

CEPAL

Review

Executive Secretary of ECLAC
Gert Rosenthal

Deputy Executive Secretary
Carlos Massad

Director of the Review
Anibal Pinto

Technical Secretary
Eugenio Lahera



UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

SANTIAGO, CHILE, DECEMBER 1990

The Secretariat of the Economic Commission for Latin America and the Caribbean prepares the *CEPAL Review*. The views expressed in the signed articles, including the contributions of Secretariat staff members, are the personal opinion of the authors and do not necessarily reflect the views of the Organization.

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area of its authorities, or concerning the delimitation of its frontiers or boundaries.

Notes and explanation of symbols

The following symbols are used in tables in the *Review*:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A blank space in a table means that the item in question is not applicable.

A minus sign (-) indicates a deficit or decrease, unless otherwise specified.

A point (.) is used to indicate decimals.

A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.

Use of a hyphen (-) between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.

Reference to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated.

Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates.

Individual figures and percentages in tables do not necessarily add up to corresponding totals, because of rounding.

LC/G. 1642 - P

December 1990

UNITED NATIONS PUBLICATION

ISSN 0251-2920

ISBN 92-1-121168-9

Applications for the right to reproduce this work or parts thereof are welcomed and should be sent to the Secretary of the Publications Board, United Nations Headquarters, New York, N.Y. 10017 U.S.A. Member States and their governmental institutions may reproduce this work without application, but are requested to inform the United Nations of such reproduction.

Copyright © United Nations 1990

All rights reserved

Printed in Chile

CEPAL

Review

Santiago, Chile

Number 42

CONTENTS

Note by the secretariat	7
Opening statement delivered by the Executive Secretary of ECLAC, Mr. Gert Rosenthal, at the seminar on "The ideas of ECLAC and of Raúl Prebisch".	8
The nature of the "principal cyclical centre", <i>Celso Furtado</i> .	11
The present morphology of the centre-periphery system, <i>Jan Křiakal</i> .	17
The early teachings of Raúl Prebisch, <i>Aldo Ferrer</i> .	27
Neo-structuralism versus neo-liberalism in the 1990s, <i>Oswaldo Sunkel</i> and <i>Gustavo Zuleta</i> .	35
Evolution and present situation of styles of development, <i>Eric Calcagno</i> .	53
Adjusting power between the State and the market, <i>David Ibarra</i> .	67
The State and changing production patterns with social equity, <i>Eugenio Lahera</i> .	93
Runaway inflation: experiences and options, <i>Felipe Pazos</i> .	115
Structural elements of spiralling inflation, <i>Héctor Assael</i> .	131
Latin American integration and external openness, <i>Germánico Salgado</i> .	135
Present and future integration in Central America, <i>José Manuel Salazar</i> .	157
Economies of difficult viability, <i>Arturo Núñez del Prado</i> .	181
The Mexican economy at the end of the century, <i>Miguel Sandoval Lara</i> and <i>Francisco Arroyo García</i> .	195
Economics and happiness, <i>María Conceição Tavares</i> .	211
Guidelines for contributors to <i>CEPAL Review</i> .	221
Some recent ECLAC publications.	223

The nature of the "principal cyclical centre"

*Celso Furtado**

In the author's opinion, Prebisch's greatest contribution was his idea of a structural rift in the international economy caused by the slow spread of technical progress and kept in being by the international division of labour which existed at that time. According to this approach, external trade was no longer viewed as an extension of the domestic economy but was considered to have a dynamism of its own which depended on the linkages between the central economies and the efficiency of the principal centre in exercising its "regulatory" functions.

An important difference between the United Kingdom and the United States, as principal centres, has been their degree of integration into the international economy. The United States had a low import coefficient, which weakened its potential external drive, whereas the United Kingdom had a high import coefficient: higher than that of its exports. Its trade deficit was covered by the remittances of profits generated abroad by its earlier investments. Those investments, for their part, had been financed by the initial trade balance generated by the country's situation of technological leadership.

The United States had not received the necessary preparation to act as the principal centre, and it lacked the capacity to act as regulator of the world economy. The relative decline in its rate of increase of productivity and the simultaneous drop in its rate of saving, which were to be observed as from the early 1970s, prevented that country from playing the role of principal centre of the capitalist economy, and this process accelerated still further in the 1980s with the appearance of a deficit which absorbed an amount of resources greater than the total private saving.

At present, the United States continues to play part of its role as the principal centre, since the dollar still continues to play a very important part in the world economy. Other countries, however, are now the main suppliers of international resources.

The article concludes that if the international economy is to keep on functioning without there being a true principal centre, there must be a system of regulation by consensus among the main central countries, and indeed, the world seems to be moving in this direction.

*Professor at the University of the Sorbonne.

In a summary presentation of his theoretical works,¹ Raúl Prebisch referred to the idea of "a system of international economic relations which I named the 'centre-periphery' system", which had arisen as a by-product of his reflections on the cyclical fluctuations that occur in international activities. At first, it seemed to him that the cycles originated in the economies of the industrialized countries and then spread to the international sphere. In that process of spreading, the countries specializing in the production and export of primary commodities behaved in a "passive" manner, even though the fluctuations in the level of economic activity affected them with particular force.

This reflection on the spread of the cycle led Prebisch to perceive that the system of the international division of labour had arisen primarily to serve the interests of the countries which were in the vanguard of the industrialization process. "The countries producing and exporting raw materials were thus linked with the centre as a function of their natural resources, thereby forming a vast and heterogeneous periphery incorporated in the system in different ways and to different extents."²

This global view of the capitalist economy, which revealed that it was suffering from a structural break initially caused by the slow spread of technical progress and perpetuated by the system of the international division of labour which existed at that time, was Prebisch's main theoretical contribution and formed the starting point for the theory of underdevelopment which dominated Latin American thinking and strongly influenced other regions of the world too. For Prebisch, underdevelopment stems from "the concentration of technical progress and its fruits in economic activities oriented towards exports", giving rise to heterogeneous social structures "in which a large part of the population remains on the sidelines of development".³

In this late synthesis of his ideas, Prebisch limited his explanation of the Centre-Periphery view to the structural imbalances caused by the slow spread of technical progress, which he claimed was responsible for the downward trend in the terms of

¹ Raúl Prebisch, "Five stages in my thinking on development", in *Pioneers in Development*, Gerald M. Meier and Dudley Seers (eds.), a World Bank publication, New York, Oxford University Press, 1984, p. 175.

² *Ibid.*, pp. 176-177.

³ *Ibid.*, p. 177.

trade of the commodity-exporting countries. In his classic text of 1949,⁴ however, Prebisch strove to construct the nucleus of a dynamic theory of the international economy on the basis of his Centre-Periphery view. He started with a critique of the current theory of balance-of-payments imbalances, which was a mere extension of the quantitative theory of money, considered in this case as being a good of unlimited demand (gold). Prebisch denounced the static nature of this theory, which merely registers the fact that "each disturbance represents transition from one period of equilibrium to another".⁵ In his criticism he went further, however, noting that the prevailing theory might have had some validity when the centre of the capitalist economy was the United Kingdom, in view of the profound integration of that country into the system of the international division of labour, since the high degree of openness of the British economy (its import coefficient averaged over 30% between 1870 and 1914) meant that that country had a considerable capacity to respond to external stimuli. In the economy of the United Kingdom, its exports "fulfilled a dynamic function similar to that of capital investment".⁶ If other industrialized countries activated their economies and increased their imports from the United Kingdom, the stimulating effect on the latter was felt immediately, so that British imports grew rapidly too. Thus, there was no tendency towards an accumulation of gold reserves by the then principal centre.

According to Prebisch, this situation underwent a radical change when the United States took over the function of the principal centre of the capitalist economy, since its import coefficient was extremely low. If the cyclical reactivation began in the United States, then the external inductive power generated by that country's imports was only small; if it began in another industrial economy, then the response of the United States economy was extremely slow. This unfavourable situation for the peripheral economies—which depend on external impulses for their growth—was rendered still more adverse by the constant downward trend in the latter country's import coefficient, which sank from 6% in 1925 to 3.1% in 1949.

⁴ See ECLAC (Economic Commission for Latin America and the Caribbean), "Growth, disequilibrium and disparities: interpretation of the process of economic development", *Economic Survey of Latin America 1949* (E/CN.12/164/Rev.1), New York, Part I, 11 January 1951, United Nations publication, Sales No. 1951.II.G.1.

⁵ *Ibid.*, p. 38.

⁶ *Ibid.*, p. 36.

For Prebisch, the world economy is not just a structure which reproduces itself, but rather a system which registers cyclical expansion under the influence of the spread of technical progress. Departing from the traditional approach, which sees external trade as a mere prolongation of domestic productive activity—a sort of bartering of surpluses which makes it possible to increase the productivity of the relatively most abundant factors—Prebisch assigns it a dynamism of its own which depends on the interlinkages of the central economies and the efficiency with which the principal centre carries out its regulatory functions.

Contrary to what is implicit in the traditional balance-of-payments theory, the time factor plays a fundamental part in Prebisch's concept, and this factor is a function of the degree of openness to the exterior of the principal centre.

Technical progress spreads from the central economies outwards, while they in turn are under the influence of a principal centre. This process of interaction among the central economies underwent a considerable change when the United States became the principal centre.

In contrast with the first aspect of the Centre-Periphery concept—which was the starting point of the theory of underdevelopment—this second aspect was not duly elaborated in the years following its formulation, even though balance-of-payments imbalances had become the main problem of the international economy from the 1960s onwards.

Prebisch drew attention to the fact that when the United Kingdom was playing the role of the principal centre, its import coefficient was much higher than its export coefficient. Indeed, in the late 1920s the United Kingdom paid for a third or more of its imports with the profits from its investments abroad. The principal centre had initially built up its position thanks to its technological leadership, which was reflected in the strong penetration capacity of its exports and the consequent big trade surplus. Thus, a considerable proportion of British savings was quite naturally channelled abroad, so that, in a first stage, the principal centre played the self-created role of the main disseminator of technological progress. In a later stage, this principal centre received the benefit of the returns on these foreign investments: its currency was overvalued because of the entry of royalties and dividends, and this favoured an increase in imports over exports. This was the culmination of an economy which benefited from big returns from the profits generated abroad by previous investments.

Prebisch did not return to the question of the balance-of-payments adjustment problems of the central countries in the period following the appearance of his classic 1949 study. The entry into action of the Bretton Woods institutions seemed to indicate that this matter was now closed.

In the period from the end of the Second World War to the end of the 1950s, the United States enjoyed a substantial trade surplus on the current account which permitted it to finance heavy spending abroad in both the military and investment fields. This was the period of the "dollar shortage", which many economists attributed to the positive productivity differential of the United States economy. At that time, it was taken for granted that its leading position as regards productivity—the result of heavy spending on research and development—would guarantee the United States' position as the principal centre of the capitalist economy for a long time to come. The relatively faster growth of productivity observed immediately after the war in other industrialized countries was explained away as being due to the process of "economic recovery" in which they were involved. It was explained that when they got nearer the higher level which the United States had already reached, it would not be so easy for them to keep up such high rates of growth in productivity.

Since the 1960s, however, there has been a process of profound changes in the relations between the central economies which has seriously affected the United States' position as the principal centre. The system of fixed exchange rates, which linked the dollar to gold, gave rise to a patent overvaluation of that currency, which adversely affected the external competitiveness of the United States economy. Paradoxically, this situation favoured foreign investments by United States firms, which also helped to put pressure on the country's gold reserves. In 1963, the Johnson Administration brought in the *Interest Equalization Act*, whereby it sought to check the outflow of capital—the first sign of weakness in the economy which had been acting as the principal centre of the capitalist world. An unexpected result of this measure was the strengthening of the incipient Eurodollar market, since United States enterprises operating abroad began to keep part of their liquid assets outside the country. With the accumulation of massive liquid assets in dollars in the Central Banks of certain central countries, as well as in United States private banks abroad, the convertibility of the dollar against gold could no longer be sustained.

The official suspension of such convertibility took place in 1971 and gave rise to a big increase in the price of gold. The dollar value (and, to a lesser extent, the value in terms of other currencies) of reserves held in the form of this metal rose exorbitantly, thus greatly inflating international liquidity. Two years later the United States Government definitively abandoned the fixed exchange rate system. In spite of the intervention of the most powerful Central Banks, there was a considerable devaluation of the dollar *vis-à-vis* the currencies of the other central countries, and the resulting flight towards real assets gave rise to a wave of speculation on international markets.

The prolonged overvaluation of the dollar—from the Second World War until 1973—must naturally have been a major influence in the weakening of the United States' position as the principal centre. In order to keep up that position, it would have been necessary to maintain a level of reserves and an accumulation of reproductive assets abroad capable of preserving the dollar from any threat whatever, regardless of the level of activity of the United States economy. The principal centre is the country which issues the currency that serves as a reserve for the whole of the capitalist system: a prerogative which naturally demands an exceptionally solid balance-of-payments current account position. By this I mean solid not only *vis-à-vis* changes in the international situation but also with regard to abrupt changes in domestic conditions. The monetary policy of the principal centre must also be such as to contribute to the fluidity of international flows of short-term capital.

If we take the analysis further, we see that it was not only the overvaluation of the dollar which helped to undermine the solidity of the position that the United States undoubtedly occupied as principal centre until the early 1970s. Nothing contributed more to this result than the burden of the United States Government's outlays on the establishment of a defence system with installations in every continent. The United States faced restrictions on its spending abroad precisely because of the relatively closed nature of its economy. With the passage of time, its huge military spending forced Washington to cover its outlays abroad with paper currency that it virtually forced into international circulation by obliging the Central Banks of other countries to build up excessive reserves in dollars which were subsequently transformed into United States Treasury debt paper. It

is sufficient to observe the behaviour of military spending—an increasing proportion of which took place outside the country in the 1960s— in order to grasp the magnitude of the distortions produced in the United States economy, which reduced it to a situation of financial dependency *vis-à-vis* other central economies. In 1973, military spending represented 5.6% of the United States GDP, and this spending reduced the capacity of the public sector to make investments in economic and social activities. From that year onwards, a marked decline was to be observed in the growth rate of average United States productivity.

In the 10 years from 1973, productivity grew at no more than half the rate of the previous ten years. This slowdown in productivity growth did not prevent military spending from increasing, however, to such a point that it came to 6.6% of GDP in 1983. Furthermore, the rate of saving dropped from 9.5% to 6.7% over that same 10-year period. The truth is that United States society was simply not prepared for exercising the dominant international role that fell to its lot as a result of the Second World War.

The absence of a principal centre capable of keeping the capitalist economy in order is of course a major factor in the great upsets observed in the international economy from the 1970s onward, the most striking manifestation of which is the enormous size of the peripheral countries' external debt.

The disorder that took root in the international monetary and financial system as a result of the excess of liquidity caused by the crisis of the dollar was the factor that created favourable conditions for the process of indebtedness of almost all the countries of the periphery. In 1973, interest rates were not more than 2% negative, but the following year they went down to 6% negative, remaining extremely low until the end of the decade. This situation of maladjustment was aggravated in the second half of 1973 by the abrupt rise in petroleum prices, which permitted a group of countries with little or no capacity to absorb large amounts of financial resources to rapidly build up enormous reserves in the form of certificates of deposit in the international banks.

The imbalances caused in the external accounts of the central countries—almost all of them heavy importers of petroleum— led them to boost their exports. Thus, the efforts of the industrial economies to increase their external trade in the period following the oil price shock brought about an increase in the imports of the peripheral countries as well as the

conversion of the excess liquidity of the international banks into loans to those countries. The underdeveloped countries, which had always had to struggle with a severe shortage of capital in the past, suddenly found themselves faced with a virtually unlimited supply of financial resources on the international market, and moreover at negative interest rates.

This combination of an unrestricted supply of capital on the international market, plus the striving of the central countries to correct the imbalances in their external accounts caused by the sudden rise in oil prices, explains the rapid build-up of external debt by countries which sought ways of increasing their growth rates or simply raising their level of expenditure.

The system of floating exchange rates, by permitting the rapid devaluation of the previously overvalued dollar, set off a wave of price rises at the international level. In the countries which were forcing their exports, financed by the banks which were trying to manage the glut of international liquidity, there were additional inflationary pressures too. Consequently, there was a run on real assets and on the building-up of stocks. Food prices on the international market rose by 54% in 1973 and 60% in 1974, while metal prices increased by 45% and 25% in the same two years. Double-digit inflation was widespread in the industrialized capitalist world: something not seen since the Second World War.

In 1979, the United States Government decided to abandon its carefree attitude to inflation and adopted a shock policy of the most uncompromising monetary type. The fact is that the international monetary system is based on the dollar, and Eurodollars are no more than a credit multiplier based on dollar deposits outside the United States. The United States monetary authorities therefore have the power to influence the international monetary market through manipulation of the monetary base in the United States. If the Federal Reserve raises interest rates, there is immediately a flow of financial resources towards that country, together with a rise in interest rates on the international market.

When it applied a restrictive monetary policy in these circumstances, Washington discovered how easy it was to finance its needs abroad, thus opening the way to the uncontrolled expansion of its own expenditure. The United States current account remained in balance up to 1978, but at the beginning of the 1980s it became negative: in 1983 the deficit came to US\$45 billion, and by 1987 it had reached the staggering figure of US\$147 billion.

The deficit on the United States current account was the second great break in the international structure of the capitalist economy, and it is the basic cause of the abnormal rise in real interest rates that has taken place over the last decade. In 1980 those rates were already over 8%, and by 1982 they had reached 12%.

Thus, two adjustment processes which took place in the central economies—the first one connected with the effort made by those countries to recover their external equilibrium after the first oil price shock and made possible by the uncontrolled glut of international liquidity, and the second one connected with the restrictive monetary policies of the United States Government and the financing of its fiscal deficit with resources attracted from abroad by high interest rates—lie at the root of the enormous debt now burdening the countries that make up the periphery of the capitalist system.

The relative decline in the growth rate of productivity and the simultaneous drop in the rate of saving which were observed from the early 1970s on prevented the United States from playing its role as principal centre of the capitalist system. This process speeded up in the 1980s with the appearance of a fiscal deficit which absorbed a quantity of resources greater than the whole of private saving. This qualitative change in the international position of the United States economy is illustrated by the behaviour of the enterprises of that country. Direct Japanese investment in the United States rose from US\$4.7 billion in 1980 to US\$53.3 billion in 1988, while direct United States investment in Japan grew from US\$6.2 billion to US\$16.9 billion over the same period. The same is true with respect to the European Economic Community, since direct investments by its member countries in the United States rose from US\$50 billion in 1980 to US\$193 billion in 1988, with United States direct investments in the Community growing from US\$80 billion to US\$126 billion over the same period.⁷

An important indication of the changed situation of the United States economy is that in the last quarter of 1987 the payments of interest and dividends to the exterior exceeded the receipts under this heading. In 1980, the net external investments position of the United States was positive to the tune of US\$106 billion dollars, but as from 1985 the situation became

negative. In 1986, United States assets abroad totalled US\$1 067 900 million, whereas foreign assets in the United States in the same year totalled US\$1 331 500 million.⁸

The problem now facing us is to know how the function of the principal centre is being carried out at present. The United States continues to carry out part of this function, since the international monetary system is still based on the dollar. However, the United States no longer plays the role of the main supplier of international financial resources, which is now carried out by Japan and the Federal Republic of Germany. All we need do is look at the balance-of-payments current accounts in recent years. In 1987, the deficit of US\$147 billion dollars of the United States contrasted with the surpluses of US\$84 billion for Japan and US\$50 billion for the Federal Republic of Germany. This situation obviously cannot last for ever, since it involves the growing indebtedness of the United States to the other two great central countries. As long as this situation of financial dependence continues, interest rates will continue to be high, which means growing deterioration of the United States position. The negative consequences of this situation for the over-indebted countries are only too obvious.

In order for the capitalist economy to function properly in the absence of a principal centre, it is necessary that the main central countries should reach consensus on appropriate forms of regulation. It may be wondered whether the appearance of such co-ordination groups as the 10 and the seven main capitalist countries is not a step in this direction. However, there are only two countries which are really competing for the leadership of the system, and it remains to be seen whether these countries would not really prefer to extend the present process of increasing financial dependence of the United States. There would seem to be no doubt that we are moving in the direction of a system of regulation by consensus. However, such consensus will only reflect the will of a few countries, and the relative weight of these nations still remains to be determined. At all events, the possibility of a single economy playing the role of the principal centre no longer exists.

⁸ UNCTAD (United Nations Conference on Trade and Development), *Trade and Development Report, 1988* (UNCTAD/TDR/8), Geneva, 1988, United Nations publications, Sales No. E.88.II.D.8, p. 68.

⁷ Figures based on *Survey of Current Business*, published in *Le Monde*, Paris, 31 October 1989.