformation not available.
## APPENDIX D

### BALANCE SHEET OF THE BANK OF MEXICO
(in millions of pesos)

<table>
<thead>
<tr>
<th>Assets</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956a</th>
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<td>36.2</td>
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<td>Loans and discounts</td>
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<td>1,011.9</td>
<td>1,918.2</td>
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<td>70.4</td>
<td>99.7</td>
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<td>to national banks</td>
<td>24.1</td>
<td>148.4</td>
<td>400.7</td>
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<tr>
<td>to private banks</td>
<td>1.8</td>
<td>7.7</td>
<td>5.4</td>
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<td>Rediscounts:</td>
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<td>30 days</td>
<td>33.9</td>
<td>25.2</td>
<td>53.4</td>
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<td>90 days</td>
<td>219.3</td>
<td>257.3</td>
<td>439.3</td>
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<td>180 days</td>
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<td>154.4</td>
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<td>long term</td>
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<td>1,717.5</td>
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<td>---</td>
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<td>692.7</td>
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<td>22.4</td>
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<td>109.1</td>
<td>138.1</td>
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<td>16.2</td>
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<td>8,693.5</td>
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<td></td>
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<td>Liabilities</td>
<td>1952</td>
<td>1953</td>
<td>1954</td>
<td>1955</td>
<td>1956</td>
</tr>
<tr>
<td>-------------------------------------------------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
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<tr>
<td>Notes outstanding</td>
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<td>Other obligations in domestic currency</td>
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<td>Deposits and obligations in foreign currency</td>
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<td>50.0</td>
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<td>Reserves</td>
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<td>8,693.5</td>
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*Information not available.*
## Appendix E

**Federal Government Accounts of Mexico**

*(in millions of pesos)*

<table>
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<tr>
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<th>1952</th>
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<th>1953</th>
<th>%</th>
<th>1954</th>
<th>%</th>
<th>1955</th>
<th>%</th>
<th>1956</th>
<th>%</th>
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<tr>
<td>Income from government property and services</td>
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<td>Services</td>
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<td><strong>Total income</strong></td>
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APPENDIX E (continued)

<table>
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<th>Expenditures by Function</th>
<th>1952</th>
<th>%</th>
<th>1953</th>
<th>%</th>
<th>1954</th>
<th>%</th>
<th>1955</th>
<th>%</th>
<th>1956</th>
<th>%</th>
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<td>977.1</td>
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<td>954.0</td>
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</table>


- Included in "Income taxes."
- Includes sale of national property, transfers, and so on.
- Includes income from franchise and opportunity fees, products, and other income.
- Includes irrigation, agriculture, and education.
- Includes health and education.
- Expenditures of 834.2 millions of pesos not accounted for in 1955.
- Less than one-tenth of one per cent.
- Information not available.

Components do not always add to one-hundred because of rounding.


### APPENDIX F

**GOLD AND FOREIGN EXCHANGE HOLDINGS OF MEXICO**

*(in millions)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Foreign Exchange (pesos)</th>
<th>Gold (pesos)</th>
<th>Total (pesos)</th>
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<tbody>
<tr>
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<td>(dollars)</td>
<td>(dollars)</td>
<td>(dollars)</td>
</tr>
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<td>1951</td>
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<td>106</td>
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<td>1953</td>
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<td>1954</td>
<td>1,739</td>
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<td>1956</td>
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</tr>
</tbody>
</table>


*Conversions made at the following rates: 1951-1953, 8.65 pesos per dollar; 1954-1956, 12.51 pesos per dollar.

*Includes holdings as of August, 1956.*
CHAPTER III

THE CASE OF VENEZUELA: A Survey of Recent Monetary, Fiscal, and External Practices

Venezuela was chosen as a second underdeveloped nation for study because it is an example of an export economy. It is recognized that special problems as well as certain benefits characterize the development of nations so dependent upon foreign trade. Nevertheless, many countries in the underdeveloped areas of Latin America depend in varying degrees upon the external sector for a sizeable portion of their income while, at the same time, they must rely in part upon capital imports for their domestic growth. This is certainly true of Venezuela.

The rise of the national product and income of Venezuela has not been as spectacular as that of Mexico.\footnote{The value of Venezuela's commodity trade has averaged 57.2 per cent of its national product during the period 1952 to 1955. Export income averaged 36.9 per cent of the national product over the same period, including the participation of foreign owned oil companies. Refer to the Central Bank of Venezuela, Memoria, 1955, p. 257; and the International Monetary Fund, International Financial Statistics, January, 1954, p. 233.} On the other hand, the increase of these two important

\footnote{The gross national product of Venezuela has risen from 13,370 millions of bolivares in 1952 to 17,096 millions of bolivares in 1956. See the Central Bank of Venezuela, Memoria, loc. cit.; and the Council for Inter-American Cooperation, Inc., Noticias, November 29, 1955, p. 3.}
factors has been at a steadier pace in Venezuela. Furthermore, inflation and the problems connected with it have not been of such great magnitude as they were in Mexico over the same period of time.

A special aspect of the problem of international equilibrium is introduced when one is concerned with an export economy. This special view consists, in the first instance, of the international equilibrium situation without recognition of the significant external forces which characterizes the nation as an export economy, such as the contributions of foreign owned oil companies in the case of Venezuela; and secondly, the practical recognition of all the factors which contribute to a state of international equilibrium. In other words, the position taken here is one which attempts to explain the economic situation of the country, with private firms and the government working hand-in-hand, then to incorporate the foreign element as a factor which, although responsible for a sizeable portion of economic activity, may at some time in the future be withdrawn.

A separate treatment of these two aspects of the problem of international equilibrium will present the growth, or lack of growth, of the economy in recent years. The following sections will be developed according to the two-aspect approach stated above.
Monetary and fiscal policy and their effects upon the economic development of Venezuela will be analyzed in subsequent sections.

Venezuela maintains a multiple exchange rate system with few quantitative restrictions for the purpose of controlling trade and payments. Although the government does not practice exchange control through the exclusion of private sales and purchases of foreign exchange, it does maintain five buying rates and two selling rates.

Since this paper is concerned with short run policy, this chapter will be limited to an analysis of Venezuela during the last five years, that is, from 1952 to 1956 with emphasis upon the practical problems derived as concepts in Chapter I of this paper.

I. INTERNATIONAL EQUILIBRIUM: A Dual Aspect Approach

In Chapter I it was found that a condition of international equilibrium requires that intended saving equal intended investment and that imports equal exports, or that the difference between these two factors be offset through

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lending, positive or negative. It was further contended that should an international disequilibrium exist, monetary, fiscal, and external policy could be so applied that together they would either prevent a tendency toward greater disequilibrium, or better still, they would reduce the degree of disequilibrium.

This study will begin with the two factors of saving and investment during the five-year period. This will be followed by an appraisal of exports and imports (the current account) and a determination of the balancing factor of lending (the capital account). At this point an appraisal of the international equilibrium will be undertaken.

A. Saving and Investment

Table I, page 187, presents the estimated saving and investment relationship in Venezuela during the last five years excluding the contribution of the foreign owned petroleum companies. The saving figures account for the total saving of the nation. Figures revealing the savings of the petroleum companies were not available. Nevertheless, the oil companies would not be expected to maintain any

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5See Chapter I, pp. 15-17.
6See Chapter I, pp. 18-19.
### TABLE I

**SAVING AND INVESTMENT OF VENEZUELA EXCLUDING FOREIGN OWNED OIL COMPANIES**

(in millions of bolivares)

<table>
<thead>
<tr>
<th>Year</th>
<th>National Product (1)</th>
<th>Saving as a % of Total (2)</th>
<th>Private Sector Saving (3)</th>
<th>Public Sector Saving (4)</th>
<th>Saving as a % of National Product (2)</th>
<th>Private Sector Saving as a % of National Saving (5)</th>
<th>Public Sector Saving as a % of National Saving (5)</th>
<th>Investment (6)</th>
<th>Private Sector Investment as a % of Total Investment (7)</th>
<th>Public Sector Investment as a % of Total Investment (7)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>13,370</td>
<td>100.0</td>
<td>3,488</td>
<td>26.1</td>
<td>1,500c</td>
<td>43.0</td>
<td>57.0</td>
<td>2,167</td>
<td>1,232</td>
<td>56.9</td>
</tr>
<tr>
<td>1953</td>
<td>14,127</td>
<td>100.0</td>
<td>3,193</td>
<td>22.6</td>
<td>1,373c</td>
<td>43.0</td>
<td>57.0</td>
<td>2,273</td>
<td>1,281</td>
<td>56.4</td>
</tr>
<tr>
<td>1954</td>
<td>15,507</td>
<td>100.0</td>
<td>3,489</td>
<td>22.5</td>
<td>1,500</td>
<td>43.0</td>
<td>57.0</td>
<td>2,569</td>
<td>1,500</td>
<td>58.4</td>
</tr>
<tr>
<td>1955</td>
<td>16,282d</td>
<td>100.0</td>
<td>3,248</td>
<td>19.9</td>
<td>2,037</td>
<td>62.7</td>
<td>37.3</td>
<td>3,670</td>
<td>2,386</td>
<td>65.0</td>
</tr>
<tr>
<td>1956</td>
<td>17,096d</td>
<td>100.0</td>
<td>3,508e</td>
<td>20.5</td>
<td>2,210c</td>
<td>63.0</td>
<td>36.7</td>
<td>3,853</td>
<td>2,505</td>
<td>65.0</td>
</tr>
</tbody>
</table>


a Private and national enterprises only.

b National government only.

c Estimated at 43 per cent of total saving for the years 1952 and 1953, and 63 per cent for 1956.

d Estimated increase at a rate of 5 per cent.

e Estimated increase at 8 per cent over that of 1955.
sizeable amounts of savings within the country. Profits of these firms are readily withdrawn to be paid out in part as dividends to investors located in the United States and other foreign nations. It may be further assumed that the remaining portion of the profits would be invested in plants and facilities within Venezuela. For these reasons, the savings of the petroleum firms are probably of small magnitude.

Figures representing the investment expenditures of oil companies were obtainable; therefore, they were deducted from the total investment figures.

The area referred to as the private sector should be viewed with reservation because the figures include the contribution of national enterprises. Perhaps a more accurate classification would be to place the national enterprises in the same category as the public sector rather than the private sector. Since the figures for private and national enterprises were not segregated, they were placed within the category of the private sector.

The autonomous institutions have a peculiar existence of a quasi-public nature. An authoritative report explains their legal characteristics in the following manner:

. . . These government entities have a distinct legal existence, possessing property separate from and independent of the Treasury. Their income and expenses are not considered as public revenues and expenditures, and they are not subject to the regulations governing the national budget.
All capital contributions, contributions to operating expenses, and loans and grants that a ministry makes to these agencies are listed among expenditures of the ministry. However, the ministry receives no statement of agency expenditures of either ministry funds or agency earnings. On the receipts side the ministries list only the net amounts which the agencies, under their special regulations, must pay into the Treasury.7

These government entities compete with as well as supplement the activities of private firms, and this would seem to place the latter firms in a disadvantageous competitive position.

The national product figures of Table I consist of the contributions of all sectors, including the foreign owned oil companies; therefore, the amounts are somewhat overstated. Nevertheless, this point does not appear too detrimental to the purpose of comparing the domestic relationship between saving and investment.

Figures of the private sector saving were available for the years 1954 and 1955 only. The saving-rate in 1954 was applied to the two earlier years, 1952 and 1953, while the saving-rate for 1955 was extended to 1956.

The rise in the national product for the years 1955 and 1956 was estimated at a rate of 5 per cent.8

7United States Department of Commerce, Office of International Trade, Investment in Venezuela, 1953, p. 82.

8This percentage figure was taken from a recent report. See the Council for Inter-American Cooperation, Inc., Noticias, November 29, 1955, p. 3.
It may be observed from the figures presented in Table I, page 187, that total actual saving exceeded total actual investment during the first three years of the survey; namely, 1952 with a saving excess of 1,321 millions of bolivares, and 1953 and 1954 each indicating a saving surplus of 920 millions of bolivares. The saving balance would normally serve as a satisfactory explanation for a decline in the national product and national income for these years. However, this was not the result since both the national product and income continued to rise in each of the three years in which there was a saving excess.\textsuperscript{9}

Out of the total saving during the three year period (1952-1954), the public sector accounted for approximately 57 per cent while, over the same period of time, the private sector accounted for about 57 per cent of the total investment expenditures. Furthermore, the figures revealed that the private sector maintained its proportionate contribution to total investment expenditures during the first two years, that is, 56.9 and 56.4 per cent of total investment while in the third year

\textsuperscript{9}The national income figures for the period under study were as follows: 1952, 9,616; 1953, 10,257; 1954, 11,042; 1955, 11,200; and 1956, 11,760, all in millions of bolivares. Refer to the Central Bank of Venezuela, \textit{Memoria}, 1955, pp. 254 and 257. The figure for 1956 was based upon an estimated rise of 5 per cent over 1955.
considered, 1954, private investment expenditures rose to account for 58.4 per cent of the total investment expenditures. At the same time, the public sector held its proportionate saving figures at 57 per cent (see Table I, page 187, columns 4 and 6). Subsequently, in 1955, the public sector reduced its saving to 37.3 per cent of total saving while, during the same year, private investment rose to 65 per cent of the total investment. The implication is that once the government reduced its saving, the private sector provided for a sizeable increase in its expenditures. Nevertheless, a note of caution should be mentioned; that is, the exceptional rise in private investment in 1955 could have been attributed to national institutions rather than private enterprises. The reduction of government saving implies that the saving was made available to national entities for investment expansion. However, this point cannot be established clearly, since private and national enterprise investments are not separated.

During the years when saving was larger than investment (1952-1954), one would expect a reduction in outstanding credit or an increase in idle bank accounts. Total credit rose, however, from 1,117.8 millions of bolivares to 1,748.7 millions of bolivares during the period (refer to Money and Credit of Venezuela, Appendix A, page 279).
Savings deposits did rise from 233.7 millions of bolivares in 1952 to 419.0 millions of bolivares at the end of 1954, but the increase in savings deposits was equally as large in the following two years, 1955 and 1956, rising to 635.2 millions of bolivares at the end of 1956.\(^{10}\)

The saving and investment relationship was reversed during the last two years. Actual investment expenditures exceeded actual saving. In other words, savings deposits rose during the whole period under study and, therefore, negated the reasoning that a rise in savings balances served to partially explain an excess of actual saving over investment expenditures. In addition, the rise in credit would not support the fact that saving was greater than investment.

At least one other factor could help explain the excess of saving during the years 1952 to 1954. High rates of taxation would imply that savings were at a high level. By referring to the Receipts and Expenditures of the National Government of Venezuela in Appendix B, page 230, one finds an insignificant change in the yield from taxes on income. The amounts collected rose from 635.1 millions of bolivares in 1952 to 680.6 millions of bolivares

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in 1954. The income tax was modified somewhat in 1955, however, during the three earlier years "... the normal income tax rate never exceeds 4 per cent." It was true that the greater proportion of taxes received by the government came from the petroleum industry. No doubt a large part of the public sector saving was derived from this income source.

It is quite clear that the domestic investment of firms and the government were not large enough to maintain the national product and income at a given level. The saving balance did decline, however, from 1,321 millions of bolivares in 1952 to 920 millions of bolivares at the end of 1954. The explanation as to why the national product and income did, in fact, rise during this three year period is not apparent from a review of the domestic forces alone.

Table I, page 187, further reveals that actual investment exceeded actual saving in both 1955 and 1956. The amounts were 422 and 345 millions of bolivares, respectively. The rise of both saving and investment in the private sector is of particular importance. The figures also indicate that the government reduced its absolute and relative share of saving. The government's

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investment expenditures continued to rise; nevertheless, the increase was at a slower rate than that of the private sector. The result in percentage figures indicated a smaller relative contribution to total investment.

The extent of indirect government assistance would seem to indicate that the figures given tend to understate the influence of the national government. The government classifies its debt according to direct and indirect groupings. The indirect public debt consists of obligations emitted by the autonomous institutions with the guarantee of the national government. The institutions include, among others, the Venezuelan Development Corporation, the National Institute of Sanitary Works, and the Central Simon Bolivar, C. A., an institution created for the development of Caracas. These institutions received guarantees for expenditures from the national government to the extent of 461.1 millions of bolivares in 1954, 671.5 millions of bolivares in 1955, and although figures were not available, the amount in 1956 probably exceeded that of 1955.

The direct public debt of Venezuela has been relatively small. The figures in recent years were as follows: 1953, 45.2; 1954, 35.4; and 1955, 30.7 millions of bolivares. Refer to the Central Bank of Venezuela, Memoria, 1955, p. 211.

Ibid.
enterprises contributed in no small way to the increase in the private sector investment expenditures of 1,005 millions of bolivares in the last two years, 1955 and 1956.

A partial explanation for the surplus of domestic investment expenditures over domestic saving (767 millions of bolivares during 1955 and 1956) comes from the expansion of loans by the national government and national enterprises. Furthermore, a resort to Appendix A, Money and Credit of Venezuela, page 279, reveals that money and credit rose by 573.2 millions of bolivares during the last two years of this survey. A recent statement which is indicative of the above reasoning states:

... The public sector is more important than the private sector in controlling the direction of economic development, for the Government also invests a large proportion of the private savings obtained from the capital market. ... 14

It appears that domestic development in general is progressing at a more rapid rate than current opinion indicates. Although saving and investment have not provided a balance, the discrepancy is not exceedingly large. It is recognized that the oil industry is exceptionally important to the development of the nation. Yet, domestic investment rose some 78 per cent during the period without the aid of the petroleum industry. Even though total

increase in saving was meager and sporadic, private sector saving rose approximately 61 per cent, i.e., from a low of 1,373 millions of bolivares in 1953 to 2,210 millions of bolivares in 1956. In addition, the rise in saving of this sector has been consistently moving upward since 1953.

Bringing together some of the loose ends of the findings up to this point, it seems safe to state that the private and public sectors saving and investment relationships indicated that the national product and income would have declined from 1952 to 1954. However, during the year 1955 a turn of events occurred. The saving excess of 920 millions of bolivares at the end of 1954 was reversed during the following year so that at the end of 1955 investment exceeded saving by 422 millions of bolivares. This was accomplished without giving rise to additional inflation. Furthermore, the investment balance continued in 1956. This meant that the two sectors, without the helping hand of the oil companies, were strong enough to maintain and perhaps to increase the national product and income. Recent literature refers to numerous evidences of the tremendous advances made by the private sector via increased investment and diversification of

15See the Index of Wholesale Prices in the Federal District, Appendix C, p. 232.
facilities. A few examples will suffice:

Well-known group of Venezuelan businessmen are forming a real estate development company which will finance large city housing projects . . . and later on will build factory buildings for rent and for sale, office buildings, warehouses, and supermarkets throughout the nation. . . . Also,

. . . 107 new industrial concerns were established last year, their total subscribed capital being 24.9 millions of dollars . . . and bought machinery and equipment worth 15.1 millions of dollars. . . . And,

. . . Venezuela is now self-sufficient in corn and rice, and all sugar requirements are expected to be covered by domestic production this year. . . .

One should not forget, however, that the influence of the oil companies is perhaps greater than it appears on the surface. For example, the earnings of petroleum firms help to provide funds which private firms may utilize for the expansion of production and trade, and the oil companies contribute large sums of money which have made it possible for the national government to realize surpluses in its national accounts.

To take into consideration the precise influence of the petroleum industry, a second table, Table II, page 198, has been constructed for the purpose of analyzing the

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16 Council for Inter-American Cooperation, Inc., Noticias, October 18, 1955, p. 4.

17 Ibid., issue of September 27, 1955, p. 5.

<table>
<thead>
<tr>
<th>Year</th>
<th>National Product (in millions of bolivares)</th>
<th>Saving As a % of Total</th>
<th>Private Sector As a % of Private Sector</th>
<th>Public Sector As a % of Public Sector</th>
<th>Investment As a % of Investment</th>
<th>Private Sector As a % of Private Sector</th>
<th>Public Sector As a % of Public Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>13,370</td>
<td>100.0</td>
<td>3,488 (2)</td>
<td><em>(2)</em></td>
<td>1,500 (3)</td>
<td>43.0</td>
<td>1,988 (4)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5,469 (5)</td>
<td></td>
<td>26.0</td>
</tr>
<tr>
<td>1953</td>
<td>14,127</td>
<td>100.0</td>
<td>3,193 (2)</td>
<td><em>(2)</em></td>
<td>1,373 (3)</td>
<td>43.0</td>
<td>1,820 (4)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3,249 (5)</td>
<td></td>
<td>23.0</td>
</tr>
<tr>
<td>1954</td>
<td>15,507</td>
<td>100.0</td>
<td>3,489 (2)</td>
<td><em>(2)</em></td>
<td>1,500 (3)</td>
<td>43.0</td>
<td>1,988 (4)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3,706 (5)</td>
<td></td>
<td>23.9</td>
</tr>
<tr>
<td>1955</td>
<td>16,282</td>
<td>100.0</td>
<td>3,489 (2)</td>
<td><em>(2)</em></td>
<td>2,037 (3)</td>
<td>62.7</td>
<td>1,211 (4)</td>
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<td></td>
<td></td>
<td></td>
<td>4,820 (5)</td>
<td></td>
<td>22.5</td>
</tr>
<tr>
<td>1956</td>
<td>17,096</td>
<td>100.0</td>
<td>3,508 (2)</td>
<td><em>(2)</em></td>
<td>2,210 (3)</td>
<td>63.0</td>
<td>1,298 (4)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5,027 (5)</td>
<td></td>
<td>29.4</td>
</tr>
</tbody>
</table>


*Estimated at 43 per cent of total saving for the years 1952 and 1953, and 63 per cent for 1956.

*Estimated increase at a rate of 5 per cent.

*Estimated a 5 per cent rise of petroleum industry investment during 1955 and 1956.

*Estimated increase at 8 per cent over that of 1955.

*Estimated private, national enterprises, and national government expenditures at 5 per cent.
aggregate saving and investment relationship in Venezuela. This table is the same as Table I except that it includes the investment expenditures of the petroleum industry and a small amount of foreign investment. The investment expenditures of the oil companies have been added to those of the private sector and, appropriately, the foreign investment figures have been included with the national government in the public sector.

Total actual investment has averaged about 25 percent of the national product for the five-year period. This may be compared with an 18.8 percent average shown in Table I. These aggregate figures reveal the significance of the petroleum companies along with the general increase of investment expenditures by the private sector. Investment expenditures have been separated and shown below as individual components, in millions of bolivares:

<table>
<thead>
<tr>
<th>Private investment</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private and national enterprises</td>
<td>1,232</td>
<td>1,281</td>
<td>1,500</td>
<td>2,386</td>
<td>2,505</td>
</tr>
<tr>
<td>Petroleum companies</td>
<td>1,034</td>
<td>606</td>
<td>937</td>
<td>950</td>
<td>974</td>
</tr>
<tr>
<td>Total private sector</td>
<td>2,266</td>
<td>1,887</td>
<td>2,437</td>
<td>3,336</td>
<td>3,479</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Public investment</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956</th>
</tr>
</thead>
<tbody>
<tr>
<td>National government</td>
<td>935</td>
<td>992</td>
<td>1,069</td>
<td>1,284</td>
<td>1,348</td>
</tr>
<tr>
<td>Other foreign investment</td>
<td>268</td>
<td>370</td>
<td>199</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Total public sector</td>
<td>1,203</td>
<td>1,362</td>
<td>1,268</td>
<td>1,484</td>
<td>1,548</td>
</tr>
</tbody>
</table>

19 For comparisons refer to column 5 and the percentages shown in Table I, page 187, and Table II.

20 Central Bank of Venezuela, Memoria, 1955, p. 259; also see the explanations under Table II.
This separation of the investment factors presents some important points with respect to the growth of the nation. The exceedingly large investment expenditures of the oil companies, which in 1952 amounted to nearly 50 per cent of the total private investment, is attributable to the extension of operations which began a few years earlier. Large expenditures were made to construct homes and schools for the workers, to provide electricity for the communities, to pipe fresh water to the oil camps, and so on.\textsuperscript{21} The completion of the expansion of such facilities in 1952 brought a reduction of investment expenditures during 1953. Beginning in 1954, the continued rise in petroleum exports and the need for expanded refinery capacity stimulated a constant increase of investment expenditures. The average investment expenditures of the oil companies from 1954 to 1956 were 31.6 per cent of the total private sector investment.

A large rise of investment expenditures on the part of the private and national enterprises occurred in 1954 and continued through 1955 and 1956. The absolute increase, in millions of bolivares, amounted to 219 during 1954 and 886 at the end of 1955. Perhaps a large portion of the investment was channeled through the national enterprises.

The following explanation would seem to support this view:

... The Government made large investments [1954], either in the form of public works or by granting development loans. ... 

... The use of the Government's reserve fund in the Central Bank to finance a vast new programme of public works [was] provided for in the 1954/55 budget. ... 22

The above quotation also gives cognizance to the fact that the national government expenditures expanded abruptly in 1954 and continued upward in the two subsequent years.

Reverting back to Table II, one finds that the private sector's contribution to total investment varied from 58.1 per cent (1953) to 69.2 per cent (1956). Furthermore, investment expenditures were on the incline during the whole period except for the year 1953 as mentioned above.

In contrast, the public sector's relative share of investment spending has declined (see column 7 and the relative percentages). However, the figures indicate that the absolute expenditures have risen during most of the current period. The reason for the opposite movements of the relative and absolute figures was that the private sector spending increased at a more rapid rate

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than that of the public sector.

Before analyzing the external accounts, a comparison of the saving-investment relationship of Venezuela may be presented. This comparison is shown in Table III. These figures reveal quite clearly some of the major points that have been presented. By observing the left-hand column of the table one is able to see that total actual investment was smaller than actual saving for the first three years of the five-year period. However, during the last two years (1955-1956) investment (A) rose to exceed saving (S). The gradual decline in saving during the first three years, the equality between saving and investment during the year 1954, and the investment excess thereafter, all serve to emphasize the rapid domestic growth of the economy. This observation is of special importance since the change in the saving-investment balances was accomplished without severe inflation.

**TABLE III**

**EXCESS OF REALIZED SAVING (S) OR INVESTMENT (A)**
*(in millions of bolivares)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Aggregate Balances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Excluding the Petroleum Industry</td>
</tr>
<tr>
<td>1952</td>
<td>1,321 S</td>
</tr>
<tr>
<td>1953</td>
<td>920 S</td>
</tr>
<tr>
<td>1954</td>
<td>920 S</td>
</tr>
<tr>
<td>1955</td>
<td>422 A</td>
</tr>
<tr>
<td>1956</td>
<td>345 A</td>
</tr>
</tbody>
</table>

Source: Table I, page 187, and Table II, page 198.
Turning to the right-hand column of Table III, one may observe the great impact of the oil industry with respect to the domestic growth of the country. In only the first year, 1952, was saving larger than investment. Between the years 1952 and 1953 saving and investment were equated at a national product figure approximating 13,749 millions of bolivares.

At the end of 1953 the figures indicate an investment excess of about 56 millions of bolivares. However, as Table II, page 198, reveals, the investment balance for this year did not come about because of a rise of investment expenditures. Those expenditures actually fell. Nevertheless, the balance was possible because saving declined by a larger amount than did investment.

The investment excess continued to swell during the next two years (1954 and 1955). Finally, at the end of 1956, the already large investment balance declined by a small amount. The extraordinary rise of investment would normally be explained by inflation. This explanation would not be sufficient in the case of Venezuela. As will be explained later, the rise of the real national product and the diversification of development, starting with a narrow base, are important points attempting to verify the growth of the nation nearly free of inflation.

Before analyzing the approximate state of
international equilibrium of Venezuela, an appraisal of the nation's external relations should be made. This is the purpose of the following section.

B. Imports, Exports, and Lending

The survey of the domestic factors of saving and investment just completed has shown that an equality between saving and investment has not been realized in Venezuela during the past five years. Chapter I of this paper states that if saving were greater than investment a condition of international equilibrium may be attained, provided that exports exceed imports by the amount of the saving excess. The opposite relationship may also allow international equilibrium to be maintained, that is, with imports exceeding exports by the exact amount of the investment surplus. Should either of these above requirements fail to be realized, lending should provide the appropriate directional flow in order to close the gap between the accounts.

The present task is to analyze the current and capital accounts of Venezuela for the purpose of

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23 Imports include all the current account minus items while exports represent the sum of all the current account plus items. Lending constitutes the (net) capital account balance.

24 See Chapter I, pp. 15-17.
determining their final balances. The dual approach will be employed as it was in connection with the domestic sector. In other words, the current account will be explained, in the first instance, with the exclusion of the petroleum industry's contribution to external trade. By making this observation it will be possible to determine by rough measure the domestic and external sectors' ability to achieve and maintain economic progress.

The second part of the dual approach in the external sector will be to present the aggregate current account figures which will include the external contribution of the oil industry.

Of course, the capital account involves movements of funds and assets and, therefore, it will be employed in both of the above situations.

Table IV, page 206, presents the current account of Venezuela's balance of payments exclusive of the petroleum industry's contribution to the external trade of the nation.

A general view of Table IV yields some significant facts. Venezuela depends to a great extent upon its petroleum exports in order to achieve a favorable current account. The domestic sector contributes about 6 per cent of the total exports. The remaining 94 per cent is derived from the petroleum firms. At least this has been
the experience of the country during the last five years.\textsuperscript{25}

**TABLE IV**

**IMPORTS AND EXPORTS OF VENEZUELA EXCLUDING FOREIGN OWNED OIL COMPANIES**

*(in millions of bolivares)*

<table>
<thead>
<tr>
<th>Item(^a)</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956(^b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports, f.o.b.</td>
<td>228.8</td>
<td>288.1</td>
<td>365.8</td>
<td>373.9</td>
<td>411.3</td>
</tr>
<tr>
<td>Imports, f.o.b.</td>
<td>2,015.4</td>
<td>2,374.8</td>
<td>2,783.9</td>
<td>2,919.9</td>
<td>3,211.9</td>
</tr>
<tr>
<td>Transportation and insurance</td>
<td>-235.8</td>
<td>281.4</td>
<td>338.4</td>
<td>351.8</td>
<td>387.0</td>
</tr>
<tr>
<td>Investment income</td>
<td>-1,374.2</td>
<td>-1,355.7</td>
<td>-1,522.3</td>
<td>-1,847.9</td>
<td>-2,032.7</td>
</tr>
<tr>
<td>Capital</td>
<td>237.9</td>
<td>169.2</td>
<td>71.7</td>
<td>66.7</td>
<td>73.3</td>
</tr>
<tr>
<td>Other services</td>
<td>-173.9</td>
<td>216.7</td>
<td>236.2</td>
<td>346.4</td>
<td>381.0</td>
</tr>
<tr>
<td>Other</td>
<td>-213.4</td>
<td>207.8</td>
<td>217.4</td>
<td>175.4</td>
<td>192.9</td>
</tr>
<tr>
<td>Balance</td>
<td>-3,546.0</td>
<td>-3,979.1</td>
<td>-4,804.1</td>
<td>-5,334.2</td>
<td>-5,867.5</td>
</tr>
</tbody>
</table>


\(^a\)Minus items denote debits or a reduction of purchasing power.

\(^b\)All items except exports and imports represent net figures.

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**IMPORTS AND EXPORTS OF VENEZUELA EXCLUDING FOREIGN OWNED OIL COMPANIES**

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**TABLE IV**

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*(in millions of bolivares)*

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<th>1954</th>
<th>1955</th>
<th>1956(^b)</th>
</tr>
</thead>
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<td>373.9</td>
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<td>217.4</td>
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<td>192.9</td>
</tr>
<tr>
<td>Balance</td>
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<td>-3,979.1</td>
<td>-4,804.1</td>
<td>-5,334.2</td>
<td>-5,867.5</td>
</tr>
</tbody>
</table>


\(^a\)Minus items denote debits or a reduction of purchasing power.

\(^b\)All items except exports and imports represent net figures.

\(^b\)Estimated at a rate of 10 per cent above the 1955 figures.

Minus balances accompany every item with the exception of the exports and the capital (net) item for

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\(25\) As noted under Table IV, the imports and exports figures for 1956 were estimated. The 10 per cent rise would seem to be adequate according to a recent report which states that petroleum exports rose 12 per cent during the first half of the year and 14 per cent during the last six months. Refer to United States Department of Commerce, *Foreign Commerce Weekly*, May 13, 1957, p. 33.
the first two years of this study. This result infers that the authorities must feel assured that large oil exports will continue, otherwise some of the items would tend to be reduced during the latter part of the period. Yet, nearly every item has progressively risen throughout the period considered in this survey.

The two main items in terms of size are the imports and investment income. Together they constitute an overwhelming portion of the total debit balance. Imports have risen in every year considered and, during the five-year period, have risen to the extent of 59.4 per cent.

The investment income item showed the same upward tendency. A debit balance revealed by this item is considered normal for countries which are in a state of underdevelopment. Nevertheless, the figures indicate a substantial rise for Venezuela, and may not be considered as indicative of a prudent accomplishment unless the exports of oil in the future are maintained on a plane at least equal to their present level, or even higher.

During the period under study, the investment income item has shown a persistent rising debit balance

---

The item capital (net) refers to that part of the Donations Account which consists of goods and services and, therefore, is charged to the Current Account. This explanation may be found in the Central Bank of Venezuela, Memoria, 1955, p. 165.
which amounted to a 47.9 per cent increase between 1952 and 1956. The only year in which the investment income item registered a decline was 1953, and it was then less than 20 millions of bolivares. No doubt foreign investment in petroleum and other industries has contributed a good deal to the larger debit balances of this item. The extent of the nation's ability to diversify its investment outlets rapidly will determine whether or not the amounts shown at the present time can be repaid in the future.

Table V, page 209, is constructed for the purpose of showing the aggregate current account figures. This table constitutes the total current receipts and expenditures which include the petroleum industry's contribution.

It is quite apparent from this table that the exports of petroleum made possible the credit balances in four out of the five years included in this survey. Page 209 shows the yearly percentage changes of oil exports as compared to the yearly percentage changes of total imports. This comparison should reveal the capability of oil exports to support the rising demand of the nation for imports. The absolute figures for oil exports and total imports show that the former was approximately double the latter during the last five years.
TABLE V

IMPORTS AND EXPORTS OF VENEZUELA INCLUDING FOREIGN OWNED OIL COMPANIES
(in millions of bolivares)

<table>
<thead>
<tr>
<th>Item</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports, f.o.b.</td>
<td>4,864.9</td>
<td>5,071.9</td>
<td>5,603.5</td>
<td>6,374.4</td>
<td>7,191.9</td>
</tr>
<tr>
<td>Imports, f.o.b.</td>
<td>-2,615.7</td>
<td>-2,857.9</td>
<td>-3,193.9</td>
<td>-3,372.5</td>
<td>-3,709.8</td>
</tr>
<tr>
<td>Transportation and insurance</td>
<td>285.7</td>
<td>312.9</td>
<td>376.9</td>
<td>399.4</td>
<td>439.4</td>
</tr>
<tr>
<td>Investment income</td>
<td>-1,374.2</td>
<td>-1,355.7</td>
<td>-1,522.3</td>
<td>-1,847.9</td>
<td>-2,032.7</td>
</tr>
<tr>
<td>Capital</td>
<td>237.9</td>
<td>169.2</td>
<td>-71.7</td>
<td>66.7</td>
<td>73.3</td>
</tr>
<tr>
<td>Other services</td>
<td>-173.9</td>
<td>-216.7</td>
<td>-236.2</td>
<td>346.4</td>
<td>381.0</td>
</tr>
<tr>
<td>Other</td>
<td>-273.4</td>
<td>-207.8</td>
<td>-217.4</td>
<td>-175.4</td>
<td>-192.9</td>
</tr>
<tr>
<td>Balance</td>
<td>439.9</td>
<td>290.1</td>
<td>14.9</td>
<td>166.1</td>
<td>362.8</td>
</tr>
</tbody>
</table>


aAll items except exports and imports represent net figures.

bOil exports estimated at a rate of 13 per cent. All other items at a rate of 10 per cent.

<table>
<thead>
<tr>
<th></th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports, oil</td>
<td>6.7</td>
<td>3.2</td>
<td>9.5</td>
<td>14.6</td>
<td>13.0</td>
</tr>
<tr>
<td>Imports, total</td>
<td>11.8</td>
<td>15.0</td>
<td>11.8</td>
<td>5.6</td>
<td>10.0</td>
</tr>
</tbody>
</table>

A definite pattern is indicated by the above percentages. On the one hand, oil exports increased by 6.7 per cent in 1952, rose by over 3.2 per cent in 1953, and, in 1954, ascended by 9.5 per cent. On the other hand, imports shot upward by 11.8 per cent in 1952, moved even higher in 1953 which shows a 15.0 per cent rise, and, in 1954, increased by 11.8 per cent over 1953, the same percentage rise as that of 1952. The year 1954 seemed to be
a breaking point, since after that year oil exports rose rapidly in both of the following two years. Imports increased but at a much smaller rate in 1955. However, the estimated percentage rise in 1956 was somewhat larger.

In a relative sense, exports of petroleum have risen at a more rapid rate in the latter years of this survey than have total imports. In other words, the rising oil output has been large enough to support the growing imports. To say that this fortunate trend will continue would be only conjecture. Its continuation will depend upon political as well as economic decisions on the part of other nations, including the United States, along with those made in Venezuela.

A few comments should be made in connection with the debit balance on current account which appeared in 1954. The figures in Table V show that imports and exports have been rising up to and including the year 1954. Because of the total commodity rise, the service items would be expected to increase too. This they did as is shown by a glance at Table V. In addition, it was found that petroleum exports rose at a slower rate than total imports. The result was that the rise of imports plus the increases in the service items exceeded the increase of exports in 1954. Thereafter, the relative increase of exports was more than sufficient to offset the rise of
imports and the service items taken together. One should further keep in mind the fact that exports, exclusive of petroleum, have been rising steadily. The figures indicate that these exports increased by approximately 79.3 per cent from 1952 through 1956 (see Table IV, page 206). The reasons explaining why these exports have been increasing in recent years are presented in a later portion of this chapter (see page 262 ff.). At this point, it will suffice to state that export prices for coffee and cocoa were pegged. In addition, a portion of the export tax levied on petroleum was used to subsidize the production of coffee, cocoa, and perhaps other products. World prices were sufficiently high to encourage the production of coffee and cocoa for export. Finally, iron-ore deposits are being exploited on a larger scale facilitating an increasing quantity for export.

A survey of the current account of Venezuela's balance of payments has presented some interesting results. No doubt the flow of funds as represented by the capital account will be equally revealing. The task at hand is to describe the capital account items.

Table VI, page 212, shows the capital account items and their directional movements. All positive items

---

Information was not available for 1956. Taking into consideration the erratic movements of capital, it was considered unwise to employ estimates for that year.
represent inward movements of capital or negative lending (borrowing), or return on loans made. The minus items indicate outward flows of capital or positive lending, or the repayment of previous borrowings.

**TABLE VI**

CAPITAL ACCOUNT OF VENEZUELA
(in millions of bolivares)

<table>
<thead>
<tr>
<th>Item</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term</td>
<td>279.7</td>
<td>305.3</td>
<td>265.5</td>
<td>159.5</td>
</tr>
<tr>
<td>Private</td>
<td>267.7</td>
<td>305.5</td>
<td>290.4</td>
<td>170.9</td>
</tr>
<tr>
<td>Official and bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export-import</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>bank loans</td>
<td>16.4</td>
<td>11.0</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Amortization</td>
<td>- 4.4</td>
<td>- 10.7</td>
<td>9.4</td>
<td>5.4</td>
</tr>
<tr>
<td>Purchase of foreign</td>
<td>---</td>
<td>---</td>
<td>- 15.7</td>
<td>- 6.0</td>
</tr>
<tr>
<td>investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term</td>
<td>-234.5</td>
<td>-151.1</td>
<td>78.4</td>
<td>-171.5</td>
</tr>
<tr>
<td>Official and bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td>- 12.1</td>
<td>- 10.7</td>
<td>- 15.1</td>
<td>32.2</td>
</tr>
<tr>
<td>Foreign assets (increase -)</td>
<td>-222.4</td>
<td>-140.4</td>
<td>93.5</td>
<td>-203.7</td>
</tr>
<tr>
<td>Balance</td>
<td>45.2</td>
<td>154.7</td>
<td>343.7</td>
<td>- 12.0</td>
</tr>
</tbody>
</table>


The long-term movements of capital were inward on balance in every year considered in this study. This directional movement of funds appears quite logical in the case of an underdeveloped country. Nevertheless, the trend seems to be one of reduced inflows of capital as one views the figures from 1952 through 1955.

Private long-term capital constituted the bulk of total long-term capital movements. The amortization of
the Export-Import Bank loans was nearly completed by the end of 1955. Loans from the Bank during the years 1951 through 1953 totaled 33.4 millions of bolivares while the amortization payments over the same period amounted to 31.9 millions of bolivares, leaving only 1.5 millions of bolivares to be amortized.\textsuperscript{28}

The purchase of foreign securities on the part of Venezuela has amounted to 21.7 millions of bolivares between 1952 and 1955. Although precise figures were not available, the larger portion of long-term foreign investment probably consisted of United States Government securities.\textsuperscript{29}

The short-term capital account showed a net outflow of capital from Venezuela in three of the four years surveyed. In 1952 the outflow of short-term funds was offset by an increase of foreign assets. In other words, the capital was employed in the purchase of stocks, bonds, or other assets, including foreign currency, bank deposits,

\textsuperscript{28}The 1951 Export-Import Bank loan figure was 6 millions of bolivares, and amortization amounted to 2.0 millions of bolivares. See the International Monetary Fund, \textit{International Financial Statistics}, January, 1957, p. 233.

or brokerage balances amounting to 222.4 millions of bolivares. In addition, non-residents withdrew their net bank deposits in Venezuelan banks to the extent of 12.1 millions of bolivares. The total short-term outflow as revealed by the two above accounts amounted to 234.5 millions of bolivares.

The following year, 1953, showed a similar short-term capital outflow which totaled 151.1 millions of bolivares. At the end of 1954 the short-term balance was positive; that is, a net inflow of short-term capital took place. This inflow was possible since Venezuela's foreign assets declined. This meant that the government or banks either sold some of their holdings of foreign stocks, bonds, or other assets, or they reduced their holdings of foreign currency, bank deposits, or brokerage balances abroad in an amount of 93.5 millions of bolivares. Furthermore, foreigners withdrew their bank deposits on balance in Venezuela again in 1954 by about 15.1 millions of bolivares.

The short-term minus balance at the end of 1955 indicated a different situation which led to an outflow of short-term capital totaling 171.5 millions of bolivares. Foreign assets rose by 203.7 millions of bolivares while short-term liabilities also increased by 32.2 millions of bolivares.
In summarizing the short-term capital items one finds that total liabilities changed by only 5.7 millions of bolivares, that is, foreign bank deposits in Venezuela declined on balance by the above amount. On the other hand, foreign assets held by the government and banks in Venezuela rose some 473.0 millions of bolivares.

To conclude the capital account survey, it may be stated that there was a positive balance in every year except 1955. During the first two years, 1952 and 1953, the long-term capital inflows were larger than the short-term capital outflows. In 1954, both long- and short-term capital movements were inward on balance. Finally, the long-term capital inflow was larger than the short-term capital outflow in 1955.

As will be shown at a later point, the current and capital account balances must be offset by the unilateral account or gold movements in order to provide an equilibrium in the balance of payments.

Now that the analysis of Venezuela's current and capital accounts has been completed, it is possible to examine the state of international equilibrium of that country. The procedure employed will be to analyze the various factors with the exclusion of the petroleum industry's contribution to the country in order to find out whether or not the domestic sector was able to achieve
a condition of international equilibrium. After that analysis is completed, the contribution of the oil industry will be included for the purpose of determining the actual state of international equilibrium.

The discussion of this phase of international equilibrium will be short. There is justification for brevity in this instance since the situation to be described is not actually found within Venezuela. However, some degree of benefit should be forthcoming from a consideration of the domestic sector because if that sector is contributing to greater disequilibrium, then those persons in responsible positions should not hesitate to do all they can to develop the nation on a broader basis. In addition, this discussion will indicate the approximate importance of the petroleum industry to the nation as a whole.

Before getting under way, a note of caution should be mentioned. It is possible that the figures to be presented may not be entirely free of the impact of the oil industry. In fact, it was mentioned earlier (pages 186 and 188) that saving figures include those of the oil companies. Furthermore, some portion of the capital

---

account may involve flows of funds created by the oil industry. The same reasoning holds true in connection with the movements of gold and foreign exchange.

An examination of Table VII indicates that actual saving was in excess of actual investment from 1952 through 1954. Thereafter, the nation encountered an investment surplus. In the external sector imports were greatly in excess of exports during the whole period.

### TABLE VII

**THE INTERNATIONAL EQUILIBRIUM OF VENEZUELA EXCLUDING FOREIGN OWNED OIL COMPANIES**

(in millions of bolivares)*

<table>
<thead>
<tr>
<th>Year</th>
<th>National Product</th>
<th>Saving(S)- Investment(A) Balance</th>
<th>Lending Balance (4-inflow)</th>
<th>Import(M)- Export(E) Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>13,370</td>
<td>S &gt; A 1,321</td>
<td>← - 45.2</td>
<td>M &gt; E 3,546.0</td>
</tr>
<tr>
<td>1953</td>
<td>14,127</td>
<td>S &gt; A 920</td>
<td>← 154.7</td>
<td>M &gt; E 3,971.1</td>
</tr>
<tr>
<td>1954</td>
<td>15,507</td>
<td>S &gt; A 920</td>
<td>← 543.7</td>
<td>M &gt; E 4,804.1</td>
</tr>
<tr>
<td>1955</td>
<td>16,282</td>
<td>A &gt; S 482</td>
<td>→ 12.0</td>
<td>M &gt; E 5,334.2</td>
</tr>
<tr>
<td>1956</td>
<td>17,096</td>
<td>A &gt; S 545</td>
<td>... a</td>
<td>M &gt; E 5,867.5</td>
</tr>
</tbody>
</table>

Source: Table I, page 187; Table IV, page 206; and Table VI, page 212.

*Monetary conversions were made at the official rate of 3.35 bolivares per dollar.

*aInformation was not available.

The lending factor was relatively small in amount throughout the period, and it revealed a change in directional flow in 1955.

The saving balances during the first three years
amounted to 1,321 millions of bolivares in 1952 and 920 millions of bolivares in both 1953 and 1954. Since these were excesses of saving, it might be assumed that an equality between saving and investment could be realized should there be an outflow of capital in an amount equal to the above saving surpluses. The lending balances show, however, that capital moved inward. This directional flow of capital had the effect of aggravating the imbalance already created.

In order to ameliorate the domestic condition which ordinarily accompanies a saving excess, monetary policy would have needed to be expansive with the banking system providing for a downward revision of quantitative controls and a reduction of bank interest rates. Accordingly, fiscal policy would have called for a decrease in taxation and a rise in government lending, among other measures.

Monetary and fiscal policy together would have required a maximum expansion amounting to approximately 3,704.5 millions of bolivares. This figure represents the summation of the lending balances plus the saving excesses during the three-year period. However, a rise

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31 It is possible that some portion of the inflow of capital would have been utilized directly in investment endeavors. Monetary and fiscal policy could have been moderated if this were the case.
in money and credit of this magnitude would probably have raised costs and prices a good deal, and would have forced savings to even greater heights.

The external sector indicated an excess of imports during the first three years of this study (1952-1954). Table VII shows that the import balances totaled about 12,321.2 millions of bolivares for those years. The negative lending balances amounting to 543.6 millions of bolivares were too small to cope with the vast import surplus. Consequently, a rapid drainage of gold and foreign exchange would have taken place.

Internal conditions changed in 1955. Investment was larger than saving by approximately 422 millions of bolivares. This investment gap would have been closed through the inflow of capital (negative lending) equal to the above figure. Nevertheless, lending was positive and an outward flow of capital was encountered to the extent of 12 millions of bolivares.

Monetary and fiscal policy could have helped close the domestic gap through appropriate contractive measures which would have included an upward revision of quantitative and qualitative controls, a rise of bank interest rates, an increase in taxation, stepped-up government borrowing, and so on. Yet, such a reversal of policy would not have been easy to instigate and, furthermore,
the problem which evolved in the external sector would have perhaps prevented these contractionist measures from becoming effective.

Imports continued to be excessive in 1955. The figures in Table VII indicate the approximate amount to be 5,334.2 millions of bolivares. This balance would have called for negative lending, or an inflow of capital. Since lending was positive by 12 millions of bolivares, the inflow that would have been needed to balance the import-export items amounted to 5,346.2 millions of bolivares. However, since the inflow of capital was not forthcoming, gold and foreign exchange would have left the country again at the end of 1955.

The withdrawal of foreign exchange reserves of this magnitude, that is, approximately 15 times as large as total exports, would probably have created extensive borrowing and deficit financing in order to provide additional funds to satisfy foreign commitments.

A summation of the findings may now be presented. Negative lending (inflows) throughout the first three years would not have provided a balance between either saving and investment in the domestic sector or imports and exports in the external sector.

Monetary and fiscal policy would probably have contributed to extremely high prices because the rise of
real investment would have required a greater expanse of
time in an underdeveloped nation. Externally, the loss of
gold and foreign exchange would probably have created a
demand for depreciation of the currency.

At the end of 1955 lending also failed to offset
the saving-investment balance as well as the import-export
balance. The apparent heavy loss of gold and foreign
exchange would probably have created adverse effects upon
monetary and fiscal policy of a contractionist nature.

The following year, 1956, was similar to that of
1955 except for the fact that the internal improvement via
a smaller investment balance was more than offset by a
larger import balance. Although the lending figure was
not available, it is reasonably safe to assume that it
would not have created a balance between the internal or
external accounts. Monetary and fiscal policy problems
along with the external loss of gold and foreign exchange
would have been accentuated during the year.

It is safe to say that the national product and
income would have fallen during the period. There would
have been a possibility that the downward movement might
have been curtailed by the end of the period. This would
have depended upon the extent of success in applying moné-
tary and fiscal policy. Also, exchange depreciation would
have possibly been imposed, particularly if emergency
funds from abroad were not forthcoming.

This short survey of the domestic sector shows quite conclusively that there is a great need for further diversification of production. Should the petroleum market dwindle or some new invention or discovery lessen the need for petroleum, the domestic sector could not be expected to maintain a level of income anywhere near its present plane. The likelihood of a depression, inflation, or exchange rate modification would be a probable outcome.

In order to establish the current state of international equilibrium of Venezuela, the contribution of the petroleum industry should be included. Table VIII is constructed for the purpose of showing the aggregate contribution of the total economy.

**TABLE VIII**

**THE INTERNATIONAL EQUILIBRIUM OF VENEZUELA**
**INCLUDING FOREIGN OWNED OIL COMPANIES**
(in millions of bolivares)

<table>
<thead>
<tr>
<th>Year</th>
<th>National Product</th>
<th>Saving(S)</th>
<th>Investment(A)</th>
<th>Balance</th>
<th>Lending Balance (↔-inflow)</th>
<th>Import(M)</th>
<th>Export(E)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>13,370</td>
<td>S &gt; A</td>
<td>19</td>
<td></td>
<td>← 45.2</td>
<td>E &gt; M 439.9</td>
<td></td>
</tr>
<tr>
<td>1953</td>
<td>14,127</td>
<td>A &gt; S</td>
<td>56</td>
<td></td>
<td>← 154.7</td>
<td>E &gt; M 290.1</td>
<td></td>
</tr>
<tr>
<td>1954</td>
<td>15,507</td>
<td>A &gt; S</td>
<td>217</td>
<td></td>
<td>← 343.7</td>
<td>M &gt; E 14.9</td>
<td></td>
</tr>
<tr>
<td>1955</td>
<td>16,282</td>
<td>A &gt; S 1,572</td>
<td>→ 12.0</td>
<td>E &gt; M 166.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1956</td>
<td>17,096</td>
<td>A &gt; S 1,519</td>
<td>→ a</td>
<td>E &gt; M 362.8</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


*aInformation was not available.*
A few general comments concerning Table VIII seem to be in order before analyzing the factor changes which occurred in the respective years. Overall, the national product rose approximately 27.9 per cent, in current bolivares, that is, about 5.6 per cent per year. Investment (A) exceeded saving (S) in every year except 1952. Furthermore, the rise of the investment balance was quite abrupt beginning with the year 1954. The directional flow of the lending balance was inward for the first three years, then, in 1955, the item showed a net outflow of capital. Finally, one observes that exports were larger than imports four out of the five years under consideration.

Each year contains its own unique set of factor relationships; therefore, the analysis will proceed in a chronological sequence.

I

At the end of 1952 realized saving was larger than realized investment by about 19 millions of bolivares. Even though this was a moderate surplus, negative lending (an inflow of capital) moved in the opposite direction from that required to balance the saving-investment items. The summation of the lending balance, approximately 45 millions of bolivares, and the saving excess produced a domestic imbalance of about 64 millions of bolivares.
This is a small figure in terms of the national product totaling 13,370 millions of bolivares.

The rise of money and credit in circulation amounted to 435.9 millions of bolivares. Under this condition, the price level would be expected to rise somewhat. The index of wholesale prices indicates a small rise in the average level of prices amounting to 1.6 per cent for the year.

Exports were 440 millions of bolivares greater than imports. Lending, moving inward on balance, failed to close this gap. If the movement of capital is included in the calculation, the gap amounts to 485 millions of bolivares. This difference had to be offset by unilateral and gold movements, foreign exchange reserves, and the unaccountable portion assigned to errors and omissions. As for actual figures connected with such items, gold moved out to the extent of approximately 1 million of bolivares, donations left the country in an amount of about 64 millions of bolivares, foreign exchange reserves increased some 191 millions of bolivares, and the remaining negative balance of 613 millions of bolivares was

\[32\] Refer to Money and Credit of Venezuela, Appendix A, p. 279.

\[33\] See Index of Wholesale Prices in the Federal District, Appendix C, p. 282.
classified as errors and omissions.

The year 1952 was, in one sense, a turning point. Each subsequent year produced an investment surplus in the internal sector. A saving excess would normally explain a fall in the national product. However, the national product rose about 770 millions of bolivares during the present year. This rise is justified, in part, by reason of prior government expenditures which provided completed projects during the year, and of the large export surplus in the external sector. In addition, the national product figure would have been somewhat less than the figure shown if it were in terms of constant prices.

The export balance in 1952 was the largest accumulated in any one of the five years. Also, the Index of Import and Export Prices of Venezuela in Appendix C, page 232, reveals a 14.5 per cent rise in export prices between the base year, 1950, and 1952. Although a small amount of gold was exported, the gold and foreign exchange balance showed a net accumulation of 190 millions of bolivares.

II

The following year, 1953, produced an investment

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34 The national product was estimated at 12,600 millions of bolivares for 1951. The above figure represents a 6.1 per cent rise between 1951 and 1952.
surplus of some 56 millions of bolivares. Lending was inward on balance to the extent of 155 millions of bolivares. The correct directional movement of capital was greater, however, than that required to achieve an equilibrium between saving and investment. The influence of lending then had the effect of supplementing the apparent lack of saving to an amount greater than was required. The precise figure was 99 millions of bolivares (155 - 56).

It would appear that monetary and fiscal policy should have revealed a contractionist tendency. Nevertheless, money and credit, taken together, rose some 476 millions of bolivares. This expansion along with the lending balance provided funds amounting to 575 millions of bolivares.

In the external sector exports were 290 millions of bolivares larger than imports. The export excess required an outward directional flow of capital. Yet, lending was negative, or capital moved inward, as mentioned above. The export surplus plus the inflow of capital (155 millions of bolivares) produced an imbalance amounting to approximately 445 millions of bolivares.

The remaining accounts in the balance of payments, including the movement of foreign exchange, produced offsetting balances to equate the import, export, and lending figure of 445 millions of bolivares. To sum up the
balancing factors, gold was exported in an amount of 300,000 bolivares and donations indicated a net outward flow of 68.4 millions of bolivares. Foreign exchange reserves rose by about 143 millions of bolivares while the errors and omissions item accounted for a debit balance of some 519.3 millions of bolivares.

Overall, the year 1953 presented some unique relationships. Even though the national product rose, the amount was less than that for the preceding year. From a monetary standpoint, money and credit increased; however, the rise was less than that of the national product.

The average price level declined by slightly more than 3 points. Furthermore, both saving and investment fell, the former by more than the latter. The private and public sectors together contributed to the smaller saving balance while a reduction of petroleum investment expenditures explained the decline in private sector investment.35

The current account yielded a large credit balance again this year, and the net gold and foreign exchange account rose.

III

The saving and investment items were not equated

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35Refer to Table II, page 198, and to the investment figures given on page 199.
in 1954. Table VIII, page 222, shows that investment exceeded saving by some 217 millions of bolivares. In order to close this investment gap, lending should have been inward or negative on balance. The flow of capital was in the right direction, but the amount was larger than that required to produce a saving-investment balance. The 344 millions of bolivares of negative lending created an excess of 127 millions of bolivares internally.

The internal condition as indicated in the above paragraph is similar to that of the preceding year except that in the current year the investment excess was larger and the capital inflow was greater.

Money and credit in circulation rose by 544 millions of bolivares, a sum larger than last year. This figure, added to the 127 millions of bolivares mentioned above created additional funds representing a maximum amount of 671.0 millions of bolivares. The figures seem to indicate that monetary and fiscal policy should have been of a contractionist nature. Since such was not the case, prices should have risen. The average price did move upward but only to the relatively small extent of 2.7 points.

The experience in the external sector was very much different from that of last year, 1953. This year imports were greater than exports by a small amount, only 15
millions of bolivares. The import balance would lead one to believe that lending should be negative, that is that an inflow of capital should take place. The movement of capital was in the right direction in order to close the import gap. However, the capital movement was larger than that required to balance the external accounts. The excess totaled 329 millions of bolivares (344 - 15).

The external excess was accounted for in the balance of payments, including the foreign exchange reserve, in the following manner: gold moved inward to the extent of 101 millions of bolivares, donations indicated an outward flow of funds of about 72 millions of bolivares, while foreign exchange holdings declined by 97 millions of bolivares. The errors and omissions item made up the remaining debit balance of 261 millions of bolivares.

In conclusion, the year 1954 witnessed an investment excess. Lending, which moved in the direction necessary for closing the apparent investment gap, was too great. The result was a surplus of funds. Money and credit in circulation rose and further contributed to the supply of spendable funds.

The small import surplus which called for an inflow of capital resulted in a continued imbalance because the inward movement of capital was larger than that required
to create an import-export balance.\textsuperscript{36}

The gold and foreign exchange account remained nearly constant. The receipt of gold representing 101 millions of bolivares and the loss of foreign exchange amounting to 97 millions of bolivares created a net accumulation of 4 millions of bolivares.

Although money and credit in circulation rose, the national product increased by a larger amount (1,380 millions of bolivares). Investment expenditures of earlier years continued to produce more real capital. Of particular importance in the present year was the expansion in private sector investment. The figures shown on page 199 reveal that private and national enterprises increased their investment expenditures by more than 200 millions of bolivares. Furthermore, saving on the part of both the private and public sectors showed improvement.

The price level which rose by a few points resulted from the pressures exerted by the additional money and credit in circulation and the time interval required to produce goods and services.

IV

The year 1955 produced an abrupt variation in the

\textsuperscript{36}Total exports did not decline. However, the rise of imports accompanied by greater current investment (income) payments were largely responsible for the current account debit balance.
domestic sector. Table VIII, page 222, shows that investment was larger than saving by 1,572 millions of bolivares. Negative lending (borrowing) would have been required to close this large investment gap. Nevertheless, the flow of capital was outward by 12 millions of bolivares. Lending contributed, therefore, to the already large investment surplus which now approached the figure of 1,584 millions of bolivares.

The expansive effect of investment and lending would seem to emphasize the necessity of a contractionist monetary and fiscal policy. Yet, money and credit in circulation rose by 472.6 millions of bolivares. Nevertheless, the rise was not exceptionally large in comparison to the investment surplus. Furthermore, the price level increased by less than one point.

Externally, exports were in excess of imports by 166 millions of bolivares. The directional movement of lending, that is, an outflow of capital, was in the proper direction to close the export gap. However, positive lending amounted to only 12 millions of bolivares. There was, therefore, a net accumulation in the external sector amounting to 154 millions of bolivares (166 - 12).

Movements of foreign exchange and changes in the

\[37\text{See Money and Credit of Venezuela, Appendix A, p. 279.}\]
remaining balance of payments accounts offset the external accumulation mentioned in the preceding paragraph. To sum up these movements: donations indicated an outflow of capital to the extent of 76 millions of bolivares. Foreign exchange rose by approximately 145 millions of bolivares, while errors and omissions absorbed the remaining 223 millions of bolivares.

The year 1955 was one of marked changes which may cause a good deal of concern in the future. The most noticeable changes occurred in the domestic sector, which began with a large investment excess. Money and credit in circulation rose too. The price level was not responsive because of the constant accumulation of real capital which was made possible by reason of prior expenditures in both the private and public sectors. However, the current year investment expenditures of the national government rose quite sharply (see page 199). In addition, the large rise of private investment expenditures was forthcoming primarily from the national enterprises. The expenditures of these two bodies normally require a certain time interval before real capital is realized. This reasoning tends to explain why there existed a large investment gap in the current year.

^38Refer to the discussion of this subject matter on pages 200-201.
Nevertheless, the 775 millions of bolivares increase in the national product was larger than the rise of money and credit in circulation.

Another point to keep in mind is the fact that total saving declined in 1955. Even though private saving rose, public sector saving fell to a greater extent than the rise of the former (refer to Table II, page 198).

The excess of exports over imports presented a more normal occurrence. Although the export balance was not exceptionally large, it did contribute to the net accumulation within the gold-foreign exchange account. The rise in the export price index to 132.5 from the 1950 base year was partially responsible for the credit balance in the current account.

V

Unfortunately, the year 1956 does not present a complete picture of events.\footnote{Information which was not available includes the capital account (lending) figures, the amount and direction of unilateral payments (donations), and the balancing account figure—errors and omissions.} Internally, investment was larger than saving by some 1,519 millions of bolivares. This figure, though somewhat smaller than that of the preceding year, indicates the continuation of domestic spending. However, the expansion of money and credit in circulation amounting to 100.6 millions of bolivares was a good
deal less than that of 1955.\textsuperscript{40} Also, the national product increased by approximately 814 millions of bolivares.

The estimated rise of private and public investment expenditures revealed the exceptionally large participation on the part of the government and national enterprises. Nevertheless, private firms were found to be expanding at a rapid pace too.\textsuperscript{41}

In the external sector, exports exceeded imports by about 362.8 millions of bolivares. This excess is greater than that of any prior year with the exception of 1952.

Since both saving and investment increased during the year, it is quite evident that money and credit at the end of the year would have been larger than that given at the end of the first four months. No doubt the gold and foreign exchange holdings of Venezuela rose by the year's end.

Having completed the survey of the state of international equilibrium, a few statements by way of conclusion may be given.

The national product of Venezuela rose in every year included in this study. Investment (A) exceeded

\textsuperscript{40}This figure includes money and credit through the month of April only.

\textsuperscript{41}Refer to pages 196-197 for a discussion of the expansion of investment on the part of private enterprises.
saving (S) in four of the five years, while exports were greater than imports during every year except one.

Lending, as a balancing factor, failed to equate either the internal factors of saving and investment or the external accounts of imports and exports.

Money and credit in circulation increased some 2,029 millions of bolivares during the period under study. Nevertheless, the rise of the national product was of a greater magnitude, showing an increase of 3,726 millions of bolivares.

The above statement serves to explain, in part, why the average price level rose only 5.9 points throughout the period.

Total saving and investment rose generally during the five years. Saving faltered in two years, 1953 and 1955, while investment declined only in 1953.

The large investment excesses created during the last two years may pose a future problem for monetary and fiscal policy. In addition, the inflow of funds (lending) tended to create an even greater imbalance in the domestic and external sectors in some of the years. The normal inflow of capital contributed somewhat to the rise in the national product and partially to a larger supply of funds in circulation.

The preceding analysis has revealed many of the
changes that have occurred within Venezuela during the last five years. Although many of the problems have been mentioned, the following section is to deal primarily with the means employed to cope with these problems via monetary and fiscal policy and external policy.

II. SOME OBSERVATIONS ON INTERNAL AND EXTERNAL POLICY

The Venezuelan economy which represents a typical export economy is a good deal more complex than is perhaps realized. The reason for the apparent complexity from the standpoint of short-term stability is found in the numerous elements which play such an important role in determining the direction in which the economy is moving at a given time.

Incorporated within the private and public sectors there is the influence exerted upon the economy by the petroleum industry. Furthermore, the influence of the national entities must be given recognition. It is also realized that a country so dependent upon the external sector must be able to deal immediately with changes occasioned by the desires of other nations. This is a fundamental problem of all nations which depend to a large extent upon the world markets for a sizeable portion of their trade and income.

The dependence upon one industry for a relatively
large portion of the country's total export trade and national income further subjects that country to a more serious problem than if there were several industries to absorb external shocks. This is a current problem faced by Venezuela. In addition, the single industry dominating the external sector of Venezuela creates internal repercussions. In other words, not only is the public sector dependent upon the petroleum industry for a large part of its income, but the private sector also feels the shock caused by the variations in the oil industry's production and exportation.

The autonomous entities mentioned at an earlier stage (see pages 188-189) must co-operate with fiscal policy measures in order to assure success of their implementation.\textsuperscript{42} It is not an easy task to obtain the full co-operation of these institutions, especially since they have separate identities and are not subject to laws binding them to measures implemented by the National Treasury.

It is contended that fiscal policy has been applied to a far greater extent than has monetary policy to maintain economic stability in Venezuela. According to one report, fiscal policy is heavily relied upon to provide

both short-term and long run stability. It should be of some importance, therefore, to analyze the essential roles played by monetary and fiscal policy in this more recent period.

A. Monetary Policy

The Central Bank of Venezuela enjoys most of the powers attributed to such a bank. In Venezuela the Bank is the sole issuer of money, acts as a depository for the government, and possesses the ability to control, in certain respects, the supply of money and credit in circulation.

There is, no doubt, a closer relation between the national government and the banking system in Venezuela than in the United States since the government of the former nation owns one-half of the capital stock of the Bank.

The Central Bank has the authority to adjust discount and rediscount rates. It may advise the Executive Department with respect to changes in reserve requirements of the commercial banks. However, open market operation is not an important method of monetary control so far as the

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44United States Department of Commerce, Investment in Venezuela, p. 84.
Central Bank is concerned.

The Bank cannot make direct loans to the national government, and it cannot acquire securities or other obligations of the latter body except those quoted in the market. In other words, the government rather than the Central Bank utilizes these securities in order to influence the market.

At the end of 1955 there were 27 commercial banks in Venezuela. Fifteen of these were located in Caracas while the remaining twelve were scattered throughout the country.

The law requires commercial banks to keep a 15 per cent reserve behind sight deposits and an 8 per cent reserve behind time deposits. In addition, one-third of the required reserves must be on deposit with the Central Bank. Other important limitations include the following:

1. Total obligations not supported by special funds or guarantees may not be larger than six times the paid-in capital and reserves.

2. Holdings of foreign exchange and foreign securities may not be greater than 10 per cent of the paid-in capital and reserves.

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46 Central Bank of Venezuela, Memoria, p. 220.

47A more comprehensive coverage of commercial bank activities may be found in the United States Department of Commerce, Investment in Venezuela, pp. 84-85.
(3) Loans cannot extend beyond two years in duration while advances and discounts are limited to one year, and so on.

The dependence of a nation upon monetary policy as exercised through the Central Bank requires a certain amount of liquidity on the part of the Bank. The legal reserve of the Central Bank of Venezuela cannot be less than 50 per cent of its demand obligations. The figures below indicate that the reserves averaged 92.6 per cent of the current obligations for the five-year period.

<table>
<thead>
<tr>
<th>Year</th>
<th>Current obligations</th>
<th>Legal reserve requirement— 50% of current obligations</th>
<th>Actual reserve of Central Bank obligations</th>
<th>Actual reserve of current obligations as a % of current obligations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>1,423.7</td>
<td>711.35</td>
<td>1,326.7</td>
<td>93.2</td>
</tr>
<tr>
<td>1953</td>
<td>1,564.8</td>
<td>732.40</td>
<td>1,462.7</td>
<td>93.5</td>
</tr>
<tr>
<td>1954</td>
<td>1,625.3</td>
<td>812.65</td>
<td>1,453.7</td>
<td>89.4</td>
</tr>
<tr>
<td>1955</td>
<td>1,744.9</td>
<td>872.45</td>
<td>1,606.2</td>
<td>92.1</td>
</tr>
<tr>
<td>1956(May)</td>
<td>2,011.7</td>
<td>1,005.85</td>
<td>1,892.6</td>
<td>94.8</td>
</tr>
</tbody>
</table>

One other interesting comparison may be made for the sake of revealing the degree of liquidity of the Bank. The following figures, in millions of bolivares, show the ratio of gold to notes in circulation:

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48Ibid., p. 84.


Notes in circulation | Gold reserve | Gold as a % of notes in circulation
---|---|---
1952 | 1,000.8 | 1,140.8 | 114.1
1953 | 1,041.1 | 1,140.8 | 108.6
1954 | 1,121.3 | 1,233.0 | 110.0
1955 | 1,154.1 | 1,233.6 | 106.9
1956 (May) | 1,063.9 | 1,233.5 | 115.9

The total gold reserve has not fallen below 106.9 per cent of the total note circulation for the period covered by this survey. The above calculations emphasize not only the extreme liquidity of the Central Bank but also a good deal of conservatism on the part of the officials. The point is, however, that the Bank has maintained a high degree of liquidity with the aid of which it should have been able to direct a flexible monetary policy in such a way as to help provide for stability within the economy.

The reliance placed upon the Central Bank in the interest of stability in the domestic economy created by changes in the external sector may be expressed in terms of the variations of gold and foreign exchange as compared to changes in the money supply and credit extended by banks. The following figures (in millions of bolivares) show that during the first two years (1952-1953) gold and foreign exchange holdings rose some 328.5 millions of bolivares. On the other hand, money in circulation and

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51 See Money and Credit of Venezuela, Appendix A,
bank credit increased to a maximum figure of 919.5
millions of bolivares. This latter figure is well over
double the amount of the external earnings.

<table>
<thead>
<tr>
<th>Year</th>
<th>Change in gold and foreign exchange holdings--Central Bank</th>
<th>Change of money in circulation</th>
<th>Change in commercial bank credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>201.8</td>
<td>+263.4</td>
<td>+189.2</td>
</tr>
<tr>
<td>1953</td>
<td>126.7</td>
<td>+166.5</td>
<td>+300.4</td>
</tr>
<tr>
<td>1954</td>
<td>5.9</td>
<td>-102.9</td>
<td>+368.1</td>
</tr>
<tr>
<td>1955</td>
<td>158.9</td>
<td>+241.3</td>
<td>+300.4</td>
</tr>
<tr>
<td>1956</td>
<td>281.9(April)</td>
<td>+2.2(April)</td>
<td>+85.0(April)</td>
</tr>
</tbody>
</table>

In 1954 gold and foreign exchange declined by about
5.2 millions of bolivares. Yet, money and credit rose by
nearly the same yearly amount, that is, 472.0 millions of
bolivares.

Once again, in 1955, external earnings increased
approximately 158.9 millions of bolivares. The internal
expansion, however, amounted to more than three times the
rise of gold and foreign exchange earnings.

The incomplete data for 1956 indicate that the
281.9 millions of bolivares rise of gold and foreign
exchange was accompanied by a relatively small increase
of money and credit in circulation amounting to about
87.2 millions of bolivares.

Although the above comparisons must take into con-
sideration other pertinent factors such as the change in

p. 279; and the Balance Sheet of the Central Bank of
national income, variations in the price level, and so on, the internal shocks caused by yearly vicissitudes in the external sector were not smoothed out by action of the Central Bank.

To substantiate the case, the rise of gold and foreign exchange in the years 1952 and 1953 should have been offset through a reduction of money and credit in circulation. One would further expect that the decline of gold and foreign exchange accumulations in 1954 would be counteracted by a small rise of money and credit in circulation. Nevertheless, money and credit rose by a larger amount than that in either of the two prior years. In addition, the increases of gold and foreign exchange holdings during 1955 and 1956 were accompanied not by a decline of money and credit in circulation, as one would think, but with a rise of the latter amounting to nearly one and one-half times the total gold and foreign exchange inflow.

The inflexibility with respect to the application of monetary controls is quite evident as one reviews the period. The information at hand does not indicate a change in reserve requirements over the five-year period. The rate applicable to discounts and advances was 2 per cent.52

This rate has been in effect since 1947. However, one type of control exercised by the Bank revealed some flexibility. The Central Bank granted loans to autonomous entities upon the presentation of collateral. The rates on these loans moved from 6.4 per cent in 1951 to 7 per cent in 1955.53

There are perhaps many reasons which help to explain the relatively inflexible nature of monetary policy as a short-term expedient contributing to economic stability. Some of the reasons are offered at this point. Apparently, the officials of the Bank were not free to alter the various controls at their disposal. Instead, they had to recommend to the Executive their desire to make changes. The ultimate decision was, however, in the hands of the Executive.

Again, since inflation had not been a pressing problem in Venezuela, the authorities may have felt that there was little reason to create a contractionist tendency. Furthermore, any suppressive action might have slowed down economic development. In terms of objectives, the latter held a key position.

No doubt it was felt that fiscal policy may be so implemented that it could provide for both economic

53 Central Bank of Venezuela, Memoria, p. 229.
development and relative stability at the same time.

Before discussing some of the more important aspects of fiscal policy, a few comments should be made with respect to prices. As stated before, the price level of Venezuela, unlike those of many other countries, has not risen sharply. This is not to say, however, that prices were not high in the major cities. They were. The high price level was influenced primarily by the export (petroleum) industry on the one hand, and the relatively high prices paid for imports from the United States, and the internal shortage of many commodities on the other hand.

Wages and salaries of workers who were employed by the oil companies compared favorably with those of workers almost anywhere else in the world. Wage increases have been quite extensive in recent years. The last wage boost attained in October, 1956, amounted to 10 per cent and affected approximately 51,000 oil workers.

The price of most commodities tended to keep abreast of the rising wage trend. A few examples of retail food

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54 The average direct wage for oil workers is about seven dollars per day. Fringe benefits bring the average total to nearly fifteen dollars per day. Refer to Venezuelan Embassy, Venezuela Up-to-date, (November, 1956), p. 18.

55 Ibid., p. 17.
prices, although not current, will be sufficient:56

<table>
<thead>
<tr>
<th>Meat</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tenderloin</td>
<td>$1.30</td>
</tr>
<tr>
<td>Pork chops</td>
<td>1.20</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fruits and vegetables</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apples, imported</td>
<td>.15</td>
</tr>
<tr>
<td>Tomatoes, fresh</td>
<td>.40</td>
</tr>
<tr>
<td>Carrots, fresh</td>
<td>.35</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Dairy products</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Butter, local</td>
<td>1.20</td>
</tr>
<tr>
<td>Eggs, fresh</td>
<td>1.05</td>
</tr>
<tr>
<td>Eggs, imported</td>
<td>.90</td>
</tr>
<tr>
<td>Milk, pasteurized</td>
<td>.30</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Groceries</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bread</td>
<td>.30</td>
</tr>
<tr>
<td>Flour</td>
<td>.20</td>
</tr>
<tr>
<td>Sugar</td>
<td>.15</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Canned goods</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>String beans, peas, carrots</td>
<td>.75</td>
</tr>
<tr>
<td>Peaches, apricots, pears</td>
<td>.90</td>
</tr>
</tbody>
</table>

Price indices were based largely upon prices in Caracas, the capital, but sometimes included a few of the other large cities. Prices of most commodities, where available, were no doubt much lower as one proceeded into the interior of the country. In some sections barter was employed as a means of exchange.

One other aspect to consider in this section is that of savings of the general public.57 Savings deposits in


57 There are no savings banks in Venezuela. Commercial
commercial banks have been steadily rising, as the following figures show.\(^5\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Saving deposits (in millions of bolivares)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>233.7</td>
</tr>
<tr>
<td>1953</td>
<td>321.0</td>
</tr>
<tr>
<td>1954</td>
<td>419.0</td>
</tr>
<tr>
<td>1955</td>
<td>584.4</td>
</tr>
<tr>
<td>1956(April)</td>
<td>635.2</td>
</tr>
</tbody>
</table>

Though the amounts are quite small, the increase of commercial bank savings deposits amounted to 170.9 per cent during the five-year period. Smaller amounts of savings were deposited with other institutions such as the Agriculture and Livestock Bank and the Worker's Bank.

The rise of savings deposits is encouraging. However, the figures above indicate that a relatively small portion of the population had funds available for saving.

Savings through the purchase of stocks and bonds has been growing in recent years too. The securities exchange of Caracas began operations in 1947. The following figures reveal the growing trend of securities transactions.\(^5\)

and other kinds of banks provide saving facilities. See the United States Department of Commerce, Investment in Venezuela, p. 86.


\(^5\) The figures for 1952 were taken from the United States Department of Commerce, Investment in Venezuela, p. 87, and the figures for 1955 were obtained from the Central Bank of Venezuela, Memoria, p. 288.
Security listings included those of the government, government guaranteed bonds, and securities of numerous enterprises. A comparison of stock and bond transactions is of particular importance. Bonds were traded to a far greater extent than were stocks. This relation suggests that government and government guaranteed obligations predominated on the market. Also, the smaller stock-trading showed that private firms were not being financed to the same extent as were the government and quasi-public enterprises. Nonetheless, this outlet for savings was becoming more important as time passed. Its continued growth is essential for the expansion of privately owned firms.

B. Fiscal Policy

The two apparent objectives of fiscal policy are to encourage economic development and to maintain stability within the economy of the country. Since the utilization of monetary measures have not been very effective in recent years, an inquiry into the application of fiscal measures employed to carry out the aforementioned objectives will be undertaken.
The taxation policy appears to have been applied for the purpose of producing mixed results. The tax law which applied to individuals and most firms was incorporated within a section called the Supplementary Tax. The tax rate applied varied from 1.5 per cent on taxable income up to 10,000 bolivares (approximately $3,000) and ascended to 26 per cent on amounts earned in excess of 28,000,000 bolivares (about $8,500,000).\textsuperscript{60}

The progressive nature of the income tax indicated the desire to extract only small sums from the large group of low income earners. The higher rates in the larger income groupings were for the purpose of diverting large sums previously invested in land holdings.

The normal tax contained in the Venezuelan tax structure applied to income obtained from exploiting hydrocarbons, refining, transportation, and so on.\textsuperscript{61} This levy was a major one and pertained to the petroleum industry. The rate was a flat 2.5 per cent assessment on the net income derived from operations.

This tax seemed to be imposed for the purpose of maintaining a formidable contribution to the national budget. It also suggested an expected penalty imposed upon foreign owned firms.

\textsuperscript{60}Venezuelan Embassy, \textit{Venezuela Up-to-date}, (July--August), 1956, p. 12.

\textsuperscript{61}\textit{Ibid.}, p. 11.
A third major form of taxation was also associated with the oil industry. It was referred to as the Additional Tax. The idea behind its implementation was that of making sure that the government shared on an equal basis with the petroleum firms whenever there existed a taxable excess of the enterprises' profits after the normal tax had been deducted.62

Customs duties were levied primarily for protection, although the yield was quite high. Of the five groups of receipts contributing to the income of the national government, customs duties ranked third.63 Rates were low on the importation of machines, equipment, and some foodstuffs while the charges were extremely high on import competing products.

Other forms of taxation included the inheritance tax and commodity taxes imposed upon cigarettes, liquors, matches, and other such commodities.

The ability of the government to make large expenditures and yet create a balanced budget depends to a great extent upon the revenue obtained from the petroleum industry. The figures which follow (in millions of bolivares) emphasize the importance of the oil industry in providing revenue

62Ibid., p. 13

63See the Receipts and Expenditures of the National Government of Venezuela, Appendix B, p. 280.
for the Treasury. 64

<table>
<thead>
<tr>
<th>Item</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
</tr>
</thead>
<tbody>
<tr>
<td>Surface tax and royalties</td>
<td>826.4</td>
<td>904.5</td>
<td>1,034.4</td>
</tr>
<tr>
<td>Income tax</td>
<td>593.7</td>
<td>507.1</td>
<td>585.1</td>
</tr>
<tr>
<td>Customs duties</td>
<td>65.7</td>
<td>60.6</td>
<td>65.3</td>
</tr>
<tr>
<td>Others</td>
<td>112.0</td>
<td>25.7</td>
<td>29.3</td>
</tr>
<tr>
<td>Total</td>
<td>1,597.8</td>
<td>1,497.9</td>
<td>1,714.1</td>
</tr>
</tbody>
</table>

The total of the itemized taxes compared to total fiscal income of the government yields the following results:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total government receipts</th>
<th>Revenue derived from petroleum industry</th>
<th>Revenue of petroleum industry as % of total government receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953</td>
<td>2,533.5</td>
<td>1,597.8</td>
<td>63.1</td>
</tr>
<tr>
<td>1954</td>
<td>2,631.9</td>
<td>1,497.9</td>
<td>56.9</td>
</tr>
<tr>
<td>1955</td>
<td>2,994.9</td>
<td>1,714.1</td>
<td>57.2</td>
</tr>
</tbody>
</table>

These figures clearly reveal the dependence of the Treasury upon a single export industry. It is no wonder that economic development was a major objective of the authorities. Even though the oil industry carried on most of its trade with the United States, a recession or depression, or even a change in the tariff in the latter country could have created a serious depression in Venezuela.

A three-year period is almost too short a time period to make fully satisfactory comparisons; however, it may be possible to explain changes in the national budget which were caused by variations of oil revenues. The budget balancing figures were taken from Appendix B, page

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64 Central Bank of Venezuela, Memoria, p. 206.
and are expressed in millions of bolivares.

Year | Revenue derived from the petroleum industry | Budget receipt-expenditure balance (‡ surplus)
--- | --- | ---
1953 | 1,597.8 | 128.6 ‡
1954 | 1,497.9 | 39.1 ‡
1955 | 1,417.1 | 153.6 ‡
1956 | ---- | 10.0 —

There is a direct correlation between the changes in petroleum revenue and those of the receipt-expenditure balance. Of course, there are many items composing the expenditures of the government, and their variations have helped to bring about changes of the balancing figures; nevertheless, it seems reasonable to state that changes in petroleum revenues were one of the dominant causes of the variations in the surplus of the national government accounts.

The decline of petroleum revenue in 1954 amounting to 99.9 millions of bolivares was accompanied by a receipt over expenditure balance which was 89.5 millions of bolivares less than in 1953. Again in 1955, petroleum revenues fell by 80.8 millions of bolivares. The budget receipt balance rose that year, however, by 114.5 millions of bolivares. Yet, at the end of 1956 budget figures reveal an expenditure balance of 10.0 millions of bolivares. It appears reasonable, therefore, that the declining oil revenues influenced the downward trend of the budget balances.
The changes in oil revenues and total expenditures tended to relate the indirect importance of the petroleum industry to economic development. Reduced exports of petroleum would create the necessity of finding a new financial source for a portion of the economic development program. The ever-present threat of such necessity may be, in part, the reason why the tax structure of Venezuela has been more varied than that of many other underdeveloped nations.

Government deposits in the Central Bank were employed for the purpose of counteracting the increase in currency and credit in circulation. The deposits consisted of revenues derived from the petroleum industry, along with other sources mentioned above. The government created a special deposit reserve which consisted of a portion of its total deposit set aside in the Bank. The special deposit reserve tended to monetize a part of the total deposit. As money and credit in circulation changed, the government varied the size of its special reserve fund. The figures for the various years are presented along with the variations of currency in circulation.65 All the figures are expressed in millions of bolivares.

Year | Change of currency in circulation | Government special reserve deposits in Central Bank
---|---|---
1952 | 77.9 + | ----
1953 | 25.4 + | ----
1954 | 60.0 + | 19.5
1955 | 51.5 + | 108.5
1956 (April) | 76.5 - | 108.8

The emission of bills and coins have been quite moderate; yet, the rise has been constant during the last five years. Although special reserve deposit figures were unobtainable for the years 1952 and 1953, the intent of the government is quite clear. The figure of 19.5 millions of bolivares in 1954 represented one-half of the Treasury surplus. This meant that the government monetized, in effect, that portion of the surplus to counteract the emission of bills and coins.

The special reserve deposit balance at the end of 1955 was 108.5 millions of bolivares. This increase was considerably in excess of the rise of currency in circulation. Furthermore, the decline of bills and coins in circulation as of April, 1956, was not occasioned by a reduction of the special reserve fund. The latter rose slightly.

The increase of the special reserve deposit in the last two years (1955-1956) may be explained in terms of the rise of credit rather than changes of currency in circulation.

It appears, therefore, that variations of government
deposit reserves are part of a program to provide for stability on the one hand and to allow for economic development with moderate amounts of money and credit on the other. This particular device could not, by itself, achieve much success should the petroleum industry earnings decline abruptly.

Furthermore, a large expansion of expenditures in one or more areas would tend to drain away both the official and special reserve deposits. This may be occurring at the present time. It was found that government investment expenditures principally for development rose sharply in 1955 and 1956 (see Table II, page 198). Because actual expenditures may not be encountered for a short period of time, government deposits and the budget surpluses continued to rise. Yet, the large deposit balance in the Central Bank at the end of 1956 may start to decline in the following year. This movement seems to prevail in the case of the special reserve fund which declined from 108.8 millions of bolivares in April, 1956 to 72.6 millions of bolivares at the end of May of the same year. In addition, the surplus balance in the national accounts of the prior years turned into a deficit balance at the end of 1956. The point is that increased government spending

will prevent deposits and reserves in the Central Bank from acting as a buffer against changes of money and credit in circulation.

The autonomous entities are of special importance in helping to achieve the developmental goals of the nation. Nevertheless, they could pose a serious threat to economic stability.

During the period of this study, the national product has been constantly rising. Expansion in all sectors, though uneven, has been upward. Therefore, there is little opportunity to test the probable course of action which would have been taken by these entities if economic conditions presented violent fluctuations. Nevertheless, some important comments may be made concerning the autonomous entities:

It would probably have been impossible for the national government to stimulate economic development toward its present stage unless a deficit had accrued in one or more of the years considered in this survey.

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67 Autonomous entities are government owned enterprises. Their legal existence allows them to possess property and to finance themselves by selling securities in their own name. In addition, the Treasury has no control over their income and expenditures. Some examples of autonomous entities include the Venezuelan Development Corporation, the Agricultural and Livestock Bank, the State Railways Administration, the National Sanitation Institute, and the Venezuelan Navigational Company. Refer to the United States Department of Commerce, Investment in Venezuela, 1953, p. 82.
The autonomous enterprises engaged, however, in
development projects which tended to reduce the need for
national government expenditures in this area except for
guarantee obligations. These obligations accounted for
the indirect debt of the government. The following figures
indicate the rising trend of financing undertaken by the
autonomous entities. The government guaranteed debt
consisting of mortgages and bonds increased in 1955 from
between 2 to 3 times the 1952 level.

<table>
<thead>
<tr>
<th>Year</th>
<th>Government guaranteed obligations (in millions of bolivares)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952(June)</td>
<td>157.1</td>
</tr>
<tr>
<td>1954</td>
<td>461.1</td>
</tr>
<tr>
<td>1955</td>
<td>671.5</td>
</tr>
</tbody>
</table>

Hundreds of investors and perhaps thousands of
workers are directly connected with the numerous enter­
prises. Should a sizeable depression occur, workers would
probably suffer unemployment. The government could proba­
bly pay off its guarantee responsibilities if it were
forced to, but if the issues of these obligations continue
to rise at the present rate a later depression may cause
deficit financing on a broad scale. Furthermore, should
inflation develop, the cost of selling securities involved
in this financing would rise. In such event, the govern­
ment would probably be left holding the inflated securities.

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68 Refer to the United States Department of Commerce,
Investment in Venezuela, 1955, p. 83, and the Central Bank
of Venezuela, Memoria, 1955, p. 211.
The numerous and varied development projects carried on directly through the autonomous entities would seem to interfere, to some extent, with private enterprises. It is difficult to appraise the extent of this interference accurately. However, it would be interesting to see if a private firm could successfully carry on the activities of one of the autonomous enterprises. The Development Corporation of Venezuela has been boldly offering its holdings to private firms. A fairly recent announcement states that "... it will sell all holdings, cos. [companies], and farms owned by it if they can be better developed by private capital or do not satisfy the needs of economic development. ..."^69

Since these autonomous entities are not accountable to the Treasury or other ministry for their receipts and expenditures, it would probably be difficult to make comparisons between the operations of such enterprises and those of privately owned firms.

The basic criteria for judging the benefit received from autonomous enterprises is based upon long-term development and the utilization of economic resources. At this early stage of development almost any type of activity would be beneficial to the nation. However, as time

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elapses, cost differences will make their importance known.

Development through private firms constantly changes as cost and price varies. In this respect, private firms would tend automatically to develop the nation based upon comparative costs and prices. The later consequences of making accurate decisions now must depend upon the action of those who are responsible for setting the policy of the autonomous entities.

A balanced budget is essential not only for fostering economic development but as a stimulant to private sector expansion. Venezuela's budget surpluses in the first four years of the five-year period, abundant credit, and a high but relatively stable price level, have all aided in creating an atmosphere conducive to economic expansion. There is little wonder as to why private sector investment expenditures—national enterprises included—have approximately doubled (see page 199) during the period covered in this study. Furthermore, bank savings and security purchases on the part of the public were expanding at a favorable rate.

In summarizing this section on monetary and fiscal policy one must keep in mind the fact that the economy was in a state of progression throughout the period. This setting has not been very conducive to an analysis which
is intended to suggest the immediate steps necessary for remedying certain unfavorable influences such as a depression.

Although most of the usual controls employed by the banking system existed within the structure of the Venezuelan banking system, there has been much apathy with respect to their utilization. The absence of a powerful tool, open market operations, appears to have reduced the effectiveness of monetary policy. In addition, reserve requirements and loan and discount rates were held rigid throughout the period. Even though currency in circulation rose moderately, credit expanded about 18 per cent during the last two years of the period.

The requirement that the Central Bank officials must seek the approval of the Executive before they are able to implement policy changes seemed to reduce the effectiveness of monetary policy.

The liquidity of the Central Bank is unquestioned; therefore, it has been in a position to deal with short-term shocks created either at home or abroad. Nevertheless, the reliance upon stability and economic development appeared to be a manifestation of fiscal policy.

Various taxes were imposed in Venezuela during this period, but the revenue secured from the petroleum firms was the most important source of tax income.
The new tax law which went into effect in 1956 altered only slightly the existent rates; nevertheless, it did produce a simplification of the tax structure.

The income derived from the petroleum industry has helped to make possible budget surpluses. A comparison of the changes of petroleum revenues and variations of the national budget balances showed the extent of the repercussions in the public sector attributed to the single export industry.

Government deposits and special reserve funds in the Central Bank were used as stabilizing factors. As currency in circulation and credit rose the government monetized funds by increasing its official deposits and special reserve funds, particularly the latter.

The possibility of inflation which was evident in the last two years of the survey was not offset through increased deposit reserves in 1956. Instead, the government increased its investment expenditures and thereby contributed to the expansion. The decline of the special deposit fund and the budget deficit were evidence of the above fact.

The autonomous entities played a crucial role in economic development. Their existence, however, could cause a special problem for fiscal policy. Government guaranteed obligations of these enterprises were expanding
rapidly. If the trend continues and a depression or serious inflation sets in, the government may be required either to make good its guarantee or absorb these securities.

The autonomous enterprises rather than private enterprises seemed to direct economic development. This responsibility is a grave one since the manner in which they encourage or discourage the various industries will determine whether or not the nation will make the best use of its resources.

Private industry was assigned an important part in the development of the nation. The surpluses accumulated in the national budget produced a stimulative effect upon privately owned firms. This effect was quite pronounced as private investment expenditures increased over the five-year period.

C. External Policy

In Chapter I of this paper it states that there is only one income level at each exchange rate that would assure international equilibrium, given the rate of lending and the influence of monetary and fiscal factors.70 This statement suggests that the market forces would bring about

70Refer to Chapter I, p. 24.
the desired exchange through the operation of a freely fluctuating exchange rate system.

It also explains in Chapter I that some of the authorities who support the modern theory of international trade accept the proposition that it is justifiable for a nation to apply controls in the export sector in order to carry out internal adjustments of a short run nature.\textsuperscript{71}

The exchange rate system of Venezuela did not appear to support either of the two concepts presented above. The multiple exchange rate system operated by that country differed from a freely fluctuating system. Yet, the exchange control authorities did not rigidly control the application of exchange to the external sector. The following explanation of the exchange rate system will make this distinction more clear.

For the purpose of technical classification, Venezuela employed a multiple exchange rate system. Practically speaking, the exchange rates were not employed for the purpose of controlling the balance of payments.

The official exchange rate was established at 3.35 bolivares to one United States dollar.\textsuperscript{72} This rate

\textsuperscript{71}\textit{Ibid.}, pp. 32-33, and footnote 24.

\textsuperscript{72}The technical material explaining the exchange rate system was taken from the following sources: United States Department of Commerce, \textit{Investment in Venezuela},
prevailed throughout the five-year period. All exports were consummated, however, at a rate of 3.33 bolivares per United States dollar except those of petroleum, coffee, and cocoa.

Petroleum exporters converted their foreign exchange earnings into bolivares at a rate of 3.09 bolivares per dollar. This rate was effective in amounts up to a limit which was equal to the Central Bank's sales of foreign exchange during any one year. A lower rate of 3.046 bolivares per dollar was received by the oil companies for conversions of foreign exchange into bolivares which were in excess of the Central Bank's sales of foreign exchange during the year.

The exchange rate for coffee and cocoa exports was 3.33 bolivares per dollar with the provision that, should world prices decline by a certain amount, the coffee rate would rise to 4.80 bolivares to the dollar.

The exchange rate for cocoa was also pegged. If the world price fell below the fixed rate, cocoa exporters would receive 4.25 bolivares for every dollar surrendered to the Bank. On the other hand, if the world price rose above the fixed rate, cocoa exporters would receive 3.33

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bolivares per dollar.

The premium rate for coffee ranged from $12.00 per bag for inferior, unwashed coffee to $18.00 per bag for fine grade, washed coffee. In a similar manner, the premium rate was applied to cocoa exports if world prices fell below $29.00 per bag.

The exchange rate system also allowed for a partial premium payment should world prices for coffee range from $18.00 to $30.50. At prices above the latter figure no premium was allowed. In the case of cocoa, a partial premium was allowed if world prices for this commodity varied between $29.00 and $39.00. At higher world prices no premium was given. The cocoa exporters received the premium rate only during 1952 and 1953 while coffee exporters did not receive any premium between 1952 and 1956.

An export tax was applied to both coffee and cocoa whenever the world price rose above the fixed rates. This tax revenue along with a portion of the export tax levied on petroleum was used to subsidize coffee and cocoa growers.

On the selling side of the market, the Central Bank made foreign exchange available to importers and others who had payments to make at the official rate of 3.35 bolivares to the dollar. The only exception to this rate was allowed in the case of purchases of foreign exchange
by the government from the Bank. The rate for government purchases was 3.09 bolivares per dollar.

All purchases and sales of foreign exchange were carried on without restriction except that the petroleum companies were required to surrender their foreign exchange to the Central Bank.

Purchases and sales of foreign exchange between the Central and commercial banks were at a rate of 3.335 bolivares per dollar. The commercial banks (free market) purchased exchange from the public at 3.33 bolivares to the dollar and sold exchange to individuals at 3.35 bolivares per dollar.

This multiple exchange rate system of Venezuela produced various results. Most foreign exchange transactions were accomplished without restriction. In addition, the general buying and selling rates were extremely narrow (3.33 to 3.35 bolivares to the dollar). These features are characteristic of a freely fluctuating exchange rate system in which there are no restrictions and the buying and selling rates are nearly identical.

On the other hand, the exchange rate system resembles an exchange control system with different rates and compulsive sales of the bulk of foreign exchange entering the country. However, this situation applied only to the oil companies.
The pegging of exchange rates in terms of world prices is a practice which one may expect to find within a strict exchange control system for the purpose of stimulating certain industries. In Venezuela that practice was limited to only two products. Furthermore, the high world prices in recent years resulted in little use of the pegging process.

The application of some fiscal policy measures was evident in the operation of the multiple exchange rate system. Export taxes were applied in order to subsidize certain favored commodities for export (coffee and cocoa). Also, the government (through the Central Bank) realized additional revenues from the difference between the price of its purchases of foreign exchange from the petroleum firms (3.09 and 3.046 bolivares per dollar) and its sales of foreign exchange to the commercial banks and others (3.335 and 3.35).

From a monetary standpoint, the Central Bank was assured a constant source of supply of foreign exchange, since the petroleum firms were forced to sell their exchange to this one institution in order to satisfy their local currency needs. Consequently, the Bank not only acquired foreign exchange, but it obtained its holdings at a low rate of exchange.

The official and free rates of exchange were
maintained throughout the five-year period of this study. It does not appear that Venezuela's multiple exchange rate system was employed for the purpose of controlling the external sector. As was mentioned earlier in this study, the country has no balance of payments problem as such. Of course, there would be a serious problem if the petroleum industry were to lose its dominant position. However, the exchange rate system seemed to be used for the purpose of aiding internal stability.

The question may be posed: how important was the external sector to the development of the nation over the ensuing five-year period? A partial answer to this question has already been given in various sections of this chapter. For example, it was found that the domestic sector could not maintain the given levels of national production and income without the contribution of the external sector. Furthermore, internal sector development depended primarily upon export income. Finally, it was shown that the financial stability of the country was contingent upon the activities in the external sector.

A few more points bearing upon an answer to the question stated above may be added to those already given. The relatively favorable international standing of Venezuela made it possible for the country to receive outside capital. More important still, the nation could perhaps make use of
additional foreign investments in order to develop the country more rapidly.

The following figures specifically indicate, in millions of bolivares, the relative size of export income in relation to the national product. The export income constituted a formidable contribution to the national product. The overwhelming portion of export income consisted of exports of the petroleum industry.

<table>
<thead>
<tr>
<th>Year</th>
<th>National product</th>
<th>Export income</th>
<th>Export income as % of national product</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>13,370</td>
<td>4,865</td>
<td>36.4</td>
</tr>
<tr>
<td>1953</td>
<td>14,127</td>
<td>5,072</td>
<td>35.9</td>
</tr>
<tr>
<td>1954</td>
<td>15,507</td>
<td>5,604</td>
<td>36.1</td>
</tr>
<tr>
<td>1955</td>
<td>16,282</td>
<td>6,374</td>
<td>39.1</td>
</tr>
<tr>
<td>1956</td>
<td>17,096</td>
<td>7,192</td>
<td>42.1</td>
</tr>
</tbody>
</table>

The above calculations help to explain why the year 1953 was less prosperous than the remaining four years. It may be recalled that the national product rose by its smallest amount in 1953 (757 millions of bolivares). This was the only year included in the survey in which both saving and investment declined. The larger portion of the smaller total saving was attributed to the private sector. Even though public sector investment rose, the fall of private sector investment was more pronounced. Furthermore, the petroleum industry was responsible for the

73See the International Monetary Fund, International Financial Statistics, January, 1957.
reduced investment expenditures.\textsuperscript{74}

The figures clearly reveal that the rise of export income in the year 1953, 207 millions of bolivares, was the smallest realized during the period. In other words, the failure of the petroleum companies to increase domestic investment was influenced somewhat by the smaller expansion of export earnings. In addition, the smaller increase of export income contributed to the smaller rise of the national product at the end of the year. This finding is evident from the percentage figure (35.9), page 269, representing the relationship between the increases of export income and the national product of 1953 and those of the other four years.

Imports are vital to the country from the standpoint of both consumption and capital expansion. According to figures taken from an official source, capital goods imports averaged about 64 per cent of total commodity imports. The following figures indicate the percentage division between consumption and capital goods imported during the four-year period (1952-1955).\textsuperscript{75}

\textsuperscript{74}Refer to Table II, page 198, and the discussion which follows.

\textsuperscript{75}See the Central Bank of Venezuela, \textit{Memoria}, 1955, p. 145.
The small remainder in each instance consisted of imports by the Federal Government. The figures reveal small differences in relative imports between the two groups of commodities. However, the larger portion constituted vital capital goods which seemed to be in keeping with the major objective of economic development.

The final comments in this area will pertain to the terms of trade of Venezuela. This would seem proper because the terms of trade relate to many influences, internal and external, which are brought together and connoted by a single expression.

Although figures were unavailable for the last year of this survey, 1956, some interesting comments may be presented. The base year employed was 1950, and the changes in the figures refer to yearly variations beginning with 1952.\textsuperscript{76}

<table>
<thead>
<tr>
<th>Year</th>
<th>Δ Imports</th>
<th>Δ Exports</th>
<th>M+E (-unfavorable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>8.2 +</td>
<td>3.7 +</td>
<td>-2.22</td>
</tr>
<tr>
<td>1953</td>
<td>3.4 -</td>
<td>5.5 +</td>
<td>.62</td>
</tr>
<tr>
<td>1954</td>
<td>3.0 +</td>
<td>4.2 +</td>
<td>.71</td>
</tr>
<tr>
<td>1955</td>
<td>1.4 -</td>
<td>8.2 +</td>
<td>.17</td>
</tr>
</tbody>
</table>

\textsuperscript{76}Ibid., p. 152.
It was found that only one year, 1952, produced an unfavorable terms of trade. This meant that for each unit of goods imported 2.22 units of exports were given up in return. On the other hand, the three following years were characterized by either smaller price rises of imports than those of exports, or actual price declines.

Export prices dominated by petroleum products continued to move upward because of the rising demand for these products and the interruption of production in other areas of the world. Selectivity in the case of imports through the employment of a license system and the rising national demand for Venezuelan goods, along with the growing competition in world markets, all contributed to lower prices paid for imports.

Although favorable terms of trade prevailed in the last three of the four years included in this survey, volume changes should be taken into consideration as well. The index figures based upon the year 1950 represent yearly changes in millions of tons. 77

<table>
<thead>
<tr>
<th>Year</th>
<th>Changes of quantum index of imports</th>
<th>Changes of quantum index of exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>11.7 -</td>
<td>9.2 +</td>
</tr>
<tr>
<td>1953</td>
<td>5.9 +</td>
<td>4.1 -</td>
</tr>
<tr>
<td>1954</td>
<td>11.7 +</td>
<td>14.3 +</td>
</tr>
<tr>
<td>1955</td>
<td>17.7 +</td>
<td>10.4 +</td>
</tr>
</tbody>
</table>

77 Figures were taken from the Central Bank of Venezuela, Memoria, p. 123. The above figures were rebased for 1950 in order to provide for comparisons of other material on the same basis.
By comparing the volume changes with those of price changes shown on page 271, one finds a close parallel with respect to the import price—quantum data. For example, the price rise of imports in 1952 amounting to 8.2 points was occasioned with a decline in commodities imported by 11.7 points. Conversely, the fall of import prices in 1953 by 3.4 points brought a rise of imports of 5.9 points. Yet, the price increase of imports for the year 1954 amounting to 3.0 points was accompanied by a 11.7 point rise of goods flowing into the country. But in 1955 the small price decline of 1.4 points was more than matched by a 17.7 point rise of imports.

Price and volume changes were quite sensitive and tended to move in opposite directions. This movement infers that importers acted quickly whenever prices varied. The licensing system, which is not extensively employed, suggested, however, that the authorities were using keen judgment with respect to keeping the current account of the balance of payments in a favorable condition.

The only year in which the price and quantum indices did not move in the opposite direction was 1954. An explanation as to why both prices and volume rose would seem to be related to the greater improvement of economic activity after the slower expansion which characterized the previous year. The rapid increase of investment expenditures in
1954 as shown in Table II, page 198, required a greater amount of imports. The result was that even though the price index rose 3.0 points, imports flowed into the country in larger volume.

The price and quantum indices of exports increased together in each year concerned except 1953. The continued demand for petroleum and the rise of exports of iron ore and coffee tended to explain this favorable condition.

The reduction in the quantum index amounted to 4.1 points in 1953. This result could be expected since there was a sharp reduction of petroleum investment expenditures during the year. This point was developed more fully on pages 269 and 270 in connection with export income contributions to the national product.

SUMMARY

A state of international equilibrium was not achieved in the case of Venezuela in any one of the five years under consideration. The analysis of the equilibrium condition, ignoring, as far as possible, the influence of the external sector, revealed that the national product (income) would have declined throughout the period. There was, however, a possibility that the downward movement would have been curtailed by the end of the five years under study. Although there is evident need for greater diversification in
production, the survey indicated that a good deal of expansion has already occurred.

The inclusion of the petroleum industry in the study showed that a state of international equilibrium was not maintained principally because of the constant rise in the national product and the inability to produce an equality between saving and investment on the one hand and imports and exports on the other hand.

The major objectives seemed to have been those of economic development and financial stability. The oil industry provided the greatest source of the direction that was necessary in carrying out the objectives.

The exceptional stability of the period would seem to be quite unusual in a nation which is underdeveloped. Nevertheless, considering the period as a whole the national product rose by a greater extent than did money and credit in circulation. The price level was prevented, therefore, from encountering extreme vicissitudes.

The autonomous entities appeared to take the lead in directing economic development. Their close connection with the Federal Government on the one hand and the need for rapid expansion on the other hand, provided many new completed projects within the last five years.

The Federal Government seemed to carry on its objectives in the capacity of a moderator. The force of
moderation was created, primarily, through fiscal measures. It allowed expansion to be pursued chiefly by the autonomous entities via guaranteeing the latter's securities. However, the government provided extra stimulation whenever it was felt desirable. A case in point was the extra-large expenditures in 1955.

In addition, the Federal Government maintained a surplus in its national accounts during four of the five years of the survey. Private enterprises were stimulated to a certain extent by this policy. Other measures were instigated for the purpose of stimulating the private sector; such as, a low rate of taxation and abundant credit.

Fiscal policy was employed to a greater extent than monetary policy. Although the Central Bank appeared to maintain a high state of liquidity and possessed most of the instruments of control, the banking authorities used their resources to only a minor degree. Perhaps the control of the Federal Government over the Central Bank and the relative prosperity of the period explain the minor role assigned to monetary policy.

Variations in the official deposits and particularly the special deposit reserve funds appeared to be a major instrument of fiscal policy. Other important fiscal measures were the indirect debt created through loans to autonomous entities and the utilization of petroleum
revenues.

External policy was dominated by a multiple exchange rate system. Nevertheless, this system incorporated features characteristic of a freely fluctuating exchange rate system. Most all foreign exchange transactions were accomplished without restriction, and the buying and selling rates were nearly identical.

The exchange rate system resembled an exchange control system with different exchange rates. Yet, the various rates were not applied for the purpose of controlling the external sector but to supplement internal stability. Quantitative devices were used to some extent in order to encourage internal development.

The system contained other features of exchange control. The petroleum firms were required to sell their foreign exchange earnings to the Central Bank. Although those earnings represented a large portion of the total foreign exchange entering the country, there were no other restrictions with respect to purchases and sales of foreign exchange.

The pegging of exchange rates for coffee and cocoa are normally practiced within a strict exchange control system. Nevertheless, recent high world prices resulted in little use of the pegging process.

External policy was closely related to fiscal policy.
Export taxes were applied in order to subsidize certain commodities for export. Furthermore, the Central Bank created additional revenue for the government through the different buying and selling rates levied on foreign exchange.

Venezuela, a nation which is representative of an export economy, has realized unusual economic progress in recent years. The petroleum industry made its influence felt in all sectors of activity. The reliance of the country upon this one industry places the whole economy in a precarious situation. This condition has been realized, however, and domestic development is expanding at a steady pace.

The long run outcome with respect to the degree of prosperity to be enjoyed by this country will depend quite largely upon the extent and direction in which it develops the internal sector, and also, of course, upon the general state of world prosperity.
## Money and Credit of Venezuela

### Money in Circulation

*(in millions of bolivares)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Currency</th>
<th>% of Total</th>
<th>Demand Total</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>1,613.4</td>
<td>818.0</td>
<td>50.8</td>
<td>795.4</td>
<td>49.2</td>
</tr>
<tr>
<td>1952</td>
<td>1,876.8</td>
<td>895.9</td>
<td>47.7</td>
<td>980.9</td>
<td>52.3</td>
</tr>
<tr>
<td>1953</td>
<td>2,043.3</td>
<td>921.3</td>
<td>45.1</td>
<td>1,122.0</td>
<td>54.9</td>
</tr>
<tr>
<td>1954</td>
<td>2,147.2</td>
<td>981.3</td>
<td>45.7</td>
<td>1,165.9</td>
<td>54.3</td>
</tr>
<tr>
<td>1955</td>
<td>2,388.5</td>
<td>1,032.8</td>
<td>43.3</td>
<td>1,355.7</td>
<td>56.7</td>
</tr>
<tr>
<td>1956a</td>
<td>2,390.7</td>
<td>956.3</td>
<td>40.0</td>
<td>1,434.4</td>
<td>60.0</td>
</tr>
</tbody>
</table>


*a*Data available for the first quarter of 1956 only.

### Central and Commercial Bank Credit

*(in millions of bolivares)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Central Bank</th>
<th>% of Total</th>
<th>Commercial Banks</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>945.3</td>
<td>67.5</td>
<td>7.1</td>
<td>877.8</td>
<td>92.9</td>
</tr>
<tr>
<td>1952</td>
<td>1,117.8</td>
<td>50.8</td>
<td>4.5</td>
<td>1,067.0</td>
<td>95.5</td>
</tr>
<tr>
<td>1953</td>
<td>1,427.3</td>
<td>59.9</td>
<td>4.2</td>
<td>1,367.4</td>
<td>95.8</td>
</tr>
<tr>
<td>1954</td>
<td>1,867.4</td>
<td>131.9</td>
<td>7.1</td>
<td>1,735.5</td>
<td>92.9</td>
</tr>
<tr>
<td>1955</td>
<td>2,098.7</td>
<td>62.8</td>
<td>3.0</td>
<td>2,035.9</td>
<td>97.0</td>
</tr>
<tr>
<td>1956a</td>
<td>2,197.1</td>
<td>76.2</td>
<td>3.4</td>
<td>2,120.9</td>
<td>96.6</td>
</tr>
</tbody>
</table>


*a*Data available for the first quarter of 1956 only.
### APPENDIX B

#### RECEIPTS AND EXPENDITURES OF THE NATIONAL GOVERNMENT OF VENEZUELA

*(in millions of bolivares)*

<table>
<thead>
<tr>
<th>Receipts</th>
<th>1952</th>
<th>%</th>
<th>1953</th>
<th>%</th>
<th>1954</th>
<th>%</th>
<th>1955</th>
<th>%</th>
<th>1956</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct taxes on income and wealth</td>
<td>653.1</td>
<td>27.1</td>
<td>745.0</td>
<td>29.4</td>
<td>680.6</td>
<td>25.9</td>
<td>792.3</td>
<td>26.4</td>
<td>686.0</td>
<td>27.0</td>
</tr>
<tr>
<td>Royalties (mining and petroleum)</td>
<td>822.7</td>
<td>34.2</td>
<td>826.6</td>
<td>32.6</td>
<td>901.1</td>
<td>34.2</td>
<td>1,035.3</td>
<td>34.6</td>
<td>846.4</td>
<td>33.3</td>
</tr>
<tr>
<td>Customs revenues</td>
<td>506.2</td>
<td>21.0</td>
<td>508.4</td>
<td>20.1</td>
<td>544.8</td>
<td>20.7</td>
<td>587.2</td>
<td>19.6</td>
<td>393.1</td>
<td>15.5</td>
</tr>
<tr>
<td>Indirect taxes on consumption</td>
<td>252.7</td>
<td>10.5</td>
<td>264.5</td>
<td>10.4</td>
<td>292.3</td>
<td>11.1</td>
<td>313.6</td>
<td>10.5</td>
<td>416.0</td>
<td>16.4</td>
</tr>
<tr>
<td>Other receipts</td>
<td>172.8</td>
<td>7.2</td>
<td>189.0</td>
<td>7.5</td>
<td>213.1</td>
<td>8.1</td>
<td>266.5</td>
<td>8.9</td>
<td>198.5</td>
<td>7.8</td>
</tr>
</tbody>
</table>

**Total receipts**

2,407.5 100.0 2,533.5 100.0 2,631.9 100.0 2,994.9 100.0 2,540.0 100.0

<table>
<thead>
<tr>
<th>Expenditures (ministry)</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interior relations</td>
<td>366.2</td>
<td>15.4</td>
<td>366.8</td>
<td>15.2</td>
<td>368.7</td>
<td>14.2</td>
<td>386.1</td>
<td>13.6</td>
<td>317.5</td>
<td>12.4</td>
</tr>
<tr>
<td>Foreign relations</td>
<td>22.6</td>
<td>1.0</td>
<td>24.9</td>
<td>1.0</td>
<td>32.9</td>
<td>1.3</td>
<td>23.4</td>
<td>0.8</td>
<td>na</td>
<td></td>
</tr>
<tr>
<td>Treasury</td>
<td>209.0</td>
<td>8.8</td>
<td>234.8</td>
<td>9.3</td>
<td>284.8</td>
<td>11.0</td>
<td>344.8</td>
<td>12.1</td>
<td>'</td>
<td></td>
</tr>
<tr>
<td>National defense</td>
<td>208.1</td>
<td>8.7</td>
<td>230.6</td>
<td>9.6</td>
<td>239.3</td>
<td>9.2</td>
<td>253.3</td>
<td>8.9</td>
<td>224.4</td>
<td>8.8</td>
</tr>
<tr>
<td>Development</td>
<td>118.3</td>
<td>5.0</td>
<td>126.5</td>
<td>5.3</td>
<td>112.6</td>
<td>4.3</td>
<td>147.4</td>
<td>5.2</td>
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<tr>
<td>Public works</td>
<td>797.7</td>
<td>33.5</td>
<td>744.0</td>
<td>30.9</td>
<td>806.9</td>
<td>31.1</td>
<td>876.3</td>
<td>30.8</td>
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<td></td>
</tr>
<tr>
<td>Education</td>
<td>137.1</td>
<td>5.8</td>
<td>144.0</td>
<td>6.0</td>
<td>156.8</td>
<td>6.0</td>
<td>158.9</td>
<td>5.6</td>
<td>163.2</td>
<td>6.4</td>
</tr>
<tr>
<td>Health and welfare</td>
<td>150.4</td>
<td>6.3</td>
<td>157.1</td>
<td>6.5</td>
<td>167.2</td>
<td>6.4</td>
<td>172.3</td>
<td>6.1</td>
<td>177.0</td>
<td>6.9</td>
</tr>
<tr>
<td>Agriculture and livestock</td>
<td>129.0</td>
<td>5.4</td>
<td>123.5</td>
<td>5.1</td>
<td>126.2</td>
<td>4.9</td>
<td>140.7</td>
<td>4.9</td>
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<td></td>
</tr>
<tr>
<td>Labor</td>
<td>21.0</td>
<td>.9</td>
<td>22.1</td>
<td>.9</td>
<td>26.7</td>
<td>1.0</td>
<td>28.0</td>
<td>1.0</td>
<td>'</td>
<td></td>
</tr>
<tr>
<td>Communications</td>
<td>121.6</td>
<td>5.1</td>
<td>135.7</td>
<td>5.6</td>
<td>157.2</td>
<td>5.1</td>
<td>145.1</td>
<td>5.1</td>
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<tr>
<td>Justice</td>
<td>75.1</td>
<td>3.1</td>
<td>76.5</td>
<td>3.2</td>
<td>78.0</td>
<td>3.0</td>
<td>78.7</td>
<td>2.8</td>
<td>'</td>
<td></td>
</tr>
<tr>
<td>Mining and petroleum</td>
<td>27.4</td>
<td>1.1</td>
<td>20.2</td>
<td>.8</td>
<td>34.6</td>
<td>1.3</td>
<td>85.9</td>
<td>3.0</td>
<td>'</td>
<td></td>
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</tbody>
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### APPENDIX B (continued)

<table>
<thead>
<tr>
<th>Expenditures</th>
<th>1952 %</th>
<th>1953 %</th>
<th>1954 %</th>
<th>1955 %</th>
<th>1956 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on debt</td>
<td>.8 *</td>
<td>.4 *</td>
<td>.7 *</td>
<td>.4 *</td>
<td>.5 *</td>
</tr>
<tr>
<td>Other expenditure</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>1,667.4</td>
</tr>
<tr>
<td>Total expenditures</td>
<td>2,384.3</td>
<td>100.0</td>
<td>2,404.9</td>
<td>100.0</td>
<td>2,592.8</td>
</tr>
<tr>
<td>Surplus</td>
<td>23.2</td>
<td>128.6</td>
<td>39.1</td>
<td>153.6</td>
<td>10.0</td>
</tr>
<tr>
<td>Deficit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


*Information not available.*

*Less than five-tenths of one per cent.*

Components do not always add to totals because of rounding.
APPENDIX C

INDEX OF WHOLESALE PRICES IN THE FEDERAL DISTRICT

<table>
<thead>
<tr>
<th>Year</th>
<th>General Index (1938 base)</th>
<th>National Product Index (1938 base)</th>
<th>Year</th>
<th>General Index (1950=100)</th>
<th>National Product Index (1950=100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>164.7</td>
<td>100.0</td>
<td>1950</td>
<td>163.3</td>
<td>100.0</td>
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<tr>
<td>1951</td>
<td>173.7</td>
<td>105.5</td>
<td>1951</td>
<td>172.4</td>
<td>105.6</td>
</tr>
<tr>
<td>1952</td>
<td>176.4</td>
<td>107.1</td>
<td>1952</td>
<td>172.6</td>
<td>105.7</td>
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<td>1953</td>
<td>170.9</td>
<td>103.8</td>
<td>1953</td>
<td>169.5</td>
<td>103.8</td>
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<tr>
<td>1954</td>
<td>175.4</td>
<td>106.5</td>
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<td>106.8</td>
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<td>1955</td>
<td>176.5</td>
<td>107.2</td>
<td>1955</td>
<td>171.0</td>
<td>104.7</td>
</tr>
<tr>
<td>1956(May)</td>
<td>173.3</td>
<td>105.2</td>
<td>1956(May)</td>
<td>176.2</td>
<td>107.9</td>
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</table>


INDEX OF IMPORT AND EXPORT PRICES OF VENEZUELA

<table>
<thead>
<tr>
<th>Year</th>
<th>Import Index (1948 base)</th>
<th>Export Index (1948 base)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>77.3</td>
<td>74.4</td>
</tr>
<tr>
<td>1951</td>
<td>87.3</td>
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<td>1952</td>
<td>93.6</td>
<td>85.2</td>
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<tr>
<td>1953</td>
<td>91.0</td>
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<tr>
<td>1954</td>
<td>93.3</td>
<td>92.4</td>
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<tr>
<td>1955</td>
<td>92.2</td>
<td>98.6</td>
</tr>
<tr>
<td>1956(May)</td>
<td>na</td>
<td>na</td>
</tr>
</tbody>
</table>


na Information not available.
APPENDIX D

BALANCE OF PAYMENTS OF VENEZUELA
(in millions of bolivares)

<table>
<thead>
<tr>
<th>Account</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956^a</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Account</strong></td>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Exports of oil, f.o.b.</td>
<td>4,636.1</td>
<td>4,783.8</td>
<td>5,237.7</td>
<td>6,000.5</td>
<td>6,780.6</td>
</tr>
<tr>
<td>Exports, f.o.b.</td>
<td>228.8</td>
<td>288.1</td>
<td>365.8</td>
<td>373.9</td>
<td>411.3</td>
</tr>
<tr>
<td>Imports, oil firms, f.o.b.</td>
<td>-600.3</td>
<td>-483.1</td>
<td>-410.0</td>
<td>-452.6</td>
<td>-497.9</td>
</tr>
<tr>
<td>Imports, f.o.b.</td>
<td>-2,015.4</td>
<td>-2,374.8</td>
<td>-2,783.9</td>
<td>-2,919.9</td>
<td>-3,211.9</td>
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<tr>
<td>Transportation and insurance, oil firms (net)</td>
<td>-49.9</td>
<td>31.5</td>
<td>38.5</td>
<td>47.6</td>
<td>52.4</td>
</tr>
<tr>
<td>Transportation and insurance (net)</td>
<td>-235.8</td>
<td>-281.4</td>
<td>-338.4</td>
<td>-351.8</td>
<td>-387.0</td>
</tr>
<tr>
<td>Investment income (net)</td>
<td>-1,374.2</td>
<td>-1,355.7</td>
<td>-1,522.3</td>
<td>-1,847.9</td>
<td>-2,032.7</td>
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<tr>
<td>Capital, oil firms</td>
<td>237.9</td>
<td>169.2</td>
<td>71.7</td>
<td>66.7</td>
<td>73.3</td>
</tr>
<tr>
<td>Other (net)</td>
<td>213.4</td>
<td>207.8</td>
<td>217.4</td>
<td>175.4</td>
<td>192.9</td>
</tr>
<tr>
<td><strong>Balance</strong></td>
<td>439.9</td>
<td>290.1</td>
<td>14.9</td>
<td>166.1</td>
<td>362.8</td>
</tr>
<tr>
<td><strong>Capital Account</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term</td>
<td>279.7</td>
<td>305.8</td>
<td>265.3</td>
<td>159.5</td>
<td></td>
</tr>
<tr>
<td>Private</td>
<td>267.7</td>
<td>305.5</td>
<td>290.4</td>
<td>170.9</td>
<td></td>
</tr>
<tr>
<td>Official</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export-Import Bank loans</td>
<td>16.4</td>
<td>11.0</td>
<td>------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Amortization</td>
<td>4.4</td>
<td>10.7</td>
<td>9.4</td>
<td>5.4</td>
<td></td>
</tr>
<tr>
<td>Purchase of long term investment</td>
<td>------</td>
<td>------</td>
<td>15.7</td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>Short term</td>
<td>234.5</td>
<td>151.1</td>
<td>78.4</td>
<td>171.5</td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td>12.1</td>
<td>10.7</td>
<td>15.1</td>
<td>32.2</td>
<td></td>
</tr>
<tr>
<td>Foreign assets (increase-)</td>
<td>222.4</td>
<td>140.4</td>
<td>93.5</td>
<td>203.7</td>
<td></td>
</tr>
<tr>
<td><strong>Balance</strong></td>
<td>45.2</td>
<td>154.7</td>
<td>343.7</td>
<td>12.0</td>
<td></td>
</tr>
</tbody>
</table>
APPENDIX D (continued)

<table>
<thead>
<tr>
<th>Account</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unilateral Account(^b)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private donations</td>
<td>-64.0</td>
<td>-68.7</td>
<td>-73.0</td>
<td>-76.4</td>
</tr>
<tr>
<td>Official donations</td>
<td>.3</td>
<td>.3</td>
<td>.7</td>
<td>.7</td>
</tr>
<tr>
<td>Balance</td>
<td>-63.7</td>
<td>-68.4</td>
<td>-72.3</td>
<td>-75.7</td>
</tr>
<tr>
<td>Gold Account(^b)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monetary gold</td>
<td>.7</td>
<td>.3</td>
<td>-101.2</td>
<td>---</td>
</tr>
<tr>
<td>Errors and Omissions(^b)</td>
<td>-422.1</td>
<td>-376.7</td>
<td>-155.3(^c)</td>
<td>-78.4</td>
</tr>
</tbody>
</table>


\(^a\)Estimated oil exports at 13 per cent, all other items at a rate of 10 per cent.

\(^b\)Figures for 1956 were unavailable.

\(^c\)Amount given is 30.2 millions of bolivares less than that presented by the source material because the item "Official and Bank Capital" does not total the correct figure of the items presented.
## APPENDIX E

### BALANCE SHEET OF THE CENTRAL BANK OF VENEZUELA

*(in millions of bolivares)*

<table>
<thead>
<tr>
<th></th>
<th>1951</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956a</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reserves</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold at home</td>
<td>904.8</td>
<td>904.8</td>
<td>904.8</td>
<td>905.6</td>
<td>906.1</td>
<td>906.1</td>
</tr>
<tr>
<td>Gold abroad</td>
<td>256.0</td>
<td>256.1</td>
<td>256.1</td>
<td>327.4</td>
<td>327.4</td>
<td>327.4</td>
</tr>
<tr>
<td>Deposits</td>
<td>.9</td>
<td>202.6</td>
<td>329.4</td>
<td>231.3</td>
<td>389.7</td>
<td>671.6</td>
</tr>
<tr>
<td>Less: foreign bank obligations</td>
<td>31.7</td>
<td>16.8</td>
<td>7.6</td>
<td>10.6</td>
<td>16.3</td>
<td>12.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,110.0</td>
<td>1,326.7</td>
<td>1,462.7</td>
<td>1,453.7</td>
<td>1,606.9</td>
<td>1,892.6</td>
</tr>
<tr>
<td><strong>Loans and discounts</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture and livestock</td>
<td>50.7</td>
<td>----</td>
<td>----</td>
<td>61.6</td>
<td>45.7</td>
<td>62.3</td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>16.8</td>
<td>----</td>
<td>----</td>
<td>70.3</td>
<td>17.2</td>
<td>10.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>67.5</td>
<td>50.8</td>
<td>59.9</td>
<td>131.9</td>
<td>62.9</td>
<td>76.2</td>
</tr>
<tr>
<td><strong>Other assets</strong></td>
<td>75.9</td>
<td>60.2</td>
<td>56.2</td>
<td>54.4</td>
<td>90.5</td>
<td>42.9</td>
</tr>
<tr>
<td>Unpaid capital</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
<td>....</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>1,258.4</td>
<td>1,442.7</td>
<td>1,583.8</td>
<td>1,645.0</td>
<td>1,765.3</td>
<td>2,011.7</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes in circulation</td>
<td>870.7</td>
<td>1,000.3</td>
<td>1,041.1</td>
<td>1,121.3</td>
<td>1,154.1</td>
<td>1,063.9</td>
</tr>
<tr>
<td>Deposits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National government</td>
<td>73.4</td>
<td>119.7</td>
<td>209.4</td>
<td>222.3</td>
<td>230.8</td>
<td>544.5</td>
</tr>
<tr>
<td>Banks</td>
<td>209.8</td>
<td>222.6</td>
<td>218.2</td>
<td>180.2</td>
<td>238.6</td>
<td>292.6</td>
</tr>
<tr>
<td>Other deposits</td>
<td>37.5</td>
<td>34.9</td>
<td>44.8</td>
<td>24.2</td>
<td>32.8</td>
<td>32.7</td>
</tr>
<tr>
<td>Other obligationsb</td>
<td>49.3</td>
<td>46.2</td>
<td>51.5</td>
<td>77.3</td>
<td>88.6</td>
<td>78.0</td>
</tr>
<tr>
<td>Capital</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>....</td>
</tr>
</tbody>
</table>
APPENDIX E (continued)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General and special funds</td>
<td>7.7</td>
<td>9.0</td>
<td>9.0</td>
<td>9.7</td>
<td>10.4</td>
<td>...</td>
</tr>
<tr>
<td>Total liabilities and capital</td>
<td>1,258.4</td>
<td>1,442.7</td>
<td>1,583.8</td>
<td>1,645.0</td>
<td>1,765.3</td>
<td>2,011.7</td>
</tr>
</tbody>
</table>


aIncludes first 5 months only.

bIncludes deposits in foreign money, other foreign bank obligations, expired letters of credit, dividend accumulations, and so on.
# APPENDIX F

**GOLD AND FOREIGN EXCHANGE HOLDINGS OF VENEZUELA**

(in millions of bolivares)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>% of Total</th>
<th>Gold</th>
<th>% of Total</th>
<th>Foreign Exchange</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>1,371.0</td>
<td>100.0</td>
<td>1,180.0</td>
<td>86.1</td>
<td>191.0</td>
<td>13.9</td>
</tr>
<tr>
<td>1953</td>
<td>1,513.7</td>
<td>100.0</td>
<td>1,179.7</td>
<td>77.9</td>
<td>334.0</td>
<td>22.1</td>
</tr>
<tr>
<td>1954</td>
<td>1,508.9</td>
<td>100.0</td>
<td>1,271.8</td>
<td>84.3</td>
<td>237.1</td>
<td>15.7</td>
</tr>
<tr>
<td>1955</td>
<td>1,653.6</td>
<td>100.0</td>
<td>1,271.8</td>
<td>76.9</td>
<td>381.8</td>
<td>23.1</td>
</tr>
<tr>
<td>1956(^a)</td>
<td>2,497.4</td>
<td>100.0</td>
<td>1,390.3</td>
<td>55.7</td>
<td>1,107.1</td>
<td>44.3</td>
</tr>
</tbody>
</table>


\(^a\)Figures taken from International Monetary Fund, *International Financial Statistics*, January, 1957, and include holdings through September, 1956 only.
CHAPTER IV

SOME CONCLUDING OBSERVATIONS

The two preceding chapters dealing with Mexico and Venezuela revealed the varying effects upon income and price levels caused, in part, by monetary, fiscal, and exchange practices. Specifically, the Mexican experience suggested that the authorities in charge of these policies failed to provide proper co-ordination between them so as to achieve a higher national income at stable price levels. The Venezuelan experience seemed to reveal a special preference toward fiscal, and to some extent, external policy over that of monetary policy. Yet, both nations appeared to have greater success in the application of these policies at the close of the five-year period.

It should be recalled that these two nations were selected for study on the basis of their dissimilar economic structure. This means that although both countries represent underdeveloped nations, Mexico is primarily a domestic economy; that is, industry and agriculture account for a major portion of the national product (income). Furthermore, its external trade is free from exchange restrictions.

1Even though the price level appeared to be quite stable, it was maintained at a relative high level. In addition, the tremendous influence of petroleum exports created a special need for adequate fiscal and external measures.
On the other hand, Venezuela is typical of an export economy. Export income provides a large portion of the national income of the nation. In addition, exchange control is employed to some extent by the application of multiple exchange rates.

Many of the Latin American countries may be classified, in a broad sense, according to the above distinguishing factors characteristic of Mexico and Venezuela.

Table I, page 290, presents a small number of selected Latin American nations which are separated into two general groups on the basis of the contribution of their export income to total income. There is a good deal of uncertainty as to the amount or rate of export income which clearly reveals that a country is a domestic economy or an export economy. By employing an approximate 20 per cent rate, this figure should be large enough to definitely place a nation within Group II, or an export economy. Thus, Country Group I of Table I includes three Latin American nations that are recognized as domestic economies according to the above criteria.

During the last five years, or a lesser number of years for those countries in which information was lacking, the contribution of export income to the national product was a good deal less than the 20 per cent rate arbitrarily employed as a dividing-point rate. On the other hand, the
### TABLE I

**EXPORT INCOME IN RELATION TO NATIONAL PRODUCT (INCOME) IN SELECTED LATIN AMERICAN COUNTRIES**  
(in millions of domestic units)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Argentina (pesos)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National product*</td>
<td>82,811.</td>
<td>93,965.</td>
<td>104,839.</td>
<td>na</td>
<td>na</td>
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<tr>
<td>Export income</td>
<td>4,392.</td>
<td>7,189.</td>
<td>6,757.</td>
<td>'1</td>
<td>'1</td>
</tr>
<tr>
<td>Export income as % of national product</td>
<td>5.3</td>
<td>7.7</td>
<td>6.4</td>
<td>'1</td>
<td>'1</td>
</tr>
<tr>
<td><strong>Brazil (cruzeiros)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National product*</td>
<td>292,100.</td>
<td>356,500.</td>
<td>439,900.</td>
<td>549,300.</td>
<td></td>
</tr>
<tr>
<td>Export income</td>
<td>26,056.</td>
<td>32,047.</td>
<td>42,968.</td>
<td>54,521.</td>
<td></td>
</tr>
<tr>
<td>Export income as % of national product</td>
<td>8.9</td>
<td>9.0</td>
<td>9.8</td>
<td>9.9</td>
<td>'1</td>
</tr>
<tr>
<td><strong>Mexico (pesos)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National product</td>
<td>58,300.</td>
<td>56,300.</td>
<td>66,478.</td>
<td>84,000.</td>
<td>92,400.</td>
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<tr>
<td>Export income</td>
<td>5,353.</td>
<td>5,095.</td>
<td>8,188.</td>
<td>10,128.</td>
<td>5,688.</td>
</tr>
<tr>
<td>Export income as % of national product</td>
<td>9.2</td>
<td>9.0</td>
<td>9.2</td>
<td>12.3</td>
<td>6.2 (6 mos.)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Chile (pesos)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National product*</td>
<td>190,480.</td>
<td>226,600.</td>
<td>498,630.</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Export income</td>
<td>53,929.</td>
<td>44,945.</td>
<td>80,200.</td>
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<td>'1</td>
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<tr>
<td>Export income as % of national product</td>
<td>28.3</td>
<td>19.8</td>
<td>16.1</td>
<td>'1</td>
<td>'1</td>
</tr>
<tr>
<td><strong>Peru (soles)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National product</td>
<td>20,970.</td>
<td>22,650.</td>
<td>25,080.</td>
<td>'1</td>
<td>'1</td>
</tr>
<tr>
<td>Export income</td>
<td>3,827.</td>
<td>3,979.</td>
<td>4,952.</td>
<td>'1</td>
<td>'1</td>
</tr>
<tr>
<td>Export income as % of national product</td>
<td>18.2</td>
<td>17.1</td>
<td>19.7</td>
<td>'1</td>
<td>'1</td>
</tr>
<tr>
<td><strong>Venezuela (bolivares)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export income</td>
<td>4,965.</td>
<td>5,072.</td>
<td>5,604.</td>
<td>6,574.</td>
<td>7,192.</td>
</tr>
<tr>
<td>Export income as % of national product</td>
<td>36.4</td>
<td>35.9</td>
<td>36.1</td>
<td>39.1</td>
<td>42.1</td>
</tr>
</tbody>
</table>


*National income figures. na Information not available.*
export income of Country Group II nations represents approximately 20 per cent, or more, of the national product.

The division of the countries into two groups should not be construed to mean that each of the three nations within a grouping have nearly exact, or even closely related, types of domestic development or similar external policies. For example, Brazil is perhaps less industrialized than is Mexico while Argentina has nearly attained a position of balance between agriculture and industry.

Externally, Argentina and Brazil have been utilizing exchange controls in order to protect their domestic economies. Yet, Mexico does not employ such restrictions. Furthermore, Argentina and Brazil are considered as non-dollar countries since the major portion of their trade is directed toward Europe. Mexico, on the other hand, is recognized as a dollar nation because the bulk of its trade is with the United States.

A similar differentiation may be offered in connection with the three remaining countries in Country Group II, namely: Chile, Peru, and Venezuela. Peru and

---

2 Tariffs compensate, in part, for the lack of monetary control.

Chile are predominately agricultural countries which export one, or a few, basic agricultural commodities. However, Venezuela has a proportionately larger industrial development and exports large quantities of petroleum along with iron-ore and coffee. In addition, Chile has a severe restrictive exchange control policy while Peru and Venezuela utilize a more moderate form of exchange restrictions.

The above differences among the countries are pointed out so as not to infer a kind of fixed relationship between one another. In other words, each individual nation contains characteristics which are peculiar to it, and no other.

Since the six Latin American nations now have been segregated into two general groups, three of which are considered as domestic economies and the other three as export economies, one may apply various measures to determine the effectiveness of monetary, fiscal, and external policies of the countries within the two groups. Perhaps it may be possible to draw some broad conclusions with respect to their effectiveness.

I. MEASURES OF THE EFFECTIVENESS OF INTERNAL AND EXTERNAL POLICIES

It is realized that the authorities in charge of establishing policies which are conducive to a higher standard of living in the underdeveloped countries have a
tremendous task before them. It is further contended that in their desire to raise the plane of living they are apt to lose sight of the over-all influence that their policies exert, whether beneficial or harmful, to the functioning of the economy.

Three types of measuring devices are offered in order to better visualize the general effects of internal and external policies which, if taken into account, may modify extreme downturns or sharp upsurges in income and prices. The three measuring devices are: (1) the relationship between gold and international reserves and the money supply, (2) a comparison between the money supply, national product, and price level, and (3) changes in current account balances and long-term capital movements.

A. The Relationship Between Gold and International Reserves and the Money Supply

By analyzing comparative changes in gold and international reserves and the supply of money and credit, one may obtain a general impression of the influence of the external sector upon the domestic economy. Of perhaps

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Mr. Brovedani explained that this measuring device is used to control money and credit in Uruguay. Refer to Bruno Brovedani, "Latin American Medium-Term Import Stabilization Policies and the Adequacy of Reserves," International Monetary Fund, Staff Papers, Washington, D. C., Vol. IV, No. 2, February, 1955, pp. 272-273.
greater importance to the nation of the direct comparative relationship between the changes in gold and foreign exchange holdings and the changes in money and credit is the fact that should the variations in money and credit fail to reflect comparable changes in international reserves, there is good reason to believe that the authorities have lost sight of the objective of attaining equilibrium. Furthermore, it would suggest that monetary, fiscal, and exchange policies are either not being employed, or are being used with little success.

Table II, pages 295 and 296, shows the changes in gold and international reserves compared to that of the money supply and credit extended during the five-year period. Of special interest is the fact that money and credit rose in every country for the five-year period with only one country revealing an exception to this trend. Money and credit of Mexico declined during the first seven months of 1956. Although the percentage decline in 1956 was quite small in terms of the rise of money and credit in the four prior years, it indicates that a real effort is being displayed in order to stabilize economic conditions and to make effective use of monetary and fiscal policies.

On the other hand, Table II indicates that international reserves fluctuated a great deal during the
TABLE II

CHANGES IN MONEY, CREDIT, AND INTERNATIONAL RESERVES*
(in millions of units)

<table>
<thead>
<tr>
<th>Country**</th>
<th>1952</th>
<th>Yearly % Change</th>
<th>1953</th>
<th>Yearly % Change</th>
<th>1954</th>
<th>Yearly % Change</th>
<th>1955</th>
<th>Yearly % Change</th>
<th>1956</th>
<th>Yearly % Change</th>
</tr>
</thead>
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<tr>
<td>Argentina</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money</td>
<td>5,606</td>
<td>12.8</td>
<td>11,942</td>
<td>24.2</td>
<td>10,972</td>
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<td>14,069</td>
<td>19.5</td>
<td>19,405</td>
<td>22.5</td>
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<td>Credit</td>
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<td>16,602</td>
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<tr>
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<td>267</td>
<td>185.4</td>
<td>-9</td>
<td>-2.2</td>
<td>219</td>
<td>-54.5</td>
<td>-106</td>
<td>-57.9</td>
</tr>
<tr>
<td>Brazil</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Money</td>
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<td>14.9</td>
<td>20,000</td>
<td>19.2</td>
<td>27,400</td>
<td>22.1</td>
<td>26,400</td>
<td>17.4</td>
<td>21,200</td>
<td>11.9(Aug)</td>
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<td>17.6</td>
<td>45,400</td>
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<td>28,700</td>
<td>13.0</td>
<td>33,400</td>
<td>13.0</td>
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<td>77</td>
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<td>130</td>
<td>-20.0</td>
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<td>19.0</td>
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</tr>
<tr>
<td>Money</td>
<td>278</td>
<td>4.1</td>
<td>575</td>
<td>8.1</td>
<td>1,071</td>
<td>14.0</td>
<td>2,049</td>
<td>23.5</td>
<td>514</td>
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<td>11.2</td>
<td>1,514</td>
<td>19.8</td>
<td>3,670</td>
<td>40.1</td>
<td>926</td>
<td>7.2</td>
<td>1,265</td>
<td>9.2</td>
</tr>
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<td>Reserves</td>
<td>6</td>
<td>2.3</td>
<td>34</td>
<td>12.5</td>
<td>13</td>
<td>5.5</td>
<td>211</td>
<td>3.8</td>
<td>15</td>
<td>3.4(Aug)</td>
</tr>
<tr>
<td>Chile</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money</td>
<td>3,720</td>
<td>35.8</td>
<td>16,190</td>
<td>48.9</td>
<td>25,870</td>
<td>52.5</td>
<td>52,710</td>
<td>70.1</td>
<td>31,680</td>
<td>24.3(Oct)</td>
</tr>
<tr>
<td>Credit</td>
<td>9,015</td>
<td>27.2</td>
<td>12,540</td>
<td>29.7</td>
<td>17,270</td>
<td>31.6</td>
<td>35,360</td>
<td>46.3</td>
<td>24,080</td>
<td>22.9</td>
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<td>27.3</td>
<td>2</td>
<td>2.2</td>
<td>32</td>
<td>-35.4</td>
<td>46</td>
<td>75.4</td>
<td>6</td>
<td>5.6</td>
</tr>
<tr>
<td>Peru</td>
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<tr>
<td>Money</td>
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<td>366</td>
<td>13.4</td>
<td>193</td>
<td>6.2</td>
<td>181</td>
<td>5.5</td>
<td>163</td>
<td>4.7(June)</td>
</tr>
<tr>
<td>Credit</td>
<td>934</td>
<td>25.7</td>
<td>692</td>
<td>15.2</td>
<td>367</td>
<td>7.0</td>
<td>756</td>
<td>13.4</td>
<td>132</td>
<td>2.1</td>
</tr>
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<td>.5</td>
<td>2</td>
<td>.1</td>
<td>1</td>
<td>.0</td>
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<tr>
<td>Venezuela</td>
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<td></td>
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</tr>
<tr>
<td>Money</td>
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<td>16.4</td>
<td>166</td>
<td>8.8</td>
<td>104</td>
<td>5.1</td>
<td>242</td>
<td>11.3</td>
<td>38</td>
<td>1.6(Sep)</td>
</tr>
<tr>
<td>Credit</td>
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<td>18.3</td>
<td>309</td>
<td>27.6</td>
<td>240</td>
<td>16.8</td>
<td>432</td>
<td>25.9</td>
<td>377</td>
<td>18.0</td>
</tr>
<tr>
<td>Reserves</td>
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<td>15.6</td>
<td>45</td>
<td>10.0</td>
<td>1</td>
<td>.2</td>
<td>55</td>
<td>11.0</td>
<td>189</td>
<td>34.2</td>
</tr>
</tbody>
</table>

January, 1957.

*Money comprises the monetary liabilities of the Central Banks to the private sector, including official entities and development banks, Treasury coin outside banks, and monetary deposits of the private sector— including official entities and development banks— with the commercial and savings banks. Credit includes claims on the government, private sector, and official entities.

**Money and credit are expressed in domestic units, international reserves in dollars.

1Refers to Central Bank only.
five-year period. Only Venezuela revealed a consistent trend in its international reserve holdings. They rose throughout the period. Yet, the international reserves of Peru indicated a much smaller percentage change than did the remaining four nations. Overall, the changes in international reserves were as follows: Mexico, rose in three years and fell in two years; Argentina, rose in one year and fell in four years; Brazil, rose in two years, fell in two years, and remained constant in one year; and Chile, rose in three years and fell in two years.

There seems to be little, if any, correlation between the changes of money and credit and international reserves among the nations within Groups I and II. Nevertheless, the figures do indicate that the larger percentage increases in money and credit were found in Argentina and Brazil in the Group I countries and Chile of Group II. If a fourth nation were included, it would be Mexico. The result is that three out of the four nations which enlarged their money supply most were Group I countries.

With respect to changes in international reserves, there was a lack of consistency in the size of reserve holdings. For the five-year period, exchange reserves rose (on a percentage basis) in five out of the six countries. Only Peru showed a slight decline in its holdings. The largest increases in gold and foreign exchange reserves
were those of Mexico, 81.5 per cent and Argentina, 28.6 per cent in Group I countries, and Venezuela, 71 per cent and Chile, 65.4 per cent in Group II.

The international reserve accumulations are, however, misleading. For example, Argentina realized a rise in gold and foreign exchange in only one of the five years. Yet, the increase in the one year, 1953, was larger than the total decline of exchange in the remaining four years. In other words, the nation tended to lose reserves quite consistently even though the gain in one year was large. Thus, the longer the time period considered, the greater the probability of loss in reserve holdings.

Another important factor relating to changes in gold and exchange reserves is the amount and frequency of exchange rate changes. From a short run standpoint, a rise in the country's exchange rate (depreciation) may bring with it a spontaneous rise in gold and foreign exchange holdings. Nevertheless, the new, high rate may be offset shortly because of a volume decline. Then too, retaliation on the part of other nations as well as the possibility of internal price increases may become too serious to bear.

As one examines the external policies of the six nations, it becomes apparent that increases in the international reserves were possible, in part, because
depreciation was quite common during this relatively short period of time. It may be recalled that Mexico changed its exchange rate in 1954. Table II shows the effect of the depreciated rate which increased international reserves in 1955 by some 93.8 per cent. Every nation considered here with the exception of Venezuela had its exchange rate altered at least once during the five years.\(^5\)

It is now possible to compare the relative changes in the money supply and international reserves. One way to prevent money and credit from getting out of hand would be to keep credit in line with changes in international reserves. Should credit rise by a much greater percentage than the accumulation of international reserve holdings, either the banking system should refuse to increase the money supply, reduce it, or it should reduce credit.

The effectiveness of such manipulation would be expected to vary between nations, and would directly depend upon the relative importance of the external sector to the

\(^5\)Exchange rate changes for the six nations included in this section were as follows (rates are either basic, preferential, or free selling rates and express domestic units per dollar): Argentina 7.5 per dollar 1951-1955, 18 per dollar 1956; Brazil 18.38 per dollar 1951-1952, 23.26-1953, 31.50-1954, 37.06-1955-1956; Mexico 8.65 per dollar 1951-1958, 12.51-1954-1956; Chile 90.0 per dollar 1951, 118.6-1952, 110.0-1953, 200.0-1954, 300.0-1955, and 563.0-1956; Peru 15.28 per dollar 1951, 15.43-1952, 16.85-1953, 19.29-1954, and 19.0-1955-1956; and Venezuela 3.25 per dollar 1951-1956. Refer to International Monetary Fund,
domestic sector. Yet, even if a nation depended to only a small extent upon the income contribution of the external sector, it would still be desirable to utilize the above measuring device. It is true that the limitations placed upon the money supply as determined by international reserves would be of lesser importance than purely domestic measures. Nevertheless, the former could be employed in conjunction with internal measures to provide greater stability.

All the six nations being observed in this section rely to a great extent upon the external sector of their economies to provide for economic stability and growth. The relation of export income to national product (income) as presented in Table I, page 290, is not indicative of the full reliance that these nations place upon external activity. Of great importance to them besides export income is the import of goods, particularly capital goods, and the flows of international capital. Thus, it seems quite logical that all six countries would benefit from the use of the controlling device discussed at this point.

To what extent have the Latin American countries made use of this measure? Table II, page 295, shows that

very little effort was expended in attempting to provide monetary stability by regulating money and credit in accordance with international reserve variations.

Reviewing the countries in Group I, one finds that in Argentina credit rose by 15.3 per cent in 1952. At the same time, international reserves declined some 42.2 per cent. Yet, the money increased, too, by about 12.8 per cent. International reserve holdings increased approximately 185.4 per cent in 1953 while total money and credit rose some 65.8 per cent. The exceptional rise of international reserves in this latter year was more than enough to offset the total increase of money and credit for the same two-year period. The last three years, 1954-1956, showed a continual decline in gold and foreign exchange while money and credit moved in the opposite direction.

The experience in Brazil was similar to that occasioned by Argentina. Credit rose about 20 per cent in 1952, and international reserve holdings declined by 3 per cent. Money followed the course of credit, and rose some 15 per cent. The expansion of credit amounted to nearly 18 per cent in 1953. This increased rate was nearly offset by a rise of international reserves by approximately 13 per cent. The money supply rose, however, by 19 per cent. During the years 1954 and 1955, credit and money rose while gold and foreign exchange declined. But an
abrupt change was encountered in 1956; credit was larger than in the previous year by about 13 per cent while international reserves rose by some 19 per cent. Money expanded by almost 12 per cent leaving a money and credit balance of approximately 5 per cent over that of gold and foreign exchange accumulation.

Mexico, the last of the three Group I nations, experienced a more mixed-pattern relationship than either Argentina or Brazil. Credit increased by about 11.2 per cent in 1952, but international reserve holdings were larger by approximately 2.3 per cent. Money did rise, but the increase was only about 4.1 per cent. A consistent change was noticeable during 1953 and 1954. The increase in credit amounted to some 59.9 per cent. On the other hand, international reserves declined by about 18.0 per cent. During 1955 and the first seven months of 1956, a reversal occurred. The rise in credit for 1955 was but 7.2 per cent while gold and foreign exchange accumulations amounted to nearly 93.8 per cent. Money also increased about 23.5 per cent. Finally, credit and money declined in 1956, the total amounting to 14.0 per cent. At the same time, international reserve holdings were larger by some 3.4 per cent.

With respect to the above three nations, only Mexico seemed to pay attention to the relative changes in
credit, money, and international reserve holdings, and then only in the latter two years. Furthermore, only Brazil, and to a lesser extent Mexico, revealed a downward trend in the rise of money and credit.

Turning to the Group II countries, the analysis will show results similar to those of the Group I nations. A definite trend emerges as one reviews the credit, money, and international reserve holdings of Chile. At the end of 1952, the rise in credit of some 27.2 per cent was nearly equal that of the rise of gold and foreign exchange--27.8 per cent. Yet, the money supply also increased by about 35.8 per cent. Beginning with 1953 and continuing through 1956, with the exception of the year 1955, Chile's international reserve holdings declined while credit and money continued to rise.

Peru's experience indicates a more fixed pattern in that the annual rise in credit has been at a decreasing rate beginning with a 25.7 per cent increase in 1952 and falling to a 2 per cent increase by June, 1956. The only year excepted was 1955 when the rise in credit was 13.4 per cent. In addition, there was only a small change in gold and foreign exchange reserve holdings during the period. A decline of about 5.8 per cent occurred during 1952 and 1953. Thereafter, a 0.6 per cent rise was occasioned. The downward pattern also applies to changes
in money. The money supply rose by approximately 13.3 per cent in 1952. During the remaining four years, the increase was smaller each year; it was 4.7 per cent for 1956.

Venezuela, the only country which realized an increase in all three items throughout the five-year period, reveals a more determined approach with respect to money, credit, and international reserves. At the end of 1952, credit rose by some 18.3 per cent. Although gold and foreign holdings fell short of the rise in credit, they were larger by nearly 15.6 per cent. The money supply increased too, the total amounting to approximately 16.4 per cent. The following year witnessed a reversal since credit rose by about 27.6 per cent while international reserves increased by some 10.0 per cent. Yet, the money supply was only 8.8 per cent larger. This trend is also noticeable during 1954. The last two years of the period revealed a continuous rise in credit; however, gold and foreign exchange accumulations were larger than the increase in the money supply.

It would appear correct to say that only Venezuela as one of the three Group II countries showed a serious determination to restrict the expansion of money and credit according to variations in its gold and foreign exchange reserves.
To summarize the findings at this point, it is quite clear that of the six nations considered, only two, Mexico and Venezuela, showed an inclination to directly relate the changes in money and credit with variations in international reserve holdings.

There seemed to be no clear-cut trend with respect to the domestic economies of Group I countries and the export economies of Group II nations. Perhaps a part of the explanation as to why the Group I countries attached little importance to the measuring device described above is that the internal problems overshadowed those of the external sector. On the other hand, one should consider the fact that these countries were evidently having problems in their external trade. No doubt this is true because of the numerous changes they made in their exchange rates. Such problems as were related to the external sector appeared equally important to the Group II nations.

It is quite clear from the information in Table II that only a few of the Latin American nations sought relief from the pressing inflation by making co-ordinated use of monetary, fiscal, and exchange policies. The frequent change in exchange rates, along with financial controls in some of the countries, may have been employed to seek relief in both the external and internal sectors of the economy. Surely depreciated exchange rates were used to
increase exports or to reduce imports, or both. In brief, they were attempts made for the purpose of relieving the strain on the balance of payments. Nevertheless, their imposition may have been a manifestation of a more recent development; namely, the desire to protect the domestic sector from foreign repercussions. At any rate, monetary and fiscal policy failure was quite evident.

The lack of success in applying the measuring device, the subject of this section, suggests that the overwhelming desire to develop the countries was of greater importance than clinging to the objective of international equilibrium.

A comparison of the money supply, national product, and price level of five of the Latin American countries should serve to throw more light upon the relative situation with respect to saving and investment as well as to indicate the approximate influence of monetary and fiscal policy.

B. A Comparison Between the Money Supply, National Product, and Price Level

A comparison between the money supply, the national product, and the price level of the several countries presents a basis for estimating the relationship between saving and investment. If the change in money supply is not accompanied by an approximately equal change, and
in the same direction as that of the national product, then the price level will vary in such a way as to reflect the difference. According to the development pattern in the underdeveloped countries, the money supply appears to rise faster than the real national product. This proportionately larger increase in the money supply suggests that if an excess of investment over saving were realized, it would be attributed, in part, to the larger money supply. The national product must be deflated by using the price level indicator for the purpose of showing the influence of the larger money supply.

Since the study of Mexico and Venezuela, two of the more advanced underdeveloped nations in Latin America, revealed the tendency of excessive investment balances along with exceptional increases in money and credit, particularly in the case of Mexico, it may be safely assumed that most all of the remaining countries in Latin America have realized similar effects. From the saving side, the constant pressure of insufficient saving was noticeable in Mexico and Venezuela, especially the former. This saving trend would also be expected to prevail in most of the other Latin American nations.

An attempt to approximate the saving-investment relationship through the money supply and national product allows for only rough estimates of the actual situation.
Furthermore, it does not allow one to manifest sound judgment with respect to the approximate state of international equilibrium of a nation because of the failure to take into account the external contribution via exports, imports, capital, and unilateral movements.

Yet, the influence of the current account may be closely estimated if a comparison between the international reserve movements and the supply of money is known. For the most part, the movement of gold and foreign exchange reveals the relationship between exports and imports. In a sense, they represent the money flow of the two accounts.

This second measuring device, which is to be employed in connection with the six countries chosen, should help in determining the success, or lack of success, of monetary, fiscal, and external policy application.

Table III, page 309, has been constructed to better visualize the changes in the national product and money supply of the five nations involved. In current terms, the percentage changes in the national product of the several nations appear exceptionally large (column 2). In many instances the national product figures seem to rise at a rate greater than that of the money supply. Yet, the yearly changes in real national product figures

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6Argentina was omitted because of insufficient price data.
**TABLE III**

**COMPARATIVE CHANGES IN NATIONAL PRODUCT, MONEY SUPPLY, AND PRICE LEVELS IN SELECTED LATIN AMERICAN COUNTRIES**

(in millions of domestic units)

<table>
<thead>
<tr>
<th>Country</th>
<th>National Product (see Table I)</th>
<th>Yearly % Change</th>
<th>Real National Product (see Table I)</th>
<th>Yearly % Change</th>
<th>Money Supply* (see Table II)</th>
<th>Yearly % Change</th>
<th>Wholesale Price Index (1953=100)</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>40,100</td>
<td>15.9</td>
<td>12,671</td>
<td>3.9</td>
<td>38,700</td>
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<td>20,753</td>
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<td>46,400</td>
<td>18.3</td>
<td>100</td>
<td>1953</td>
</tr>
<tr>
<td></td>
<td>82,400</td>
<td>25.4</td>
<td>-20,698</td>
<td>-5.8</td>
<td>72,800</td>
<td>24.2</td>
<td>131</td>
<td>1954</td>
</tr>
<tr>
<td></td>
<td>109,400</td>
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<td>37,872</td>
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<td>55,100</td>
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<td>147</td>
<td>1955</td>
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<tr>
<td></td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>54,600</td>
<td>12.8(Aug)</td>
<td>186(Sept)</td>
<td>1956</td>
</tr>
<tr>
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<td>12.5</td>
<td>4,300</td>
<td>8.1</td>
<td>1,048</td>
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<td>1952</td>
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<td>857</td>
<td>-1.5</td>
<td>2,089</td>
<td>14.2</td>
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<td>4,689</td>
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<td>28.2</td>
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<td>1954</td>
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<td>17,522</td>
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<td>3,755</td>
<td>6.2</td>
<td>2,975</td>
<td>13.8</td>
<td>124</td>
<td>1955</td>
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<tr>
<td></td>
<td>8,400</td>
<td>10.0</td>
<td>7,446</td>
<td>11.5</td>
<td>1,779</td>
<td>7.2</td>
<td>128(Oct)</td>
<td>1956</td>
</tr>
<tr>
<td>Chile</td>
<td>45,390</td>
<td>31.3</td>
<td>15,314</td>
<td>7.0</td>
<td>17,735</td>
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<td>55,760(Oct)</td>
<td>23.9</td>
<td>485(Aug)</td>
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<tr>
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<td>1,468</td>
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<td>7.7</td>
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<td>6.7</td>
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<td></td>
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<td>937</td>
<td>10.5</td>
<td>119</td>
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<td>295(June)</td>
<td>3.0</td>
<td>131(Sept)</td>
<td>1956</td>
</tr>
<tr>
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<td>960</td>
<td>7.7</td>
<td>814</td>
<td>6.7</td>
<td>437</td>
<td>17.1</td>
<td>103</td>
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<td>787</td>
<td>5.7</td>
<td>1,146</td>
<td>8.3</td>
<td>475</td>
<td>15.9</td>
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<td>1953</td>
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<tr>
<td></td>
<td>1,380</td>
<td>9.8</td>
<td>928</td>
<td>6.2</td>
<td>344</td>
<td>9.9</td>
<td>103</td>
<td>1954</td>
</tr>
<tr>
<td></td>
<td>775</td>
<td>5.0</td>
<td>753</td>
<td>5.0</td>
<td>674</td>
<td>17.7</td>
<td>103</td>
<td>1955</td>
</tr>
<tr>
<td></td>
<td>814</td>
<td>5.0</td>
<td>620</td>
<td>4.0</td>
<td>415</td>
<td>9.2</td>
<td>104(Oct)</td>
<td>1956</td>
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</table>


*Includes money and credit. naInformation not available.*
A glance at the price level index in Table III reveals the tremendous pressure exerted upon the price level caused, in part, by the exceptionally large increases in money and credit. There does seem to be a trend toward reducing the amount of money and credit in some of the countries. For example, the rise of money and credit in Mexico was reduced by nearly one-half in 1955, and together they actually declined in 1956. The money supply of Venezuela increased by a much smaller proportion in 1956 than in 1955. In addition, a similar trend occurred in Peru.

To make some specific observations, one finds that the percentage rise of the money supply of Brazil was several times that of the increase in the real national product. Although the percentage increase in the real national product was favorable, on the average, to the rise of the national product in industrialized nations, it was obvious that the money supply had to be enlarged by nearly 20 per cent each year in order to raise real national product figures to the amounts shown in Table III.

Mexico appeared to be in a much better situation than Brazil. The real national product showed larger yearly percentage increases with smaller proportionate injections of money and credit. Nevertheless, the
effectiveness of greater amounts of money and credit was quite small as compared to those of the more developed nations.

It is evident, too, that Chile has suffered because of especially large injections of money and credit ranging from 25 per cent to 58 per cent a year. On the other hand, the real national product rose from 7 to 19 per cent during the years for which information was available. According to the price index for the last two years of the period, prices rose to 277 and 485 per cent of the 1953 base year. These price increases, along with the exceptional rise in the money supply, would seem to support the conclusion that the real national income would have been a good deal lower in 1955 and 1956 than in the three earlier years.

National product (income) information was also lacking for Peru during 1955 and 1956. It required, however, an approximate 41 per cent increase in the money supply in the first three years of the survey to raise the real national product by about 13 per cent.

A more moderate rise in money and credit was evidenced in the case of Venezuela. Furthermore, the real national income rose in a consistent fashion throughout the five-year period. The relatively small changes in the price index is a manifestation of the greater degree of success in the employment of money and credit than is
true of the remaining four countries. On the other hand, the average price level was quite high throughout the period from 1952 to 1956. One reason which explains this condition is the fact that Venezuela's trade was closely allied with that of the United States (refer to the price data presented on page 246).

It may be recalled from an earlier analysis of Venezuela that large capital expansion occurred during 1952 and 1953. This expansion was attributed both to the oil companies and the private sector. The result of the added investment is revealed in Table III by a larger increase in real national product than that of the nominal national product at the end of 1953.

Table III makes possible several general conclusions with respect to the five nations under observation. Planned saving and investment were probably at a low level. At least one-half of the total expansion in the money supply was accomplished by credit expansion. The remainder consisted, therefore, of continuous injections of new money. In other words, realized investment may have been larger than realized savings in the respective nations because of the expansion of the money supply. The inflationary impact would tend to support this statement. Also, the large expansion in the money supply failed to yield proportionate yearly returns in the real national
output of these relatively underdeveloped nations. The opposite result would normally be expected in such countries. By this it is meant that added expenditures should provide immediate results via increased output. Once again, this effect suggests a partial long-term answer to the problem of growth, that is, a probability of mal-allocation of resources.

Evidently, little attention was directed toward the application of monetary and fiscal policy. Yet, and as pointed out on page 310, the expansion of money and credit appears to have been reduced in some of the countries by the end of 1956. In fact, the money supply of Mexico actually declined in the latter year. Furthermore, there seemed to be no apparent trend developed by either Group I or Group II countries that would distinguish one group from the other with respect to these matters.

Overall, Table III presents a picture which suggests that those in charge of guiding economic activity were unable to create a condition within the domestic sector which would contribute toward a state of international equilibrium.

Since it is quite clear that monetary and fiscal policy was rather ineffective and that the concept of international equilibrium was not a major objective of the domestic sector activity, the question posed is: what
was the contribution of external policy toward international equilibrium in the countries under observation during the five-year period?

In order to express judgment with respect to short-term capital movements and, hence, the relative condition of the current account of the balance of payments, the findings from the analysis of the first measuring factor—international reserves and the money supply of the several nations—may be helpful at this point.

It was found that international reserve holdings rose about as often as they declined. The total movement of these holdings indicated a net loss for the countries involved. Furthermore, the acquisition of international reserves was often possible only at the expense of depreciated currencies.

A partial result of this action was realized by imposing added difficulties in the domestic sectors. One of the most important problems created was the extensive rise in prices which occurred during the period. Venezuela was the lone exception in this respect. To carry the point a step further, the external problem caused by depreciated currencies which were reflected in the domestic sector, did not occur in Venezuela. In other words, the money supply of Venezuela rose by small amounts, and the real national product constantly increased. Thus, a
partial explanation for this effect was the fact that the country did not depreciate its currency.

The imposition of strict exchange controls by some of the countries further revealed their inability to attain a current account balance.\(^7\)

It would seem safe to state, therefore, that external policy was employed, in part, for the purpose of insulating the domestic sector, but apparently produced little beneficial results. To the extent that external policy was applied to accomplish a current account balance, the effect was either a failure to accomplish the goal or, if realized, the domestic sector suffered a setback. To sum it up, the authorities responsible for external policy did not co-ordinate such policy with a view toward accomplishing a condition of international equilibrium.

Before one can pass judgment in connection with the external sector, a more accurate measurement must be forthcoming. This is the purpose of the third measuring device which will now be observed. It was possible to estimate the approximate state of the current account based upon the flow of gold and international reserves.

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\(^7\)The following countries maintained government control of the purchase and sale of foreign exchange as well as multiple exchange rates: Argentina, Brazil, and Chile. A lesser degree of exchange restrictions were imposed by Peru and Venezuela. Mexico did not impose exchange control.
Yet, in order to provide a more accurate interpretation of the effectiveness of external policy, information with respect to both short-term and long-term capital movements is essential. This measuring device will now be considered.

C. Changes in Current Account Balances and Long-Term Capital Movements

A comparison of the current account balances with long-term capital movements provides us with a rough guide as to the directional flow of capital of the countries involved. A favorable current account balance (exports in excess of imports) indicates that long-term capital should move out of the country, on balance. The reverse capital flow would be occasioned if imports exceed exports, or an unfavorable current account balance prevailed.

There is, however, a serious shortcoming in such an analysis because capital movements are not likely to change as suddenly or abruptly as are the variations in imports and exports. In other words, the longer the time period involved as a basis for comparing these two factors, the greater is the accuracy in terms of need for capital.

Capital, as used here, is one of the major factors which supports saving and investment and, therefore, has an important role to play in helping to maintain the national product. The lack of saving and the tendency

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8 United Nations writers have developed an investment
toward unfavorable current account balances are characteristic of underdeveloped nations. Primary reliance is placed, therefore, upon the (inward) flow of capital to uphold a given income level. No doubt the inability of some countries to find a source of constant capital flow has, in turn, caused them to alter their exchange rates in an effort to provide a stable national income. Also, their inability to attract capital has forced them to create it internally. The result of such activity has contributed to inflationary pressures. This explanation suggests that if expanded sources of capital could be found, the problems relating to monetary, fiscal, and exchange policies would be alleviated to some extent.


A new approach for providing capital to underdeveloped areas is suggested by Professors Max F. Millikan and W. W. Rostow. Among other things, it provides for: (a) a long-term program of economic aid to be initiated by the United States, (b) America should make about $12 billion available to underdeveloped countries over a five-year period, (c) governments of other advanced industrialized countries should make available approximately $3 billion over the same time period to the underdeveloped nations, (d) measures should be taken to expand private investment to some $2.5 billion during the first five years, (e) the total funds of $17.5 billion should be loaned according to sound banking principles rather than allocated to specific countries, and (f) loans and grants should be made by existing national and international
It is not the purpose of this undertaking to specifically measure capital needs of the countries, but rather to show the wrong directional movements of capital, and, hence, the external problems associated with such capital movements and an explanation of how the lack of capital has influenced internal activity.

Table IV, page 319, is constructed for the purpose of revealing the relationship between current account changes and variations of long-term capital movements. Unilateral transfers are omitted from the calculations primarily because they consist of erratic types of capital movements. In addition, they are of minor significance to the majority of the countries considered here.

To begin the summary of Table IV, it would seem prudent to consider the relationship between the current account balances and long-term capital movements for the period as a whole. Five of the six countries realized import surpluses. Only Venezuela achieved an export surplus, on balance, for the four years reported. This result infers that the nations which obtained import surpluses should have witnessed an inflow of capital which would have helped to offset the current account balances.

<table>
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<td></td>
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<td>-25</td>
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<td>-893</td>
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<td>10(June)</td>
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<td></td>
</tr>
<tr>
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</tr>
<tr>
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<td></td>
</tr>
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<td>-4</td>
<td>50</td>
<td>108</td>
<td>68</td>
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<tr>
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<td>91</td>
<td>79</td>
<td>29</td>
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<td>233</td>
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</tbody>
</table>


*Unilateral transfers omitted.

**Direct investments included for most countries.
One of the five nations which occasioned import surpluses for the period—Argentina—did not achieve a capital inflow. In addition, Venezuela with an export surplus acquired an inflow of capital. This effect is contrary to normal expectations of a nation which realized an export surplus.

Looking at the account balances as a group, one finds that four of the six countries, all with import surpluses for the period considered, managed to import long-term capital. The other two nations witnessed wrong directional flows in their long-term capital balances.

To review the results in the specific countries, Argentina acquired an import surplus of $189 million. Instead of moving into the country, long-term capital moved outward to the extent of $28 million. Furthermore, gold and foreign exchange holdings declined during the period by $172 million. The failure of this country to reduce its import surplus, to attract long-term capital, and its inability to prevent the loss of gold and foreign exchange, all contributed to the explanation of its external policy, i.e., strict exchange control. At that, exchange control brought with it a depreciation of

\[^{10}\text{Refer to Table II, Changes in Money, Credit, and International Reserves, p. 295.}\]
Argentina's exchange rate.\(^{11}\)

The depreciation of the exchange rate was employed, in part, to reduce imports and to increase exports. The desired effect was not realized, however, during the period under observation. This kind of external policy apparently was not conducive to attracting long-term capital.

Since both short- and long-term capital declined over the period, the major portion of an increased supply of money and credit was accumulated internally. Although the internal factors as presented in Table III, and which are necessary to substantiate the prior statement, were unavailable for Argentina, all indications point toward such a result. In other words, the supply of money and credit should have risen along with prices, and the real national product should have declined, or, at least, remained quite constant.

One other point with respect to the external policy of Argentina should be made. It has to do with the effect of external policy and international equilibrium. In Chapter I of this paper it was contended that there is only one exchange rate and national income level which would provide an equilibrium condition; and that the national income may rise or fall, but there is only one

\(^{11}\)For a review of exchange rates see page 299, footnote 5.
exchange rate at each income level which would support an equilibrium. Furthermore, there may be different exchange rates but there is only one income level at each exchange rate that would assure equilibrium.\textsuperscript{12}

As far as the national income (product) is concerned, it has risen during the period, that is, at current prices.\textsuperscript{13} On the other hand, Argentina's exchange rate rose (depreciated) once over the same period of time. The question that arises, then, is: what significance may be attached to the change in the exchange rate with respect to the variation in the national income? The answer is that such exchange rate change apparently had very little to do with the variation in national income. In other words, such portion of external policy as was related to an alteration in the exchange rate was carried out for the purpose of alleviating the balance of payments rather than maintaining national income. And even at that, it has not been successful. Of course, the depreciation of the exchange rate may indirectly contribute to a rate of income which is conducive to maintaining a condition of equilibrium. This

\textsuperscript{12} Chapter I, pp. 24-25.

\textsuperscript{13} Refer to Table I, page 290. It should be noted that the national (product) income figures were not available for 1955 and 1956. It is assumed that their upward trend, in current prices, continued during these latter two years.
effect, however, has not occurred in Argentina. It would seem, therefore, that internal factors rather than external policy were primarily responsible for changes in the national income.

The experience in the external sector of Brazil presents a different picture from that of Argentina. Table IV reveals that Brazil encountered an import surplus during the period. In addition, only one year, 1953, revealed an export surplus. Long-term capital was attracted to Brazil in an amount greater than the current account's import surplus. Nevertheless, the gold and foreign exchange account showed a loss of these holdings (see Table II, page 295). The result was a near-equality in the balance of payments. Expressed in figures, they are: import surplus of $893 million and long-term capital inflow of $919 million, less short-term capital outflow of $73 million, or a capital movement balance of $846 million. From this vantage point, the external sector was nearly in balance. Yet, this result occurred, in part, because the nation's currency depreciated in nearly every year of the period considered.

According to the information presented thus far, it seems a bit strange that Brazil was able to attract a sizeable portion of long-term capital when the current account showed a negative figure, short-term capital was
moving out of the country, and the exchange rate was subject to numerous changes. The answer seems to be that the major portion of the long-term capital inflow consisted of foreign government or institutional funds, along with some private direct investment, rather than portfolio capital.14

Depreciation of the effective exchange rates apparently contributed somewhat toward relieving the current account imbalance. The internal result of exchange rate changes appeared to be of minor significance except for the probable influence registered in the higher price levels. More specifically, the change in the money supply was quite constant and revealed no changes that were proportionate to the variations of the exchange rate.

Although long-term capital was the major factor which closed the balance of payments import gap, the inflow of such capital created an internal problem. Long-term capital must provide a means of payment, in short, an export surplus. It was found, however, that the real national product did not rise at rates considered normal for underdeveloped areas. Furthermore, the rise in the real national product required huge increases in the money

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14 United States provided approximately $600.0 million of long-term capital during the three year period 1953–1955. See the International Monetary Fund, Balance of Payments Yearbook, Vol. 7, 1957.
It is conceded, however, that in the near future greater efficiency in the application of capital is probable. The 11.3 per cent rise in the real national product of 1955 suggests this likely outcome.

There further seems to be little direct correlation between the changes in national income and the pattern of external policy. Yet, external policy contributed more, no doubt, toward realizing an equilibrium situation in Brazil than it did in Argentina. The rise in Brazil's exchange rate did contribute to some extent toward a nearly-realized current account balance. A current account balance is necessary before a state of international equilibrium may be established. On the other hand, the depreciated exchange rates and the long-term capital inflows tended to transfer a part of the external responsibility to the domestic economy. Thus, the responsibility of monetary and fiscal policy became more onerous.

According to the information presented in Table IV, page 319, Mexico has witnessed an experience in the external sector somewhat different from that of Argentina and Brazil. An import surplus of $202 million accumulated from 1952 to June, 1956. Yet, the nation obtained an export surplus during the last one and one-half years of

15 Refer to Table III, page 309, and to page 310 of the present chapter.
that period.

With respect to capital movements, Mexico was able to acquire an inflow of long-term capital amounting to approximately $419 million. In addition, gold and foreign exchange showed a positive balance of about $185 million.

To round out the external picture, only one change was occasioned in the exchange rate. The authorities raised the Mexican exchange rate (depreciated the currency) in 1954. One result of such action was mentioned above; that is, an export surplus arose in 1955.

To what extent the depreciation of the exchange rate was beneficial or harmful is difficult to say. As a part of short run policy it appeared beneficial. There is some question as to the method employed in dealing with the deterioration of the current account balance which lasted until 1954. It would seem commendable, however, that the authorities chose currency depreciation in preference to some form of exchange control. Yet, the domestic sector appeared to be as responsible for the inflationary impact as was the external sector. Table III, page 309, shows that the money supply expanded rapidly through 1954. Thereafter, monetary and fiscal measures were applied with more success. This result occurred even though export income was contributing to the money supply.

Returning to Table IV once again, one finds that
long-term capital flowed into Mexico in a constant stream. This flow does not mean that the amounts of capital were especially large in any one year. Nevertheless, capital accumulation for the period as a whole totaled $419 million. In order to visualize the effectiveness of this capital inflow, one must consult the results registered by the real national income. The year 1953 occasioned a decline in both the nominal and real national income (product). But beginning with 1954 and continuing through June, 1956, the real national income rose at something more than moderate rates. In addition, the money supply in 1955 increased by only one-half that of 1954, and it declined in 1956. Surely this explains that the efficiency of capital was much greater near the end of the period than in the earlier years.

But what about the contribution of external policy toward a condition of international equilibrium? The depreciation of the peso did convert an import surplus into an export surplus. This action, in itself, may not solve the current account problem. There is created, however, an atmosphere for the free rate to be subjected to the forces of demand and supply. So far, the new rate has been maintained and an export surplus has been created. The situation may change as the long run forces make their weight felt. The depreciated rate no doubt was influential
in raising the price level by nearly fifteen points in 1955. Nevertheless, the increase amounted to only four points between 1955 and October, 1956 (see Table III, column 7, page 309).

The stock of gold and foreign exchange reserves were larger by some $185 million. This accumulation can be utilized in case of a temporary current account deterioration.

The external sector has been favorable enough to attract long-term capital. The desirability of capital inflow depends upon the relation between exports and imports and saving and investment plus the ability of the economy to show a larger output. Recent Mexican experience reveals that the export surplus reduces the need for so much outside capital. On the other hand, it was found that, in general, the deficiency in saving required the inflow of capital. The tedious balancing of these factors seemed to create a more favorable result in the latter years of this study, particularly after depreciation became effective.

With respect to the influence of capital inflows, it was found that the country could better utilize increasing amounts of capital as time passed. The reason for this is found in the greater efficiency that was evident in the domestic sector. Also, the inflow of capital
seemingly reduced the need for continued expansion of money and credit. Finally, the export surplus which was required to service capital imports became a reality.

For these reasons, it is quite certain that those in charge of external policy were concerned with the state of international equilibrium as they made their decisions relating to the external sector. In conclusion, one should further state that monetary and fiscal policy were responsible, in part, for the reorientation of the more sound economic condition which has been accomplished in Mexico.

Turning to Chile, Table IV, page 319, shows that this nation has acquired an import surplus for the period (1952-1955) amounting to about $30 million. Oddly enough, there was only one year (1953) in which Chile occasioned an import surplus. Nevertheless, this figure was greater than the export surpluses of the remaining years.

Capital, on balance, flowed inward. The extent of the inflow ($84 million) was more than enough to offset the import surplus of the current account. Gold and foreign exchange holdings increased, too, by about $36 million.

On the surface it would appear that Chile was witnessing little trouble in carrying out its external policy. Looking further into the matter, one finds that
the opposite situation prevailed. An important reason which explains the prevalence of an export surplus in every year except 1953 was the continual depreciation of the exchange rate. The rate change was violent. In 1951 the exchange rate was 90 pesos per dollar; in 1956 the rate was 563 pesos per dollar.

A short review of exchange rate variations will begin with the year 1952. An export surplus amounting to about $8 million was realized. This surplus was possible primarily because of the depreciated rate which changed from 90 to 118.6 pesos per dollar at the close of 1952.

At the end of 1953 an import surplus of some $69 million occurred. Perhaps a good explanation as to why this result took place is found in the variation of the exchange rate. In 1953 the effective rate was appreciated, that is, from 118.6 to 110.0 pesos per dollar. Evidently, the external sector of the economy was extremely sensitive to this new, lower (appreciated) rate. The result was that imports rose while exports declined, or, at least, the two failed to move proportionately. With the realization of the sensitivity in the external sector, the authorities allowed depreciation of the exchange rate to continue throughout the remainder of the period. In other words, the only way in which an export surplus could be accumulated was by repeated depreciation.
As for capital inflow, figures relate that long-term capital moved into the country in three of the four years for which information was available. As in the case of Brazil, a major portion of the Chilean inflow has come from foreign governments or financial institutions rather than from individuals.

The gold and foreign exchange reserve balance for the period amounted to approximately $36 million (refer to Table II, page 295). Since an import balance occurred over the same period of time, this balance implies that the country was losing (selling) short-term assets in order to cover excess imports.

It has already been pointed out that monetary and fiscal policy was applied with little success in Chile. External policy appears to have been just as ineffective. But getting closer to the facts, one would, in the first place, question the ability of a nation to enjoy benefits from continued depreciation. In the case of Chile, the persistent depreciation brought with it significant rises in the price level. Table III, page 309, indicates a 57 per cent rise in prices in 1954 over those in 1953. With further depreciation in the following year, the price level rose by over 100 per cent of 1954. Again in 1956 the price level increased. It reached a height of some 485 per cent of the base year, 1953. Of course, some of the responsibility
for rising prices attaches to internal causes. Yet, the external policy must have contributed in no small way to this unfortunate experience.

The accumulation of long-term capital constitutes a problem of repayment. A nation that is able to create export surpluses only at the expense of severe depreciation cannot maintain such a situation indefinitely. And since it cannot, defaults in capital repayments may be expected unless the problem is solved. There seemed to be no substantial effort directed toward a state of international equilibrium in Chile.

Peru is the only country in this survey which recorded an import surplus in its balance of payments in every year of the survey. The total amounted to $189 million. This trend occurred even though the currency depreciated. In fact, the inability of the nation to sell more abroad was responsible, in part, for the changing value of its currency which took the following course: 15.43 soles per dollar, 1952; 16.35 - 1953; 19.39 - 1954; and 19.00 - 1955-1956. It is true, however, that the exchange rate was held constant during the last two years at a rate slightly lower (appreciated) than that of 1954. Nevertheless, the only improvement realized appeared to be a larger amount of long-term capital inflow.

To trace the long-term capital movements, one finds
that capital was inward on balance during the period. The total inflow of $156 million was, nevertheless, less than the current account deficit. This condition is indicative of a fundamental disequilibrium, and serves notice of a long run problem with respect to the external sector of this country. Furthermore, gold and foreign exchange holdings as presented in Table II, page 295, show a change of only $1 million.

The result of Peru's external experience over this relatively short period of time may be explained in that (1) the nation has been selling short-term assets, and (2) some portion of its trade was carried on by clearing agreements.

The external problems of the Peruvian economy would be expected to cause some repercussions within the nation. To better understand the domestic disturbances, one may refer back to Table III, page 309. Because of the inability to acquire foreign capital in desirable quantities, the internal money supply was forced to expand. In doing so, the rate of money expansion was greater than the productive facilities could support. Thus, inflation occurred. The constant rise in the price level was attributed, in some degree, to the extensive depreciation of the exchange rate.

It would seem prudent to state, then, that the rise
in the real national product of less than one percentage point in 1954, the last year in which national product information was available, was a partial responsibility of external policy.

There is little justification for stating that the concept of international equilibrium was visualized, much less applied, in connection with the external policy of Peru.

With a brief discussion of the external policy of Venezuela, this survey of the six nations will be completed. Venezuela is the only nation of the group that obtained an export surplus over the period considered. The amount of this surplus was $68 million.

The long-term capital movement which was inward, on balance, for the period, flowed in the wrong direction and thus did not enable the country to maintain an equilibrium in its balance of payments. In addition, gold and foreign exchange accumulated to the extent of $156 million.

The experience of Venezuela is, therefore, different than that occasioned by most of the older countries considered thus far. To use an analogy similar to that employed in the discussion of the other countries, it would appear that the exchange rate of Venezuela was overvalued. But this reflection would be incorrect. The major reason why this nation has attained an export surplus is to be
found in its huge petroleum shipments. All other items making up its exports and imports do not reveal the tendency toward an appreciated currency. In other words, the fact that Venezuela's one major export is oil should not lead one to believe that that item determines the rate of exchange of the country's currency.

On the other hand, the experience in Venezuela's external sector is such that it could have created severe internal problems. These problems were mitigated, however, by the wise employment of monetary and fiscal policy. Since earlier discussions have explained the application of domestic policy measures, it will suffice at this point to call attention to Chapter III which indicates that the Federal Government and, in certain respects, the Central Bank carried out policies which prevented extreme inflation. The results of their action is presented in Table III of this chapter. It shows that the increases in the money supply were quite effective in bringing forth additional production so that the real national product rose steadily. And it did so without sharp increases in the price level.

The inflow of foreign capital seemed to be utilized to further production rather than merely to add to the blaze of inflation. In this period of early growth it appears that Venezuela was capable of employing large amounts of capital quite successfully.
There is one certain danger in connection with the external sector of the nation's economy. Should the country ever lose its heretofore dependable export market for petroleum, its current account would be subject to a sudden reversal.

The authorities in this nation, perhaps more than those of any other included in the survey, seem to have worked toward a more balanced economy. In the external sector, the exchange rate was maintained at 3.35 bolivares per dollar throughout the whole period. The satisfactory current account balance encouraged the inflow of capital. From a long run viewpoint, the nation was able to produce an export surplus which is essential to service the inflow of this type of capital. All this occurred with only moderate changes in prices and a steady rise in real income.

To conclude this section, there appears to be no clear-cut trend which emphasizes a definite type of external policy of the domestic economies of Group I nations which is distinctly different from that employed by the external economies of Group II countries. For example, Argentina and Brazil, two representative nations of Group I countries, occasioned nearly as much external difficulty as did Chile of the Group II nations. In fact, Argentina and Brazil witnessed more serious problems in
the functioning of their external sectors than was true of Venezuela. On the other hand, Mexico of the Group I classification was more successful in overcoming external difficulties than was Chile or Peru.

Once again there appears to be sound justification for stating that each nation is confronted with a set of problems which are peculiar to that nation. An attempt to set forth recommendations for the purpose of relieving difficulties, whether of internal or external origin, encompassing several nations or a specific area can be expected to meet with only limited success.

The nations involved in this study employed various means to achieve a current account balance, none of which realized this goal. The specific measures varied from a nearly free market determination of the exchange rate—as in the case of Mexico—to severe exchange controls as applied by Argentina, Brazil, and Chile.

Depreciation was the most popular device used to help solve the current account problem of these countries. The effect of depreciation differed in the several nations. From a short run viewpoint, Mexico appeared to achieve some success after depreciation was instigated. On the other hand, the depreciation of the Chilean exchange rate probably produced more harm than good.

Appreciation as an external device was little used.
It appeared only in connection with two isolated instances. The Chilean peso rate appreciated in 1953. The realization of an import surplus in the same year led, however, to depreciation. Peru was the other nation which revealed an appreciated exchange rate. The change occurred in 1954 and was of small magnitude.

The three measuring devices as developed in this section yield valuable information which may be used as a partial basis to explain the effectiveness of monetary, fiscal, and external policies. An analysis has shown that the several nations enjoyed different degrees of success, or lack of success, in applying the three policies. In fact, these observations indicated some of the factors which caused difficulties in the functioning of the economies.

Not only was it possible to describe the general effectiveness of internal and external policies, but the three measuring devices revealed how one policy measure influences the operation of other such measures. In this respect, one may determine with the aid of those measuring devices the relative importance of monetary, fiscal, and external policies as each of them is employed. Finally, the measuring devices serve as a basis for judging whether or not a nation is directing its policies toward a condition of international equilibrium.
II. GENERAL CONCLUSIONS

In Chapter I the concept of international equilibrium was presented. Briefly, it explained that a nation could maintain a given national income at a stated exchange rate provided that saving equated investment and imports equated exports. Furthermore, the above condition could be achieved if the balance between the internal accounts of saving and investment were different from those of the external accounts of imports and exports, provided that the movement of capital was equal to the difference.

It was also proposed that a condition of international equilibrium is unlikely to be achieved without the employment of flexible monetary, fiscal, and external policies. To substantiate the above statement, it was shown that underdeveloped countries are not likely to acquire or lose capital in amounts sufficient to provide a balance between saving and investment and imports and exports. Furthermore, some of the internal difficulties experienced by the lesser developed countries are not directly related to capital flows. The tremendous desire to develop the countries may serve as one example which creates internal problems. Then too, external difficulties evolve which have little direct relation to capital movements. For example, it appears that some nations attempt to control exchange rates and depreciate, or appreciate,
their currencies in order to attain current account balances. The strict control of exchange rates or the intermittent juggling of these rates reflect changes in demand and supply of foreign exchange regardless of capital movements.

Important factors which relate to the functioning of underdeveloped nations may have an impact which is quite different from the influence they would expect to have in highly industrialized nations. These factors create, therefore, additional problems for study.

In connection with the relationship of these factors to monetary policy, it was found that in Latin America there was a lack of uniform banking systems. One nation was found to have a central banking system, a second nation relied upon foreign branch banks, and a third country emphasized commercial banking with little central direction. Although there was a definite trend toward central banking in this underdeveloped area, the different types of banking systems created a problem of monetary control. The survey of Mexico and Venezuela revealed that the controls employed by the Central Bank of Mexico were different from those utilized by the Central Bank of Venezuela. The Central Bank of Mexico required that commercial banks keep up to a 100 per cent reserve against deposits, but provided an escape clause which allowed lower reserves if
loans were channeled into predetermined sectors, or if the banks provided a certain portion of short-, intermediate-, and long-term loans. This kind of control provided quantitative and qualitative requirements with an issue of one decree. On the other hand, the Central Bank of Venezuela retained the more orthodox controls such as changes in reserves, rediscount privileges, and so on.

It was found that savings banks were quite numerous in Mexico; the number of these banks increased a good deal in recent years. Yet, in Venezuela there were no savings banks.

Interest rates played a rather unimportant role in the countries studied. In general, interest rates were high, and were determined by the governments rather than by the demand and supply of money. One of the reasons offered in explanation of the lack of influence exerted by interest rates in channeling funds was the failure to establish organized exchanges, or, at least, the fact that such exchanges were just beginning to develop.

In addition, the control over money and the banking systems by the governments or autonomous entities tended to prevent or restrict the implementation of the more orthodox monetary measures.

Fiscal factors pose problems in underdeveloped areas that are different from those of the more developed
nations. Not only are personal savings quite low but, for this reason, the tax structure often differs from that found in the relatively more developed countries. Although progressive individual taxation was in operation in both Mexico and Venezuela, the rates were very moderate in the former country while taxes derived from petroleum far exceeded those levied on personal income in the latter nation.

It is certain that capital accumulation is becoming more effective in many of the Latin American countries. Yet, a study of two of the more advanced countries in this area revealed that capital accumulation is a slow process. The incentive toward capital accumulation via development programs was surely not lacking. The rapid rise in money, credit, and prices was indicative of the limited ability of most of the nations to increase real output.

Either the governments or their representatives, the autonomous entities, rather than private enterprise, seem to enjoy a major share in the direction of economic activity. Nevertheless, there appeared to be definite indications as to the desirability of expanding private enterprise in Mexico and Venezuela. In the case of Mexico, loans were made in increasing amounts directly to individual firms. Also, one of the larger autonomous entities offered its assets for sale to private bidders. With
respect to Venezuela, private groups were spending millions of dollars in the various fields of trade and commerce.

External policy of the lesser developed nations is usually practiced in a manner distinguishable from that of the more highly developed countries. For instance, the exchange systems of the Latin American nations varied from flexible exchange rates, as in the case of Mexico, to strict exchange control systems of Argentina, Brazil, or Chile. In between these two extreme types of exchange systems were those of Venezuela and Peru in which some moderate form of exchange control was practiced.

Both internal difficulties and external problems seem to explain why some form of exchange restriction is utilized. In an earlier section of this chapter it was explained that most lesser developed countries rely quite heavily on external trade. This reliance is greater, perhaps, than is indicated by a comparison of the contribution of export income to total income. Also, nearly all of the countries considered were unable to create an equilibrium in their current accounts. Yet, it was also found that the majority of the nations were plagued with internal problems normally associated with development plans.

The evidence presented revealed that a few of the countries employed external controls in order to isolate
their domestic economies. Venezuela, for example, appeared to do this. On the other hand, Chile showed a severe current account problem. This difficulty was largely responsible for the implementation of a strict exchange control system. The pattern of exchange restrictions in other countries indicated that they were created for the purpose of mitigating both internal and external difficulties.

This analysis further suggested that at least a few of the countries attempted to seek a rate of exchange which expressed a closer relation between demand and supply conditions. The depreciation of the Mexican exchange rate was indicative of this reasoning. Nevertheless, depreciation of currencies by most of the countries seemed to create a more serious internal problem than the difficulty it was supposed to overcome in the external sector.

Such observations implied that the approach to the study of underdeveloped countries must be altered somewhat from that employed in the study of developed nations. What may be key factors for studying problems of advanced nations may be of minor significance in the study of the lesser developed countries.

From a policy standpoint, Mexico was unable to successfully cope with the numerous internal and external problems until near the end of the five-year period.
Two outstanding reasons given to explain the lack of effective policy results were (1) a failure to co-ordinate monetary, fiscal, and external policies and (2) improper timing of policy measures. Since all economic activity was centered around economic development, policy implementation was made more difficult. Yet, those in charge of policy making appeared to direct policy toward a more balanced growth pattern.

Although fiscal and, to some extent, external policies were more important in Venezuela than was monetary policy, the whole period was characterized with exceptional stability for an underdeveloped country. Even though economic development was an important objective, financial stability was not forced into the background.

The external sector was responsible in large measure for the relative economic stability over the five-year period. Export income was usually channeled into the hands of the government and utilized as a part of fiscal policy instead of being directed into the banking system and thereby being controlled by monetary policy.

One of the most serious threats to economic stability in Venezuela is the possible loss of its export market. Yet, an analysis of this country indicated that this shortcoming was realized and that great effort was made to diversify domestic industries.
Neither Mexico nor Venezuela achieved a condition of international equilibrium during the five-year period under study. It would seem quite logical, however, that the lesser developed countries would not achieve such a delicate balance among the several factors required by a state of international equilibrium. Nevertheless, these two nations came closer to achieving this goal than did any of the other four countries considered in the present chapter.

A study of the two dissimilar economies of Mexico and Venezuela in Chapters II and III, respectively, leads one to suggest the necessity of incorporating measuring devices for the purpose of revealing the effectiveness of monetary, fiscal, and external policies. Although several kinds of measuring devices may be useful, those offered in this study were (1) the relationship between gold and international reserves and the money supply, (2) a comparison between the money supply, national product (income), and the price level, and (3) changes in current account balances and long-term capital movements.

The use of the first measuring device sustained the proposition that greater monetary stability is possible in the open economies of the lesser developed countries if changes in money and credit are proportional to the variations of gold and foreign exchange holdings. The
application of this device among six representative nations of Latin America indicated that little effort was expended by the authorities in most of these countries toward maintaining a direct relation between changes in gold and foreign exchange holdings and the money supply.

The second measuring device showed the relative effectiveness of domestic policy, that is, monetary and fiscal policy. The result of this measuring device revealed that planned saving and investment, besides being quite small, produced a situation in which realized investment was larger than realized saving. Money and credit were primarily responsible for this condition. Inflation prevailed, therefore, in most of the countries reviewed. In addition, the evidence indicated that some of the nations were in no position to absorb large amounts of capital flow. With only a few exceptions, monetary and fiscal policy was applied with little success.

The third, and final, measuring device revealed the portion of the external problem which was associated with capital movements. It also indicated the internal influences exerted by capital flows. Of the six nations under observation, it was found that the majority realized an import surplus. In some cases, the capital flow was inward; however, the amount required to cover the import surplus was not sufficient. It was larger than that
required to balance the import surplus in only one instance. In addition, one country witnessed an export surplus and a capital inflow. In any event, capital movements did not offset current account balances in exact proportions.

The flow of capital had much to do with depreciation which, in itself, created internal difficulties. The most noticeable difficulty was the pressure on the ascending price levels of most of the countries.

This last measuring device is also useful in helping to determine the approximate need for capital and the ability of a country to absorb it. At present, popular criteria for explaining capital needs center around the association between changes in capital and available goods and services. A consideration of the three measuring devices would give a better indication of the probable effects on the functioning of the economy as a whole occasioned by a change in capital movements.

There are other beneficial results to be derived from the utilization of the three measuring devices mentioned in the preceding paragraphs. For example, they provide a means for checking the effectiveness of policy implementation. By this is meant that these devices indicate whether or not monetary, fiscal, and external policies are clearly implemented toward the purpose of achieving a condition of international equilibrium. This objective or
goal is, of course, subject to change in a dynamic economy; yet, the measuring devices act as signals calling for changes in policy application for the purpose of producing a more balanced growth.

This study has quite conclusively supported the view that the intensive desire for economic development is so strong that it tends to overshadow the principal objective of balanced growth as expressed by the concept of international equilibrium. This trend is dangerous from the standpoint of both short and long run growth. As observed, the short run effect of stimulated development often produces high prices and inflation rather than increased output. From a long run viewpoint, there is the problem of mal-allocation of resources. This difficulty, in itself, may turn possible short run gains into long run losses, particularly if key factors are inflexible to change.

An analysis of the evidence covered by this study reveals that there is but limited benefit to be derived from making broad observations which may be said to apply to groups or areas of nations. Each country is confronted with problems and means of solving them, and these are often different from nation to nation.

Although this study has suggested, at various times, the influence of long run structural factors, it has covered but a five-year period. It therefore contains
shortcomings which will become clearer as the short run blends into a longer period of time.
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BIOGRAPHY

Dale L. Cramer was born in Dixon, Illinois in 1924. He was educated in the public school system and graduated from Dixon High School in 1942. Subsequently, he received the Bachelor of Science and Master of Arts degrees from Bradley University. The latter degree was conferred in 1951.

He served in the United States Army from January, 1943 to February, 1946. Eighteen months were spent in the European Theater of Operations.

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