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**THE RETURN OF VULNERABILITY AND RAÚL PREBISCH'S  
EARLY THINKING ON "EL CICLO ECONÓMICO ARGENTINO"**

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## THE RETURN OF VULNERABILITY AND RAUL PREBISCH'S EARLY THINKING ON "EL CICLO ECONÓMICO ARGENTINO"

(to be submitted to ECLA's seminar on "La teoría del desarrollo en los albores del siglo XXI"-Santiago-Chile, 28-29 August 2001")

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There is something paradoxical about the rise and fall – maybe we could speak about a renewed rise – of Raul Prebisch's thinking on what in the early years of his intellectual life would have been called primary producer's economies. In parallel with what had happened with development economics at large, say, by the early 1960s his thinking was being progressively dismissed both in public and academic discourse.<sup>1</sup>

In their more generous forms, criticisms waged against Prebisch's theories described them as plainly out of date. From such a point of view they might have been all right as an interpretation of events in the pathological 1930s Depression years or the immediate post Second World War dominated by scarcities and controls. But in the fast growing world economy of the 1960s with a progressive opening-up to international transactions what was thought – in an exaggerated way – as Prebisch's teachings on import substitution and state interventionism were supposed to be no longer applicable.

Now protagonists of those criticisms basically were the advocates of liberalization of the by then labelled as developing economies. Import barriers had to come down, foreign exchange controls eliminated and countries had to stake all their fortunes to a fast expansion of exports that would result from the increased efficiency achieved through those measures. Their success maybe not only based on their capacity for intellectual argument has been phenomenal. The following decades have witnessed the adoption, first gradual and reluctant, in most cases and in the last decade as a stampede, of precisely those policies.

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<sup>1</sup> See, for instance, Paul Krugman's comments in his "The Rise and Fall of Development Economics".

And what have been the consequences of all those reforms? An extraordinary degree of instability with repeated crises hitting what now have become “emerging economies” highly vulnerable to international economic shocks.

As I will try to show in the following, Latinamerican economic problems mirror the circumstances of the late 1920s not to speak of the following depression decade. And all of a sudden Prebisch’s thinking regains topicality. Those questioning Prebisch’s ideas having been successful in reinstating a world economy quite alike that of the early XXth. century or of the late 1920s, have ended up doing him the greatest possible intellectual favour. Prebisch thinking on the difficulties of a “peripheral” open economy has regained validity.

To develop this theme is devoted this presentation. I will proceed to summarily survey the progressively more unstable character of the world economy in the last quarter of a century and its impact on our region. Second, I will draw some parallels with the character of the Argentine economy in the interwar period. Third, I will examine the early development of Prebisch’s thinking in the late 1920s and early 1930s as related to the study of that economy. And, fourth, what will be his reactions to the Depression years. What, I hope, will emerge is how clear and true to even present-day realities were Prebisch’s views about the problems of an early “emerging market” economy even if not all of us would agree with his rather conservative economic policy proposals.

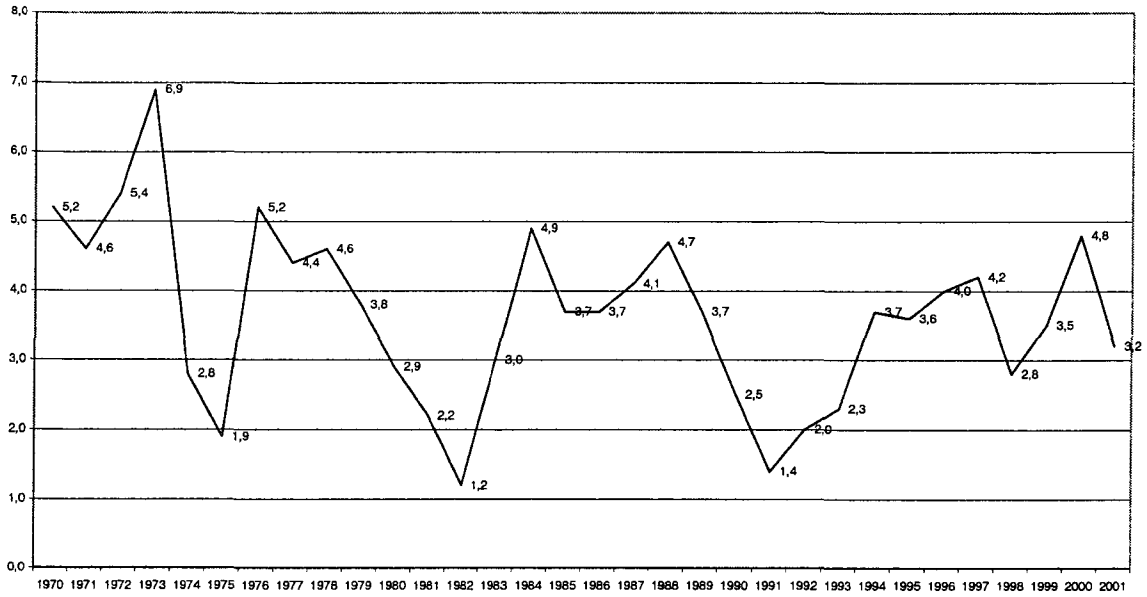
### **The instability of the world economy and the renewed vulnerability of the Latin American economies**

Beginning in 1975 – and as acknowledged in several of the last issues of the IMF’s World Economic Outlook – the world economy has undergone several slumps. In their view, up to recently, four of them.<sup>2</sup> And right now – in 2001 – another one which we could easily rate as a sixth one, something that comes out very clearly if one looks at figures for the rate of growth of international trade as might be gathered from the second figure below.

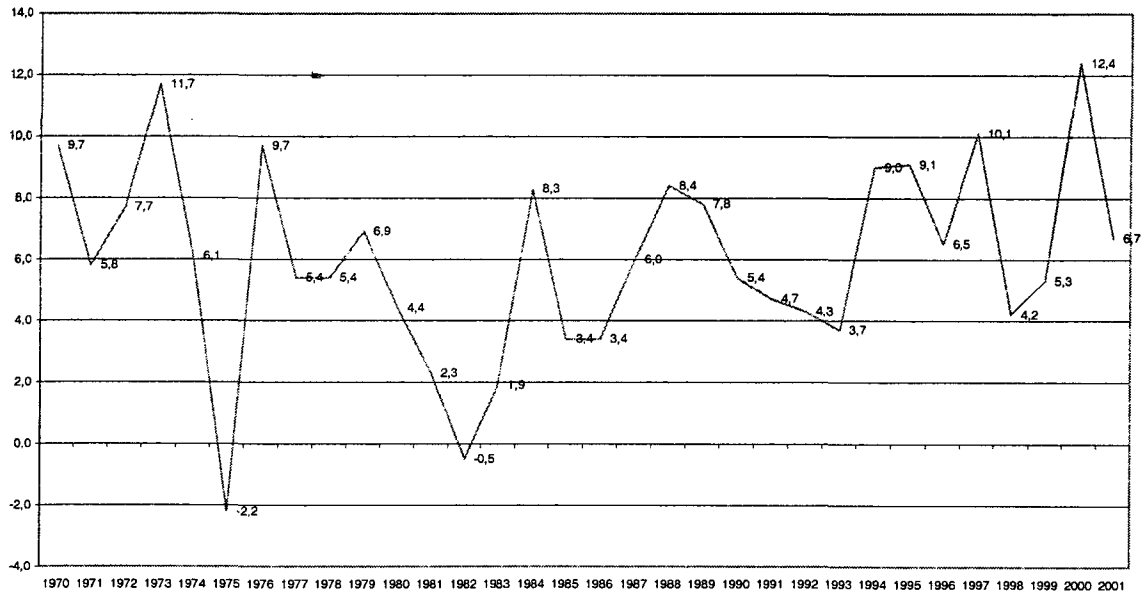
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<sup>2</sup> See IMF World Economic Outlook, April 1999, Chap.1 “Global Economic Outlook and Policy Responses to the Global Slowdown”, pp.2-5. In the graph for world industrial production – Figure 1.2. in page 5 – of that same report, a clear fifth slowdown may be detected in 1995 and not only in Latin America.

**WORLD REAL GROSS DOMESTIC PRODUCT**  
(percentage annual rate of change)



**WORLD TRADE VOLUME OF GOODS AND SERVICES**  
(percentage annual rate of growth)

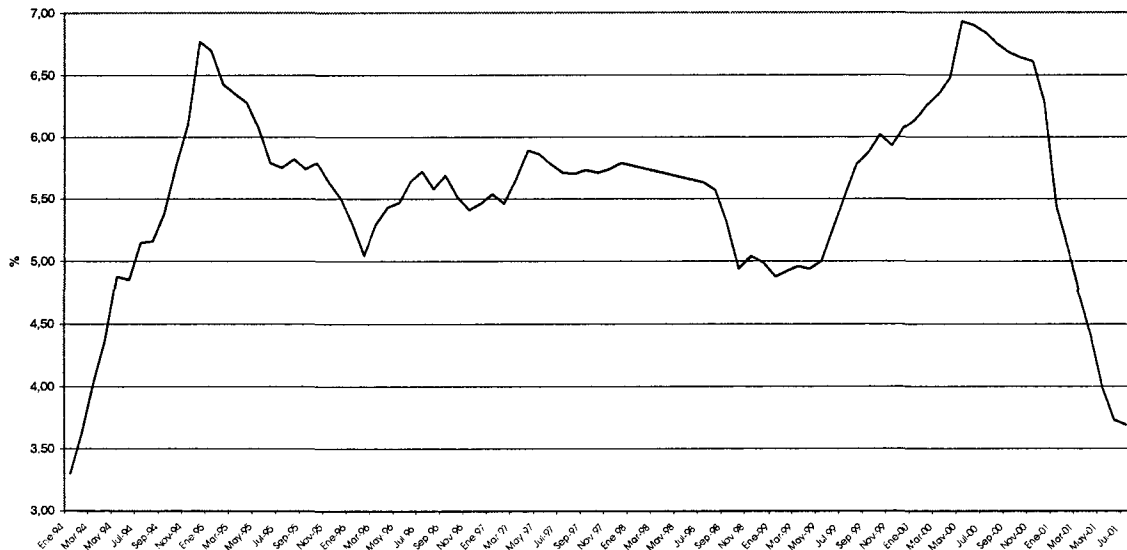


Frequency of crises seems to be increasing, i.e.; we have had 6 crises in about 25 years, but 4 in the last 10 years, 3 in the last 5 years and 2 in the last 3. Such

a casual perusal of the frequency of crises is, for instance, confirmed in recent work by Bordo, Eichengreen et al.<sup>3</sup>. In their examination of 120 years of financial history, crisis frequency after 1973 turns up to have been double that of either the Classical Gold Standard Period or the post-Bretton Woods one. Interestingly enough for the argument we are trying to develop in this paper, it has been similar to that of the interwar period. Additionally, the last 25 years' period shows a higher frequency of twin – currency cum banking – crises; these crises are known and have been shown to be rather severe resulting in high output losses.

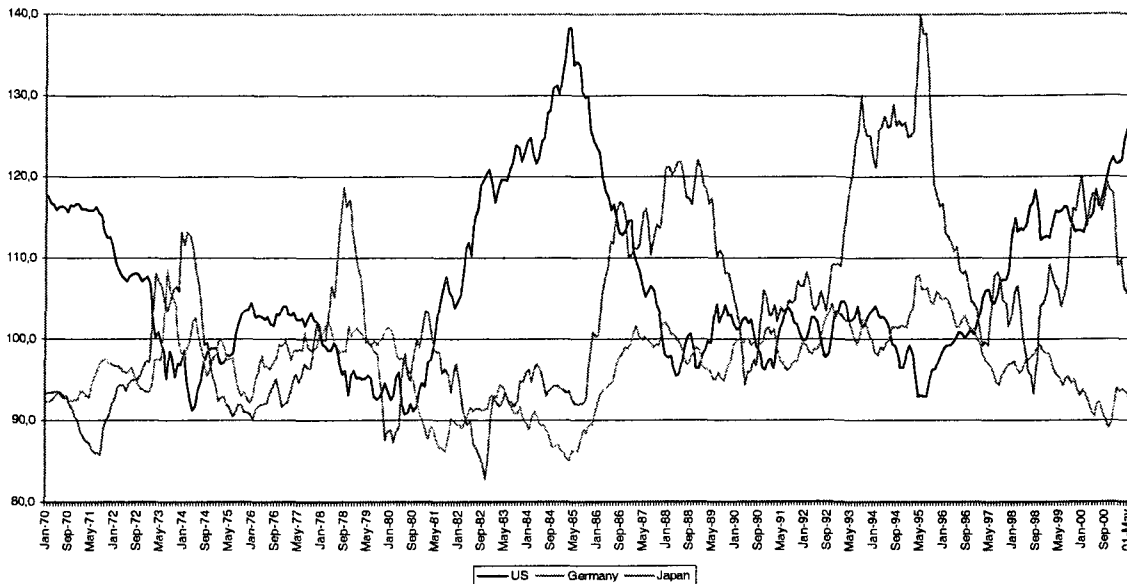
And, of course, as further background on the instability in the world economy, we have also the extreme volatility of interest rates and of the exchange rates among the major currencies which some authors make responsible for the behaviour of commodity prices reference to which will be made immediately below.

INTEREST RATES  
LIBOR 6-Month  
Monthly Data  
January 1994-July 2001



<sup>3</sup> See Bordo, M., B. Eichengreen, D. Klingebiel and M.S. Martínez-Peria "Is the Crisis Problem Growing More Severe?", December 2000.

REAL BROAD EFFECTIVE EXCHANGE RATES \*  
United States, Germany and Japan  
1990=100



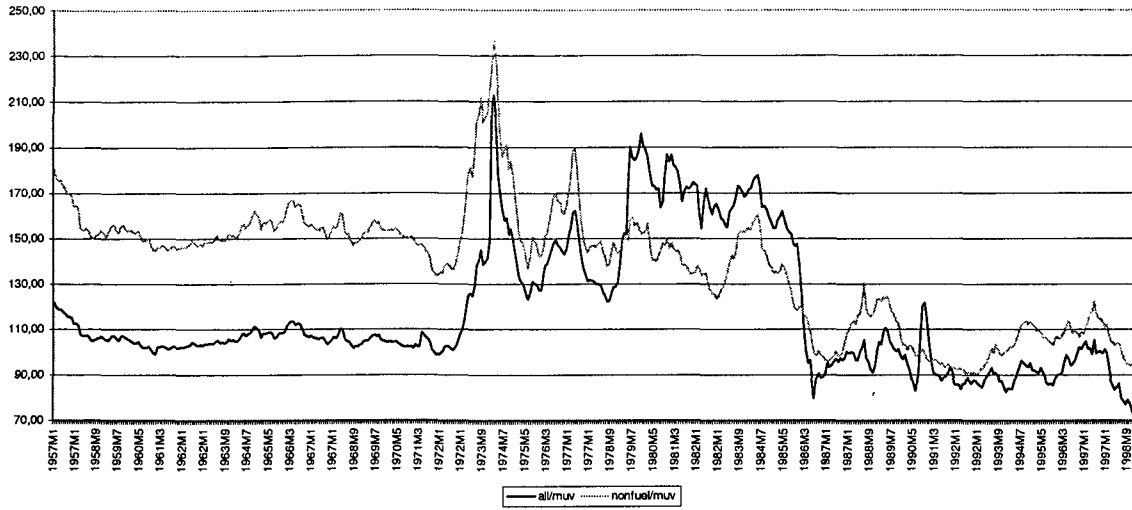
Besides frequent slowdowns in economic activity amplified by strong variation in international trade volume and volatility of interest and exchange rates, this last quarter of a century has shown extraordinary variability in two other aspects of great significance for developing countries, i.e., in commodity prices and in capital flows.

As to real commodity prices, recent work has, on the one hand, vindicated at least the facts of the Prebisch-Singer hypothesis, i.e., there is a long-run trend – over a 140 years span – to a decline in these prices (at a 1.3% per year rate). Moreover, there is a break around 1917 after which the decline accelerates to 2.3% per year and in the 1990s to 6.9% per year.<sup>4</sup> Not only there is such a declining trend but also volatility has significantly increased in the later period with larger swings in prices and cycles of higher frequency.<sup>5</sup> A quick look at the following figure – related to the Bretton-Woods and post-Bretton Woods period - helps in confirming those assertions.

<sup>4</sup> See Cashin, Paul and C. J. McDermott “The Long-Run Behavior of Commodity Prices: Small Trends and Big Variability”, IMF Working Paper WP/01/68, May 2001.

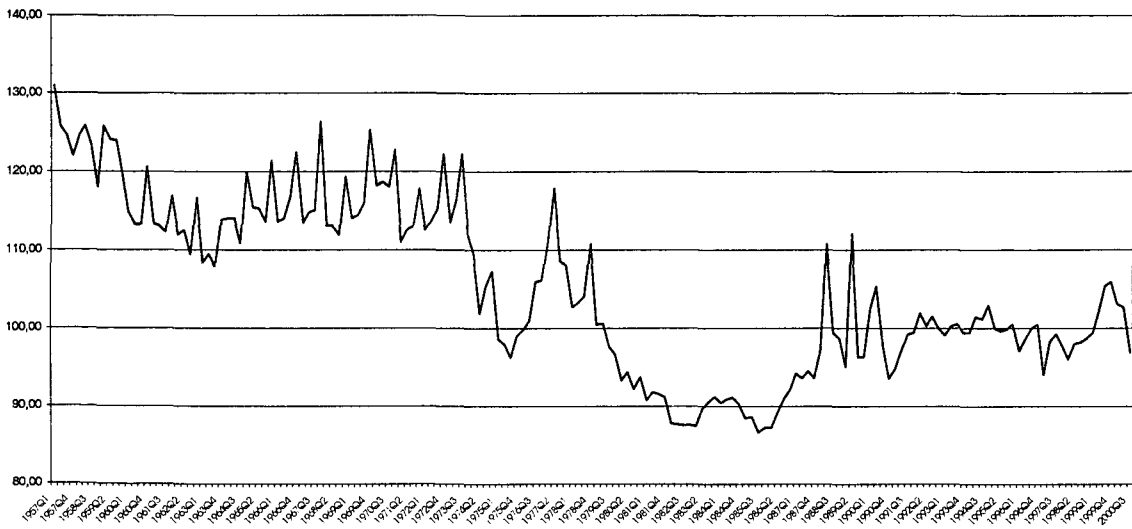
<sup>5</sup> “...rapid, unexpected and often large movements in commodity prices are an important feature of the behavior of commodity prices.”; *Ibid.*, p.25.

REAL COMMODITY PRICES  
All and Non-Fuel  
1957-1998  
Indices; 1990=100



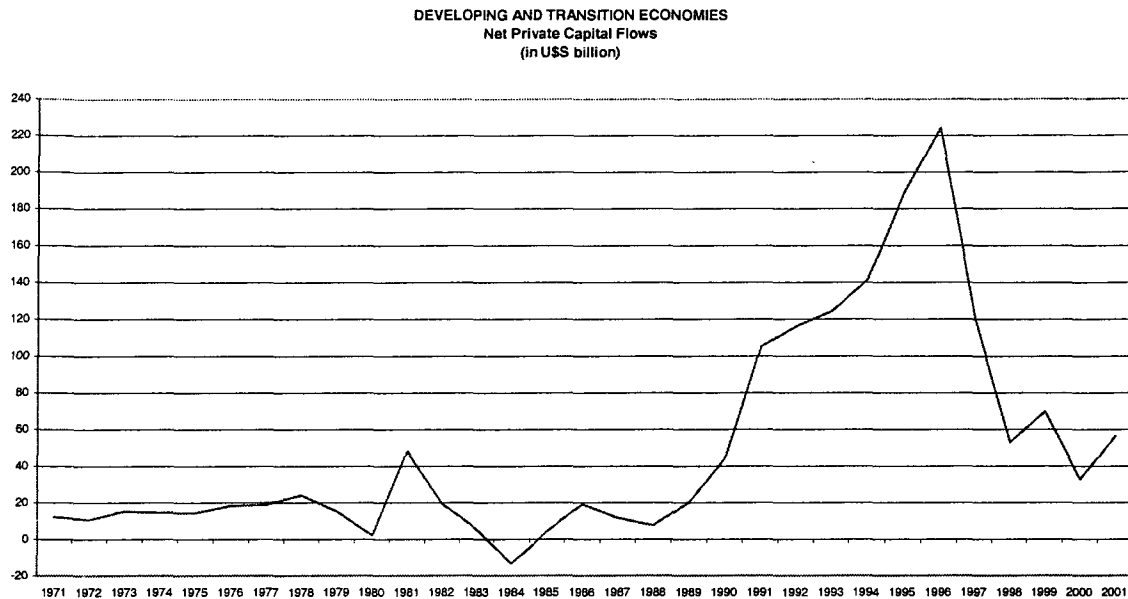
It is useful also to remind that by the beginning of the year 2000, real commodity prices were fully 40 per cent below their level at the beginning of the 1970s. The result of such a performance of real commodity prices on the terms of trade of developing countries are obvious as may be gathered from the following figure about non-oil developing countries.

Terms Of Trade  
Non-Oil Developing Countries  
1957-2000  
(1995=100)



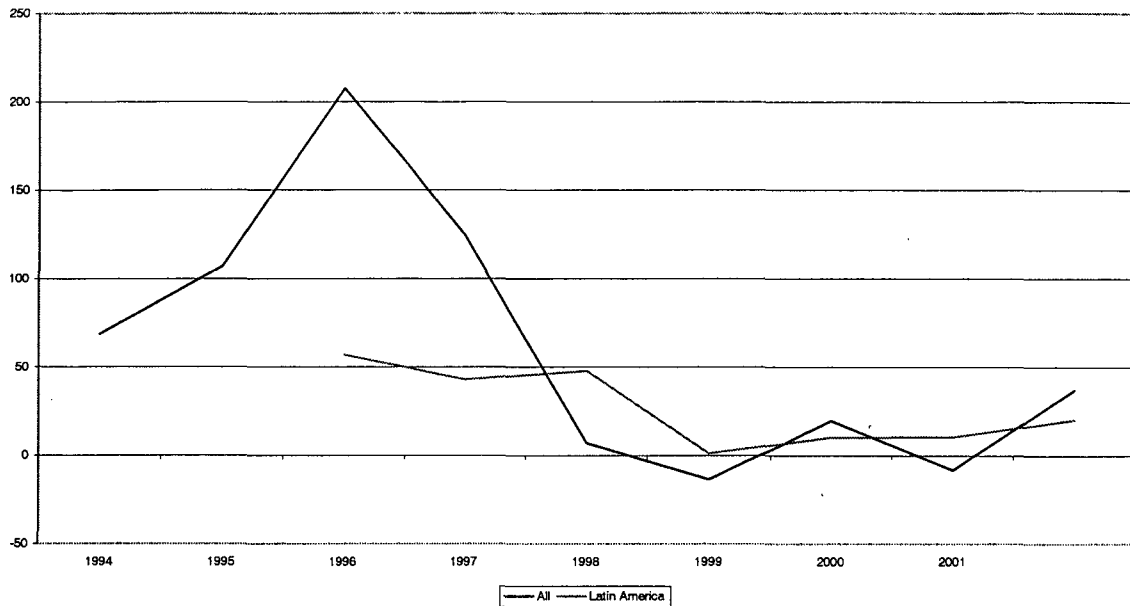


In relation with capital flows, the following figure tells a closely similar story.



Since the beginning of the 1970s, two distinct cycles of boom and bust may be detected. The first one, the well-known related to bank loans in the 1970s leading to the “sudden-stop” of the early 1980s and the debt crises spanning the whole decade. The second one, the more recent boom of the early 1990s which was followed by the collapse starting with the Asian crisis of 1997. If one were to look at quarterly figures in the last several years, one would easily detect superimposed on those long cycles an extreme variability in the behaviour of private capital flows. Most specifically, bank lending - and also bond issuing although less so – display extreme volatility moderated by a more stable performance of foreign direct investment. As may be gathered from the following graph, net non-equity capital flows not only have been much more unstable but also in the last few years have been nil or even negative.

NET NON-EQUITY PRIVATE CAPITAL FLOWS TO EMERGING MARKETS  
(in US\$ billion)



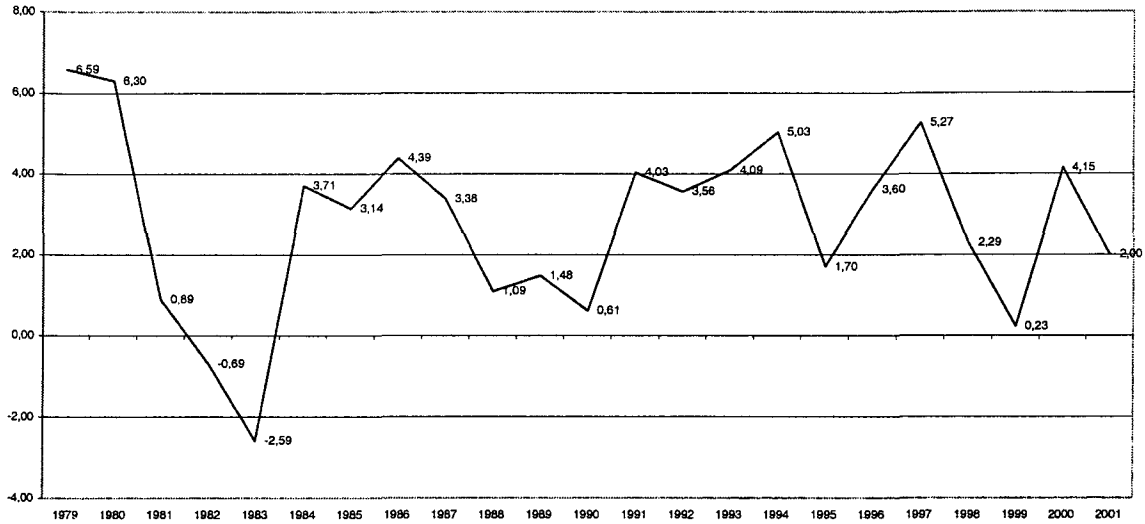
To summarize, as it should be well known although not always well recollected the world economy has shown an extraordinary degree of instability in the post-Bretton Woods era and more specifically in the last decade.

### From the “lost decade” to the “topsy-turvy decade” in Latin America

In Latin America, the consequences of such performance in the world economy have been obvious.

The following figure shows the behaviour of GDP in the last two decades. The instability strikes the eye at first sight. But what must be reminded also is that the last decade’s rate of growth on the whole was only marginally greater than that of the “lost decade” of the 1980s (2.2 vis à vis 2.1 per cent per annum).

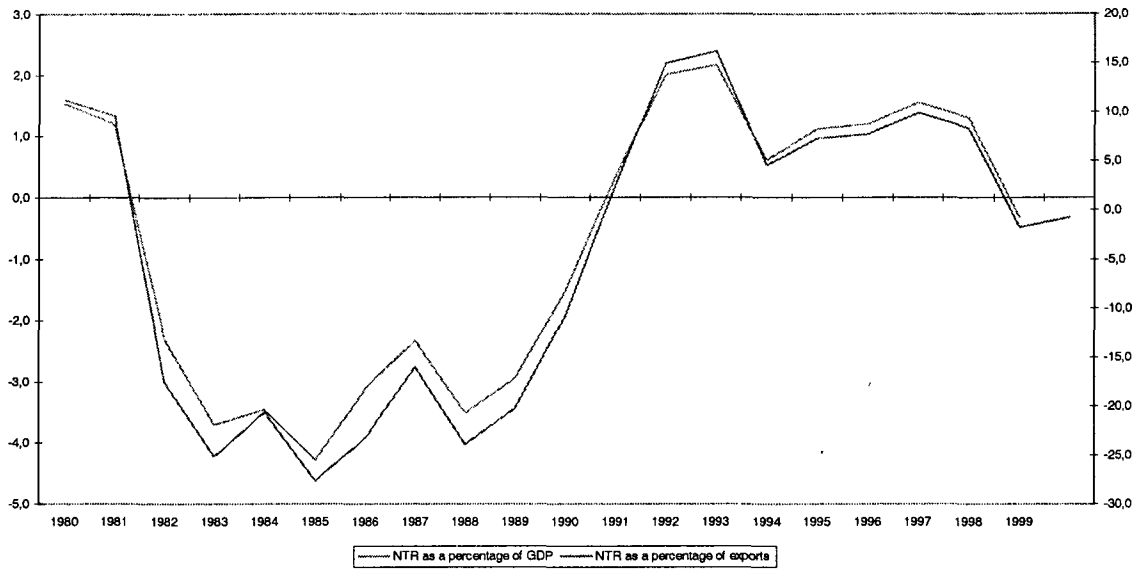
LATIN AMERICA AND THE CARIBBEAN  
Real GDP Growth Rates  
1979-2001  
(in percentage per year)



The region, of course was subject to the various external shocks derived from the instability of the world economy. Growth rates in GDP and international trade volumes played their part as well what we have seen were the behaviour of interest rates, real commodity prices and capital flows.

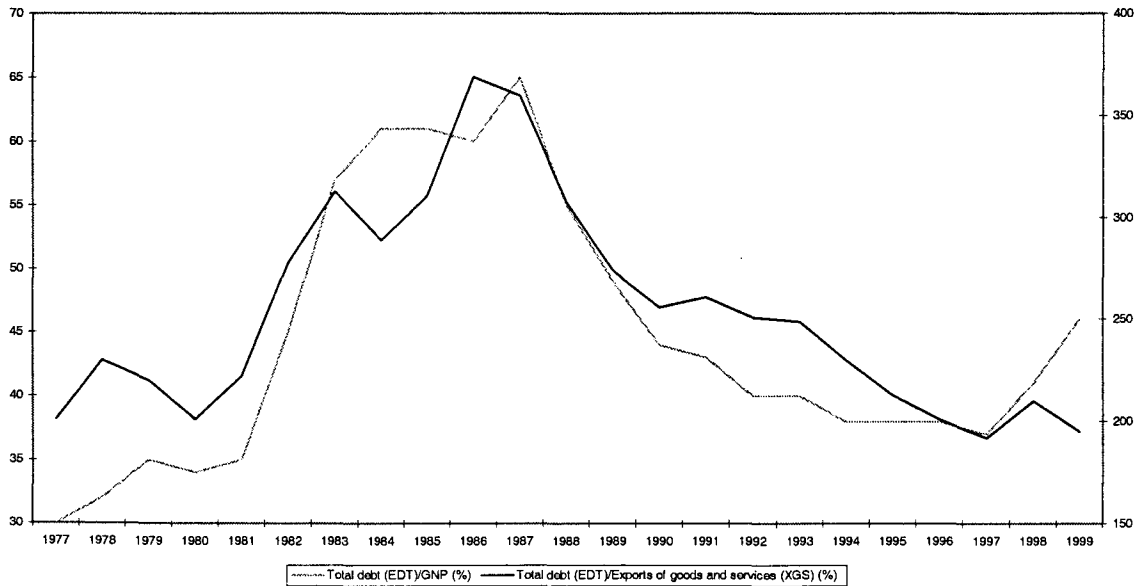
Net transfer of resources which on the whole was positive in the 1990s, compared with the negative figures of the 1980s, however, ended up the century being negative again, having also shown a slump in the mid-1990s.

LATIN AMERICA AND THE CARIBBEAN  
 Net Transfer of Resources  
 (as a percentage of GDP and Exports)  
 1980-2000



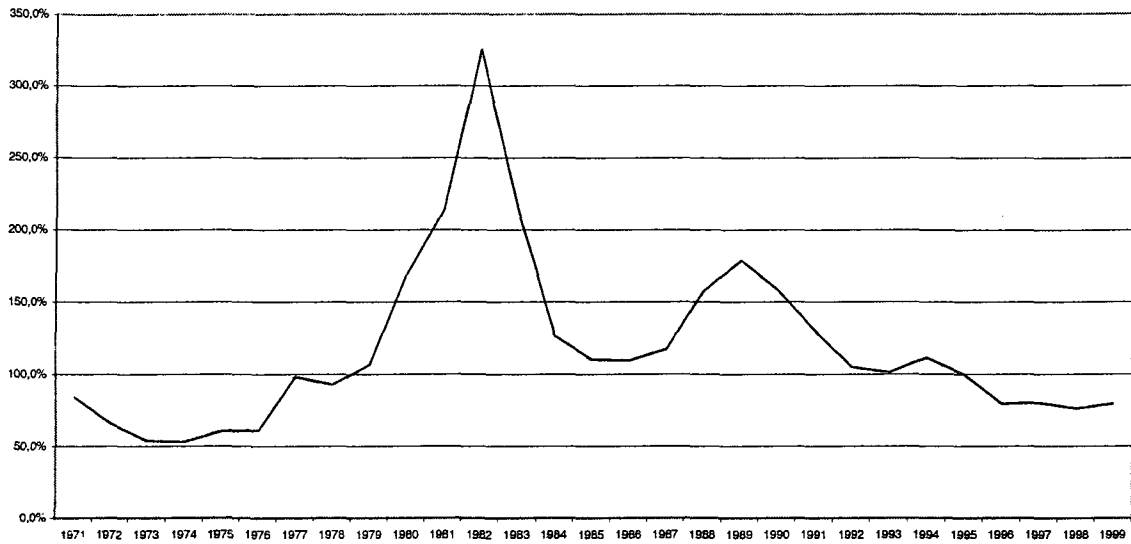
By the end of the decade also external debt ratios had started to climb again and were standing at levels seen at the beginning of the 1980s crisis.

LATIN AMERICA AND THE CARIBBEAN  
 External Debt Ratios  
 (In percentages)

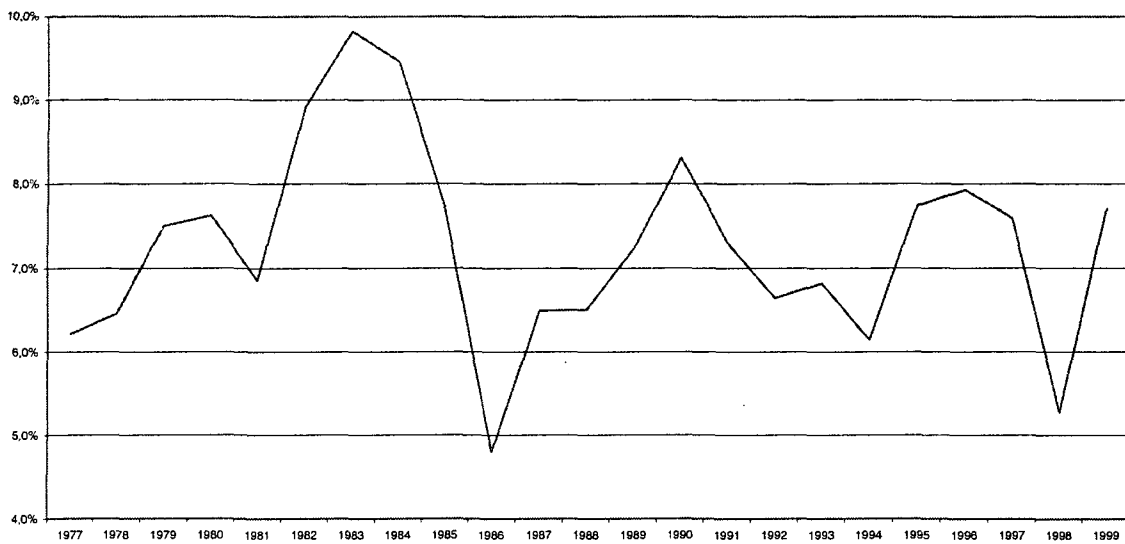


Although short-term debt – as a percentage of foreign exchange reserves – was low and falling towards the end of the 1990s decade, financing requirements were building up as a consequence of the growth in external debt.

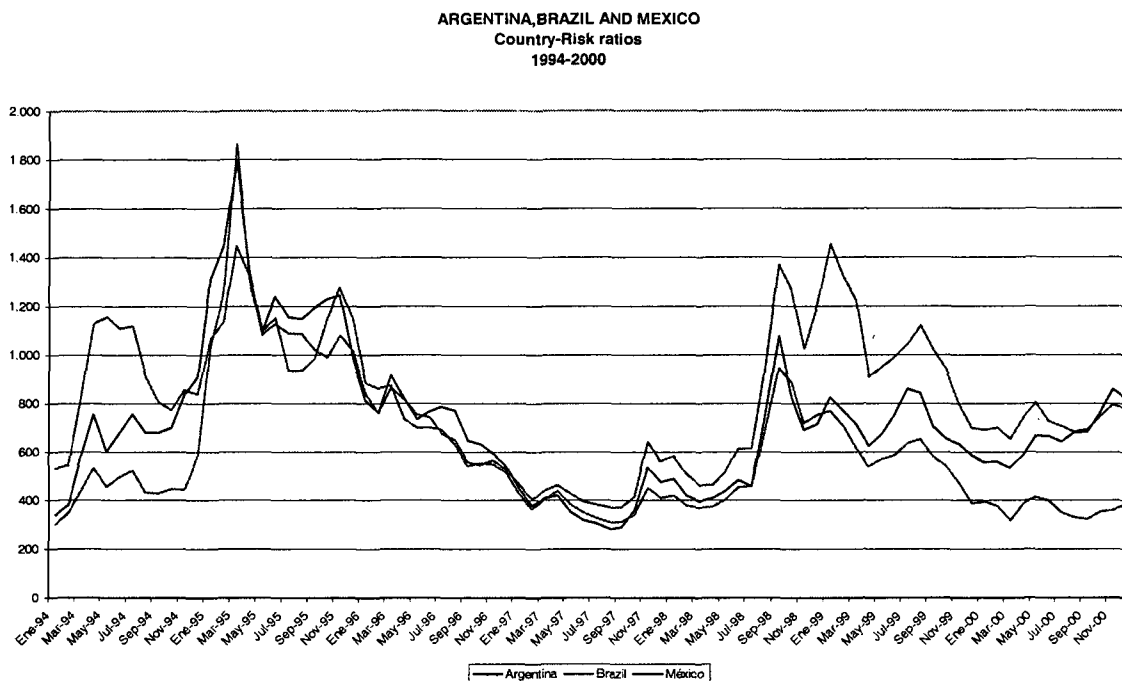
LATIN AMERICA AND THE CARIBBEAN  
Short-Term Debt as a percentage of Foreign Exchange Reserves  
1971-1999



LATIN AMERICA AND THE CARIBBEAN  
Financing Requirements  
(as a percentage of GDP)



No wonder therefore that under those various pressures crises have visited the region and the various countries have been placed at risk of a collapse in their exchange rate pegs and/or their debt service.



## The Argentine economy in the late 1920s

Parallels with the Argentine economy in the late 1920s – the period when Raúl Prebisch starts developing his ideas about the “peripheral economy” – are many. We have already noted that in terms of frequency of crises as well as the behaviour of commodity prices, the interwar period was the one – in the last 120 odd years – most similar to the post-Bretton Woods era and more specifically the last decade.

Let us take a look at the Argentine economy of those years. Crises and fluctuations did not first visit the country after 1929. The idyllic version of an only prosperous 1920s is far from the facts. A clear pattern of economic fluctuations had previously emerged to the point of being christened by Prebisch and his team as the “ciclo económico argentino”. Differently, however, from the, for instance, U.S. business cycle that was being subject to analysis by Mitchell and the NBER in those same years, that of Argentina, they posit, was dominated by

the instability of exports and capital inflows rather than by that of investment. For Prebisch and his team, the examination of the economic cycle was of utmost practical significance. The study of past behaviour could throw light on the current situation. And for that recollection of data would be essential.<sup>6</sup> But the first thing Prebisch points out to is to the wide gap between the performance of the Argentine economy in terms of constant prices and that in terms of current prices. In spite of later visions of the 1920s as an era of prosperity that had brought wealth and happiness to Argentina, there was widespread dissatisfaction. Prebisch shows that as measured by indices influenced by the price level, like bank clearings or the value of foreign trade, economic activity stood – after the recovery in the 1926-1928 period – only at levels comparable with the beginning of the decade. But that the volume of economic activity as measured by various indices of physical output, for instance volume of railway traffic or the physical volume of external trade, was clearly increasing.<sup>7</sup> Later estimates of GDP at constant prices do confirm that assertion as might be gathered from the following graph. The explanation, of course, lies on a for modern standards phenomenal deflation. In 1929, wholesale prices stood 29 per cent below those of 1920.<sup>8</sup>

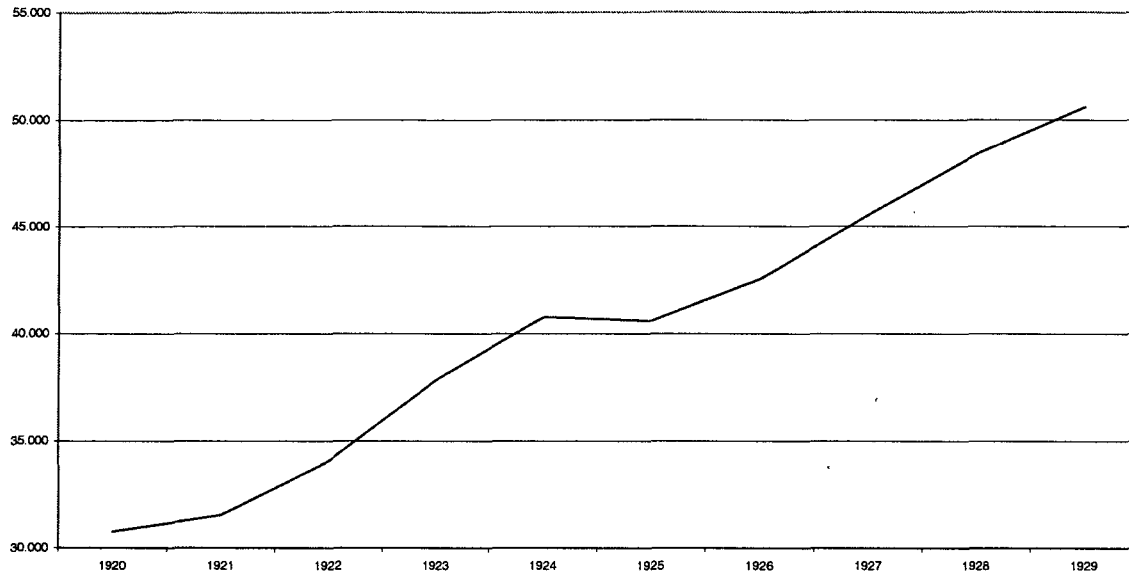
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<sup>6</sup> For an examination of the Argentine economy of those years see “Revista Económica” (there is an English version published as “Economic Review”) of the Banco de la Nación Argentina, various issues, followed for a brief period by the newly created Central Bank after 1935 as new series. An Economic Research Department, that published this review, had been organized at the Bank under the direction of Raúl Prebisch. For a survey of their studies see the first section – “The Argentine Business Cycle” - in my “Argentina into the Depression: Problems of an Open Economy” in Rosemary Thorp (ed.) “Latin America in the 1930s; The role of the periphery in world crisis”; St. Antony’s-Macmillan, London, 1984. For a defence of the need to produce indices of economic activity and their first attempts, see the first issue of the Revista Económica, vol.1, No.1, agosto de 1928.

<sup>7</sup> See Revista Económica, vol.2, No.1, enero de 1929. There was not yet any estimation of GDP neither at current nor at constant prices. Later estimates have been produced; the most generally accepted although contested by some economic historians is that produced by a CEPAL mission that in the mid-1950s under the general supervision of Prebisch – by then Executive Secretary of CEPAL – produced a report on the Argentine economy “El Desarrollo Económico de la Argentina”, E/CN.12/429, 30 de junio de 1958; see Anexo “Algunos estudios especiales y estadísticas macroeconómicas preparados para el informe”, were estimates of GDP at constant 1950 prices might be found.

<sup>8</sup> See Comité Nacional de Geografía “Anuario Geográfico Argentino”, Buenos Aires, 1941, p.368.

ARGENTINA  
GDP at constant prices  
(in US\$ 1990 million at PPP exchange rates)



In fact, more than fully recovered from the crisis of the First World War – a very serious one in the economic history of Argentina resulting in an accumulated drop of GDP of 20% between 1913 and 1917 – economic activity increased 65% between 1920 and 1929.<sup>9</sup> As examined in the *Revista Económica*, when corrected for price changes, agricultural exports in the 1920s had been growing at a rate as fast as that previous to the First World War.<sup>10</sup> Exports and capital flows, dominated the “ciclo económico argentino” and made the Argentine economy extremely vulnerable to the vagaries of the international economy.

First, exports were overwhelmingly agricultural exports. In the period 1923-1927, on the average, 96% of exports originated in the agricultural sector.<sup>11</sup> Moreover just four products (wheat, maize, linseed and beef) made up for two-thirds of exports.<sup>12</sup>

Those exports had another very special characteristic as different from those of other primary producers like, for instance, Brazil, exporting coffee, i.e., those Argentine exports – being temperate zone agricultural products – entered

<sup>9</sup> See Maddison, A. “Monitoring the World Economy, 1820-1992”, OECD, Paris, 1995.

<sup>10</sup> See *Revista Económica*, vol.3, No.1, enero, 1930, “El estado económico”.

<sup>11</sup> Fifty-five per cent were agricultural products and 41% produce from stockbreeding activity. See Dirección General de Estadística de la República Argentina, *Anuarios de Comercio Exterior*, años 1921-1924 and 1926-1929.

<sup>12</sup> Wheat made up for 22% of total exports, maize for 19%, linseed for 12% and beef for 11%. *Ibid.*



into competition with the domestic output of the more advanced Western European and North American countries. Additionally, agriculture in these countries – by the 1920s – had become a crisis sector where protectionism and measures of direct support to the domestic producers were becoming rampant.<sup>13</sup> Some studies published by that time or immediately afterwards would show a chronic trend, beginning by the end of the 19<sup>th</sup> century, for instance, for wheat prices, to decline in real terms.<sup>14</sup> In fact the First World War had additionally thrown the whole world agricultural sector out of balance. As output fell in continental Europe due to the ravages of trench war, the overseas producers had experienced a boom in production. The return to normal of European agriculture by the mid-1920s – under a panoply of support measures - did produce a situation of chronic oversupply. Additionally, Argentina was far from being a marginal supplier in some of these markets so that, as conditions of oversupply developed, her exports were bound to encounter barriers.<sup>15</sup>

As mentioned above recent studies of long-run trends have confirmed that a declining behaviour of real primary product prices was in place. No wonder, therefore, that observing the late 1920s situation, Prebisch starts placing emphasis on the “trend towards a deterioration of terms of trade between primary products and manufactured products”.

But going back to fluctuations, a second characteristic of Argentine exports, that brings forward the attention of Prebisch and again confirmed later, is their extraordinary price volatility to which in those years, also, an instability in volumes due to weather factors – and a cobweb-type cattle cycle - could be added. As domestic consumption showed a steady trend, volatility in output translated into volatility of exports.<sup>16</sup>

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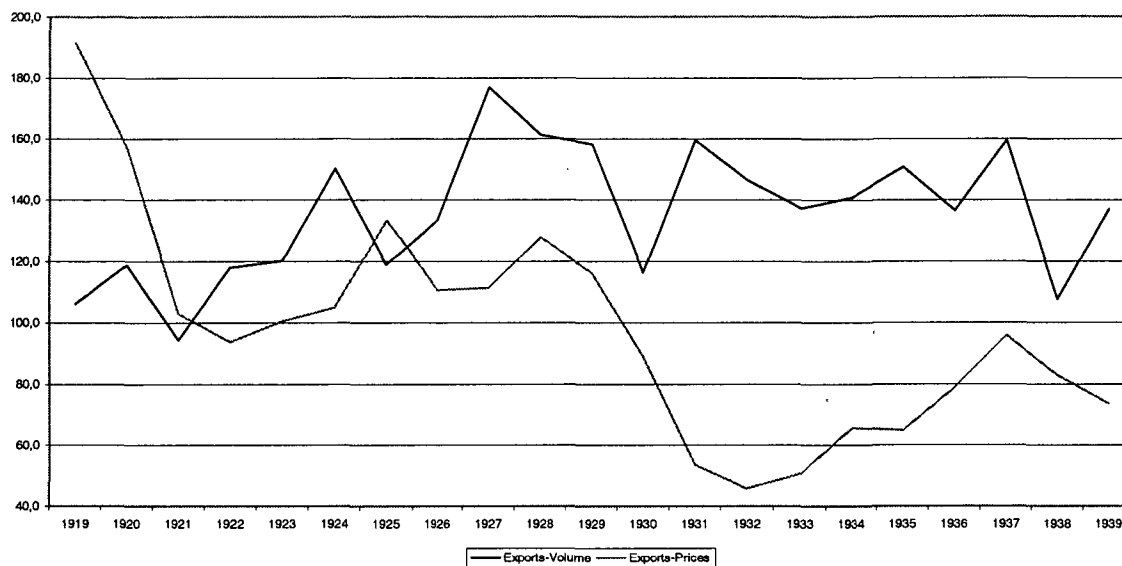
<sup>13</sup> For an account of the mounting tide of protectionism, with roots in the late XIX<sup>th</sup>. century, see my “Free Trade in One (Primary Producing) Country; the case of Argentina in the 1920s” in Di Tella, G. and D.M.C. Platt “The Political Economy of Argentina, 1880-1946”, St. Antony’s-Macmillan, 1986 (this volume, by the way, was dedicated to “Raúl Prebisch-Elder Statesmen of the Emerging Nations”, Prebisch having attended the seminar at St. Antony’s College-Oxford to which most of the contributions for this volume were first presented).

<sup>14</sup> Mandelbaum, W. – see his “The World Wheat Economy, 1855-1939”, HUP, 1953 – shows that wheat prices had been falling –in real terms – beginning in the early 1880s. For V.P.Timoshenko – see his “World Agriculture and the Depression, vol.V, No.5, Ann Arbor, 1933 – prices for fifteen important agricultural products were already falling by the mid-1920s not to speak to what happened in the early years of the Depression. In Argentina, wheat prices fell from an average of 15,13 pesos per “quintal” – 100 kgs. – in the 1920/24 period to 10,50 in 1927/28 and 9,68 in 1928/29, well before the Wall Street crisis.

<sup>15</sup> Argentina was the second world exporter of wheat – 22% of total – and the first in maize with more than two-thirds of total. Participation in world exports for beef (61%) and linseed (80%) was also very high. See Taylor, H.C. and A.D. Taylor “World Trade in Agricultural Products, NY, 1943” for shares of Argentine exports in the world markets.

<sup>16</sup> For an analysis of export volume instability see Revista Económica, vol.3, No.1 (January 1930) and also New Series, vol.1, Nos.2 and 3 (1937). For an instability index following MacBean see H. L. Diéguez “Crecimiento e inestabilidad del valor y el volumen físico de las exportaciones argentinas en el período 1864-1963”, Desarrollo Económico, vol.12, No.46 (July-September

**ARGENTINA**  
Exports-Volume and Prices  
1919-1939  
(1913=100)



In spite of some inverse relation between export prices and export volumes - to be expected of a country which was not a price-taker for quite a few products - export values also showed a high degree of instability. In fact, in the period 1917-1929, it was much higher than in any other period of Argentine economic history and well above that experienced by developing countries in the Bretton Woods era.<sup>17</sup>

Had import prices fluctuated in the same direction and magnitude as export prices, the volatility would have been neutral for the country at large although having significant income redistribution consequences. But that was far from being the case. Terms of trade, therefore, experienced wide swings before 1930 and only recovered the level previous to the First World War by 1946-1950.<sup>18</sup>

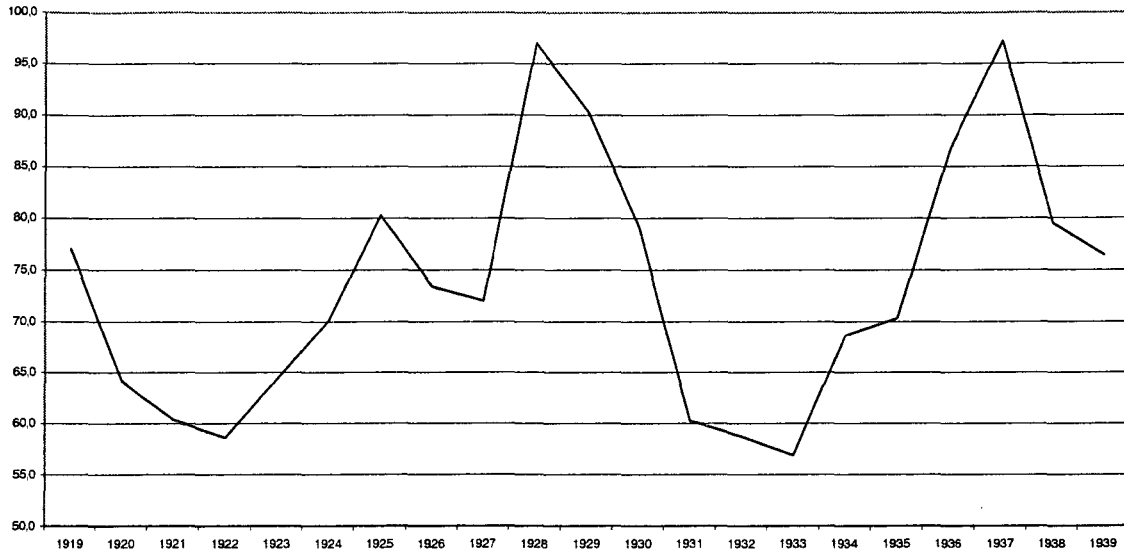
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1972). Prices normally were less unstable than volumes. But in 1917-29 the instability of prices was slightly higher than that of volumes (respectively, 12,5 vis à vis 12,2 per cent).

<sup>17</sup> The instability index - à la MacBean - for export values in the 1917-1929 period was 16,8%, while that estimated by MacBean for developing countries in the 1948-1958 period was only 9,06%. Ibid.

<sup>18</sup> For a terms of trade index see Ministerio de Finanzas de la Nación, Banco Central de la República Argentina "La evolución del balance de pagos de la República Argentina", Buenos Aires, 1952.

ARGENTINA  
Terms of Trade  
1919-1939  
(1913=100)



Terms of trade not only experienced strong fluctuations but, on the average over the 1920s, they were at the same level as over the 1930s and in both cases 27% below that of 1913. Once again a picture of the 1920s far away from the idyllic one.

The rigidity of Argentina's foreign trade was amplified by monopoly positions in its exports and imports. The so-called "Big Four" cereal houses handled 60 to 80 per cent of grain exports. And the meat trade was organized by a "pool" – a cartel – dominated by three U.S. and two British firms that distributed among themselves refrigerated cargo space. Quite a sizable chunk of imports, on the other hand, was also in the hands of big foreign-owned public utilities that were connected with a net of suppliers making it for high purchasing prices.<sup>19</sup> No wonder that when later, in the 1930s, Prebisch was under attack for being interventionist and against free trade, he would proclaim, "Free Trade"? "What free trade are you speaking about?". "That of the 'frigorífico' pool?". Additionally, other elements contributed to lend further rigidity to Argentina's foreign trade. Beef exports and most specifically "chilled beef" exports, the output of which was controlled by the most powerful section of the livestock

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<sup>19</sup> Right before taking up the position as head of the Research Department at the Banco de la Nación Argentina, Raúl Prebisch wrote "El Pool de los Frigoríficos, Necesidad de la intervención del Estado" for the "Sociedad Rural Argentina" where a careful analysis is made of price manipulation by the big meat-packing houses. The big British-owned railways, for instance, were buying all their supplies from some British firms, directorates of them being closely interconnected. The big cereal firms were under the accusation that devaluation of the peso was made to play in their hands resulting in lower prices in foreign currencies.

producers and the big “frigoríficos”, had it’s almost single market in Great Britain, the “mercado único” as it used to be called. On the other hand, the country had been developing an active import trade with the United States. Prosperity and geographical similarities to the Mid-West as well as similar productions made it for Argentina to increasingly cater for U.S. products rather than the traditional British exports. Consequently, a significant “triangular” trade developed under which Argentina accumulated positive trade balances in sterling to later transform them into U.S. dollars to pay for its imports. A significant proportion of that surplus sterling, however, went up to pay for British shipping, insurance and service on British investment in the country.

In principle there was no problem for such “triangular” compensation. But under the growing problems of the British economy and most specifically its inability to acquire U.S. dollars, pressure would be brought on Argentina to redirect its import trade towards Great Britain. Assurances also were asked so that British investors would be able to fully collect service on their credits and direct investment whatever the balance of payments position.<sup>20</sup>

| ARGENTINA   |              |              |                |              |              |                |              |              |                |
|---|--------------|--------------|----------------|--------------|--------------|----------------|--------------|--------------|----------------|
| Geographical Pattern of Foreign Trade   |              |              |                |              |              |                |              |              |                |
| (m\$ <sup>n</sup> million)  |              |              |                |              |              |                |              |              |                |
|   | 1913         |              |                | 1925         |              |                | 1928         |              |                |
|   | <i>Exp</i>   | <i>Imp</i>   | <i>Balance</i> | <i>Exp</i>   | <i>Imp</i>   | <i>Balance</i> | <i>Exp</i>   | <i>Imp</i>   | <i>Balance</i> |
| GB  | 294          | 350          | -56            | 472          | 436          | 36             | 687          | 373          | 314            |
| U.S.  | 56           | 166          | -110           | 163          | 469          | -306           | 198          | 441          | -243           |
| Western Europe(1)   | 417          | 386          | 31             | 629          | 545          | 84             | 1.165        | 527          | 638            |
| Brazil  | 59           | 25           | 34             | 76           | 83           | -7             | 92           | 73           | 19             |
| Rest  | 354          | 201          | 153            | 633          | 460          | 173            | 255          | 488          | -233           |
| <b>Total</b>  | <b>1.180</b> | <b>1.128</b> | <b>52</b>      | <b>1.973</b> | <b>1.993</b> | <b>-20</b>     | <b>2.397</b> | <b>1.902</b> | <b>495</b>     |
| <i>(1) Includes Germany France and Italy, for imports and Germany, France, Belgium, the Netherlands and Italy for exports.</i>    |              |              |                |              |              |                |              |              |                |
| <i>Source: Rep. Argentina, Dirección Nacional de Comercio Exterior, "Anuario de Comercio Exterior, 1940", Buenos Aires, 1941.</i> |              |              |                |              |              |                |              |              |                |

<sup>20</sup> For a full examination of the triangular structure of Argentina’s foreign economic relations in the interwar period, see J. Fodor and O’Connell, A. “Argentina y la economía atlántica en la primera mitad del siglo XX”, Desarrollo Económico, Buenos Aires, 1974.

| <b>ARGENTINA</b>   |               |               |               |             |
|--|---------------|---------------|---------------|-------------|
| <b>Balance of Payments</b>                                   |               |               |               |             |
| <b>Triangular Structure</b>                                  |               |               |               |             |
|  | 1921-1930     |               |               |             |
|  | Total         | U.S.          | G.B.          | ROW         |
| (in million gold pesos)                                      |               |               |               |             |
| <u>Trade Balance (Surplus (+) or Deficit (-))</u>            | <u>725</u>    | <u>-1.057</u> | <u>1.391</u>  | <u>391</u>  |
| Exports  | 8.422         | 769           | 3.009         | 4.644       |
| Imports  | 7.697         | 1.826         | 1.618         | 4.253       |
| <u>Services</u>  | <u>-2.206</u> | <u>-221</u>   | <u>-1.071</u> | <u>-914</u> |
| Immigrant's Remittances                                      | 340           | 0             | 0             | 340         |
| Tourism (net)  | 210           | 0             | 50            | 160         |
| Interest and Profit Remittances (net)                        | 1.656         | 221           | 1.021         | 414         |
| <u>Current Account Balance</u>                               | <u>-1.481</u> | <u>-1.278</u> | <u>320</u>    | <u>-523</u> |
| <u>Capital Account Balance and Foreign Reserve Movements</u> | <u>994</u>    | <u>735</u>    | <u>317</u>    | <u>-58</u>  |
| <u>Capital Movements</u>                                     | <u>950</u>    | <u>750</u>    | <u>275</u>    | <u>-75</u>  |
| Lending and Bond Issuance                                    | 1.025         | 750           | 275           |             |
| Amortization   | 75            |               |               | 75          |
| <u>Reserve Movements</u>                                     | <u>44</u>     | <u>-15</u>    | <u>42</u>     | <u>17</u>   |
| Gold Outflows  | 240           | 128           | 53            | 59          |
| Gold Inflows   | 196           | 143           | 11            | 42          |
| <u>Multiangular Payments, errors and omissions, etc.</u>     | <u>-487</u>   | <u>-543</u>   | <u>637</u>    | <u>-581</u> |

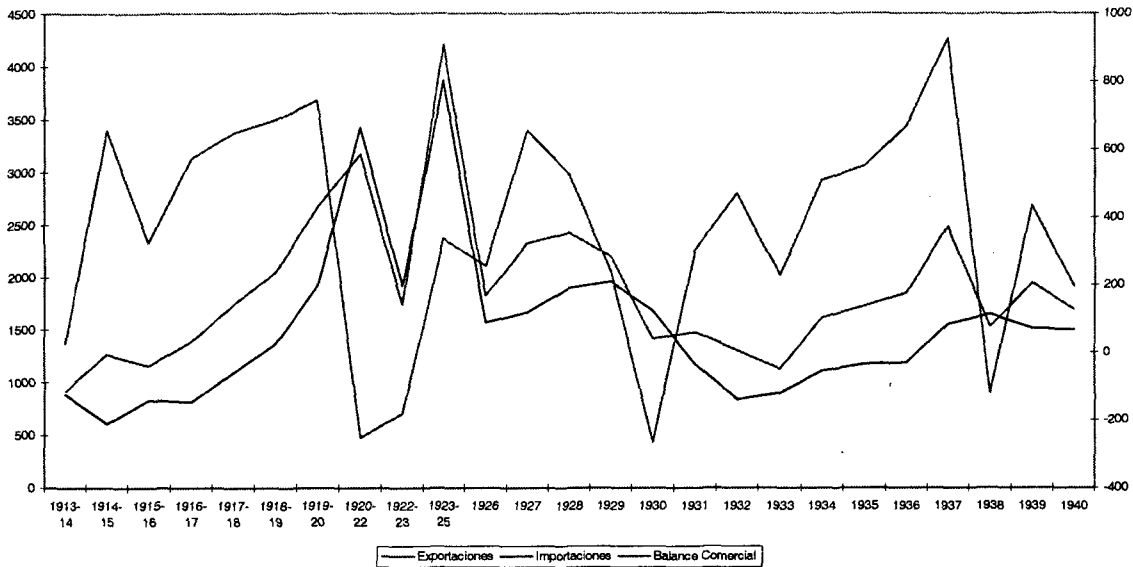
Fuente: Phelps, Vernon "The international economic position of Argentina"; Table XXVII, p. 190.

Imports, on the other hand, were quite a high share of GDP, almost 25% in 1925-1929. In this same period imports supplied 13% of consumption and those of machinery and equipment were supplying 35% of domestic investment. Moreover, the years of the First World War had shown how essential they were for the behaviour of the economy when a dearth of supplies – admittedly also a crisis of the building sector due to financial difficulties – had resulted in the worst slump of the whole century.

Imports, additionally and as analysed by Prebisch's team, displayed a high income-elasticity and a ratchet effect as there was some inertia in their adaptation to lower levels of national income. Consequently, when an export downturn – or a drop in capital inflows - hit the country, leading, first, to a scarcity of foreign exchange and, second, to a drop in GDP, the preservation, for a time, of high levels of imports, resulted in further pressure on the balance of payments. Consequently wide swings in trade balances were experienced as may be visualized in the following figure.<sup>21</sup>

<sup>21</sup> For figures on share of imports in GDP, consumption and investment, see CEPAL, op.cit.cuadros 24, p.26 and 25, p.27. In the period 1996-1998, under the recovery from the "tequila" crisis, import elasticity in Argentina was between 3 and 4. That is very much the case of most present-day "emerging market economies" consequently putting under danger their external position.

**ARGENTINA**  
Exports, Imports and Balance of Trade  
1913-1940  
(in million pesos m/n)



The second element of instability identified by Prebisch was that originating in capital inflows. Gross capital inflows amounted to the equivalent of 10% of exports, making them a significant supplier of foreign exchange. Contrary to what is habitually asserted as different in that world to the present-day one, on the average, in the 1920s, fully 53 per cent of inflows were going into the private sector and only the rest into public debt.<sup>22</sup>

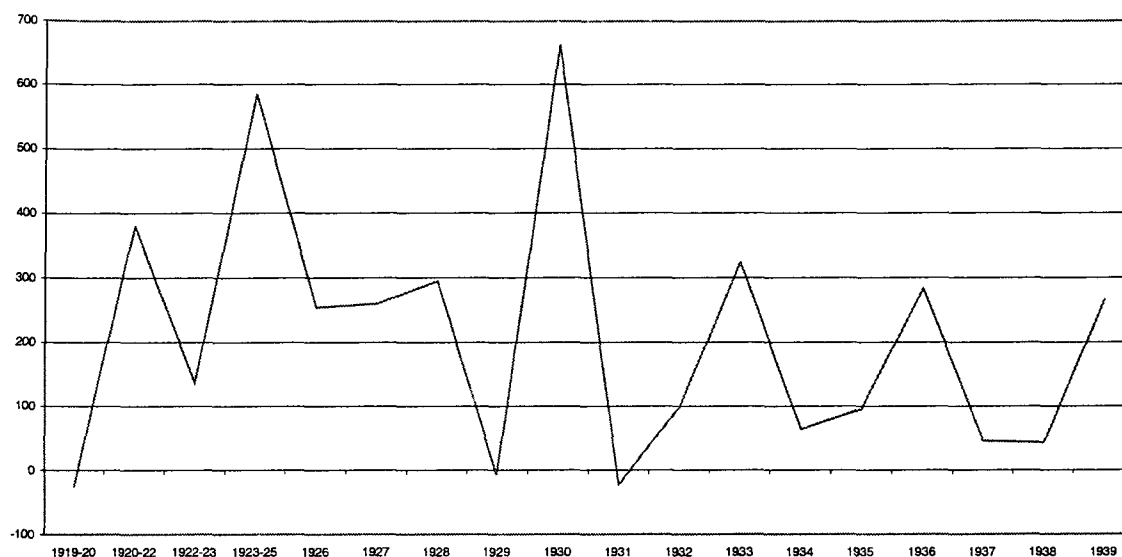
Besides debt flows there was a significant amount of foreign direct investment which as in the present-day case, to a significant extent, was financed by debt issues. Foreign Direct Investment – in stock terms – was 32% of estimated total capital invested in Argentina and gross inflows were 10% of fixed capital formation.<sup>23</sup>

Capital inflows, however, were notoriously unstable as may be gathered from the following figure related to the interwar period, instability already quite present in the 1920s.

<sup>22</sup> See Ministerio de Finanzas, op.cit.

<sup>23</sup> For these figures see CEPAL, op.cit. Fully 60% of FDI originated in the United Kingdom; in its turn, in 1929, Argentina accounted for 27% of all UK's FDI and 42% of that in "foreign countries", i.e., beyond what was still the British Empire. See UN "International Capital Movements in the Inter-War period"; NY, 1949, Table 7. For the U.S., Argentina was much less important as a field of FDI – only 8% of total - ranking behind other countries in Latin America. Ibid., Table 6. However, many U.S. firms started establishing themselves in the Argentine market manufacturing motorcars, electrical home appliances, cosmetics, and other things. See D.M. Phelps "Migration of Industry to South America", NY & London, 1936 and G. Whyte "Industry in Latin America", NY, 1945.

**ARGENTINA**  
**Gross Capital Inflows**  
**1919-1939**  
 (in million pesos m/n)



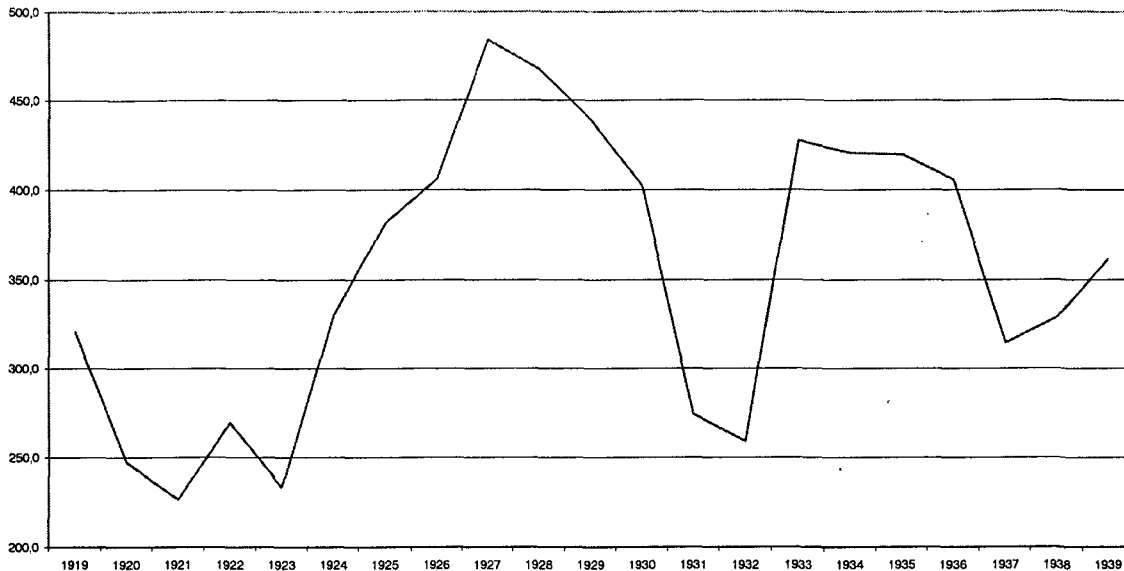
Instability of exports and capital inflows transmitted itself to the economy through various mechanisms. From the income side of things, exports, in the period 1925-1929, represented 24 per cent of GDP and more than two-thirds of the final demand for “Pampa” produce. In its turn, agriculture accounted for between 25 and 30 per cent of GDP, at 1950 prices, admittedly extremely low for these sectors so that its true significance should have been much larger.<sup>24</sup> And then, capital inflows either those going to the private or to the public sector went up to finance expenditures that had to accommodate itself to the availability of these inflows.

Shocks were also transmitted via the fiscal and monetary systems. Three-fourths of government current revenue originated in customs duties and other taxes on foreign trade. Availability of resources for government expenditure was also determined by capacity for further indebtedness. As we may gather from the following figure, there were strong oscillations in that.

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<sup>24</sup> See CEPAL, op.cit.

ARGENTINA  
Foreign Public Debt  
(in US\$ million)



But in the monetary mechanism is where the parallels with present-day preoccupations are more striking. The monetary system of Argentina in those years has been christened as “sporadic gold standard” by Mr. Hueyo, a Minister of Finance in the early 1930s. Hueyo – following orthodox teaching and as Mr. Hoover did in the U.S. – tried to stabilize the economy by bringing down the fiscal deficit, cutting wages, etc. a feat he almost succeeded at with less than favourable consequences for economic recovery. In fact Argentina, had adopted a Currency Board system early in the XXth. century but had left “convertibility” - to use modern Argentine parlance – at the beginning of the First World War only to resume the workings of the “Caja de Conversión” in August 1927. As with many other cases of early resumption of the Gold Standard, the experiment failed by late 1929 and the country only returned to a Caja system by early 1931, this time on a U.S. dollar standard. The opening of the Caja, in 1927, pitted the politically powerful agricultural exporters against foreign investors. Exporters asked for a return to “convertibility” as the peso was appreciating too much, even beyond parity, while foreign investors were happy to see their earnings in pesos translated into larger amounts of sterling pounds and other “divisen”.

Of course, under the “Caja de Conversión” credit and money supply had to accommodate the vagaries of the trade balance and of net capital inflows. The Central Bank was only created by 1935, so that some of the functions of “lender of last resort” were fulfilled by the Banco de la Nación Argentina, echoes



of which may be detected under the "tequila" crisis and under today's - what we should call it? - "tango" crisis.<sup>25</sup>

Analysing the instability of capital inflows, Prebisch comes to the very up-to-date conclusion widely accepted nowadays, i.e., that capital flows are negatively connected with activity levels in what he later would label as the "monetary centres". New York being almost the only one in the 1920s, capital inflows would be put under threat when as it happened in 1928-1929, a boom in the U.S. economy and in the stock markets - accompanied by an attempt by the Federal Reserve to stop the "irrational exuberance" - would determine a capital drain from Argentina. The cycle in Argentina, therefore, tended to be the reverse of the U.S. one, something reinforced by the fact that exports to that country represented only a tiny fraction of totals.<sup>26</sup>

Instability of exports and capital inflows, therefore, directly hit the balance of payments position but additionally through the workings of income and monetary links transmitted itself to the rest of the economy.

On the other side of the coin, rigid elements of the economic structure made Argentina extremely "vulnerable" to the instability induced by the international economy.

To begin with, mention has been made above to the behaviour of imports; fast expansion resulted in trade imbalances in booms and temporary downward rigidity in slumps, deteriorating even further those imbalances. Government finances, also, tended to behave in an asymmetrical manner. With easy availability of funds, expenditures –also supported in higher revenues fed by the expansion – tend to explode. But in a downturn, contraction becomes more difficult because of the rigidity of commitments previously entered into. Consequently, in slumps fiscal deficits tended to explode which did not allow the economy to contract to a new level of availability of foreign exchange. Additionally, service on foreign debt in the 1920s, on the average, took 20% of export proceeds (it would shot up to 35% in the first few years of the Depression). Current account deficits plus amortization on private and public

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<sup>25</sup> Mr. Hueyo's pronouncements on the Argentine monetary system may be found in Ministerio de Hacienda, Memoria Anual, 1932. At that time, there was also an "Empréstito Patriótico" – as those launched back in 1995 and this year of 2001 - that for lack of demand had to end up in the Banco de la Nación Argentina, using for the first time a Rediscount Law that had been passed back in 1914 to counter the crisis unleashed by war in Europe. Mr. Hueyo asked for the advice of the Bank of England in setting up a Central Bank. As "money doctor" the Bank of England sent down a high ranked official, Sir Otto Niemeyer, that was extremely critical of the Gold Standard. See his opinions in "Revista Económica", vol.7, Nos.5-8, 1934.

<sup>26</sup> As may be gathered from a previous table about the geographical composition of foreign trade, by 1925, only 8% of Argentine exports were directed to the U.S. market. Imports from the U.S., on the other hand, had come to account for 23% of total Argentine imports, becoming the largest supplier of Argentina displacing the UK. See Dirección Nacional de Comercio Exterior "Anuario de Comercio Exterior, 1940", Bs. As. 1941.

lending led to high financing requirements hovering around 25 to 30 per cent of exports in the 1920s to increase to almost 60 per cent in the 1930s. In spite of normally balance of trade surpluses the country – year after year - had to find new resources to finance service on foreign debt and investment. On the whole, net transfer of resources was clearly negative, in the 1925-1929 period it would account for almost 5 per cent of GDP.<sup>27</sup>

There were, therefore, two almost fixed charges against foreign exchange proceeds, somewhat rigid imports and service on foreign debt and capital invested in the country. Against these, both exports and capital inflows were extremely volatile. These circumstances – according to Prebisch's thinking - made the Argentine economy "vulnerable" to an unstable international economy.

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<sup>27</sup> For figures on the debt burden and financing requirements in relation with export proceeds see Ministerio de Finanzas, op.cit. As to the net negative transfer of resources, see CEPAL, op.cit., Cuadro 28, p.29 and cuadro 24, p.26.

## The early development of Prebisch's thinking about the "ciclo económico argentino"

For Prebisch, therefore, a "ciclo económico argentino" was well established.<sup>28</sup> And economic policy and the conduct of private as well as public affairs should take it for granted that the downturn is just around the corner, even during what looks like the most solid of booms. It seems adequately prescient compared with all the "new economy" advocates and those of the endless indebtedness of the emerging market countries.

Leaving aside the impact of weather on the volume of produce available for export, the other factors determining that cycle - prices and demand for agricultural goods and capital inflows - were intimately connected with international economic behaviour. In the Argentine case, without a domestic machinery-producing sector, the "accelerator" mechanism that Prebisch takes for granted was behind the cyclical behaviour of advanced countries, is not applicable. All the instability, therefore, originates abroad.

The decade of the 1920s had been clear proof of his vision. A slump in incomes - remember again the significance of price deflation - had inaugurated it. The sharp reduction in agricultural prices after the end of the war had a special impact on Argentina as dependent on these products. Recovery followed - after deflation run its course - in the 1922 to 1924 period with good harvests and the beginnings of large capital inflows originated in the United States. A bad harvest in the 1924-1925 season led to a new decline in economic activity accentuated by renewed deflation, which extended itself into 1926.<sup>29</sup> Beginning in that last year a new phase of expansion set in but prices, this time, experienced a slight downward trend. Due to an expansion in exports and capital inflows, the peso started appreciating, leading to the reinstating of the "Caja de Conversión" system - a return to the Gold Standard - in August 1927. This movement found support in the U.S. Federal Reserve policy that had cut interest rates by that time, resulting in an outflow of capital. Government borrowing abroad expanded at an even faster pace as might be gathered from a previous figure about the performance of foreign public debt. Gold entered the country with reserves expanding from US\$ 466.5 million in January 1927 to the high point of US\$ 680.1 million in July 1928.<sup>30</sup>

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<sup>28</sup> "Por más que no se sepa cómo, ni bajo cuál forma, ni en qué momento preciso ha de sobrevenir la reacción cíclica después de las épocas de bonanza, el saber que vendrá ineludiblemente es suficiente para aconsejarnos tomar a tiempo las medidas que propendan a moderar la amplitud de la oscilación o atenuar sus consecuencias económicas y sociales". See Banco Central de la República Argentina, Memoria Anual, 1938., I. Introducción.

<sup>29</sup> See Revista Económica, vol.2, No.1, enero 1929, "La posición de 1928 y las variaciones económicas de la última década", for an account of the early and mid-1920s cycles.

<sup>30</sup> For an analysis of the impact - not only on Argentina but on the world economy - of Federal Reserve Policy in the late 1920s, see Revista Económica, vol.2, No.6, junio de 1929, "El movimiento internacional del oro". In August 1927, the Fed had lowered interest rates to 3 ½ %

During that expansive period, currency and deposits increase. Lending however did not expand at an equivalent rate as banks tried to rebuild reserves and cancel old credits, a hangover from the previous downturn. From the high point of June 1927, interest rates fell from an average of 6.75% to 5.75% by July 1928. The Banco de la Nación Argentina – which in the absence of a Central Bank proper was half-playing this role – that had extended credit to other banks during the previous period of stress, started recovering these loans.<sup>31</sup>

The 1928-1929 year is most interesting for our attempt at drawing parallels with the more recent decade and the present-day situation. As might be gathered from previous figures, exports increased less and imports kept increasing at a faster pace than in the previous expansion. On top of it capital inflows started declining and some funds left as the tightening up by the Fed plus the Wall Street boom attracted them towards New York. Beginning in the second half of 1928 – way before the Wall Street crash – gold started leaving the country and mainly because of its boom rather than the later crash. By the end of 1929 – when de “Caja” was closed again – all the gold – more precisely slightly more – that had entered Argentina after the return to the Gold Standard had been lost.<sup>32</sup> Banking reserves started declining after September 1928, reaching a point lower than that previous to the 1927-28 boom.<sup>33</sup> Again the Banco de la Nación Argentina was playing a compensatory role by lending to the government and other banks; bank lending, in spite of the outflow to NY, increased therefore 15% between September 1928 and December 1929.

A drastic fall in export prices was the reason behind lagging exports, which added to the crisis unleashed by the financial movements. Wheat harvests in the main producing countries, for the year 1928/29, were much larger than in previous years and led to further accumulation of already heavy unsold stocks. Between May 1928 and May 1929, again way before the Wall Street crash, wheat prices in Argentina fell 30%. Although not all agricultural prices fell so heavily, the general index dropped 7% between 1928 and 1929. Land prices fell in sympathy with these movements.<sup>34</sup>

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from 4% and engaged in an active “open market” policy of credit expansion. But beginning in early 1928, policy reverses because of increasing preoccupation about the “irrational exuberance” of Wall Street; bonds are sold and rates of interest in successive hikes are put, by July 1928, at the 5% level.

<sup>31</sup> See Revista Económica, vol.2, No. 10, octubre de 1929, “Situación Bancaria”.

<sup>32</sup> See Revista Económica, vol.2, No.12, diciembre de 1929, “Los pagos internacionales y el sistema monetario”; between September 1928 and December 17<sup>th</sup>, 1929 – when the “Caja” was closed – gold outflows amounted to 187.6 million gold pesos (roughly equivalent to pre-1933 dollars), slightly more than the 179.4 million that had entered Argentina since the opening of the “Caja” back in August 1927.

<sup>33</sup> Ibid.

<sup>34</sup> For the behaviour of land prices see Sociedad Rural Argentina “El Precio de la Tierra”, Buenos Aires, 1979.

The stage was set for a significant slump in economic activity before the Wall Street crash of October 1929 signalled the beginning of the Depression that would dominate the following decade.

What followed is better known. Up to 1932, export prices continued their fall, on the whole between 1928 and 1932, by 64%. Import prices also fell although less so; as a result terms of trade deteriorated over that four-year period by 40%.<sup>35</sup> Price levels were also important and not only their relative decline. Export prices now – 1932 – stood at half their pre-First World War level placing an enormous burden on producers and their creditors.

As to capital inflows they almost dried up with some recovery only by 1933.<sup>36</sup>

The Argentine economy only recovered in 1934 and even more firmly afterwards due to prolonged and serious drought in North America that later extended to Australia. This drought, on the one hand, generated the famous “dust bowl” and the misfortune of poor farmers but, on the other, made the prosperity of Argentina that saw its export prices climbing by the second quarter of 1934 to unexpected levels. The country underwent a balance of payments bonanza fed by exports at those high prices and on the back of it a return of capital inflows, also originating in political instability in Central Europe. This time, however, these inflows were mainly short-term and started leaving the country as soon as in 1937 the situation turned to the worse.

Argentina, that almost alone had not defaulted on its foreign debt service, actually repatriated part of it, besides engaging in major domestic sterilization operations. The newly created Central Bank and his General Manager, Raúl Prebisch, were widely praised, for instance, by the League of Nations economic and financial section, for those measures.<sup>37</sup>

The result of foreign exchange abundance was obvious, imports went up – by 74% between 1932 and 1937 – and GDP expanded by 27% in that same period.<sup>38</sup>

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<sup>35</sup> Figures for foreign trade prices and terms of trade in Ministerio de Finanzas, *op.cit.*

<sup>36</sup> Some short-run “compensatory finance” was provided – in the absence of an IMF – by Brown-Harriman of New York – in fact it went up to repay a previous loan from Phoenix Corp. – and the British Railway Companies managed to issue some debentures, both in 1930 and 1931.

<sup>37</sup> Examination of the minutes of discussion of the Anglo-Argentine Treaty of 1933, reveal that the Argentine delegation was insistent in complying with full debt service even under the pressure from the British side to better make room for British exports and, above all, for profit remittances of the British owned firms – the most important the railways – in Argentina. By the way, Raúl Prebisch was a member of that Argentine delegation as financial expert, formally still – in 1933 – an official of the Research Department at the Banco de la Nación Argentina, in which capacity he had been invited to attend the preparatory meetings – in Geneva - for that year's World Economic Conference and had gained the appreciation of the head of the British delegation Sir Frederick Leith-Ross.

<sup>38</sup> Export prices shot-up by 43% in 1933-34, 21% in 1935-36 and 22% in 1936-37. By 1937 terms of trade were at their highest level in the century up to that moment. Export values exploded by 128% between 1932 and 1937. See A. O'Connell “Argentina into the Depression; problems of an

In opposition to both traditional and some modern scholarship, Prebisch himself, however, was careful enough not to claim the recovery mainly for the policies followed. In the *Revista Económica*, new series, now edited by the Central Bank, Prebisch – speaking again about the cycle the country had been going through - would say: “From 1934 up to the present there has...been a gradual improvement (of the economic situation in Argentina), partly brought about by the adoption of measures tending to facilitate readjustment of international accounts and revive internal economic activity, but mainly as the result of the gradual rise in the world prices of the country’s export products”.<sup>39</sup>

For Prebisch, the mechanics of the cycle hinged around credit and monetary expansion and contraction and their impact on import levels. Only later in the 1930s the Keynesian – or Khanian – income multiplier enters into his analysis. Expansion of exports – due to a larger harvest but mainly to better market conditions abroad – or larger capital inflows lead to creation of “high-powered” money. Banks expand through the “monetary base” multiplier creating purchasing power additional to that originally created by the inflow from abroad. Trade and industry expand and imports – remember their being a high proportion of GDP – surge and the expanded availability of foreign exchange is rapidly exhausted. Either gold – under the “Caja de Conversión” system – or “divisen” start leaving the country or, under the floating exchange regime that predominated in Argentina for some time after the closing of the “Caja”, the national currency will experience a depreciation. To which a cyclical downturn in either export proceeds or capital inflows may add an additional force. In the meantime, foreign obligations also have increased.

The scene now is set up for the descending phase of the cycle. The outflow of gold and foreign exchange contracts the monetary base and the expansion of credit not only comes to a halt but also in fact reverses itself. For that to happen smoothly, Prebisch insists, credit should have been granted only for short-term purposes, meaning that their cancellation would be almost automatic their purpose of financing merchandise trade having been fulfilled. If that had been the case, no necessary financial crisis should happen. If expectations of sale have been too optimistic, some difficulty might arise in cancellation of credit. But then it would fall on banks and the Central Bank to resort to their reserves and rediscounting operations to sort out the problem. Thus what Prebisch criticizes as an unwarranted contraction of credit could be avoided.

On the other hand, he takes a strong stance vis à vis those advocating the use of bank credit to finance long-run investment. In his opinion, a confusion between credit and savings is the reason for such advocacy and banks should

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open economy”, op.cit., for an account of how the drought in North America determined the recovery of the Argentine economy.

<sup>39</sup> See Banco Central de la República Argentina “Economic Review”, Series II, vol.1, Number 1, 1937 (English version), page 1.

refrain from granting credit for such purposes unless funds from the public have been collected specifically towards that end. Again the main reason for his opposition is based on the impact on imports and consequently on foreign imbalances of such operations.

But, anyway, the cycle has followed its course and the whole country has been subject to its ups and downs. Government financial position also suffers because of its impact on revenues. And the rigidity of fiscal expenditure coupled with that of imports only worsen the imbalances into which the economy has run. Prebisch also points out to the pernicious character of short-run capital inflows, what he labels as “floating funds”. In his vision, these funds “...tend to duplicate foreign exchange demand; once to pay for imports that result from their inflow and (twice) for the need to support their later outflow”.<sup>40</sup>

On the other hand, Prebisch introduces another element in his analysis of the short-run behaviour of an “emerging market economy”. Businessmen expectations are brought in as a moving force that could lead to output expansion or contraction and the consequent demand for credit. But those expectations – in a rural country – he makes dependent on the state of the rural sector going back, therefore, to weather and prices from abroad being the main determinant of the cycle coupled with the vagaries of capital inflows. In all his writings and analyses dependence on imports – with its high income elasticity to increases in GDP and its asymmetric downward rigidity - is what plays the main role in placing an insurmountable obstacle to expansion. And, further, to any attempt at a countercyclical policy – an expansive monetary policy one of them - in conditions of balance of payments crisis.

Economic policy, therefore, had very limited autonomy to cope with the “ciclo económico argentino”. With such a primitive fiscal and monetary system as the one described many instruments for such countercyclical policies were, anyway, absent. The only possible course was one of extreme prudence during expansions so that excessive credit and government expenditure based on further indebtedness could be avoided. That would make it for what Prebisch considered the inevitable downturn to be more manageable.

### **The Depression and further developments in Prebisch’s thinking**

The way in which Argentina overcame the Depression, as we have seen, was more related to “exogenous” events – a prolonged and serious drought that hit foreign competitors – than to any shift in economic policy making.

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<sup>40</sup> Ibid., Cap. II, “El Ciclo Económico y la política monetaria”, for this sentence (my translation) and, more in general, for a succinct later account of Prebisch thinking about the “ciclo económico argentino”.

But it is at the same time true that the crisis forced some changes both in economic policy and in economic structure.

In terms of shifts in economic policy régime, maybe, the major event was the introduction of exchange controls right after the sterling pound went off gold in September 1931. Priority was granted to essential imports and service on foreign debt placing other imports and profit remittances in a second order of importance.

Again rather than a prescient policy of “import substitution”, rationing of foreign exchange became a necessity because of the balance of payment crisis. Exchange controls would remain in place for decades although experiencing significant changes, the first one, inspired by Prebisch himself at the end of 1933. Under a new régime instituted in November 1933, a “free market” was established separated from the “official” market. In the free market exchange would be sold by the authorities by auction. That was thought to introduce an element of flexibility that would lead to a gradual fading away of the controls.<sup>41</sup> Rationing of exchange, in fact, substituted for a true real devaluation as those undergone by other countries in South America; in Argentina, in fact, the peso had undergone overvaluation against the sterling pound over the 1929-1933 period not fully corrected by the devaluation of November 1933.

As soon after that subdivision started, foreign exchange - boosted by good market conditions for Argentine exports - became abundant for reasons already mentioned, the “free rate” tended to fall towards the “official” rate at which point the authorities decided to make the margin between the two as fixed. In this sense – Prebisch acknowledges later in his life - it was confirmed that the system was being used more as an element of discrimination in favour of Great Britain and some of the European countries and against the United States as it was their transactions to benefit from the official rate while American exporters and firms established in Argentina had to supply themselves in the “free” market. Such a policy, of course, had to do with the extreme triangularity of Argentine trade that worsened the sterling pound area deficit with the U.S. dollar area and the leverage Great Britain had to force the country into a bilateral exchange agreement.

The other innovation in the economic policy régime was the institution of a Central Bank, beginning in 1935. Such a move consolidated and reinforced the role that the Banco de la Nación Argentina had been playing in shoring up banks – and the government – and represented a further step away from the “Caja de Conversión” system.

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<sup>41</sup> The official market, in its turn, was divided between a purchase and a selling rate, with some margin in between. This margin would go to pay for the increased cost of foreign public debt service – after a devaluation of around 20% was introduced – plus a price support scheme for wheat, maize and linseed.



Mention has been made that Sir Otto Niemeyer – our British “money doctor” – was extremely critical of the workings of the Gold Standard. Prebisch, although disagreeing with Sir Otto about some of his recommendations for the Central Bank, did share those criticisms.

The Gold Standard – or the “Caja de Conversión” system based on gold – was deemed to be too a rigid mechanism both in the upswing and in the downswing for a country the economy of which was dominated by movements in export values and capital inflows. It would lead to easy over-expansion in an era of easy foreign exchange and to excessive contraction in a moment of slump. Thus Prebisch ends up defending the exchange control system. In his vision, exchange controls are absolutely necessary to be able to adopt a “national monetary policy” that would gain some autonomy for the country from world forces beyond her control. Exchange controls are thought only as a mechanism in the financial sphere and not – at least in his writings – as an element of protectionism. For that, Argentina – he says – must have her own customs policy; otherwise it would be imposed by the great powers.

The other piece of news in Prebisch’s thinking is that related to the role of industry. Industrialization, a larger share of GDP originated in manufacturing activities, again, is reckoned as a way to regain autonomy as this sector would be less connected with developments abroad. Still, at that time, no other element in defence of industrialization as the arguments that would make him and CEPAL famous in the late 1940s.

For the rest both in writing, speeches and lectures as well as in economic policy making, Prebisch resorted to consecrated orthodox solutions. A restrictive monetary policy and sound government finance. A banking system based on short-term credit and under strong supervision by the central bank. And of course honouring debt. No wonder then that if a comparison is drawn between the availability of foreign exchange and the rate of growth of GDP or of manufacturing in Argentina and other “emerging market” economies of the era – Brazil and Chile in South America as well as the Danube basin countries in Europe or India – the performance of Argentina is decidedly slower.<sup>42</sup> Prebisch’s vision of the problems of an “emerging market economy” in an unstable international system, however, have regained significance and stand as a source of insights about the mechanics of its functioning. From that point of view his enemies have ended up playing him the greatest homage of them all.

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<sup>42</sup> For such a comparison with Brazil see M. Abreu “Argentina and Brazil during the 1930s: the impact of British and American international economic policies” in R. Thorp (ed.), op.cit. and with other countries in my own “Argentina into the Depression...”, op.cit., in that same volume.





