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PLANNING, PUBLIC EXPENDITURE AND GROWTH: SOME INTERNATIONAL EVIDENCE *

I.

Public expenditure and the public sector have come under severe criticisms in the recent years. Broadly, there are two types of criticisms: (a) alleged failure of economic planning in both socialist and mixed economies, and (b) excess growth of public expenditure which is alleged to have caused not only inflation but also recession in industrial countries (1). Both criticisms basically emanate from an ideological perspective about the role of state in economic activity. Neo-classicals not only disapprove of Marxian and Marxian influenced development planning models but also question the validity of Keynesian theory of public expenditure as an instrument of stabilisation (2). The concept of 'welfare state' which has gained acceptability in the post-war period and is responsible for rise in social welfare expenditure in most industrial countries after the second world war is also attacked as 'selfishly redistributive' (Becker 1985, and North 1985) and affecting consumer choice and individual freedom (Buchanan 1975) (3).

Keeping aside broad theoretical and ideological issues, the neo-classical criticisms of public expenditure and the public sector rest on the following assumptions: (a) economic planning distorts prices, mal-allocates resources and thereby retards growth and welfare; (b) public investment 'crowds out' private investment which has a higher productivity than the former; (c) public expenditure beyond 'monetary' rather than 'fiscal' norms is inflationary; (d) social welfare expenditure reduces private saving, work incentives and labour productivity; and (e) finally, at the microeconomic level, public expenditure and taxation have detrimental effects on resource allocation, economic incentives and income generation (4).

In view of these it would be worth examining whether: (a) the so called free market economies have performed better than planned economies or not, and (b) public expenditure in general, and social welfare expenditure in particular, has been responsible for recent inflation and recession in industrial economies or not.

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II.

Traditional neo-classical literature on economic growth emphasized the success of Latin American countries. In the recent period the attention has been shifted to East Asia, and in particular to the so called 'gang of four': South Korea, Taiwan, Hongkong and Singapore. The rapid economic growth in East Asia, according to Bhagawati (1985), Krueger (1986) and many others, is basically due to 'open door policy' with regard to not only foreign trade but also private capital flows and least interference by government in free market mechanisms. Further, they argue that the East Asian success can be repeated in other developing countries with a similar policy package (5). Little (1982) predicts that "inEast Asia capitalism would produce results that make its nineteenth century performance look like that of a donkey" (quoted in Chakravarty, 1987). Linder (1986) goes even further and asserts that Asian NICs have played havoc with neo-Marxian views of growth, so that concepts like 'periphery', 'dependency', 'exploitation' and 'delinking' have lost much of their attraction. He also claims that newcomers can make rapid progress through capitalism. In contrast to them, Chakravarty (1987), Streeten (1980) and Lewis (1984) caution against such hasty generalisation of East Asian success and argue that East Asian growth model is neither pure neoclassical, nor is it easily replicable in other developing countries, particularly in a democratic country, like, India.

The basic contention of the neo-classicals is that free (of freer) market economies perform better than planned economies. As an evidence they typically contrast slow growth in India with rapid growth in East Asia. Such a comparison is however inappropriate for two reasons. First, as Lewis (1978) rightly pointed out "If India was carved into countries of Latin American size, we would find several regimes that matched Latin America or East Asian performance; what holds down India's average is the larger population that continues to live at subsistence level". Second, and more important, is that in a mixed economy, poor performance can be attributed to either, or both, private and public sector. A more appropriate test would therefore be a comparision of growth between socialist and free market economies.

International comparison of national income growth rates suffers from several pitfalls. First, the concept of income differs between socialist and non-socialist economies. The former measures net (or gross) material product which is conceptually different from net (or gross) domestic product. Secondly, prices and relative weights of goods and services differ between countries. Finally, conversion of different country estimates into a common unit of measurement through an appropriate exchange rate is an acute problem. Despite all these limitations UN and World Bank (hereafter WB) publish international data on national income and growth rates, and such data are widely used in empirical research.

UN converts individual country estimates of national income or net material product into US dollar through prevailing exchange rates. WB instead uses a 3 yearly average of exchange rate. WB also adjusts the official exchange rate data whenever it is considered to be significantly different from the effective exchange rate applied to actual foreign exchange transactions (6). The growth rates from

these two sources may therefore differ, and hence we may use both sources. Neither UN nor WB figures are adjusted for differential purchasing power of domestic currencies. A comparison of WB estimates with UN international comparison project estimates of real GDP computed on the basis of purchasing power parity, suggests that exchanges rates probably underestimate real income of socialist economies relatively more than free market economies (7). This may be due to two reasons: (a) underpricing of basic necessities in socialist economies, and (b) relatively more stable prices in socialist economies as compared to free market economies.

Table 1 presents growth rates of major socialist and representative market oriented developing economies of Asia and Latin America from both UN and WB sources for the period 1960 – 79. Taiwan is excluded for lack of data in either sources. Instead we have included Spain which has achieved fastest growth among developing countries of Western Europe. The sample period is choosen on two considerations. First, WB data on most socialist economies are not available after 1979. Secondly, free market economies have generally achieved peak growth rate during Sixties and Seventies, and suffered from recession in the Eighties.

As mentioned before, it is difficult to draw any definite conclusions from Table 1. Notwithstanding limitations, Table 1 however suggests, that socialist economies in general have performed better than so called free market developing economies. In fact if we compare average performance of socialist economies with all other economies, excluding oil rich middle east countries, (data not reproduced here) then the performance of the former may appear to be still better, as far as growth rate is concerned. Further, if we take note of relatively better income distribution and price and income stability in socialist economies then it is not at all clear why free market economies may be considered better than planned economies.

In East Asia, South Korea, Hongkong and Singapore have performed very impressively, although Romania has done even better. In Latin America only Brazil alone has achieved a fast growth rate, but it has lagged behind all socialist economies, except North Korea, Czechoslovakia and perhaps USSR.

Hongkong and Singapore are basically city states. Hongkong grew mainly due to export of labour intensive goods, and Singapore owes its success, among other factors, to international financial centres (Chakravarty 1987). It is therefore too naive to assume that these two tiny states can provide a model of development that can be replicated in giant states, like, India and China.

South Korean's development no doubt is very impressive, particularly in comparison to North Korea. South Korea's development has however some disturbing features. First, it has one of the highest external debt/GNP ratio. Secondly, average inflation rate in South Korea at above 15 per cent per annum is far higher than most other developing countries, excluding hyper-inflationary Latin America. Third, it has a very skewed distribution of income (8). The negative features of South Korea are even more pronounced in Brazil.

South Korea's economy is not purely 'free'. Wage rate and credit policy are strictly controlled by the government. Scitovsky (1985) reported that the average

Table 1: Comparative Performance of Socialist and Market Oriented Developing Economies, 1960 – 79 (average annual percentage growth rate of per capita Real GNP/Net Material Product)

Socialist Economies	W.B.	U.N.	Market Oriented Developing Economies	W.B.	U.N.
Korea, Democratic Republic	3.5	–	Malaysia	4.0	–
Romania	9.2	8.3	Korea, Republic	7.1	7.2
Bulgaria	5.6	7.2	Hongkong	7.0	6.8 a)
Yugoslavia	5.4	5.1	Singapore	7.0	6.3
Poland	5.2	6.0	Mexico	2.7	2.8
Hungary	4.8	5.4	Chile	1.2	1.0
U.S.S.R.	4.1	5.7 b)	Brazil	4.8	6.3 c)
Czechoslovakia	4.1	4.5	Argentina	2.4	2.5
German Dem. Rep.	4.7	4.9	Spain	4.7	4.7
China	5.0 d)	–	Indonesia	4.1	2.6

a) 1963 – 79, b) 1960 – 76, c) 1965 – 79, and d) 1960 – 81

Sources: World Bank – World Development Report (1981), p. 135; U.N., Yearbook of National Accounts Statistics 1980, Volume II, International Tables, pp. 251 – 390.

length of the working week in manufacturing industry in South Korea in 1980 was above 59 hours, which was at least 50 per cent more than the same in India and Indonesia, where it varied between 35 to 40 hours. Such a long working hours in South Korea can not be explained by work ethics alone. To a great extent it is due to the lack of bargaining power of trade unions under military regimes. In both South Korea and Brazil real wage rate lagged far behind labour productivity, which enabled them to maintain export competitiveness. Such a policy can not be practiced for long in a democracy, like India.

It is interesting to note that while South Korea succeeded through relatively free market mechanism, Chile failed miserably. Chile, after 1973, can be regarded as an almost laboratory test case of neo-classical growth model. And yet the real GDP in Chile grew only 2.0 and –1.1 per cent per annum during the period 1973 – 79 and 1980 – 85 respectively, and per capita real GNP has actually declined after 1973 (9). Until now neo-classicals have not been able to provide any satisfactory explanation why Chilean experiment failed. The Chilean failure raises a big doubt about the universal application of a standard neo-classical growth model.

Many of the socialist countries listed in Table 1 – Bulgaria, Poland, Hungary, USSR, Czechoslovakia and GDR – are listed as industrial economies in World Bank (1981). It may be of some interest therefore to compare their relative performance with industrial market economies. According to World Bank (1981, p. 135), except Japan, which is a special case of its own, none of the other industrial market economies have performed as good as any socialist economy in terms of average rate of growth of per capita real GNP during the period 1960 – 79. In fact, excluding Austria and Finland, all industrial market economies have performed much worse than even the slowest growing socialist economies.

III.

After the second world war there was a general consensus in favour of public expenditure in most industrial countries. This was partly due to Keynesian revolution and partly due to the gradual acceptance of the policy of 'welfare state' as opposed to 'minimal state' advocated earlier. The basic debate in those days, as mentioned by Saunders & Klau (1985), was not the need, but the form of additional public expenditure. In the Seventies both Keynesian economics and 'welfare state' have come under increasing criticisms from monetarism, rational expectations school and supply-side economics, and the focus of attention has now shifted to the relative size of public expenditure. Critics argue that excess growth of public expenditure has not only caused inflation but also slowed down GDP growth rate in industrial economies.

Table 2 presents long-term growth rate of real GDP, inflation rate, unemployment rate and the share of public expenditure in GDP at current prices in OECD countries during the period 1960 – 84 (10). As expected, the Japanese growth rate turns out to be far superior to the rest. The Japanese miracle however can not be explained in terms of a neo-classical growth model; it owes a great deal to its economic nationalism and culture. If we exclude Japan, then we find no systematic relationship between long-term GDP growth rate and share of public expenditure in GDP. The simple correlation between the two is –.4 (R^2 = .2) which is hardly significant. In fact, if we drop Spain and Portugal – the two countries which explain a significant proportion of inverse relationship – the simple correlation becomes + .4 (R^2 = .2). Nor does there appear to be any systematic relationship between the long run inflation rate and share of public expenditure. In fact the correlation coefficient turns out to be negative (– .6) rather than positive. Even if we drop Spain and Portugal, which had much higher than average inflation rate among all countries, the correlation coefficient continues to be negative (– .5). From the long-run behaviour therefore we can neither infer any inverse relationship betwen GDP growth rate and share of public expenditure nor any positive relationship between inflation rate and share of public expenditure. On the other hand there appears to be a fairly strong inverse relationship between share of public expenditure and unemployment rate (r = – .65).

The basic argument against public expenditure is however based not so much on the long run behaviour but on the apparent inverse relationship between real GDP growth rate and share of public expenditure in post 1973 period. Industrial countries have suffered from two major recessions in the recent years: 1974 – 75 which was short but sharp, and 1979 – 83 which was less acute but prolonged. Table 3 shows that while average growth rate of real GDP declined in all industrial

Table 2: Long-Term (1960 – 84) Growth, Inflation and Unemployment Rates and Share of Public Expenditure in GDP in OECD Countries

	Real GDP growth rate (a)	Inflation rate (a)	Unemploy-ment rate (b)	Share of Public Expenditure (c)
USA	3.3	5.4	5.9	32
Japan	6.9	6.6	1.7	28
Germany	3.1	4.0	2.5	42
France	4.0	7.4	2.9	42
UK	2.2	8.5	3.9	41
Italy	3.8	9.8	6.3	40
Canada	4.2	5.8	6.5	37
Austria	3.7	5.0	1.9	43
Belgium	3.4	5.6	4.8	41
Denmark	3.1	8.0	2.9	43
Finland	4.0	8.2	3.3	34
Netherlands	3.3	5.5	3.9	48
Norway	4.1	7.0	1.5	43
Portugal	4.7	13.1	3.9	25
Spain	4.8	11.0	6.1	25
Sweden	3.0	7.1	2.1	48
Switzerland	2.6	4.2	–	24
Australia	4.0	6.7	3.8	38
Newzealand	2.8	8.6	–	29
Ireland	4.0	9.9	7.1	42

(a) average annual percentage change, (b) percentage share in labour force, (c) percentage share in GDP

Source: OECD (1986).

countries after 1973 the share of public expenditure increased, thus creating an impression of a causal effect of the latter on the former. However if we scrutinise the Table more carefully then we may find that the increase in the share of public expenditure could be an effect rather than a cause of decline in GDP growth rate.

When the first oil crisis occurred, inflation rates increased, and output and employment fell as a result of structural mal-adjustment in industrial countries. Since the resultant stagflation was contrary to the Keynesian stabilisation theory, many a governments tried to combat it through a cut in public expenditure. The policy succeeded only partially because of the downward inflexibility of government expenditure (Sounders & Klau 1985). However, when inflation reescalated after the second oil crisis, governments in most industrial countries imposed a severe restriction on aggregate demand through a cut in the growth rate of govern-

Table 3: Real GDP Growth Rate, Inflation Rate, unemployment Rate and Shares of Public Expenditure in GDP at Current Prices in Selected Industrial Countries, 1960 – 1973 and 1973 – 1984

Country	Growth Rate (a)		Inflation Rate (a)		Unemployment Rate (b)		Share of Public Expenditure (c) Consumption Expenditure		Social Security Transfers		Total	
	60–73	73–84	60–73	73–84	60–73	73–84	60–73	73–84	60–73	73–84	60–73	73–84
USA	4.0	2.3	3.2	7.9	4.8	7.5	18	19	6	11	30	35
Japan	9.5	3.7	6.1	6.9	1.2	2.1	8	10	5	10	25	31
Germany	4.4	1.5	3.3	4.6	0.8	4.8	15	20	13	17	37	48
France	5.6	1.9	4.5	10.9	1.8	6.1	13	15	16	23	38	47
U.K.	3.1	0.9	5.2	12.2	1.9	6.8	17	21	8	12	37	46
Italy	5.2	1.8	4.7	16.1	5.3	7.8	14	17	12	17	34	48
Austria	4.8	2.2	4.2	5.7	1.7	2.2	14	18	15	19	39	48
Denmark	4.3	1.7	6.2	10.1	1.3	7.8	18	25	9	16	34	55
Finland	4.8	2.8	5.7	11.1	2.1	4.9	14	18	7	9	30	37
Netherlands	4.8	1.3	5.0	5.9	1.1	7.8	15	17	18	26	41	57
Norway	4.3	1.9	5.1	9.2	1.2	2.1	16	19	11	15	36	50
Sweden	4.1	1.7	4.6	10.0	1.9	2.4	19	27	10	17	39	59
All OECD	5.0	2.3	4.1	8.9	3.2	6.5	16	17	8	14	32	40

Source: Same as Table 2. a, b and c same as in Table 2.

ment expenditure and money supply and a nike in interest rates. The restrictive demand policy however succeeded in reducing inflation only at the expense of output and employment (Stewart 1984).

The demand induced recession affected the share of public expenditure in GDP at current prices in two ways. First, a higher unemployment rate led to an increase in social welfare expenditure, which as Table 3 showed, accounted for the bulk of the rise in total public expenditure after 1973. In contrast the share of government consumption expenditure in GDP has increased only moderately. For all OECD countries put together, out of 8 percentage point increase in average share of public expenditure in GDP between 1960 – 73 and 1973 – 84, social welfare expenditure accounted for 6 and government consumption expenditure only 1. Secondly, because of downward inflexibility of government expenditure in nominal terms, the gap between government current revenue and expenditure widened after the slowing down of GDP growth rate, necessitating a larger public debt to balance budget. Rising public debt together with higher interest rate increased interest payment burden of government, and this in turn increased the share of public expenditure even further. The rise in the share of public expenditure in GDP can therefore be regarded as an effect rather than a cause of inflation and recession in industrial countries.

IV.

The recent neo-classical literature on growth generally highlights the rapid progress made by some East Asian countries as an evidence of the superiority of market forces over planning. A close examination of the international growth statistics however suggests that while growth records of some East Asian countries are quite impressive, that of some centrally planned economics is no worse, if not better. The latter have perhaps more egalitarian distribution of income than the so-called fast growing free market economies, particularly South Korea and Brazil. Further, while South Korea succeeded in achieving fast growth through market mechanism, Chile failed miserably. This raises serious doubts about the universal applicability of a standardised neo-classical growth model for all developing economies.

A second hypothesis examined in this paper is whether an excess growth of public expenditure has been responsible for recent inflation and recession in industrial economies. Data on long-run behaviour of growth, inflation, unemployment and public expenditure in industrial economies suggest neither an inverse relationship between the share of public expenditure in GDP and growth nor a positive relationship between share of public expenditure and inflation. The share of public expenditure in GDP has however risen in all industrial countries after 1973. But this was perhaps an effect rather than a cause of inflation and recession in industrial economies.

NOTES

(1) This view is typically reflected in the World Bank and IMF Reports. To quote: "Higher public spending and greater public sector involvement in the economy were indirectly responsible for other problems that hindered growth in industrial countries." (World Bank 1986, p. 21).

(2) The rational expectations shool in this regard is much more critical than traditional monetarists — see, for instance, Sargent & Wallace (1976).

(3) For a critical review of theories of excess growth of government in Europe and America, see, Myhrman (1985).

(4) Saunders & Klau (1985) have examined some of these assumption in the context of the OECD countries.

(5) Neo-classicals blame planning and bureaucratic controls as basic causes of slow growth in India. They also blame India's close door policy regarding foreign trade and private capital.

(6) For further details, see World Bank (1987, pp. 268 – 71).

(7) UN International Comparison Project (ICP) has developed measures of real GDP on an internationally comparable scale by using purchasing power parities instead of exchange rate as conversion factors. ICP data are available for a limited number of countries for some discrete years. According to WB estimates, per capita gross product in Hungary, Poland and Yugoslavia in 1985, was between 12 – 13 per cent of the same in US. According to ICP estimates the per capita gross product in these countries in 1985 was between 33 and 41 per cent of the same in US or rughly about 3 times the WB estimates. In contrast the ICP index of per capita gross product in free market developing economies in 1985 was about 2 – 2.5 times the same from WB estimates. Index of per capita gross product (US = 100) of selected countries according to ICP and WB estimates are given in World Bank (1987, p. 270).

(8) Fragmented data on income distribution, as given in World Bank (1987, p. 253) show that poorest 20 per cent in South Korea account for only 6 per cent of household income, while richest 10 per cent account for 28 per cent. In Brazil it is far worse: the poorest 20 per cent only 2 per cent and the richest 10 per cent for more than 50 per cent. Similar figures for Hungary and Yugoslavia are: poorest 20 per cent 7 per cent each and richest 10 per cent 20 and 23 per cent respectively. Socialist economies therefore appear to be more egalitarian. Data on income distribution suffers from several limitations and hence should be interpreted very cautiously.

(9) World Bank (1981 and 1987).

(10) Greece and Turkey are excluded because they perhaps belong to different regimes than mainstream industrial countries. Iceland and Luxemburg are also excluded because of their small size.

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TENDENCIES TOWARDS A "NEO-LISTIAN" WORLD ECONOMY

I.

While the 1970s were characterised by vehement demands for restructuring the framework of the global economy – most clearly expressed by the demand for a New International Economic Order – the 1980s are marked by a severe backswing, which could be called a rollback of Third World power, had the periphery ever had any actual power. In light of the historical evolution it is more accurate to call this backswing the final warding-off of the demands for change voiced by Periphery Countries (PCs), accompanied by an increase of PCs' dependence on the centre.

After the political decolonisation process and the consolidation of political independence of most of the new states, and after attempts to achieve a better position by changes within the system had shown disappointing results, a change in attitudes occurred (cf. Sauvant 1981, pp. 3 ff.). Doubtlessly the successful attack on the Northern dogma of globally beneficial laissez-faire by Prebisch and Singer shortly after the War, as well as the debacle of the "desarrollismo" of the 1960s, and the emerging dependency shool have contributed to this shift in attitudes. As Sauvant (1981, pp. 4 f.) puts it: development questions became "high politics" after a period of being considered "low politics" to be left to some technocrats. These issues were politicised. The idea of the New International Economic Order is pointedly expressed by Julius Nyerere: "... to complete the liberation of the Third World countries from external domination. That is the basic meaning of the New International Economic Order" (quoted from Sauvant 1981, p. 134). In other words: after casting off colonialism, economic equality was perceived as the next goal. In parantheses it might be added that the perfect market of the textbook, which leads to optimality in production, consumption and allocation in general, is critically dependent on the existence of equal partners transacting freely and without any coercion. In a global economy based on dependence and coercive structures moves towards a textbook market are sure to meet little sympathy from the centre, in spite of its free-market-preaching. Thus the reaction of the North has simply been to defend the *status quo* of the world system.

The drive for economic changes was certainly enhanced by the so-called "OPEC price increases" in 1973/74, which were wrongly interpreted as bargaining – or price setting – power of PCs (cf. Raffer 1985; 1987, pp. 158 ff.). The idea of Northern dependence on periphery exports gained – in spite of facts – undue popularity, and the establishments of "many OPECs" were advocated. The encouragement to follow the OPEC example given by Boumediénne during the General Assembly's Special Session on raw materials suffice to illustrate the thinking at this time. In any case attempts to follow OPEC were serious enough to make