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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.

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An economic policy for development

*Norberto González**

This article seeks to make a contribution to the conceptual review of economic policy design and implementation in Latin America. To this end, the author addresses three topics. The first section is devoted to a brief analysis of a number of the factors behind the challenges now being faced, some of which were already in existence prior to the present crisis and some of which have emerged or grown more serious since it began.

The second section is given over to an examination of the orthodox economic policy option as regards the adjustment and the fight against inflation. In the course of this analysis, the author discusses the conceptual postulates of this approach, the policy recommendations made by its advocates and the experiences to which its implementation has given rise.

In the third section, the author deals with some of the currently controversial issues associated with the question of how to manage economic policies so as to bring about structural change. In this connection, he discusses both the conventional or orthodox position and other approaches which might serve as a basis for a different option oriented towards achieving a more dynamic and socially more just form of development.

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Introduction

As economic policy-makers in Latin America and the Caribbean strive to reconcile the need for a recovery and for economic and social development with the adjustment of the region's economies and the control of inflation, they are faced with challenges of a much broader scope than those encountered for many decades. Hence the need for a thorough review of the conceptual foundations for the design and implementation of these economic policies. In so doing, it is necessary to bear in mind the power relations which serve as their backdrop since, by virtue of their presence, the processes of adjustment and of controlling inflation are not purely technical or economic problems, but social and political issues as well.

This article is intended as a contribution to such a conceptual review. To that end, I will touch upon three topics. In the first section I will comment briefly on a number of the factors underlying the challenges now being faced, some of which were already present before the current crisis and some of which have appeared or grown more serious since it began.

In the second section I will examine the orthodox economic policy option for achieving an adjustment and fighting inflation on the basis of its conceptual postulates, the policy recommendations made by its advocates, and the experiences to which its implementation has given rise. These experiences have varied quite markedly. In some cases, such as in the countries of the Southern Cone around the year 1980, the application of this option was more systematic and adhered relatively closely to its conceptual postulates. In other cases, its implementation has been partial or sporadic. For the sake of brevity, I will not go into these cases in detail. For the same reason, rather than presenting a comprehensive analysis of the orthodox approach in relation to adjustment and stabilization policies, I will focus on those characteristics of this approach which, in my opinion, largely account for the recessionary effects of the policies based on such recommendations.

In the third section I will deal with some of the currently controversial topics associated

with the question of how to manage economic policy so as to bring about structural change. In this connection, I will refer both to the conventional or orthodox position and to other

approaches which might serve as a basis for a different option oriented towards the achievement of a more dynamic and a socially more just type of development.

I

The crisis and economic policy

1. The challenges

Even before the onset of the crisis, the task of managing the balance of payments and maintaining a reasonable fiscal and monetary balance was quite complex, if this were to be done in a way which would permit growth and through-going economic and social changes to be achieved in the countries of the region. This complexity stemmed from the particular pattern of development which characterized the region over a period of 50 years, a pattern that combined considerable progress in certain aspects with structural flaws in others. A few examples will illustrate this point.

After the great 1930 world crisis, a process of industrialization and agricultural modernization took place in the region. However, backward manufacturing sectors continued to exist, as did an agricultural peasantry whose productivity was very low, and these circumstances placed constraints on supply which were conducive to inflationary processes.

Some degree of export diversification had been achieved, but it was a limited one, and there continued to be a sharp asymmetry in foreign trade between the structure of exports and that of imports. The region's economies were heavily dependent on other countries for technology and were highly vulnerable to fluctuations in the international economy. This gave rise to a systematic tendency towards balance-of-payments deficits and external bottlenecks.

The conflict over income distribution sharpened as the development process continued. The high-income strata of the population acquired luxury goods in what amounted to a premature imitation of the consumption patterns of developed countries, thereby hampering

efforts to achieve the levels of saving and productive investment necessary for growth while, at the same time, meeting the needs of the poorer segments of the population. The emergence of middle-income strata, although undoubtedly an economic and social step forward, also generated aspirations to a better standard of living which outstripped the possibilities opened up by the region's economic growth, and this created additional social and economic tensions.

The urbanization process gave these sectors an even greater voice. It was thus no easy task to align the level of consumption of the whole of the population with the total amount of goods available, and this difficulty gave rise to persistent pressure from the excess of demand over supply and to a dispute among social sectors concerning the distribution of income.

Meanwhile, the public sector's responsibilities in connection with the economic and social development process had been growing and, as a result, its expenditures had been increasing steadily. Its income, however, had not been rising at the same pace owing to the resistance put up by those sectors which were called upon to shoulder the greater part of the increase in tax payments. The outcome was a mounting—and inflationary—fiscal deficit.

This combination of progress and shortcomings in the economic and social structure gave rise to short-term imbalances and tensions in two different ways. Firstly, it made it difficult to carry forward the process of economic and social development while at the same time maintaining fiscal, monetary and balance-of-payments equilibria. Secondly, it generated the sort of price and wage spiral typical of inflationary processes.

These problems, which already existed prior to 1981, are still with us, but they have grown even more serious since the beginning of the crisis and have assumed truly dramatic proportions. In addition, some new factors of major significance have emerged. One such factor that is particularly deserving of attention is the payment of interest on the external debt, which constitutes an unprecedented burden on both the balance of payments and the fiscal sector. As regards the balance of payments, the interest on the external debt represents around 35% of exports, a proportion which is not compatible with a normal management of the external sector in the countries of the region. Even after deducting net capital inflows (which have, moreover, diminished due to the reluctance of private banks and international public financial agencies to lend to the region), the net transfer of resources out of the region still amounts to approximately one-fourth of its exports. Given the slow growth —or even decrease— of exports, in order to make these transfers the countries have had to drastically cut back their imports, thereby exacerbating the external bottlenecks to which they are subject, as well as the internal imbalances between supply and demand in terms of the availability of goods and consumers' aspirations.

As for the fiscal sector, since it is responsible for paying a portion of the interest on the external debt equivalent to around 4% of the product, it has become virtually impossible for this sector to balance its accounts. In order to do so, it would have to generate income far in excess of its expenditures on consumption and investment and this, in turn, would entail an even greater sacrifice as regards the wages of public employees and the expenditures necessary for economic and social development than those already made in recent years.

The consequences of the crisis have been even greater than they might otherwise have been because it has taken place over a much shorter time span than would be needed in order to change the countries' economic and social structures and to raise their exports and fiscal income.

Bearing these facts in mind, it becomes easier to account for the very rapid acceleration of inflation seen in Latin America in recent years

and for the difficulties encountered by the countries in their attempts to carry out an adjustment and to manage inflation. The countries' and governments' scope of action has been so greatly reduced that it is virtually impossible for them to achieve sustained growth, an external equilibrium and the control of inflation all at the same time.

This has been going on for six years now, and the situation shows signs of continuing for quite some time into the future, with no indication of when any substantial improvement may be expected. This is not a temporary problem. The countries of the region find themselves forced into a behaviour pattern that entails structural features of stagnation, marked economic instability and mounting social tensions, which are difficult to reconcile with political stability and the consolidation of democratic processes. The countries of the region are caught up in a vicious circle whereby their limited capacity for action hampers growth, and their lack of growth hinders them from expanding their manoeuvre room.

2. What is needed in order to broaden the options

During the past few years, an effort has been made in various countries of the region to construct an economic policy option based on an approach which would incorporate elements of economic reactivation, economic and social development and, particularly, structural change in such a way that all these processes would be compatible with the adjustment and the control of inflation. Although some countries in the region have experimented with combining long- and short-term objectives and have obtained interesting results, this is far from being enough.

One of the preconditions for this option is a major reduction in the net external transfers represented by interest payments on the external debt, which, as mentioned earlier, take their toll on both the balance of payments and the fiscal sector. If this is not done, the countries will have to continue generating large surpluses of exports over imports and of fiscal revenue over fiscal expenditure on consumption and investment. Under such conditions, the possibility of creating a different economic policy option

either becomes quite remote or ceases to exist entirely, no matter how effective the design and management of such a policy might be.

Even assuming that a substantial decrease in net external transfers were to be achieved, the countries would still be faced with the task of defining an economic policy orientation different from that suggested by the orthodox school of thought. It is important to grasp the fact that, although this task is not an easy one, it is possible and should be undertaken—resolutely and with a sense of urgency—by building upon the progress and experiences of recent years. It is imperative that the economic discipline required to keep inflation within acceptable bounds should be maintained in order to prevent an economic disarticulation such as that seen in processes of hyperinflation. However, controlling inflation in the countries of the region, which has gradually given rise to types of social behaviour that lead to expectations of instability, is a complicated undertaking. These economies

must also be modernized and must undergo a structural change so that they may become more efficient and competitive and so that both economic effort and its fruits may be distributed more equitably.

Genuine progress towards long-term economic and social development objectives is not a by-product of policies whose chief aim is to prevent price increases and permit the payment of the interest owed on the debt. Instead, the transformation of the economic and social structure, the creation of more equitable and participatory societies, a frontal attack on underemployment and poverty, the improvement of the living standards of middle-income sectors and the achievement of a faster rate of growth should carry a high priority in the management of economic policies and in the approach taken to the payment of interest on the external debt.

Thus, the challenge before us is a very great one, and a great deal of realism and imagination will be required in order to meet it successfully.

II

The orthodox approach to the adjustment and to controlling inflation

1. Some basic characteristics of the orthodox approach

First of all, the orthodox approach places the whole of its emphasis on the management of demand. According to this focus, adjustment and stabilization policies are primarily aimed at rectifying imbalances caused by excess demand—generated mainly by the public sector—which produces a deficit on the current account of the balance of payments, speeds up inflation, and distorts the relative prices of internationally tradeable and non-tradeable goods. It ascribes little importance to the fact that these problems may not be caused by the excess demand of the public sector, but instead by the private sector, by cost-push factors (coming from outside the country or stemming from an internal conflict over income distribution), or by a reduction in supply resulting, for example, from the deterioration of the terms of trade, from higher interest

payments on the debt or from a slump in agricultural output due to adverse weather conditions. Consequently, the policies designed in accordance with this approach may not attack the true causes of these problems and may thus produce negative effects unnecessarily.

Secondly, this approach relies almost exclusively on aggregate instruments for achieving an adjustment and stabilization. Hence, in seeking to lower demand, consideration is not given to the differences in the importance of various types of public and private expenditure on consumption and investment. Some government outlays, such as excessive military spending, may be cut without having a detrimental effect on economic and social development. The same may be said of the private consumption of luxury items. On the other hand, public or private expenditure on education, health, support for important production activities, the promotion of non-traditional exports, or consumption by

lower-income strata are of a high priority and should be defended to the utmost when it comes to reducing overall demand.

Thirdly, at least as applied in the region, this approach has not taken into account the fact that policies of adjustment and of inflation management are not one and the same. Some policy measures which are good for the adjustment may be bad for the fight against inflation, and vice versa. For example, a currency devaluation reduces imports and increases exports, thereby improving the trade balance, but at the same time may intensify the inflationary process. Since the onset of the crisis in the region, relatively more attention has perhaps been paid to the adjustment than to inflation, and this may help to account for the sharp and widespread deterioration seen in the stability of domestic prices.

Fourthly, this approach strives to carry out the adjustment quickly, using short-term measures, without taking either the time or the steps needed in order to make structural reforms in the economy, raise fiscal revenues, and increase and diversify exports. The adjustment therefore tends to be a recessionary one involving a drastic reduction in consumption and investment. Fifthly, an attempt has been made to apply these policies in a large number of countries at the same time, without taking into account the fact that their simultaneous implementation has a more widespread effect on the world economy. I will come back to this point later on.

Finally, the same or very similar versions of these policies are recommended for all the countries, despite the fact that the prevailing circumstances usually vary considerably from one country to the next. These policies have not been made flexible enough so that they might be tailored to the quite distinct circumstances and characteristics of each one of the various countries and to the particular stage each has reached in its history.

2. Experiences with the application of the orthodox approach

The choice of which approach to take to the adjustment and to the fight against inflation, as well as its form of implementation, depends on the amount of power held by different social

groups. It should therefore come as no surprise that the burden of this effort may be unequally distributed. The more influential sectors will attempt to see to it (and they will succeed in doing so) that the measures taken will be such as to protect them in so far as possible from the adverse consequences of these processes. Hence, the effort demanded of the weaker social groups will be disproportionately great.

In those cases in which the orthodox approach has been put into practice it has succeeded in ensuring that the interest on the debt has indeed been paid, but it has not diminished the relative debt burden being shouldered by these countries' economies. Inflation has been reduced, but has later often increased once again. Furthermore, the characteristics mentioned earlier have largely been responsible for the recessionary results of these orthodox policies.

The reduction of demand has been pursued by means of cuts in the fiscal deficit (primarily made by decreasing expenditure on consumption and investment) and the tightening of credit. Attempts have also been made on the basis of this approach to lower production costs and correct relative prices through wage controls and currency devaluations.

Thus, there has been a failure to take into account the fact that—unlike the situation in the past—ever since the beginning of the debt crisis, the interest payments made on the external debt have been the cause of a very large part of the fiscal deficit, of the struggle over income distribution and of the balance-of-payments deficit on current account.

Hence, the concrete facts are that the cuts made in fiscal expenditures on consumption and investment and the reduction in domestic demand required in order to generate the trade balance needed to offset the countries' interest payments have been of an unprecedented magnitude and have not attacked one of the main roots of the problem, i.e., reducing the enormous outlays made in the form of interest payments on the debt.

The reduction of demand alone will not enable the developing countries to adapt to changes in the international context such as the slowness of the world economy's growth, the decline of commodity prices, the increased protectionism

of the developed countries and the high level in real terms of international interest rates.

These policies are capable of doing no more than temporarily fending off some of the symptoms of the increase in the developing countries' external debt and of the crisis in their economies. They do so, however, in a way which causes these same policies to become unstable over the medium term, as demonstrated by the experiences of many Latin American and Caribbean countries during the past few years. The burden of the adjustment cannot be shouldered only by the developing debtor countries without creating tensions which will adversely affect the continuity of such policies.

Due to their lack of differentiation and selectivity, these orthodox policies frequently produce results which are just the opposite of those desired. Non-essential expenditures are continued and even increased (e.g., military spending and expenditures on luxury consumer goods), while the bulk of the reduction is made in the living standards of low-income sectors and in expenditures on consumption and investment which are essential to economic and social development.

In those cases where inflationary processes are nearing the point of hyperinflation, shock policies may be appropriate. Structural economic changes, however, are quite a different case altogether; in such situations, shock treatments are counterproductive.

In addition, unlike what occurred in the past, when this approach was applied in just a few countries at the same time, in recent years and especially since the crisis began, it has been implemented simultaneously in a large number of developing countries whose exports are heavily concentrated in a limited number of commodities or traditional manufactures. This constitutes an additional cause for concern inasmuch as, if many countries reduce their imports and increase their exports of similar products simultaneously, this will tend to depress the international economy, push down export prices and heighten the protectionism of the developed countries.

In those instances where the orthodox approach has been implemented in the region, the drastic reduction in demand—made without selecting or prioritizing the expenditures to be

cut back—has resulted in a sharp deterioration in the living standards of wage-earners and other low-income groups and has thereby exacerbated social inequalities, as well as causing a steep drop in investment. Consequently, these economies are not growing and their production capacity is not being modernized. The increases in output which have been achieved in some years have constituted no more than a partial recovery from previous declines rather than representing any actual expansion of their production capacity. Since other countries in the world, including other developing nations, are making new investments and are constantly modernizing their production capacity and adapting it to the new technologies which are gaining sway in the world economy, the region's relative level of competitiveness is rapidly declining and this, in turn, gives rise to further devaluations and additional inflationary pressures. The region's economies are thus becoming structurally stagnant and its societies are becoming less and less equitable. Moreover, since the drastic nature and rapid pace of the reduction being made in fiscal expenditure render it impossible to programme, the State is losing its capacity for action and its ability to meet economic and social development needs.

Furthermore, in some countries which have implemented the orthodox approach, economic power has been concentrated in the hands of a few and in some cases has been used in a highly speculative manner and in the pursuance of objectives which, to a great degree, are aimed at transferring existing assets from one owner to another rather than augmenting production capacity.

3. The structural adjustment according to the conventional approach

A number of the basic structural guidelines followed by the orthodox approaches to the adjustment and to the fight against inflation used to be, to a certain extent, implicit. In recent years, however, they have been stated more explicitly in the terms and conditions generally laid down by international lending agencies and the positions adopted by developed countries in international negotiations such as the Uruguay Round of GATT.

This conventional or orthodox approach to the structural adjustment involves three main points:

a) The liberalization and opening up of the economies to the outside world in respect of both trade in goods and services and foreign investment.

b) The predominant role assigned to market forces, which are allowed to operate freely or with the least possible interference, and to the price system as the mechanism for resource allocation, along with the reduction of the State's role in directing the economy to a minimum.

c) The privatization of public enterprises and of activities formerly conducted by the public

sector as such or by its decentralized units, coupled with a reorganization of public enterprises aimed at ensuring that they will operate on the basis of criteria which are either identical or very similar to those used by private enterprises.

These three elements are closely interrelated and together constitute what has been termed a "neo-liberal" concept of development. I will discuss these elements as a group in the final section of this article, as well as suggesting some alternatives to them which I believe are better suited to the actual conditions in the region and provide a sounder basis for guiding its development strategies and policies.

III

Towards an economic policy for development

1. Two ways of opening up the region's economies

The concept of opening up the region's economies to the rest of the world can be interpreted in two different ways, which, although interrelated, have different implications. On the one hand, the opening up of an economy may involve an emphasis on the export of new goods and services and on the winning of new markets. On the other hand, it can be interpreted as the dismantling of existing protectionist barriers in order to allow the unrestricted, or less restricted, entry of goods or services produced by other countries into the domestic market where they can compete with locally-produced goods or services; in this second sense, the opening up of an economy usually also involves the unrestricted movement of finance or of direct foreign investment.

As regards the movement of goods and services, the first interpretation is perfectly compatible with, and complementary to, the most intensive possible utilization of the domestic and regional markets of Latin America and the Caribbean. The second interpretation, entailing the total or partial dismantlement of protectionist barriers, may or may not be compatible with

the internal development of economic activities, depending on whether or not it is a measured process which takes two requirements into consideration. The first of these is that a reasonable amount of time must be allowed for the strengthening of national economic activities before they are subjected to competition from products of more developed countries. The second is that consideration must be given to how much protection other countries, particularly the developed nations, provide for their own activities so that the degree to which the economy in question will be opened up may be determined in relation to whether or not other countries place increasing obstacles in the way of the entry of its products into their markets and whether or not they subsidize their exports of similar goods.

History shows that all the industrially developed countries except England (which had the advantage of being the first) started out by protecting their local economic activities from foreign products. Even countries already at a quite high level of industrialization have provided support and protection for new sectors in order to overcome their relative disadvantage *vis-a-vis* countries which had a headstart. It is therefore both sensible and necessary to apply foreign trade restrictions in order to achieve technologi-

cal progress through the incorporation of more advanced production activities.

On the other hand, as national industries acquire experience and maturity, they need to be subjected to an increasing degree of external competition so that they will be spurred on to greater competitiveness and efficiency. Thus, protection should be gradually reduced over time. Nevertheless, this reduction must also be a measured process which takes into account the level of openness or protectionism of other countries in the world and the extent to which they subsidize their exports.

In parallel with this, appropriate protection, promotion and support need to be provided in order to stimulate other sectors whose development plays a functional role in each stage in the evolution of these economies so that the process of technological progress and dissemination may reach increasingly higher levels of complexity.

The reduction of protection and promotion in given production sectors should therefore be gradual rather than abrupt, as it has sometimes been when orthodox concepts have been applied in the region. In these instances, the protective structure was dismantled quite swiftly on a very widespread and relatively unselective basis and was also, in some cases, coupled with an overvaluation of the local currency in an attempt to help lower inflation. The excesses committed under this doctrine when attempts have been made to apply a very low and uniform level of protection to all sectors have been based on the mistaken idea that the industrialization process must be spontaneous and have resulted in major setbacks in the industrial and technological development of the economies concerned.

We live in a world of imperfect competition, in which all countries, and particularly the developed nations, erect substantial tariff and non-tariff barriers and subsidize their exports. The protectionism of the developed countries has been a persistent and significant phenomenon ever since the great worldwide crisis of 1930. The reduction in protectionism achieved through the series of GATT negotiations has primarily been in relation to goods which the industrialized countries trade among themselves, while a much smaller decrease has been made in the protectionism applying to the manufactures and semi-manufactures exported

by the Latin American countries. Moreover, the protectionism of the developed countries *vis-à-vis* these goods has been on the rise since the 1970s and has come to include a growing number of products. Restrictions tend to be placed on the exports of developing countries in precisely those sectors in which they are managing to become competitive in the developed countries' markets, due to the demands for protection made by producers in those countries. There are many well-known cases of protectionism and subsidization by developed countries in respect of activities in the agricultural sector, the textile industry, automobile production, electronics and iron and steel, to name but a few. It is important to underscore the fact that the developed countries' attitude towards the protection and promotion of economic activities has been a dualistic and changeable one. During certain periods they have strongly favoured the opening up and liberalization of those sectors in which they have had a competitive advantage over the developing world. However, they have applied heavy restrictions (and, moreover, continue to do so and even to increase such restraints) in those sectors and time periods in which they have been at a competitive disadvantage.

Thus, while the developed countries try to convince the developing countries of the virtues of conventional economic doctrines, they themselves generally choose whether or not to use these same approaches according to the specific requirements of each given situation. Sometimes they opt for free trade and sometimes for protectionism. The developing countries of the region should therefore take this into account and avoid doctrinaire excesses.

One of the topics which has been much discussed in recent years in connection with the opening up of economies has been that of service activities. Some of these are high technology sectors whose development is closely tied to overall economic development and which are becoming of increasing importance for goods-producing sectors as well. Certain sectors related to technology, information sciences, banking and marketing are of great importance not only because of the direct contribution they can make to overall development, but also because the goods-producing sectors must rely upon them in order to achieve an adequate level of efficiency.

This topic is currently being actively discussed at the international level. In my view, an approach much like that applied to goods-producing sectors needs to be implemented in these service sectors so that they will receive the protection and support which will permit rapid progress to be made in activities of such great overall significance. In so doing, however, care must be taken to ensure that the support required by these activities does not result in an excessive increase in the costs of other products for which they provide inputs.

The international market's price structure is useful as a basic point of reference for the behaviour of the various economic sectors and as a tool for economic decision-making and for the management of the development process. Exaggerated and unnecessary distortions of domestic prices, especially when maintained for an indefinite period of time, cause the economy to lose its point of reference, promote inefficiency and reduce the incentives for improving competitiveness so as to bring it up to international standards. On the other hand, however, in many cases developing countries need to adopt a long-term view which takes in the dynamics and external factors involved and, on the basis of this perspective, modify the domestic prices of certain sectors or goods, moving them away from international levels, so that new production sectors may be developed. The use of economic policy tools, the exchange rate, protective tariff and non-tariff measures, export promotion mechanisms, taxes, subsidies and credit, as well as direct action when necessary, are all forms of State action which should be used to promote and guide overall development, with emphasis on priority activities.

2. Planning and the economic role of the State

Planning must play a leading role in guiding economic policy. The setting of priorities and the effective implementation of an economic and social development strategy should be basic components of economic management. Short-term factors need to be managed with a view to the direction in which the economy should move in order to reach its medium- and long-term goals. Concern for the real economy needs to be

reintroduced into short-term management, and the countries need to put aside the predominantly financial approach and the aggregate tools of economic policy which have become prevalent in many of them as a consequence of the crisis and the use of orthodox policies. A type of planning directed towards these aims should play a concrete part in decisions concerning which expenditures should be reduced and which expenditures should be increased, what economic and social projects should be carried forward, and what are the most suitable policy tools for promoting industrial, agricultural, technological and social development. The need for a genuine and effective use of planning is an important one because formulations of general medium- and long-term goals and guidelines are only useful if they are put into practice by means of an appropriate set of implementational tools.

As regards the role of the State in the economy, an animated discussion is now going on in the region as to what size it should be, what types of functions it should perform and what are the most effective ways for it to do so. In recent years a number of groups both inside and outside the region have strongly advocated a reduction in the size of the State and the privatization of activities which have until now been carried out by State enterprises, decentralized units or the central government administration itself.

Stating this problem in terms of what size the State and its enterprises should be is, in my view, a mistaken approach. Instead, the discussion should focus on what functions the State needs to perform, directly and indirectly, and what is the most efficient way for it to do so. On the basis of such an analysis, a decision could then be taken as to which elements should be privatized and which should be maintained within or incorporated into the sphere of direct State action. The outcome might well be that the State should be smaller, the same size or larger than at present. Another result would be the formulation of definite guidelines concerning the way in which to modernize it and to make it more effective.

There have been many instances in the past when the State has taken on too large a number of activities or when too large a portion of the labour force has been employed by the government or public enterprises. In some cases this

incorporation of enterprises or functions has come about in response to crisis situations in private enterprises or economic activities that have been resolved through their absorption by the public sector, which has thus taken on problems and responsibilities normally outside its purview. One such case occurred as a result of a hasty opening and liberalization of the economy, which placed private enterprises operating in the local market in serious difficulties and, without giving them the time or support they needed to become more efficient, presented them with the option of going out of business unnecessarily or being taken over by the State. It is quite easy to find examples of enterprises now in the public sphere which were incorporated into it when they were on the point of going bankrupt.

It is therefore clear that there are situations in which it is best to reduce the size or privatize certain functions and to seek to increase the efficiency of the operations of the public sector and its enterprises.

However, it is equally clear that there are extremely important direct functions of production or consumption and investment expenditure which the State and public enterprises should continue to perform in order, among other things, to carry out activities that are essential to development and to ensure that external savings will complement domestic savings rather than taking their place. Furthermore, in some countries of the region, public enterprises have played an important role in establishing a balance with transnational corporations, especially in situations where local private enterprise is not yet strong enough to function as a major independent force. Dealing with foreign enterprises is useful, not only because of the financial contribution they may make, but also because of the important role they play in incorporating new technologies into the economy and in opening up external markets to non-traditional exports. At the same time, however, direct foreign investment must conform to the development needs of each country, the need for an increasing endogenous capability for creating technologies and the Latin American countries' need to maintain control over the basic workings of their economies and to conserve an essential measure of decision-making autonomy in regard to their economic and social

development. The public sector as such, as well as State enterprises, have a highly important part to play in all of this. A reasonable degree of articulation must therefore be achieved among the roles of the State and of State enterprise, foreign enterprise, and private national or regional enterprise. Otherwise, in the absence of an appropriate public-sector policy, foreign investment may simply become a substitute for domestic investment, rather than complementing it.

3. The complementarity of exports and import substitution

Another point in connection with development strategies which warrants discussion is the complementarity that ought to exist between a reasonably efficient form of import substitution and the exportation of non-traditional goods. In the debate of economic matters within the region, these two courses of action have often been presented as if they were opposed to one another rather than as complementary activities. It has been said that the possibilities of import substitution have been exhausted and that engaging in it greatly reduces the possibilities of promoting exports and winning over external markets.

While it is true that in some cases the authorities have waited too long before combining policies for promoting non-traditional exports with import substitution and that protectionist barriers have been too great and have been maintained longer than they should have been, this does not mean, in my opinion, that the import substitution process should be discarded.

When all is said and done, the term "import substitution" signifies the development of new sectors which are essential to the incorporation and dissemination of technology. From this standpoint, the possibilities of import substitution have not been exhausted, nor will they be, at least not for a long time. The incorporation of new and more advanced sectors is important not only because they can make a direct contribution to the level of economic activity, but also because the continuation of technical progress in the entire economy hinges upon them.

Furthermore, it is perfectly possible to manage economic policy tools in such a way that import substitution and export promotion will be both compatible and mutually complemen-

tary. If the use of these tools is differentiated according to the stage of development of each of the various economic sectors and if the levels of protection and export promotion are co-ordinated both between and within sectors, then a strategy combining substitution and exportation can be developed which will serve to promote and expedite structural changes in the economies and societies of the region.

In short, the artificial dichotomy between import substitution and exportation, between the State and the private sector, and between planning and the market must be laid to rest as soon as possible in the region. When these elements are presented as if they were mutually exclusive alternatives, or when an attempt is

made to discuss in the abstract, how important each should be, then these subjects come to be treated as issues of economic doctrine rather than as the object of realistic analyses. If, however, the discussion is based on the assumption that the State and the private sector, planning and the market, import substitution and exports all have essential functions to fulfil in economies such as those found in most of the Latin American countries, then the right question to ask—and to answer—is what type of functions each needs to perform and, above all, how these functions should be co-ordinated so that, together, these elements will operate as they must in order to bring about changes in the economic and social structures of the countries of the region.

Conclusion

In this article I have focused on the subjects of economic policy management, the opening of economies to the rest of the world, and the role of the State and of the private sector so that I might examine these topics with some degree of specificity. This has meant, however, that I have had to pass over other subjects which are equally vital to the region's development, despite the fact that they should occupy a position of central importance among the region's concerns and activities. These include production-sector strategies; policies on technology; international economic, trade and financial relations and the region's position in the world economy; the strategies and policies required in order to bring about a transformation of the social structure; broader participation and greater equity in the development of the region; and co-operation within the region and with the rest of the developing world. These subjects have, however, been analysed on repeated occasions by ECLAC, and the author therefore refers the reader to these studies.

In conclusion, I would like to return briefly to the subject of the external debt in order to stress the need for changing the way in which this issue is addressed so that an effective and stable reduction may be achieved in the net external transfers and interest payments that must be

made by the public sector. The object of such a reduction would be to allow the countries to pursue adjustment policies and their fight against inflation under substantially different conditions than those now prevailing and to make these objectives more viable and more compatible with the countries' economic and social development. Such development, hitherto postponed, has clearly become not only imperative but urgent as well.

The burden of the adjustment cannot be shouldered by the debtor countries alone but instead must be properly distributed between creditors and debtors, between developed and developing countries. Furthermore, the countries of the region, for their part, need to achieve a more equitable distribution of the effort required to bring about structural change and to control inflation, as well as of the fruits of this effort.

Only in this way can the countries attain a socially enlightened form of development, greater decision-making autonomy and the consolidation of democracy, which, in addition to its intrinsic value as a fundamental political objective, is also necessary in order to arrive at the social consensus that is, in turn, essential if a sustained development process is to be achieved.

An assessment of the structuralist paradigm for Latin American development and the prospects for its renovation

*Osvaldo Rosales**

The promotion of export-led development is usually accompanied by strong criticism of the modalities assumed by import-substitution industrialization (ISI) in Latin America. The premise underlying the criticism leveled at ISI by the neoliberal school is that these modalities have conformed more or less closely to the theoretical recommendations of ECLAC and the structuralist approach deriving therefrom.

In this article the author examines the validity and currency of the main proposals of the ECLAC school of thought. In so doing, he underscores the latter's ongoing concern with the questions of productive efficiency, selectivity in import substitution, and a proper complementarity between industry and agriculture, as well as the early emphasis it placed on the promotion of industrial exports and on the articulation of industrial development with regional integration. This contrastive analysis of the well-known neoliberal criticism of ISI and the proposals made by Prebisch and ECLAC demonstrates that the former is to a large extent unjustified.

The author goes on to examine the real flaws in the structuralist proposal, pointing out the weaknesses in its view of short-term economic policy management, its failure to attach sufficient importance to monetary and financial aspects and its excessive confidence in the virtues of economic interventionism.

The article concludes with an assessment of the prospects for the revival and renewed relevance of the Latin American structuralist paradigm.

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Introduction

The failure of orthodox policies to cope with the problem of the external debt has led to a gradual modification of the proposals made by international financial institutions. In fact, as Sachs recently pointed out (1987), even after six years of orthodox remedies, the majority of the economies under IMF supervision have still not recovered their capacity for growth and the danger of a collapse has still not receded.

The orthodox school of thought within international financial circles was quick to alter its proposals in response to this fact. Thus arose the idea that debt-burdened economies should undergo a "structural adjustment" to enable them to increase their exports and improve the quality of their growth. However, as the recent experience of Latin America demonstrates, not just any kind of increase in exports will contribute to development.

The specific characteristics of this proposal for structural adjustment (which will be considered in an article now under preparation) are in some ways opposed to certain precepts of the notion of structural change, a proposal that is more deeply rooted in the tradition and revival of the Latin American paradigm of economic development.

Indeed, the experience of various developing countries shows that a strong export performance is closely associated with the export of manufactures and, consequently, no sustained export policy can be considered in isolation from the design of industrial policy. In this regard, an urgent need exists for a new kind of industrialization in Latin America in order to improve the competitiveness, establish an equilibrium in its industrial balance and attach greater weight to the promotion of technology and to innovation, which are the mainstays of competitiveness in the medium term.

The neoliberal reading of the experiences of South-East Asia, which, in all truthfulness, pays scant regard to the historical evidence, has created the myth of the "South-East Asian model". This model supposedly constitutes an empirical test of the effects of a strict application of the neoliberal paradigm: a small and passive role for the State, the liberalization of imports, a realistic exchange rate, the allocation of resour-

ces in accordance with the signals conveyed by a distortion-free price system and by the comparative advantages manifested in the market and, finally, the almost exclusive role of the market as an instrument for the allocation of resources, of the private sector as the leading agent of development, and of integration into the world economy as a stimulus for demand.

The customary counterpoint to this model in the neoliberal approach is Latin American Industrialization based on import substitution (ISI) and its theoretical underpinnings, i.e., the structuralist approach to development, which has been strongly influenced by ECLAC studies.

In the discussion that follows some of the main features of the Latin American structuralist approach will be examined on the basis of a number of studies by ECLAC, with emphasis on what, in the author's opinion, appear to be its strong and weak points. A critical analysis of structuralist proposals will be presented, and a more systematic examination will be made of the most significant ones.

The question of the current validity of such structuralist proposals for Latin American development will then be considered. The conclusion reached in the course of this discussion is that the main body of ECLAC's work will continue to be fully relevant—provided that its limitations in setting forth with sufficient clarity the instruments of economic policy are overcome, that greater importance is attached to monetary and financial questions and that a more in-depth exploration is undertaken of the requirements for a more effective type of State intervention.

It is clear, in any event, that over the next few years the economies of the region will have to come to grips with an inevitable structural adjustment involving substantial changes in the production structure and in the management of economic policy. However, depending on whether public development policies are passive or active, aggregate or selective, the economic and social consequences may be very different.

It is undeniable that the region's economies will have to allocate more of their resources to exports and to efficient import substitution. This may take place as part of a favourable scenario, i.e., within a context of growth, of an upswing in investment and of a diversification of

the export structure. Structural adjustment—in the sense of changes in the production structure—may also take place, however, in a situation marked by stagnation, declining investment and an increasing specialization in primary exports.

The latter scenario leads to an impoverishing sort of specialization, to a regressive adjustment which increasingly disrupts the production structure and engenders a dependency on short-term balance-of-payments adjustments, thereby setting the stage for a reduction of domestic demand and its inevitable recessionary aftermath.

It is therefore clear that the region must face up to the challenge of improving the quality of its international specialization by seeking a more active insertion in the dynamic spheres of international trade. This, first of all, presupposes putting a halt to the drain on its resources represented by the current net transfer of capital abroad. Otherwise, the idea of a sustained recovery, much less a transformation of the production structure, cannot be seriously entertained.

1. Substitutive industrialization and the analytical framework of ECLAC

Faced with the depression of the 1930s, the countries of Latin America tended to adopt policies providing for devaluations and cuts in expenditure in the hope that the crisis would be a passing phenomenon. As it became evident that the problem was of a more medium-term character, the countries began to place direct controls on imports and exchange controls on exports. These measures, which were designed to do no more than to contain the outflow of foreign exchange, were of an improvised nature and reflected the countries' inexperience in these matters (ECLAC, 1975). As pointed out on many occasions, this was a process of "unintentional industrialization" in the sense that an incidental effect of these economic policy decisions, which were intended to redress the disequilibrium in the balance of payments, was to modify price relationships and levels of protection in ways favouring domestic production.

The appearance of deliberate substitution policies was associated with the perceptive

studies carried out by Prebisch in the 1950s, when he began to articulate what subsequently became known as "the ECLAC approach".

According to this view, the world economy is composed of two major segments which interact with each other: the centre and the periphery. Their production structures are dissimilar, since in the periphery they are heterogeneous and specialized, while in the centre they are homogeneous and diversified. These differences determine the types of trade and technology transfer that take place in the world economy. In the long run, the economic evolution of this system causes the periphery to lag behind in both productive and technological terms and leads to a deterioration in its terms of trade (Rodríguez, 1980).

The school of thought associated with ECLAC thus gradually coalesced around the following elements:

a) *Criticism of the traditional theory of foreign trade.* Such criticism was prompted by the observation that the kind of specialization which arose out of the international division of labour led the peripheral economies to produce food-stuffs and raw materials for the economies of the centre, while importing manufactures and equipment in exchange. According to Prebisch (1950), this pattern was reflected in a more or less continuous deterioration in the terms of trade and in external-sector bottlenecks.

The deterioration in the terms of trade, in its turn, was attributed to the retention of the benefits of technological progress in the central economies, inasmuch as increases in productivity in such economies were distributed between labour and capital rather than being transmitted, through lower prices for manufactured goods, to the periphery, as predicted by the classical theory of foreign trade. In contrast, increases in productivity in the exporting enclaves situated in the periphery were transferred to the central economies because of the weakness of trade unions in the peripheral countries.

Other reasons given for this deterioration include: i) the low income elasticity of primary products; ii) the widespread substitution of synthetics for commodities; iii) the reduction in the amount of primary commodity inputs per pro-

duct unit brought about by technological change; and iv) the protectionist policies adopted by the central economies (Prebisch, 1950 and 1951).

According to this approach, the disparity in income between the centre and the periphery could be corrected through industrialization, which could enhance the efficiency of production and facilitate access to technological advances, and through proper social legislation, aimed at producing a gradual increase in real wages that would be commensurate with increases in productivity (Prebisch, 1950).

b) *Arguments in favour of industrialization.* Industrialization was regarded as the only valid means available to the countries of Latin America of deriving benefit from the advantages of technological progress. It would permit them to achieve a more dynamic and autonomous type of development that would be less vulnerable to external influences, to absorb an increasing amount of manpower, raise productivity and gradually improve the standard of living of the masses (Prebisch, 1950).

This argument against the traditional theory of foreign trade and in favour of industrialization had clear implications for the macroeconomic balance, since it posited that the chief limitation to growth was the scarcity of foreign exchange rather than insufficient domestic savings. On the other hand, the characteristics of the external sector were seen as invalidating the option of reallocating resources to the export sector, since it had been demonstrated that static comparative advantages led to a specialization in primary commodities, and this did not guarantee the dynamic efficiency advocated by Prebisch. Trade policy should thus seek to effect a permanent restructuring of relative domestic prices in favour of the industrial sector rather than confining its efforts to the achievement of a temporary equilibrium in the balance of payments (Fishlow, 1985).

In order to promote industrialization, a suitable policy of protection —an instrument that has played a fundamental role in all contemporary cases of industrialization— was considered essential.

"There are two principles, the frank recognition of which would exert a substantial influence on the policy of the Latin American countries as regards their trade relations both with indus-

trialized countries and with each other. Firstly, in differing degrees according to individual countries, industrialization is an inevitable feature of economic development. Secondly, a reasonable measure of protection is generally indispensable for industrialization" (Prebisch, 1954).

However, it was not a question of promoting just any kind of protection. Attention was drawn to the fact that it was necessary to make a choice: "There are two types of protection in developing countries. Firstly a type of protection exists which encourages the structural changes required by economic development without provoking a reduction in imports below the volume corresponding to the capacity for external payment and without either reducing world trade or weakening its rate of growth. Secondly, there is the type of protection which exceeds these limits and adversely affects world trade" (Prebisch, 1954).

Great importance was, then, clearly attached to a programmed selectivity in import substitution, especially with a view to dealing with the economic cycle from a strategic perspective. Prebisch had shown that within the region increases in the inflow of foreign-exchange in the form of export earnings did not lead to an expansion of reserves, but rather to a rapid rise in imports. On the other hand, when foreign sales declined, the Latin American countries usually found themselves faced with an asymmetrical structure of consumption, since consumers, who had become accustomed to a large supply of imports, had difficulty in adjusting to the reduced availability of foreign exchange. This led to an improvised effort at import substitution, which was undertaken only after the corresponding balance-of-payments crisis had already begun.

"Above all, it is essential to adopt substitution measures in advance without waiting until external disequilibrium imposes them, as an unavoidable necessity. It is precisely in the ascending phase, when savings are mounting and there are greater resources for importing capital goods, that special emphasis should be laid on substitution policy" (Prebisch, 1963).

In so far as the import substitution effort tended to be indiscriminate, the result was the emergence of a new type of vulnerability on the

part of these Latin American countries in their relationships with the rest of the world.

It remains a paradox that industrialization, instead of helping greatly to soften the internal impact of external fluctuations, is bringing us to a new and unknown type of external vulnerability... it is essential to formulate a substitution policy whereby the requirements of economic feasibility [the term today would be efficiency] and the aim of endowing the economy with the strongest possible structural resistance to external fluctuations are combined.

Reasons of economic feasibility should induce us again to create a situation in which it would be possible to import a wide range of finished consumer goods for which substitution production would be less economic than that of other goods whose manufacture would enable the reducible margin of imports to be restored in whole or in part, an essential condition of anti-cyclic flexibility" (Prebisch, 1963).

c) *Planning as a development imperative.* ECLAC's analysis indicated that the spontaneous interplay of market forces sharpened the contradictions of industrialization in the periphery: a structural tendency towards external disequilibrium, structural unemployment, and intersectoral productive imbalances (Rodríguez, 1980). Industrialization therefore had to be given a direction, that is to say, it had to be programmed. The development process was seen as being a result of policy rather than as a spontaneous creation of the market. The State should direct the accumulation of capital and infrastructural developments and should at least supervise major industrial projects. It was considered necessary for public enterprises to engage in those activities that were beyond the scope of the private sector and for the activities of the latter to be regulated by the State (Fishlow, 1985). Thus, for example, it was asserted that sectoral plans needed to be formulated in order to deal with the bottlenecks affecting the economy (energy, transport, basic industries), to promote specific industries, and to strengthen the links between agriculture and industry. This, in turn, called for the design of investment plans, which would require financing and which would have both real and financial repercussions on the economy as a whole (Prebisch, 1952). In other words, the rationalization of government action

and the indispensable link between short- and medium-term policies required that development be programmed, particularly in areas such as capital accumulation, external trade and the correction of the excessive social and geographic disparities (Prebisch, 1971).

In another study, Prebisch introduced three new considerations into the debate concerning the scope of economic intervention by the State. He contended that such intervention was essential in order to lessen the vulnerability of the domestic economy to excessively sharp external fluctuations and suggested that the most appropriate form of intervention would consist of strengthening and diversifying the domestic production structure, in accordance with criteria of productive efficiency. By the same token, he argued that government intervention in the banking sector was necessary in order to increase the supply of medium- and long-term credit and of development loans; all of this, far from being detrimental to private activity, would serve as an effective complement to private business activities and as a mechanism for their promotion. Lastly, Prebisch maintained that a forward-looking economic development policy required that the State should play a sustained and far-reaching role in the sphere of technology (Prebisch, 1954).

d) *The functionality of external financing and of direct foreign investment.* Given the need for foreign exchange and the inadequacy of domestic savings, external financing was regarded as a necessary element of the industrialization strategy advocated by ECLAC. However, such inflows were of interest only in so far as the net contribution they made, i.e., contributions in respect of costs, terms and remittances of profits and interest which would actually help to expand the import capacity of the peripheral economies. In any event, recourse to external financing was considered to be an essentially transitory expedient, since it was postulated that in the medium term the national character of development should be reflected in a substantial component of domestic financing.

e) *Regional integration.* The idea of integration played a key role in the analyses formulated by ECLAC. In view of the small size of domestic markets and the need to use technologies requiring large production scales, regional integration

was seen as offering the economies of the region an opportunity for industrial specialization, which would allow them to reduce their under-utilization of capital and the inefficiency of the production process. In addition, it would facilitate the diversification of exports and would promote a learning process in preparation for a subsequent effort to penetrate the markets of other parts of the world.

This concern was present early on, as may be seen in a classic study by Prebisch: "The present division of markets, with its consequent inefficiency, constitutes another limitation of industrial growth, in this case one which could be overcome by the combined efforts of countries which, by reason of their geographical position and economic features, would be able to undertake it to their general advantage" (Prebisch, 1950).

Five years later it was observed that the form of industrialization being promoted by the governments was neglecting this key area, and renewed emphasis was placed on the need for integration: "Industrialization is developing in 'water-tight' compartments of national economies, and trade in industrial products between Latin American countries is very rare. While industrialization merely covered those goods for which the national market permitted enterprises of sufficient size to be established, this industrial isolation was no cause for serious concern. But when, to meet the needs of development, industrialization is extended to goods which can only be economically produced by mass production methods which exceed the demand of the domestic market, it is imperative to organize reciprocal trade between the Latin American countries" (Prebisch, 1954).

Three years later these efforts yielded partially satisfactory results. During the seventh session of ECLAC (La Paz, May 1957), the governments of the region requested that this body collaborate in the formation of a regional market. Accordingly, ECLAC convened a commission composed of distinguished Latin Americans who drew up the "Bases for the formation of the Latin American regional market" (see *Boletín Económico de América Latina*, vol. 3, No. 1, March 1958, Santiago, Chile, United Nations). This document restated the arguments previously advanced by ECLAC, i.e., the

need to articulate national industrialization efforts on the basis of an integration scheme which would permit the countries in question to expand their markets and to take greater advantage of the available technological potential.

Since external bottlenecks were seen as constituting a severe restriction on development, a forward-looking attempt was made in the early 1970s to explore three mutually-complementary means of giving impetus to the process of industrialization: a regional integration-based import substitution programme designed to achieve a 20% reduction in the potential external trade deficit projected for the 1980s; a manufacturing export policy aimed at easing external bottlenecks by 37%; and an increase in net external financing, which was expected to lower the potential trade deficit by 10% (these percentages were calculated on the basis of the potential trade deficit corresponding to trend projections (González, 1972). The idea of integration was linked to the notion of a transformation of production which would be in keeping with an increase in efficiency and technological development and complementary to the export of manufactures. The sectors called upon to participate in this programme were the mechanical, basic chemicals, iron and steel, paper and pulp, and petroleum and petroleum products industries, in other words, those sectors in which economies of scale were significant.

This transformation of production would have to go hand in hand with a change in the structure of demand. Thus, for example, growth in the mechanical industry, which had been based on consumer durables up until that time, would be reoriented towards the production of capital goods with a view to mitigating external bottlenecks, making the process of capitalization more autonomous and promoting technological development (González, 1972).

f) *The need for structural changes and an integral view of the development process.* ECLAC's studies during this period highlighted the inadequacy of traditional analyses, which saw economic development as a by-product of the free market, of the spontaneous operation of the socioeconomic system and of the management of aggregate demand. In the context of the extremely heterogeneous peripheral economies, ECLAC's analyses underscored the need for an

explicit willingness on the part of the government to intervene in the economy, in a rational and systematic manner through the planning process.

However, this did not seem to be enough. Development is not merely a question of growth; it also involves changes in the productive, demographic, occupational and distributive structures, all of which are more than mere automatic by-products of increases in per capita income. Moreover, from its very inception the process of industrialization in the region laboured under the burdensome legacy of the types of specialization and heterogeneity that had originated during the period of externally-oriented development (Rodríguez, 1980); hence, what was required was not just any kind of growth, but rather a form of growth which, as well as diversifying production and increasing the average productivity of labour, would help to strengthen the links among productive sectors, to extend the region's export activities to include products other than commodities and to reduce the technological gap. The existence of a significant degree of structural heterogeneity in the region augmented the importance of these objectives. Indeed, it was observed that the modern sector's capacity for dissemination, rather than homogenizing the production structure, heightened its heterogeneity and produced a "three-way concentration" of the benefits of technological progress: at the social level, at the level of the economic stratas and at the regional level (Pinto, 1973).

An important conclusion was drawn from this fact: the generic formulation of requirements for development (an increase in the investment coefficient, improvements in the system of taxation, the streamlining of financial mechanisms, etc.) did not suffice, because the logic of the model led to an increasing degree of heterogeneity. An alternative was required whose central elements would be based on the advancement and dissemination of technological progress, the expansion of the domestic market, the homogenization of the production system and the attainment of a greater degree of autonomy and self-sufficiency in respect of the dynamics of growth (Pinto, 1973).

The above considerations once again raised the issue of structural reforms, and particularly

agrarian reform, inasmuch as the coexistence of *latifundios* and *minifundios*, as well as various insecure forms of landholding, resulted in a lack of flexibility in agricultural supply and in an oversupply of labour (Rodríguez, 1980). Another no less important task was fiscal reform, particularly as regards the revision of the taxation system so as to make it more progressive and more dependent on income taxes.

The need for these structural transformations constituted an additional argument against an exclusive reliance on the pricing system as the main tool of development. Indeed, the concentrated ownership of land, technological backwardness and the fact that labour was tied to the land for non-economic reasons and was therefore artificially cheap diminished the effectiveness of relative prices as an instrument for determining the allocation of resources (Fishlow, 1985). Merely increasing the relative prices of agricultural products would guarantee neither an expansion of the supply of foodstuffs nor a greater demand for industrial goods, much less the modernization of the sector, as long as the agricultural sector continued to be technologically backward and to be concentrated in the hands of a few.

These redistribution initiatives—which sought to alter the distribution of assets (land) and of income flows (taxes, fiscal expenditure, income policies)—soon ran up against the rigidity of the distributive structures concerned, which in turn reflected the power structures existing in the societies of the region. This meant that an additional step had to be taken: development had to be viewed as an integral process encompassing economic elements, the political and social structure and institutional determinants.

g) *Emphasis on the social dimension of development.* From the very start ECLAC was concerned about the structural heterogeneity of the region's economies, its tendency towards structural unemployment and its failure to adapt incoming technologies, inasmuch as these factors accounted for the fact that vast sectors of the population were unemployed or underemployed and for the low levels of capital and of productivity (Prebisch, 1950). These factors were at the very root of rural and urban poverty, of migration phenomena and, indeed, of the processes of

fragmentary modernization and limited social participation characteristic of ISI.

In the light of these circumstances a number of pioneering studies were undertaken on the distribution of income and poverty, at the same time as diagnostic studies were being prepared on social deficits in areas such as housing, health and education. Subsequently, these studies were complemented by ILPES studies on social policies and by research on employment carried out by PREALC.

The approach taken by ECLAC was aimed at modifying the position of the regional economies in the international division of labour and advocated a type of industrialization which would be based mainly on the expansion of the domestic market with a view to providing substitutes for imports or meeting new demands as they arose with locally-produced goods and services. This process relied on the action of the State as a major executing agent which would co-ordinate its efforts with the private sector and it underscored the importance of the public sector in matters related to finance, investment, infrastructure and technological development.

The rationale of this type of industrialization lay in planning, which was assigned an important role in directing the process of investment and financing so as to overcome the bottlenecks hindering the achievement of a more sustained form of development.¹

This kind of industrialization was aimed at promoting a more autonomous sort of development within whose framework domestic agents should assume an increasingly greater role in the provision of financing. This in turn, created a need for major reforms in the financial and taxation systems. By the same token, a number of structural transformations in the landholding and educational systems would have to be made and new policies on foreign investment would have to be formulated in order to safeguard national interests.

¹An assessment of planning in the region falls outside the scope of this article. It should be noted, however, that this inclination towards large projects and the "real" sector of the economy led to an underestimation of the financial impacts of government action. This had the effect of gradually relegating planning to a position of secondary importance, in which it became characterized by rigidity and formalism, since its limited links to short-term policies prevented it from responding in a timely manner to economic problems as they arose.

Added to this was the realization that, despite the high rates of growth being registered, the economic system was incapable of reducing the scale of marginality and social exclusion. In the light of this fact, the concern felt about the social development effects of industrialization gave rise to a complex analysis of social actors, alliances and hegemonies and of the political viability of proposals under consideration.

This area may constitute the weak link in the proposals put forward by ECLAC. Although these proposals took into account the sociopolitical complexity of the tasks of development, they tended to place great emphasis on one agent—the State—and to assume that this agent was endowed with the capacity to distance itself from the sociopolitical environment which had produced it and to modify this environment to suit the industrialization programme. An indepth consideration of the role of the State as an economic agent and as an arena for social and political conflicts was conspicuously absent from these industrialization proposals. While they did indeed characterize the State as a leading agent of development, and as a vehicle for the technical rationality manifested in planning, as well as attributing to it a scope of action greater than that suggested by Keynesianism (since the State would be called upon to undertake structural reforms), they failed to include a rigorous examination of the possibilities and limitations of the Latin American State in carrying out these tasks (Gurrieri, 1987).

This sociological tendency may, to some extent, be accounted for by the fact that ECLAC's thinking was historically conditioned by the concrete processes of industrialization and development examined by its analysts. In this connection, the experiences of Brazil, Mexico and Chile, in particular during the 1940s and 1950s, provided examples of active States which were supported by relatively broad social alliances and which had to their credit an encouraging record as regards good industrial showings and the promotion of new economic activities. Where these proposals erred was probably in their linear extrapolation of this trend in time and in space, as if it were necessarily permanent, and in their failure to take account of the experience of other Latin American societies.

Thus the characteristics of the production structure, of the technological profile and of the resulting demand structure combined to create a concentrative pattern of distribution and, in the case of the more dynamic economies, an excessively diversified pattern of consumption in relation to average national income.

Moreover, the location of industry, the type of demand which manufacturing activity sought to satisfy and the nature of its intersectoral relations with agriculture led to an excessive urban growth, to an overexpansion of services—most of them of low productivity—and to continuous rural-urban migration which increased unemployment and urban marginality. The persistence of large landholding structures and the economic and sociopolitical exclusion of the peasantry constituted the framework for this process, whose net result was to curb the supply of agricultural commodities. At a later stage, when ISI moved on to more complex phases involving the substitution of intermediate and capital goods, which required the use of more resources, this discouragement of the production of food-stuffs was aggravated by policies designed to hold down agricultural prices with a view to safeguarding the purchasing power of urban wages, which was threatened by the limited effectiveness of ISI in the area of job creation.

In short, although the ISI model successfully promoted the expansion and modernization of the production structure, with marked effects on employment and income, this growth—more than 5% per annum over three decades—was not manifested in any significant reduction in poverty. This provided categorical proof that while growth was essential to overcoming the bane of poverty, it alone was not enough, since the nature and content of this process and the effectiveness and scope of social policies were also determinants.

Thus, despite its considerable contribution to growth, by the end of the 1950s the ISI model had been shown to have serious shortcomings in respect of the balance of payments and technological dynamism, as well as a marked inability to resolve the problems of employment and poverty in Latin America.

"Import substitution policy, while reflecting an inevitable structural change, has been carried out with very serious flaws. Very often consider-

ations of economic feasibility have not been given their due, and it was not until recently that an attempt was made to break the confining bonds of national markets by means of the gradual economic integration of our countries. First and foremost, this policy has been applied in a discriminatory way, without promoting a corresponding expansion in exports, and thus it has been carried farther than it might have been under other circumstances."

The cost of substitution has thus been exaggerated to the detriment of mass consumption, particularly when the increase in productivity has been small in the rest of the economy. (Prebisch, 1961).

Consequently, the results of this model were unsatisfactory. This form of "industrial development is taking place in watertight compartments, under the strong protection of high tariff barriers and of restrictions and prohibitions that eliminate external competition and hamper the assimilation of technological progress and the efficient use of the factors of production... Industrialization on these lines is inefficient and costly for the all-too-well-known reasons: markets are small and the spur of competition is lacking. The process bears within itself the seeds of its own loss of dynamism, since industrial development takes place within a closed circuit of costs and prices which, because it has no contact with the world market, discourages exports of manufactures; and these are really essential, for industry needs to stretch outward in order to develop inward in depth" (Prebisch, 1971, pp. 193-194).

2. ISI, structuralism and economic policy

In taking stock of the situation, it becomes relatively clear that economic policy was one of the areas that was neglected by the structuralist formulation. Its emphasis on the structural characteristics of socioeconomic phenomena led to a kind of unconcern for short-term instruments of economic policy. One of the failings of structuralism has probably laid in its extrapolation, without deeper analysis of the characteristics of development processes in the Southern Cone to the rest of Latin America. Valuable instruments of analysis thus lost their relevance through their somewhat mechanical application to other

contexts, inasmuch as one of the principal characteristics of the region is the great heterogeneity of the various national experiences. For example, the debate on inflation and growth might have taken on other dimensions if developments in Central America had been followed more closely. The integration process in this zone represented a significant source of dynamism for industrial exports, and the average growth rate during the period 1950-1980 of more than 5% per annum was accompanied by a marked degree of financial, fiscal and price stability, even though all this was achieved at the cost of a pattern of development that was more exclusionary than that of South America.

i) In the case of *inflation*, the structuralist position was at first ambiguous. Inflation was at times considered to be a more or less unavoidable by-product of growth; at other times, it was viewed as the result of economic stagnation and of structural pressures on price levels. At all times, at any rate, a major component of distributive conflict was attributed to it. Highlighting, in many cases accurately, the structural environment of the inflationary process —basic inflationary pressures, circumstantial and cumulative pressures, and propagation mechanisms), a noted exponent of the structuralist school stated that: "The underlying sources of inflation in the less developed countries lie in the basic problems of economic development and in the structural characteristics of the production system of these countries" (Sunkel, 1958).

While this assertion in itself cannot be faulted, there is also such a thing as an error of omission, and in this case it should be recognized that the structuralist paradigm underestimated the potential of monetary, fiscal and exchange rate policies to combat inflation (Fishlow, 1985). Similarly, the question of stabilization was virtually absent from the initial agenda of structuralism. It was believed that domestic stability would be achieved through development, in other words, by overcoming the rigidities of the agricultural structure, the taxation system, etc. External stability, for its part, was seen as being attainable only through a form of industrialization which would overcome external bottlenecks. Concerns about stabilization and the transmission of external shocks were thus characterized by a short-term focus whenever these

matters bore no direct and immediate connection to structural constraints.

This in some way helped to create an official—academic and political—tolerance of inflation and fiscal deficits. The Latin American—or South American, to be more exact—structuralist mentality was reflected in a lack of concern about inflation which disappeared only in situations where the rate of inflation surged far beyond the usual levels of the period. At such times, the response that came most readily to mind was to curb prices through an active policy of administrative price controls (Fishlow, 1985).

ii) As regards *protection policies*, the objective of bringing about a permanent change in relative domestic prices in favour of industry led to the widespread introduction of high and differentiated tariffs, which, moreover, were then maintained or, in some cases, gradually raised. This led in turn to greater inefficiency, since industry was guaranteed a profit, while at the same time protection for agriculture and incentives for exports were eliminated. In addition, it led to the proliferation of various controls on foreign trade and on the foreign exchange market as a result of the inability of tariff and para-tariff mechanisms to balance the countries' external accounts. Finally, it also made it necessary to maintain the real exchange rate at an artificially low level as a result of the administrative contraction of imports and, in other cases, of the fiscal authorities' need to absorb a portion of the exporters' surplus which was difficult to secure through ordinary tax mechanisms (as in the case of foreign-owned property of export enclaves and in that of agro-exporting oligarchies).

The emergence of the concept of "effective protection" has brought out other dimensions of the protection policy associated with ISI. This concept demonstrates that an economy cannot protect all of its sectors, since when economic policy favours one of them, it necessarily discriminates against the rest. It also shows how import restrictions end up by limiting exports and how, a very moderate structure of nominal tariffs can lead to a system of excessive and economically unjustified net incentives (Corbo, 1985).

Actually, protection should be measured in terms of its impact on the value added, since the

relevant concept of protection does not refer to the nominal tariff protecting a final product, but rather to that resulting from a comparison of this nominal rate with the weighted rate applying to the inputs used in the good's production (Corden, 1971). As long as there are high tariffs, and differentiated tariffs, an entrepreneur will naturally seek to maximize the difference between the protection of the good he produces and the protection of the inputs which he must purchase. ISI when it is chiefly based on tariff protection, will therefore tend towards a highly differentiated tariff structure as a result of the pressures exerted by businesses in an effort to improve their relative profitability. The "investment" made in bringing pressure to bear on the public sector thus ensures comfortable profits for such businesses while allowing them to avoid undertaking a more complicated process of technological innovation, cost reduction, penetration of external markets, etc.

The fact that government involvement in the administration of such protection was not based on economic criteria tended to create an opportunity for discretionary actions—exemptions, concessions, tariff surcharges, etc.—which were clearly linked to the manoeuvring skill and relative powerfulness of the social actors involved. Such pressures could hardly be expected to come from the poorer and less organized sectors; as a result, this system of resource allocation ultimately had an indirect regressive impact on the degree of equity existing in the societies concerned.

Since, protection also increased the price of imported goods, it entailed a relative improvement in respect of the factor that was most intensively used in their production (capital), in conformity with the Stolper-Samuelson theory. The choice of technology was also biased in favour of those that served to help meet the demand of high- and medium-income groups, i.e., in favour of a prematurely diversified consumption pattern involving an excessive proportion of luxury items when measured against the average income of the economies of the region.

Prebisch's concern with the question of productive efficiency and his criticism of the characteristics of the type of protection utilized in the region are recurrent themes in his writings and

must therefore be included in any thorough review of this period of history.

"The criterion by which the choice [of which imports to provide substitutes for] was determined was based not on considerations of economic expediency, but on immediate feasibility, whatever the cost of production.

"The tendency has been for prohibitions and restrictions to take the form of customs tariffs. This is a step in the right direction. However, these tariffs have been carried to such a pitch that they are undoubtedly —on an average— the highest in the world. It is not uncommon to find tariff duties of over 500 per cent.

"As is well known, the proliferation of industries of every kind in a closed market has deprived the Latin American countries of the advantages of specialization and economies of scale, and, owing to the protection afforded by excessive tariff duties and restrictions, a healthy form of internal competition has failed to develop, to the detriment of efficient production" (Prebisch, 1963).

Nor did Prebisch fail to see the macroeconomic link between such excessive protection and disincentives to exports:

"The closed industrialization fostered by excessive protectionism, as well as the unduly high customs tariffs applied to some staple agricultural commodities, have created a cost structure which makes it extremely difficult for Latin America to export manufactured goods to the rest of the world" (Prebisch, 1963).

This gave rise to his proposal for trade liberalization based on the expansion of non-traditional exports:

"The customs tariffs in force for the rest of the world must gradually be lowered, both in the light of economic expediency and to ensure that industry is constantly encouraged by external competition to narrow the gap in productivity *vis-à-vis* the major centres" (Prebisch, 1963).

In this proposal Prebisch suggested that the reduction of customs tariffs should be gradual and should be in keeping with the expected increase in exports. In order to modify the cost and price structure affecting exports, he proposed a devaluation proportional to the reduction in customs tariffs, together with a special tax to prevent excessive profits from being earned on traditional exports. This tax, would

also compensate for the shortfall in fiscal revenue caused by the reduction in customs tariffs (Prebisch, 1963).

iii) *Macroeconomic balance*. The ISI model tended to produce a progressive imbalance in external transactions, thereby giving rise to a pattern of growth that entailed a high risk of inflation. The undervaluation of the exchange rate reduced the medium-term exportable supply, the supply of foodstuffs and the availability of foreign exchange, the latter being a crucial element in determining the possibilities for an expansion of industrial investment.

Discrimination against agriculture eroded the surplus available for transfer to industry. To the extent that this surplus decreased, the State had to provide proportionately greater subsidies for industrial investments in the form of *ad hoc* subsidies and various tax exemptions (Fishlow, 1985) due to the higher relative cost of urban labour. The use of these policy instruments, in addition to severely affecting the transparency of resource allocation, placed constraints on fiscal resources because it reduced the possible sources of revenue and increased the pressures for expenditures.

A great deal has been written about the crowding out of fiscal policy on private investment, i.e., about the impact on the credit market of the Treasury's need to engage in domestic borrowing in order to finance its current imbalances, which pushes up the interest rate and ultimately acts as a disincentive to private investment. It would be useful, however, to look further into the economic history of ISI with a view to considering the other side of the coin: the sum total of the pressures brought to bear by entrepreneurs on the public budget with the object of reducing their share of taxes and increasing their share in public expenditures.

Because the dynamic insufficiency of the growth process made it difficult to provide productive work for the entire urban labour force, in various countries the public sector became the employer of last resort, particularly for intermediate sectors and professional groups, in the interests of the sociopolitical stability of the model.

The chronic fiscal deficit associated with ISI may therefore be attributed not only to a poor handling of economic policy, but also to the type

of political and social alliances underlying it and to the role which these alliances assigned to the State in their plans for accumulation.

The monetization of the fiscal deficit produced demand-pull inflation, which made it necessary to increase the "inflation tax" in order to finance the public sector and to sustain investment rates. The resulting inflation eroded real wages and created a need, depending on the political context, for periodic wage readjustments, which fueled inflation further by introducing a cost-push dimension. The effects of inflation on the countries' external accounts led to sudden and unavoidable devaluations, producing in turn further cost-push inflation which did not respond to attempts to reduce it by means of sharp contractions in demand (Fishlow, 1985).

The short-term macroeconomic conditions thus provided a strong stimulus for the creation of a rent-seeking environment. A context of high inflation and substantial fluctuations in relative prices sends out signals which lead the business sector to specialize in obtaining timely information that will enable entrepreneurs to anticipate such changes. In this manner, rational individual behaviour —the reduction of uncertainty— was transformed into a perverse social and macroeconomic behaviour pattern. Entrepreneurial agents devoted much of their efforts, creativity and resources to forecasting economic policy "shocks" and to gearing their asset portfolios to the expected changes. The authorities' manoeuvring room in applying the inflation tax was progressively reduced by the rapid adjustment of expectations, thus pushing inflation up still further. Since the different economic agents' capacity to defend themselves against the inflation tax varied, this speculative factor also contributed to the regressive trend in the pattern of income distribution.

In short, ISI failed to ensure the stability of short-term macroeconomic conditions, thus indirectly discouraging efforts to achieve productive efficiency, technological innovation and long-term investment.

iv) *Structuralism and "real economic policies"*. According to the unrelenting neoliberal rhetoric, the anti-export bias is the direct result of ECLAC studies. However, to the surprise of many, nothing that directly backs this assertion up is to be found in the principal studies of

ECLAC. Indeed, Prebisch consistently expressed a clear concern in this regard: "The more active Latin America's foreign trade, the greater the possibility of increasing productivity by means of intensive capital formation. The solution does not lie in growth at the expense of foreign trade, but in knowing how to extract, from continually growing foreign trade, the elements that will promote economic development" (Prebisch, 1950, p. 2).

The arguments advanced in subsequent ECLAC studies followed the same lines, noting that the specific modality of ISI that was applied displayed weaknesses in: i) the autarkic character of industrial production; ii) the absence of selectivity and, consequently, the absence of economic considerations in the criteria for protection and, iii) the inability to correct external vulnerability, which in practice had led to a situation that discriminated against exports (ECLAC, 1977). The failure to attach sufficient importance to gaining access to external markets precluded the exploitation of economies of scale and made it difficult to achieve more efficient specialization. This excessive and indiscriminate protection of domestic industry took place, moreover, in a context of uncompetitive industrial sectors, so that it may be said that this policy also favoured the development of national monopolies and oligopolies, as well as of branches of transnational corporations (ECLAC, 1977).

In view of the difficulties encountered by the ISI strategy in the 1960s, ECLAC emphasized the importance of a policy of promoting exports of manufactures in order to improve the trade balance and give greater impetus to industrial development. In this regard, three aspects were highlighted: i) the possibility of exporting manufactures depends not only on the sectors that are directly involved, but also on the efficiency of the economy as a whole, ii) a large and dynamic domestic market constitutes an excellent basis of support for export activities, and iii) there is some degree of inter-temporal complementarity between an effective import substitution policy and a policy of exporting manufactures (González, 1972).

According to another widely-heard neoliberal criticism of ISI, the latter had become biased against agriculture, as reflected in the continuing

decline in the latter sector's terms of trade with industry and in the low or negative effective protection levels granted to agricultural products. However, this incorrect sectoral articulation—which, did indeed arise from the industrialization process and which is one of the chief characteristics of Latin American development—cannot, in all honesty, be blamed on ECLAC.

"The industrialization of Latin America is not incompatible with the efficient development of primary production. On the contrary, the availability of the best capital equipment and the prompt adoption of new techniques are essential if the development of industry is to fulfil the social objective of raising the standard of living. The same is true of the mechanization of agriculture. Primary products must be exported to allow for the importation of the considerable quantity of capital goods needed" (Prebisch, 1950, p. 2).

A general criticism levelled by neoliberalism against ISI concerns the inefficiency to which it is alleged to give rise in the allocation of resources among the sectors that produce internationally tradeable goods—exportable and importable—and between these tradeable products and non-tradeable goods. The imposition of a protective tariff leads to higher costs of consumption and production, since it causes domestic oversupply at costs that exceed the international price. This over-production of importable goods reduces the resources available for the other sectors, causing a contraction in the production of exportables and non-tradeable goods. The tariff leads to a lower level of consumption of importable goods, which are then produced domestically at a higher cost, and to a greater consumption of exportable goods, with a price spread higher than it would have been at international prices (Corbo, 1985). On the other hand, the small size of the domestic markets, in terms of the technologies and scales of production adopted, led to an underutilization of the installed capacity and of labour, making it even more difficult to achieve greater industrial competitiveness.

At the risk of being repetitive, but in the interest of an objective debate, it must be emphasized that this concern was consistently reflected in the writings which gave rise to the concept of Latin American structuralism.

"In order to achieve this, the purpose of industrialization must be clearly defined. If industrialization is considered to be the means of attaining an autarkic ideal in which economic considerations are of secondary importance, any industry that can produce substitutes for imports is justifiable. If, however, the aim is to increase the measurable well-being of the masses, the limits beyond which more intensive industrialization might mean a decrease in productivity must be borne in mind" (Prebisch, 1950, p. 3).

And what are these limits? A reading of the above essay by Prebisch suggests the following:

- i) The efficient allocation of capital;
- ii) Attention to the optimum size of industrial enterprises;
- iii) Dynamic efficiency (increase in socially measurable productivity): "It would be a matter of discovering whether the increase in industrial production brought about by the factors diverted from primary production was or was not greater than the amount of goods formerly obtained in exchange for the exports. Only if it were greater, could it be said that there was an increase in productivity, from the standpoint of the community; if it were not, there would be a loss of real income." (Prebisch, 1950, p. 17).

A summary diagnostic study undertaken from the structuralist point of view might point out that although the region attained comparatively high rates of growth, this neither reduced the countries' vulnerability to external influences nor contributed to job creation and social participation to the degree expected. The dynamism of industrial growth was insufficient to establish an autonomous mechanism for capital accumulation, with the result that the leading role in industrialization, which was initially played by the public sector, was gradually transferred to foreign capital, particularly in the more dynamic economies. This was reflected in an increase in the external debt and in a gradual denationalization of the growth sectors.

Furthermore, the inefficiency in the adoption of alternative technologies caused the capital goods sector to fall behind, thus accentuating the considerable technological backwardness of the region's economies. As a result of costly protection policies which were not governed by criteria of selectivity —i.e., which were not

directed towards fostering a learning process and which did not provide for a gradual lowering of protective barriers—industrial activity tended to operate very inefficiently in both economic and technological terms. This was reflected in the diminished international competitiveness of manufactures, which exacerbated the existing external bottlenecks since the pressure on foreign exchange was heightened by the need to import inputs and capital goods. The Latin American industrial sector ended up being a source of demand, in net terms, for foreign exchange, due to its persistent trade deficit, which constituted the structural dimension of the external imbalance of the region. And since the bulk of the machinery and equipment in which the countries were investing was imported, the growth of the industrial sector remained subject to the performance of the primary exporting sector—the only domestic source of foreign exchange—and, at a later stage, to its association with foreign capital or to an increase in the external debt.

Thus arose a singular paradox: while the primary exporting sector suffered the ill effects of the exchange and tariff policies, it nonetheless served as the financer of last resort for industrial investment. In so far as the export sector remained relatively undiversified and continued to concentrate on products whose prices were highly erratic and which were of declining importance in world trade, the dynamism of the industrial sector, and consequently of ISI, came to depend to a crucial degree on the evolution of the value of primary exports. This intensified the economies' vulnerability to external trade shocks, inasmuch as the latter had come to be a determinant of investment and industrial employment, together with public-sector financing, which was highly dependent on the income earned from external trade. In other words, this type of industrialization functioned as a multiplier of external shocks, transmitting the ups and downs of the international economy to industry, to the public sector and to closely related activities such as construction.

Thus in the ISI model the incipient nature of the capital goods producing sector weakened the expansionary effect of investment on the domestic market and negatively affected the balance of payments. The investment multiplier fell as the imported component of investment rose, while,

on the other hand, the instability of export earnings imposed cyclical limits on the expansion of the industrial sector (Kalecki, 1953; Tavares, 1981).

The granting of excessive levels of protection to uncompetitive domestic industry tends to guarantee satisfactory profit levels even in cases where industry's utilization of equipment is low and its technological innovation is limited. A policy of indiscriminate protection thus encourages profit-seeking, instead of promoting innovation, competitiveness and cost reduction. Moreover, such over-equipping of industry is fostered by policies on relative factor prices which subsidize the use of capital (through customs exemptions, tax deductions on the importation of capital goods) and act as a disincentive to the employment of labour (e.g., the charging of the cost of employee benefits as payroll expenses). It is therefore possible to argue that the major differences between neoliberalism and structuralism do not lie in their diagnoses of the specific failings of industrialization in Latin America. Their differences crop up later on, in their overall interpretations of the situation and in their policy recommendations.

However, the renovation of the structuralist paradigm requires that its analytic and economic-policy framework should include an identification of the objective flaws of the industrialization process as a basis for the refinement of alternative proposals to the "structural adjustment" approach which is the essence of the renewed form of neoliberalism. This task lies far beyond the scope of the purposes of this article and the capacities of the author. Nevertheless, by drawing on various studies, a preliminary list of such problems may be suggested:

- i) An underestimation of short-term economic policy management, particularly as regards its monetary and financial impacts;
- ii) Neglect in the management of public enterprises, including an excessive tolerance of their financial deficits and of their conversion into semi-autonomous centres of power;
- iii) Over-confidence in the virtues of government intervention in the economy. The mere observation of market inefficiency tended to be seen as sufficient grounds for government intervention in certain activities, without any studies being carried out or

- any show of concern for the requirements of efficient public management;
- iv) Lack of transparency in the allocation of resources, as manifested in the proliferation of tax exemptions, in *ad hoc* spending and tariff measures, and in cases of huge capital gains as a result of the above;
 - v) The urban-industrial bias of economic policy. The scheme of latent cause and effect implicit in the ISI approach was, in a sense, one of industrialization as the vehicle for attaining growth and modernization. This has perhaps been the chief merit of structuralism: to incorporate into a development project the latent aspiration for modernity of the majority of Latin Americans. Perhaps, however, therein lies its principal weakness as well. The industrial bourgeoisie, the middle classes and the urban proletariat adopted the industrialist approach to modernization in so far as it served their aim of displacing the agrarian oligarchies from power. *But that was the only part of the structuralist message which they adopted:* its advocacy of the incorporation of considerations of economic efficiency and selectivity in decision-making and its concern about the irrationality of excessive protection, the relegation of agriculture and exports to a position of secondary importance, the need for integration, etc., were shunted to the wayside in the quest for industrialization at any cost.

The blame for this situation must be shared, since the significant changes, in terms of the expansion and diversification of production, which began to take place in the Latin American economies, with the aid of an active and interventionist State, as part of their more rapid processes of urbanization and economic growth tempered somewhat the misgivings which the structuralist school should have voiced in respect of the evolution of the countries' fiscal, financial and monetary imbalances.

The structuralism of ISI thus leaves a statist and industrialist legacy which must be revised with a view to the elaboration of a theory of social change that will be useful today, particularly if we aspire to more economically efficient and more socially inclusive models of development.

3. The validity and revival of the proposal for structural change

Twenty years ago an ECLAC document cited the following structural factors as basic causes of the insufficient dynamism and the social imbalances typical of Latin American development (ECLAC, 1971):

a) *Unsatisfactory political and institutional conditions*, which included the slowness of the process of political and social change and a resistance to the establishment of new institutional schemes for the promotion of development. The progress of agrarian reform programmes aptly illustrated these conditions. To this must be added the absence of banking, financial and tax reforms; the lack of national policies on foreign investment, with the consequent weakening and foreign acquisition of national enterprises; and, lastly, the obstacles to the expansion of intra-regional trade.

b) *The limited spread of technological progress*, in so far as the incorporation of technological advances constituted a circumscribed and limited kind of modernization, with a modern sector which was increasingly distancing itself from the rest of the economy in terms of productivity and income. The spontaneous dynamics of this process tended to sharpen this differentiation, along with its corollary of a pronounced geographic concentration of economic activity.

c) *Socially ineffective capital formation and a concentrated distribution of income*, whereby the high concentration of income in the region resulted in a pattern of consumption by the upper economic strata that was excessively diversified in comparison with the average national income.

The concentration of income also affected the structure and sectoral allocation of investment by favouring consumption by high-income groups and depressing the demand for consumer goods by low-income sectors. The allocation, either directly or indirectly, of resources to the satisfaction of the demand of privileged groups reduced the amount of funds available for investment in the traditional industries producing goods for mass consumption and in social services. Moreover, it also reduced the production or importation of intermediate and capital goods which would have permitted an increase in pro-

ductivity in backward sectors and the creation of a larger number of productive jobs.

d) *The backwardness of the agricultural sector*, in which institutional, social and economic conditions prevailed that constituted a serious obstacle to development. These included the system of landholding and low crop yields.

e) *The weaknesses of substitutive industrialization*, notwithstanding its contribution to economic growth and to modernization. Excessive protection, indiscriminate substitution, inefficiency, high costs, plants of an inappropriate size, the waste of capital, low productivity, and the absence of specialization were some of the more significant shortcomings. It was asserted that it would not be easy to remedy these defects and that, in order to give fresh impetus to the process of industrialization, one possibility would be to invigorate domestic markets and to broaden industries' activities to include exporting. In order to expand the domestic market, it was recommended that redundant labour should be incorporated in a productive manner. Emphasis was placed on the need for a policy of income redistribution and on agrarian reform; in connection with the opening of industry to the outside world, it was suggested that integration should be promoted and that a more efficient and aggressive foreign trade policy should be adopted.

f) *The harmful ramifications of chronic inflation*, which in many cases tended to get out of control. With the laudable objective of redressing prior misguided biases, ECLAC expressed support for a determined effort to combat inflation, since, in addition to having the unfavourable effects already mentioned, inflation made it difficult to adopt medium-term decisions on income and prices, exchange rates, taxes and public expenditure, all of which were considered vital to any development policy.

"It must not be concluded from this vicious circle [of inflation and the structural barriers to development] that until certain structural features or deficiencies are remedied no steps can be taken to curb or control inflationary pressures. This is borne out to some extent by the different effects inflation has had on economies with very similar characteristics" (ECLAC, 1971, p. 11).

g) *The lack of an effective policy on external relations*. In addition to reviewing the origin of external constraints on Latin American develop-

ment, ECLAC underscored the need to promote a kind of growth that would be more closely tied in with dynamic international trade activities, and denounced the defensive and sterile character of the region's links to the traditional centres.

This argument concluded with an assertion which, unfortunately, remains fully valid in the late 1980s:

"It is obvious from its action in the international sphere that Latin America has not been strong enough to forestall or influence the adoption of decisions that have proved increasingly prejudicial to its interests, and that it has failed to act with the rapidity and vision necessary to adjust to the changes that have been taking place in international trade as a result of the economic and technological progress of the industrial centres" (ECLAC, 1971, p. 12).

The question now is whether ECLAC erred in its analysis of the 1960s, or, alternatively whether its analysis was correct for that period but irrelevant in the 1980s.

It is true that the region has changed considerably over the course of the last 20 years. However, these changes have tended to deepen the region's problems of structural heterogeneity and distributive concentration. Two decades of socially non-inclusive growth and of delays in implementing structural reforms have not enhanced the economic dynamism of the region, lessened its external vulnerability or reduced the incidence of extreme poverty.

In this regard, ECLAC's analysis remains fully valid in the late 1980s. Moreover, the concern expressed today about the question of structural adjustment actually constitutes a belated tribute to the Latin American structuralist school. This school of thought has always insisted that, in addition to the management of aggregate demand and relative prices, an attempt must be made to overcome the structural obstacles to the development of the region.

An updated structuralist analysis stresses three key aspects of the Latin American economy as of the late 1980s:

- i) The existence of a pattern of trade insertion which, in view of the trends in international trade, leads to a poverty-inducing type of specialization;
- ii) The prevalence of a pattern of production that is unco-ordinated, vulnerable, highly heterogeneous, concentrative in respect of

- technological advances and hence incapable of productively absorbing the increase in the labour force; and,
- iii) The persistence of a highly concentrated and exclusionary pattern of income distribution which reflects the economic system's inability to bring about a significant reduction in extreme poverty.

These three aspects are closely related to each other and need to be addressed on an integral and simultaneous basis. This is what the term "structural change" seeks to convey. The question is one of creating a production structure which will enhance the trade insertion of the countries of the region, expand the creation of productive jobs, decrease structural heterogeneity, and thereby improve income distribution and reduce extreme poverty.

In the light of the current challenges facing Latin America, structural change in the region has a domestic facet and an external facet (PREALC, 1987). At the domestic level, the following problems need to be addressed:

- i) The insufficient creation of productive jobs;
- ii) The decline in real wages and in various social benefits;
- iii) The decline of the share of wages in national income;
- iv) The deepening of poverty.

At the external level, structural change must be oriented towards overcoming:

- i) The structural deterioration of Latin America's external trade (its persistent trade deficit in manufactures and its sharply declining surplus in the trade in primary products);
- ii) the growing need for external saving to deal with this structural erosion of trade relations. The substantial trade surpluses achieved in recent years, thanks to significant increases in the volume of primary exports, do not lessen the urgency of the need for changes in the system of production. On the contrary, they highlight this challenge, in view of the poor results of this export effort in terms of prices.

In the light of these challenges, the extent of structural change must not be reduced in order to maximize growth. Special attention needs to be devoted to the nature of this growth, the character of technological policies, the types of invest-

ment to be made, the link between agriculture and industry, the composition of employment, and the kind of financing to be used, to mention only some of the elements which are crucial to a modality of growth that will be compatible with structural change (García, 1987).

At this stage of the debate the following question is relevant: *what has become of the structural obstacles to development in Latin America in the 1980s?* If, as seems obvious, these obstacles have increased, and have been compounded by unprecedented conjunctural restrictions, then it must be concluded that special importance should be attached to the political economies of structural change.

The only valid context for such political economies is one which is characterized by both dynamism and equity. At the political level, the viability of structural change is enhanced by a scenario of concerted social action in respect of a national development effort.

Structural adjustment is thus one component of structural change, and consequently the stability of government policies, the logic governing decision-making in the processes of investment and financing, the tax structure, the region's international insertion and the institutionality of its factor markets, for example, should be examined within the wider framework of the structural changes called for in the economic, social and political spheres.

In any case, if the goal is a type of development whose principal objectives are growth, a transformation of the production structure, the improvement of the distribution of the fruits of growth, the achievement of a greater degree of autonomy, a reduction of external vulnerability and progress towards participatory and democratic societies (ECLAC, 1986), then it would clearly be unrealistic to expect structural adjustments serving the purposes of this strategy from stagnant economies with declining investment levels which are making net transfers of resources abroad.

In a recent document ECLAC highlighted this analytical approach when it stressed that development was not a spontaneous process, but rather one requiring a systematic and deliberate effort by governments and societies. The concept of a plurality of national approaches and the existence of a range of possible strategies were

acknowledged in this same document, but it was also emphasized that the most suitable scenarios for achieving this objective would probably be those that would permit the mobilization of social energies behind projects of social renewal within democratic and participatory frameworks (ECLAC, 1986).

It is for this reason that the debate on structural adjustment and especially the discussion of structural change, are inextricably linked to the

dialogue which is starting to take place in the region in regard to the notions of a more efficient and democratized State, a strengthened society and development efforts that would promote equity, decentralization and social and political participation, as well as flexibility, competitiveness and strategic economic adaptation. Within this framework, the renovation of the structuralist paradigm is surely a promising step.

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An outline of a neo-structuralist approach*

*Ricardo Ffrench-Davis***

In the 1980s, for the first time in four decades, Latin America has been faced with a prolonged period of setbacks in its development. If it is to begin to move forward once again, it will have to formulate new development strategies which will offer a technically consistent and politically viable approach.

The author sets forth a comparative analysis of the neo-liberal and neo-structuralist approaches which covers both their theoretical aspects and their application to the design of public policies. Within the framework of this analysis, his selection of what points to stress among those on which the two approaches differ markedly has been influenced by the state of Latin American development and the outlook for the international economy.

The author illustrates this analysis with examples concerning the economic performance of the region before and after the onset of the debt crisis. In so doing, he draws attention to the underlying theories and the policy recommendations associated with each of these two approaches. Finally, he underscores the need to further develop the neo-structuralist approach, especially as regards policy design (how and when to do what) with a view to constructing a future marked by greater growth, equity and regional autonomy.

*See the note on the use of the term "neo-liberal" at the beginning of the article by Sergio Bitar in this issue of "CEPAL Review".

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Introduction

It is no easy task to outline an alternative to the orthodox economic approach. The latter is relatively straightforward and well-defined and has become even easier to characterize since the changes it underwent during the 1970s. The predominance of the monetary approach to the balance of payments has made it even more so, and its economic policy conclusions and recommendations have become more extreme. When the debt crisis began in the early 1980s, the orthodox school of thought—which was partly responsible for it¹—appeared to be losing ground. This trend was short-lived, however, as may be seen by the fact that the theory and practice of the orthodox or neo-liberal approach have occupied a dominant position in the management of the debt crisis.

Latin America carried out a successful development process during the three decades between 1950 and 1980, when, despite serious shortcomings, it achieved an annual growth rate of over 5%. In the 1980s, however, it has achieved markedly poorer results. Today, it is searching for a new development strategy in line with its new status as a semi-industrialized region and with an international economic situation which is expected to be substantially different in coming years from what it was in earlier decades.

Within this framework, the renewed currency of approaches of a neo-structural character appears to be a highly useful development in connection with the formulation of consistent and effective strategies.

This article, which is inevitably subject to certain limitations and simplifications, includes a brief review of the relationship between structuralism and neo-structuralism in section I. Section II consists of a comparative analysis of the main theoretical features of the neo-liberal approach (also termed "neo-conservative" in the United States, "orthodox", or "monetarist") and of the neo-structuralist approach, as well as of the main economic policy recommendations of the two. The article closes with some brief conclusions in section III.

¹This school supported excessive borrowing by advocating the liberalization of financial markets and by arguing that going into debt was "good business" and that, if done by private agents, it was a self-regulating process.

I

The origin of neo-structuralism

No theoretical approach starts from zero. All build upon prevailing contemporary concepts, either by extension or antithesis. This has been the case with classic, Marxist and Keynesian theory. Under the influence of social and economic phenomena and changes in the alignment of political forces, different approaches rise and fall. Sometimes theories whose roots go far back in history experience a rebirth. One example of this is the monetary approach to the balance of payments, which is reminiscent of the gold standard and the automatic adjustment processes of the nineteenth century.

Creation, whether in a positive or negative sense, is the re-mixing of many different known components, coupled with the addition of some new elements and of others which had been forgotten. This new combination, however, may lead to radically different interpretations and recommendations despite the fact that it shares some components with the opposing approach. One central example of this is the presence of the market. It is not a question of accepting or rejecting it, but rather of the extent of the role it is assigned and of the supplementary and compensatory factors which accompany it.

Structuralism, which has emerged as a vigorous force in the interpretation of the problems of Latin America, has been heavily influenced by Keynesian and post-Keynesian thought. Neo-structuralism, for its part, draws upon the structuralist tradition, but also goes beyond it because its analytical development is strongly oriented towards the design and implementation of economic strategies and policies. There is no question about the fact that it has retained many of the postulates it inherited from the structuralist thinking developed since the 1950s: the existence of structural heterogeneity in national and the world economies; the simultaneity of several deep imbalances; the fundamental role played by institutional variables; the instability and deterioration of the terms of trade; the uneven distribution of the benefits of technological change; etc. Prominent structuralist writers also provided an early warning as to the exhaustion of

the "easy" stage of import substitution and the need to couple it with the promotion of exports (see Prebisch, 1961).

However, structuralism suffered from two shortcomings in the realm of implementation. One was its limited concern with the management of short-term macroeconomic variables, in that the analysis and definition of areas in which action might be taken with respect to fiscal deficits and monetary liquidity occupied a secondary place in structuralist thinking. It did not make a systematic transition from diagnosing the source of such disequilibria to a consideration of appropriate regulatory policies.

Its other flaw was the weakness of its thinking concerning medium-term policies for linking national development objectives with planning, although the fact that it considered them at all was a step forward, in view of the conspicuous absence of the subject in neo-liberal thinking.

One of the reasons for this failing has undoubtedly been the neo-classical school's focus on the examination of extreme positions (e.g., arbitrary protectionism versus totally free trade). This, of course, discouraged structuralism from seeking constructive contributions to policy making and co-optable inputs from the orthodox approach.

Approaches to regulating foreign trade, the definition of the objectives and the regulation of public enterprises, and the examination of alternative mechanisms for promoting investment, creating productive jobs, controlling foreign investment and organizing the financial system generally played no more than a secondary role in the development of structuralist thought. This school did, however, contribute to the progress made in the application of public policies in these spheres. Furthermore, its criticism of the orthodoxy of the time was essentially correct, as was its combination of abstract and historical elements (see Sunkel and Paz, 1970). Particularly noteworthy contributions have been made to the understanding of inflationary processes by such authors as Ahumada, Furtado, Noyola,

Pinto, Prebisch and Sunkel. Nevertheless, no systematic effort was made to formulate economic policies to go along with the structuralist analysis of the situation. The advances made in this sphere, and there were many, were not a central concern.

After the analytical retrogression seen under the globalism of the monetarist approach, the time has come, in our opinion, to restore the structuralist tradition by incorporating into it a systematic concern with the design of economic policies. Macroeconomic equilibria, the co-

ordination of short-term and long-term measures, initiatives aimed at ensuring that the public and private sectors will act in concert with one another, the building of structures of production and management which will entail a greater degree of equality, and the consideration of strategies and policies which will permit greater national autonomy are all highly important aspects in this respect. This is what might be called "neo-structuralism", whose most outstanding feature is that it offers selective policies in contradistinction to the theoretically neutral policies of neo-liberalism.²

II

Neo-liberalism versus neo-structuralism

The comparative analysis made in this section between the theoretical approaches and policy recommendations of neo-liberalism, on the one hand, and those of what might be characterized as neo-structuralism, on the other, inevitably involves some overlapping of the various elements into which each approach will be broken down. The reader should note that the sole purpose of this outline is to illustrate those features which best describe the basic nature of each paradigm, with emphasis on the main points upon which they differ.

Obviously, many of the specialists in the North who move in academic circles associated with the neo-classical tradition do not share all of the beliefs or characteristics which are ascribed to the neo-liberal school in this analysis.³ The classification outlined below is chiefly based on those postulates which have figured prominently in the recommendations and pressures directed towards the developing world in

recent years, rather than on the "middle-of-the-road" positions of the neo-classical tradition. It also reflects the interpretations, arguments and policies used in the Southern Cone during the 1970s and in three or four Latin American nations during the 1980s (the most notable case being that of Chile). Nonetheless, the extreme expressions of these theories in their pure forms are more often found in textbooks and intentions than in real life. The neo-liberal approach might be, for example, summed up by the following elements: the new type of conditionality which figures in the Baker Plan; the set of theoretical and policy propositions which go to make up the monetary approach to the balance of payments; and the proposals for a "financial deepening or liberalization" which gave rise to the financial reforms instituted during the 1970s in the Southern Cone and other countries.

The following outline compares the neo-liberal and neo-structuralist approaches, first in relation to their theoretical features and then as regards their policy recommendations.

³For example, the inputs provided by such specialists in relation to the implications of product differentiation, economies of scale, the learning process and dynamic externalities play a very important role in the neo-structuralist approach and help to give it a more formalized character. Generally speaking, the recommendations of the neo-liberal school often overlook these aspects.

²This refers to the "neutrality" of the target policy (e.g., a free trade policy which seeks to treat all types of goods equally). However, the transition from the prevailing situation to the target policy is not neutral.

A. THEORY

Neo-liberal paradigm

1. An adjustment is quicker and more benign in a liberalized economy. Tends towards theoretical propositions which work with marginal changes in a homogenous economy.

2. A static comparative analysis; focuses on microeconomic efficiency, while failing to give sufficient consideration to the macroeconomic effects on employment, distribution and productive investment.

3. Tends to consider just one disequilibrium at a time, which is assumed to be the result of ill-advised public policies; Pareto's optimum state is regarded as attainable.

4. Only one policy tool is used for each problem to be analysed, although this is not seen as precluding the application of economic policy packages.

5. Economics is a science which provides the same answers for the same problems in each case, regardless of the historical, political and economic contexts of the analysis.

6. Economic liberalization ensures the deconcentration of political power. Extensive economic freedom is postulated as a pre-condition for full political freedom.

7. Advocates economic internationalism and assumes that there is a trend towards the obsolescence of the nation-State. The main unit of analysis is the microeconomic unit.

⁴One undoubtedly very significant orthodox theoretical proposition refers to human capital formation. Nonetheless, orthodox stabilization and macroeconomic adjustment policies frequently end up discouraging human capital formation and reducing expen-

Neo-structuralist paradigm

1. Adjustments are slow and/or may produce disequilibria in a heterogeneous national economy; the costs of the transition greatly affect the final equilibrium, depending on what course the adjustment process has followed.

2. The analysis takes the dynamics of adjustment processes into consideration; the search for macroeconomic efficiency predominates and takes into account the effects on the rate of utilization of production resources and on physical and human capital formation.⁴

3. Acknowledges the existence of many different disequilibria and maintains that a number of them are of a structural origin. The quest for efficiency is seen within the context of a real "sub-optimal" ("second-best") world.

4. Considers the simultaneous application of a package of policies to deal with a group of problems, establishing priorities as regards the timing and intensiveness of each policy.

5. The answers may vary, according to the point in time concerned and the prevailing institutional structure.

6. Selective economic regulation and an improved distribution of power buttress one another. Excessive economic freedom is conducive to concentration among small groups.

7. The main unit of analysis is the nation-State. Attention is focused on the deliberate (as opposed to spontaneous) maximization of national social well-being.

diture on research, the funding for education and the rate of utilization of available resources.

B. POLICY RECOMMENDATIONS

Neo-liberal paradigm

1. Passive government and neutral economic policies.
2. No public interference in production; any possible redistribution is only *ex post*, primarily through monetary transfers.
3. The State is not a producer. Privatization of public enterprises. Emphasis on private capitalist enterprise.
4. Atomization of economic agents; disincentives in relation to unions and professional associations.
5. Neutral tax system, except for incentives to promote private saving and investment.
6. Free financial system which spontaneously guides the structuring of the supply and demand for goods and services; flexible interest rates freely determined by the market. Central Bank independent from political authorities.

7. Free trade

- a) Indiscriminate and unilateral opening up of the economy to the entire world, regardless of prevailing trends on international markets; "small country" incapable of influencing external environment.
- b) Low and uniform nominal tariff, with the objective being to bring it down to as close to zero as possible; elimination of non-tariff mechanisms.

Neo-structuralist paradigm

1. Active government and selective economic policies.
2. Selective intervention in the production system in order to create greater equity: production to satisfy basic needs, services which equalize opportunities, labour-intensive activities.
3. Pluralism in the forms of ownership and management, which include public enterprises playing an active leadership role in priority sectors and various types of private enterprise. Public and private enterprises are regarded as being complementary.
4. Development of intermediate bodies: unions, co-operatives, neighbourhood councils, professional associations, etc.
5. Progressive taxation system which redistributes expenditure and reallocates production resources.
6. Financial system regulated so as to serve the purposes of productive development, with regulated real interest rates and preferential access and interest rates for small and infant producers. Central Bank subordinate to the Executive Branch, on a level similar to that of fiscal policy and productive development.
7. Selective insertion
 - a) A gradated process, influenced by the functioning of the international economy; preferential treatment for countries participating in integration processes and negotiated trade with the country in question.
 - b) Differentiated effective tariff; use of non-tariff mechanisms in response to external instability as a means of directing State purchases and regulating certain types of transactions among subsidiaries of transnational corporations.

- c) Export promotion by means of the exchange rate and the liberalization of imports; diversification of products and markets is seen as the spontaneous result of free trade.
8. Unified exchange rate: free rate (closed economy monetarism after the style of Friedman) or fixed rate (monetary approach to the balance of payments). Assumes that the government cannot modify the real market exchange rate, except in the short run.⁵
9. Capital movements (whether of credit or foreign investment) should not be regulated and their allocation should be determined by the market; foreign investment should compete freely with national entrepreneurs, without sectoral restrictions.
10. Comparative advantages are well-defined and easily identifiable in a free market. No production sectors carry a special priority.
- c) Differentiated compensatory subsidies; negotiation with other governments and transnational corporations with a view to gaining greater access to external markets.
8. Regulated real exchange rate: unified or dual, depending on the differences between the behaviour of trade in goods and services and capital movements; crawling or programmed rate, with "mini-adjustments".
9. Capital movements should be regulated in order to avoid macroeconomic impacts that would result in disequilibria; their use should be directed towards compensating for fluctuations in the terms of trade and complementing domestic savings; foreign investment should be admitted on a selective basis with a view to promoting inputs of technology and access to external markets.
10. There are open-ended comparative advantages in sectors where such advantages are acquirable; national development is based on efforts to acquire comparative advantages, which should be selective.

III

Some concluding remarks

The substantial difference between these two approaches comes down to being a matter of degree as regards the homogeneity and integration of markets, products and factors. The neo-liberal school of thought assumes that, in the absence of governmental restraints, markets are homogenous and integrated; market signals are therefore believed to be free-flowing, transparent and marked by high inter-market and inter-

generational price elasticities.⁶ Consequently, it does not acknowledge the existence of structural disequilibria, except those generated by the State. It also maintains that the dissimilarities among the existing capacities of different factors are due to natural elements; if a decision is made

⁵At the theoretical level, this idea retains much of its force. Nevertheless, since the beginning of the debt crisis "crawling-peg" policies have predominated.

⁶According to this last assumption, one generation would not irresponsibly go into debt at the expense of subsequent generations. Similarly, the extreme argument is made that it does not matter whether fiscal expenditure is financed by present taxes or by borrowing (which would involve future taxes). This orthodox theoretical concept is not generally reflected in the neo-liberal recommendations directed to Latin American nations.

to compensate for these differences, then this should be done outside the bounds of the production system.

Paradoxically, the policy recommendations derived from the microeconomic theory of price optimization on which neo-liberalism bases its policy recommendations, is founded upon the "maximization" of liberalization. It does not recognize the existence of intermediate points between the extremes. One example of this is the management of the exchange rate, inasmuch as this approach shifts abruptly between recommending absolutely free and absolutely fixed exchange rates.⁷ The manifest force of circumstance has obliged the neo-liberals to accept (although often only temporarily) "mini-adjustment" policies. This new exchange rate policy, which made its debut two decades ago, may be characterized as a neo-structuralist contribution.

The neo-structuralist approach ascribes a vital role to structural heterogeneity. This includes, *inter alia*, the heterogeneity of external markets; the heterogeneity of different phases of the economic cycle (i.e., differing market responses during recessions and economic booms); the varying response capacity to the stimuli affecting regions or market segments (large and small, peasant and urban, infant and mature enterprises); the differing degrees of resource mobility and price flexibility; and the possibly perverse dynamics of macroeconomic adjustment processes, depending upon the intensity of the response made by different sectors and markets and upon the perceptions or expectations of economic agents.

⁷In another sudden move, neo-liberalism abruptly modified its proposals for monetary and exchange rate policy. In the 1950s and 1960s, this school recommended the use of the money supply as a means of controlling inflation and of the free exchange rate as a means of restoring the balance of payments to equilibrium within a Friedmannesque world. During the 1970s, however, these same neo-liberals threw themselves wholeheartedly into the use of monetary policy as a means of placing the balance of payments in equilibrium and of the exchange rate as a means of regulating the rate of inflation. This constituted a spectacular leap from closed to open monetarism (the monetarist approach to the balance of payments). Such sharp turnabouts are facilitated by the assignment of a single policy to each problem. The author's criticism on this point does not preclude an acknowledgement of the fact that there are policies which produce more significant effects in given spheres and that they should therefore be used chiefly for that purpose.

This is illustrated by the genesis of the present debt crisis. Some economic agents failed to grasp a number of facts including the following: a) that the international private capital market was "coming of age", and that therefore net capital flows, which had been very large during its formative years, might be sharply reduced as the market approached maturity (i.e., to equilibrium levels); b) that with the freeing of capital movements, the structures of production and domestic expenditure adapted to the existence of large financial flows; c) that, perversely, the exchange rate became geared to financial rather than real forces (i.e., currency revaluations despite the presence of growing deficits on current account); and d) that external credit was siphoned off for consumption because economic agents assumed that the flow of funds and the flexible interest rates would remain at levels favourable to debtors for an extended period of time. Hence the neo-structuralist recommendation of regulating capital movements, exchange rates and trade policy and of applying a productive development policy, of directing resources towards investment, and of promoting the acquisition of comparative advantages as a means of creating and taking advantage of greater opportunities for investment and innovation.⁸

Latin America's adjustment in the aftermath of the debt shock is another case in which the two approaches take different paths. The adjustment has primarily been based on demand-reducing policies. Policies designed to bring about the switching of supply and of expenditure have played a minor role, as attested to by the sharp decline in economic activity observed in Latin America. The neo-liberal response to a deficit on current account tends to be to reduce aggregate demand, even if this means that production then decreases, investment shrinks and demand must be further reduced in order to follow production in its downward spiral.

Neo-structuralism stresses a more balanced combination of a decrease in aggregate demand with reallocative policies. Certainly, the size of the deficit was indeed too great to be sustained

⁸These things are not easy to do. Clearly, a *laissez-faire* policy is very simple to design, as is arbitrary interventionism; any more efficient policy, however, must be more sophisticated and complex.

since, as noted earlier, the net inflow of external funds during the 1970s was excessive. Neo-liberalism, however, by recommending the regular payment of interest on the debt and neutral policies, led to an over-adjustment. In any event, an adjustment was inevitable, even if the countries had succeeded in making an optimum arrangement (i.e., net transfers near to zero) with their creditors.

What needed to be adjusted was the excess of demand over domestic supply, which was being met by an unsustainable volume of external resources. If, however, production declines during the adjustment process, this then exacerbates the problem because it makes necessary a further drop in demand; in its turn, will pull down investment, which will be discouraged by the underutilization of installed capacity and by a recessionary macroeconomic situation. This is the basis for recommending selective policies in connection with public expenditure, taxation, credit and trade which, in combination with the exchange rate policy, will help to:

a) Localize the reduction of aggregate demand in those of its components in which decreases are sought (expenditure on foreign goods), while maintaining effective demand at levels commensurate with the existing production capacity.

b) Strengthen capital formation, rather than weakening it. Since aggregate demand must be lowered, it is therefore necessary to reduce its other component: consumption. The two approaches again part ways here, with the

options being either to lower wages and/or employment, or to reduce non-essential consumption.

This debate is of great significance for the future. Neo-liberalism places great faith in the efficiency of the traditional private sector and is extremely mistrustful of the public sector. In contrast, neo-structuralism requires that the State play an active role. It bears repeating that this last task is not an easy one. This being so, in order to remain true to the concept of "structural heterogeneity", it is therefore necessary to be selective: the number of actions undertaken by the State must not exceed what it is capable of carrying out on a socially efficient basis, and it must concentrate its efforts in those areas where it can have the greatest macroeconomic impact.

The identification of the most socially productive spheres for State action, and the formulation of criteria for ascertaining the optimum degree of public intervention in each, are areas in which more intensive research is needed.

In part B of section II a number of strategic areas were identified. Some of these have been examined in depth, such as exchange policy and interest rates; others have been discussed less fully, such as the design and implementation of an efficient and dynamic process for identifying and utilizing acquirable comparative advantages, the organization of efficient public enterprises, and the establishment of clear guidelines concerning the optimization and concerted action of the various sectors of production and of society.

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Neo-conservatism versus neo-structuralism in Latin America

Sergio Bitar*

The devastating effect of the financial crisis has rekindled the debate in Latin America on development strategies. The short-term logic of the recessionary adjustment has proven to be unworkable, and in order to find a solution the formulation of a new kind of thinking aiming at structural change is now required.

From the North, the multilateral agencies and the governments of the industrialized countries, as well as certain research centres, have begun to use a language rather like that used in the region in the past, calling for "structural adjustment". What is involved, however, is an approach that tries to produce change through liberalization, privatization and market policies. This conceptual scheme, which in Latin America is termed "neo-liberalism", and in the U.S. and the U.K., "neo-conservatism", is also termed in this paper the "liberalizing/privatizing" approach.**

For a long time, a structuralist approach has prevailed in Latin America which, notwithstanding the different individual expressions it has assumed, has left its stamp on the concepts of economic development in Latin America. With the passage of time, the shortcomings of this approach have gradually been revealed, and it began to show signs of exhaustion, but in recent years this approach has gained renewed vigour, with the emergence of a better-articulated tendency which seeks to rise above the limitations and to make structural changes taking into account the new economic, financial and external and internal trade factors. In this article, this tendency is called "neo-structuralism" or "the mainstream thinking" of the region.

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**In Latin America the term "neo-liberalismo" is used to denote economic measures aimed at privatization, deregulation, reduction of the role of the State, and greater opening-up to the exterior in the spheres of both trade and finance. In English, however, this policy approach is known rather as "neo-conservatism", part of the reason for this being that in Latin America "liberalism" is understood as referring to economic matters in this sense, whereas in English it is more closely associated with political considerations.

I

The new liberalizing/ privatizing approach

On the basis of a refined version of a model which had been applied in some Latin American countries from the mid-seventies, the World Bank, the IMF and the United States government began during the 1980s to promote a new strategy for the entire region. The purpose of this strategy is to induce a "structural adjustment" which will help to overcome the external debt crisis. This new policy has profound implications affecting the long-term evolution as well as the structure and method of functioning of our economies.

Structural adjustment loans, which were introduced in 1980, closely resemble those made under the "Extended Fund Facility" instituted by the IMF in 1974. When the latter was introduced it triggered off a fundamental change of strategy: trade liberalization, removal of price controls and restructuring of public enterprises (Haggard, 1985 cited in Sachs, 1986). The abrupt changes which subsequently occurred in the international financial system seriously affected such attempt. In March 1986 the IMF began to apply a new credit formula, that of the "Structural Adjustment Facility", which contains features very similar to the "Structural Adjustment Loans" of the World Bank (*IMF Survey*, June 29, 1987, pp. 196-197).

The new approach aims in the short term to reduce the size of the fiscal deficit and of public expenditure; to apply a strict monetary policy to curb inflation; and to keep up positive real interest rates and a "suitable" real exchange rate. The medium-term objectives, for their part, are to transform exports into the engine of growth; to liberalize foreign trade; to make maximum use of the market and reduce government regulations; to concentrate investment in the private sector and reduce the presence of the State sector; and to promote a price structure without "distortions".

The proponents of these measures are openly against import substitution; undervalued exchange rates; high and differentiated tariffs and non-tariff protection measures; negative

real interest rates; managed and artificially low prices for food and other mass-consumption goods; compulsory wage readjustments; tax and/or tariff exemptions; controls and/or subsidies in order to achieve redistribution effects; the shifting of resources to the public sector, etc.

The new orientation displayed by the World Bank was prompted by the Government of the United States. At the joint meeting of Governors of the Bank and the IMF held in Seoul, Korea, in October 1985, the Reagan administration formally initiated a process to correct its policies in respect of the Latin American debt, as it took cognizance of the fact that the new situation prevented the continuation of the strategy pursued since 1982 (Council of Economic Advisers, February 1986).

In the so-called "Baker Plan", the Secretary of the Treasury urged the World Bank to assume a more dominant role. He further stressed the dual need to grant fresh resources and to "correct" the development policies of the debtor countries. As he saw it, the availability of fresh resources in the World Bank would provide an effective instrument for producing such changes.

Among his main proposals were the following:

- Privatization of public enterprises and increase in the efficiency of non-privatized public enterprises, accompanied by less government interference in the economy.

- Greater opening-up of the capital and stock markets.

- Improvement of the "atmosphere" for national and foreign investment, liberalization of investment regulations and measures to reverse capital flight.

- Liberalization of trade and rationalization of import regulations.

- Tax reform to stimulate greater growth.

- Reform of the labour market so as to eliminate the rigidities which prevent a freer play of labour supply and demand.

- Correction of price distortions.

The intentions manifested in Seoul in October 1985 did not come to fruition, and the commercial banks continued to reduce their flows to Latin America. In 1986 their total loans to the region fell by US\$900 million, and they continued to decline in 1987 (data given by the Bank for International Settlements in *Latin American Report*, 31 July 1987). Although the World Bank offset this slide by increasing its loans, the total availability of multilateral loans in the countries covered by the Baker Plan still went down (Morgan Guaranty Trust Company, June-July 1987, page 1).

Furthermore, the growth rate in the industrialized countries has been low. This slowness and the subsequent protectionism led to the deterioration of the terms of trade and a consequent fall in the quantity and price of exports from the debtor countries.

The failure of the commercial banks to meet the demands set forth in the Baker Plan was clearly reflected in the decision taken by Citibank and followed by the major United States and British banks to set aside funds in order to write off their loans to the debtor countries.

After an abrupt change in the initial assumptions had led to the failure of the Secretary of the Treasury's initial plan, he made some changes in it. Firstly, he stressed the importance of the multilateral agencies and tried to increase Washington's degree of control over the World Bank and the IDB. Secondly, he increased the pressure on the debtor countries to make radical changes in their economic policies in the direction of liberalizing them and privatizing State enterprises.

II

Attempts to overcome the structuralist approach

The structural approach, which was in vogue during the 1950s and 1960s laid emphasis on a medium and long-term perspective, the factors of production, and their linkage with the social and political variables. It further stressed State intervention mechanisms for inducing the structural changes considered necessary.

Viewed with hindsight, it is now clear that its main weaknesses were its insufficient incorporation of financial variables of both internal and external origin and its failure to give adequate consideration to the most appropriate economic policy instruments for achieving the objectives sought.

In order to overcome these limitations and to enhance the scope of this approach, several contributions have been made which laid the foundations for "neo-structural" thinking.¹

The vast majority of Latin American economists agree that the external vulnerability of the countries of the region has grown more acute. The financial burden is excessively heavy and is incompatible with a policy of rapid growth. The adjustment processes have been inefficient, in so far as they have not been made a part of a long-term perspective. The productive structures are disjointed, uncompetitive and slow to face the technological changes and the new trends which are emerging in world trade. The technological and productive gap between Latin America and the advanced countries has grown even wider.

Furthermore, the inequality within the countries themselves has worsened. The share of the lower-income strata in national income has gone down, while extreme poverty, open unemployment and underemployment have got worse.

¹One basis for evaluating the present situation in this respect can be found in the documents drafted for the Expert Meeting on Crisis and Development in Latin America and the Caribbean ("CEPAL Técnica"), Santiago, Chile, 29 April-3 May 1985, as well as those prepared during and after that meeting.

On the basis of this diagnosis, a strong consensus has been formed regarding the need:

i) To overcome false dilemmas.

— Import substitution and export promotion do not have to be mutually exclusive options: the real challenge to be faced is how to choose a combination of policies which will optimize the countries' own productive capacity and increase their international competitiveness.

— Nor is there any dichotomy between planning and the market. Planning must be improved by using decentralized methods and by concentrating it only in strategic areas. However, the market must also play an important role in the decentralization of decisions. At the same time, the policy of leaving decisions to the automatic operation of the market must be rejected because of the distortions which it creates in resource allocation and its ineffectiveness in achieving a fairer distribution of income and in protecting national autonomy.

— The traditional antagonism between agricultural development and industrialization is now obsolete. Agroindustry constitutes a form of joint development involving both these sectors. Peasant agriculture must also play an important role because it employs labour, provides mass-consumption goods, helps to raise the level of food security, contributes to higher productivity and is a factor of expansion of the demand for non-agricultural goods in so far as it incorporates new sectors into the market.

ii) To recognize the vital importance of political and institutional factors in the analysis of economic problems.

More attention is now being paid to the processes of democratization, participation and decentralization of power, as strategic objectives that economic policy should seek to attain, and also to the weight of social factors, behaviour patterns, values and attitudes in the formulation of stable policies.

The discussion on the restructuring of the State has also become more penetrating, in an

attempt to redefine its economic functions, enhance its efficiency, combat bureaucracy and, in the political sphere, to foster concertation between workers and employers.

iii) To regard inflation as a social phenomenon. At present, it is subordinated to the expectations of the economic agents, as well as to the conflicts between them and the institutional mechanisms for settling them, especially in the increasingly frequent cases of hyperinflation. Consequently, in addition to monetary and fiscal policies and structural changes, measures should be jointly formulated on the psychological, social and politico-institutional aspects.

iv) To realize that there is an urgent need to increase the level of domestic saving in order to raise the investment rate, since the contraction in voluntary external financing is likely to last for a long time. It is also obvious that individual national and regional capacity must be strengthened in order to grow more rapidly and thus reduce dependence on external factors which are, by their very nature, unstable and unpredictable.

v) To bring down the risks involved in our present form of insertion in the international economy.

To this end, we must reduce our dependency on the "locomotive" of the North as much as possible. The North no longer has enough strength to carry with it the full weight of international trade, and still less to improve the situation with regard to primary commodities, whose real prices have, on the contrary, declined steadily.

ily because of the rapid technological changes which have taken place. It is also essential to reduce economic and social heterogeneity, at the national level and throughout the region.

vi) To strengthen the countries own productive and technological base and to build up a well co-ordinated domestic nucleus which will be able to secure more autonomous growth and achieve a satisfactory level of international competitiveness in specific manufactured goods.

vii) To inject new life into the Latin American integration process. Although recent experience has been frustrating, skepticism must be overcome in order for the region to survive. Trade, financial relations, technological research and industrialization can be considerably expanded and strengthened if flexible regional integration policies are devised.

viii) To alter the form of adjustment advocated by the IMF, the new conditionality contained in the Baker Plan and the requirements for structural adjustment credits from the World Bank, and to oppose the new orientation in this same direction which the United States is trying to impose on the IDB.

ix) To find formulas of concertation and work towards building up broad-based social alliances which can sustain the new development strategy for long periods. The idea of a "national project" reflecting the interests of the majority sectors is an obvious first requirement. The existence of democracy and progress towards greater equity are essential preconditions for any concertation to be viable.

III

Guiding principles of the neo-conservative and neo-structural policies

The liberalizing/privatizing school of thought takes on different characteristics, depending on who is expounding these ideas. Some versions are more flexible, others more rigid. The neo-structural school of thought, for its part, is only now being put together. However, despite the different features and even some partial convergence, fundamental differences still persist

between the two approaches. The clearest way to explain these is to analyse the stand taken by each approach on some key issues.

With respect to principles, when the general statements formulated by the advocates of the liberalizing/privatizing system are compared, a strong similarity is observed with the positions of the neo-structuralists. Both the "mainstream"

thinking in Latin America and the new structural adjustment theories of the World Bank attach priority to speeding up the growth rate, the eradication of extreme poverty, improving efficiency and competitiveness and increasing exports. However, these overall similarities conceal important differences.

The World Bank and the IMF assign priority to lifting price regulations, promoting openness in the fields of finance and foreign trade, and the liberalization of labour regulations. In their view, the private sector should play the leading role, and they seek to reduce the role of the State. They are in favour of establishing a global, national and international market system governed by automatic regulation mechanisms oriented by a system of signals which are free from "distortions". They place emphasis on fiscal, monetary, tariff and tax policy instruments, while neglecting structural, institutional and political factors.

In the case of Latin America, the criticisms levelled at the liberalization scheme highlight the existence of imbalances and the absence of production linkages, which undermine the efficiency of a neo-liberal approach. Conversely, the criticisms of the dominant thinking attribute the inefficiency of the model based on this to the excessive size of the State. Those advocating liberalization and a free-market system maintain that the private sector is better equipped than the government to determine the activities in which it is desirable to specialize. The market could give more appropriate guidance for the long term.

Despite all this, the IMF's analytical framework for external adjustment and stabilization has proved to be incapable of even partially achieving its most basic objectives. It has not been possible to make the transition from an external adjustment strategy to one of structural adjustment through private and market mechanisms. Experience shows that inducing a change in the structure of production calls for a variety of instruments corresponding to a variety of proposals: in other words, one which is much broader than that of the neo-conservative scheme. In cases where external adjustment is promoted simultaneously with a stabilization plan, the multiple purposes are sometimes incompatible. There are no examples of coun-

tries which have successfully achieved stabilization and external balance at the same time as liberalization, especially if "structural adjustment" is added to the objectives too (Sachs, 1986).

A fundamental criterion in defining policies in Latin America is the effectiveness of each instrument for achieving specific goals. Viewed from this angle, the liberalizing/privatizing approach limits its instruments, since it restricts the possible range to certain guiding "principles" adopted *a priori*. It thus tends to reject a number of regulatory and public participation measures out of hand in trying to bring about changes in the structure. As a result, it has to face a very broad range of objectives with a limited number of instruments.

In contrast, the policy proposals based on the dominant thinking give priority to the medium-term perspective and highlight those aspects connected with the productive base, the equilibrium among the different sectors, technological progress, the development of natural resources, concentration of ownership and the destination of the surplus. In this medium-term perspective, the public sector is assigned a preponderant role in policy implementation. This dominant thinking tends more towards dirigisme, with a State which takes part in the selection of priority activities and uses administrative instruments to achieve its goals. The "mainstream" approach sees development as a deliberate process where social and political energies are concentrated on a national project, and not as the spontaneous result of market forces.

The proposals emerging from the mainstream Latin American line of thinking undoubtedly call for a more vigorous instrumental capacity. The approach of this school of thought has been successful in defining policies of structural change but has proved inadequate for dealing with acute short-term external maladjustment situations. Nor has it been effective in combining the goals of adjustment and stabilization, on the one hand, and those of change in the productive base on the other.

From a Latin American standpoint, it is essential to give increasing analytical and practical attention to instrumental aspects. A more highly perfected neo-structuralist scheme needs to have a bigger range of instruments at its disposal.

1. Differences in the approach to foreign trade

The question of how to change the foreign trade structure of Latin America has become one of the main topics of the debate on development strategies. The inadequacy of the external adjustment applied since 1982 has been due largely to the weak growth of exports. Although the physical volume of exports has expanded, there has been a sharp drop in their international prices, so that the final increase in income has been only slight.

There is an urgent need to secure and increase in the physical volume of exports, as well as an improvement in their value, for which purpose it is also vital to change their composition, which is at present disproportionately concentrated on natural resources with a low level of processing. Thus, in the mid-1980s primary commodities accounted for almost 80% of the region's total exports (INTAL, 1985 and Ibarra, 1986). These are the products most severely affected by the world trade crisis. During phases of expansion, on the other hand, the demand for raw materials scarcely rises, because technological changes have substantially altered the respective demand elasticity. The consumption of raw materials in the industrial countries per unit of GNP has declined, whereas that of manufactures has grown (Kuwayama, 1986 and Malan *et al.*, 1986).

There is consensus among the different currents of thought on this subject. However, there are different views regarding the relative importance of exports as the engine of growth and also the identification of the most suitable instruments for improving the trade balance.

The liberalizing/privatizing viewpoint is strongly against substitution and assigns excessive responsibility for promoting growth to exports. With regard to policies, it focuses its attention almost exclusively on two instruments: low tariffs, and a high and stable exchange rate, in order to facilitate the operation of the market.

It is beyond discussion that growth necessarily means deploying a much more vigorous effort to export, and especially to export manufactures. This goal demands a change in the productive base to heighten its specialization and selectivity. It presumes that there are medium- and

long-term plans for investment, technological development, human resources training and organization for external trade.

These objectives are not feasible within a "neo-conservative" policy. There is no empirical evidence that the developing countries which have succeeded in rapidly increasing their exports have done so thanks to low across-the-board tariffs and a high and stable exchange rate. This has not been the experience of the South-East Asian countries, for example. Korea and Taiwan, two of the most important economies, used differentiated tariff policies and concentrated their efforts on specific activities which were not chosen solely through the action of the market. In addition, the process received determined State support in both these countries (Yung Whee Ree, 1984). Likewise, Brazil's success was the result of a suitable combination of policies, specialization in certain branches, financial support, and incentives, in addition to the existence of a competitive exchange rate.

Having said this, however, there is no question of underestimating the need for exchange and tariff policies differing from those used in the past. Low tariffs are undoubtedly required, but they must be applied in a programmed, selective and discriminating way. It is also essential to have an exchange rate whose real value is relatively stable and serves to encourage exports. These instruments and criteria should be incorporated more positively into development policies.

It is also advisable to work towards equalizing the costs in terms of national resources required to generate one export dollar and one substitution dollar. This involves carrying out a tariff reduction while also establishing equivalent incentives for exports and in particular the non-traditional ones. However, this equalization need not take place immediately nor even in the very short term. Selectivity, learning new skills and the acquisition of new comparative advantages may make it advisable, for a certain length of time, to maintain a bias in favour of substitution or of certain carefully selected activities, and the same goes for exports of certain items.

Transforming the productive base is a slow process, and therefore any abrupt policy which involves intensive and sudden liberalization is a highly inefficient one. The shift from a scheme

primarily based on substitution to one based on exports involves changes in products and processes, as well as investments and technical, human and organizational adjustments which take years and which ought to be gradual.

The size of the tariff reduction will depend on the initial situation, but in any event a policy of programmed reduction of tariffs is preferable. It is also necessary to distinguish between sectors in accordance with the specialization priorities.

Selectivity and specialization, which are indispensable for increasing exports of manufactures, in turn require the establishment of a close linkage between export and industrial policies. It is possible to progress towards better use of natural resources through vertical integration, by identifying activities using such resources where it is feasible to "create" comparative advantages in such areas as inputs, engineering and the production of equipment or services.

The experience of the Nordic countries, because of their small size, their exploitation of natural resources and the autonomy to operate in the world economy, can provide valuable lessons for many Latin American countries. The cases of Sweden, Norway, Denmark and Finland deserve a careful study because they constitute successful examples of industrialization with specialization. It should be recalled that 40 years ago Finland's industrial development was less than that of many Latin American countries.

Services have been increasing in importance in international trade. A policy of indiscriminate liberalization in this field carries with it the risk of losing development potential. There is considerable room for well-articulated growth by the Latin American countries in the areas of transport, financial services, information, insurance, technology and marketing. Brazil's decision to reserve its information processing market for itself is an interesting example (SELA, 1986). Such a step is obviously not a viable option for everyone, because in each case the size of the market and the sector must be carefully considered. The important thing is to formulate suitable measures to enhance competitiveness and avoid lagging behind, because catching up later would be very costly.

In the case of industry and services, the world market has the capacity to absorb more Latin American exports. With regard to raw

materials, however, a policy of simultaneous expansion of production by the Third World countries could be disastrous. Priority must be given to manufacturing and to the establishment of closer links between that sector and agriculture and mining.

In 1983, a mere 0.2% of the industrialized countries' consumption was supplied by Latin American manufactures (Balassa *et al.*, 1986, p. 25), which shows that there is much scope for increasing the sales of this type of product to those markets. The region should set itself the target of reaching a higher exports/GDP ratio, based on manufactures. Furthermore, an export/industrialization linkage exercises a greater pull on the economy than a purely liberalizing policy that fosters the exploitation of natural resources.

Taken to the extreme, the liberalization/privatization system leads to the exploitation of raw materials with little added value and seeks to take advantage of cheap labour as a "comparative advantage". Both these factors will only increase the region's external vulnerability.

The mainstream Latin American thinking has repeatedly maintained that priority should be given to regional concertation. On the other hand, this topic is almost completely ignored in the neo-conservative arguments, although this is not surprising, since the approach favouring liberalization seeks to have each country trying to find its own place in the world economy, without coming to any preferential agreements with other Latin American countries. It is clear, however, that an export strategy based on manufactures will have a better chance of success if it has access to a wider market —namely, the entire region— where investment, technological research, manufacture of equipment, marketing efforts, etc., can all be co-ordinated. The recent complementation agreements between Brazil and Argentina augur well for the reactivation of a process, which for a long time was in abeyance. The pending reviews within the Andean Group and the Central American Market take on particular urgency in this connection.

One of the many obstacles that must be overcome is the excessive fluctuation exchange rates. With such sudden fluctuations it is difficult to keep up a steady effort to increase exports within the region. It is instructive that the European

Community has assigned high priority to the adoption of a common exchange policy.

The neo-structural approach, for its part, offers a suitable basis for expanding exports on the basis of greater productive and technological capacity. The range of instruments it uses must be increased, however, by more active steps to incorporate a policy of low tariffs and a stable exchange rate.

2. The structure of production

The requirements of foreign trade are key factors in reorienting the productive structure.

The level of specialization of an economy is reflected in the weight of its foreign trade, particularly in manufactures, with respect to the product. In Latin America, the global coefficient (total exports/GDP) is less than 20%, and if raw materials are excluded it sinks to only about 5%.

The small and medium-sized nations which have managed to create a productive base capable of competing on international markets (South-East Asia, the Nordic countries, and some other countries in Western Europe) register much higher coefficients, especially in the area of manufactures.

Specialization does not mean that some activities are dealt with in isolation from the rest. On the contrary, this process too requires a properly articulated productive base in which various sectors (engineering, data processing, electronics, metal products and machinery, capital goods, chemicals, technological research and manpower training) are interlinked. Specialization helps to orient priority efforts but a solid network, that is, a "critical mass", must first have been established. In the mainstream thinking, the term, "dynamic endogenous nucleus" has been used to express this idea, which can be implemented through the formation of comprehensive productive nuclei which, starting from natural resources, extend to capital goods, intermediate inputs, engineering, data processing, etc. This is a useful concept, but one which needs to be elaborated further in order to make it more operational.

A feature of the dominant Latin American approach is that it has centered its analysis both on the productive structure and on the links between sectors (especially industry, agriculture

and energy and, more recently, technology and services). This structural approach offers a better means of tackling the task of productive change, but it has certain shortcomings.

The goal is not industrialization *per se*, but rather how to increase productivity and competitiveness and create dynamism for change. If this approach is used it may be observed that selective industrialization, properly articulated with natural resources, provides a first-rate channel for inducing technological progress and improving the quality of management and human resources, which are the key factors of growth and competitiveness.

Industrialization and progress in technology and management must not be the monopoly of the large countries. The challenge now facing the small and medium-sized countries is that of specialization. Dispersion and not scale is the obstacle to be overcome.

It is essential that the public sector should play an active role. Effective implementation of this policy calls for less red tape, less centralization, and the removal of a host of petty administrative regulations. The functions of the State should be concentrated primarily on the strategic variables, leaving aside those of minor importance. In this new stage of development, the neo-structural approach understands that those functions will be quite different from the ones that were required during the substitution industrialization phase extending from the end of the last war to the late 1970s.

Natural resources are one of the pillars of specialization. At the same time, once a certain level has been reached the support activities must also be given autonomy. Finland, for example, after expanding its copper exports, was able to export copper technology, engineering and other services and machinery, thus enabling it to earn a higher income than from the mere exploitation of the natural resource.

Microelectronics and data processing are activities which pervade the entire productive structure, so that they should be given priority in any development scheme. The importance of services related to production and activities with a higher level of technological development will continue to grow. Consequently, they must be expressly included in any analysis of structural change.

Strengthening the productive base involves a tremendous technological effort. The amount of money allocated for this purpose by the entire Latin American region is only equivalent to that spent by Italy alone in the same field. Brazil, which accounts for half of the technological expenditure of the region, comes between Belgium and Switzerland in this respect, whereas Mexico only invests amounts similar to those spent by much smaller European countries, such as Austria and Denmark (ECLAC/UNIDO, September 1985, p. 12, c.1). Latin America should at least double the resources allocated to technological research and adaptation, which at present represent only 0.5% of the product.

Radical changes are taking place in the world industrial structure because a new technological pattern has emerged. The "third industrial revolution" now underway is profoundly changing the productive and social base. This transformation centers around a new key factor, microelectronics—an unlimited, low-cost resource which is spreading quickly in every branch of activity—which is taking the place of the cheap energy that provided the dynamic impulse for the previous phase. This change represents a "long wave" and is not just a partial adjustment (Pérez, 1986).

In these circumstances, the Latin American structuralist tradition surpasses the free market approach. It is obvious, however, that periods of radical change call for a much broader range of industrial policy instruments that will have a more forceful impact in the areas of technology, education, organization and investment and will favour the key sectors of the future.

The same can be said about the training of human resources, an area in which the industrialized countries vie with each other for the leading place. The Reagan administration has just submitted to Congress a bill designed to improve the competitiveness of the United States in order to prepare that superpower for the twenty-first century. The bill provides for the creation of federal research centres and massive training programmes in mathematics and computer operation in primary schools. How much more important it is for Latin America to take up this challenge!

The spatial dimension of the productive structure is just as important. This should help

to reduce regional imbalances. The cost of continuing to expand the great Latin American cities is reaching unsustainable levels. Regionalization allows better use of the local resources, potential and markets, while at the same time favouring each region's initiative. Information processing opens up new horizons for decentralization, and local powers must be strengthened in order to make the best use of this opportunity.

These topics are completely overlooked by the liberalizing/privatizing school of thought which is predominantly global, since in most cases it does not go deeply into sectoral analysis, nor does it take account of the pace and sequence of the changes in production. It establishes a framework of market indicators to orient the decisions taken by enterprises and assumes that this alone is enough to lead to the right selection of the most dynamic activities. In other words, its approach is disaggregated as far as economic policies are concerned, but globalistic with respect to sectoral issues.

In its purest expression this approach cannot lay claim to any relevant successes. It is impossible to consider it as a valid option, and still less in countries where the productive structure shows substantial imbalances. Guiding the process calls for a combination of both managed instruments and those governed by the market. What is more, the liberalizing/privatizing approach does not have a consistent analytical framework for assessing the temporal effects of the policies and deciding on a sequence of the most effective measures for obtaining multiple objectives over long periods.

3. Financing, saving and investment

The growth of the region will continue to be conditioned by the severe restrictions prevailing in external financing. The majority of the new proposals seek to deal with this situation by eliminating the net transfer of resources abroad (ECLAC, 1986, p. 101, and table 9). The multilateral agencies, the private banks and the governments of the industrialized nations agree that a positive flow must be restored as a matter of urgency, but they hold that this should be achieved mainly through the efforts of the debtor countries themselves and through changes in

their policies aimed at promoting liberalization/privatization.

This is where the two main approaches diverge fundamentally. The dominant criterion in Latin America maintains that growth must come first, and that the amount earmarked for servicing must therefore be subordinated to the attainment of this objective. As far as the "neoconservatives" are concerned, the important issue is the payment of the debt, and this means avoiding critical situations which could adversely affect the international financial system.

In the 1980s the rate of saving has gone down. Due to the decline in external saving (reduction of the current account deficit), recovery will have to be based primarily on both public and private domestic saving. Public saving must therefore be increased. Efforts on the part of the State can generate significant volumes of resources and open up the possibility of channelling these funds towards priority projects and areas, establishing close links with investment.

This goal may be incompatible with the underlying principles of the liberalizing/privatizing approach, which envisages a smaller public sector. Even United States authorities have been reluctant to allow the credits available from multilateral agencies to be used by public enterprises. The systematic application of an anti-State criterion can only stand in the way of an autonomous development strategy.

It is undoubtedly essential for the public sector to make unremitting efforts to improve its efficiency and reduce current expenditure, while gradually divesting itself of non-priority functions. To some extent savings can be improved by reducing the deficits or increasing the profits of public enterprises.

However, the indiscriminate sale of well-run State enterprises at low prices makes no contribution to increased saving. It may even reduce it if, for example, the new private owners divert resources to consumption or transfer them abroad, or if over the medium term the income from the sale of the enterprises is exceeded by the loss of profit. Rationalizing the public sector may mean the privatization of a considerable number of enterprises, but it is important not to fall into the simplistic trap of confusing that process with the dismantling of the State apparatus or the imposition of obstacles to the crea-

tion of new public bodies needed to meet the challenges now emerging with regard to technological progress, education and investment which take a long time to mature.

Fiscal income should also be increased by raising the level of tax collection. This level is too low in many countries, and such a move would avoid excessive cutbacks in expenditure. The existence of a light tax burden only favours the higher income groups. Moreover, in some cases the tax structure is far from progressive, which indicates that considerable amounts could be collected for saving.

The reallocation of expenditure can also lead to increased public saving. In particular, the possibilities that a reduction in military expenditure could provide for the Latin American countries should be explored.

Private saving should be encouraged. However, the "liberalization/privatization" approach, which claims that a contraction in the public sector is a condition for encouraging more saving by the private sector, could be counterproductive. There is no proof that any kind of automatic mechanism operates in these cases. On the contrary, the experience in the countries of the Southern Cone shows that a decline in public saving does not necessarily produce an increase in private saving and may even produce the reverse effect. What is observed is rather that public investment and private investment complement each other. If managed selectively, the first can promote the second by providing it with a more secure and stable frame of reference.

Furthermore, the creation of financial savings in the private sector does not guarantee that it will be turned into real saving and investment. Thus, it may well occur that privatization only encourages the transfer of assets or speculation. In fact, while domestic financial saving responds positively to the profitability of financial instruments the same is not true of private saving.

What is needed is a moderate and stable real interest rate. However, this should not be the only policy objective, since this alone is not the most effective instrument for encouraging an increase in the levels of domestic savings and investment. The experience of a considerable number of countries suggests that in certain circumstances the interest rate bears no relation to private saving. In Korea, for example, although

for long periods the real interest rate was negative, rates of saving were nevertheless high. In Chile and Argentina, in contrast, there were periods during which the real interest rates were disproportionately high but saving was even below its historical levels. Consequently, it is necessary to take into account the whole set of policies and not just one in particular.

The actual behaviour of private agents in Latin America is different from what is expected in the privatization/liberalization approach. It is quite true that entrepreneurs adapt themselves to the context in which they are operating and that market signals have a significant impact on their decisions. But there are also patterns of behaviour which are historically conditioned by cultural factors, perceptions of risk or economic and institutional structures. Thus, for example, the adoption of tax measures which will alleviate the burden of businesses ("supply side" measures) does not necessarily lead to higher real saving.

External financing for the developing countries, for its part, shows little elasticity with respect to interest rates. Nor is it a suitable mechanism for containing capital flight, because decisions in this regard are taken in line with a policy of diversifying the risk by national investors.

The region's economists and the international agencies agree that capital flight has been a widespread phenomenon throughout Latin America. They have widely divergent views, however, as to the best policies for reversing this trend. The multilateral agencies contend that the Latin American nations should adopt measures that attract this flight capital back, so that it will decide to return of its own accord. However, neither liberalizing policies nor interest rate differentials are enough to put a stop to this flight, since the phenomenon is influenced by a considerable number of political, psychological and historical factors.

The motives that prompt capital flight abroad can only partially be offset by incentives. Even in periods of strong stimuli (extremely high real interest rates) and political "security" (democratic stability in Venezuela and Mexico and the existence of tough authoritarian dictatorships in Argentina, Chile and Uruguay) capital flight has increased. It would be difficult to

apply measures to win over the persons responsible for this flight, because at the present time the scarcity of foreign exchange and the controls are greater than ever, on account of the deterioration in the international financial situation. Emphasis must therefore be placed on containing the flight. There is no doubt that a stable economic policy with prospects of growth reduces the magnitude of the phenomenon and may even attract some capital back to the country. In addition to this, however, there must also be suitable administrative control measures.

The measures proposed by the World Bank and endorsed by the Baker Plan and the IMF for attracting fresh capital envisage the expansion and opening-up of the stock and capital markets. It may well be that these measures lead to an increase in the capital inflow; however, this inflow will still be only slight. Moreover, in seeking to expand this type of financing, the use of incentives which impair the achievement or implementation of other important objectives should not be eschewed. It may be added that the extension of the capital and share markets is a gradual process and should be based on a set of rules that ensure its stability and protect the small and medium-scale investors from speculative operations. This is particularly valid for the Latin American countries, whose markets are usually small and therefore very vulnerable to manipulation and instability.

The violent fluctuations observed recently in the stock markets of the industrialized countries, which possess huge capital markets, constitute another factor of great uncertainty which affects the Latin American stock markets. This shows the big risks involved in the policy of encouraging humble workers to deposit their savings in such systems.

Finally, the reduction of the degree of concentration of economic and financial power is another essential factor in the development of these markets along sound lines.

Foreign direct investment, channelled primarily through the transnational corporations, may be another spur to regional development. It must be borne in mind, however, that at the present time its behaviour is different from its historical patterns. The percentage of the contribution to primary capital made by the firm itself has declined and the percentage financed with

credits has risen. Furthermore, new formulas involving contributions of technological and production know-how, with little direct investment, have multiplied. Consequently, such investment cannot be regarded as a substitute for external bank financing. In financial terms the contribution is small, and its value lies in the improvement of the technological, managerial and trading capacity (Bitar, 1987; Helleiner, 1986).

The foreign investment policy should be aimed at attracting enterprises in the sectors chosen, in order to strengthen specialization. An attempt should preferably be made to attract medium-sized or highly competitive firms which have not yet extended their operations on a worldwide scale. The indiscriminate granting of incentives in a precipitate fashion in order to improve the "atmosphere", which some banks, multilateral agencies and governments of the industrialized nations are suggesting, could prove to be very costly and give few concrete benefits for the host countries.

The practice of converting debt into equity ("debt for equity swaps") is now growing. The banks see this as an interesting way of lessening their risks through diversification of assets, quite apart from the fact that the management and intermediation operations themselves earn them considerable profits. For the debtor countries, however, the advantages are very doubtful. In some cases, this formula involves new investments, but in others all it involves is the transfer of existing assets to foreign enterprises. Its effects on the balance of payments can even be negative in the short term, if there is no inflow of new capital and the saving gained from non-payment of interest on the debt thus converted into equity is less than the remittances of profits by the denationalized companies.

Furthermore, it should be borne in mind that the current situation will probably lead to a change in debt servicing conditions. Symptoms of this which are already evident are the moratoria which major debtor countries have resorted to and the increase in the funds set aside to cover losses by the creditor banks. In these circumstances, advance payment through the conversion of assets could turn out to be bad business for the national interest. If the discounts on debt paper continue to increase on the secondary markets, it

would be advisable to encourage this decline and to look for repurchase formulas that will benefit the countries and not the middlemen or some foreign shareholders.

Finally, it should be pointed out that the conversion formula advocated by the supporters of liberalization/privatization is negative and even inconsistent with its own postulates, for if it is true that the market should rule decisions, then why not accept the indications of the secondary market of debt promissory notes?

In so far as the financing of investment is concerned, it is obvious that in order to carry out a programmed structural adjustment, funds directed towards and concentrated in certain areas of specialization will be required, on favourable terms and conditions (ECLAC/UNIDO, 1985). This calls for the active participation of the State: it is not enough to adopt general rules and market criteria. It is also necessary for the State to participate in channelling resources towards small and medium-sized enterprises and preventing these resources from being concentrated in the large firms, which would hinder healthy competition.

In the institutional sphere it should be borne in mind, finally, that a considerable change has taken place in the international financial system. Capital movements now greatly exceed the amounts involved in trade. The integration of the global system means that the fluctuations generated in the North spread to the Latin American economies with remarkable speed. The presence of bank subsidiaries integrated into the world banking system may unduly restrict the effectiveness of domestic policies. These considerations cast doubt on the desirability of the external financial openness advocated by some supporters of liberalization. It is necessary to establish regulations and mechanisms to protect the national economies from the vicissitudes originating in the external financing system. This also means that the State must play an active supervisory and regulatory role.

Increasing private saving will inevitably involve greater austerity in the spending of the higher income groups. Conspicuous consumption must be restrained, or at least its rate of expansion must be reduced, especially if it is aimed at the same time to increase the consumption of essential products. Changing the pattern

of consumption requires new fiscal and tax measures.

The adoption of a liberalizing/privatizing framework can become a serious obstacle for any austerity policy, since it inevitably triggers off a greater concentration of income. Consequently, the removal of regulatory measures must only be carried out after a very careful evaluation, and it must be compensated by other measures which promote greater equality.

4. Distribution of income and wealth and extreme poverty

The crisis of the early 1980s heightened the disparities in the distribution of income and wealth in Latin America, which were already very pronounced, and it became urgent to make radical changes in order to reduce concentration. The inequality is so extreme, however, that its correction cannot be left to the trickle-down effect of growth.

The liberalization/privatization school of thought attaches little importance to redistributive mechanisms, since it believes that the market and growth by themselves will favour equity, without any need for direct measures to alleviate the problem. An instructive example of this attitude is the fact that the name of the "employment and income distribution" department of the World Bank has been changed to the "labour markets" department (Annis, 1986). This way of thinking assumes that free competition and the removal of regulations will stimulate growth and thus indirectly bring about a rise in employment levels and real wages. This approach therefore envisages very few direct instruments (Feinberg, 1986, pp. 18-20). Another shortcoming inherent in this approach lies in the underestimation of structural factors in its interpretation of the root causes of this inequality.

The advocates of the liberalization/privatization scheme claim that in crisis periods such as the present one, little can be done to meet unsatisfied basic needs, so that efforts should be directed instead towards growth, since this improves the condition of the poorest through the trickle-down effect. They also recommend that the terms of trade for agriculture should be improved in order to assist the peasant sector: a

measure which will undoubtedly have a greater impact in those countries with a large rural population, but not in the case of the urban agglomerations which are typical of Latin America. In addition, they advocate the termination of indiscriminate subsidies, so that the limited public resources used for social expenditure will be channelled only to the poorest groups, leaving the other sectors to bear the cost of education and health, for example. Finally, they claim that it is the fight against extreme poverty which should have top priority.

This line of thought pays little heed to the structural causes of inequality: the concentration of ownership; the tenuous social and trade union organization, especially in agriculture and in the marginal urban sectors; the spread of consumption habits from the industrialized countries in the middle and upper classes; the low levels of education, and technological backwardness. These distortions cannot be corrected by market mechanisms alone, but call for measures aimed specifically at changing the structural elements which created them in the first place.

We feel that an effective approach must combine the two components: measures to deal with the structural elements, and price, fiscal and tax policies that eliminate rigidities and foster growth.

In particular, the reduction of inequality requires that changes be made in the structure of ownership. Concentration should be reduced in every case where it is not justified on grounds of technical efficiency, and in those cases where it is considered absolutely essential, it must be supervised, regulated and offset by administrative mechanisms. At the same time, broader forms of ownership should be promoted (co-operatives, small- and medium-sized enterprises, etc.).

The concentration of the financial apparatus in a few hands, quite apart from providing political power which can unbalance society, stimulates the use of resources in activities related to the same financial groups, and this further increases concentration. Consequently, all efforts to move towards greater equality call for control over the financial apparatus.

The organization of workers and of the more vulnerable social groups must also be encouraged. The persons concerned can best protect their interests by organizing themselves. Poli-

cies aimed at liberalizing the labour market seek to bring about downward flexibility of real wages, the argument being that this will encourage more employment. However, empirical analysis shows that in global terms the assumption that a drop in real wages will lead to higher employment is unfounded. What has really occurred is that these policies have weakened labour organization and increased inequality.

The strengthening of worker-run enterprises, self-help construction organizations or self-managed health clinics, as well as different forms of local power, will promote greater equality and reduce the excess burden on the State apparatus. It is also essential that measures should be taken parallel to the market, or outside of it, in order to overcome the worst manifestations of extreme poverty as regards unemployment, malnutrition and the lack of housing. Specific rural and urban groups should be targeted, and especially children, since giving special attention to them will help to progress towards greater equality of opportunity.

Tax reform and more efficient use of fiscal resources are also vital. More revenue should be collected from the high-income groups and transferred to the poorer groups. It should be noted that in quantitative terms, the fight against extreme poverty should not involve a very significant fraction of the product. The transfer of only 5% of the income earned by the richest tenth of the population to the poorest third would be enough to change the situation considerably. If progress is to be made in this area the direct tax burden must be raised and tax collection must be made more efficient. A change in the composition of expenditure would make it possible to generate additional resources.

The mass education and retraining of manpower to equip it to work at more complex and more productive jobs is another priority task for reducing inequality.

The policies suggested here are motivated by more than ethical, social and political reasons. They can also have a favourable impact on the capacity for growth. A labour force which is better trained physically, mentally and technically will be more productive and more adaptable to changing conditions.

It is not for want of ideas that the governments of the region have progressed little in

applying effective formulas. Political reasons have been a key factor in this. Hence there is a need to dovetail the desired goals more clearly with the resources needed to implement them. This aspect has been totally ignored in the approach taken by the multilateral agencies and in the reasoning of the privatization/liberalization school of thought.

5. The State and the private sector: an ideological conflict

The question of the size and the functions of the State has become a central issue in the economic policy debate. Criticisms have been levelled at the State from two angles: its supposedly negative effect on the efficiency of production and the supposition that it tends to expand fiscal expenditure. The vehemence of these criticisms and the repeated proposals for privatization have polarized the debate, robbing it of realism and practical usefulness.

The proponents of the privatization/liberalization approach advocate a reduction of the State apparatus, suggesting that public enterprises should be sold and that new credits should be channelled to the private sector. This stance has been reinforced by the United States government agencies and the commercial banks of that country (Baker, 1986b; Morgan Guaranty Trust, 1986). There are Latin American economists who hold a similar view (Balassa, Bueno, Kuczynski and Simonsen, 1986).

The proposals that the functions and size of the State should be reduced appear to be based on the assumption that such a contraction would provide a stimulus for the automatic expansion of the private sector. This assumption leads to an undue concern for reducing the size of the public sector, while at the same time neglecting ways of directly stimulating private enterprise.

At least two of the assumptions on which the liberalization/privatization approach is based are inaccurate. The first is the claim that the distortions in the Latin American economies can be corrected through liberalization. The truth is that excessive confidence in the automatic role of the market leads to other shortcomings, especially in the case of economies plagued by serious imbalances. On the contrary, the "programmed structural adjustment" approach calls for guidance. What is important here is not liberaliza-

tion in itself, but rather the efficient management of the programmed adjustment.

The second of these erroneous claims is that the private sector reacts to the market signals, thus leading to an increase in investment and efficiency. These assumptions on the behaviour of the private sector have little historical evidence to support them. Even during phases which were very favourable to Latin American entrepreneurs, only in a few exceptional cases has liberalization led to an innovative attitude and to efforts within a medium-term perspective.

In order to develop the habits which have been present for a long time in the countries of the North and in some Asian countries, deeper cultural changes would be needed. It is not realistic to attempt to achieve such modifications in the short term, using purely market instruments.

Considerable importance should be attached to increasing the efficiency of public enterprises. Without a doubt, it may be advisable to privatize some of them, but it is clear that inefficiency cannot be combatted solely by this means. It is also necessary to make substantial improvements in management techniques and in rate and price-fixing, to increase decentralization, and to bring about institutional reforms which allow for decisions to be taken autonomously. In contrast with the south-east Asian countries, Latin America has a long tradition of the State as entrepreneur, and this should be updated, as it would be unwise to seek to eliminate it.

It is essential to recognize that the State has accumulated too wide a range of activities, some of which are linked to the industrializing function in an inward-looking development scheme, while others are connected with the supply of basic services to the poor sectors or with various administrative regulation mechanisms for orienting investments or consumption or fighting inflation. There must be a profound change in this respect.

The State must assume qualitatively different functions which are more in keeping with the challenges of the twenty-first century and bear little relation to the public structure that took shape after the Second World War. The point is that before assuming new responsibilities some of the old ones must be relinquished.

It is the responsibility of the State to guide the structural adjustment towards greater specialization and competitiveness within a long-term perspective: a form of guidance that the market does not provide. This is the proper function of the "leader" State. In addition, the State should concern itself with protecting equity and national autonomy. What is needed is a State which acts as the "guardian" of certain basic socio-political equilibria.

Concertation among workers, entrepreneurs and the State is a key factor in any development strategy. This approach helps to build up consensus around a national project and reduces the sometimes artificial struggle between the State and private-sector agents.

These elements, if duly integrated, will lend greater vigour to the neo-structural way of thinking and thus avoid the spread of a neo-conservative model with disintegrating effects.

6. Political and social factors

In the political and social sphere, there is a wide gap between the neo-conservative concepts and the neo-structural approach. The first-named pay little or no attention to the social and power variables which interact with economic policies and which determine the viability of any development strategy.

The privatizing/liberalizing approach rules out any express reference to sociological and political factors. It is essential, however, to take account of the interaction between economic and political elements. There are two particularly important perspectives: the impact of given economic measures on social and political variables, and secondly, the conditions and power requisites needed in order to apply such policies successfully.

If any of these create inequality, lower the standard of living of large sectors of the population, lead to denationalization, etc., which are results incompatible with the existence of democratic institutions and standards, it must be asked how a liberalizing/privatizing strategy could possibly be applied. If the only way to do this is by using force, then the exclusion of political and social considerations implies the acceptance under this scheme of a non-democratic frame-

work, as has occurred and is occurring in several countries of the region.

A gradual transformation of the structure of production necessarily requires ongoing social support. Under certain circumstances, a shock policy may possibly secure some degree of price stabilization. It is also possible to apply this "by surprise" for a brief period without having popular support. However, this cannot be so in the case of more thorough-going strategies of change. An abrupt policy causes very high economic and social impacts and costs, and it could therefore hardly be used for an extended period of time.

Nor is it politically viable to subordinate the development strategy to burdensome external conditions which imply an excessive loss of national autonomy. An abrupt or simplistic liberalizing/privatizing policy runs the risk of unleashing reactions that will lead to the authoritarian exercise of power or to the system's own collapse.

The experiences of the Southern Cone countries have led many social and political scientists to explain the crumbling of democratic systems partly in terms of the breakdown of certain minimum social agreements and of the battle that is unleashed for the appropriation of the State surplus. Furthermore, the acceleration of inflation and the failure of stabilization policies have been attributed to the sharp conflict over the distribution of income.

These experiences have had some influence on the neo-structural approach, in that they have encouraged the search for ways and means of consensus, concertation and participation with the aim of reducing conflicts or channelling the energy generated during them towards common objectives. The idea of a national project has thus

assumed growing importance, as has the need to build up broad social and political support in order to sustain the project for extended periods. These factors are crucial in assessing whether the implementation of a given strategy is feasible.

It would be an illusion to assume that conflicts will disappear by the mere use of these expedients, but they can be lessened and subordinated to collective aims. Because this approach does not think in terms of "zero-sum societies", it opens up opportunities to seek joint progress. An efficient form of insertion in the world economy would provide space for a shared national effort to redound to the benefit of all.

The repercussions of a given strategy on the military establishment must also be taken into account. A national project must be understood and backed by the armed forces in view of its favourable effect on security in the broadest sense. The strengthening of autonomy, equity and technological capacity have a positive impact on security (Varas, 1986). In many cases, there is no doubt that military expenditure should be restricted. It may be noted that these aspects do not explicitly form a part of the conceptual framework which governs the liberalizing/privatizing school of thought.

The power requirements for sustaining a long-term strategy are satisfied better in a democracy where there is concertation and broad participation. At the same time, however, these same requirements dictate the type of economic policies that are acceptable to the majority. The effect that the measures adopted will have on equity are of particular importance if the aim is to further democracy and strengthen this system.

IV

Final reflections

The strategic priority in Latin America is growth and development, which demands that structural changes be made in the productive base to increase international competitiveness and satisfy basic needs.

There is no single model for carrying out such a structural transformation and it is therefore necessary to learn from experience and act pragmatically. Supposedly highly perfected

"doctrines" based on immutable "principles" can bring with them a host of negative effects.

These conceptual schemes whose philosophy is based almost exclusively on the notion of balance and on the validity of the "market laws" may achieve some degree of efficiency for brief periods in helping to overcome external maladjustments and to stabilize prices, but they are not appropriate for structural change, which must stem rather from a dynamic perspective. Seen in this light, the challenge to be faced is how to manage and regulate the sequence of changes, while taking care to keep the financial and economic distortions inherent in any change in the productive structure within manageable limits.

The relatively unpredictable nature of these processes is at odds with the practice of establishing a strict conditionality for managing the main macroeconomic variables, which is the method of procedure followed by certain multi-lateral agencies and favoured by the advocates of neo-conservatism.

The application of a long-term strategy requires political stability, which in turn calls for the shaping of social agreements shared by the majority of the people. The economic strategy must also protect the political spaces in order to preserve a broad, permanent social alliance.

Consequently, a liberalizing/privatizing scheme will be at variance with the goal of growth with equity, given the prevailing condi-

tions in Latin America, and will therefore jeopardize political stability.

In the long run, the importance of purely economic considerations is reduced and the viability of the strategy will depend on a host of political and cultural variables. In order to be useful, an approach must be able to adapt to changing situations while keeping economic/political interaction under constant and rigorous scrutiny.

To sum up, a policy which seeks to further growth with equity and autonomy must face the double challenge of bringing about change in the productive structure while protecting financial equilibrium and at the same time building up social support in a democratic system.

Both challenges can most effectively be dealt with if action is based on a conceptual approach which draws on the Latin American tradition, past experience, and the new type of international and national economy which now exists.

Ideas possess great power. The existence of a mature Latin American line of thought is thus extremely valuable for promoting new stages of development. The important thing is to get away from a defensive attitude to neo-conservatism by proposing functional ways of tackling the problems affecting national life, and especially those concerned with the new role of the State. An open and flexible "neo-structural" approach is the appropriate framework for taking up the new challenges.

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The challenges facing Latin America in the world today

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In this article the author analyses various long- and medium-term developments in the world economy and in the sphere of international economics and politics and explores their impact on Latin America. He then goes on to consider the regional scenario and, in particular, the current economic crisis, with special attention being devoted to the efforts made by Latin America to improve its present position.

The inventory of constraints and achievements which emerges from these observations suggests that there are a number of challenges to be met by the region, including those represented by the need for the consolidation of democracy, the preservation of peace, the restoration of the countries' manoeuvring room in their efforts to carry forward the process of development, the achievement of increased autonomy in the formulation and application of policies, and the furtherance of integration processes.

Latin America must adopt a variety of approaches in order to respond to these challenges. There is a need, for example, to design an alternative development strategy, to increase regional co-operation, to effect a qualitative change in the international insertion of the countries of Latin America and to establish a zone of peace in the region. The international community bears some responsibility in this respect, since the realization of such objectives depends on the stability of the international economy as well as on the reduction of the debt burden and of protectionism. The conclusion reached in the article is that development, integration and democracy are the pillars of any political programme designed by and for Latin America.

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I

The international scenario and its impact on Latin America

1. Relations between the superpowers

The relationship between the two superpowers has always had a decisive political influence in the area of international relations since, in essence, their behaviour reflects the world power structure. This relationship is marked by periods of tremendous tension and by others of apparent calm, but the ideological confrontation between the two countries is an ongoing one and is reflected in various parts of the world. The economic effects of this struggle may be seen in an astonishing increase in the amount expended on weapons, which diverts funds from their normal productive ends and from international co-operation for development. This mounting expenditure has, moreover, resulted in the creation of a nuclear arsenal powerful enough to obliterate all signs of life from the face of the globe. Two fundamental objectives of the United Nations are thus in jeopardy: peace and development.

However, in the midst of ideological confrontations and localized conflicts in the Middle East, the Persian Gulf, Afghanistan and Central America, some appreciable progress has recently been made in the disarmament negotiations between the two superpowers, and this may result in a needful and constructive period of worldwide détente.

The extraordinary increase in the defence spending lies at the root of the fiscal deficit of the United States and causes this country, whose impact on the Latin American economies is very considerable, to compete with the region for the financial resources which Latin America needs so urgently in order to carry forward its economic and social development.

The coming months will be of key importance in terms of the outcome of the disarmament negotiations; in future summit meetings, it would be desirable if the two superpowers would not only provide for the elimination of nuclear arsenals but would also give priority to the con-

solidation of peace, the promotion of economic and social development and the full re-establishment of multilateralism and international co-operation.

2. Relations among the developed countries

The leading industrialized market-economy countries are experiencing a period of substantial structural change, and this is altering their traditional relationships. In spite of the unity they have maintained so far at the political level in their stand against the socialist countries, as manifested primarily in the support they give to the United States in its confrontation with the Soviet Union through various military and strategical alliances, signs of friction have emerged during the present decade at the economic level.

In international trade, for example, the world's main trading partners are engaged in an unrelenting struggle which has given rise to an increasingly pervasive, persistent and complex form of protectionism and are showing extraordinary belligerence in their use of reprisals reflecting the relative bargaining power of each party. This confrontation has led them to bypass the rules of the General Agreement on Tariffs and Trade by applying new concepts and rules which have not been agreed to at the international level. At bottom, these trade conflicts are a sign of the varying degrees of speed and effectiveness with which each of the industrialized countries is able to absorb the technological change now sweeping the world.

This constant friction in the commercial and financial spheres is aired in direct negotiations among the leading developed countries which are held within the framework of the form of macroeconomic co-ordination agreed to by them at their summit meetings. By these means the developed countries have invested themselves with powers which are virtually absolute and are not recognized by the international community. They thus use intergovernmental negotiations to set exchange rates and interest rates in a manner which bears little resemblance to the orthodox approach they preach but do not practice. The conflicts among these countries are not, however, indicative of any long-term divergence at the economic and political levels. Rather, they are indications of a realignment that is being

forged at the level of production in an attempt to arrive at a different relationship and a different order of specialization, which will undoubtedly alter the present International Division of Labour. Not only will the division between the centre and the periphery change, but there will also be more than one centre, from an economic standpoint, and different peripheries in varying stages of deterioration.

One of the ways in which this realignment is felt is in severe macroeconomic imbalances among the main developed countries of the West. These nations have been incapable of redressing such disequilibria within the framework of their joint scheme of co-ordination in spite of the fact that a substantial devaluation of the United States dollar against the currencies of Europe and Japan has been negotiated and interest rates have been set at levels designed to allow financial resources to flow easily out of the surplus countries in order to cover the persistent fiscal and trade deficits of the United States. Needless to say, this macroeconomic scheme of co-ordination and the attendant negotiations taken no account of the interests of Latin America, whose commercial and financial flows are being profoundly altered.

In spite of everything, the United States' deficits remain, and it is demanding that its main partners raise the level of their economic activity — a demand which they are resisting not only for fear of reactivating inflationary pressures but also because, in some cases, cultural factors take the form of habits that favour saving rather than consumption. In any case, the conclusion seems to be gaining ground that the developed countries will not be able to reconcile the objectives of full employment and price stability by means of orthodox policies.

All this, together with the failure to redress the macroeconomic imbalances of the leading developed countries and the lack of international control over such disequilibria, points to the need for a proper reform of the international financial and monetary system, as has been repeatedly proposed by the Group of 24 and even by some developed countries.

In short, in spite of the growing internationalization of national policies and economic affairs, the world economy has ceased to transmit dynamic impulses to Latin America. On the

contrary, it is transmitting instability, recession and costs which are out of line with the need to adapt to new circumstances.

3. The crisis of multilateralism

Following the Second World War the system governing international economic relations was organized in accordance with the way the world was viewed from the perspective of the North. This view was based on the concept of multilateralism, just as multilateralism was based on the world power structure and on the international division of labour which had been established.

The Latin American countries and the other developing countries could not participate in this system unless they were accorded special and differentiated treatment because the rules of the game had been designed to facilitate North-North relations more than North-South relations. The result was the well-known and lengthy list of measures for which the third world countries fought so hard in international forums: Part IV of the General Agreement on Tariffs and Trade, the creation of UNCTAD, the Generalized System of Preferences, and the establishment of codes of conduct and international commodity agreements, to mention only a few examples.

The only viable alternative for the developing countries was to accommodate themselves to the multilateral system created by the North, and in doing so they in some way modified and eroded it. There can be no doubt that a major role in this phenomenon was played by the presence, in force, of the developing world in the United Nations and other multilateral forums and its importance either as a market for the centres' exports of manufactures or as a source of supply of raw materials. These are the factors which have given rise to the so oft-discussed interdependence of these countries, but it is a basically asymmetrical type of interdependence between parties that are on an unequal footing.

The experience of recent years shows that multilateralism is clearly in decline and is giving way to direct dealings based more on the real and specific "power" of each country which have little to do with the rules and forms of conduct befitting a relationship of "co-operation" among sovereign States.

Multilateralism as practised in the postwar period no longer corresponds to the new world view which now clearly prevails in the developed North. The structural changes taking place in the more advanced countries, as manifested in the technological revolution (which some people call "the third industrial revolution"), in the boom in services and in the internationalization of economic activities, are the marks of what might be characterized as a period of transition towards new forms of production, power and relations between States. This period is also one of instability, of change and of new developments in the international trade, financial and monetary systems.

In short, as the North sees it, multilateralism is no longer appropriate either to the new world power structure or to the emerging international division of labour. In contrast, for the countries of Latin America, multilateralism is both valid and necessary in that it provides the best means of attenuating the imbalances in economic political power which exist between States. If this were not the case, why would the North itself choose a multilateral forum to establish the rules for a new system of international trade in goods and services? The answer, quite simply, is because this still confers legitimacy. In the eyes of Latin America, a number of major challenges remain to be met through multilateralism: keeping the peace, promoting development, halting the deterioration of the international system of trade, re-establishing stability and financial equity and reforming the international monetary system, finding a political solution to the problem of the external debt, and effectively meeting the needs of the developing countries in such a way as to make their participation in the international economy more equitable, symmetrical and dynamic.

4. The technological revolution

There is no doubt whatsoever that today Latin America is confronting a world which is changing and moving forward very rapidly, sometimes in surprising directions. The development of microelectronics, information sciences and telecommunications, together with other advances derived from space research, has brought services to the international market which previously

did not exist, or if they did, were not internationally tradeable.

The parallel progress made in information sciences and telecommunications has given rise to the field known as telematics, which, at an international level, gives continuity to and inter-links the services made possible by these two activities: the transmission of commercial, financial, tourist and scientific information, designs, quality control standards, the long-distance signing of contracts, etc. This allows services to be provided internationally without any need for the movement of personnel or the clearance of customs controls at national borders and permits such advances to be applied in the fields of health, education and other social services. The developed countries, which have already mastered these new technologies, have rapidly become net exporters of this type of services to the rest of the world.

If these services are to be further developed in the future, there will be a need for the capital goods and other generally "high-technology" equipment which make up the infrastructure that channels the flows of information traded in the form of services. Consequently, it is worth bearing in mind that international trade in services depends on the possibility of investing in infrastructure either beforehand or concurrently and on the availability of the necessary equipment. At this point we can clearly see the close links which exist among "trade in services", "trade in goods" and "service-related investments".

These considerations underscore the fact that the economic determinants of international trade in services are not merely an extension of those of international merchandise trade and that there is no reason why they should be governed by the same rules.

It is becoming increasingly clear that transactions which are directly or indirectly linked to the international provision of these types of services will have a decisive influence on the future development of the third world countries. Not only is the whole concept of comparative advantages changing, but a host of strategic, geopolitical, cultural and even national security considerations are introduced by participation in worldwide information networks which are

created, processed and distributed by the leading industrialized countries of the West.

Like other developing countries, the Latin American countries are net importers of services and are only beginning to form industries in the majority of these new and revolutionary fields. In contrast, the industrialized countries are exporters of such services, possess efficient industries in these sectors, and invest large amounts of money in basic and applied research and development, and all of these elements are closely linked to their external trade. This accounts for the developed countries' determined effort to include these subjects on the agenda of the Uruguay Round and points up the consequent need for Latin America to prepare itself for a much more comprehensive round of negotiations than the multilateral rounds which have taken place within the framework of GATT in the past.

All these changes clearly show that an international division of labour is emerging which, as under the present arrangement, would relegate Latin America to a raw materials-producing periphery, but this time that periphery would be facing one or more centres whose rapid technological progress would make them much more remote. Latin America must face up to this challenge. It is the key to the twenty-first century. This emerging division of labour will reflect not only the new structure of production in the world but also a new balance in world power, and it will no doubt require a new institutional order at the international level to support it. The region must prepare itself for all this. And not much time remains for it to do so.

5. The orthodoxy which is preached but not practiced

The phenomena to which the international scenario and its impact on the countries of Latin America have given rise lie in the realm of ideas as well as in that of facts. For example, the response to the Great Depression of 1930 in the leading industrialized societies of the West (and it was a response which had a great impact on development-related thinking in Latin America in the postwar period) was the Keynesian paradigm. This is characterized by the free operation of markets in combination with a welfare State which concerns itself not only with attenuating

the recurrent cycles of prosperity and depression but also with providing employment and a minimum level of well-being to the entire population. The excesses committed in the name of this paradigm over the years gave rise to a new orthodoxy in many industrialized societies in which the unrestricted operation of market forces tended to be favoured as the pre-eminent instrument for allocating resources. Accordingly, the role of individuals and private enterprises as agents of change was stressed and that of the State was therefore reduced to one of establishing a minimum of rules and keeping order.

Furthermore this paradigm is set forth as being valid both for central and for peripheral societies. With regard to the latter, the proponents of this paradigm advocate a development path which is patterned after the thinking of the industrialized countries and based on the technical solutions provided by them. This approach is transmitted through, *inter alia*, the coercive components of the rules of conditionality to which the countries of the region must submit when they seek external financial support. Some of the main features of this approach include the dismantling of barriers to external trade in order to ensure that international prices will be the prices which contribute to an optimal allocation of resources; the adoption of "correct" macroeconomic policies in order to avoid internal and external imbalances; and the scaling down of the role of the State as compared with that of private sector agents, since the latter are allegedly the actors which will react more dynamically and creatively to market signals. It is also argued that the optimization of growth rates is compatible with the population's general well-being, i.e., with considerations of equity.

Three types of observations may be made which reflect a view that is definitely gaining ground in Latin America. In the first place, there is no reason whatsoever to think that approaches which may be valid for one society will necessarily be so for another, much less that the theoretical models applicable to a contemporary industrialized economy can be validly applied to Latin American systems of production. Such thinking reflects a gross simplification of a process in which no one theory is universally valid. Secondly, this orthodox approach is preached but not practiced in the very societies which formulated it. Examples of this which affect Latin America very directly may be found in the macroeconomic imbalances characterizing the world's leading developed economy (and in their manifold repercussions on international economic growth); in the production and export subsidies for agricultural commodities provided by the majority of the industrialized economies of the West; and in the growth of protectionism in international trade. Finally, the main tenets of this approach do not take account of various constraints and realities, including the extent of its political support and its applicability in a complex and changing international context. As emphasized below, even those countries of the region which have moved in the direction of greater openness in their economies have encountered external resistance to their efforts to achieve a different sort of insertion in the international economy. Thus, in the case of many Latin American countries, instead of facilitating the recovery of their own economies, liberalization policies have helped to maintain only the industrialized economies' level of activity by lessening the decrease in their exports to the region.

II

The regional scenario

1. General features

It cannot be denied that present-day Latin America has undergone tremendous and significant changes. Its productive apparatus has been diversified. Infrastructure works have been built

which have called not only for large investments and the use of modern technologies but also for bold new designs in order to overcome natural obstacles that have challenged the national capacity to carry out such projects. At the same

time, the development models which have been applied have not been successful in eliminating distributive inequities within national societies. Many social evils still persist, such as those of extreme poverty, hunger, malnutrition, infant mortality, inequality in terms of the opportunities offered by life in society, the constant illegal interruption of the democratic process, etc. All these problems are facing the renewed democratic effort being made in the region as its champions take up the heavy responsibility of guiding national destinies at this critical point in history.

The present decade has been one of paradoxes. One of the most significant achievements of the people of Latin America has undoubtedly been the restoration of democracy as a system of government and as a life style. The international community has unreservedly applauded this process, but the economic realities confronting it have come to pose a serious threat not only to the possibilities of re-embarking upon the road to development but also to social tranquility and to the very survival of democracy. At the same time, however, the reconstruction of democratic systems and the re-establishment of civil liberties have become the main bulwark against the economic crisis in that they make the sacrifices in terms of well-being more tolerable. This is because even though the measures adopted by democratic governments may be a subject of debate and disagreement domestically, they nonetheless contain a new ingredient which is of fundamental importance, i.e., their legitimacy.

This bulwark of democracy is, however, being subjected to pressures which are undermining it. The idea that domestic savings can continue to be drained off in order to service the external debt is unthinkable. The proposition that the quality of life and income levels should be allowed to continue to deteriorate for the sake of the recessive adjustment which has been imposed on the region without anything having been done in the international economy to compensate for the sacrifices made by Latin America as an idea that does not stand up to analysis. To force matters further would be to run the risk that the region's economic lags and shortfalls would in the end eat up the political advances it has made, plunging it once again into a dark age of authoritarianism and social unrest.

A meaningful lesson to be drawn from these harrowing years is that economic phenomena neither come into being nor are applied, in a theoretical vacuum. They occur within a living social body in which ideas and interests sometimes clash. Now more than ever it is difficult to draw a neat dividing line between the political and the economic spheres. It may be more correct to think of the economic management of countries as constituting a substantial part of their political management, with all that may imply.

2. The economic crisis

The crisis of the 1980s in Latin America is without historical parallel in that not only has it caused the development of the region to regress by 10, and in some countries by nearly 25 years, but that also it is taking place in an international context which differs from that of the past.

The region has had to deal with serious external imbalances and to take steps to adjust to the new circumstances it faces. The adjustment has been taken very seriously and has been made at great sacrifice in terms of the legitimate and frequently-postponed aspirations of the people of the region, on the understanding that the international economy would live up to its own part of the bargain, i.e., that growth would be reactivated, that interest rates would be lowered, that protectionism would be eliminated and that the flow of capital into the region would be re-established. None of this has happened. Instead, the signals transmitted by the external sector have been ones of confusion, instability and uncertainty. There can be no doubt that there has been tremendous asymmetry as regards the cost of the adjustment. Too high a percentage of the region's capacity for growth and savings has been transferred to the exterior in a trend which must be halted and reversed, not only through Latin America's own efforts but also with the staunch support of the international community.

The most overwhelming feature of the crisis in terms of its magnitude and implications is the external debt. It undoubtedly constitutes the most difficult barrier to overcome in order to resume the region's economic and social development process. Between 1977 and 1986, the external debt of Latin America rose from

US\$120 billion to US\$390 billion. The factors most responsible for this striking increase were the flight of capital and the capitalization of the unduly high interest charged. The trade deficit for the region as a whole has in itself been responsible for only 17% of the increase in the debt during this 10-year period.

If the growth of Latin American exports is estimated at 6% up to the end of the century (which is quite close to the historical average) and 20% of export earnings are allocated to servicing the debt (interest payments only), then the debt will stand at approximately US\$675 billion by the beginning of the twenty-first century.

Seen from this perspective, the debt problem can be solved only if it is understood to be the joint responsibility of debtors and creditors, one which must be the object of a dialogue involving governments and private sectors, and if it is acknowledged that the nominal debt figures do not accurately represent its real value. In other words, in order to resolve the problem of the debt, it must be scaled down to an equitable and manageable size in keeping with Latin America's legitimate right to development.

Interest and exchange rates are two features of the world economy which have a decisive impact on the economic behaviour of the Latin American countries. It has almost invariably been argued that interest rates, in particular, are the result of the free interplay of market forces. Something similar happens in the case of exchange rates, especially since the adoption of floating rates in 1971. The current disorganization of the international financial and monetary system demonstrates, however, that these rates are not actually set by the market but are instead decided upon in the course of painstaking negotiations among a small group of industrialized countries within the context of what has come to be known as "macroeconomic co-ordination". For Latin America, high interest rates have been the principal means by which financial resources have been extracted from it and the magnitude of its external debt has multiplied.

The problems of Latin America have been aggravated by the structural crisis affecting the commodities exported by the region, which account for three-fourths of its annual foreign exchange earnings. The unprecedented collapse of international commodity prices, which puts

the majority of them at levels far lower than the production costs of these goods, is compounded by the surplus supply generated by the need to export in order to meet the requirements of the adjustment programmes and to service the debt. In addition, there are some very worrying short- as well as medium- and long-term trends. At the moment, there is a marked contraction in demand on the world market as a result of the prevailing financial conditions (and, in particular, of the high interest rates) and of the protectionist policies and practices of the developed countries. This trend is reinforced by the defective structure of international marketing, whereby producers receive only a tiny fraction of the final price obtained for products on the market where they are sold. An even more serious situation is looming ahead, however. Investment programmes in the sector are showing a decline because nobody risks making investments without being absolutely certain whether or not the corresponding products can be sold on the international market. An inadequate degree of processing goes into the primary products which Latin America exports, and this robs them of value added and dynamism. The impact which the technological changes occurring in the centres will have on the production and consumption of commodities is severe and irreversible. Steel is a case in point: the decline in the demand for it cannot be reversed since it is noted even in periods of economic growth in the developed countries of the West. Technological changes are encouraging the increasing use of substitutes, of synthetics and other artificial products and of new materials such as optical fibres and the superconductors whose advent has been announced.

As if all this were not enough, the steady deterioration in the purchasing power of commodity exports is becoming another instrument for the extraction of Latin American resources. The greatest challenge, however, is that if Latin America is to cease being an exporter of raw materials, it will have to achieve a high degree of production and marketing efficiency, since such exports are the main source of wealth at its disposal and, consequently, offer the best opportunity for saving in order to invest in and diversify the productive apparatus. This process may take many years, but it must be set into motion at once.

In addition to the drop in the earnings brought in by commodity exports, external lending, not only by international private banks but also by bodies such as the International Monetary Fund, the World Bank and IDB, has been sharply reduced. In the case of the international lending agencies, the situation is now bordering on that experienced in relation to private banks—negative financial flows. It is a situation which verges on the ridiculous.

In recent years international trade has been subject to intense pressure which has undermined the validity and credibility of the rules agreed to internationally. Floating exchange rates have introduced elements of uncertainty, since the direction and stability of trade flows are difficult to improve upon and change by artificial means. Countries which follow protectionist policies and engage in protectionist practices draw upon an arsenal of tariff and non-tariff barriers as a means not only of reserving their local market for national production activities but also of keeping efficiently-produced goods from Latin American countries out of their and other countries' markets. To this end, the industrialized countries resort to production and export subsidies while at the same time condemning such subsidies when they are used by other countries as constituting unfair practices and countering them with trade reprisals. In some developed countries, the protectionist trend is reflected in legislation which totally alters the concepts of international trade (concepts such as reciprocity, for example). They even go so far as to use their voting power in international financial bodies to deny resources to development projects in sectors in competition with their own production sectors. A multi-lateral means must be found of resolving this inconsistency whereby the region is, on the one hand, asked to form closer links with the world economy by increasing its exports while, on the other hand, markets are closed not only to its basic commodities but also to its manufactures.

Protectionism is not only detrimental to the exports of the developing countries. It also affects the relationships among the member countries of OECD, whose secretariat has issued all kinds of warnings concerning the adverse effects of protectionist policies and practices on the international economy and on the efficiency and competitiveness of the various production

sectors. In recent months the subject of agricultural commodities has attracted special attention in that a proposal for the elimination within one decade of all production and export subsidies has been submitted for consideration at the Uruguay Round of negotiations. Some Latin American countries, together with other developed and developing nations, working in conjunction with each other in the Cairns Group, have played an active part in ensuring that priority is given in the GATT negotiations to the dismantling of agricultural protectionism. This is an example of what might be accomplished in other sectors which are the object of international economic negotiations.

3. The consequences

In addition to its severity and length, the economic crisis in Latin America has been notable for its widespread and multifaceted character. Although its consequences have been more serious and long-lasting in some countries than in others, it has affected the large economies of the region as well as the medium-sized and small economies, the oil-exporting countries as well as those which are totally dependent on imports for their fuel supply and those economies which had advanced further along the road to development as well as the poor countries and those with less diversified structures of production.

The exceptional nature of the crisis has also been reflected in the simultaneous and persistent deterioration of the principal economic indicators. In many countries not only has production fallen or its growth rate declined, but the employment situation has grown worse and real wages and salaries have dropped. At the same time, inflationary processes have gathered force and are being felt more widely, and the problems encountered by the external sector have grown more severe.

Thus, although the gross domestic product showed a partial recovery in 1986, for the region as a whole it was still 7% lower in that year than in 1980 and barely higher than it had been in 1977. Moreover, since during the same period the terms of trade showed a severe and persistent deterioration and net remittances of interest and profits to the exterior increased significantly, the drop in per capita national income, which is the best measure of average standards

of living, was much more pronounced (-13%) than the decrease in the per capita product.

This latter drop is also indicative of the very considerable extent to which the domestic savings and production efforts made by the countries have been undermined by the unfavourable nature of the external environment. This has been due, in the first place, to the fact that in order to finance the abundant net transfer of resources being made to the exterior in recent years, the economies of Latin America have had to export much more than they import, with a consequent reduction in the amount of goods and services which is actually available for consumption or investment. This disparity between the countries' domestic production and saving efforts and the benefits they reap in the form of consumption and investment has, in the second place, been exacerbated by the constant and severe deterioration of the terms of trade, which has made it necessary for them to export an increasingly larger volume of goods and services in order to obtain the same quantity of imports.

Another particularly serious aspect of the crisis has been the drop in investment. In the region as a whole, investment has fallen by 30% over the past six years, and in many countries the decrease has been even more greater; indeed, in some of them the decline has been so large that investment has not even covered the depreciation in capital holdings. Thus, in addition to adversely affecting present living conditions, the crisis has also seriously jeopardized the possibilities of bringing about a rapid rise in living standards in the future.

Furthermore, given the high rate of growth of the labour force, the decline in economic activity and the drop in investment have gone hand in hand with a sharp rise in the rate of open unemployment and with an increase in various kinds of underemployment. In spite of the decrease in unemployment observed in the majority of the principal cities of the region since the end of 1985, the levels of open unemployment in general were higher in 1986 than in 1980.

The negative social effects of the deterioration in the employment situation have, moreover, been aggravated in many cases by substantial drops in real salaries and wages and by the contraction in many countries of public expenditure on education, health and housing as

a result of the application of policies aimed at reducing fiscal imbalances. Thus, in spite of the efforts made by governments to continue with those programmes or services that most directly benefit the most underprivileged groups, in many of the countries of the region extreme poverty has increased while the distribution of income and opportunities, which was already very unequal, has become even more so.

These developments constitute some of the more notable and painful effects of the crisis, but they have also been accompanied by others which, while less visible, are no less serious. These include the reduction in the authorities' manoeuvring room as regards their handling of economic policy and, in particular, fiscal policy. While public-sector revenues have been constricted by the decline or slow growth of economic activity and by the sharp decrease in the prices of the countries' main export products, government expenditure has been under pressure from the rapid and relentless increase in the interest payments due on the public debt. In these circumstances, governments have often been faced by the dilemma of whether to reduce other expenditures which are vital in order to meet pressing and legitimate needs of the poorest groups of the population or in order to augment the dynamism and autonomy of the development process, or, alternatively, to try to maintain these expenditures, financing them through mechanisms which have increased inflationary pressures. Thus, the transfer of resources to the exterior caused by the increase in interest payments and the steep decline in external financing has not only curbed development by sharply diminishing the countries' import capacity and by absorbing a substantial amount of domestic savings, but has also limited the governments in the performance of their role in redistributing income and promoting development and has helped to speed up inflation.

4. Progress in the face of adversity

The people of Latin America have shown signs of a vitality far surpassing the most optimistic expectations. Not only have they weathered the most severe crisis in their history, but they have also found ways of achieving growth and of sav-

ing even though some of the fruits of their efforts may have been siphoned off by external forces. They have recovered their freedom and reinstated democracy in a process whose viability had been questioned from both within and without. Today régimes governed by the rule of law whose leaders are responsible for their acts to parliaments legitimately elected by the people are in the majority, and this has made it possible for these governments, within a context of respect for human rights and civil liberties, to adopt painful economic austerity measures which have postponed the satisfaction of many of the people's most pressing needs. In some cases, people's views concerning the directions taken by their government have been expressed through elections, introducing democratic dialogue, relations and pluralism and reaffirming or altering the course plotted for the nation.

At the same time, it has been possible to maintain peace among the countries of the region and, except for one lamentable border incident at the beginning of this decade, there have been no armed conflicts between Latin American countries, even though there are some long-standing disputes which call for peaceful settlement. The prolonged and complex conflict in Central America seems to be on the way to a genuinely subregional solution in the signing of the Esquipulas II presidential agreements, which constitute an extraordinarily significant act of Latin American sovereignty in Central America. The ongoing and tireless activity of the countries that make up the Contadora Group and its support group have provided the regional framework which is indispensable to the viability of the Esquipulas agreements. Peace and the strengthening of democratic processes in the countries of Central America will bring to the fore that spirit of unity which has historically prevailed among them.

During the past few months tremendous efforts have been made to arrive at formulas for integration which will have a real impact on the development of the countries of the region and on their relations with each other. The agreements reached by Argentina and Brazil and between them and Uruguay constitute a telling example of the application of political will to the creation of solid regional interdependence. The conduct of trade is viewed as a healthy sign as

regards the creation of real and lasting interdependence among the countries taking part in such integration initiatives, but the pivotal element is interdependence and co-operation in a broader sense, as a source of the instruments needed to make headway in the field of technological change, which is the key to the twenty-first century.

On another front, the signing of the Protocol to Amend the Cartagena Agreement and the adoption of a transition programme aimed at the reinstatement of the levels of reciprocal trade formerly achieved by the Andean countries are indications that the Andean Group, following a marked deterioration in its overall operation and an increasing lack of co-ordination among its member countries, has once again embarked on a course which will enable it to participate actively in regional integration and co-operation forums.

After many months of study, the efforts being made within the framework of the ALADI Regional Round of Negotiations are being focused on an ambitious programme for the expansion and recovery of trade. Preferential tariff arrangements have entered into force which, while modest in scope, open the way to the utilization by the region of a multilateral instrument for safeguarding and stimulating trade.

These fresh winds of change that have sprung up within the new atmosphere of Latin American democracy must be directed towards promoting the unity of the region, inasmuch as this represents the only feasible way out of the crushing and dangerously persistent crisis affecting it.

Overcoming old barriers and prejudices, a new diplomacy has taken root in Latin America as contact between Presidents and Foreign Ministers becomes customary and joint efforts to achieve peace in Central America are redoubled. One outcome of this was the founding of the Rio Group on the basis of its members' shared values and ideals concerning democracy and Latin American unity. All this made it possible to schedule the first exclusively Latin American presidential summit conference with a view to the institutionalization of a forum for concerted political action at the highest level aimed at the promotion of development and Latin American integration and democracy.

III The challenges

It may be seen from the brief overview of achievements and obstacles presented in the preceding paragraphs that Latin America is now confronting a great many complex challenges. In addition to the need to overcome the effects of the economic crisis of the 1980s, these challenges include the defence and strengthening of the process of democratization which is inherent to development; the consolidation of the economic and social progress achieved over the preceding three decades; and, at the same time, the resolution of the region's long-standing structural problems and its preparation for life in the radically different conditions which will prevail in the twenty-first century.

In more concrete terms, the governments and societies of the region will have to organize themselves in such a way as to achieve the following objectives:

In the first place, democracy must be consolidated. Only wholly legitimate governments can provide a setting in which it becomes possible to mobilize whole societies for the realization of national goals and such higher values as equality, civil liberty and justice. And only through broad-based participatory processes is it possible to choose, with the consent of the population, the combination and extent of the efforts to be made to achieve various objectives and to rank them by order of priority within a given time frame with a view both to ensuring better living conditions for the population and to conserving democracy.

In the second place, an objective which is closely linked to the first one is the preservation and consolidation of peace in the region as a reflection of Latin American solidarity and Latin American brotherhood. This would bolster

intra-regional co-operation, make it possible to concentrate entirely on development—political, economic and social—, help to reduce the arms race and strengthen the voice of Latin America in its dialogue with other countries. Seen in this light, the process recently initiated with the aim of ensuring a solid and lasting peace in Central America and the efforts being made to avoid conflicts in the South Atlantic constitute priority objectives which the entire region must pursue.

In the third place, there is the pressing and complex task of recovering the capacity to achieve development. This involves, *inter alia*, transforming the production structure of the region with a view both to meeting domestic and regional demand and to giving the countries of the region a greater role in the international economy; promoting structural reforms designed to improve the distribution of the benefits of economic growth; redressing the macroeconomic imbalances which have impeded efforts to achieve an expansionary adjustment and stabilization in recent years; and ensuring that a rational use is made of the region's natural resources and environment.

In the fourth place, Latin America needs to gain autonomy in the formulation and application of its economic policies. This objective is of importance at the level of the individual countries, within the framework of intra-regional co-operation, and as regards the way in which the region operates in the international context.

Finally, the achievement of all these objectives will undoubtedly call for an increased degree of interdependence among the countries of the region, which in turn makes it necessary to give a fresh impetus to integration processes.

IV The responses

1. Alternative Latin American development strategies

In Latin America it is necessary to close the gap between words and action. It falls to the democratic governments of the region to transform all

the social aspirations which have hitherto been neglected into concrete achievements just at a time when the world economy and the legacy of authoritarianism are severely restricting their manoeuvering room as they strive to design and

apply economic policies in line with the needs and realities of each national society.

It has been amply demonstrated that there is no one theoretical model which is universally applicable to the economic development of all the Latin American countries. A conceptual framework therefore needs to be constructed which will take the actual conditions in the Latin American countries as well as the changing and fluid international environment into account so that the countries may recover their capacity for growth.

The most serious problems are those faced at the external level, over which the Latin American countries have little or no control. There are also domestic problems which, given the increasing heterogeneity found in Latin America, cover a very broad range. These must be solved by means of policies that enjoy full domestic support, and this support must be won in the ways which the democratic systems themselves designate as being the most appropriate.

Consequently, growth is not only a matter of the will of the countries of the region. It calls for external conditions which will make national political programmes viable. If the signals transmitted by the world economy continue to be unfavourable as they have been so far, the Latin American countries will have no alternative but to introduce an inward-oriented style of development, substituting imports not as a matter of principle but by force of circumstance, as has happened in the past. This solution would not be viable unless the countries were to redirect the resources they are now using to service the external debt, and such a step would create unmanageable turmoil in the international financial system.

Latin America's present situation is one of extreme and dangerous vulnerability to the external sector. For this reason it must move towards a position of autonomy in the design and application of growth-directed economic policies, and in order for it to do so, the responsibilities to be borne by the industrialized economies must be clarified. Within the framework of an increasingly and asymmetrically integrated world economy, it is necessary for all the parties to play a well-defined role so that the benefits to be reaped from an expanding international economy can be distributed more equitably.

2. Assuming our own responsibilities

It is necessary to grasp the fact that no favourable result for Latin America will come about spontaneously. Positive achievements are always the result of carefully thought-out political decisions. Democratic governments must stand ready to face up resolutely to the challenges involved in achieving growth. There are things which depend on the countries themselves; measures can be devised and directed by the countries themselves whose effectiveness will depend primarily on the degree of political determination with which they confront today's realities and tomorrow's challenges.

It is clear that in circumstances such as those which now prevail, re-embarking upon the path to development is a task beyond the scope of any one Latin American country acting on its own. It is necessary, on the one hand, to strengthen regional co-operation and integration and, on the other, to organize and wield bargaining power at the international level. The need for the simultaneous management of these two lines of policy does away with a dangerous old dilemma —that of whether to direct action "towards" or "away from" the region. What is suggested is that it be directed "from within" the region in order to bring about a qualitative change in the region's position in the contemporary world. Real bargaining power for the region can be achieved only if the stances it takes *vis-à-vis* the exterior are backed up by serious, definite and united efforts to achieve co-operation and integration at the regional level. Bargaining power forged in this manner will have two necessary and fundamental characteristics: credibility and effectiveness. Experience in international negotiations shows, with striking clarity, that positions which are merely declarative and demand-oriented have no future at international bargaining tables.

On this basis, it will be possible to put the national economies back onto the road to sure and stable growth. By working together, the Latin American countries can arrive at viable formulas for ensuring their future industrial development, for casting off their role as raw-material exporters, for freeing resources now earmarked for the servicing of their heavy external debt and for generating and adapting the

technological know-how they need in order to diversify their production apparatus.

The Latin American countries have a commitment to spare no effort in striving to adjust to the new regional and international circumstances in a way that will permit their continued growth and to bring about a qualitative change in the insertion of Latin America in the world of today and tomorrow. The democratic governments should direct the whole of their political will to achieving these ends.

3. The co-responsibility of the international community

The scenario constructed for the future has to take into account the interdependence of the countries, the right of Latin America to development and the need for the region to participate actively in economic growth, the generation and dissemination of technical progress, the international division of labour, the taking of decisions which affect it and the organization of institutions. For this reason it is vital for Latin America to take initiatives which safeguard its interests and for the international community to assume its own responsibilities, at least in so far as the following matters are concerned:

a) The creation of a more stable development-oriented international environment, starting with the reactivation of the economies of the industrialized countries.

b) The urgent need for a comprehensive solution to the problem of the external debt of Latin America. Creditors and debtors must undertake a political dialogue and effect a reduction in the size of the debt, as this is the only way in which it can be serviced without interfering with growth. It is no longer possible for the region to continue transferring foreign exchange to the industrialized world.

c) An effort to ensure the consistency and viability in both economic and political terms of the programmes which IMF and the World Bank "recommend" to Latin American debtors. Emphasis is placed on export-led development, but the protectionism practised by the industrialized countries is ignored. The structural adjustment of the countries of the region is not matched by a dismantling of tariff and non-tariff

barriers in non-competitive sectors of the developed countries. The creation of an international system of trade which would be more favourable to the developing countries would increase their capacity to grow and to meet their external obligations.

d) A reform of the international financial and monetary system that would make possible, *inter alia*, an effective form of international monitoring of the leading developed economies, with particular attention to trends in exchange rates, interest rates, trade and capital flows and fiscal equilibria, in conformity with the growth objectives set forth in article I of the IMF Articles of Agreement.

e) The structuring of a stable, predictable, transparent, non-discriminatory, universal and lasting system of trade which could serve to promote growth and the coherent resolution of issues relating to the external debt, of financial and monetary problems and, of course, of those difficulties now encountered within the sphere of international trade.

The foregoing should not be viewed as part of the long list of demands which the developing countries have been making on the developed North without letup for over two decades. Rather, it should be viewed as a reiteration of the clear-sighted diagnosis made by Raúl Prebisch at the first session of UNCTAD in 1964. Since then, the problems affecting the region have grown worse, and new ones have emerged in a different context. The international community and the developed countries in particular need to understand that in striving to solve these problems they would find ample opportunity for a meeting of common interests, which would allow international co-operation to serve once again as the most effective instrument for the reactivation of the world economy and the progress of the developing countries.

4. Regional co-operation and integration

As Latin American integration has advanced and retreated in step with the economic cycles, it has repeatedly been asserted that integration is a process which enjoys the political support of the governments; nonetheless, both public and private entrepreneurial circles view it with reserva-

tions. This is because the process suffers from a lack of credibility due to past failures to live up to commitments assumed under law.

What integration has not been is a political project engineered by Latin Americans. The political dimension of integration has always been relegated to a place of even less than secondary importance or, indeed, has been bypassed altogether. A more mercantile view has prevailed, as if integration were merely a matter of amassing the greatest possible number of commercial transactions. Integration is considered and decisions are taken with regard to it only within national bureaucratic circles or select entrepreneurial groups. In cases where these sectors have opposed integration, it has become apparent that it exists within a political vacuum and that no other actors stand ready to carry it forward. This includes the political community of the region, which is the only group that can ensure that integration becomes an integral part of national political programmes and that can bring about an articulate, rational and harmonious reconciliation between the objectives of the individual nations and those of the region as a whole.

Thus, regional integration and co-operation could contribute to the fulfillment of the domestic responsibilities assumed by each country and could help augment the region's capacity for action *vis-à-vis* other countries through the use of its bargaining power at the international level.

The qualitatively different nature of the region's insertion in the world of today is reflected not only in economic terms but also, and perhaps primarily, in political terms. In the light of this fact, a new type of regional diplomacy is required whereby Latin America could be presented as a unified whole rather than merely as a group of countries and whereby the developed countries, including those in the socialist camp, could be persuaded to negotiate on concrete matters relating to the economic and political contours of the international environment. Only the concerted action of the region at the international level, firmly grounded on domestic co-operation and integration efforts, can guarantee the success of such an undertaking.

The growth of democracy, regional integration and political co-operation calls for a new concept of Latin American security which would make possible the gradual establishment of a zone of peace in Central America, South America and the Caribbean. Latin America must identify its common security interests in order to overcome the alleged bases for conflict among fellow countries of the region and to work together in dealing with the external threats, drug trafficking and terrorism affecting them. There is an urgent need to organize a regional security system which will strengthen democratic régimes and promote Latin American co-operation and integration.

The establishment of a zone of peace in Latin America is a gradual process requiring a recognition of the special traits of Central America, South America and the Caribbean and of the mechanisms best suited to each. Some of the initiatives which might be considered within national, subregional and regional frameworks are the following: policies for promoting border co-operation; commitments to renounce the use of force as a means of resolving pending conflicts among countries of the region; a balanced limitation of arms expenditures; the maintenance of the military denuclearization of Latin America; measures for preventing the regionalization and internationalization of internal conflicts; joint measures to reduce the global arms race; the encouragement of détente among the superpowers; and information and education policies which promote the ideal of permanent peace in the region. The promotion of policies for the elimination of extreme poverty would allow political solutions to be applied more effectively to violence in its various forms and to the internationalization of domestic tensions whose continuation jeopardizes the security and peace of Latin America.

Development, integration and democracy are therefore the pillars of any Latin American political programme. The most cherished ideals of the member governments of the Rio Group would find expression in such an initiative, whose implementation would involve a gradual process which would be the responsibility of all the countries and all social actors.

International primary commodity marketing and Latin America

Mikio Kuwayama*

A major concern to the developing countries in the commodity area has been their insufficient participation in the marketing of export commodities and the resulting low share of the final consumer prices retained by them. In the light of the general assessment that international trade is conducted in a tightly controlled market environment, especially by transnational corporations, the paper attempts to bring to light some major features of commodity marketing, by examining the intra-firm trade in the said sector, with special reference to Latin America. The author argues that in contrast to manufactured goods exports, where intra-firm trade constitutes an important marketing mechanism, primary export commodities of importance to the region do not, in general, involve this type of marketing practices. For many commodities, the paper argues, the bulk of world trade is handled by a relatively small number of transnational, multi-product trading companies. The author subsequently gives a theoretical exposition on the modes of operations, functions and services of the transnational trading companies. Taking into consideration the peculiarities of commodity markets and the potential benefits that the organizational structure of a multi-product, multi-service trading company offers, the author asserts that this type of trading entity may be the kind of marketing organization which the countries in the region should aspire to develop for their own use. The poor performance record, examined in the paper, of international and regional entities involved in the sphere of commodity marketing and of the State trading organizations operating in the region leads the author to conclude that these entities should engage more actively in the marketing of commodities, either by taking their own initiatives or by becoming more effective co-ordinators of policies among the countries in and outside the region.

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Introduction

The well-being of the commodity sector has been a major concern for the countries of Latin America and the Caribbean, due to its expected capability to generate export earnings on a sufficient scale, to finance development, and now especially to generate the required external financial resources. As a natural consequence of this, a substantial part of ECLAC's research efforts has been directed towards the examination of the specificities of the said sector and towards the search for solutions to the problems confronting it.

As is well known, the works of Dr. Raúl Prebisch marked a milestone in the evolution of international commodity policy. His works in the early 1950s overturned the conventional wisdom of classical economics that, as a consequence of diminishing returns on the production of commodities from a fixed stock of land, population increase and capital accumulation, the prices of such commodities would rise over the long run in relation to the prices of manufactures. Prebisch in turn made the challenging assertion that the international division of labour —the relegation of developing countries to the status of producers of primary commodities and the appointment of the industrialized countries to that of producers of manufactures— contained in itself an asymmetric division of benefits. He argued that the countries in the centre, as importers and consumers of commodities, received benefits accruing from the lower commodity prices resulting from productivity increases. Moreover, he stressed that these benefits to the centre were further increased by others accruing from the retention of productivity increases in the manufacturing sector in their own domestic markets, as improvements in labour productivity were appropriated largely by organized labour in the form of improved incomes, with little consequent downward pressure on prices. In developing countries, on the other hand, the unorganized, excess labour force reduced its negotiating capacity, allowing a major appropriation of labour productivity increases in the form of higher profits. As the rate of profits was sufficiently remunerative, the business sectors of the periphery could augment their supply even further, ceding partially the fruits of technologi-

cal progress through price reductions in world markets. These multiple benefits for the centre and impoverishing effects for the periphery, in his view, had self-perpetuating, differentiating income consequences, making the asymmetry even more severe.

In his report to UNCTAD I, Prebisch (1964) went on to identify the trend of long-term deterioration in the terms of trade of the commodity-exporting countries as the principal external constraint on their development process. He maintained that international policy should be focussed on establishing commodity agreements with the aim of reversing the long-run downward trend in the prices of the commodities exported by developing countries and on promoting national measures by developed countries to give better access to their domestic markets for commodities produced by developing countries. Prebisch recognized that, for many products, it may not be feasible to reverse long-term downward price trends of the developing countries' exports by the sole means of intergovernmental intervention in world markets in the form of commodity agreements, especially for those products facing strong competition from synthetics and substitutes. In such cases, he advocated the use of a compensatory financing mechanism to offset any deterioration in the terms of trade.

In short, instead of relying solely on the free play of market forces to stimulate development, the logic of Prebisch's argument called for positive intergovernmental actions, designed specifically to correct the worsening of the terms of trade, to improve commodity earnings prospects, and to reduce short-term fluctuations in those earnings, especially in the interests of the developing countries, on a non-reciprocal basis. This interrelationship between commodity policy and development, formulated by Prebisch, has formed the basis for all subsequent commodity negotiations and policy proposals debated in ECLAC and UNCTAD as well as in other international fora.

As the postwar history of international negotiations surrounding commodities testifies, Dr. Prebisch's arguments remain valid and their validity is further strengthened when considered in the light *first* of the very deprived state of

the commodity sector¹ and *second* the fact that his proposals, originally made more than 35 years ago, have continuously been put on negotiation tables (e.g., at the recent UNCTAD VII in Geneva, July 1987), though regrettably with very few concrete results.

From the outset the remedial actions initially proposed by Prebisch have faced strong opposition from the developed market economies, while the socialist countries have kept an indifferent stance on these international initiatives. The lack of progress in commodity negotiations reflects, to a large extent, the growing differences of approach between the countries of the South, which perceive the need for market intervention, and those of the North, which stress the need for solutions through the free play of market forces. The implicit assumptions made by the developed market economies on commodity markets are that they are characterized by perfect competition, with high factor mobility and the absence of market imperfections. The logic of this laissez-faire philosophy leads to the conclusion not only that any regulation of or intervention in the free play of market forces would produce a misallocation of resources, but also that the problems inherent in commodity markets are of a cyclical rather than a structural nature. Furthermore, in general, the developed countries have viewed these remedial actions purely in terms of their commercial interests, rather than as a common endeavour forming part of a broad strategy of development and international co-operation, as Prebisch had envisaged.

The perception by the South of commodity problems as "structural" has been reinforced in the post-World War II period by the transnationalization of this sector. Today, developing

¹Commodity prices have shown remarkably unfavourable trends in nominal as well as in real terms: real commodity prices fell by about 30% between 1980 and 1986, and prices have now reached a level lower than in the Great Depression (1932). The resulting cumulative terms-of-trade loss in the present decade has reached US\$93 billion for the developing countries as a whole. In addition to this long-term deterioration of prices, other outstanding features of the commodity sector are: a continuing fall in the share of primary commodities in world trade; a continuing decline in the share of developing countries in world commodity export earnings in contrast with the growing role of developing countries in world commodity imports; and structural changes depressing demand and increasing supply.

countries have to contend not only with issues related to sharp fluctuations in prices and deterioration of their terms of trade, but also with unfavourable distribution of export benefits, particularly between the producers in the South and the transnational corporations (TNCs) which exercise a powerful influence in the marketing sphere of the commodity trade. The structure of the international marketing of commodities, which is the subject of the present paper, has assumed strong oligopolistic and/or oligopsonistic features, with the result that a comparatively small number of enterprises has come to handle the bulk of world trade. The limited participation of Third World producers in the final consumer prices of commodity exports has as its counterpart the highly organized trading community.

Restructuring the international commodity trading system has been one of the focal points of the North-South dialogue. The Integrated Programme for Commodities (IPC), as defined in UNCTAD Resolution 93 (IV), adopted by consensus by the international community at Nairobi in 1976, specifically calls for greater participation by Third World producers in the marketing and transport of commodities and better access of these producers to the markets of the industrialized countries. Specifically, the IPC calls, *inter alia*, for the adoption of international measures to "improve marketing, distribution and transport systems for commodity exports of developing countries, including an increase in their participation in these activities and their earnings from them".

During the course of continuing negotiations, the mandate of Nairobi was reconfirmed both in UNCTAD V at Manila in 1979 and UNCTAD VI at Belgrade in 1983, which agreed on the acceleration of the formulation of international co-operation in those specific areas.²

²In Manila, for instance, Resolution 124 (V) was adopted, without dissent, reaffirming to the international community the need to establish global co-operation, within the overall context of the IPC, in the field of the marketing and distribution of the commodity exports of developing countries. On this occasion, governments agreed to take into account, *inter alia*, the following specific aspects of the trading system from the Third World perspective: i) improvement in market transparency, including action where appropriate to improve the functioning of commodity exchanges; ii) increased technical and financial support for the development of national marketing and distribution systems of

Despite these efforts, however, there have been no concrete proposals for action, and to make it worse, the recent tendency of the industrialized countries regarding these issues is to slide back and even to question the UNCTAD mandate.³

The above dismal record of international negotiations for more than a decade and the rigid positions of the developed countries regarding these issues mean that the prospects for positive results through the instrument of North-South co-operation are indeed limited. Recent experience also supports the conclusion that seeking effective solutions to the many problems inherent in the commodity sector within a framework based exclusively on traditional commodity agreements involving both producer and consumer countries will lead to little action.⁴ Consequently, if the developing countries seek rapid improvements in international marketing activities, these countries must look for alternative solutions. The objective of this paper is to facilitate discussions on possible solutions to achieve these goals.

Section I seeks first to identify the principal characteristics of the commodity markets by examining the U.S. intra-firm and related-party transactions. The analysis of the former is based primarily on the data contained in the recent publication, *United States Direct Investment Abroad 1982: Benchmark Survey Data*, while that of the latter is based on a non-confidential but unpublished source of information made available by the Foreign Division of the US Bureau of the Census. The latter, which gives the 1981 US related-party import trade data, is presumably the only, most up-to-date, and most comprehensive data source which allows an in-depth examination of the commodity marketing structure, and to the knowledge of the author it

developing countries; iii) examination of contracts, practices and arrangements governing the marketing of commodities; and iv) elimination of barriers to fair competition between marketing enterprises of developed and developing countries.

³The divergent views between the industrialized countries and the developing countries regarding these issues of commodity marketing and processing are documented in UNCTAD (1985 a, 1985 b).

⁴A summary of the events leading to this conclusion is to be found in ECLAC (1983a).

has not been analysed elsewhere.⁵ Given the importance of the United States in global commodity trade, especially for the Latin American region,⁶ the results derived from this data source should bring out some major characteristics of the trading systems surrounding commodities.

The results obtained suggest that though the proportion of intra-firm (or related-party) trade in total US imports is high (for example, related-party trade accounted for almost half of total U.S. merchandise imports in 1981), the share of such trade in the case of primary commodities, is, in general, relatively low. They also indicate that within commodities, the degree of "relatedness" tends to increase in proportion to the level of processing. These observations taken together seem to indicate that the participation of transnational *industrial* firms is more marked in those areas where the value-added is high. This finding is borne out by the bird's-eye look, given in Section II of the marketing structure of individual commodities which are major interest

⁵A pioneering work analysing this census data base up to 1977 has been published by Professor G. Helleiner of the University of Toronto (Helleiner, 1981a). The analysis made in the present study deals with the 1981 trade figures. More recent figures are not available, since the U.S. Bureau of the census has decided to discontinue data collection since that date. While Helleiner's work on the U.S. related-party trade covers all product groups from all countries, this study puts emphasis on the commodity sector, with special reference to Latin America and the Caribbean. Ideally, the analysis should cover similar data for other industrialized countries, but unfortunately they are not available.

⁶The United States absorbs more than 30% of the Latin American and Caribbean commodity exports. Furthermore, in view of the continuing importance of commodities in U.S.-Latin American trade overall —they account for more than three-quarters of the region's exports to the United States— the results should reveal some major features of the system of trade between the two groups of countries.

to Latin America. In this section an attempt is also made to bring out some major factors responsible for such variability in the degree of intra-firm (or related-party) trade among different groups of products.

In contrast, as discussed in Section III, for commodities exported in a raw or semi-processed form the participation of transnational *trading* companies is high. A high level of intermediation by traders, nevertheless does not mean that the commodity markets approximate themselves to the free market operations as postulated under neoclassical theory. In this section, major characteristics and features of the commodity markets and principal agents are examined in a theoretical framework, and the conclusions drawn give little support for the wide applicability of the neoclassical theory to the behaviour of these markets.

Section IV reviews the past experience of some producers' associations and the participation of Latin American countries in them in order to draw some lessons for future actions. The performance of Latin American State Trading Organizations (STOs) is also examined. It is argued that though the consulting and co-ordinating capacities of these organizations have brought about some substantial improvements in the respective industries, the problems associated with over-production and marketing have been little touched upon by them. Examination of these cases seems to imply that only co-ordination and co-operation based on strong political will can safeguard the common interests of the respective industries, and these organizations should step forward to be directly engaged in marketing activities.

I

The commercial environment for primary commodities: an analysis based on U.S. "intra-firm" and "related-party" transactions

1. U.S. intra-firm trade

International trade takes place within a very tightly controlled market environment where possibly 30-40% of global trade is on an intra-firm (broadly understood as a transaction between entities of the same concern) or related-party (between entities owning 5% or more of the total equity of the concern) basis. Another 30% is likely to constitute State trading and a further share is captive in nature as a result of sub-contracting or long-term contract agreements (UNCTAD, 1981a). Increasing rapidly in recent years are counter-trade schemes, which are estimated to account for at least 25% of world trade (Carey and McLean, 1986, p. 443). The illusionary concept of a freely competitive international market is narrowed down still further by the increasing tariff and non-tariff barriers imposed by both the developed and developing countries. Of course, some of the above are not mutually exclusive.

In view of the general acknowledgement that the developing countries' exports are pitted against a relatively small and organized group of buyers (see, for instance, UNCTC, 1983, Chapter 5), this sub-section tries to quantify and examine the degree of participation of TNCs in the marketing sphere of primary commodities. The selection of this sector reflects its vital importance for Latin American and Caribbean economies, accounting as it does for roughly 75% (excluding petroleum and its products, close to 35%) of regional merchandise exports (ECLAC, 1984 b).

A major point of interest is therefore the extent to which the transactions in commodities are intra-firm (or related-party) as against those effected at "arm's length". The term "intra-firm trade" indicates that which takes place between entities linked by direct investment,⁷ and includes trade not only between parent firms and wholly-owned subsidiaries, and between parents

and majority-owned foreign affiliates (MOFAs), but also that between parents and minority-owned foreign affiliates. The definition of arm's length trade includes all types of sales between two or more independent entities, for either immediate or forward delivery, long-term contracts, or under preferential arrangements.

The exercise of quantifying and analysing the trading activities of TNCs is constrained by lack of data. Global intra-firm data are not available, for systematic collection of such data is presently not undertaken by governments (see note 5). The United States is the only country which collects comprehensive information in this regard and publishes it (through the Department of Commerce) in the form of benchmark surveys, the latest being *United States Direct Investment Abroad 1982* (U.S. Department of Commerce, 1985). The same organization also publishes annual surveys of the international investment position of the United States abroad and of U.S. affiliates of foreign firms operating in the U.S. The data contained in these documents, however, do not allow an examination of the marketing structure, by country and product, at a reasonably detailed level.

Nonetheless, the overall implications of the above-mentioned U.S. publications, taken together with results of other studies on other industrialized countries, are extremely important in that they show that TNCs are responsible for a large share of international trade flows. In the case of the United States, table 1 shows that in 1982 this share was approximately 40% of imports and 35% of exports by U.S. companies' affiliates abroad —being understood as entities owning 10% or more of the voting stock— or by

⁷Direct investment is said to exist, in the case of the United States, for example, when 10% or more of the voting securities of a foreign enterprise is owned by a U.S. person.

foreign parents with their affiliates in the United States. It has also been observed that the proportion of intra-firm exports in the total exports of the United Kingdom increased from 29% in 1976 to 31% in 1980. The 1980 survey for Japan also reveals that intra-firm trade corresponded to 26% and 25% of total national exports and imports, respectively, of that year (Japan, MITI, 1983, table 55). A sample of the world's largest industrial enterprises for 1977 showed that one-third of all parent company exports consisted of intra-firm sales, with the share varying from 45% for U.S. firms, to 30% for those based in Western Europe and 17% for Japanese firms (Dunning and Pearce, 1981).

¹ Elaborating further exclusively on the intra-firm trade of the United States, of total U.S. imports associated with U.S. TNCs amounting to US\$120.8 billion in 1982: i) imports shipped by foreign affiliates to U.S. parents came to US\$41.6 billion (34.4%); ii) imports shipped by foreign affiliates to unaffiliated U.S. entities were US\$9.8 billion (8.1%); and iii) imports shipped by unaffiliated foreigners to U.S. parents amounted to US\$69.4 billion (57.5%). Among the three categories, only group i) falls under the definition and constitutes part of U.S.

intra-firm trade. Within this group, the U.S. 1982 benchmark survey provides data on U.S. imports shipped by MOFAs to U.S. parents at a one or two digit Standard International Trade Classification (SITC) level. United States imports shipped by MOFAs were US\$38.5 billion. In table 2, these intra-firm trade figures are contrasted with the total imports of corresponding SITC groupings in order to assess the relative importance of intra-firm trade within and across different sectors.

Looking at the data by countries of affiliates, as in the table, 32.3% of U.S. imports shipped by MOFAs were petroleum and its products, 27.4% were road motor vehicles and parts, and 22.1% were machinery. Imports of other products were relatively small. By region of MOFAs, imports from developed countries exceeded those from developing countries, overall as well as in such categories as food, petroleum and machinery.

In relation to the total U.S. import values of individual SITC groupings, imports from MOFAs to U.S. parents were most pronounced in road vehicles and parts (32.9%), machinery (20.9%), and petroleum and products (18.4%). For the developing regions as well, these three sectors were those which showed a high intra-firm trade

Table 1
INTRAFIRM TRADE OF THE UNITED STATES, 1982

(Billions of dollars)

Imports		Exports	
1. Imports from affiliated foreign firms	83.4	1. Exports to affiliated foreign firms	60.2
2. Imports from foreign affiliates of US parents	41.6	2. Exports to foreign affiliates of US parents	46.6
3. Total imports from affiliates (1+2)	125.9	3. Total exports to affiliates (1+2)	106.8
4. Overlap between 1 and 2	(30-35)	4. Overlap between 1 and 2	(30-35)
5. Total US merchandise imports	243.9	5. Total US merchandise exports	212.3
6. Percentage of affiliated imports (3-4)/5	37.3-39.3	6. Percentage of affiliated exports (3-4)/5	33.8-36.2

Source: Item 1: US Department of Commerce (1984, table 8). In this survey, a US affiliate is a US business enterprise in which there is foreign direct investment - that is, a single foreign person owns or controls, directly or indirectly, 10% or more of the voting securities if an incorporated business enterprise or an equivalent interest if an unincorporated business enterprise.

2: US Department of Commerce (1985 b, table 3). Affiliate is defined as "ownership directly or indirectly by one US person of 10% or more of the voting securities of an incorporated foreign business enterprise or an equivalent interest in an unincorporated foreign business enterprise".

3: Total US imports are on a Census basis and represent transaction values, f.a.s. the foreign port of exportation. Similarly, total US exports are on a Census basis and represent transaction values, f.a.s. the US port of exportation.

4: As the Department of Commerce acknowledges, exports and imports by US affiliates of foreign firms (item 1) cannot be simply added to US exports and imports associated with US parents (item 2), due to duplication in the two data sets. To the extent that US affiliates of foreign firms in turn had affiliates abroad, they would have been considered the US parents of those foreign affiliates in the 1982 annual survey. A highly preliminary match between the companies reported in both surveys indicated that the overlap for exports and imports was sizeable, roughly US\$30-35 billion each (Department of Commerce, 1985 c).

Table 2

IMPORTANCE OF US IMPORTS SHIPPED BY MOFA's TO US PARENTS AS A PERCENTAGE
OF OVERALL US IMPORTS, BY COUNTRY OF AFFILIATES AND BY PRODUCTS, 1982^a

(Millions of dollars)

Country of affiliate	Total SITC groups	Food	Beverages and tobacco	Crude materials, inedible, except fuels	Petroleum and petroleum products	Coal and coke	Chemicals	Machinery	Road vehicles and parts	Other transport equipment	Metal manufactures	Other manufactures	Other
	0-9	0	1	2	3	32	5	71-77	78	79	67, 68, 69	61-66, 8	4, 9
Imports originating from:													
Developed countries^b													
Total imports (i)	147 982	5 785	2 847	6 389	16 581	85	8 634	28 433	31 534	2 956	16 030	23 142	5 653
By MOFA's (ii)	21 813	218	210	1 017	3 494	6	1 175	3 466	10 016	245	738	1 198	30
(ii)/(i) (%)	14.7	3.8	7.4	15.9	21.1	7.1	13.6	12.2	31.7	8.3	4.6	5.2	0.5
Canada													
Total imports (i)	46 792	1 872	440	4 444	7 948	56	2 371	4 813	11 308	929	3 179	6 184	3 005
By MOFA's (ii)	16 551	35	51	628	d	0	d	1 645	9 855	214	245	701	d
(ii)/(i) (%)	35.4	1.9	11.6	14.1		-		34.2	87.2	23.0	7.7	11.3	
EEC (10 countries)													
Total imports (i)	44 462	1 190	2 209	513	6 853	2	3 719	11 623	5 134	1 372	4 984	8 161	1 629
By MOFA's (ii)	3 266	50	132	43	383	0	546	1 172	149	30	372	372	19
(ii)/(i) (%)	7.3	4.2	6.0	8.4	5.6	-	16.7	10.1	2.9	2.2	7.5	4.6	1.2
Japan													
Total imports (i)	39 916	302	19	72	30	4	923	12 814	14 103	402	5 639	5 330	340
By MOFA's (ii)	762	d	0	e	0	1	17	d	2	0	d	83	0
(ii)/(i) (%)	1.9	-	-	-	-	25.0	18.4	-	-	-	-	1.6	-
Total imports from all countries (i)	254 862	15 717	3 666	9 437	67 500	91	9 885	40 794	32 074	3 236	20 414	44 219	7 923
Imports by MOFA's, all countries (ii)	38 533	921	272	1 471	12 437	6	1 331	8 511	10 549	262	1 026	1 714	34
(ii) / (i) (%)	15.1	5.9	7.4	15.6	18.4	6.6	13.5	20.9	32.9	8.1	5.0	3.9	4.3

Table 2 (concluded)

Country of affiliate	Total SITC groups	Food	Beverages and tobacco	Crude materials, inedible, except fuels	Petroleum and petroleum products	Coal and coke	Chemicals	Machinery	Road vehicles and parts	Other transport equipment	Metal manufactures	Other manufactures	Other
	0-9	0	1	2	3	32	5	71-77	78	79	67, 68, 69	61-66, 8	4, 9
Imports originating from:													
Developing countries^{bc}													
Total imports (i)	103 211	9 645	771	2 874	50 158	5	934	12 186	506	269	4 143	19 477	5 924
By MOFA's (ii)	16 720	703	62	454	8 943	0	156	5 045	3534 ^f	17	288	515	3
(ii)/(i) (%)	16.2	7.3	8.0	15.8	17.8	-	16.7	41.4	105.5	6.3	7.0	2.6	-
Latin America													
Total imports (i)	39 570	6 828	432	1 515	20 323	5	678	3 263	317	135	1 673	3 062	1 344
By MOFA's (ii)	6 251	621	39	295	3 086	0	123	1 279	534 ^f	d	72	189	d
(ii)/(i) (%)	15.8	9.1	9.0	19.5	15.2	-	18.9	39.2	168.5	-	4.3	6.2	-
Africa													
Total imports (i)	16 399	1 088	29	383	14 265	-	9	16	-	-	478	77	117
By MOFA's (ii)	2 544	0	d	d	2 350	0	0	e	0	0	d	d	0
(ii)/(i) (%)	15.5	-	-	-	16.5	-	-	-	-	-	-	-	-
Asia													
Total imports (i)	47 129	1 665	309	976	15 571	-	247	8 922	189	133	1 973	16 333	578
By MOFA's (ii)	7 925	82	d	d	3 508	0	32	3 766	0	d	d	d	d
(ii)/(i) (%)	16.8	4.9	-	-	22.5	-	13.0	42.2	-	-	-	-	-

Source: Figures for MOFA's are taken from US Department of Commerce (1985 b). Trade figures by SITC grouping are from United Nations, *Commodity Trade Statistics*.

^aIn this table, data for affiliates are only for non-bank affiliates of non-bank parents. MOFA's (Majority Owned Foreign Affiliates) are defined as affiliates owned more than 50% by all US parents combined.

^bExcludes centrally planned economies.

^cThe sum of the three developing regions does not add up to the total of developing countries, due to the exclusion of Oceania.

^dSuppressed to avoid disclosure of data of individual companies.

^eLess than \$500 000 (+/-) or 50 employees.

^fImports shipped by MOFA's exceed the overall total, due probably to reporters' incorrect classification of transportation equipment, parts and accessories.

Table 3

US RELATED-PARTY TRADE AS A PERCENTAGE OF TOTAL IMPORTS
(CUSTOMS VALUES), BY US TARIFF SCHEDULE (TSUS), 1981

TSUS schedule	Product group	Schedule number	Total imports (US\$ million) (A)	Related-party trade (US\$ million) (B)	(B)/(A) %
Schedule 1	Animal and vegetable products	100.0110-193.2560	20 261	3 440	17.0
2	Wood and paper; printed matter	200.0300-274.9040	9 647	2 405	24.9
3	Textile and textile products	300.1020-390.6000	9 780	1 377	14.1
4	Chemicals and related products	401.0200-495.2000	94 796	49 870	52.6
5	Non-metallic minerals and products thereof	511.1100-548.0500	5 874	1 099	18.7
6	Metals and metal products	601.0300-696.6000	97 127	61 413	63.2
7	Specified products; miscellaneous and non-enumerated products	700.0500-799.0000	20 179	6 727	33.3
8	Special classification provision	800.0000-870.4500	4 687	2 046	43.6
Appendix to the tariff schedules		901.0020-957.1500	363	341	93.9
Total			259 012	126 788	49.0

Source: Data provided by the Foreign Trade Division of the US Bureau of the Census.

ratio. Though it was not possible to make a direct comparison, due to the manner in which the SITC groupings were aggregated by the Department of Commerce, those categories usually understood to constitute primary commodities (SITC 0-4; 68) can be said to have a relatively low intra-firm ratio. Latin America does not differ significantly from other developing regions in terms of relative sectoral importance in the intra-firm import trade of the United States.

2. U.S. related-party trade (RPT)

For an examination by individual country and at a much more disaggregated product level, the data employed below are those of the Foreign Trade Division of the U.S. Bureau of the Census, and show the value and volume of U.S. imports, within each individual tariff classification of the U.S. tariff schedule (TSUS) and from each country of origin, which originate from "related parties". The definition of a "related party" is a firm in which 5% or more of the voting stock is

owned by the other party with which it trades. The coverage is for both U.S. firms and for firms based outside the United States.

Examination of the 1981 figures indicates that, for that particular year, 49.0% of total U.S. merchandise imports were transacted in the form of RPT (table 3). This coincides roughly with the figures of 45.0% and 48.8% for 1975 and 1977 respectively given in the studies by Helleiner (1979; 1981), though indicating a slight increasing trend over the years. The overall figure also seems to be in conformity with the results obtained from the 1982 benchmark survey just mentioned above: a lower intra-firm import ratio of roughly 40% (table 1) could be explained by the difference in definition of the coverage of capital ownership between RPT and direct investment (10% or more of the voting securities of a foreign enterprise owned by a U.S. entity). The wide variations in RPT ratios observed among major product groups, even at the most aggregated level, are also in accordance with the results of the 1982 benchmark study. In

the case of RPT ratios, in general, high ratios were observed for manufactured goods, especially in the heavy industrial sectors, while animal and vegetable products and non-metallic minerals registered a relatively low RPT coefficient. An exception to the above was textiles and their products. Two groups (chemicals, and metals and their products) were most dominant in this respect, accounting for 74.1% of total imports and 87.8% of the RPT total.

RPT can be disaggregated further along the TSUS sub-groupings and compared with total U.S. imports, as shown in table 4. It should be noted first that within each schedule, there was a large variation from product to product, in the agricultural as well as the mineral and metal sectors. Though generalization is difficult, the RPT rose as a proportion of the total as one moved from primary products, excluding petroleum, to semi-manufactures. Within primary commodities, the degree of "related-ness" tended to increase in accordance with the level of processing/manufacturing,⁸ an aspect to be further elaborated later on in the paper. A large number of commodities which are of major interest to the Latin American region showed an extremely low RPT ratio, as in the cases of hides and skins, sugar, beverages, cereals, spices and oilseeds.

The order of absolute RPT values at the sub-grouping level, was led by petroleum, followed by road vehicles; machinery for industrial use; electrical machinery; apparatus and appliances; iron and steel; precision apparatus; power generating machinery; general industrial machinery; office machines and automatic data processing equipment, etc. The manufacturing sectors mentioned herein were those in which high absolute import values were accompanied by high RPT ratios. As a primary commodity,

⁸This conclusion accords well with the findings by Helleiner on the earlier years. He indicated that this general pattern was found for the 1977 imports from both the Third World and OECD members. As he concluded, "other things being equal, one can expect increases in the role of related-party trade as industrialization proceeds in the Third World and the relative importance of their manufactured goods trade continues to rise". Mainly due to the interrelationship between RPT and manufacturing, Helleiner found that the relative importance of RPT seems to be much greater in the imports from the OECD countries than in the case of imports from the developing countries.

only aluminium exceeded the 1 billion dollar mark.

Lastly, on the basis of the same data it is possible to examine the degree of RPT in primary commodities with special reference to Latin America and the Caribbean, as shown in table 5.⁹ In this exercise, the product was analysed at a 7-digit TSUS, on the assumption that further disaggregation would shed more light on the participation of TNCs in the international marketing of commodities. Furthermore, individual commodities were grouped together and compared in accordance with their degrees of processing. Products selected here were of major export interest to the region.

One of the principal findings of this exercise was that in some commodities (such as bauxite/alumina/aluminium and bananas) the RPT ratio was extremely high, while in others, it was nearly non-existent (as in sugar) or very low (in the case of cocoa beans and coffee beans). Looking at the commodity sector alone, however, it can be concluded that those items of importance to the region registered, with some exceptions, low RPT ratios. This seems to suggest that the number of commodities which display total integration from production to the last stage of external marketing is not large.

The above analysis also highlights the point that within a given commodity group (with some exceptions) a higher RPT ratio is observed for products with a higher level of processing, and thus higher value-added. Good examples of this are the product chains of: i) cocoa beans/cocoa butter/chocolate; ii) live animals/meat/meat preparations; iii) hides and skins/footwear; iv) timber/lumber/furniture; v) leaf tobacco/manufactured tobacco; and vi) some mineral ores/metals, as in the case of copper and tin. What may be inferred from this is that transnational *industrials* are involved and practice most effective market control in the downstream processing activities where the value-added is high. Those high value-added activities usually involve the use of brand names, heavy advertising and product differentiation, as

⁹Due to the very detailed nature of the information contained in the data provided by the U.S. Bureau of the Census, the figures are aggregated at the regional level. For figures at the individual tariff schedule level and by country, see ECLAC (1986 c, table 3).

Table 4

US IMPORT STRUCTURE: RELATED-PARTY TRANSACTIONS
BY US TARIFF SCHEDULE (TSUS), 1981

Product sub- groupings	Product descriptions	Total imports, customs values (US\$ 000)	Related-party transactions, customs values (US\$ 000)	(B)/(A) (%)
		(A)	(B)	
101	Animals, live	359 928	45 114	12.5
102A	Bird meat	3 371	247	13.6
102B	Other meat and meat preparations	1 990 274	432 569	21.7
102	Meat and meat preparations	1 993 645	432 816	21.7
103A	Fish, fresh, chilled or frozen	1 282 896	495 229	38.6
103B	Fish, dried, salted	81 440	2 928	3.6
103C and D	Fish, prepared or preserved	230 901	40 176	17.4
103E	Crustaceans and molluscs, prepared or preserved	1 333 155	236 220	17.7
103	Fish and fish preparations	2 928 393	774 552	26.4
104A and D	Milk and cream	16 088	10 286	63.9
104B	Butter and fresh or sour cream containing over 45% butterfat	2 155	34	1.6
104C	Cheese and curd	332 062	39 202	11.8
104D	Birds' eggs and birds' egg albumen and yolks	5 541	777	14.0
104	Dairy products and eggs	335 846	50 299	14.1
105A	Hides and skins (except furskins), undressed, raw or cured	454 989	8 430	1.9
105B	Furskins	193 795	3 538	1.8
105	Hides, skins and furskins, undressed, raw or cured	648 783	11 968	1.8
106A	Plants, live	67 830	20 152	29.7
106B	Seeds of plants	57 714	6 387	11.1
106	Plants and their seeds	124 543	26 539	21.3
107	Barley, buckwheat, corn, sorghum, oats, rice, rye, wheat, starches	95 060	6 436	6.8
108	Vegetables, fresh, frozen or temporarily preserved, and dried leguminous vegetables, roots and tubers	839 061	403 165	48.0
109	Fruits and nuts, fresh or dried, prepared or preserved	1 605 124	616 484	38.4
110A	Sugar, sirups, molasses and honey	2 306 812	25 558	1.1
110B	Cocoa beans, butter, powder and chocolate	876 212	101 192	11.5
110C	Other food preparations containing cocoa or chocolate	123 759	53 484	43.4
110	Sugar, molasses, honey; cocoa and its products	3 306 783	180 234	5.5
111A	Coffee, tea, mate	3 019 422	147 390	4.9
111B	Spices	136 033	2 425	1.8
111	Coffee, tea, spices and manufactures thereof	3 155 456	149 814	4.7
112A and B	Beverages nonalcoholic	656 672	137 612	21.0
112C and D	Beverages alcoholic	2 338 086	460 091	19.7
112	Beverages	2 668 024	489 658	18.4
113	Tobacco and its manufactures	184 140	36 456	19.8
114	Oilseeds, oil nuts and oil kernels, non-specified	558 039	32 619	5.8
115	Cereal preparations and miscellaneous food preparations	1 068 893	159 967	15.0

Table 4 (continued 1)

Product sub- groupings	Product descriptions	Total imports, customs values (US\$ 000) (A)	Related-party transactions, customs values (US\$ 000) (B)	(B)/(A) (%)
Schedule 1	Animal and vegetable products	20 260 724	3 440 047	17.0
201, 202, 203	Wood, lumber, cork	3 482 229	426 074	12.2
204	Pulp and paper	5 559 341	1 824 329	32.8
205	Books, printed matter	605 633	154 453	25.5
Schedule 2	Wood and paper; printed matter	9 647 202	2 404 855	24.9
301A	Cotton fibre, waste, yarn	49 763	14 327	28.8
301B	Other textile fibres, waste, yarn, abaca, flax, hemp sisal, henequen, jute, etc.	44 402	1 740	3.9
301C	Wool and other animal hair and yarn	222 138	22 003	9.9
301D	Raw silk, yarn	12 483	2 554	20.5
301E	Manmade fibres	218 640	72 738	33.3
301F	Other yarns	1 404	564	40.2
301	Textile fibres, waste, yarn	548 829	113 927	20.8
302	Cordage, twine	103 597	12 798	12.4
303A	Cotton fabrics	590 143	37 479	6.4
303B	Fabrics, vegetable fibres	160 893	15 041	9.3
303C and D	Woven fabrics, silk, wool	205 069	13 205	6.4
303E and F	Woven fabrics, manmade fibres	553 637	180 422	32.6
303	Textile fabrics	1 509 741	258 415	17.1
304	Knitfabrics of textile fibres, narrow fabrics, lace, netting, etc., special textile fabrics and related products	310 552	124 254	40.0
305	Floor coverings, tapestries, and particles of vegetable plaiting materials	527 799	48 153	9.1
306	Wearing apparel and accessories	6 512 782	778 905	12.0
307	Bags, ornaments, ribbons, rags, wipenings	268 647	40 145	14.9
Schedule 3	Textile fibres and textile products	9 779 948	1 376 598	14.1
401	Organic chemicals and related products	2 141 409	1 133 549	52.9
402	Inorganic chemicals and related products	4 067 633	1 803 397	44.3
403	Medical and pharmaceutical products	711 178	392 081	55.1
404	Synthetic resins; and rubber and plastics materials	1 181 082	455 277	38.5
405, 406, 407	Essential oils and perfume			
408 and 409	materials, toilet, polishing and cleansing preparations	813 493	137 427	16.9
410	Crude petroleum, petroleum products	80 337 109	43 324 614	53.9
411	Fertilizers, manufactured	1 393 909	425 176	30.5
412	Explosives	20 720	4 291	20.7
413	Animal and vegetable oils and fats, processed, fatty acids, waxes of animal, vegetable or mineral origin	417 575	141 172	33.8
Schedule 4	Chemicals and related products	91 094 107	47 940 701	52.6
501	Crude materials, graphite, cement, limestone, marble, stone, mica, asbestos; natural abrasives, crude or processed, including industrial diamonds, natural or synthetic, other precious and semi-precious stones	4 153 492	624 336	15.0
502A and B	Clay and refractory construction materials	275 742	56 404	20.5

Table 4 (continued 2)

Product sub- groupings	Product descriptions	Total imports, customs values (US\$ 000)	Related-party transactions, customs values (US\$ 000)	(B)/(A) (%)
		(A)	(B)	
502C, D and E	Pottery, porcelain or china household ware, earthenware or stoneware, ceramic, and china ornamental articles	780 264	201 044	25.8
503	Glass, glassware, and articles thereof	664 104	217 332	32.7
Schedule 5	Non-metallic minerals and products thereof	5 873 604	1 099 116	18.7
601	Non-ferrous metals, ores	2 372 504	953 087	40.2
602A	Precious metals, incl. gold and silver	3 859 783	508 053	13.2
602B	Iron and steel, various types and forms	11 260 776	7 330 680	65.1
602C	Copper and copper alloys, wrought and unwrought, waste and scrap, and related products	1 151 028	213 198	18.5
602D	Aluminium and aluminium alloys, wrought and unwrought, waste and scrap, and related products	1 384 909	1 029 879	74.4
602E	Nickel and nickel alloys, wrought and unwrought, waste and scrap, and related products	895 639	563 895	63.0
602F	Tin and tin alloys, wrought and unwrought, waste and scrap and related products	645 312	182 812	28.3
602G	Lead and lead alloys, wrought and unwrought, waste and scrap, and related products	89 559	21 156	23.6
602H	Zinc and zinc alloys, wrought and unwrought, waste and scrap, and related products	562 257	104 137	18.5
602 I, J and K	Other metals and alloys, waste and scrap, and related products	616 227	36 516	5.9
602	Non-ferrous metals	20 456 490	10 072 509	49.2
603	Manufactures of metal	5 658 425	1 140 220	20.2
604A	Power generating machinery and equipment, general industrial machinery and equipment	6 342 651	2 989 773	49.1
604B	Mechanical handling equipment	1 612 466	909 889	56.4
604C	Agricultural and horticultural machinery (except tractors), food processing machinery	748 306	442 585	59.1
604D	Printing and bookbinding machinery and parts thereof	671 196	240 299	35.8
604E	Textile machinery; washing, bleaching, dyeing	965 313	490 416	50.8
604F	Metal working machinery, machine tools	2 268 852	1 206 397	53.2
604G	Office machines and automatic data processing equipment	3 492 998	2 565 045	73.4
604H	Shoe machinery, machinery for sorting, molding, cigarette making, audio-players, radios, etc.	1 766 375	857 068	48.5
604J	Balls, ball bearings, valves, etc.	1 554 368	779 448	50.1
604	Machinery of industrial use	19 422 528	10 480 920	54.0

Table 4 (concluded)

Product sub- groupings	Product descriptions	Total imports, customs values (US\$ 000)	Related-party transactions, customs values (US\$ 000)	(B)/(A) (%)
		(A)	(B)	
605	Electrical machinery, apparatus and appliances	11 160 255	8 048 663	72.1
606	Road vehicles, other transport equipment	31 776 287	26 574 475	83.6
Schedule 6	Metals and metal products	97 127 166	61 412 971	63.2
701A	Footwear	8 141 218	234 138	7.5
701B	Headwear of all materials	154 524	20 455	13.2
701C	Gloves of textile fibres, rubber, plastic	215 507	72 150	33.5
701D	Travel goods, handbags	290 807	51 303	17.6
701	Various wearing articles	3 802 056	378 046	9.9
702A	Contact lenses, optical lenses	779 071	293 797	37.7
702B	Medical equipment and apparatus	672 467	357 704	53.2
702C and D	Professional and scientific instruments	1 187 876	676 706	57.0
702E	Watches and clocks	1 250 716	645 961	51.6
702F	Photographic apparatus and equipment	1 463 403	1 006 109	71.7
702G	Motion-picture film, phonograph records, recorded tapes, etc.	393 874	228 781	58.1
702	Precision apparatus and equipment	5 687 406	3 209 058	56.4
703	Musical instruments, cases, parts	262 852	119 206	45.4
704A	Furniture	1 256 706	321 764	25.6
704B	Floor coverings	36 059	7 909	21.9
704	Furniture and floor coverings	1 292 765	329 673	25.5
705A	Firearms, munitions, cartridges	159 659	29 459	18.5
705B	Fishing equipment	136 999	36 809	26.9
705C	Bicycles, baby carriages	340 533	73 873	21.7
705D	Sporting equipment	1 140 403	356 968	31.3
705E	Toys	862 303	222 977	25.9
705	Sporting goods and toys	2 639 897	721 086	27.3
706, 707, 708	Other manufactured articles	1 642 567	251 002	15.3
709, and 710	Art works, antiques	725 809	35 191	4.8
711	Rubber manufactures	2 784 515	1 515 538	54.4
712	Miscellaneous	828 916	141 036	17.0
Schedule 7	Specified products; miscellaneous and non-enumerated products	20 178 878	6 726 712	33.3
801, 802, 803	US goods returned, re-imported goods			
804, 805, 806	for public use and institutions	4 687 375	2 046 316	43.7
Schedule 8	Special classification provision	4 687 375	2 046 316	43.7
901, 902, 903,				
904, 905	Miscellaneous	362 945	340 709	93.9
Schedule 9	Appendix to the tariff schedules	362 945	340 709	93.9
SCH 1 - 9	Total	259 011 948	126 788 024	49.0

Source: Data provided by the Foreign Trade Division of the US Bureau of the Census.

Table 5
STRUCTURE OF US PRIMARY COMMODITY IMPORTS: RELATED-PARTY
TRADE, BY TSUS AND BY REGION, 1981
(Thousands of dollars)

TSUS No.	Product description	Total import value (A)		Total related-party (B)		(B)/(A) %	
		Latin America	All countries	Latin America	All countries	Latin America	All countries
1061029	Beef with bone, fresh, chilled	1 380	21 523	0	42	-	0.2
1061060	Beef without bone, fresh, chilled, frozen	189 957	1 313 897	14 844	283 247	7.8	21.6
1074820	Corned beef	96 526	97 003	27 877	28 011	28.9	28.9
1074840							
1144545	Shrimps and prawns, shell-on	491 759	537 818	112 624	116 543	22.9	21.7
1201400	Cattle hides, raw or cured	136	28 716	-	1 397	-	4.9
1216138	Bovine leather, not fancy, n.s.p.	18 464	29 777	-	629	-	2.1
7002960 ^a	Footwear, leather	419 877	1 590 007	15 392	119 873	3.7	1.5
1464000	Bananas, fresh	708 956	709 496	499 621	500 048	70.5	70.5
1552045	Cane or beet sugar, syrup, molasses, n.s.p.	1 483 982	2 292 585	-	17 083	-	0.7
1561000	Cocoa beans	157 131	501 346	450	16 991	0.2	3.4
1562000	Chocolate, unsweetened	78 617	89 196	8 607	10 730	10.9	12.0
1563500	Cocoa butter	125 216	228 115	13 581	29 043	10.8	12.7
1601020	Coffee, crude	1 915 862	2 769 649	46 940	113 311	2.4	4.1
1601040	Coffee, roasted or ground	32 860	40 564	1 881	4 227	5.7	10.4
1602000	Soluble or instant coffee, no additives	212 629	227 321	6 974	15 153	3.3	6.7
1653540	Orange juice, concentrated	197 581	199 108	564	565	0.3	0.3
1703210							
1703230	Cigarette leaf tobacco, not stemmed	17 184	43 757	3 401	14 778	19.8	33.8
1706020	Cigar leaf scrap tobacco	20 594	37 186	518	616	2.5	1.7
1706600							
1707000	Cigars	26 271	28 045	9 979	9 981	40.0	35.6
1708045	Tobacco, manufactured or not	75 549	146 712	9 398	26 652	12.4	18.2
2003549	Hardwood logs and timber	579	1 236	3	-	0.1	0.1
2023200							
2023420	Lumber, balsa/teak, mahogany and others	54 371	83 851	185	747	0.3	0.1
2024400							
2026600	Hardwood moldings, carvings, etc.	6 098	24 680	2 335	4 303	38.3	17.4
2070080	Articles of wood, n.s.p.	5 721	70 639	2 218	6 426	38.8	9.0
2400320							
2402360	Hardwood veneers, plywood	22 758	176 739	9 078	17 396	39.9	9.8
7272900							
7273540	Wooden chairs, furniture and parts	31 358	791 119	5 220	107 384	16.6	13.6
7275560							
3001040	Raw cotton, n.s.p.	4 573	5 246	4 026	4 026	88.0	76.7
3013000	Cotton yarn, hot bleached	6 699	10 386	16	16	0.2	0.2
3044600	Sisal and henequen, waste	950	2 228	-	-	-	-
3063172	Wool finer than 58s	20 082	56 999	667	13 251	3.3	23.2
6010600	Crude bauxite	357 915	491 015	271 671	374 256	75.9	76.2
4171240	Aluminium oxide (alumina)	236 206	880 557	138 909	448 090	58.8	50.9
6180200	Aluminium, unwrought, not alloyed	901	359 001	-	309 437	-	86.2
6180650	Aluminium, unwrought, alloyed	4 428	220 244	3	27 622	0.1	12.5
6182565	Aluminium, sheets and strip	42 202	548 690	2 117	433 178	0.5	78.9
4751010	Crude petroleum, 250 deg. API or over	7 012 018	58 560 007	3 221 099	35 456 288	45.9	60.5
6012430							
6012450	Iron ore	253 164	835 041	13 774	454 505	0.5	54.5
6012760	Manganese ore	6 649	39 538	145	5 897	2.2	14.9
6015400	Tungsten ore	32 252	92 710	6 408	8 586	19.8	9.3
6021011	Lead ore, initially treated	20 309	22 272	-	-	-	-
6240350	Lead, unwrought, not alloyed	24 431	69 358	14 373	14 473	58.8	20.9
6022022	Zinc ore, initially treated	34 785	113 458	-	32 704	-	28.8
6260200	Zinc, unwrought, not alloyed	106 844	567 827	31 827	109 679	29.8	19.3
6023033	Copper ore, initially treated	17 218	55 502	97	1 843	0.1	3.3
6120640	Copper, unwrought, not alloyed	296 330	598 336	10 644	54 652	3.6	9.1
6220200	Tin, unwrought, not alloyed	130 147	645 386	13 831	182 751	10.6	28.3
6220420	Tin, unwrought, alloyed	1 152	3 688	-	1 319	-	25.8

Source: Data provided by the Foreign Trade Division of the US Bureau of the Census.

^aThis group includes 7002980, 7003515, 7003530, 7004510, 7004540, 7004560.

in the case of most food and beverage markets like those of chocolate, processed tea or coffee.

The degree of RPT in Latin American commodity exports to the United States was not significantly different from that in exports from all origins. Exceptions included processed wood products, tungsten ore, lead and zinc, in which the Latin American figure was higher. In the case of petroleum, the Latin American ratio was substantially lower than the corresponding one for the world.

What can be concluded from the preceding analysis is that though intra-firm trade (or RPT) is frequently found in industries or sectors in which there is a high degree of market concentration, it is not necessarily directly correlated with it. A high concentration in production/refining/processing does not necessarily imply an accordingly high intra-firm (or RPT) ratio.

The observations made up to now raise several interesting questions, namely: i) what factors are responsible for the high RPTs in manufactures and low RPTs for primary commodities in general? and ii) what are the reasons for the varying RPT ratios among different commodities? In short, an important question is why the TNCs, trading or manufacturing alike, decide to employ intra-firm trade (or RPT) rather than arm's-length trading in some commodities and not in others.

While bearing in mind the risks involved in generalizing issues of this nature, it may be said that TNCs are more likely to seek to internalize trade operations under the form of intra-firm trading when one or more of the following factors are of importance:¹⁰

- i) When intermediate inputs are highly specific to the firm in terms of quality, specifications and technology, as in the case of many manufactured goods, or of bauxite;
- ii) When there are substantial marketing and after-sale requirements for finished product sales, as is the case in many manufactured products, but less so in primary commodities;
- iii) When there are risks of intermediate input supply disruptions;

¹⁰Some of these points are mentioned in Helleiner (1981a, p. 54).

iv) When there are problems of perishability or limited storability of the product, as exemplified by bananas, which requires very timely co-ordination between production and marketing across different national boundaries;

v) When there is a protective umbrella against rising prices which allows a rise in raw material costs to be passed on to the final product price without too much difficulty. For instance, the share of bauxite in the final price of aluminium is very low, so that a large increase in bauxite prices will not affect too much the final price of aluminium. On the other hand, as in the case of the majority of commodities, the share of raw material costs is high and this produces a higher risk, thereby inducing a higher level of intermediation (such as that offered by trading companies) in order to reduce the risks arising from sudden price changes;

vi) When there is weak tax or exchange control which increases the potential for transfer pricing.

The concept of "transaction costs" is helpful in explaining the major differences in marketing between commodities and manufactured goods. These are the costs which are incurred by the transacting parties in a market exchange in order to enforce their exclusive rights to the assets or services being traded. R.H. Coase (1937) long ago pointed out that the operation of the market is not costless, and that *internalization* of certain functions, instead of arm's-length transactions, is a rationale for creating a firm. Internalization brings about efficiency in such areas of production as transaction, contracting and enforcing contracts. The brokerage cost of finding a correct price, the cost of defining the obligations of parties in a contract, the risk of scheduling and related input costs, and costs related to foreign exchange in the case of foreign trade are not insignificant. Reduction of these costs and of the risk and uncertainty associated with them is a justification for vertical integration. By integration, the organization can occasionally use administrative fiats to set internal prices, and can control the production and marketing of intermediate products.

Business by fiat creates opportunities for price maneuverability. Predatory pricing, price discrimination and transfer pricing are often-discussed incentives for integration on the part

of the manufacturer. For the trading company also, integration in the form of a worldwide subsidiary/branch office representative network not only facilitates information flows but also increases room for such tactics.

In addition to administrative fiat, there are two other levels of transacting: the price mechanism and contracts. J.C. McManus (1972), in attempting to describe the various forms of foreign business activities by a firm, explains that "some dimensions of interdependence, those in which transacting costs are relatively low, will be constrained by the price mechanism. For others, the members of the set may choose to constrain their actions by contractual arrangements. Some combination of these two means of constraining the actions of individual producers is the alternative to the establishment of an international firm".

In conjunction with this clarification, it is important to note that among the many areas of commodity trading, intermediation is most marked in transacting materials whose quality and quantity can be relatively easily specified by a contract. Such materials include raw cotton, grains, sugar, soybeans and their products, coal, copper, tin, rubber, wool, etc. These commodities also require little or no servicing or after-care once they are handed over to the respective buyers. In contrast to other areas (e.g., importation of technology), the brokerage cost of finding a correct price and the cost of contract enforcement are relatively minor. Within the same context, W.P. Rapp (1976) argues that the general tendency in foreign trade today is for large trading companies to deal with large producers because there is a minimum desirable marketing scale for each transaction.

II

Market structure and price determination

As noted in the preceding section, the marketing systems for primary commodities are of great variety: some rely on arm's-length type operations, others are traded intra-firm, while others adopt a mixture of the two. The complexity of the trade structure can be confirmed by the following illustration, at the individual product level.

Most *bauxite* is traded intra-firm —some three-quarters of all bauxite mined is refined within corporate systems¹¹ or at least by related parties. The remainder is sold under long-term contracts, with only small amounts left for the spot market. Similarly, in the case of *alumina*, only some 26-30% is traded outside integrated company systems and only 5-8% is sold in the spot market (Metal Bulletin, 1986). Therefore, only a small fraction of the total volume traded is exposed to—and thus responsive to—the fluctuations of the "freeness" of the spot market.

¹¹Outside the centrally planned economies, the industry continues to be dominated by the "Big Six": the Aluminum Company of America (ALCOA), Alusuisse, Pechiney-Ugine-Kuhmann, Alcan Aluminum Ltd., Reynolds Metals, and Kaiser Aluminum and Chemical Corporation.

However, within the same group, *aluminium* ingots have both a producer price and a London Metal Exchange (LME) and a New York Commodity Exchange (COMEX) price. As a matter of fact, the quotations on the exchanges have replaced the role of the producers' price, e.g., that of ALCAN, which for a long period of time was considered as the market price of aluminium.¹²

Iron ore exhibits a high concentration on both the buyer and the seller sides, as in bauxite, but prices are determined through a wide variety of mechanisms, ranging from bilateral negotiations on long-term contracts to transfer pricing.¹³ Even short-term contracts (usually for one

¹²One of the factors contributing greatly to the expansion of operations on the commodity exchanges in recent years, (in the cases of aluminium, nickel, copper and petroleum, for example) has been the great short-term swings in prices which made it increasingly difficult for producers to maintain long-established systems of administered prices on world markets.

¹³Long-term contracts are estimated to cover 70% of the international trade of iron ore. Western European long-term contracts are believed to cover about 40% of that region's iron ore import requirements, while Japan had already completed in 1976 arrangements to import all the iron ore it will need throughout the 1980's (Radetzki, 1980).

year) are often regularly renewed in such a way that relationships are built up which may extend over decades. In the case of this mineral, trading firms or trading arms of the steel companies are known to be the principal marketing agents. It is estimated that only about one-third, or even less, of world trade in this commodity is transacted in the "free" sector of the world market, i.e., without being covered by special marketing arrangements (Radetzki, 1980).

The frequency of long-term contracts for iron ore derives from the size of the investments required to mine it and the ensuing need to guarantee that the ore will be sold for a number of years, in order to ensure the company's solvency. Contracts negotiated between buyers in the Federal Republic of Germany and the Brazilian State mining company (CVRD), those between Japanese buyers and the Brazilian CVRD, and those between Japanese buyers and Australian mines normally act as "price setters" for the international market in iron ore (UNCTAD, 1984 l).

In the case of metallic copper, whether refined or unrefined, exports consist mainly of arm's-length transactions, and whether long- or short-term, all copper contracts are priced at some LME-related value over which a single trader rarely exercises a decisive influence. Although there is a high degree of vertical integration in the copper industry, with a few exceptions integration in copper is confined within national boundaries and the largest part of international trade takes place between independent entities. Even though LME and COMEX handle only 5-10% of the total trade in copper, their quotations act as the peg on which a much larger volume of copper contracts are based. Though the prices for sales of unrefined copper are LME-based, the determination of toll costs (deductions to cover the cost of processing) gives the buyers ample opportunities to use their negotiating power. Efforts on the part of developing country copper producers to integrate as far as the refining stage may be explained by their desire to overcome the existing imbalance in these respects. Even though there has been an increase in direct sales from countries in which national interests have assumed control over marketing,¹⁴ an important part of their sales is still handled by established agents or distributors

in the major copper consuming countries (UNCTAD, 1984 h).

With regard to tin, since mining and smelting operations have been mostly independently owned, the marketing is generally done among independent entities. The bulk of tin concentrates traded internationally is handled either directly by the producers or indirectly through trading companies. The bulk of trade in metal has traditionally been conducted by international traders, and their role as intermediaries is more pronounced in metal than in concentrates, mainly due to the diversified use of this metal at the consumer end (UNCTAD, 1984 j). The commodity exchanges which transact metals have played an important role in the price determination of tin. However, owing to the failure of arduous negotiations to secure a breakthrough in solving the tin crisis which has existed since October 1985, LME decided to suspend transactions of this metal. Considering the large size and great influence of LME's operations before the crisis (the Kuala Lumpur Tin Market in Malaysia was believed to represent about 20% of the international tin market, while LME had an even more direct influence), it can be concluded that this product has lost an important centre for price determination.

For lead and zinc, there is a dual price structure composed of the LME price and the producers' price. With respect to zinc, the prices published in *Metal Bulletin*, based in London, and *Metal Week*, based in New York, are taken as reference prices for contracts. For this metal, producers' prices, such as the European Producer Price, have a wide application and this is especially true for concentrates. The United States Producer Price has its validity in that country's own domestic market. In comparison with lead, zinc producers have little degree of forward linkage, so that they sell their production directly to consumers: a situation which has given rise to various producers' price systems. Due to this predominance of producers' prices, the proportion of transactions actually finalized at LME for

¹⁴The Chilean Copper Corporation (CODELCO) sells its copper directly through its selling offices in London, New York, and São Paulo and a network of agents in other markets. The direct sales effort of CODELCO is reflected in the fact that only 10-20% of Chilean copper is handled by international agents.

zinc is thought to be smaller than for lead or copper.

Among agricultural products, there are a group of commodities where market conditions *seemingly* approximate to those assumed by perfect competition: there are a large number of sellers and buyers, no one of which can, to a large extent, influence the price by their own actions. This appears to hold true for commodities sold by auction (e.g., *tea* and *tobacco*), but the price formation at the auction could be substantially influenced by the actions of a limited number of large-scale buyers. In most cases, these buyers have capital links with the world-leading processing firms of the developed market economies (UNCTAD, 1978; 1984 f). Contrary to what is generally assumed, these products face a high degree of oligopoly, and the transnational processing/manufacturing firms have achieved tight control from the stage of production to retailing in the major consuming markets. A handful of large TNCs control the world market through, *inter alia*, partial or total ownership of plantations, ownership relations with brokers, concentration of buying at auctions, ownership of processing facilities, dominant shares in major consuming markets, and increased market power through product differentiation and advertising. Also included in this category of products are *bananas*, which display probably

the highest level of integration by TNCs in production and marketing activities (FAO, 1986).

For other agricultural commodities (e.g., *coffee*, *cocoa*, *sugar*, *oilseeds* and *cotton*), operations in futures markets assume particular importance. The quotations in these markets are not only heavily influenced by prevailing supply and demand situations but also by hedging and speculative activities of the marketing and producer entities involved and especially by the selling/purchasing operations of large trading companies. All these products are highly sensitive to future expectations, thus allowing traders with "inside" knowledge to reap large speculative gains. As the raw material price looms high in the price of the final consumer product in these commodities, in order to avoid disproportionate risks in holding large stocks at hand, the major processors rely heavily on traders for the acquisition of the raw materials and for their hedging at commodity exchanges. Markets for meat, sugar, and grains, which all display high participation of large trading companies in the international markets, are composed of various fragmented national markets, where preferential channels or special arrangements, tariff and non-tariff barriers or export and production subsidies are important determinants of the direction of trade.

III

Marketing agents and major characteristics of primary commodity markets

1. Principal marketing agents

The foregoing analysis seems to suggest that for many primary commodities, the bulk of world trade is handled by entities other than transnational *industrials*. Various studies on the issue of commodity trading, emphasize instead the importance of a relatively small number of multinational, multi-product trading companies which are interposed between the producers and the consumers. These companies have extensive backward and forward linkages, but their main

line of business lies in the trading phase.¹⁵ According to one study (Chalmin, 1980), the bulk of the international commodity trade is in

¹⁵Though the importance of particular agents varies from product to product, it is increasingly difficult to draw a distinction on a product basis because of the very diversified activities of the trading agents. The distinction between manufacturing, mining and trading enterprises is also becoming blurred, due to their attempts to diversify into conglomerates with a wide range of interests. Manufacturing transnationals acquire or establish trading companies, trading companies expand their range of operations into manufacturing, banking, and the entire range of other services, and retailers acquire interests in manufactures.

the hands of about 50 companies, which are classified as *traders* rather than *industrials*.

The enormous size of international traders' operations and their control over the commodity sector are reflected in the fact that in 1980, of the roughly US\$980 billion global primary commodity exports, around 70 to 80% was controlled by multi-commodity traders. This figure includes US\$230 of US\$306 billion worth of crude petroleum exports under the control of the world's petroleum giants; and around US\$500 billion of US\$674 billion worth of the remainder of primary commodities, composed of agricultural, mineral and metal products and other fuels, under the control of multi-commodity traders and the trading affiliates of industrial TNCs (Clairmonte and Cavanagh, 1982).

Among international traders, the best-known are the Japanese multi-product traders, known as "sogo-shosha". This term is usually used in connection with the top nine trading firms in Japan, which controlled in 1985 more than 44% of Japanese exports and 72% of Japanese imports. Their combined total sales (domestic, exports, imports and offshore trade) accounted in the same year for 35% of the country's GNP. In 1985, the total combined sales for only the top nine companies came to US\$440 billion. Of this figure, US\$270 billion corresponded to foreign trade (imports to and exports from Japan and offshore transactions). It can be estimated, therefore, that the total foreign transactions of the nine companies —US\$135 billion one way— accounted for approximately 7% of global trade in that year (US\$1 900 billion). If the transactions by their wholly-owned subsidiaries and affiliates abroad are added to the above figures, it can be concluded that their participation in world trade rises to almost 10%. According to the *Forbes* 1985 sales ranking, excluding U.S. companies, the Mitsui Bussan Co., one of the two largest, came second only to Royal Dutch Shell. Seven of the nine sogo-shosha appear among the ten largest companies in the same ranking. Mitsui Bussan, jointly with Mitsubishi Shoji, according to a U.S. source, transacts roughly 10% of U.S. exports (U.S., Dept. of Commerce, 1985 a).

The size and complexity of commodity trading agents can also be highlighted by taking the example of Cargill, the world's largest grain

trader, a private company with registered sales exceeding US\$25 billion in 1980, which has established a network of more than 140 subsidiaries in over 30 countries (UNCTAD, 1981a). In addition to its wide commodity operations, its insurance arm offers individual and group finance, and its expertises covers bulk commodities, all facets of agriculture, marketing and speculation, handling and transportation logistics.¹⁶

2. Some conceptual considerations

The foregoing observations on the strong foothold maintained by transnational trading companies in the commodity sector do not necessarily lead to the conclusion that commodity markets are of a purely competitive nature. The intermediation provided by such trading companies, even though it is categorized as arm's-length, can come close to something significantly different from the purely competitive situation. The price mechanism advocated in theory under the free market system is, in many cases, not applicable to the commodity trade, where a group of oligopsonic buyers confront a large number of suppliers, as in many agricultural commodities, or similarly, where oligopsonic buyers confront a small number of oligopolistic sellers, as in some of the minerals exported by the developing countries. In these asymmetric market conditions, prices are determined not only by the prevailing market conditions, but also by the relative bargaining power of the two negotiating parties.

This type of imbalance in negotiating capacity is applicable to those cases where a powerful trading conglomerate represents a group of producing or manufacturing companies as their procurement or selling agent, either on the buying

¹⁶A small number of grain traders, including Cargill, Continental Grain, Bunge and Born, Louis Dreyfus, Barnac and Cook Industries, etc., are responsible for an extremely high percentage of world grain trade: from 1970 to 1975 the above six companies accounted for as much as 96% of world wheat exports, 95% of maize exports, 90% of oats and 80% of the sorghum exports of the United States. The same companies also accounted for roughly 80% of Argentina's wheat exports, 90% of Australia's sorghum exports, and 90% of the wheat and maize exported from the EEC. In Canada, they were responsible for the whole of the share of exports allocated to the private sector (20%), as well as for a very substantial portion of sales of the remaining 80%, which were made through the Canadian Wheat Board (UNCTAD, 1981 b).

or selling side. Large trading companies are, in general, in a position to influence market prices by the volume of their purchases, their capital strength and their sophisticated information network. What developing countries face in the commodity markets is not only the oligopsonic market structure of the developed economies but also the oligopsonistically organized buying groups. The weak bargaining power of developing countries reflects the increasing market power of the multi-commodity trading agents as well as that of the giant industrials.¹⁷

The usual presumption adopted with regard to commodity markets is that their spontaneous functioning, in perfectly competitive conditions, is basically an efficient and neutral instrument for resource allocation rather than a means of generating a particular pattern of income distribution. In reality, however, the neoclassical approach has only limited applicability to the behaviour of commodity markets, some of its major deficiencies (among others) being: i) its frequent assumption of free entry without any uncertainty as well as of the absence of any government intervention,¹⁸ and its failure to deal with the externalities and market imperfection, which are an integral part of the present functioning of these markets; ii) its difficulty in explaining why markets move from one disequilibrium to another, in a continuous series of shortages and surpluses, never establishing an automatic equilibrium position; and iii) its limited capacity to produce correct and rational

market signals as regards future prices and the allocation of resources (Maizels, 1984: Helleiner, Chap. 2, 1981 b).

A serious imperfection in commodities markets is the relative scarcity of market information. In a world of perfect competition, all participants have equal and complete access to all information, and there is no uncertainty regarding future price configurations. In reality, however, the markets for information itself are highly imperfect, if they exist at all, and are characterized by bilateral monopoly or oligopoly (Helleiner, 1981 b). Uncertainty as to the future of prices, when these are as volatile as those of primary commodities, makes buying/selling, storage, shipping and financing operations much more complex and introduces a speculative element in the decision-making process. Those with the most information are placed in the best position to gain from this market imperfection.

It is generally agreed that the search for information has the characteristic that it provides increasing returns. The fixed costs of acquiring either a fixed stock or a continuing flow of information can be spread over a varying volume of transactions. Though the marginal cost of supplying information to the first user is very high, since it includes all search costs, the marginal costs of supplying subsequent users include only the cost of communication, and in most instances this is small. It is also true that since trading activities involve striking a mean between low-and high-price centres, the number of possible trades between centres will increase exponentially for every additional information/trading centre. This means that the larger the number of existing contact points, the greater will be the potential for striking business deals among them. Maintenance of these centres is extremely important, since information (especially on goods and services which are subject to continuous disturbance) is highly perishable. Thus, in order for the information to have some value to the user, he must incur costs not only for procuring the information itself, but also for maintaining and possibly up-dating and upgrading it through a trading presence in the market.

Information can always be made available to another individual without any elimination of

¹⁷Raderzki points out that price theory, whether under conditions of perfect or monopolistic competition or of oligopoly and monopoly among sellers (buyers), has little applicability to the commodity markets, as its implicit assumption in most cases is that perfect competition prevails on the other side of the market. Price theory is of little help in determining the bilateral monopoly/oligopoly price level. The theory of industrial organization also suffers from the same deficiency in that it ordinarily only studies one side of the market, implicitly assuming perfect market conditions on the other side. With regard to bargaining theory, though it provides interesting insights into behavioural patterns in two-person zero-sum games, it loses its applicability to the commodity market in general where there is mutual dependence between decision-making entities operating on each side of the market (Raderzki, 1980).

¹⁸Regarding government intervention, it is important to mention that in recent years the developed market economy countries have become much more outspoken in their opposition to international commodity agreements, on the ground that they would interfere with the free functioning of market forces. However, many commodities produced and exported by the developed countries are already subject to government intervention and controls.

the existing user's access to it. This "public property" characteristic creates the problem of the appropriability of new information for which there is no regular market.

These peculiarities taken together suggest that, as K. Arrow has pointed out, "the demand for information is difficult to discuss in the rational terms usually employed. The value of information is frequently not known in any meaningful sense to the buyer; if, indeed he knew enough to measure the value of information, he would know the information itself" (1963, p. 947). The intrinsic value of particular information depends on how the user perceives its marginal utility, and his evaluation of the information is likely to change over time as a result of market shifts. Under these circumstances, co-ordination or internalization within an administrative apparatus such as a multinational trading company, i.e., information acquisition through its domestic/foreign subsidiaries and offices, can avoid the transaction (bargaining and enforcing) costs which might have to be incurred under arm's length negotiation.¹⁹

From this standpoint, a major problem contributing to the relative weakness of trading agents of the Third World is their limited access to the information held by the private sector in the developed economies. The little information that they receive from governmental or other sources is inadequate for efficient decision-making on marketing. Unless the relative weakness of the developing countries in their information collection/screening/assessment capacity is corrected, these countries will be likely to continue supplying their products to the world market on terms and conditions laid down by the consumers, the fairness of which these countries are unable to evaluate.

Many of the world's main primary commodity exports have their prices determined on commodity exchanges.²⁰ These exchanges are often

cited as examples of markets where pure competition is found and where prices are determined by the free play of supply and demand for a given commodity. Once again, in the actual world, prices on exchanges are affected not only by the current supply and demand balance but also by expectations of supply and demand, by repercussions from the currency markets, and even by manipulation. With regard to futures, expectation as regards the basic economic factors becomes more important and the prospects for the commodity in question are weighed together with the broader economic outlook and the expectations of the currency in which the deal is denominated. Optimal pricing for each agent depends on its own expectations about future developments, its conjectures on buying and selling interests, and all the economic forces which affect future prices. Its buying/selling practices are also constrained by its financial position and utilization of its physical facilities, such as storage and shipping. In short, in a futures transaction, there is little room for the mark-up pricing common in many manufacturing activities. Prices are always in motion, and this problem is compounded by the fact that the firm is both seller and buyer simultaneously, so that its interest in one capacity might undermine that in its other capacity.

It should also be pointed out that in so far as buying/selling contracts are on a futures rather than a spot basis, there will be a greater tendency for the trading firm to have its subsidiary, affiliate or foreign office undertake the actual buying. This is because if a contract is on a spot and cash on delivery basis, the risk of possible misrepresentation of product quality can be dealt with by testing on the spot a sample of the product. Thus, when contracts are predominantly for futures, the cost of arm's-length trading tends to rise, and external transactions tend to be replaced by vertical/horizontal integration of the trading firm.

Furthermore, price determination mechanisms at commodity exchanges suffer from several serious rigidities: for some commodities there are few main producers, as in the case of tin, cocoa and coffee; for others, most of the demand comes from a few large importers, as in the case of wheat. In other cases, a few traders may loom large in the market. They are not

¹⁹The behaviour of a large trading company can be explained by its desire to protect itself from or exploit market failure. The services that a sogo-shosha, provides, for example, are information-intensive, and the characteristics of information, i.e., the lack of a market mechanism to determine its value and "public property" nature, create externalities.

²⁰These products include wheat, maize, soybeans, soybean meal and oil, palm oil, coffee, cocoa, sugar, rubber, wool, cotton, orange juice, copper, tin, lead, zinc, nickel, aluminium, silver, gold and, increasingly, petroleum.

always in evidence, as they may bid in moderate quantities at any one time or through various brokers, but if they steadily pursue a specific policy they can influence the market and thereby affect its transparency. Moreover, other restrictions and distortions are created by the exchanges themselves: for example, the rules governing admission to the various classes of membership include financial requirements such as bank guarantees and paid-up capital, as well as nationality clauses.²¹

Imperfections in commodity markets also arise due to the large investment capital necessary to establish or expand processing capacities. The areas of processing and marketing are intricately interwoven, since often the possibilities for processing before export depend on the ability to secure, beforehand, market outlets for the processed product. Prior assurance of market possibilities is often necessary in order to raise the investment funds needed, especially for minerals and metals, where large sums are involved and the existence of long-term purchase commitments or other types of arrangements for at least a sizeable portion of the output is regarded as a partial guarantee for the potential investor. A high frequency of long-term contracts in the commodity sector, in this sense, signifies that the market is no longer competitive and free through the continuous auctioning process between buyers and sellers. The nature of the long-term contract, in turn, reflects the relative strength of both parties.

The type of price determination postulated by the neoclassical approach does not apply to the transport sector either. It is found that in the case of many commodities freight rates are as much as 20% of the CIF prices and that fluctuations and changes in freight rates have a significant impact on price, on the market demand for these products and on the net earnings of producers. However, the observed structure of freight rates, in general, does not seem to reflect the true cost of carriage, and the rates are instead determined in an arbitrary manner. The general practice in the industry is to charge "what the traffic will bear" and the most often used mea-

sure is the unit value per ton of the commodity, which has little relation to the marginal cost-based system of charges.²² As a result, with high-value commodities subsidizing low-value ones, excess freight factors escalate in a similar manner to tariffs. The arbitrariness in the setting of freight rates is related, in many cases, to the different bargaining positions of the exporters and shipping companies.

In sum, contrary to the postulates of conventional theories and the solutions that they imply, commodity markets operate in far-from-equilibrium states where spontaneous self-correcting impulses fail to assert themselves.

3. Characteristics of transnational trading companies

The rationale for the existence of transnational multi-product trading companies and the reason for their expansion are to be found in the very roles and functions which they play:²³ for example, the minimization or reduction of the risks inherent in both domestic and international trade which arise from fluctuations in commodity demand and supply as well as in exchange rates. Since it is difficult and costly to insure against these factors, the trading companies reduce risks by distributing them over many transactions. The larger the number of commodities handled, and the more diversified sales are by geographical region and types of buyers, the more widely the risks involved can be distributed. The feature of multi-commodity trading is thus explained by their desire to take advantage of the risk-reducing effect arising from scale and diversification. A wide portfolio, not restricted only to commodities but compensated by large product lines in manufactures and services and also by extensive geographical markets, reduces income fluctuations by compensating for large variations in individual product income.

The risk involved in the fluctuation of exchange rates is reduced when the net transfer of cash through clearing arrangements, as in the settlement of intra-regional or interbank accounts, is only a fraction of total transactions.

²¹For a summary discussion on the problems relating to the operation of commodity exchanges in the context of higher participation in them by developing countries, see UNCTAD (1983 a).

²²These points are raised in Yeats (1981).

²³For a summary of these issues, see Yamamura (1976), Young (1978), and Roehl (1983).

It should also be borne in mind that a trading company engaged in both importing and exporting is able to buy and sell in local currencies, thereby reducing transactions across currencies to a small fraction of the total import and export business.

These companies' attribute of wide product and geographical market diversification increases the possibility of creating third-country trade or counter-trade. Unlike a single-commodity trader, the multi-commodity trading company can act, for example, as an importer of manufactured goods in exchange for exports of primary commodities or *vice versa*. When a company caters for a large clientele on both the exporting and importing sides, this can allow it to find a market for a product for which the producer has no direct marketing and distribution relationships. Similarly, in the present conditions of shortage of credit, there has been a substantial increase in the need for arrangements whereby buyers oblige sellers to provide export/markets equivalent to the hard-currency value of the goods imported.²⁴

Another feature of transnational traders is the size of their financial operations and thereby the derived credit-worthiness, which in turn rests on their ability to reduce the risks involved in transactions and to take advantage of economies of scale in using the capital made available to them. In this manner, the trading companies can often function as providers or guarantors of credit, or can engage in trading with a variety of credit instruments rather than cash settlements. In the case of the nine largest sogo-shosha, credit extended by them in 1982 to their clients reached US\$58.1 billion, while they themselves received over US\$44.1 billion of loans from various banking institutions (Sogo-shosha Nenkan, 1984).

Another important function is their ability to reduce "transaction costs". As mentioned earlier, this term refers to the costs involved in gathering/processing/screening information about market opportunities and economic intelligence, contract negotiations and enforce-

ment, and obtaining transportation services. Regarding information, for instance, the "production" of information about market opportunities —prices and locations of sellers and buyers, their credit-worthiness, etc.— includes the costs of gathering and disseminating the information. It should be noted, however, that these costs are *fixed*, independent of the use to which the information in question is put. This points to the existence of economies of scale in information-gathering activities and also to the decline in search costs per unit of information in accordance with the expansion of the market size.

In the area of transportation, although trading companies, may not necessarily provide their own transportation, they can reduce the cost per unit of goods transported by co-ordinating shipping times and locations and cargo space. Transportation costs are also reduced through the facilities provided and arrangements made at ports of origin and destination. Such facilities and arrangements are known to have large fixed costs but only small marginal costs. After the investment in fixed costs, exporters would obtain flexibility in organizing and timing shipments, thus improving their stock-keeping and marketing operations.

Since it is known that the Japanese and the Europeans rely heavily on this type of traders and that the United States is moving gradually towards the expansion of its trading sector by adopting more dynamic and diversified trading mechanisms along these lines,²⁵ either creating similar organizations or strengthening the existing trading entities in the Latin American and the Caribbean region might be a way to prevent further intensification of the control of commodity markets by TNCs. In the context of developing economies, this type of trading organization can be an effective means of combating the inadequacies of the commodity markets, particularly in the following aspects:

- i) strengthening of trade leverage against TNCs;
- ii) strengthening of more independent commer-

²⁴According to the National Foreign Trade Council of the United States, the number of countries requiring some form of counter-trade has increased from 28 in 1979 to 88 in 1984. The same organization reports that 8% of U.S. exports are currently subject to counter-trade - 47% in the case of the aerospace industry.

²⁵The passing of the Export Trading Company Act by the U.S. Congress on 8 October 1982 has signified a new trend towards introducing a Japanese-style trading company culture and especially towards taking advantage of the potential that the newly created companies offer for counter-trade.

cial information systems; iii) pooling of import requirements and export sales, which should strengthen the negotiating position; iv) taking advantage of economies of scale, particularly in such areas as shipping, bulk handling and stor-

age; v) co-ordination of actions aimed at overcoming restrictive and protective measures taken by the industrialized countries; and vi) amplification of compensatory trade at the regional and subregional level.

IV

Experiences of commodity marketing institutions in a Latin American context

1. Producers' associations

The Third World countries' inability to control various stages of the marketing chain and their subordinate position resulting therefrom are linked with the power of the TNCs, which have firm control over finance, production, markets, transport, technology, information, etc. The development of an effective countervailing force against such a concentration of power will, to a large extent, depend on the actions which the developing countries can take at their government level. Admittedly, however, the resources required and the degree of co-ordinated action necessary to countervail these centres of economic power would be difficult to find in a small, competing, national private enterprise unit. In recognition of this fact, it has been realized that only through co-ordinated joint actions can the Third World as a whole, or the region, achieve greater participation and gradually changes, for their own benefit, in the rules governing the operations of these markets.

Realization of the above has led, in the past two decades, to the creation of numerous producers' exporters' associations, either at the regional or international level. In agricultural commodities alone, during the last two decades one can identify more than 15 producers' exporters' associations of international significance (FAO, 1984). Nevertheless, as shown below, an examination of the performance of international and regional producers' associations reveals that in general they have failed in their major undertaking, either for lack of appropriate support from the countries which created them, or because

some important producers refrained from becoming members. Furthermore divergent policies and sometimes conflicting strategies pursued by individual producing countries have had detrimental effects on the international commodity markets.

In the case of CIPEC (Consejo Intergubernamental de Países Exportadores de Cobre), collective efforts have stopped short of original expectations. The eight member countries, which together account for approximately 40% of world production, have tended to seek short-term economic benefits rather than to foster the achievement of more stable real income in longer-term perspective. In the mid-1970s, for instance, when talks on a possible copper agreement were taking place as part of the Conference on International Economic Co-operation and within the Intergovernmental Group of Experts convened by UNCTAD, the Government of Chile decided unilaterally not to adhere to a 15% production reduction previously agreed upon by the Special Conference of Ministers of CIPEC. Instead, the Chilean Government implemented a programme of production expansion (Martner, 1979, pp. 89-95). This action on the part of Chile not only reduced the price of copper internationally but also "acted as an internal brake on CIPEC activity, reducing the organization to the level of a passive spectator of events on the world markets and impeding UNCTAD talks aimed at establishing a system of price stabilization" (Martner, 1979, p. 95).

In view of its ambitious investment plans to expand production, taking advantage of its very low production costs, the Chilean strategy seems

to be to expand its capacity, in spite of the world glut. One of the main objectives of CIPEC, i.e., to promote the harmonization of decisions and policies of member countries relating to copper production and marketing, has consequently met with little success.

In the case of tin, the decision by Brazil—which has rapidly increasing production and an even higher potential for the future (in 1985 it became the second largest producer of this metal after Malaysia)—not to join the recently established Association of Tin Producing Countries (ATPC) has undermined that organization's aim to stabilize the market. Brazil, which is not a member of the International Tin Council (ITC) either, has been increasing its share of the world market at an astonishing pace, at the expense of others who have been trying to institute some orderly marketing mechanisms. Non-ATPC members increased their output when the ATPC countries reduced their tin supply to the world market from 194 000 tons in 1981 to 125 000 tons in 1983. These "cut-throat" moves not only stifle the initiatives of the members of commodity associations but also give the developed consumer countries the impression that there is no co-ordination among developing producing countries.²⁶

Though the International Tin Council is not a producers' association, the crisis facing it implies a failure of the collective efforts to seek a reduction in production. For a long period, the Council tried to absorb the excessive world supply, especially through artificially high support prices, and the apparent supply-demand equilibrium was only achieved through the Council's constantly growing reserves. A detrimental factor leading to this result was undoubtedly the rapid increase in the production coming from some non-ITC members such as Brazil and China.

Another mineral producers' association of international character is the International Bauxite Association (IBA), which was created in 1974 and whose members are Australia, Domin-

ican Republic, Ghana, Guinea, Guyana, India, Indonesia, Jamaica, Sierra Leone, Suriname and Yugoslavia. The principal objectives of the Association are: i) to promote the orderly and rational development of the bauxite/alumina/aluminium industry in its member countries; ii) to secure for its members fair and reasonable returns from the mining, processing and marketing of bauxite and its products; and iii) to safeguard the interests of member countries in relation to the industry, which faces a high domination of TNCs.²⁷

In spite of their potential bargaining power, the IBA's major policy instrument is the application of minimum prices for basic-grade bauxite: a system which gives the members a fair amount of latitude, with no binding commitment except that of selling their bauxite above the minimum recommended price. However, these recommended prices have not always been observed either by the TNCs or by the bauxite-producing countries. According to a specialized publication, "transnationals have regarded the IBA as a paper tiger, because of its inability to agree on fundamental issues such as pricing policy" (Latin American Commodities Report, 1982).

More exclusively at the regional level, there are several cases of producers' associations whose functioning is severely undermined by the lack of solidarity, co-ordination and political will to safeguard the long-term interests of the respective industry.

The Unión de Paises Exportadores de Banano (UPEB) is a good case in point. The potential bargaining power of this group, which was created in 1974 and consists of eight members (Colombia, Costa Rica, Dominican Republic, Guatemala, Honduras, Nicaragua, Panama, and Venezuela), accounting for 17% of world production and 50% of world exports, has been stifled by Ecuador's decision, from the outset, to remain outside this regional arrangement. Ecuador is responsible for 15-20% of the world exports of this fruit.

²⁶Recently Brazil has decided to co-operate with the ATPC and restrict tin exports to 21 000 tons from March 1987 to February 1988. This should be a crucial element in helping to achieve the ATPC's export target of no more than 105 000 tons in a bid to buoy up world prices and reduce international stocks.

²⁷The potential importance of the IBA is reflected by the aggregated position of its 11 members in terms of total possible world bauxite reserves (72%); world bauxite and alumina production (75% and 45%, respectively); and world bauxite exports (90%).

Strictly on the issue of marketing, the Seventh Meeting of Ministers of the UPEB, held in 1976, decided to establish a commercial arm of UPEB in the form of a multinational corporation responsible for the marketing and transport of members' fruit and other related products, in order to counteract the control of TNCs in these areas.²⁸ The objective was materialized in 1977, when representatives from Colombia, Costa Rica, Honduras and Panama created the Compañía Comercializadora Multinacional del Banano (COMUNBANA, S.A.). This enterprise was and still is perceived as the executive instrument of UPEB marketing policies, and it is open to all members of UPEB.

It should be stressed that COMUNBANA faced an impossible task in seeking to fulfil its objectives when UPEB members refused to commit their shipments to it. At the peak of its operation, it was only able to handle one shipment of bananas a month (mainly due to shortage of fruit), whereas it was thought that buyers in the traditional import markets required weekly arrivals of bananas. From the initial 1978 contract with Yugoslavia up to the end of 1981, it marketed a quantity equivalent to 0.5% at the most of total annual world trade in bananas. The dismal performance of COMUNBANA was clearly due to the uncommitted stance of its member countries, and while it still exists on paper it has stopped its operations.

Lack of support from the countries which created a regional co-operation organization is also to be observed in the case of the Empresa Multinacional Latinoamericana de Comercialización de Fertilizantes, S.A. (MULTIFERT). The Panama-based company was formed in 1980 as a commercial venture, under the auspices of the Latin American Economic System (SELA), with the main objective of marketing fertilizers in order to ensure supplies of these products to and from the region and to facilitate their sale in

third markets, through the bigger bargaining power secured by the consolidation of supply and demand.

Though the performance of this organization has not been insignificant —it had total transactions of US\$129 million for the period up to February 1984—, it has been far below the original expectations of the establishing nations. The transaction figures envisaged for 1980, 1982 and 1985, for instance, were US\$155 million, US\$400 million and US\$545 million respectively, which would have meant that MULTIFERT would market in those years 30%, 60% and 70% of the total purchases of the 11 members of the SELA Action Committee (ECLAC, 1984 a). The explanation for this marked difference between the forecasts and reality must be sought not only in the over-ambitious aspirations but also the lack of political commitment of the member countries which created it. Among the 11 members of the Committee, only eight subscribed to the agreement establishing MULTIFERT. Furthermore, the low import demand was related to the inconsistency of those stockholders (mainly State companies) which decided not to channel their operations through MULTIFERT. The situation became still more complex when the Government of Peru, a member country which had been the promotor of this organization, liberalized the importation of fertilizers and the Empresa Nacional de Comercialización de Insumos (ENCI) of that country lost its major attributes as the State monopoly. Venezuela also eliminated the State monopoly of VENFERCA. Thus, as may be seen, added to the inefficiency of MULTIFERT itself was a functional instability which worked against the sustained performance of this multinational organization.

With regard to regional co-operation in the marketing of primary commodities, the experience of the Bogotá Group (later Pancafe S.A.)²⁹ is illustrative in that it demonstrated the magnitude of the influence that can be exerted by

²⁸The most prominent TNCs in the industry are United Brands, Castle and Cooke (a subsidiary of Standard Fruit) and Del Monte (R.J. Reynolds). These three firms control almost 100% of the banana exports from Costa Rica, Guatemala, Honduras and Panama, and a significant percentage of those of Colombia (60%) and of Ecuador (40%). On the other hand, it is estimated that 35% of the fruit produced in Central America, Colombia and Ecuador is marketed by national entities of the producer countries.

²⁹The objective of this group, which consisted of Brazil, Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico and Venezuela, was to establish, manage and operate a coffee trading company, and to that end to purchase, sell, handle and market coffee.

producers in the international market place when some concerted actions are decided upon and enforced. Despite its short life, the overall high price level of coffee registered in 1978/1979 and 1979/1980 was mostly attributable to the market intervention undertaken by this group. Conservative estimates indicate that the group was able to keep the price at least 10% above the usual level during these periods. Due to the insistence of the United States and other members of the International Coffee Agreement (ICA) that this group must be liquidated as a pre-condition of their willingness to restart negotiations for a new agreement, however, the leaders of the Latin American countries decided to opt for the utilization of the economic clauses within the ICA as a price defence mechanism instead of the joint actions of the group. Nevertheless, the regional efforts made in this field generated a much better bargaining position for the producing countries in the negotiations towards the new agreement and led to a softened position by the United States, in particular, over the price ranges negotiated.

An examination of the past performance of several international and regional associations working in commodities indicates that they have stopped far short of their original aspirations. Even though they have made valuable contributions, especially in the area of information collection and dissemination, there has been little success in meeting the pressing need to control supply and co-ordinate marketing decisions. These associations have not succeeded in achieving price stabilization or some scheme of orderly marketing on the basis of reduction of supply by producers. The vested interests within the associations, the weak financial capacity of producers to collectively support the withholding of supplies, inability to withstand the effects of supply cutbacks on their national economies (e.g., on employment and foreign exchange earnings), and the fact that some countries have not joined the groups (e.g., Ecuador was not a member of UPEB) have greatly undermined the bargaining position of these organizations in international negotiation fora. Much of the blame for the unsatisfactory performance of the producers' associations is attributable to the lack of a real perception of common interests and collective trust among the producing countries.

2. State Trading Organizations (STOs)

Most countries engage in some form of State trading, and the Latin American countries are no exception. On a world-wide scale, estimates based on GATT documents and other sources indicate that, in the 1970s, the proportion of State trading in exports was 20-25% in New Zealand, 10-15% in Australia, 8-14% in the U.S., and 9-11% in Canada, while the proportion represented by State trading in imports was 18-20% in the U.K., 18-24% in France and 8-10% in Japan (Kostecki, 1978). With respect to Latin America, it is estimated that close to 40% of total regional imports are accounted for by government purchases, and the percentage is substantially higher in the areas of energy and foodstuffs (Ondarto and Correa, 1982; ALADI, 1985). Referring to the region again, an UNCTAD study has shown that in the 1970s, in seven (Argentina, Brazil, Jamaica, Mexico, Peru, Uruguay and Venezuela) of the eight countries surveyed, 10% or more of imports and/or exports were in the hands of State-owned producing or marketing firms (UNCTAD, 1978 b).

The general observation may be made, as confirmed in an ECLAC document (ECLAC, 1986 c), that the nature and structure of the STOs in the region is limited. Among the most important of the large-scale trading entities which are State-owned enterprises are the producers and distributors of petroleum and its products. These include Yacimientos Petrolíferos Fiscales (YPF, Argentina), Petrobras (Brazil), Petroperú (Peru), Petroven (Petróleos de Venezuela, S.A.) and ANCAP (Administración Nacional de Combustibles, Alcohol y Portland, Uruguay). The predominance of these enterprises reflects the relative importance of petroleum in the total import/export trade of the region. In non-fuel commodities, however, the STOs' inroads into world markets are not significant in terms of volume or of the variety of products handled. The participation of COBEC (Companhia Brasileira de Entrepostos e Comercio), once often cited as one of the most influential STOs in the region, has been reduced to an almost insignificant level: in 1984, it was responsible for exports equivalent to 0.07% of the national total, whereas Interbras, a trading subsidiary of the State oil company Petrobras of Brazil (another

influential STO in the region) was responsible for roughly 3% of Brazil's total exports in the same year, not to mention its commodity exports (CACEX, Banco do Brasil, 1985).³⁰

Some Latin American STOs are said to have achieved a high level of *direct* trade. However, it should be recognized that though a major objective is to dispense with the services of traders and brokers as intermediaries and to increase *direct* exports/imports with consumers/suppliers abroad, in many cases STOs' participation in their nation's foreign trade still involves that of other economic agents, mostly foreign. For example, in the case of imports of foodstuffs ENCI of Peru merely invites periodic offers in the forms of tenders from foreign traders, who actually carry out the import transaction. This is far from what can be called *direct* trade. Rather, the participation of the State trading entity just adds another intermediation stage.

One objective common to all STOs is the strengthening of market power, especially at the international level. Regarding exports, some of the major responsibilities assigned to STOs particularly those of the Third World, involve the purchasing and marketing of products which are major sources of foreign exchange earnings, diversification of export markets and product promotion for small- and medium-size enterprises. The disadvantages arising when several thousand producers of a given commodity compete among themselves on international markets may be reduced through some form of co-ordinated marketing or centralized production control for exports. With respect to imports, the aim is frequently to obtain more favourable prices and terms by centralizing purchases or to secure stable supplies of essential imports. These objectives relating to the external sector are correlated with domestic ones, among which the most important are promotion of domestic prices and distribution policy, integration of foreign trade into central planning,

³⁰COBEC was established to compete with powerful trading firms involved in the marketing of soybeans, and it dealt in a number of agricultural commodities, including coffee. However, in 1981 COBEC exported only US\$32 million worth of coffee, against the national total exports of coffee of US\$1.5 billion. Interbras' impact was also negligible, accounting for only 2% of total exports of coffee beans. The figures are calculated from UNCTAD (1983 b).

raising government revenue, and health and strategic control considerations.

Rationales for STOs also include other arguments, such as that the government may be able to improve the country's bargaining power by utilizing its negotiating power arising from exports of other products or its capacity to import.³¹ Also export policies effected at the government level are more likely to have a possibility of modifying the commercial policies of other governments. A State-run monopoly may be in a better position to effect deals with other STOs in bilateral/multilateral negotiations.³² Furthermore, some form of government co-operation in trading is necessary in cases where private returns from entering new markets or initiating trade in new products are lower than the actual social return. If this is the case, governments may be more willing to consider the element of externality. This would apply to the case where there is a desire to break away from traditional trade links. Large orders aggregated at the national level under a State monopoly also lower the cost of procurement, transport and use of warehouse space and facilitate the systematization of import procedures.³³

STOs of the developing regions can be considered an effective means of increasing intra-regional commodity trade, which at present stands at a very low level. In value terms, Latin America's intra-regional exports of commodities account for only 15% of its total commodity exports, while more than 65% goes to the developed market economies. In imports, intra-regional trade in commodities reaches only 30% (ECLAC 1986 b). In view of this imbalance, the Latin American countries have a high potential

³¹A good case can be made here by Brazil, which has become one of the world's leading counter-traders. The government-owned Interbras has been successful in offsetting at least half of its oil purchases, which account for roughly 50% of the country's import bill, by supplying food and manufactured products to oil producers on a counter-trade basis (Carey and McLean, 1986, p. 459).

³²The increasing recognition of the importance of counter-trade on the part of developing country governments, for example, led ASTRO (Association of State Organizations of Developing Countries) to establish a reference service on counter-trade practices, and it plans to initiate programmes for teaching STO representatives negotiating tactics and contract practices in a counter-trade context.

³³For more detailed treatment of these points, see Kostecki (1978) and Sauliners (1981).

—without adversely affecting the present level of extra-regional exports—for increasing their commodity trade among themselves. Taking into account the enormous government purchasing power—it may be repeated that close to 40% of total Latin American imports are government purchases one way or another—the expansion of intra-regional trade through exist-

ing or newly created STOs provides wide scope and opportunity for regional co-operation. Equally, the strengthening of marketing entities such as STOs could greatly increase trade flows towards other developing regions where the principal growth in world demand for many of the commodities produced in the region is foreseen.

Conclusions

In general, the Latin American region—whether alone, or jointly with other regions of the Third World—has not been able to develop the alternative mechanisms or effectively pursue the objectives that it has been seeking in international negotiations with consumer countries. For example, the countries of the region have not been successful in implementing supply regulation schemes which could have had a significant impact on the level of prices. Similarly, as demonstrated above, the operation of a producers' association will be successful only when the appropriate institutional set-up and a real perception of common interests and collective trust among the producing countries exist and are effectively exploited. From this perspective, the countries of the region should seek to achieve maximum credibility as a negotiating entity by instituting regional co-operative actions as the starting point for developing their negotiating postures. Furthermore, if there were a real perception of common interests, there would not always be a need for supervision by the consuming countries in order to guarantee the fulfilment of export quotas or similar measures to support prices.

In view of the fact that a high proportion of world output and exports of many commodities is accounted for by Latin America, the existing regional producers' associations should engage more actively in marketing, either by taking their own initiatives in these areas or by becoming more effective co-ordinators of marketing policies among their member countries. This does not preclude the possibility of their becoming multinational trading companies.

Even though their impact on the national economy has been less than originally conceived,

considering that the relative bargaining position of the buyer vs. seller plays a critical role in price determination, State trading organizations can nevertheless be an appropriate instrument for the realization and exercise of market power, especially for the developing countries, in order to countervail the dominance of the marketing systems by developed country agents. Through this instrument, the importation of certain products can be tied, as a package, to exports of commodities, so as to secure stable and more remunerative prices for the latter. In the present economic environment in which the Latin American countries are immersed, there is a high probability that concentrated selling/purchasing at the government level will equip policy makers better to counter the increasing protectionist measures applied to them. State trading organizations are also considered an effective tool for increasing intra-regional trade in commodities and for enlarging and facilitating various counter-trade schemes with countries inside and outside the region.

There is increasing recognition on the part of Latin American governments that seeking solutions to many of the problems in the commodity sector in the exclusive framework of North-South co-operation does not lead to substantial results, and that the time has come to approach negotiations with consumer countries within a much broader framework, integrating commodities in the overall trade negotiations instead of leaving them isolated as they have been up to now. One of the pillars of this larger framework is that Latin America should integrate its regional purchasing power of goods and services into overall commodity negotiations. To exercise this power, it is imperative that the

countries in the region should establish mechanisms and instruments which link the capacity to import various products of the industrialized countries (e.g., manufactures, technology, capital goods, services, investments, etc.) to the need to

raise commodity export earnings. In this scenario, the strengthening of the existing trading entities (national or regional) and/or the creation of new ones of a more multi-product nature is seen as an urgent necessity.

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Urban employment: research and policy in Latin America*

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The past 15 years have served as a testing ground for urban employment policy research and design in Latin America. In this article the author analyses the major issues dealt with during this period as well as the main advances achieved in this connection. The concept of dynamic insufficiency is explored as the principal explanation for the failings of the development process, with emphasis being placed on the importance of the inappropriateness of certain technologies, the rapid increase in the labour force, and the absence of strong economic agents which would permit the achievement of autonomous and equitable growth. The fact that the initial stages of import substitution have run their course also prompts the author to consider the effects of a more markedly export-oriented approach. His examination of this subject encompasses both a review of the use that has been made of policy tools and an effort to determine the effects which various foreign-trade structures have on employment. Finally, central importance is attributed to an analysis of the inappropriateness of many technologies and the dissemination of technical progress, since structural heterogeneity is seen as accounting for both the insufficient creation of productive jobs and the quasi-permanent inequality of income distribution in the region.

The crisis of the 1980s brought out the flaws in the previous approach to the employment problem. The economic and social efficiency of conventional adjustment tools is now being reassessed, and there appears to be a greater opportunity for the application of specific policies, particularly those designed to support the informal sector. Meanwhile, unemployment has emerged as a more important dimension of the employment problem.

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A review is always a difficult task, and even more so when a wide field must be covered due to the topic, the geographical diversity and the time span involved. Employment is, in a broad sense, linked to development, growth, economic policies, inflation and wages. "Latin America" is a unifying concept which encompasses some common factors of many countries but it cannot, by definition, represent any of them in particular. Hence, this review will necessarily be incomplete.

This article is organized into three main parts, following a chronological order. The first reviews research and policies in the 1970s, while the second deals with the 1980s. The two periods are set off by different economic conditions and, particularly, by the severe crisis which has affected the region since the beginning of the present decade. Finally, in the third part the nature of the current debate on the subject will be outlined.

I

Employment issues and policies in the 1970s

The dominant issue in research during the 1970s was the labour absorption capacity of modern sectors. Indeed, the rising interest in employment problems and policies was due to the increasing evidence that the trickle-down strategy was not working as expected. Growth did not ensure full productive employment but, in addition, in Latin America the scenario on which research was based was one of stagnancy rather than growth.

1. Research in the 1970s

a) Employment effects of the modernization process

Modernization was the reference model for research and policies in the 1970s. The well-known process of labour absorption by expanding modern sectors, particularly in urban areas, at higher levels of productivity was thought to ensure productive employment for the increas-

ing supply of labour created by manpower released from agricultural activities and by population increases. In addition, manufacturing was expected to play the main role in the labour absorption process. The employment effects of this pattern of growth were well documented by several empirical and theoretical analyses at the world level (Clark, 1951; Kuznets, 1957; Lewis, 1954; Fei and Ranis, 1961). The main thrust of Latin American research had been to analyse how such models in developing countries fit in with what Prebisch referred to as the centre-periphery context. This analysis was undertaken from three perspectives: firstly, accumulation and growth; secondly, international trade insertion; and thirdly, technological change.

One of the important arguments made by Prebisch was that the Latin American model was characterized by "dynamic insufficiency". This meant that output was growing very slowly or even, in some cases, was at a standstill because investment was also insufficient. According to this argument, low investment is the result, in turn, of the way in which peripheral capitalism functions: the size of the economic surplus is reduced by transfers to foreign countries via a deterioration in the terms of trade or via profit remittances, in the case of direct investment, and another large part of the surplus is absorbed owing to the rapid adoption of international consumption habits by the middle- and upper-income groups of the population in developing countries. Dependency in trade, investment and consumption patterns results in insufficient growth. The main effect is that employment does not grow as required, particularly in manufacturing, where, as we will discuss later on, the industry's production characteristics and its international insertion as well as technological change add to the weakness of its capacity for labour absorption (Prebisch, 1981; Pinto, 1965; Sunkel, 1971). This model was advanced primarily at a regional level (ECLAC, 1965) but country studies on Argentina (Ferrer, 1963), Brazil (Tavares and Serra, 1971) and Chile (Pinto, 1964), among others, also provided supporting evidence.

By the end of the 1970s it had become clear that the model of analysis needed some adjustment, since most Latin American countries were characterized by rapid growth during the decade

due to the high level of international liquidity and the rapidly growing foreign debt of the region. The new data which had become available since 1950 indicated a significant and sustained increase in employment in modern sectors and particularly in manufacturing (Garcia and Tokman, 1985). The bias in the interpretative model was twofold. On the one hand, research in the 1970s was based on data for the preceding decades, which did not show evidence of rapid growth. On the other, the regional data were mostly based on the Southern Cone countries (Argentina, Chile, and Uruguay and, in some instances, Brazil). These countries were already largely modern by 1950 and their investment and growth performance clearly showed an absolute insufficiency. However, as the labour force was already employed in urban areas and population growth was slow, employment problems were not as significant as in other parts of the region. A comparison of the investment and growth performance of the region as a whole during the 1950-1980 period with that of the United States during the comparable period represented by the 30 years between 1873 and 1903 shows that investment rates were similar (around 19% of GNP) and that the rate of growth was higher in Latin America than in the United States. Moreover, the rate of investment in the United States was, according to Kuznets (1961), the highest of the capitalist developed world. The exceptions were the Southern Cone countries, particularly Chile and Uruguay, where both investment and growth lagged behind regional averages (Tokman, 1985) (see table 1).

This factual analysis needs to be placed in perspective, since the 1970s were exceptional years in that investment capacity as well as consumption levels were augmented by foreign financing, and this obscured the longer-run trends. Trade balances were deteriorating due to the diminishing surplus of raw materials and basic commodities available for financing an increasing deficit in manufactures. Changes in consumption patterns in developed countries as well as their subsidized agricultural activities affected export possibilities by reducing traditional markets and by increasing the competition with surplus production in new commodity areas. In addition, changes in the consumption structure in Latin American countries brought

about by increased demand and a better quality diet also affected the size of the production surplus available for export, particularly in view of the slow growth rate of agricultural production (Wells, 1987). Trade constraints notwithstanding, higher investment was possible due to increasing external financing. Investment was largely dependent on foreign decisions; internally, the public sector was responsible for a large share of investment, while private entrepreneurs were less aggressive, mostly investing jointly with the public sector or foreign investors or, more frequently, engaging in financial operations which ensured short pay-off periods and higher profits (Tokman, 1985). Indeed, the dramatic reversal of external economic conditions in the 1980s, as well as the need to adjust the fiscal situation, testified to the weakness of the accumulation process, with the investment coefficient falling to one-third of the level prevailing in the 1970s by 1985.

A second issue which drew the attention of researchers was that of the trade strategies which guided the development model. Historically, medium-sized and large Latin American countries had followed an industrialization strategy based on import substitution. More recently, particularly during the 1970s, a greater effort was made to demonstrate the superiority in terms of economic results of export promotion and diversification.

After the Great Depression, many Latin American countries embarked upon an industrialization strategy as the only feasible alternative given the prevailing international economic environment. The key instrument used to implement this policy was the maintenance of a high level of protection, which was accomplished through a variety of means, ranging from high tariffs to import quotas. According to Díaz-Alejandro (1981), this strategy allowed the region to recover at a faster rate and in a shorter period than the United States. This policy was then researched and recommended to governments in a number of studies undertaken by ECLAC, with the result that by the early 1970s most Latin American economies already had a well-developed industrial sector. This sector was the engine for economic growth and generated, directly and indirectly, a large share of the productive jobs created during the postwar period

(García and Marfán, 1981). Manufacturing employment grew at a rate of 3.5% per year between 1950 and 1980, a rate similar to that registered by various developed countries during expansion periods. Real wages rose and the skill profile was upgraded, mostly through learning-by-doing, while unions also improved their bargaining position during this period.

In spite of these favourable results, it was already clear that the import substitution strategy produced the best results during its early phase—the stage of the "easy" substitution of consumer goods—but that as further progress was made, the strategy ran up against increasing constraints. Among the problems identified were the incapacity of the strategy to overcome the foreign-exchange constraint, since the main effect it had on imports was to shift their structure from final to intermediate goods. This was due to the lack of integration and to the inexistence of a capital goods producing industry (Fajnzylber, 1983; García, 1984). The internal market for manufactured products was small and highly diversified owing to the concentration of income and the rapid adoption of the consumption patterns of developed countries, and this militated against increasing economies of scale. Furthermore, by the beginning of the 1970s there was also general agreement as to the faulty management of economic policies, inasmuch as the result of high tariffs and undervalued rates of exchange had proved to be an excessive and permanent level of protection. This ensured oligopolistic profits for producers, reduced foreign competition and resulted in production inefficiency and a bias against export promotion.

On the basis of this scenario, different research and policy proposals were explored. Some analysis, such as Fajnzylber (1983), emphasized the need to achieve more integration and a greater specialization of the industrial sector, generally favouring the production of capital goods as a way to strengthen the balance of payments, to generate more productive employment and to enhance the possibilities of endogenous technological change. Others, such as Krüger (1978) and Balassa (1977), stressed the need to open up the economies in order to ensure the expansion of exports, faster growth and job creation.

Table 1
LATIN AMERICA: GROWTH AND URBAN EMPLOYMENT, 1950-1980

	Accumulation and growth		Employment dynamics ^a			Recalcitrance of underemployment ^b					
	Growth of GNP ^a	Investment coefficient	Growth of non-agricultural labour force	Growth of urban formal employment	Growth of manufacturing employment	Degree of urbanization		Rural/traditional		Urban informal	
			1950	1980	1950	1980	1950	1980	1950	1980	
Group A	6.4	23.8	4.8	5.0	4.4	38.6	66.8	38.0	18.4	12.2	18.6
Brazil	7.0	24.7	5.1	5.2	4.7	39.2	68.1	37.6	18.9	10.7	16.5
Colombia	5.1	21.7	4.1	4.3	3.4	39.2	64.9	33.0	18.7	15.3	22.3
Costa Rica	6.0	20.6	5.2	5.5	4.9	42.0	69.5	20.4	9.8	12.3	15.3
Mexico	6.4	19.8	4.5	4.6	4.3	34.5	61.5	44.0	18.4	12.9	22.0
Panama	6.2	20.0	3.7	3.8	3.5	46.7	66.4	47.0	22.0	11.8	14.8
Venezuela	5.4	35.8	4.8	5.2	4.9	51.1	79.4	22.5	12.6	16.4	18.5
Group B	4.8	15.7	3.7	3.9	2.3	32.0	50.9	43.0	35.9	14.9	21.8
Bolivia	3.6	15.5	3.3	3.8	2.4	24.1	41.1	53.7	50.9	15.0	23.2
Ecuador	6.2	15.7	4.2	3.1	2.7	33.2	54.2	39.0	33.4	11.7	28.6
El Salvador	4.5	14.8	4.1	4.2	2.6	32.2	47.5	35.0	30.1	13.7	18.9
Guatemala	4.9	13.3	3.3	3.4	2.6	30.6	42.7	48.7	37.8	14.0	18.9
Peru	4.5	19.3	3.7	4.4	2.0	36.0	57.5	39.4	31.8	16.9	19.8
Group C	3.1	14.9	1.9	1.8	1.4	70.6	82.9	7.6	7.0	16.6	21.4
Argentina	3.1	17.9	1.9	1.9	1.2	72.0	84.9	7.6	6.8	15.2	21.4
Chile	3.6	13.7	2.5	2.6	2.3	62.9	77.2	8.9	7.4	22.1	21.7
Uruguay	2.3	13.2	1.0	0.8	0.9	77.8	82.3	4.7	8.0	14.5	19.0
Latin America (14 countries)	5.5	21.5	4.0	4.1	3.5	44.1	67.1	32.6	18.9	13.5	19.4

Source: PREALC (1985).

^aCumulative annual rates.

^bAs a percentage of the total economically active population.

This was the same policy prescription that was being made at the world level, and enthusiasm for it was given a particularly strong boost by the successful experience of the South-East Asian countries, which gave rise to a good deal of research work in Latin America. Two types of studies can be distinguished. First, there were those whose arguments were made at the macroeconomic level and were based either on an analysis of trade régimes and performance, such as the Krüger-Bhagwati (NBER) project, or on a comparison of the performance of Asian and some Latin American countries. In both cases, the message was that the opening of the economies was the only method of ensuring growth and job creation. Some caveats were introduced, for instance, by the different readings of the national case studies that led the two co-ordinators of the NBER project to write separate project summaries (1978) and by the more thorough analysis made by Ranis (1983), who noted the importance of the initial conditions which determine different development paths but who also argued that changes such as agrarian reform and increasing agricultural productivity, together with rural industrialization and a shift towards more labour-intensive technologies and product mixes, could be introduced at any stage of development. A second line of research that was undertaken was to estimate the differential effect on employment of import substitution as compared to export promotion in the manufacturing sector. This was done in the cases of Brazil, Colombia, Chile and Uruguay (Krüger, *et al.*, 1981) by calculating employment effects using an input-output model. The conclusion was, in general, that the exports basket was more labour intensive, but that the existing structure was dominated by processed raw materials in which the respective countries had absolute comparative advantages.

The conclusions of this research pointed to the need to follow a more outward-oriented strategy and to make a better use of trade instruments, particularly lower tariffs and higher rates of exchange. This might be accompanied by incentives to produce capital goods which could also result in foreign exchange savings as well as a more integrated industrial structure. At this stage of development, the characterization of the situation as being one of import substitution

versus export promotion sets up a false dichotomy. Most Latin American countries now possess an industrial base which, although it could be upgraded, is already supplying increasing exports (Teitel and Thoumi, 1986). The issue is how to make it more efficient and how its capacity can be improved to compete in world markets. We will come back to this subject later on.

A third important dimension of employment-related research was that of technological change. In this connection, technology was analysed at various levels. At the macroeconomic level, the models developed to explain why the modern sectors were unable to absorb labour at the required pace, placed great importance on the process of technological transfer and dissemination and on the characteristics of imported technology. The main argument as presented by Pinto (1965) stressed the inappropriateness of technology created in developed countries in the light of the factor endowments of the Latin American countries. In addition, as little innovation or even adaptation was being undertaken, such technology was being transferred to an entirely different structural environment which was, for the most part, characterized by a greater concentration of capital and abundance of labour. The main result was that the benefits of technical progress were not reaching the majority of the population, while productivity differences (and, hence, income differentials) tended to be wider and did not show any tendency to decrease, as they had in what are today developed countries (Pinto, 1970; Tokman, 1982; Tavares and Serra, 1971). In terms of employment, this more heterogeneous productive structure meant that a higher investment cost was involved in absorbing the natural movement of labour between sectors (from agricultural to non-agricultural) and between different technological strata (from informal to formal sectors).

An analysis of technological choice was also made at the sectoral level, mostly in reference to the manufacturing industry. Many production function analyses were conducted which calculated elasticities of substitution (PREALC, 1980) and, in general, they indicated the presence of little flexibility. More possibilities of job creation were identified at a more disaggregated level (by

industrial branches, by size of establishments) and when indirect effects were included (PREALC, 1982b). The generation of employment was, then, apparently more responsive to demand composition (which was, in turn, heavily determined by income distribution) and to the possibility of promoting business establishments of certain sizes rather than to changes in relative factor prices.

Labour absorption in modern sectors, which on the whole was similar to international standards, exhibited several characteristics that affected the employment level and structure. The expulsion of labour from agriculture led to accelerated migrations to urban areas, and although the levels of investment and growth were generally high, dependency resulted in unstable growth and technological inadequacy, while the trade strategies then in use were unable to overcome the foreign-exchange constraint. This demand behaviour also needs to be placed in context, inasmuch as the labour supply was growing so quickly that its rate of expansion was faster than those observed during comparable periods even in the more recently industrialized and younger developed countries such as the United States or the Northern European countries. The rapid growth of the labour supply was concentrated in urban areas, where internal migration was combined with high fertility rates and an age structure which resulted in a rapid increase of participation in the labour market. The outcome has been dynamic insufficiency, to use Prebisch's words, but in relative terms. Employment was created, but it was insufficient to cope with the requirements of the labour supply, with the result that a significant although slowly decreasing segment of the population was employed in low-productivity activities. This was the main feature of the urban employment problem in the 1970s, and considerable research was done into the characteristics, organization and economic interrelationships of those working in the urban informal sector.

b) *The recalcitrance of underemployment*

A great deal of research on the urban informal sector was conducted following the introduction of the topic at the world level by the ILO in its Kenya report (1972). In Latin America, under PREALC's leadership, many studies were pro-

duced which resulted in a better understanding of the sector as well as in policy prescriptions designed to help those people working in this sector (PREALC, 1981b). An in-depth review of this literature exceeds the scope of this paper and has been undertaken by the author elsewhere (Tokman, 1978; 1987b). However, it may be useful to review briefly some of the findings of the academic work done concerning the definition of the sector, the nature of behaviour patterns, growth models and income determination within the informal sector and its heterogeneity.

The point on which scholars have been most in agreement as regards the definition of the sector has been the need to look into the various forms of production as a unit of analysis. This follows the lead of the pioneering Kenya report, but goes further. Surplus labour, unable to find jobs in modern sectors and confronted with the need for survival, has to find income-producing activities to perform. Given their lack of capital, both physical and human, the activities these workers can perform have to be easily accessible. The organization of production is then rudimentary, without any clear division of labour or of the ownership of the means of production and, as a result of competition, average incomes thus become the variable of adjustment (Tokman, 1978; Souza, 1980; Carbonetto and Chávez, 1984). Some authors have emphasized the labour process characterizing informal activities, i.e., unprotected labour (Portes, 1983), while others such as de Soto (1986) have underlined illegality as the main variable of definition. Both approaches are incomplete in that, although there is a significant degree of overlapping with the more accepted definition, they fail to incorporate into their analyses—and consequently, into their policy prescriptions—the need to act upon several variables simultaneously (Tokman, 1987a).

There has been less agreement as to the nature of the sectoral interrelationships involved. The key question, first posed by Emmerij (1974), as to whether evolutionary or involutionary growth of the informal sector could be expected has been answered in different manners. Some authors have highlighted the functionality of the sector and its benign relationship with the rest of the economy (Webb,

1974). Others (Quijano, 1974; Bromley, 1979; Birbeck, 1979) have stressed the subordinate or exploitative relationship either in the labour market, through the supply of cheap labour, or in the product market, through the production of low-cost wage goods. An intermediate analysis (Tokman, 1978) has incorporated the existing heterogeneity within the sector as a means of differentiating between an overall long-run trend towards a decrease in the informal sector's share in total output and the changes of structure likely to occur as a result of the fact that some informal activities are able to expand (mostly services and commerce) while others, such as manufacturing, face stronger competition and may see their market share reduced. If adequate policies are adopted, evolutionary growth of the informal sector can be achieved, at least during a transitional period (which could last for many years), until more productive jobs are created in the modern sectors. This view has recently been challenged by Portes and Sassen-Koob (1987) who, pointing to the recent expansion of these activities in developed countries, argue that the informal sector is a universal phenomenon. This is a crucial issue which should be further analysed.

A third point on which researchers have been in agreement is that the sector is heterogeneous. Most available surveys (Costa Rica, 1985; Carbonetto, 1985) indicate that there are income differentials within the sector depending on the type of activity performed. On average, domestic servants are usually the lowest paid, followed by workers in informal firms, who obtain between double and triple the pay of the former category. Self-employed workers receive around 50% more than wage-earners in informal activities, while the owners of informal shops make more than twice as much as their employees. Although the income figures provide evidence of the existence of significant differences within the sector, after adjustments are made for payments in kind (in the case of domestic services) and for unpaid family members (in the case of owners of informal shops), the magnitude of the differences is reduced to 1.5. This suggests that, in spite of the heterogeneity of the sector, incomes tend to fall within a limited range as a result of competition in the labour market (domestic services, self-employment and

work in informal shops) or in product markets where the ease of entry does not allow for extraordinarily high incomes.

The research focused on the underemployed was also policy-oriented. The main conclusion, in line with the ineffectiveness of the trickle-down strategy, was the proposal of specific policies directly geared to the most affected groups. Selectivity was recommended as a more efficient way of confronting the employment problem, rather than relying solely on macroeconomic instruments. Furthermore, as heterogeneity was found to exist within the urban informal sector, a set of multiple measures was suggested to help the underemployed and, hence the poor by supporting the productive unit, improving the welfare of the family and reforming the corresponding institutional arrangements so as to make these policies viable and more effective (PREALC, 1981b; FAO, 1987).

2. Employment policies in the 1970s

Specific policies to tackle the underemployment problem were the exception. The belief that sooner or later the trickle-down theory would work was supported by very rapid growth during the decade, which was largely financed by foreign capital. This dynamism obscured the fact that, in spite of such growth, underemployment levels were decreasing at a very slow pace.

The only general exceptions to this were specific supply-side policies or those measures geared to the improvement of labour-market transparency. Professional training institutions expanded their programmes, while labour exchanges were gradually incorporated into many labour ministries in the region. Their effects were limited, however, because they were based on a diagnostic analysis that was not in keeping with the situation in Latin America, where the employment problems were mainly due to a lack of productive jobs rather than to a mismatching of skills or of vacancies with the unemployed.

The insufficient creation of jobs in modern activities despite rapid growth was, if anything, attributed to mistaken macroeconomic policies. Indeed, the 1970s were an active laboratory for different economic policy approaches which, in

turn, led to additional research. I will refer to only two of the issues involved: the orientation of internal demand and the degree of openness of the economy.

Internal demand is a function of the level and distribution of income. In many countries of the region two antagonist models were followed in the course of the 1970s. In the early years of the decade when political forces were more favourable to a redistribution of income, a strategy first propounded by Dudley Seers in the ILO Colombia Report (1970) was based on the idea that income redistribution, apart from being an end in and of itself, would generate a "virtuous circle" of job creation, foreign exchange savings, and growth. The main argument was that the shopping basket of consumer goods of lower-income groups was more labour-intensive and involved the use of less foreign exchange than that of higher-income groups because the production of food, clothing and shoes required more labour and less imports than the production of durable consumer goods, which were mainly assemblages of imported components. A series of research projects on a number of countries in the region were undertaken in an effort to quantify the possible employment effects and the automaticity of the process (ILO, 1975; Foxley, 1974; Cline, 1972; Figueroa, 1972; Tokman, 1975). The main conclusions they reached were that such a strategy would create more jobs primarily due to its impact on the balance of payments and that, while changes in the consumption structure would also favour employment, the effect would be slight because the net employment effect within manufacturing would not be great owing to the capital-intensiveness of food and beverage production and the fact that the increased demand for agricultural products would be partially offset by a reduction in the demand for services.

The importance of technology was also crucial and was particularly associated with the size of the business establishments which would meet the increased demand and with the degree of obsolescence of existing plants (Tokman, 1975). More recent work on linkages also shows that indirect effects are important considerations, since the production of wage goods is generally more integrated than that of consumer durables (García, 1984; García and Marfán, 1985).

This policy was usually placed within an expansionary policy context in which the prevailing macro-régime was assumed to be of a Keynesian type dominated by insufficient effective demand. Wage policies were seen as appropriate redistributive instruments and, hence, were thought to bear a positive relation to employment. In addition, unused capacity was found to exist in many industrial branches, particularly those which produced wage goods. These policies were tried out to different extents and with diverse results in countries such as Argentina, Bolivia, Chile, Colombia and Peru during the first half of the 1970s. They did not last long, however, not only because of unforeseen internal economic results (such as supply shortages) but also because the international economic situation changed dramatically after the first oil shock. An even more important factor in some countries was the political instability which accompanied this strategy, particularly in Argentina and Chile, where the balance of power among social groups was affected.

The second half of the 1970s was the scene of radical changes in both the political and economic spheres. Military régimes took power in many countries and neo-liberal policies were tried out to varying degrees, especially in the Southern Cone countries. Employment issues were clearly linked to the economy's inability to expand at a sufficiently rapid rate, which, in turn, was attributed to the heavy protection of the internal market and to excessive government intervention in the market. The relevant diagnoses, as well as the corresponding policy prescriptions, are well known and a discussion of them would go beyond the objectives of this paper, but it is important to note that the results of research on the constraints and application of import-substitution strategies were available and that new research projects were undertaken in order to evaluate the effects of the more recent policies, particularly as regards their costs in terms of a more regressive distribution of income, lower employment levels and reduced wages. Several studies (Foxley, 1982; Cortázar, Foxley and Tokman, 1984; Canitrot, 1983; Prebisch, 1982) analysed the impact of neo-liberal policies which resulted in a de-industrialization process and even, in the extreme cases of Argentina and Chile, in the destruction of industries due to an excessive

opening of the economy through a combination of low tariffs and undervalued fixed exchange rates. Import competition plus the high capital costs of attracting foreign capital also gave rise to a large number of bankruptcies and to a deterioration in the financial position of many firms which has not yet been rectified. High rates of interest also distorted the allocation of investment, channelling it towards short-run high-yield financial speculation or residential and commercial construction for high-income groups. Wage policies were restrictive because it was assumed that the prevailing régime was of a neo-classical character and, therefore, real wages were inversely related to employment; in addition, given the existence of an undervalued and fixed exchange rate, it was also thought that wages should be kept low to maintain international competitiveness (Cortázar, 1984; Canitrot, 1981).

The effects on employment were chiefly a reduction in its level in modern sectors, along with a consequent increase in open unemployment (Chile and Uruguay) or in underemployment, through the expansion of informal-sector employment (Argentina), or a combination of both (Costa Rica). The employment structure

also shifted away from manufacturing and, in some cases (e.g., Chile), away from public employment (Tokman, 1986a). Real wages decreased, since the neo-classical analytical framework used for policy design included this as one of the main targets, while in some countries, union intervention and changes in the wage-bargaining process ensured that the desired economic policy was achieved. This also resulted in a change in social stratification that was unfavourable to organized labour, since leading sectors in manufacturing lost constituents in absolute terms; furthermore, their demands were less uniform due to the changes induced by the opening up of trade and of the financial sphere, and their bargaining position was weakened by the increase in unemployment and informal employment (Lagos and Tokman, 1984).

Not all the effects on employment were negative. Changes in the structure of production did generate new jobs, particularly in modern agriculture, due to the expansion of new highly labour-intensive exports and the restructuring of some branches of the industrial sector which allowed for productivity increases and technological updating.

II

Employment issues and policies in the 1980s

The international crisis which had hit Latin America by 1982 clearly revealed the precarious nature of the source of growth during the preceding decade as well as the weaknesses of the neo-liberal approach. What occurred is well known: huge increases in international interest rates, the deterioration of the terms of trade and the recession in world markets were aggravated by the pro-cyclical behaviour of private international banks, which drastically reduced the availability of new funds just when they were most needed, thereby seriously affecting the highly indebted economies. There was no alternative but to adjust to this situation and, under the international pressure exerted by donor countries, bank creditors and international financial

institutions, all the countries in the region eventually accepted the conventional IMF economic adjustment package. Paradoxically, this new state of affairs led to a more thorough re-thinking of the prevailing economic policies than had previously been undertaken, as well as increasing the political feasibility of the specific policies suggested by researchers and some advisers during the preceding decade.

1. *Adjustment policies. Their management and their effects*

The first issue to be taken up was the critical review of the adjustment policies adopted by most countries. Two lines of analysis were fol-

Table 2
LATIN AMERICA: ECONOMIC CRISIS AND THE LABOUR MARKET, 1980-1985
(Cumulative annual rates)

	Growth of GNP	Employment effects						Wage effects				
		Non-agri-cultural employment	Unemployment	Urban informal employment ^a	Public employment	Employment in small firms ^b	Employment in manufacturing	Construction	Minimum urban	Industry	Public	
Latin America ^c	0.5	3.3	8.1	6.8	4.6	6.6	-2.2	-3.3	-3.1	-2.3	-3.2	-2.9
Argentina	-2.5	0.5	21.8	3.2	1.0	...	-3.2	0.4	2.5	0.9	-0.7	...
Brazil	1.8	4.3	-0.8	9.3	4.9	11.6	-2.5	-3.3	-3.5	2.0	...	-0.4
Colombia	2.1	3.3	11.6	5.4	-2.9	1.2	1.6	2.6	...	3.0
Costa Rica	0.3	2.4	9.6	2.2	2.3	...	7.2	-1.0	2.3	2.6	-3.5	2.6
Chile ^d	-1.6	1.2	9.5	1.2	-4.6	...	-1.7	-15.3	-10.6	-5.1	-3.3	-9.9
Guatemala	-1.2	0.4	47.5	1.6	7.7	0.7	-1.2	4.1	...	5.7
Mexico ^d	-0.5	3.6	6.6	8.4	7.4	0.3	-2.7	-2.4	-9.7	8.5	...	-9.3
Peru ^d	-1.7	0.9	18.5	6.5	2.4	...	-4.7	14.9	-3.7	-13.4	-16.5	-8.4
Venezuela	-2.0	1.7	20.4	2.2	0.9	2.8	-0.5	0.4	2.5	0.9	-0.7	-0.8

Source: PREALC (1987).

^aSelf-employment, unpaid family workers and domestic services.

^bUnder 10 employees.

^cEmployment effects refer to a weighted average of nine countries. Wages refer to arithmetic averages for about 12 countries, depending on the type of wage in question.

^d1981-1985.

lowed. The first concentrated on the social cost of such policies, since the policy package was clearly biased against those population groups which could least afford the cost of adjustment. Studies by Cornia, Jolly and Stewart (1987), Tokman (1986a, 1986b), PREALC (1985, 1987) and ECLAC (1985), among many others, raised this issue and analysed the effect of these policies on the labour market and, particularly, on the poor. This recessive policy package generated a contraction in the demand for labour by modern firms which, given the rapidly increasing labour supply, produced a significant expansion of open unemployment. Not only were fewer jobs created, but those that were generated were of lower quality. A rapid increase in informal employment, in services as compared to manufacturing, and in public employment in relation to the modern private sector diminished average productivity and resulted in a deterioration in income. This latter effect was reinforced by the decline in real wages, which was one of the key instruments of the adjustment policy package. The impact on the labour market was also compounded by the decrease in social expenditure, which was also a consequence of the required reduction in fiscal deficits, another key component of the package (see table 2).

The second line of analysis, which was, of course, not independent from the first, involved an assessment of the efficiency of economic policy instruments in correcting disequilibria. The Latin American experience clearly demonstrates that a distinction must be made between theory and reality. Although most countries were able to adjust in a very short period, they did so by cutting imports, and the adjustment was thus achieved at the cost of a pronounced recession, with inflation accelerating and real wages deteriorating simultaneously. Both of these outcomes challenge the prevailing theoretical framework, which identifies excess expenditure and a loss of international competitiveness as the main causes of the problem. The standard policy package is a mixture of contractive fiscal and monetary measures and of policies designed to shift resources from non-tradeables to tradeables by means of a devaluation of the exchange rate in real terms in relation to wages. According to this model real wages do not necessarily have to fall, since the corresponding requirements apply

only to the prices of tradeables and the recessive impact of demand policies could be at least partially counteracted by the expansionary effects of the devaluation.

The reasons why this package resulted in an over-contraction of the economy are analysed in several studies (Foxley, 1982; Ffrench-Davis, 1983; ECLAC, 1984; PREALC, 1985; Taylor, 1987; Meller and Solimano, 1987). It is interesting to note three of the many conclusions they reached. The first is that the productive structure in the region is characterized by inelasticities and, hence, the response to macroeconomic policies is slower in coming and produces effects of a lesser magnitude than in more developed countries. The second is that the expansionary effects of a devaluation are only registered after the recession and generally with a lag of two years, which, given the chronic instability of the Latin American economies, usually means never. This is so in the present conjuncture because of several factors. International recession and protectionist policies reduce the potential impact on exports, particularly when there are competitive devaluations in countries with similar factor endowments. Trade structures in Latin America are price inelastic due to the large share of commodities and raw materials in total exports and to the importance of inputs and raw materials in the import bill. A devaluation affects overall prices through cost pressures and expectations and, as a result, real wages fall. This change in the distribution of income affects consumption and introduces additional contractionary forces. Finally, in a situation where most private firms are heavily indebted abroad, a devaluation significantly raises financial costs, thus affecting these firms' capacity to increase production. A third conclusion of these research projects has been that, as the policy package operates at the macro level, it has to introduce more pronounced changes in economic policy instruments than if a more selective policy package were used. This occurs with a devaluation when a large part of tradeables are price inelastic and register absolute comparative advantages or with an internal credit contraction which affects all borrowers regardless of their size or labour intensiveness.

An important aspect of the adjustment for those concerned with research and policy was that the recession coincided with very high and

increasing inflation in some of the countries, particularly Argentina, Brazil, Bolivia, Peru and Uruguay. The need to control inflation while minimizing the social costs led to heterodox proposals which were adopted in the first two of these countries (the Austral and Cruzado plans, respectively). Without entering into the many different aspects of these policy designs, one of their main characteristics was the identification of the regulations governing contracts, particularly within the labour market, as one of the principal causes of inflation. Highly indexed contracts, including wage contracts, were seen as having a built-in inertial component which resulted in rapid inflation even if, as was argued in the case of Brazil, both the balance of payments and the fiscal budget were in equilibrium (Arida and Lara Rezende, 1985; Frenkel and Fanelli, 1987; Frenkel, 1986; Arellano, 1987; Lopes, 1986; Modiano, 1986). A key component of these programmes was therefore to change these regulations, by concentrating readjustment dates and eliminating indexation. This step was analysed and proposed by Pazos when he compared European hyperinflation with chronic inflation in Latin America in a pioneering book (1972). A revival of inflation during both the post-Austral and post-Cruzado programmes demonstrated the resiliency of inertial factors and opened up new fields of inquiry into means of identifying how these changes in labour and other contracts could be given a more permanent character following the first stabilization shock, which, in both cases, also included wage and price freezes.

As a result of research and of policy experiments, today more is known about the management of economic policies and there is a greater awareness of the social costs involved in the adjustment process. Furthermore, research has provided grounds for the conclusion that, although adjustment costs may be unavoidable during crises such as the recent one, their magnitude and particularly their distribution among social groups can be affected by policy management. Accordingly, new policy proposals have been put forward which give priority to the protection of poorer groups during the adjustment period. *Ajuste con rostro humano* ("adjustment with a human face") (1987) and *Adjustment and social debt* (1987) are only two examples of such proposals.

2. A greater opportunity for specific policies. The case of the informal sector

The greater awareness of the situation of the poor and the expansion of informal employment have increased the popularity of specific policies as a means of supporting the sector. This is the second major employment issue of the 1980s. The popularity of such policies is reflected in many government declarations and instances of policy implementation in a number of countries, including Peru, Colombia, Guatemala, Ecuador and Bolivia, as well as in the increasing interest shown by private foundations at both the national and international levels in the financing and implementation of such policies. This interest is also one which is increasingly shared by such international financial agencies as the Inter-American Development Bank (IDB) and the World Bank.

There are many reasons for the increased appeal of policies aimed at the informal sector (Tokman, 1987a). Some of them are economic, while others are political and/or ideological in nature. The main economic factors include: i) the failure of the trickle-down strategy to bring about a significant reduction in the share of the urban informal employment, as suggested by the fact that the absolute number of people employed in the sector increased by 55% during the last decade; ii) the over-expansion of informal jobs as a result of the crisis of the 1980s (between 1980 and 1985 the number of informal workers increased by 39%); iii) the strong correlation between poverty and informal employment (from 75% to 80% of informal workers receive incomes below the minimum wage); iv) the gloomy perspectives for rapid growth in the next decade; and v) the increased evidence that relatively few resources are needed to implement these policies. The major political and/or ideological factors, for their part, include: i) an increased interest in informal activities at the world level, particularly in developed countries; ii) the return of democratic régimes in most Latin American countries, which allows for more open forms of grassroots organization and pressure, and the greater weight of the sector in elections; iii) the increased degree of conflict and violence in large cities associated with the location of informal activities; and, finally, iv) the

revival of neo-liberal positions and their emphasis on informal entrepreneurship, which, according to these schools of thought is the main sphere in which real entrepreneurial capacity is to be found in developing countries.

In spite of the short period during which such policies have been implemented, at least six major lessons have been learned from this experience. The first is that it is necessary to avoid creating excessive expectations as to the results or the simplicity of these policies. The second is that productive support for the informal sector (access to markets and resources) can only be delivered to a core group in the sector, which is constituted by the more organized units. The third is that such policies will not necessarily result in short-run income gains for the poor segments of the population. Instead the first impact will be an increase in the incomes of informal entrepreneurs, which will not necessarily be transferred to the wages of their employees due to the abundance of labour, job instability, the sector's low skill requirements and the lack of labour contracts or organizations. A delayed impact will be an increased demand for labour which could mean either new jobs or longer periods of work for those already employed; in either case this would have a progressive effect as regards the level of equity. The fourth lesson is that the dual role as household and production unit of many informal establishments heightens the efficiency of a combination of productive support and welfare policies for the target groups. The fifth is the importance of consulting the potential beneficiaries to avoid ill-advised policy designs. Finally, the sixth is that the corresponding institutional infrastructure should be kept to a minimum so as to avoid an overly large bureaucracy, prevent political manipulation and ensure a more permanent form of implementation through existing institutions in the public and private sectors.

3. A new dimension of the employment problem and policies: the unemployed

The third and last issue that will be discussed here in relation to the 1980s is the new dimension of the employment problem which has emerged as a result of the fact that the crisis and the policies followed in an attempt to cope with

it have given rise to increased open unemployment. Between 1980 and 1985 the number of unemployed in urban areas grew by 48% and the unemployment rate rose from 7% to 11%. This is a new phenomenon since historically, the employment problem had been one of underemployment, while open unemployment had been low and stable, except for very short cyclical fluctuations. In addition, the unemployed were mainly members of the secondary labour force (mostly women and young people who were not heads of household) because heads of household could not afford to be without incomes while searching for more formal employment. The rise in the rate of open unemployment was also accompanied by changes in the composition of the unemployed workforce, with increases being registered in the proportions of heads of household, men in the most economically active age groups, and workers with previous experience, in more organized sectors of the labour force and with more education.

Under these conditions, the social effect of unemployment has become more dramatic and the capacity of the unemployed to pressure for policy action has also become greater. As a result, there has been an increased demand for direct employment policies, and several countries have implemented specific employment programmes, including Brazil, Bolivia, Chile and Peru. Some research on the effects of such policy instruments has already been completed, and the amount of data available is rapidly increasing (Rodríguez and Wurgafit, 1987; Houghton, 1987; Vigier, 1987; Cortez, 1987; PREALC, 1987). The general conclusion is that these programmes are efficient instruments during emergency periods because they can be implemented very rapidly at a low cost, can be highly selective and can therefore serve as a means of providing income to the poorest groups. They may also be politically attractive, both because they represent a governmental decision to take action on social issues and because, from a macroeconomic perspective, they can be used to produce a selective expansion of demand, thereby reactivating the economy without exerting too much pressure on the balance of payments or on prices.

As in the case of informal-sector policies, some lessons have already been learned from the

countries' experiences to date. First, these measures are more effective in transferring income to poor families than in reducing unemployment, since many economically inactive members of the target groups enter the market as a result of these programmes. Indeed, between 70% and 90% of the programmes' beneficiaries have been women. Secondly, in order to generate more jobs, the wages paid should be higher and the programmes should be targeted at specific groups (e.g., heads of household), or should be concentrated in zones where unemployment is higher. Thirdly, policy effectiveness is greater when the number of projects is larger and particularly when the projects involve the improvement of sites and services in marginal zones, when the projects' effects are of a more permanent nature (as in the case of

irrigation works or the creation of new firms), and when a sufficient supply of complementary resources, in addition to labour has been made available. Fourthly, in order to avoid mismatching it is necessary to take into account personnel characteristics, as these considerations will influence the type of jobs to be created, the location of the projects and the working hours among other factors. Fifthly, the target groups will show a greater degree of interest if the projects are of direct benefit to the programme participants. Finally, as in the case of the informal sector, the institutional structure for the implementation of these policies should be such as to avoid the creation of large centralized bodies. In order to be effective, the operational scheme should be highly decentralized and as free as possible of political manipulation.

III

The present debate

The need to diminish the social cost of adjustment will continue to be an important policy and research issue in the near future. However, changes in the economic and political situation make it necessary to take a fresh look at the factors involved. On economic grounds, the question is no longer how to prevent the cost of the short-run adjustment from being imposed on the poor, but rather how can the envisaged structural adjustment ensure that the solution of the historical social debt, which increased still further during the recent crisis, is not once again postponed. On political grounds, the re-emergence of democracy places increasing constraints on the traditional way of managing economic policies by decree, while social pressures will be more difficult to put off.

The economic scenario has changed from a short-run to a structural adjustment. There are many reasons for this. First of all, a dramatic short-run adjustment has already been made by most of the countries in the region (at the cost of a 9.5% drop in per capita GNP between 1980 and 1983). There is also a greater recognition of the failure of the short-run policy package to

create the necessary conditions for a longer-term recovery. The expectations of a worldwide recovery which were the basis for the conventional policy prescriptions, have proved to be unfounded and the liquidity crisis has increasingly become one of solvency. Finally, although the Latin American economy has apparently been on the road to recovery since 1984, the progress made this far has been insufficient and may be short-lived, since it is largely the result of falling oil prices and interest rates. Indeed the situation now seems to be reversing; per capita GNP as of 1987 was still 7% below its 1980 level, imports are 32% lower than they were in 1981, and the effects of the recovery on unemployment and real wages have been insignificant.

The proposed structural adjustment should incorporate new research and policy dimensions. The first such dimension relates to the impact of new technologies. The developed countries have been in the process of restructuring for more than a decade now, and the adoption of new technologies is affecting labour processes as well as labour organization. This aspect has received only marginal attention in Latin America, in

spite of the rapid incorporation of new technologies taking place in modern sectors. Two issues seem to be important in this context. Firstly, there is a need to determine what effects the new technology is having on employment, including its impact on employment levels, as well as changes in the skill profile. Research on this aspect, which even in the developed countries is still inconclusive (Emmerij, 1987), should take into account the local characteristics of the production structure and skill availability. Secondly, there is the issue of the organization of labour processes. The greater flexibility of the production process made possible by the new technology promises to be one solution for problems of low productivity in the developed world, but it also affects labour relations and, particularly, labour legislation and protection. In response to this situation, policies aimed at reforming labour codes and social security systems are being suggested, but in general they have not been based on a sound analysis of the existing situation or of the relevance of prevailing formulas to the specific characteristics of the region. These are areas in which joint efforts by the North and South could produce greater benefits.

Another area of interest is the management of economic policy instruments within a framework of structural adjustment. It is possible to analyse the effects of most such instruments on employment and income, but only two types need be mentioned here in order to illustrate the issue: public expenditure and wage policies. Undoubtedly, the possibilities of increasing public expenditure will be limited in the future. Indeed, the need to keep fiscal deficits under control will probably require spending cuts. This lends greater importance to the criteria to be followed in order either to increase employment and equity and the role of the public sector as an employer, or, in the case of reductions in public spending, to lessen the effects on them.

A selective management of public expenditure requires a knowledge of the impact that different factors or projects would have on employment and income. A number of studies have already been conducted on the employment effects of public investment (PREALC, 1984), as well as several studies on the impact of public expenditure on the poor (Foxley, Aninat and Arellano, 1979; Rodriguez, 1985; Webb, 1973;

PREALC, 1976). This opens up greater opportunities for a more selective management and targeting of public expenditure, and under these circumstances, research done during the previous decade may well prove, as in the case of the informal sector, to be a useful input for policy design. This, in turn, generates additional research requirements.

The public sector has historically been an important employer in Latin America. Public employment has increased at faster rates than non-agricultural employment and its share has grown even more rapidly in those jobs performed by the more educated (Echeverría, 1985). This has partly been the result of an increase in the functions performed by the public sector, but in part it has also been due to the fact that the sector has served as a buffer in order to diminish the social conflict associated with the inability of the private sector to create jobs at a required rate. If current trends continue, however, it is unlikely that the sector will be able to play this major role in the future, even if massive public employee lay-offs can be avoided. This opens up areas of analysis in which more research is needed. One such area relates to the question of public employees' functions and incentives, particularly in a context where reductions in the wages paid in the sector affect its ability to attract personnel having the required skills and knowledge. Another concerns the impact that a less dynamic role for the public sector could have on the overall employment situation, on unemployment as such and on the demand for given skills. This, in turn, would involve a review of the educational system, particularly at university level.

The second area of economic policy in which additional work is required is that of wages. It is generally acknowledged that real wages have declined during the adjustment period. In many countries, the present wage level is below that which prevailed at the beginning of the 1970s. A key component of any strategy will thus be an adjustment of wages with a view to restoring them, at the least, to their pre-crisis levels. However, macro- and microeconomic constraints usually lead to the adoption of a common formula under which, in the best of cases, wages are to be kept constant in real terms or, more often, further reduced. The constraints do indeed exist, but this approach is inconsistent with a policy

aimed at diminishing the social debt. New options must therefore be found. To this end, research should be undertaken to explore, for example, the degree of wage-structure flexibility which would allow for greater and differentiated readjustments in the minimum wage; the possibilities and operational means of linking readjustments to changes in productivity; and new methods of bringing about a dynamic redistribution of income and wealth through worker profit- or capital-sharing schemes.

The formulation of such wage policies will also heighten the need for further research into how labour markets function in developing countries. In the past, this has been an almost forgotten field of inquiry, inasmuch as it falls between the subject area of concern to those who have approached the employment problem from a growth and equity perspective and that of interest to those who have concentrated on a more traditional sort of labour market analysis. The behaviour of employment and wages in segmented markets has, however, led to a search for alternative analytical frameworks in these cases. The factors determining employment and wages seem to be different depending upon the segments involved, and their interrelationships are a matter that is still under discussion. The setting of wages observed in more organized sectors transfers the weight of the adjustment to unemployment, while the marked accessibility of the informal sector makes wage and income flexibility the variables of adjustment. The choice between employment at low income levels and open unemployment is not yet clear. Further research in this area will therefore be required for purposes of policy design, since con-

ventional analyses do not provide sufficient information in this regard.

Finally, the present political scenario also opens up more opportunities for interdisciplinary research. Increased bargaining and participation by social actors will call for substantive efforts in many fields within Latin America. Firstly, an effort will have to be made to build up the institutional capacity of the agents involved, and this will require a fuller knowledge of the economic situation and an ability to deal with technical issues. Secondly, the stronger the agents involved, the more lasting and equitable will be the outcome of such negotiations, and this in turn creates a need for legitimacy. Thirdly, changes in government will also have to be made in order to establish the procedures for intervention in the event that it becomes necessary, as well as in order to build up the human resources capacity required for such a step. Finally, those not represented by the traditional social actors (workers and employers), such as peasants and informal workers, should also be allowed to participate. This means that the constraints affecting them and, even more importantly, their demands must be identified. It will also require the design of more efficient institutional means of attending to these demands, which are usually made at the local level. In turn, decentralization policies should be explored with a view to increasing the delivery capacity of the public sector. Finally, negotiations between established groups should go beyond questions of equity and consider job creation as an important objective, since in the long run this will be the most effective way of assisting those now working in low productivity sectors.

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Small and medium-scale industry in the development of Latin America

*Mario Castillo and Claudio Cortelless**

The option represented by small and medium-scale production has taken on the status of a virtual paradigm. As such, it is regarded as an effective alternative for coping with unemployment and the shortage of capital and for maximizing entrepreneurial capabilities and the flexibility of production.

The subject of small and medium-scale industry (SMI) is addressed in this article from a variety of important and complementary angles. Following a consideration of the conceptual framework for SMI, the authors compare the available evidence relating to Latin America with that pertaining to the industrialized countries. Then, after evaluating three quite distinct regional cases (Brazil, Colombia and Chile), they go on to analyse the successful experiences of Japan and Italy. In the final section of the article the authors set forth some proposals with respect to the potentials of SMI in the region.

In order to analyse SMI from the standpoint of industrial policy, it is essential to clarify and dispel the formal/informal, traditional/modern dichotomies and, in particular, that said to exist between marginal enterprises and small enterprises operating on the basis of a capitalist approach.

The available evidence at the international level indicates that there is no one standard pattern as regards the development of SMI; rather, a variety of successful experiences substantiate the view that SMI can function efficiently and make an effective contribution to development when social and institutional factors and elements of economic strategy join together to support this option.

A selective promotion of SMI may thus play a substantive role in bringing about a transformation of production by contributing to articulation, technological innovation and entrepreneurial development.

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Introduction

The controversy surrounding Latin American industry in the 1980s, at a time of deep and prolonged economic crisis, has been strongly influenced by three very significant events. In outline, the first of these is related to the growing frustration felt with the results of the industrialization process during preceding decades; the second has to do with the re-opening of the debate concerning the informal economy, the micro-entrepreneurial phenomenon, public policies and the role of the State apparatus; and the third event is the sweeping technological change which is now taking place in the advanced countries' systems of production.

The challenge represented by the need to restructure industry in the countries of the region is a broad-ranging one. In the short run, such a reorganization ought to contribute to an expansionary adjustment of the economy which, in the longer term, will in its turn permit a successful articulation with strategies for redirecting development and make it possible for the region to assume an appropriate position in the new international context. This restructuring should not only help to overcome the long-standing disequilibria and asymmetries exhibited in so many different forms in the societies, economies and institutions of the Latin American nations, but should also take into account those external conditions which have taken shape most recently, such as the trends now being observed in the international economy, technological changes, the sharpening of competition and the dwindling flow of external financing.

As the situation in these economies becomes increasingly difficult, the use of small and medium-scale production units is fast becoming an option as one basic component of a new style of industrialization. Given the existence of widespread resource constraints, the explosive growth of the informal economy and of unemployment, the disarticulation of markets, the inflexibility of various aspects of the production structure and the uncertain nature of entrepreneurial leadership, it is understandable that small and medium-scale industry (SMI) holds an irresistible attraction for a wide circle of analysts, politicians and planners.

Nonetheless, there is also an enormous gap between the hopes placed in this type of productive organization and the available evidence concerning its real potentials. The current thinking as regards SMI in Latin America is, in our opinion, seriously flawed in that it relies on ambiguous conceptual underpinnings and makeshift descriptive and quantitative bases.

The authors' aim in preparing this article is to help realign the debate concerning SMI in Latin America, provide new inputs and clear up some common points of confusion. To this end, the article takes an exploratory tack in three

directions. These are, firstly, the suggestion of an analytical framework for analysing SMI from the standpoint of industrial policy; secondly, the compilation and analysis of the evidence pertaining to some industrialized countries and to the Latin American region, with particular reference to Brazil, Colombia and Chile; and thirdly, the identification of the most promising prospects for Latin America in the light of both the successful experiences of other countries (Japan and Italy) and the region's unique features and potentials with respect to industrial development.

I

Contemporary thought concerning SMI

In the developing countries, the debate concerning small-scale production was re-opened by the publication of an International Labour Organization study on Kenya in the early 1970s (ILO, 1972).¹ Since then, many more research projects have been done on the role of small and medium-scale enterprises and the impact they have on economic systems. These analyses, whether empirical or theoretical, have concentrated on describing the relationships between small and medium-scale enterprises and the other components of the economic system, the economic characteristics and behaviour of these production units and the obstacles that have held back their development (Schmitz, 1982). Yet the debate is still going on, and it comes as no surprise that many opinions and results appear to contradict one another.

How small and medium-scale enterprises are defined and what possible role they are seen as playing in economic development particularly within the industrial sector, are closely related to the characteristics of the economic system concerned. This article focuses on small and medium-scale industrial enterprises (SMIs), their role in the industrialized countries and the potentials they exhibit in the case of the develop-

ing nations. Finally, a paradigmatic definition of small and medium-scale industrial enterprises will be proposed, and it is this definition which will be referred to throughout the article.

With regard to such a definition, it should be noted that the real indicators and variables which are actually used for the classification of firms are not the most appropriate ones for describing the characteristics of a productive organization. There is, inevitably, a gap between the qualitative description and the quantification of business enterprises. The standard of measurement of the variables used to identify real enterprises needs to be simple and easily verifiable, as well as being based on suitable statistical sources. Since in real life it is an accepted fact that it is impossible to measure easily and fully all the identifying characteristics of a firm, analysts have opted for simple variables, such as the number of employees, the value of fixed capital or total sales.

In this article the following classification will be used: i) *micro-enterprise*: 10 or fewer employees; ii) *small enterprise*: 10-49 employees; iii) *medium-scale enterprise*: 50-99 employees; iv) *large enterprise*: 100 workers or more.²

¹Among the more comprehensive earlier works, see Staley and Morse (1968) and Hoselitz (1959).

²On the basis of this classification, many industries which are categorized as SMI in developed countries with large markets may

1. The role of SMI in industrialized countries

In the industrialized countries, the articulation existing among the various developmental actors is quite solid and permits a relatively more even blending of the economic performance of each part of the system, as well as ensuring its dynamism. In such economies, SMI is generally an integrated part of the industrial system.³ Analyses of the situation in the industrialized countries may be said to have arrived at some degree of consensus.⁴

The characteristics and potentials of SMI as regards the development of a given economic system have been discussed by various authors.⁵ In this article, however, the discussion will be confined to only those major spheres in which SMI has played a significant role: dynamizing the production structure, technological progress and social development.

SMIs are generally more flexible than larger units thanks to the greater ease with which they are able to adjust their use of the factors of production to market conditions. This is particularly true in the case of labour. For a variety of institutional reasons, it is easier for very small units to hire and dismiss personnel. In the remaining cases, the small numbers involved lessen the social reaction and any labour union action in response to dismissals, as well as the risk that bottlenecks may affect staff recruitment.⁶ They are also able to use capital more

flexibly, since the absolute values involved are such as to permit swift decision-making; furthermore, SMIs can make use of a broader range of production techniques and equipment (i.e., second-hand machinery) since in their case the cost of adaptation is low. These enterprises are also flexible as regards demand; SMIs usually deal in small markets or market segments, and this allows them to meet any variations in demand with appropriate speed.

The technological development of an industrial system consists of innovations (in the processes used, the product concerned or the form of organization) and their dissemination. It is difficult, however, to set out parameters for identifying an individual production unit's contribution to the technological development of an overall system, and this, in the authors view, is one of the obstacles to the achievement of a general agreement as to the correct interpretation of the situation on an empirical basis. Nonetheless, in a number of cases the effective capacity of SMI for technological innovation has been demonstrated.⁷ There does appear to be a consensus, however, as to the fact that SMI does play a highly important role in the dissemination of technology and in new technologies developed on the basis of advances in microelectronics and information sciences.⁸

be regarded as large enterprises in developing countries. In the United States and the Federal Republic of Germany, for example, small and medium-scale enterprises are considered to be those employing fewer than 500 people; in Japan, the dividing line drops to 300 employees; in Chile, it is set at 50 and in Trinidad and Tobago, at only 25.

³For a statistical analysis of the impact and economic performance of SMI in some industrialized countries, see the third section of this article.

⁴In the literature concerning SMI in these countries, production units or business establishments are usually classified on the basis of fixed capital and/or the number of employees, with the latter being the most commonly used. Generally speaking, production units having between 10 and 500 employees are categorized as SMI.

⁵See, *inter alia*, Hoselitz (1959), Anderson (1982), ECLAC (1988), ECLAC/UNIDO (1986), Schumacher (1973), Berger and Piore (1980), Brusco (1982), Fua (1983), Ikonoff (1986), Kaneda (1980) and Secchi (1985).

⁶See, for example, Brusco (1982), Storey (1983), Fua (1983) and Berger and Piore (1980).

⁷In regard to the United Kingdom, see Pavitt, Robson and Townsend (1987). After analysing 4 000 "significant" innovations made in the United Kingdom between 1945 and 1983, the authors found that the coefficient of innovations/employees was above the average in enterprises having fewer than 500 employees and in those having more than 10 000 employees. Firms with 100-199 employees had the highest ratio between their proportion of innovations and their share of employment in industry. The results are more significant at a greater level of sectoral disaggregation. Cohen, Levin and Mowery (1987) analysed the intensity of research and development in the United States. They concluded that the size of the firm involved in these activities has no statistically significant effect on R & D intensity, but that firm size did affect the probability that such activities would be undertaken. In regard to Italy, see ECLAC (1988), which underscores the important contribution made by SMI to technological progress, particularly in the field of process-related innovations.

⁸Regarding the role of SMI in the development of technology in the OECD countries, see OECD (1982). Concerning the spread of technologies to the industrial system and decentralized systems of technological development, see Stohr (1986). A great deal of literature is available on the subject of new technologies. The topics of the minimum scale of production and technical efficiency have also taken on renewed importance; see, *inter alia*, Jacobsson and Sigurdsson (comps.) (1983), Jacobsson (1985), Bhalla and Dilimus (1986), Pérez (1985) and Kaplinsky (1983 and 1985).

Finally, the role of SMI in social development should be mentioned. The existence of broad networks of small and medium-scale enterprises in Italy and Japan, for example, has strengthened their socioeconomic articulation and social cohesiveness. In Italy, the spread of SMI and the characteristics of this process have permitted a good distribution of industrialization, a low level of concentration in urban areas, the maintenance of some degree of social equilibrium during the process of economic change and a certain measure of institutional stability.⁹ In Japan, the existence of an SMI structure which is particularly well integrated with that of large firms has facilitated a smooth process of economic development and has created the conditions necessary for the social changes needed in the country.

2. SMI in developing countries

The potentials and performance of SMI in developing countries have been much analysed; these studies have, however, arrived at what are often contradictory conclusions.¹⁰

The existing literature highlights the role of SMI in the economic and social spheres. As regards the former, SMI has been characterized as highly labour-intensive, flexible in responding to changes in the market and in technologies, energy-efficient and capable of taking advantage of local abilities and materials. It has also been stated that SMI contributes to a more equitable distribution of income, to a higher rate of saving and reinvestment, and to the integration of the industrial structure. In relation to the social sphere, SMI has been portrayed as making a fundamental contribution to economic democracy by promoting social re-articulation and participation, as fostering entrepreneurship, narrowing the gap between the small cottage industries of the informal economy and large

firms, and constituting an efficient mechanism for the deconcentration of ownership.¹¹

Others, however, have taken more cautious positions and have sought to ascertain the actual scope of SMI and the accuracy of the above assertions.

Their doubts concerning the economic performance of SMI are focused on three areas.¹² The first of these is the production efficiency of SMI. All the studies which have been done agree that the labour productivity of SMI is considerably lower than that of large firms. Nonetheless, some analysts assert that there may be economically efficient technologies or combinations of factors which could raise the productivity of SMI. The debate on this point encompasses the entire and much-discussed subject matter of the influence of prices on the choice of production technologies, the distortion of the prices of factors of production and the elasticity of substitution between capital and labour (Ahluwalia, 1974). The question as to the degree of efficiency of SMI is not without importance, particularly in view of the existing constraints on resources for development (Little, 1987; Anderson, 1982).¹³

The second area of doubt, which is conceptually related to the above, concerns the supposedly greater labour-intensiveness of the technologies used by SMI. Studies have been done which demonstrate, at an aggregate level, that small firms make a greater use of labour in relation to capital. However, other research projects based on disaggregated analyses of the capital/labour ratio or the output ratio have concluded that in many cases SMI makes a greater use of capital per unit of output and per worker.¹⁴ While we will not go into all the criticisms which have been directed at the theoretical

¹¹See, *inter alia*, Staley and Morse (1968), Schmitz (1982) and FUNDACOMUN, ILDIS and CORDIPLAN (1978).

¹²In the past few years the World Bank has gained a considerable amount of experience in SMI assistance programmes and in empirical and conceptual research on the role played by such enterprises. For a quite critical but nonetheless very useful and clearly-presented study on the actual performance of SMI in developing countries, see Little (1987).

¹³Rates of saving and reinvestment are often higher in SMI, particularly in medium-scale units (White, 1978, p. 45).

¹⁴Little (1987, p. 205) asserts that "it is not sufficient to show that SSEs [small-scale enterprises] use more labor and not more capital per unit of output than do larger enterprises. This being so, one could as well employ more workers to do nothing in large factories as employ them productively in SSEs".

⁹Italy's structure of political institutions, which did not take shape until after the Second World War, has led to a rapid industrial development of the country. See ECLAC/UNIDO (1986) and ECLAC (1988).

¹⁰For an extensive discussion of these subjects and an exhaustive bibliography, see Anderson (1982), Little (1987), Liedholm and Mead (1987) and the classic works of Staley and Morse (1965) and of Hoselitz (1959).

assumptions underlying these approaches,¹⁵ two points should be taken into account: firstly, that the factors of production are not always uniform, and hence in certain cases SMI may use some factors which would otherwise go unused; and, secondly, that microeconomic analyses should also cover all the other elements, in addition to labour and capital, which go into the production of goods, particularly management and organization (White, 1978, p. 39; Stewart, 1977).

Finally, some analysts also question the purportedly dynamic nature of the part played by SMI in technological progress. In this regard, it must be assumed that the evidence drawn from the experiences of industrialized countries holds true, inasmuch as the specialized literature does not contain analyses of specific cases in respect of developing nations. This lack notwithstanding, it is worthwhile noting that SMI may be of importance in the deployment of entrepreneurial capabilities and in the dissemination of techniques through the process of "learning by doing".¹⁶

In the authors' opinion, the existence of various characterizations of the actual contribution to development made by SMI is due to the fact that both the economic and social efficiency of SMI, as well as the role it may play, depends upon the socioeconomic context. The uniqueness of each situation and economic and social system militates against the applicability of categorical statements in this respect.¹⁷

The second problem relates to the great variety of different definitions, both from a conceptual standpoint and in terms of the unit of analysis. The aggregate referred to as "SMI" encompasses a number of categories and concepts which describe intersecting situations and structures which are virtually impossible to dissociate from one another.

¹⁵See Ahluwalia (1974) and a number of the other studies presented in the same volume; Stewart and Streeten (1971); Stewart (1985).

¹⁶An effort is now underway to conceptualize the dynamic process of endogenous technological and industrial development, which is referred to in ECLAC studies as the "endogenous technological dynamization nucleus". See ECLAC (1985). A brief discussion of these subjects is found in Cortelless (1986).

¹⁷Nevertheless, analyses of past experiences are very useful in formulating hypotheses as to the potentials of SMI, based on the context in question.

The basic problem comes down to being one of clearly specifying precisely what type of enterprise is being referred to when discussing the potentials and role of SMI in economic development and when designing policies to promote SMI.¹⁸

3. *The need for a clear definition of the concepts involved*

In the debate concerning SMI, categories for which no explicit definitions are generally given are used to describe opposing structural situations. Thus, use is made of terms such as informal and formal, traditional and modern, urban and rural, small and large-scale enterprise. A classification based on types of firms necessarily involves a consideration of some qualitative features. These characteristics stem from the way in which the production activity is structured, and the analysis of this structure may be undertaken from the standpoint of either the firm's internal organization or its external relations.

In the latter case, it is important to consider the firm's market relations, those it establishes with other production units, its relationship to the socioeconomic context, and the strategy involved.¹⁹

Business enterprises establish relationships with markets in order to sell their products and to buy factors of production and inputs. In most developing countries, the markets for factors of

¹⁸There is a great deal of literature concerning the reasons for policies in support of SMI. For example, see Staley and Morse (1965), Hoselitz (1959), Anderson (1982) and the many World Bank publications on the subject.

The definition of SMI which is used is also functional in terms of industrial policy objectives. Thus, for example, if the aim is to increase employment in the short run, an impetus should be provided for micro-enterprises, defined on the basis of a low capital cost per worker. If, however, the aim is to galvanize the industrial system, then the appropriate policy tool may be one directed at fostering the spread of modern SMI. An examination of Latin American experiences with the design of policies for SMI shows that in most cases the objective has been a short-term reduction in unemployment, with the assumption being that SMI use traditional, labour-intensive technologies; these policies are therefore targeted at enterprises whose scales of production are very small. However, this objective is not explicit; on the contrary, while it is supposed that the goal is to develop SMI but, in reality, these units generally do not receive the intended benefits.

¹⁹It should be borne in mind, that these elements are interdependent rather than autonomous.

production are highly segmented.²⁰ Thus, in the labour market there are segments of supply which may be of no more than marginal interest to large enterprises: the female labour force, unskilled manpower, young people, immigrants, etc. The capital market is relatively oligopolistic: intermediation between the supply and demand for capital is not a free-flowing process (as is also true of the availability of information) and depends on an organization which sometimes overvalues risk. The markets for the sale of products are also quite heterogeneous. One differentiating factor is the scope and distance of the markets, which may be either local and restricted or more extensive, and either national or international. Another factor influencing the segmentation of demand is the income level of consumers, since this dictates the characteristics of the products required.

The relations which firms have with the other economic actors and their relationship to the socioeconomic context determine the way in which production is organized. An enterprise's relations with other firms may be competitive, complementary or based on subcontracting and may either involve a high degree of economic and strategic dependence (directly, as in the case of subcontracting, or indirectly, in respect of which entity sets prices) or take the form of relations between autonomous units.²¹ The types of relations established with the State and its institutions, with the economy and with the society vary from one enterprise to another. These firms may occupy a position within the prevailing legal system, take advantage of benefits and fulfill duties defined by the State, or may

operate outside the system. They may utilize the natural resources and some characteristics of the local markets to a greater or lesser extent and, finally, may either become deeply involved in the social environment and so take advantage of the local characteristics of the labour force or some cultural traditions, or may remain uninvolving in this respect.

As regards corporate strategies, a firm may have as its objective the maximization of total income, rather than aspiring to a level of profit such as that defined in capitalist terms (Tokman, 1987) or may adopt a survival strategy by which it seeks to maintain a minimum income (Cornia, 1987). It may also strive to increase its scale of production or simply to maintain the existing one. In addition, corporate strategies are differentiated by the time period they cover. The decisions taken in these respects will have an important influence on the way in which production is organized.²²

An enterprise's form of internal organization is determined by the functions it performs and by the relationships that exist among factors of production. The functions of managing and directing an enterprise may be performed by a unit composed of professionals and/or by the entrepreneur, and may entail differing levels of complexity. The relationship between a firm's management and its workers and employees may be one of collaboration, thereby allowing for different degrees of information exchange and of the integration of capabilities, or may be markedly hierarchical or personalized. Finally, the capital/labour ratio may be of differing levels according to the composition of production, of the financial resources invested and of the

²⁰Tokman (1987) provides a comprehensive review of the debate concerning the relationship between the characteristics of these enterprises and markets for factors of production.

²¹This subject is a very broad one and warrants a study of its own. There is no agreement as to the nature of these relations. Some experts think that a dependent relationship exists among these units similar to that seen between industrialized and developing countries, while others assert that it is possible (and in fact has occurred) for micro-enterprises to maintain autonomous relations with larger enterprises. Still others argue that some type of complementarity is feasible. See Tokman (1978), Steel and Takagi (1983) and Bayce (1984). For a review of these subjects, see Tokman (1987). This subject involves considerations relating to market characteristics, corporate strategies, trends during different periods of the economic cycle, etc.

²²Another aspect of corporate strategy relates to a firm's position in the markets where it sells its products. This topic is relevant to the definition of an SMI "paradigm", but is too extensive to examine in detail here. Nonetheless, mention may be made of a few of the opinions held on the subject. In particular, there are those who believe that SMIs may position themselves in interstices of markets which large enterprises have abandoned because they are of no interest to them (Tokman, 1978; Bayce, 1984) and those who feel that—depending upon the branch of production involved, the quality of the enterprise and the organization of the market in question—SMIs may be able to compete with large enterprises even when the respective products are not entirely substitutable for one another (Steel and Takagi, 1983).

techniques used (Staley and Morse, 1968, chap. I).²³

In summary, when viewed from the standpoint of their internal organization, firms may be classified according to the following scheme (only the most commonly-used terms are included here, rather than all the relevant terminology):

Household production system	Cottage-industry system	Dispersed production system	Factory system
1. Production for own use	2. Household-based cottage industry	4. Household-based industrial work	6. Small factory
	3. Workshop-based cottage industry	5. Small dependent or quasi-dependent workshop	7. Medium-scale factory 8. Large factory

One useful distinction is that of small, medium-scale and large enterprises. This classification cannot be rigid, but it should refer to some of the elements which have been described in the literature as being characteristic of firms of different sizes.

According to this scheme, small enterprises are those which, in so far as their internal organization is concerned, correspond to number 6, although they may display some of the features attributed to number 5. In these cases, the owner performs all (or a large part) of the activities involved in the management of the firm, and the enterprise's success is therefore closely linked to his entrepreneurial capabilities. The capital/labour ratio is low, although it varies according to the branch of production concerned, and the firm maintains a high level of technological flexibility. As regards their external relations, these enterprises normally choose nearby markets for

the sale of their products, although they may achieve national coverage or even export (in this case too, past experience indicates that the potentials depend on the branch of production involved). Generally speaking, the objective of a small enterprise's strategy is not growth in terms of a more complex organization and a larger scale of production.²⁴ The form of ownership is predominantly individual or that of a simple partnership.

The basic difference between a medium-scale enterprise and a small firm is one of strategy, in that the former seeks to increase its scale of production and broaden its markets. In a medium-scale enterprise, managerial functions are usually performed by more than one person, and its form of organization is necessarily more complex. Nonetheless, these units do maintain a certain degree of flexibility with respect to production.

A large enterprise is an industrial structure of a relatively large scale whose operational organization is diversified into specific units; its ownership structure is generally complex, and its organization of manpower is based on the division of labour. The strategy of such an enterprise is similar to that referred to in economic terminology as that of oligopoly or of imperfect competition, and it is usually active on national and international markets.

In the light of the above, the validity of some of the "adjectives" normally used to define SMI may be determined.

One aspect to be considered in this regards is the formal/informal dichotomy. An informal enterprise is characterized by "a rudimentary organization, lacking any clear-cut division of labour or of the ownership of the means of production; indeed, very little capital is committed and few skills are required. As regards its position in the market, it has ready access to competitive markets and to the ground level of concentrated markets; in these markets, because of the possibility of competition, average income is the adjustment variable. Given the limited size

²³These elements are manifested in various concrete ways, including the form of ownership, which has a significant influence on the organization of production. Other differentiating factors relate to technology, which may be traditional and thus similar to that used in generations past, or modern and thus closer to the technological "frontier". Another factor is the firm's efficiency or lack thereof, which is not necessarily related to its modernity or traditionality, since depending on the branches of production and markets involved, there may be traditional technologies which are also efficient.

²⁴See Evans (1987) and Kumar (1985). The authors agree that the rates of growth of small production units vary widely. However, this tendency disappears as the size of the firms in question increases. In any event, the relationship between firm size and growth is linked to the economy's stage of development.

of the market, the greater the surplus of manpower, the lower the income earned by each person working in the sector" (Tokman, 1987). These enterprises' objective is to maximize income, and they tend to adopt a survival strategy (Cornia, 1987). However, this definition covers micro-enterprises as well, despite the fact that such firms are registered in censuses and maintain "formal" relations with markets and with the socioeconomic context. Enterprises are regarded as "informal" if they do not maintain relations with the State because they are attempting to evade, either totally or partially, the legal regulatory system of taxation.²⁵

Finally, enterprises may be either modern or traditional. Generally, there is an implicit assumption that an enterprise is modern if it utilizes high technology and that large enterprises are modern while micro- and small enterprises are traditional. Nevertheless, many studies have been done which demonstrate the existence of large enterprises that use traditional technologies and of small enterprises that are in the technological vanguard. Moreover, the modernity of an enterprise is measured not only in terms of the technologies it employs, but also on the basis of the way in which its production is

organized, the dynamism of the relations it establishes with the economy and the activeness of its role in the industrial development of a system.

The basic hypothesis proposed in this study is that a balanced industrial system is made up of enterprises of differing types and sizes and that modern SMI is a good means of making that system more dynamic and of improving its internal articulation. Industrial policy should therefore take into account the functional differences among the various types of enterprises. In this article, consideration is given to that segment of SMI composed of modern enterprises or firms with the potential to undertake a modernization process.²⁶

For our purposes here, SMIs will be defined in terms of the number of employees, since this indicator is easy to use and makes it possible to identify production units with a scale of production which is linked to an organization's level of complexity. This method of defining SMI undoubtedly fails to include all the variables specified above; nevertheless, it does provide a valid indicator for evaluating policy efficiency and studying the evolution of an industrial system.

II

SMI in Latin America

1. SMI in the countries of Latin America and the OECD

SMI has traditionally been an important part of the industrial structure of many countries, where it has represented more than 40% of total employment (see table 1). Hence the interest this subject has aroused in the ongoing debate concerning industrial policy and economic development.

²⁵These are without question the enterprises which are most frequently referred to when micro-enterprises are under consideration. The role of the State in the economy is of enormous importance in regard to the definition of policies and strategic options, but it is not a subject which can be analysed in this article. However, a critical reading of the research project on Peru conducted by De Soto (1987) is recommended to the reader.

In analysing the available information concerning the OECD countries, two basic patterns clearly emerge from the range of experiences of these nations: on the one hand, there is the pattern represented by Italy and

²⁶Certainly, in many developing countries enterprises having a limited scale of production are for the most part inefficient and technologically behind-the-times, but these are not inevitable characteristics of SMIs. There are cases of industrial development in which SMIs are in no way overshadowed by large enterprises in terms of productivity, technical efficiency and dynamism. Furthermore, when speaking of industrial policy, only those enterprises are regarded as being useful for development which are in a position to promote it and, thus, assistance programmes for "inefficient and non-dynamic" SMIs pursue social and employment objectives rather than the dynamization of the industrial system. See ECLAC (1988) and Meller (1976).

Table 1

SHARE OF SMI IN FORMAL INDUSTRIAL EMPLOYMENT, BY FIRM SIZE
BASED ON NUMBER OF EMPLOYEES

(Percentages)

Country	Years	Firms				Employment (thousands)
		Under 10	Under 100	Under 200	Under 500	
Industrialized countries						
Federal Republic of Germany	1984 ^a		18.0	30.0	50.0	8 614
Belgium	1982		45.7			905
Denmark	1976 ^b			55.4	72.2	505
United States	1976		32.0		44.6	21 817
France	1972 ^c			39.0	60.2	5 269
Japan	1981 ^d	18.6	59.2	74.3		13 850
Italy	1981	23.0	59.3	69.4	80.4	5 819
Sweden	1978 ^b			40.7	59.2	984
United Kingdom	1981			33.9		5 773
Latin American countries						
Argentina	1984 ^e	19.6	55.6	74.3		
Brazil	1980	10.8	46.0	65.7	80.4	4 918
Colombia	1984 ^f	18.0	46.5	59.4	76.6	
Costa Rica	1975 ^f		12.8	48.5	58.7	
Chile	1984	15.0	53.6	68.0	86.7	
Ecuador	1981	39.7	62.0	72.9	86.1	
El Salvador	1976 ^{g,h}	51.7	65.7		89.0	
Mexico	1975	16.8 ^b	38.0		69.7	1 677
Peru	1973	19.6	48.8	62.3	79.6	253
Uruguay	1978	15.0	51.0	65.0	81.0	183
Venezuela	1984 ^b	20.0	53.7			433

Source: For Latin America, Italy and Federal Republic of Germany: national censuses. For Chile: World Bank, *Chile: small and medium industry project*, July 1985. For OECD countries: OECD, *Innovation in small and medium firms*, Paris, 1982. For Belgium: *Etudes d'expansion*, No. 298, 1984. For Argentina (1980): World Bank, *Argentina: Strategy towards industrial and export development*, September 1985. Data concerning total employment in OECD countries: OECD, *Labour force statistics*, Paris, 1983.

^aDoes not cover firms having from 1 to 19 employees.

^bDoes not cover firms having from 0 to 5 employees.

^cDoes not cover firms with fewer than 10 employees.

^dCovers firms having from 0 to 299 employees.

^e300 employees and over.

^fFigures for firms with 0-10 employees are estimates.

^gFrom 100 to 499 employees.

^hFrom 1 to 15 employees.

Japan, where SMI is an important part of the industrial structure; on the other hand, there is that of the Federal Republic of Germany and the United States, where the presence of SMI is significantly less notable and where there is a definite predominance of conglomerates which are highly diversified both horizontally and vertically. The use of indicators of participation in industrial activity brings out the difference in patterns of firm size even more clearly. Esti-

mates for the early 1980s indicate that enterprises employing fewer than 200 people accounted for a 20% share of industrial sales in the Federal Republic of Germany, whereas in Italy such firms had a 65% share.²⁷

²⁷Information obtained from CONFINDUSTRIA, *Sesto Rapporto*, Rome, 1983, and Statistisches Bundesamt, Federal Republic of Germany, 1986 census data.

The cases of the other industrialized countries represent a number of variations on these themes: the situation in the United Kingdom is fairly similar to that of the Federal Republic of Germany, while the experiences of France, Belgium, Denmark and Sweden are more like those of Japan and Italy. The data also indicate that industries employing more than 500 people accounted for over 50% of employment in the Federal Republic of Germany and the United States, whereas in Italy, Japan and Denmark the corresponding figure was less than 30%.

As in the case of the industrialized nations, a variety of situations are to be found in the countries of Latin America with the difference that in some of them the stratum of micro-enterprises is significant. On one side, there are the economies (such as El Salvador, Ecuador and, to a lesser extent, Peru) with a less developed industrial sector in which nearly one-half of total employment is in formal micro-enterprises (fewer than 10 employees). On the other, there are the more industrialized economies such as Brazil, Mexico, Colombia and Venezuela in which large enterprises (over 100 employees) account for an important share of employment (around 60% of all industrial jobs) and which thus exhibit a distribution pattern similar to that of the Federal Republic of Germany. A third category is made up of countries at an intermediate level of industrialization, and it is in these countries (the most notable examples being Chile, Argentina and Uruguay) that SMI carries the greatest relative weight.

The above facts, when considered in combination with the specific features of each of the countries, suggest the existence of some type of relationship between firm size, on the one hand, and industrial dynamism, articulation and underemployment, on the other.²⁸ Micro-enterprises have a greater presence in those countries exhibiting an insufficient process of accumulation and unstable industrial growth; as a result of these circumstances, in the 1980s these countries have recorded the highest rates of underemployment in the region. The pres-

ence of large enterprises is most significant in the countries which have experienced greater industrial growth but which also suffer from the highest levels of social disarticulation, measured in terms of unequal distribution (Cheney *et al.*, 1974; García, 1984; Fajnzylber, 1987). In contrast, SMI are an important presence in the industrial structures of countries which have traditionally had high levels of urbanization, industrialization and articulation but whose economies have stagnated in the course of the past few decades.²⁹

Judging by the figures, the entrepreneurial structures of some Latin American countries have similarities to those of the industrialized nations; however, the substantially different contexts associated with these two groups of nations must not be overlooked. There have been enormous structural differences between the growth and accumulation processes of the two, the specific features of their incorporation of the labour force, the articulation of their production systems and their attitudes to technical progress. Although it is not our purpose here to delve into each of these subjects, the prevailing feeling, although it varies somewhat from one country to another, is that the industrialization strategies used in Latin America have fostered the re-creation of a production apparatus having many features that are dysfunctional in relation to local needs and resources, with limited dynamism and low levels of productivity and competitiveness, and that over time this has weakened the production base and diminished these countries' ability to create new enterprises and jobs.³⁰

The most visible and controversial phenomena in this respect are the important role of the urban informal sector and the low productivity of the modern sector. If the category of micro-enterprises is extended to include informal employment in industry, which by definition is

²⁸During the period 1950-1980, the average growth rate for the manufacturing industry was: Brazil, 8.3%; Mexico, 7.5%; Colombia, 6.0%; Venezuela, 7.2%; Chile, 3.6%; Argentina, 3.6%; and Uruguay, 2.6%, while the average for Latin America was 6.7% (ECLAC). The most significant levels of underemployment are found in Ecuador, 62%; Peru, 51.6%; and El Salvador, 49%; these rates are much higher than the regional average (38%). The above figures represent the percentage of the economically active population which is subject to underemployment (PREALC).

²⁹For a more detailed discussion of the subject, see Fajnzylber (1983 and 1987), Ikonicoff (1987) and Vuskovic (1985).

²⁸The term "underemployment" is understood as referring to the performance of work whose productivity, as well as the earnings it provides, is insufficient and/or which does not adequately utilize workers' capabilities. See PREALC (1982).

Table 2
DISTRIBUTION OF TOTAL INDUSTRIAL EMPLOYMENT BY FIRM SIZE
(Percentages)

Country and year	Number of employees			Level of industrialization
	0 - 9 and informal	10 - 99	100 and over	
Large countries				
Argentina (1984)	43.7	25.2	31.1	27.1
Brazil (1980)	38.3	24.3	37.4	29.1
Mexico (1975)	54.1	11.5	34.4	24.3
Medium-sized countries				
Colombia (1984)	46.7	18.5	34.8	20.2
Chile (1984)	40.5	27.0	32.5	21.3
Peru (1973)	55.3	16.2	28.5	24.3
Uruguay (1978)	26.1	31.0	42.9	26.6
Venezuela (1984)	32.0	28.7	39.3	19.7
Small countries				
Costa Rica (1975)	33.7	27.1	39.2	20.1
Ecuador (1981)	51.7	17.8	30.5	23.1
El Salvador (1976)	65.8	9.9	24.3	19.9

Source: Manufacturing censuses and industrial surveys. The data on total employment were calculated on the basis of information provided by ILO and ECLAC. Levels of industrialization were obtained from the Joint ECLAC/UNIDO Industry and Technology Division.

not reflected in censuses of the manufacturing industry,³¹ then the distribution of firms by size becomes markedly skewed (see table 2). On this basis, the proportion of employment in the manufacturing sector accounted for by micro-enterprises ranges from 26% in Uruguay to 66% in El Salvador, with the share of employment corresponding to micro-enterprises increasing the most in Peru, Mexico and Colombia.

In order for the comparison between SMI in the Latin American and the industrialized countries to be a more realistic one, however, it is also necessary to take into consideration the socio-economic contexts involved.

2. Brazil, Colombia and Chile

There are a number of trends and features which are characteristic of the Latin American pattern of industrialization. The trends observed during

the past three decades have been associated with rapid urbanization, an increase in the rate of investment and the degree of industrialization, a failure on the part of modern sectors to create enough jobs, and a widening of the productivity gap between the modern industrial sector and services. Common traits have included a position in the international economy which is based on natural resources, the establishment of an industrial structure oriented towards the domestic market, the desire to reproduce consumption patterns typical of the advanced countries and the precarious position of national entrepreneurs (García and Tokman, 1985; Fajnzylber, 1987).

Despite the dynamism of industrial growth and of the accumulation process in Latin America since the 1950s, this has not been enough to uphold a level of production comparable to that of the industrialized countries.³² Notwithstand-

³¹In many cases this limitation is due to the lack of industrial censuses or to their incomplete coverage. These estimates are based on data provided by industrial surveys and sectoral employment figures calculated by ILO on the basis of population censuses and household surveys.

³²Whereas in 1950 the per capita product of the European countries was three times that of Latin America, in the 1980s it has been almost four times as great. Between 1960 and 1980 Latin America's industrial productivity increased at an average annual rate of 2.9%, while that of the EEC countries rose at a rate of 4.4% (estimates based on information from ECLAC and OECD).

ing these factors which the countries have in common, however, it is essential to consider the specific features of the different national experiences as well. This diversity is exemplified by the industrialization processes of Brazil, Colombia and Chile, particularly with respect to the role played by SMI in these processes.

a) *Industrial growth and SMI*

With a population of over 130 million, Brazil has a per capita product of about US\$1 600. Thanks to a prolonged and sustained industrial and technological development effort, it has joined the ranks of the newly industrializing countries (NICs). At present the country has a trade surplus in the agricultural, mining and industrial sectors. Colombia, with a population of 29 million and a per capita product of US\$1 300, has pursued an industrialization strategy which is notable for its stability. Its trade balance shows a surplus in the agricultural sector, a deficit in manufacturing and is at equilibrium in the energy sector. Chile, with a population of 12 million and a per capita product of US\$1 400, has adopted a liberal approach which has entailed sweeping changes in the economy, and has a surplus in agriculture and mining and a deficit in industry and energy.

The process of industrial expansion in Brazil during the past few decades has advanced rapidly in two main areas. Under the Target Plan (1956-1961), growth was concentrated in the transport materials sector; then beginning with the structural adjustment called for in the Second Development Plan (1974), an extremely rapid expansion was seen in the installed capacity of heavy industry oriented towards capital goods and strategic inputs, with the historical growth rate reaching 8.5% annually. In the 1980s, however, this rate has dropped to 3% (Tavares and Coutinho, 1985).

Colombia was one of the first Latin American countries to undertake an export promotion policy, and this policy produced satisfactory results between 1967 and 1974. Thereafter, however, even though the strategy remained substantially the same, the economy tended to stagnate as a consequence of both internal and external factors.³³ The historical growth rate, which stood at 6% up to the 1970s, has fallen to 2.5% in the 1980s.

A major change began to take place in 1975 in the traditional pattern of Chilean industry, which had been based on the execution of large public investment projects promoted by CORFO (iron and steel, copper refining, petroleum, sugar and wood pulp plants) and the development of the domestic market. In the mid-1970s the industrial system began to play a part as one of the components of an overall strategy aimed at opening up the economy to the outside world, deregulating the financial system and readjusting the size of the State sector. The average industrial growth rate, which had been around 5% until that time, started on a downward slide marked by sharp fluctuations; a subsequent upturn brought the average growth rate to 1% in the 1980s (Muñoz, 1986).

The effects of the last crisis were felt more intensely in Chile than in Brazil and Colombia. The countries' recoveries have also differed: the industrial growth rate for the period 1984-1986 was 9% per year in Brazil, 5% in Colombia and 4.5% in Chile. In 1960, Brazil's manufacturing output was five times that of Colombia and of Chile; currently, it is nine and 13 times greater, respectively.

The trend with respect to SMI has also been different in each of these cases. (The reader will recall that Brazil and Colombia were classified among those Latin American countries in which large enterprises have been a more important factor, whereas Chile was included in the group of countries in which SMI has been relatively significant.) In all these countries, governmental agencies have promoted SMI, through the Corporación Financiera Popular en Colombia, SERCOTEC in Chile and CEBRAE in Brazil.

Brazil's process of industrial expansion has involved a strengthening of the structure of large enterprises, and employment in such firms has risen more rapidly than in other enterprises (see table 3). Much the same thing was occurring in Colombia, until the adjustment made in the 1980s reversed this trend. The situation in Chile,

³³The above is a simplified picture of the situation, inasmuch as the various governments have emphasized different economic aspects: C. Lleras (1967-1970), economic openness; M. Pastrana (1970-1974), urban construction; A. López (1974-1978), the distributive situation; Turbay (1978-1982), regional autonomy; and Betancur, short-term balances. See Berry and Thoumi (1986).

Table 3

**BRAZIL, COLOMBIA AND CHILE: VARIATION
IN AVERAGE ANNUAL EMPLOYMENT
IN THE MANUFACTURING SECTOR,
BY FIRM SIZE**

(Percentages)

Firm size (number of employees)	Brazil		Colombia		Chile ^a 1967-1979
	1959-1974	1975-1980	1960-1975	1979-1984	
5-49	3.2	5.1	1.0	-	-0.1
50-99	6.1	4.5	4.8	-0.6	-0.3
100 and over	5.3	5.8	5.6	-2.0	-0.5
Total	4.9	5.3	4.2	-	-0.4

Source: Estimates based on industrial censuses and surveys.^aIn Chile, the relevant categories are 5-9, 10-49 and 50 or more employees.

however, has been substantially different: during the period 1967-1979, a contraction in industry was observed at the same time that a significant restructuring of employment in the manufacturing sector was taking place; this process called for adjustments in all types of enterprises, particularly the larger ones.

b) *SMI in the industrial structure*

One of the characteristics of SMIs is their subordination to the sectoral structure of the economy. This means that, in disaggregated terms, their position in the industrial structure may fall within the modern/traditional, urban/rural, formal/informal and export/domestic market spectrums. Although the information in this respect concerning the countries of the region is still of a preliminary nature, there are nonetheless some very telling indications that this is the case.

First of all, there are the changes which have been seen in the sectoral profiles of industry as a whole. The most significant of these is the increase in the size of the capital goods sector in Brazil (from 10% to 19% between 1963 and 1985). Generally speaking, Colombia and Chile have retained their industrial profiles of the 1960s, although the importance of the capital goods sector has grown slightly in the case of Colombia (from 5% to 6%), while in Chile it has

dropped from 6% to 4% (ECLAC/UNIDO, 1987).

At first glance, the available information concerning the relative importance of SMI, broken down by major branches of production,³⁴ does not reflect differences among the three pairs which would be commensurate with the degree of the contrasts existing at the industrial level (see table 4). However, there are interesting distinctions of an intermediate degree. The first has to do with the sectoral emphases of SMI, while the second concerns productivity ratios.

In Brazil there is a greater concentration of small industrial enterprises —10 to 49 employees—in the consumer goods sector, and particularly in the furniture, printed matter and food industries. This trait is even more notable in Chile, where small industry represents a large share of the clothing and plastics sectors, in addition to furniture and foodstuffs. The above suggests that some type of relationship exists between the production of goods to meet basic needs and small-scale enterprise. In the case of Colombia, the presence of small industrial enterprises is more notable in the capital goods industries, and particularly in the areas of non-electrical machinery and precision instruments. In Chile, too, small enterprises are beginning to be a force in the production of precision instruments and metal products.

These data also indicate that medium-scale industry is more evenly distributed among the various sectors in Brazil. In this country, such industry is primarily oriented towards the production of intermediate goods (wood, paper and chemicals) and capital goods (mechanical items); in Chile, it tends towards capital goods (metal products and precision instruments), as is also true in Colombia (non-electrical machinery and precision instruments). These variations would appear to be related to these enterprises' relative capacity for modernization, which allows them to produce more complex goods.

In the most industrialized production structure, i.e., that of Brazil, one notable feature is the

³⁴The following ISIC categories were used: Consumer goods: 311-12, 313, 314, 322, 324, 332, 342, 352, 356, 361 and 39; Intermediate goods: 321, 323, 331, 341, 351, 353, 354, 355, 362, 369, 371; Capital goods: 381, 382, 383, 384 and 385. In the case of Brazil, which uses different categories, the metallurgical industry and miscellaneous industries were not classified.

Table 4
PATTERN OF EMPLOYMENT, VALUE ADDED, INVESTMENT AND RELATIVE PRODUCTIVITY OF SMI IN BRAZIL,
CHILE AND COLOMBIA BY SIZE OF FIRM ACCORDING TO SECTOR OF PRODUCTION

Industrial branches (ISIC 2) by sector of production	Employment (%) by firm size ^a			Value added (%)			Net investment (%)			Productivity index (firm size = 100)				Productivity index (industrial branch = 100)				% of total value added generated by branches
	10-49	50-99	100 and over	10-49	50-99	100 and over	10-49	50-99	100 and over	10-49	50-99	100 and over	Aver- age	10-49	50-99	100 and over	Aver- age	
Brazil 1975^b																		
Consumer goods	30.2	14.9	54.9	22.0	13.6	64.4				89	90	93	90	73	91	117	100	29
Intermediate goods	27.3	15.6	57.1	20.3	15.5	64.2				109	118	107	108	74	100	112	100	33
Capital goods	17.3	13.9	68.8	14.0	11.5	74.5				112	93	98	102	81	83	108	100	24
Not classified	21.6	15.3	63.1	15.0	12.6	72.4				96	93	104	102	69	83	115	100	15
Total	25.1	14.9	60.0	18.5	13.6	67.9				100	100	100	100	74	91	113	100	100
Brazil 1980^b																		
Consumer goods	31.1	14.4	54.6	19.1	14.3	66.6				79	89	81	79	61	100	122	100	26
Intermediate goods	28.2	14.9	56.9	17.7	13.8	68.5				123	126	122	120	63	93	120	100	35
Capital goods	15.8	13.0	71.2	10.2	9.6	80.2				109	87	98	104	64	74	113	100	25
Not classified	21.1	14.4	64.5	12.1	11.1	76.8				95	89	102	101	57	78	119	100	14
Total	25.1	14.2	60.7	15.4	12.5	72.1				100	100	100	100	61	88	119	100	100
Chile 1979^c																		
Consumer goods	34.3	65.7		15.3	84.7		83.4	16.6		96	95		92	45	129		100	45
Intermediate goods	23.6	76.4		8.6	91.4		91.1	8.9		106	118		123	37	120		100	43
Capital goods	26.3	73.7		15.2	84.8		95.6	4.4		103	71		76	58	115		100	12
Total	29.2	70.8		12.4	87.6		86.5	13.5		100	100		100	42	124		100	100
Chile 1984																		
Consumer goods	33.4	17.1	49.5	15.9	15.4	68.7	16.7	19.4	63.9	96	107	78	80	48	90	139	100	42
Intermediate goods	23.4	11.5	65.1	6.8	4.8	88.4	5.6	2.9	91.5	113	96	147	154	29	42	136	100	50
Capital goods	30.5	19.5	50.0	21.6	20.2	58.2	13.0	17.6	69.4	97	84	44	54	71	104	116	100	8
Total	29.7	15.6	54.6	11.8	10.5	77.7	11.3	11.7	77.0	100	100	100	100	40	67	142	100	100
Colombia 1975																		
Consumer goods	22.4	14.3	63.3	9.9	10.0	80.1	13.8	7.6	78.6	99	107	105	102	44	70	127	100	47
Intermediate goods	14.2	10.0	75.8	6.8	5.7	87.4	7.5	1.4	91.1	109	89	97	103	48	57	115	100	38
Capital goods	25.4	18.2	56.4	12.1	13.6	74.3	9.6	19.4	71.0	92	98	94	88	48	75	132	100	15
Total	19.9	13.4	66.7	9.0	8.9	82.1	10.5	6.4	83.1	100	100	100	100	45	67	123	100	100
Colombia 1979																		
Consumer goods	19.3	14.8	65.9	8.0	8.5	83.6	16.8	10.1	73.0	94	97	103	100	41	57	127	100	47
Intermediate goods	13.6	9.5	77.0	6.3	5.3	88.4	5.7	7.4	87.0	121	108	107	114	46	56	115	100	38
Capital goods	21.5	16.4	62.1	11.4	12.7	75.9	13.6	12.7	73.8	91	99	75	75	53	77	122	100	14
Total	17.8	13.3	68.9	7.8	7.8	84.4	11.4	9.3	79.3	100	100	100	100	44	59	122	100	100
Colombia 1984																		
Consumer goods	23.1	15.4	61.5	9.0	9.4	81.6	12.6	16.3	71.1	95	99	106	101	39	61	133	100	52
Intermediate goods	15.0	11.3	73.7	6.7	6.9	86.4	2.4	4.0	93.6	120	110	104	112	44	61	117	100	35
Capital goods	23.2	15.6	61.1	12.1	11.7	76.3	10.7	13.1	76.2	93	89	73	74	52	75	125	100	13
Total	20.6	14.1	65.2	8.6	8.8	82.6	7.5	10.1	82.5	100	100	100	100	42	62	127	100	100

^aBy categories based on number of employees.

^bNo data are available on the distribution of investment.

^cThe census classification groups together all firms having over 50 employees.

major role played by large enterprises in the production of capital goods. The subsectors in which large production units figure prominently (electrical and transport equipment) are precisely those branches whose technological complexity is the greatest.

In addition, whereas in Brazil the productivity of small-scale industry —value added per employee— is relatively high in the intermediate (chemicals) and capital (electrical machinery) sectors, in the other two countries this is only true with respect to intermediate goods, i.e., in those branches in which SMIs play a minor role. As regards medium-scale enterprise, high rates of productivity tend to be concentrated in the intermediate goods sectors: chemicals in Brazil; chemicals and paper in Colombia; chemicals and basic industry in Chile. In relation to large firms, the highest rate of productivity is found in intermediate goods (chemicals and paper) in Brazil; in consumer products (tobacco, beverages and chemicals) and intermediate goods (paper, petroleum and basic industry) in Colombia; and in intermediate goods (petroleum, non-ferrous metals and paper) in Chile.

In Brazil, the productivity of SMI *vis-a-vis* that of large-scale enterprise is relatively low on average: 1.9% for small industry and 1.3% for medium-scale industry. The differences in productivity are substantially greater in Colombia and Chile.

When the figures corresponding to Brazil are broken down, it may be seen that the productivity ratios remain much the same in the relevant subsectors. It would thus be of interest to take a closer look at the conditions for the macroeconomic survival of small enterprises in Brazil, particularly in relation to the way in which these enterprises coexist with one another and with large firms.

c) *The performance of SMI*

According to the overall information for Latin America, SMI has a very limited position in the international economy, shows a preference for domestic markets and generally does not play a leadership role in the economic, political or institutional spheres, in contrast to the influence exerted by large private corporations, transnational corporations and public enterprises (Tou-

raine, 1987; ECLAC/UNIDO, 1985; Estrada and Masi, 1983).

General analyses of the region as a whole usually associate most of the countries with a pattern marked by a specialization of production oriented towards mass consumer goods, the utilization of rudimentary technology and a lack of inter-enterprise co-operation. Within firms, these factors give rise to inadequate production conditions, an extraordinarily conservative management approach, a detrimental form of dependency on input and product markets, problems of gaining access to financing, and a low level of manpower skills.

Nevertheless, a thorough analysis of these experiences indicates the existence of a variety of situations.³⁵ In Brazil, SMI developed with the help of an expanding domestic market, and medium-scale industries which produce intermediate goods are prominent. In Colombia, a relative shift of large enterprise within the domestic market was what paved the way for SMI, which has achieved a significant position in the capital goods sector. Finally, in Chile SMI has found it necessary to fall back on a survival strategy owing to this country's industrial reorganization, but it has nonetheless continued to account for a significant share of the production of capital goods. In all of these countries, SMIs have a limited technological level, primarily use their own capital, are averse to borrowing and see the governmental sector as performing more of a regulatory than a promotional function. The fact that SMI in these countries have nonetheless made a highly positive contribution is attributable to the existence of relatively stable macroeconomic policies which favour industry in general, and to an economic environment which has provided these enterprises with a steadily growing market and has allowed them to attain a systematic improvement in their productivity (Gómez, 1986). Recently, SMIs have concentrated their efforts on upgrading their technologies. At the same time, they have been increasing their demands for State support in

³⁵Some relevant studies concerning SMI at the national level are the following: Argentina: Ministry of Planning (1984); Brazil: Schmitz (1982); Colombia: Cortéz, Berry and Ishag (1987); Chile: Castillo (1986); Ecuador: INSOTEC (1986); Peru: JUNAC (1987); Venezuela: JUNAC (1986).

the areas of financing, technical assistance and export promotion.

In Colombia, the contribution made by SMI to employment and output in the manufacturing sector has been a moderate one. The development of these production units began to pick up sharply when a policy aimed at opening up the economy was launched in the late 1960s. Although promoting SMI was not one of the objectives of this process, it did make things easier for SMI, because large enterprises began to specialize in the external market and in one part of the national market, thereby leaving a considerable segment of domestic demand unmet. This situation encouraged many technicians, employees and professionals to start their own companies, especially since it was accompanied by the emergence of a market in second-hand machinery, much of which came from large enterprises that had embarked on a modernization drive (Escandón, 1981). With the crisis of the 1980s, SMI productivity levels began to fall, but it has nonetheless retained its potential with respect to capital goods.

In Chile, SMI has had to deal with a number of traumatic events. Unlike what occurred in the other two countries, SMI consolidated its position in the Chilean industrial structure during the 1960s and diversified its activities among consumer, intermediate and capital goods within a context of slow economic growth. However, its development was associated with an intensive process of import substitution and a heavy dependence on promotion and assistance policies instituted by the State. This was the position of SMI when, in 1975, it found itself confronted with an abrupt restructuring of the economy which included a rapid opening-up of trade, financial deregulation and the reduction of the public sector. As a result of this strategy, a significant number of enterprises were pushed into bankruptcy (Mizala, 1985; Castillo, 1986). After yet another crisis in 1982 and a subsequent recovery, the situation has been marked by the coexistence of surviving firms and newly-created enterprises, helped along by a more limited process of import substitution aimed at increasing the production of consumer and capital goods.

III

Successful experiences and their implications for the Latin American countries

1. Italy and Japan

If the potentials of SMI in Latin America are to be assessed, then the analysis must not be confined to the regional situation alone, but must also cover the lessons that may be learned from what has occurred in other countries.

The experiences of Italy and Japan are quite exceptional and have been the most successful ones with respect to SMI in the postwar period. In the case of Japan, the approach taken has been one of industrial programming, with the entrepreneurial sector being linked to a State that takes a long-term view, and the domestic market being reserved as a basis for the expansion of manufacturing activity. In contrast, Italy represents a more spontaneous and less directed approach marked by what might be character-

ized as an absence of State intervention, in which stable social balances are maintained and the economy functions as part of the European Market.

Tables 5 and 6 provide an overview of the development of SMI in these economies. A simplified outline is then presented which highlights those factors that have contributed the most to the strong growth of SMI: the socioeconomic context, the modality of development and the institutional framework.

a) *The socioeconomic context*

The singular course which the development of SMI has taken in Japan, coupled with the expansion of large-scale enterprise, has its origin in the Meiji Reform, undertaken in 1868,

Table 5
ITALY: SOME INDICATORS OF THE SIGNIFICANCE OF SMI
IN THE INDUSTRIAL MANUFACTURING STRUCTURE^a

(Percentages)

	Number of employees				
	1-9	10-99	101-499	500-999	1000 and over
Employment structure					
1951	29.6	23.0	21.1	9.3	17.0
1961	25.3	30.1	22.4	8.0	14.2
1971	20.3	32.7	23.2	7.7	16.1
1981	22.8	36.1	21.3	6.8	13.0
Sales^b					
1973		43.1		30.0	13.4
1981		46.3		41.1	11.2
Exports^c					
1975		17.2		26.0	56.8
1981		17.7		28.9	53.4

Source: Istituto Centrale di Statistica (ISTAT) and CONFINDUSTRIA, *Sesto Rapporto*, Rome, 1983.

^aIn Italy, SMIs are defined as firms having fewer than 500 employees.

^bSales and GNP are subdivided according to the following categories: 20-100, 100-500, 500-1 000, 1 000 or more employees.

^cThe employment categories used in relation to exports are: 20-100, 100-500, 500 and over.

Table 6

**JAPAN: INCIDENCE OF SMI IN THE
INDUSTRIAL STRUCTURE^a**

(Percentages)

	Number of employees			
	1-9	10-99	100- 299	300 and over
Employment structure				
1972	15.9	37.4	16.0	30.7
1978	18.2	40.2	15.1	26.5
1981	18.6	40.6	15.1	25.7
Sales				
1972	6.6	27.5	17.1	48.8
1979	7.0	29.1	17.1	46.8

Source: Monthly Labour Statistics Survey, Ministry of Labour, Japan; Statistical table of industry, MITI, Japan.

^aIn Japan, SMIs are defined as those firms having fewer than 300 employees and/or firms whose capital amounts to less than 100 million yen.

which marked the beginning of the modernization of the country and its involvement in the international system. The cultural traits peculiar to the Japanese society have also been a factor; these include the existence of a group-oriented

culture, the traditional skillfulness in manufacturing delicate products, sound work habits and a high degree of discipline (Hosono, 1976; ECLAC, 1986; Dore, 1986; MITI, 1983 and 1986; Latin American Society, 1984 and 1985; United Nations/ESCAP, 1985; and Astorga, 1985).

Another important aspect in achieving a better understanding of this experience relates to this society's vision of the future, which has been manifested in the concerted industrial effort that has marked Japanese economic development and is its most well-known feature.³⁶

Within this context, one of the main characteristics of the industrialization process has been the emergence and reinforcement of a new generation of entrepreneurs which has added its capabilities to those of the preceding generation. Thus, alongside the traditional sectors which resolutely embarked upon a process of assimilating Western technologies and commercial

³⁶The main stages through which industrial policy has passed are: 1955-1964, priority assigned to textiles, plastics and electrical items; 1965-1974, emphasis on heavy industry and television; 1975-1980, electronics, semi-conductors, numerically-controlled machine-tools and industrial robots.

strategies, a powerful group of national entrepreneurs has made its appearance, backed up by an institutional structure supported by a contingent of personnel devoted to public service. In this way, increasingly effective tactics based on co-operation between government and industry have been used in the pursuance of economic objectives, with the Ministry of Industry and International Trade (MITI) playing a very important role in this process.

In the case of Italy, industrial development has been the outcome of the coexistence of three different models. The more industrialized regions of northern Italy have seen the consolidation of a production structure based on large enterprises which are in turn associated with a network of SMI subcontractors. In the under-developed areas of the south, as well as in enclaves of industrialization, a highly traditional structure of micro-enterprises has managed to survive thanks to State assistance and to their evasion of taxes. Finally, yet another model has predominated in the "Third Italy", as it is called, i.e., the central and northeastern regions, where SMI is the most important type of productive organization in the industrial structure, and has demonstrated a great capacity for innovation and the ability to maintain a steady presence in international markets (ECLAC/UNIDO, 1986a; ECLAC, 1988). The level of development achieved by SMI, especially in the "Third Italy", is in its turn associated with various social and economic factors, including the characteristics of the agricultural sector, the social role of the family and the availability of an economic infrastructure.³⁷

³⁷Firstly, the extensiveness of long-standing small agricultural holdings has been a decisive factor in making independent work feasible; in time, this has led to the creation of new enterprises. Secondly, the family (which has a very strong tradition in these regions) has come to be the social structure which backs up production activities, providing as it does a basic source of support for the individual worker by virtue of the economic activities it performs, and has heightened social mobility, especially between the roles of worker and entrepreneur. Finally, the expansion of economic activities and the concentration of the population in small cities has gone hand in hand with an improvement in infrastructure which has facilitated local development, thereby preventing an exodus towards large urban centres, and attracted a portion of demand from large industrial centres; this has had a favourable effect on agricultural productivity, tourism and other services and capital accumulation. For information concerning the case of Italy see ECLAC/UNIDO, 1986 and ECLAC, 1988.

b) *SMI development modalities*

In Japan, the existing links between SMIs and large enterprises were created in two ways: through the system of subcontracting by a parent company, under which SMIs produce certain previously-specified products, and through the system of subordinate affiliation, whereby small subcontractors co-operate with large companies as affiliates rather than subsidiaries.³⁸

This dual structure, which existed in the Japanese economy until the mid-1960s, was the result of the successive predominance of two well-defined trends: a narrowing of the gap between the productivity and wages of SMIs and large enterprises; and the progressive expansion of large firms at the expense of SMIs; this last trend later began to reverse itself.³⁹

In the case of Italy, the distinctive feature of the way in which SMI has spread is associated with the "system-area" concept, which refers to a network of enterprises concentrated in a given territory which produce similar goods or which are vertically integrated. Within these systems each enterprise plays a specific role in the processing or production process and thus constitutes both a production unit and a user of goods or services required or supplied by other enterprises. The network as a whole behaves as one large enterprise in terms of the utilization of economies of scale, but retains the flexibility afforded by the independence of each of the component units.⁴⁰

³⁸From the vantage point of the large companies, inter-firm co-operation and complementarity has primarily involved the spheres of research, design, inspection, education and automation. From the vantage point of SMIs, however, it has chiefly concerned the manufacture of parts, assembly, the provision of facilities and equipment maintenance. It is estimated that in 1981 about 66% of SMIs were engaging in subcontracting, particularly in the areas of transport materials (88%), clothing (87%), electrical machinery (85%), textiles (85%) and machinery in general (84%).

³⁹This turnaround was brought about by the enactment of legal provisions designed to prevent such practices; a delayed effect of these provisions was to encourage the growth of inter-SMI associative activities. Recently, SMIs have embarked upon a vigorous process of modernization and automation.

⁴⁰Initially, system-areas developed primarily in industries having a small volume of investment and a large number of employees in which technological innovation was not called for and the process of learning-by-doing was a significant phenomenon (footwear, clothing, furniture). Later, some system-areas ceased to belong to the category of single-product enterprises as they moved towards a broader-based type of integration; this process culminated in the 1970s, with the achievement by SMI of a

The production activity to be undertaken and the type of goods and services to be produced have generally been chosen on the basis of the available technical know-how in each location, so as to take advantage of cottage-industry specializations, the low cost of manpower and the possibility of subdividing the production process among various enterprises. In addition, the existence of SMI has served to intensify the use of the pre-existing economic structure, such as houses, stables and sheds, and the utilization of prior investments (machinery and equipment) which have been discarded by other enterprises as they modernize. Finally, in addition to the division of labour among SMIs, there has also been an integration of these companies with enterprises which supply credit, administrative and other similar services to industry.⁴¹

The manner in which SMI reacted to the crisis is clearly another relevant dimension of this analysis. During the 1970s and the early 1980s, Italian industry's response to this situation took the form of an expansionary adjustment which was buttressed by a flexibilization of the economy through a greater deverticalization and decentralization of production and technology. Most new industrial facilities belong to enterprises employing fewer than 100 people, but which as a group account for a large part of the new jobs created (see table 7).

In Japan, vast sectors of SMI have recently been overcoming their dependence on large enterprises, and this has given rise to the restructuring of some units and the creation of others, all of which has been facilitated by the modernization and automation of such firms. Many SMIs thus appear to be taking a more independent stance in coping with the crisis as

high level of competitiveness. In parallel with this, a change has been observed in the profile of entrepreneurs, who are now second- or third-generation and typically possess a high level of managerial capability thanks to their experience and to their formal training.

⁴¹Since the market of the Italian SMIs is part of the European Economic Community, the country has performed an intermediate position as regards liberalization, thereby permitting its small and medium-scale enterprises to exploit more easily-penetrated neighbouring markets. In Japan the contribution to exports made by SMI is substantial, but smaller than in the case of Italy.

Table 7

ITALY, JAPAN AND FEDERAL REPUBLIC OF GERMANY: CHANGES IN EMPLOYMENT IN MANUFACTURING BY FIRM SIZE, 1970-1980

Country, size of firm	Percentage variation in employment
Italy	1971-1981
Up to 9 employees	25.6
10 - 99	23.1
100 - 400	3.0
500 or more	-6.0
Total	12.0
Japan	1972-1981
Up to 9 employees	13.5
10 - 99	4.9
100 - 299	-8.8
300 or more	-19.1
Total	-3.2
Federal Republic of Germany	1970-1984
20 - 99	-33.3
100 - 199	-22.6
200 - 499	-20.3
500 or more	-21.6
Total	-23.9

Source: Calculated on the basis of census data. Italy: Industrial Census, 1985; Japan: MITI, 1983; Federal Republic of Germany: Statistisches Bundesamt, 1972 and 1986.

they compete with large firms in some fields of high technology, especially through what are known as "risk operations".

An indirect indicator in connection with this situation is that used in table 7, which shows that although employment in manufacturing during the period 1972-1981 diminished, the proportion of such employment provided by small enterprises and the number of this type of unit increased substantially. The situation in Italy and Japan differs considerably from that existing in the Federal Republic of Germany, where employment in SMI dropped more sharply than did the average for industry as a whole.

c) *The institutional context*

After analysing these two cases, it may be concluded that the public institutional structure has been of greater importance in Japan. Beginning in the postwar period, the State began to show a strong determination to step up the

development of SMI by means of policy measures in the spheres of technology, production, organization and financing.⁴²

Notable developments have also taken place with respect to the private institutional structure in Japan. As a result of the democratization process initiated after the Second World War, the number of associations of small and medium-scale entrepreneurs increased considerably and they began to undertake activities relating to financing, the joint purchase of equipment and raw materials, training services and research and information. These associations became the focal points of the national technological information network.⁴³

Currently, the institutional structure relating to SMI is made up of over 20 public and private agencies concerned with training, advisory services and information, integration, financing, the development of technology, product design and export promotion. These efforts are divided between the Agency for Small and Medium-Scale Enterprise, which is in charge of the design of policies and action programmes, and a group of public and private organizations which, with varying amounts of State assistance, carry out tasks in support of SMI (Astorga, 1985).

In Italy, the institutional situation is quite different. In particular, much of the growth seen in small-scale production has primarily been based on the local supply of manpower, saving capacity and entrepreneurial skills inherited from the pre-industrial era. No special public support has been provided, except in the underdeveloped areas of the south. However, a substantial volume of financial resources (a key

⁴²In 1948 the Agency for Small and Medium-Scale Enterprise was created and in 1953 the SMI Stabilization Act was instituted. Then, in 1963, a series of decrees contained in the Basic Law on SMI were enacted with a view to putting a stop to the excesses committed by large-scale industry in connection with subcontracting. All of these basic measures have been reformulated and readjusted as conditions have changed. To this end, there are policies concerning the modernization of equipment, the promotion of engineering technology and training, the introduction of new administrative methods, the rectification of detrimental situations in the field of commerce and the improvement of working conditions within such enterprises.

⁴³In 1978 there were nearly 40 000 associations of entrepreneurs, with almost 50% of SMI's participating in them. Their main tasks related to joint activities in the areas of subcontracting, the purchase of materials, financial management and production.

factor for these production organizations), was made available for this process during its early stages.

Initially, co-operation among small-scale entrepreneurs in connection with the production and marketing of their products was one of the most important mechanisms used by networks of SMI. Later, greater market complexity and competition made it necessary to have a more extensive supply of information and greater management capabilities, to design common strategies and to place priority on product and service quality. The State's energetic industrial policy contributed to the accomplishment of these objectives. In recent years, attention has been focused on expanding export consortiums and providing backing for credits requested by medium-scale and small entrepreneurs.

2. Opportunities and potentials in the region

This analysis of successful experiences with respect to SMI provides information that can be used in assessing the potentials of SMI as regards the industrial development of the Latin American countries. It is not a question of mechanically transferring experiences which have taken place in different societies and in different contexts, but rather of drawing lessons from these experiences which will make it possible to cast off many of the false dichotomies that muddle the discussion of this subject.

Viewing the countries of the region as a whole, three conflictive areas may be said to exist with respect to the role of SMI. The first concerns a series of divisions and gaps in the production structure which have a great deal to do with the very limited degree of socioeconomic articulation that prevails. Linked to the above, there is the more specific matter of the relations between SMI and large-scale enterprise, which was discussed in conceptual terms in the second section of this article. The third area relates to the question as to the nature of the structural effects of the crisis. This question, which has been asked so often in recent years, is closely related to the debate concerning the informal sector and its relationship to the performance of SMI.

The available evidence indicates that there is a clear-cut difference between the economic performance of large and small enterprises, a gap between formal and informal markets and a very strong likelihood that, in the pursuance of a rapid development of technology, the distance separating traditional enterprises from modern firms is going to become increasingly greater. Furthermore, it may be concluded that out of the wide range of possible relationships between SMI and large enterprises (dependence, competitiveness and complementarity), the one most commonly found in Latin America is the last of these. This may be characterized as a "passive complementarity" in regard to both supply (subcontracting) and demand (parallel and segmented markets). Finally, it is clear that in times of prolonged economic crisis, the informal sector, micro-enterprises and some of the small enterprises whose activities are related to products or services consumed by the "poor" have the opportunity to expand, in contrast to the rest of the production structure, which stagnates (Tokman, 1987; Cornia, 1987).

Based on the above, we believe it is important to suggest at least three areas in which SMI may help to overcome the problems mentioned earlier.

Firstly SMI may play an active part in a process leading to a greater degree of socioeconomic articulation. This is because SMIs are more flexible than other enterprises, more closely linked to their markets and less autonomous in terms of co-operation and the delegation of functions. Another essential characteristic is their proximity to the source of demand, which allows them to respond swiftly to changes in the level of economic activity and to contribute to the creation of a flexible and efficient industrial system. The modality and extent of the relations between large enterprises and SMIs is far from being a trivial subject, given the variety of possibilities which exist, as demonstrated by the cases of Japan and Italy.

The experience of Japan shows that viewing large enterprises and SMI as if they were in opposition to one another sets up a false dichotomy, inasmuch as they may be perfectly complementary so long as a common view of the future is shared by a social majority, a true commitment is felt to industry and a dedication to hard work is

present. The case of Italy, on the other hand, teaches us that, in a situation where a large number of independent workers are present, the determining factors relate to an efficient utilization of the economic infrastructure, specialization among SMIs and vertical integration within given geographical zones.

The belief that SMIs are by nature inefficient and that they are, therefore, destined to disappear as industrial development progresses is a commonplace which must be laid to rest. Experience demonstrates that this need not be the case. It is interesting to note that the productivity ratios between SMI and large-scale enterprise in Brazil during the 1970s did not differ substantially from those estimated for Japan.⁴⁴ Moreover, even in those cases where SMI is to some extent inefficient, the possibility of using idle capacity mitigates the impact of this shortcoming.

The second area of SMI potential is that of technological progress. The experiences of Italy and Japan, with their various modalities of innovation, substantiate the fact that SMI, far from holding back technological development, can help to further it. This is because these enterprises are in a position to serve as effective channels for the dissemination of technological innovations originating at the "centre" of the system and as a production structure that fits in with the redefinitions of "economies of scale" associated with recent technological changes. Thus, in Italy there have often been cases of modern SMIs with a considerable capacity for innovation, particularly within the sphere of "system-areas", where the situation is such that many of these enterprises are able to introduce and adapt new technologies, thereby significantly contributing to the restructuring of the industrial system. In Japan, the close relationship between SMIs and large enterprises laid the groundwork for the modernization of small and

⁴⁴The case of Japan may be used as a standard of reference. In the 1970s, the productivity of large-scale enterprise was, on average, around twice that of small-scale enterprise and 1.7 times that of medium-scale firms. It may be seen from an examination of table 4 that in Brazil the productivity ratio of large-scale enterprise *vis-a-vis* small and medium-scale enterprise was within the same order of magnitude (1.9% for small-scale and 1.3% for medium-scale enterprise). In contrast, the differences in productivity for Colombia and Chile are substantially greater.

medium-scale enterprises in terms of both the incorporation of new equipment and systems and the production of some of these items.

Finally, SMI is destined to play an active role in sociopolitical development. In this respect, there are at least three aspects which should be considered.

Firstly, because small production units are better able to adapt to cyclical fluctuations in the economy than large enterprises are, they can choose locations in relatively peripheral areas and utilize marginal segments of the labour force. In specific terms, they can thus help to lessen the concentration of the population in large urban centres and can provide income-earning opportunities for strata which usually do not have access to them. In this sense, SMI can serve as a means of easing social tensions and of contributing to a greater degree of equity.⁴⁵

The second consideration concerns the development of entrepreneurial capabilities, which have traditionally been associated at least in the literature, with the spread of small production units. This factor not only helps to improve the efficiency of the production system, but also serves to support and ensure lasting social stability. This is particularly important in the case of Latin America, in which the commitment to entrepreneurship has been consistently weak and has often been influenced by factors relating to social values.

The third aspect has to do with the political stability of democracies. This subject has not yet been analysed in sufficient depth to provide grounds for definitive conclusions. Nevertheless, the available evidence appears to indicate that the middle class is usually the social stratum that is most concerned with maintaining the stability of a liberal democracy. In some cases in

⁴⁵"An internationally competitive industrial system which is part of a social context within which a minimum threshold of equity has been achieved (agrarian transformation), can help to promote equity in the country in question by virtue of a relatively broader distribution of property, in association with the creation of small and medium-sized firms; the dissemination of labour skills; faster growth of employment... The initial expansion of the domestic market in respect of an increasingly broader range of goods and services associated with growth constitutes the irreplaceable basis of an industrial and technological learning process which is itself a prerequisite for a better type of insertion in the international economy." ECLAC (1988a), p. 45. The combination of these elements has played a key role in successful cases of industrialization.

Latin America the middle class has played a crucial role in destabilizing authoritarian régimes by non-revolutionary means.⁴⁶ In this sense, it appears probable that small-scale entrepreneurs, although politically conservative, enjoy greater advantages in a democratic and participatory system.⁴⁷

3. Some policy considerations

In order for the Latin American countries to resume a process of growth and development, their structures of production will have to undergo a through-going transformation. This statement requires that a distinction be made among at least three aspects of differing levels of specificity which influence the performance of SMI in varying ways: the types of policies that constitute the enterprises' macroeconomic frame of reference, which may be termed "factorial" policies; the form and coverage of direct assistance programmes and programmes for creating new enterprises, which may be categorized as "sectoral" policies; and, finally, the role assigned to the State. The main thrust of "factorial" policies is the maximization of the most attractive qualities of SMI. These relate to the utilization of the chief opportunities for development, such as the capacity for modernization, co-operation, specialization and subcontracting. The types of functional mechanisms involved

⁴⁶This is no doubt a highly controversial statement. Nevertheless, it is the authors' view that in a number of instances in which a society has been making a transition towards democracy, the intervention of this segment of society, whether appropriate or not, has been a determining factor in the success of the process. This does not necessarily mean that the middle class is a progressive and dynamic factor nor that it is the class which fights the hardest in order to establish a democratic institutional structure. However, it is the class which makes the greatest effort to maintain such a structure once it has been established.

⁴⁷A system in which participation is decentralized ensures that a series of conflicts (which, in situations where co-ordination is carried out at a general level, are usually amplified) will be confronted and resolved in a pragmatic fashion at the sectoral or regional level by the actors that are directly involved. It can be argued that, in social terms, small and medium-scale entrepreneurs are a characteristic component of the middle class and have greater need of economic and political stability and of a low level of social tension than do large enterprises. In the case of Italy, this concept was explicitly recognized by the first post-fascist governments; the development of a class of small-scale entrepreneurs was regarded as playing a functional role in achieving the stabilization of democracy. See ECLAC (1988).

may be grouped in terms of tax and credit policy, technology, market access and industrial siting, training and marketing.

Within this framework, another important element is the reinforcement of the links between SMI and large economic groups which is both necessary for, and an objective of, industrial restructuring. In this connection, it is interesting to note the changes now taking place in the organization and characterization of entrepreneurs in the industrialized countries as a result of technological progress and the rapid transformation of markets: in both cases there is a tendency "to replace vertical hierarchical relations with those characterized by horizontal co-operation" (ECLAC, 1988a, p. 48). The objective is to create a flexible system of industrial production that is capable of adapting to the swift changes occurring in patterns of demand.

Insofar as "sectoral" policies are concerned, in situations where markets are undergoing a process of rearticulation and expansion, it is possible to single out, on a tentative basis, some areas of production in which SMI might be expected to figure prominently. In this respect, guidelines and instruments need to be provided that will make it possible to prioritize and select a set of activities which would then become the main target groups for more selective assistance programmes in the fields of finance and technology. The management and transformation of demand are important matters, inasmuch as they can provide a stimulus for both routinely-used and durable consumer goods. Furthermore, the expansion of the domestic market is an inevitable consequence of a policy which promotes greater equity. SMI may benefit from policies aimed at improving product design, disseminating new technology and starting up some lines of production involving the use of high technology.

The third aspect is linked to the role of the State and its relationship to the economy. In

designing strategies and policies, it is useful not only to make specific recommendations, but also to suggest ways in which the State may be more effective in promoting concerted efforts by the various agents involved. At the level of industrial strategy (the frame of reference for the development of SMI), it is assumed as a given that the system adopted should be such as to permit the coexistence of participatory planning and the market (Fajnzylber, 1983). Participatory planning would play an important role in the design of basic medium- and long-term guidelines for investment programmes in strategic sectors, the maintenance of the conditions allowing for a macroeconomic equilibrium, and the definition of sectoral promotion policies. The market, for its part, would perform an important function as a channel for the flow of information to the whole of the economic system for purposes of decentralized decision-making and the resolution of short-term tensions or maladjustments. Within this framework the market would be of less significance, however, as a basic mechanism for the allocation of resources to areas regarded as being strategic, but would continue to function as a regulator of the decentralized economy, which is the type of context that is most conducive to the operation of small enterprises.

Within this setting, the impact of policies aimed at promoting small-scale enterprise would undoubtedly extend beyond the sphere of purely economic matters and would be of importance in relation to the criteria, judgments and motivations of individuals and collectives. This is attested to by the highly significant role to be played by the formal educational system and the media in reinforcing the foundations of an efficient entrepreneurial system which would foster closer ties between the population and industry while also promoting technical progress and creativity at the local level.

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Prebisch's ideas on the world economy*

Armando Di Filippo**

This article identifies three main phases in the evolution of Prebisch's ideas on the international economy. During the first of these, he outlined his concept of the centre-periphery system and its role in the fundamental structural disequilibria of peripheral countries, with particular attention to their propensity to deficits and indebtedness and the trend towards a deterioration in the terms of trade of the primary commodities they exported. He also brought out the repercussions of their narrow specialization in primary activities, associated with adherence to the principle of static comparative advantage.

The second phase, which was an outgrowth of the first, relates to the proposals in respect of international co-operation in the spheres of production, trade and finance put forward by Prebisch during the time he served as the first Secretary-General of UNCTAD.

The third phase corresponds to his more recent ideas (mainly expressed in his last two books and in *CEPAL Review*), which coincided with a period when mechanisms for international co-operation were on the wane and international trade and financial relations were increasingly subject to unilateral decisions. Prebisch's effort to fully grasp these processes led him to adopt an increasingly interdisciplinary approach. Hence his analysis of the social use of the surplus within peripheral capitalism also proved useful in comprehending the root causes which have brought about the present international economic crisis. The article concludes with a review of some of his more recent observations on the world economy and Latin American integration.

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Introduction

The ideas of Raúl Prebisch remain extremely relevant to an interpretation of the present world economic situation and to an understanding of the position occupied by Latin America in the shifting international scene. While this statement may well hold true in regard to other aspects of his thinking about development as well, this article will concentrate on illustrating the considerable forcefulness of Prebisch's view of the centre periphery in interpreting present circumstances and in discerning questions of major significance in respect of the future of the international order.

Within the limited scope of these pages, an effort will be made to distinguish three phases in the evolution of his thought which have a valuable contribution to make both to a productive understanding of the essential features of the severe crisis affecting the world economy and to an attempt to anticipate what the future holds in store. The first phase corresponds to his fundamental ideas, formulated during the 1950s, concerning the centre/periphery system and the tendencies towards structural imbalance of the peripheral economies. The second coincides with his tenure as the first Secretary-General of UNCTAD, during which he promoted international co-operation on the basis not only of the principles upheld by the United Nations, but also of the analytical foundations of his concept of the centre/periphery system. The last phase corresponds to the period during which he founded and directed the *CEPAL Review* and developed his ideas on peripheral capitalism, with particular emphasis on the subjects of the economic surplus, the accumulation of reproductive capital and the perils of the consumer society. It was during this phase that Prebisch's thinking took on an interdisciplinary character and he became increasingly interested in the power relations which emerge from the social structure and influence economic institutions and the market mechanism.

Throughout this long period, Prebisch's ideas gradually evolved and metamorphosed, not only as a result of his own intellectual activity,

but also in response to the changes taking place in historical circumstances. Nevertheless, a basic common thread runs through his ideas which facilitates an understanding of the general trend of his thought. This thread is his ongoing concern with the factors which determine the distribution of technical progress and its benefits between the centres and peripheries, as well as within each one of these societies (Di Filippo, 1986).

1. Peripheral status and structural imbalance

At this point it will be useful to undertake a brief review of the basic ideas set forth by Prebisch during the 1950s in respect of the centre/periphery system and its impact as regards the structural imbalance of the peripheral economies. Particularly noteworthy is his concept of the international division of labour that was inherited from the industrial revolution. Prebisch held that a demographically small group of central economies, undergoing a self-sustained process of productive diversification and capable of generating technical progress on its own, interacts with a vast unindustrialized periphery. This periphery is drawn into an ever greater productive specialization in primary commodities which the centre requires in order to lower its costs in terms of raw materials and wage goods.¹

The structural imbalance of the peripheries springs from this peculiar and asymmetrical position within the international division of labour and is reflected both in the sphere of employment and in the international insertion of the economies concerned. These fundamental perceptions highlight the dynamic nature and

deep historical roots of the ideas put forward by Prebisch in respect of development. There would be no point in going over concepts here which have been examined on many occasions by various authors; the following discussion will therefore be confined to a review of some of the main features of these concepts with a view to underscoring their historical relevance.²

Prebisch regarded the development of the world economy as being an asymmetrical process. The introduction of technical advances raises average per capita income in the industrial societies, but the demand for final goods and intermediate inputs does not expand at a uniform rate in the various branches of production. This asymmetry is attributable to two main factors. First of all, in accordance with the well-known principle described by Engel's law, the income-elasticity of demand for primary goods is generally lower than that of the demand for manufactured goods and for a large number of services. Secondly, the technological development of industrial activities entails a reduction in the content of primary goods per unit of final industrial product. Consequently, both consumer demand for final products and industrial demand for capital goods and inputs contribute to the asymmetrical growth of the branches of production. It should be mentioned in passing that it was some time before these ideas, which are fundamental to the theory of economic development, were given their due by academic theory. Indeed, it is only very recently that the need to construct formal models reflecting the asymmetrical nature of the growth of productive structures has been recognized and that the analytical tools needed in order to examine this phenomenon have been developed (Pasinetti, 1981 and 1987).

With these two fundamental principles as his starting point, Prebisch posited the existence of a tendency towards structural imbalance on the part of the peripheral economies. He contended that, in the international sphere, world

¹See Raúl Prebisch, "Growth disequilibrium and disparities: interpretation of the process of economic development", Part I of the ECLAC *Economic Survey of Latin America, 1949* (E/CN.12/164/Rev.1), New York, United Nations publication, Sales No.: 51.II.G.1. See also, "The economic development of Latin America and its principal problems" (E/CN.12/89/Rev.1), New York, United Nations publication, Sales No.: 50.II.G.2, written in 1949 as an introduction to the ECLAC *Economic Survey of Latin America, 1948* and later published in the *Economic Bulletin for Latin America*, vol. VII, No. 1, Santiago, Chile, February 1962.

²See, among others, the following publications concerning the thinking of ECLAC in the 1950s and early 1960s. Essentially, these writings take up and develop the ideas of Raúl Prebisch: ECLAC (1969); Rodríguez (1980); Gurrieri (1982); Bacha (1974), Di Filippo (1981).

demand for primary products would grow more slowly than the demand for manufactures. Consequently, as exporters of commodities and importers of manufactures, the peripheries would be inescapably marked by a structural propensity to deficit and indebtedness. In parallel fashion, within the sphere of employment the global development of the world economy would witness a shift of the labour force away from primary activities and towards secondary and tertiary ones. Hence, should the peripheries persist in their narrow specialization in primary activities in strict adherence to their static comparative advantages, they would ultimately find themselves facing the dilemma of having to accept either a large-scale and increasing underutilization of their labour force or the migration of their manpower to those regions of the world where the industrial development process was in full force. This accounts for Prebisch's insistence on promoting the industrial development of the peripheries. It should be stressed that neither Prebisch nor ECLAC ever single-mindedly espoused the idea of a predominantly closed type of industrial development based primarily on import substitution; on the contrary, they underscored the need to promote competitive industry, capable of sustaining itself through exports of manufactured goods as well. Growth based on import substitution did not spring from any strategy dictated by ECLAC, but rather from the imperative of historical circumstance during the period between 1914 and 1945, when the foundations were laid for the industrialization of most of Latin America's large and medium-sized economies (Prebisch, 1986).

Another fundamental idea—which, in its original form, Prebisch shared with Hans Singer—is that of the deterioration in the international terms of trade for commodities *vis-à-vis* those for manufactured goods.³ Prebisch continued to elaborate and expand upon this idea until it came to be a logical extension of his theory of structural imbalance in the international sphere and in employment. Seen from this angle, "the deterioration thesis" may be regarded as a necessary outcome of the overall

significance of his ideas on the centre/periphery system.

It is important to delve a bit more deeply into the "deterioration thesis" as postulated by Prebisch, because it is this theory which marks the confluence not only of his ideas on the structural imbalance of the peripheries, but also of his ongoing concern with the economic and social forms taken by the appropriation of increases in labour productivity arising out of the dissemination of technical progress. The above-mentioned concept of differing elasticities gave him grounds for asserting, on the one hand, that the sluggish expansion of "central" demand for commodities constituted a very real restriction to the growth of the peripheral export economies. Any unilateral expansion of the supply of these products above and beyond the requirements of demand would, due to the price elasticities involved, lead to a sharp fall in their prices. Consequently, if the primary product-exporting economies were to attempt to overcome the tendency towards deficits and indebtedness inherent in their peripheral condition by making an effort to eliminate their deficits through an increase in exports, the result could prove counterproductive, since such a step might well lead to a steep decline in prices and the worsening of the existing deficit. The existence of surplus labour—an intrinsic feature of peripheral status—, made it either impossible or much more difficult for workers employed in primary activities to raise their wages in line with productivity increases in the output of primary goods for export. As a result, profit margins were higher in these export activities in the periphery and the entrepreneurs in these sectors were more inclined to forgo proportion of their profits in the form of price cuts. The case was just the opposite in the central economies exporting manufactured goods, where the bargaining power of labour allowed it to increase its real wages in step with improvements in labour productivity, as in fact happened following the Second World War.

In contrast with the argument formulated by Singer, Prebisch's "deterioration" thesis also includes an interpretation of the cyclical nature of this phenomenon. A discussion of this aspect of his theory is, however, beyond the scope of this brief review.

³For an examination of the essential features and evolution of this thesis, see Di Filippo (1987).

2. *The relevance of Prebisch's fundamental ideas*

Prebisch's ideas on structural imbalances and the deterioration in the terms of trade within the centre/periphery framework continues to constitute a productive way of addressing the issue of Latin America's international insertion. However, although the basic structural focus remains fully valid, the pertinent historical data have changed over the past 35 years. Prebisch's subsequent analyses and interpretations also reflected and incorporated these changes, as we shall see when we analyse the later phases of his thinking. At this point we are only concerned with two of his theses. Firstly, that of the peripheries' tendencies towards deficits and indebtedness; and secondly, that of the deterioration in the terms of trade.

The trade deficits characteristic of the peripheral countries arise out of the greater expansion of demand for manufactured goods than for primary products in the world economy. The statistical data corroborate this observation, since they indicate that during the postwar period the demand for manufactured goods has grown far more rapidly than the demand for primary products, and thus provide ample confirmation of the principles underlying the thesis of imbalance. From the standpoint of the development of the countries of Latin America, the important point is not whether their balance of trade in goods shows a surplus or a deficit, however, but rather the far broader and deeper thesis, also formulated by Prebisch, that the region's rate of growth is closely linked to its import capacity, which, in turn, continues to be a function of the centre's demand for the region's exports of primary products. Should its exports fall, then the region, in order to continue with its adjustment to external conditions, will be faced with the need to choose one of two possible options: it will either have to bring about a reduction in its imports and, hence, in its rate of growth or it will have to rely on the inflow of external savings, either in the form of international co-operation, i.e., on preferential terms, or in the form of conventional financing through the private sector.

Throughout the entire postwar period, Latin America has been dependent on external sav-

ings, judging from the deficit consistently registered by its balance-of-payments current account. The continuing validity of Prebisch's theses lies in the fact that the region obtains more than 75% of its export earnings from the sale of primary products, which makes it highly vulnerable to fluctuations in the demand for these goods on the world market.

The evolution of the Latin American economy during the 1980s has provided dramatic evidence of the validity of Prebisch's theories regarding peripheral status. First of all, commodity prices have not only followed the downward trend seen throughout the whole of the long postwar period, but have suffered a veritable "collapse" during the 1980s. Secondly, external inflows of capital have dried up, simultaneously subjecting the region to a sharp decrease in its import capacity and to a virtual suspension of external financing. A dramatic turnaround in its prospects for development during the 1980s has thus been brought about by the brutal cutbacks in imports it has made in order to balance its external accounts and the diversion of internal savings it has been obliged to make in order to pay the interest on its debt.

To summarize, the evolution of the external economic environment during the closing years of the 1970s and thus far in the 1980s has had devastating repercussions on the Latin American economy which, in structural terms, are attributable to its peripheral status, as described early on by Prebisch in the 1950s: a dependence on world demand for primary products; a heightened vulnerability to variations in their prices; and a situation in which its growth potential is heavily influenced by its capacity to export primary products and/or obtain external financial resources.

If one were to single out one area of the international economy in which the theoretical factors discussed by Prebisch are the most clearly apparent in empirical terms, it would surely be that of the terms of trade between commodities and manufactured goods, rather than his thesis on the structural imbalance of the peripheries, whose corroboration requires special precautions and considerations. Data from a variety of sources (World Bank, International Monetary Fund, UNCTAD, etc.) provide categorical proof of the downward trend in the real prices of

commodities throughout the whole of this century. Indeed, by the end of 1986 these prices had fallen to such an extent that they were even lower than during the depression of the 1930s.⁴ The steep decrease observed during the 1980s is a clear reflection of the causative factors identified by Prebisch: different price and income elasticities, both on the demand and the supply sides; the unequal ability of the various agents of production to appropriate increases in labour productivity; and the tendency of technical progress to reduce the proportion of primary product inputs per unit of final industrial product. Prebisch's observations regarding the economic cycle are particularly elucidating in respect to the collapse in prices observed in the 1980s. During the current phase of slow growth in the centres, the deterioration in commodity prices has become even more pronounced, particularly as a result of the oversupply which the peripheral countries themselves have helped bring into being as they strive to earn foreign exchange in order to meet the burdensome commitment of servicing their swollen external debts.

3. The UNCTAD phase: the impact of Prebisch's ideas within the sphere of international co-operation

The need for international co-operation was stressed by Prebisch not only in recognition of the ethical principles of the United Nations but also as a consequence of his own analysis of the centre/periphery relationship. The rationale for his advocacy of North-South co-operation lay in the asymmetrical nature of international economic development. If it were given over to the unrestricted interplay of market forces, the system would surely lead to the commercial and financial asphyxiation of the peripheries; hence the vital importance of co-operation in these areas. In the sphere of trade, such co-operation could not, however, be based upon the same criteria as those governing co-operation among the industrialized countries. For example, the "most-favoured-nation" principle established under GATT, involved applying the same stand-

ards to competitors of vastly differing capacities. In contrast to this "formal reciprocity", as he himself called it, Prebisch proposed "real reciprocity", which would take into account the structural asymmetry between the centres and the peripheries and thus require the former to grant trade preferences to the latter in order to offset the tendencies towards structural imbalance arising out of the peripheries' status as exporters of primary products. For the same reasons, financial co-operation in relation to trade and development was also required. UNCTAD was established in response to this approach, which maintained an uneasy coexistence with the more orthodox philosophy, espoused by the IMF, the World Bank and GATT, in favour of the free operation of market forces.

In his first report to UNCTAD as Secretary-General of the newly-founded institution, Prebisch drafted what can only be described as a "manifesto on North-South co-operation". This document cannot be fully comprehended unless it is considered in the light of his earlier "Latin American manifesto", which was published in 1949 when he was at the head of ECLAC. In respect of North-South co-operation, his report to UNCTAD constitutes a logical extension at the international level —although this time from an action-oriented perspective— of the basic ideas underlying the diagnostic analysis of Latin America which Prebisch had propounded when at ECLAC.⁵

If the fruits of his efforts are examined from the privileged vantage point afforded by an *ex-post* historical perspective, it must be admitted that although his objectives were ethically justified and had a rational basis, they never met with full acceptance within governmental and entrepreneurial circles in the central countries. Prebisch's ideas clashed with those of the three leading institutions (World Bank, IMF, GATT) presiding over the world economic order and were at odds with the logic of market liberalization favoured by the major international firms in the developed world. Nonetheless, even a cursory reading of the arguments set out in his first report to UNCTAD reveals that Prebisch was

⁴See, among others, ECLAC (1986), the World Bank (1986), Sarkar (1986) and Sapsford (1985).

⁵This report to UNCTAD was published by the Fondo de Cultura Económica under the title *Nueva política comercial para el desarrollo*, Mexico City, 1964.

advocating international North-South co-operation as a strategy designed to ensure the harmonious development not only of the peripheries, but also of the industrial centres. What he was putting forward was, essentially, an equitable formula for gradually overcoming the structural asymmetries affecting both the centres and the peripheries.

With the benefit of hindsight, it might also be said that the ethical justification and scientific rationality of his ideas regarding co-operation, while essential to the task he had undertaken, were not enough to ensure its success. Those achievements that were engineered within UNCTAD (the Generalized System of Preferences, the associations of commodity producers and consumers, compensatory financing arrangements, etc.) came into being either during the latter part of the most dynamic period in the history of the world economy (1945-1970) or as a result of exceptional circumstances (the first major oil crisis), which made it possible to wrench concessions from the industrialized countries. Unfortunately, the slowdown of the world economy in the 1970s marked the onset of a deterioration in the structure of international co-operation. In this new setting, international economic negotiations began to disregard the spirit of co-operation championed by the United Nations and to be increasingly based on the power (in production, trade, finance, etc.) of the countries or blocks of countries represented at the negotiating table. In other words, the long-term decline of the industrial centres in terms of their development has revealed, as so often before throughout history, the role played by power relations as an underlying force in market dynamics.

It was precisely during the third phase in the evolution of his thinking that Prebisch devoted particular attention to the manner in which the power relations arising out of the social structure affect market relations, influencing them so strongly that an interdisciplinary analysis is required in order to grasp them in full. This new perspective was manifested in the way he went about examining the social struggle to appropriate the surplus in the Latin American economies, as well as in his study of the impact of this phenomenon on the processes of development and democratization. These ideas, whose pur-

pose was to arrive at an understanding of peripheral capitalism, nonetheless prove equally useful in interpreting some of the fundamental causes which have brought about the present international economic crisis.

4. Social use of the surplus, "consumerism" and capital accumulation

At this point it may be useful to provide a brief synthesis of the ideas which Prebisch developed in this field, prior to examining their relevance to an understanding of the present international crisis.

The concept of surplus developed by Prebisch was an outgrowth of his ongoing interest in studying the social and economic forms of appropriation of increases in labour productivity. Similarly, his interest in the "social use of the surplus" —to employ his own terminology— is no less than a new approach to the study of the forms of utilization of increases in labour productivity (Prebisch, 1981).

At this stage in his thought, Prebisch was concerned with those forms of capital accumulation tending to prevail in contemporary consumer societies, as well as with their detrimental impact on the possibilities of growth. He saw the "consumer culture" which has spread out from the centres as constituting one of the features of the "imitative capitalism" of the peripheral economies. Within a line of thought which had already been developed by other Latin American writers, he impugned the premature adoption by poor peripheral economies of consumption patterns appropriate to developed societies. This trend was aptly described by Aníbal Pinto (1973 and 1976) as "a caricature of the consumer society".

Prebisch made a theoretical distinction between reproductive and non-reproductive forms of capital accumulation. These terms did not refer to any specific characteristic of given capital goods, but rather to contrasting "styles of accumulation". Reproductive accumulation was that which raised the productivity of labour while simultaneously increasing employment opportunities in the economic system as a whole.

In order for these two things, which were apparently mutually exclusive from a static viewpoint, to occur simultaneously, the agents responsible for the accumulation process in the public and private spheres would have to adopt an austerity-oriented and "productivist" approach. Thus was because successive increases in labour productivity made possible by the introduction of technical progress had to be diverted away from consumption, and particularly from the imitative consumption of luxury items, so that they could be reinvested in a productive manner that would continue to bring about rapid increases in labour productivity. As this increase in productivity gathered speed, the process of accumulation would have to keep pace with it in order to maintain a balance in the labour market.

In contrast, non-reproductive accumulation was that which was aimed at diversifying existing forms of consumption and rendering them more complex. Since it did not increase labour productivity, this form of accumulation slowed down the growth rate of the surplus, thereby limiting the possibilities of subsequent accumulation. It was precisely on these non-reproductive types of accumulation that imitative capitalism in the peripheral regions was based; moreover, these modalities of accumulation were accompanied by a struggle over the distribution of wealth among the different social sectors which led to disordinate levels of inflation and jeopardized the progress of the democratization process.

Although these ideas were developed on the basis of an observation of peripheral capitalism, they also proved valid as a means of anticipating the evolution of some central economies (Prebisch, 1984). In examining the "stagflation" that affected the industrialized world during the 1970s, Prebisch attributed the phenomenon to insufficient reproductive accumulation and excessive public and private consumption, trends which were particularly strong in the main dynamic centre of contemporary capitalism. The huge trade and fiscal deficits and scant rates of reproductive accumulation of the United States economy attest to the fact that in recent years this country has been living beyond its means by making use of its monetary power, which has allowed it to finance these unprecedented imbalances with external savings.

Prebisch also took an interest in the extraordinary growth of the Japanese economy, whose style, which is similar to that adopted by other Asian nations, is in clear contrast to the consumerism prevalent in the main dynamic centre. The Japanese economy corresponds much more closely to a model of reproductive accumulation designed to achieve rapid increases in labour productivity, which are then reinvested in order to speed up the process even further. This style of development, oriented towards the export of manufactures, strongly protected against external trade and financial interference and based on close collaboration between the public and private sectors, is what led to the so-called "Japanese miracle". Thanks to the extremely swift increase in labour productivity, Japan simultaneously accomplished three decisive results: it raised the standard of living of its labour force, maintained higher profit margins than those of the industrialized Western economies and came to represent an overwhelmingly competitive force on international markets (Prebisch, 1981).

The outcome of these disparate economic trends is apparent in the type of relationship which has gradually emerged between the United States and Japan. The United States has a deficit-laden and indebted economy and utilizes its monetary power to finance a life style beyond the reach of its actual economic means while it brings pressure to bear on Japan to moderate its competitive drive. For its part, the Japanese economy maintains large surpluses in its trade with the United States. These surpluses are then recycled in the form of financial flows which help to absorb the United States deficits. It is only through international co-operation and the harmonization of the two countries' external policies that it will be possible to overcome these macroeconomic imbalances, which are decisive factors in the present international crisis, without serious repercussions.

This is not the place to elaborate further upon these observations. It is sufficient to stress the undeniable usefulness of these analytical categories in arriving at an understanding of the underlying causes—or at least some of the most significant ones—of the acute friction and trade and financial imbalances characteristic of the present international economic crisis.

*5. Prebisch's later observations on
the world economy and on
Latin America*

Following the publication of his last book on peripheral capitalism (1981), Prebisch continued to observe the evolution of the world economy and to present his views in the *CEPAL Review*. In his final essay, he returned to the topic which had been his constant concern: the sharing out of technical progress and of its fruits in the course of international dealings. In a few brief paragraphs he linked his new concept of the surplus with the long-standing, but omnipresent problem of the deterioration in the terms of trade. It is worthwhile reproducing his words here, inasmuch as they provide a telling example of the interdependence of the various components of his theoretical approach, including those developed during different phases in the evolution of his thinking:

"I have already said that there are factors which account for the unfavourable reaction of the centres to imports of manufactures from the periphery. I think that for a proper understanding of this fact it is indispensable to recall the dynamic role of the economic surplus of enterprises that I have sought to explain in earlier articles. In the surplus is mainly embodied that part of the fruits of the system's increasing productivity which is not transferred to the labour force. This is a matter of profound dynamic significance, since the surplus is the source of a considerable proportion of the capital accumulation of enterprises. Thus, as the evolution of demand calls for more and more diversification, capital investment also shifts towards production of goods that are diversified. Inter-enterprise competition is directed towards capturing markets in the diversification process rather than towards reducing prices, except in the case of those goods that have been surpassed by others deriving from the incessant innovations aforesaid.

"Here a point arises which must be stressed: the shift in investment is effected by virtue of the growth of the surplus, and this growth occurs precisely because, in general, and thanks to diversification, prices of manufactures do not fall. If there were no diversification resulting from ceaseless innovations, consumer demand would tend to reach saturation point.

"This is a phenomenon characteristic of capitalist development. It happens, however, that when imports from the periphery acquire competitive capacity [in the central economies] through the combination of technical progress with relatively low wages, competition in this case is based on price reductions, and adversely affects not only the growth of the surplus but also the ability of industries hard hit by competition to redeploy their forces and invest in the diversification process or step up their productivity. This explains why entrepreneurs and workers are antagonistic to imports from the periphery. Clearly, an additional element today is unemployment, which, as we have said, stems from the sluggishness of the economies of the centres".

A few pages later he goes on to say: "The time has now come to pose this other question: why do the centres look with favour upon a downward movement in the prices of these primary products while they take pains to withstand a fall in the prices of the manufactures they import from the periphery? The answer is very simple. A reduction in the prices of primary products enlarges the economic surplus of the enterprises [which] purchase them, whereas a decline in industrial prices weakens their surplus and consequently their capacity for accumulation" (Prebisch, 1986, pp. 204 to 206).

In these paragraphs, which were written shortly before his death, when he was 85 years of age, an outline is given —Prebisch considered the essay from which they are taken to be a set of "notes"— of fresh and promising conceptual interrelationships that he would undoubtedly have continued to develop, had time allowed.

However, during this period his attention was not directed solely to the central elements of his theoretical concepts. He also had keen insights into the new and burning monetary issues which began to surface in the 1970s. In this connection, he placed stress on a perspective that was linked to the role of the underlying power relations in the market mechanism, a concept which has already been commented upon in an earlier section. In the sphere of international monetary relations, this same perspective led him to undertake a critical analysis of how the utilization of the international monetary power of the United States had influenced the international monetary system and how it

had thereby also affected the market relations of the world capitalist economy as a whole. The announcement of the inconvertibility of the dollar in the early 1970s, together with the creation of the Eurodollar market and its connection with the growing ability of the transnational banking system to expand the money supply with no substantive supervision by any international authority, thus became objects of his concern. In the late 1970s, the stagflation observed in the industrialized countries — a trend which had a particularly strong impact on the United States economy — led him to consider further not only the consumerist style of development of the Western centres, but also, once again, the unilateral use of monetary power by the United States. Subsequently, in analysing the sharp turnaround which occurred in the monetary and financial policies of the centres at the beginning of the 1980s, Prebisch laid stress on the nature of their repercussions on the peripheral countries and on Latin America in particular. Nor did the part played by the decrease of commodity prices in the industrialized nations' success in reducing their rates of inflation escape his attention as he kept a close watch on the world situation. In particular, the topic of Latin American indebtedness prompted compelling insights into the origin of the monetary and financial changes which had set off the debt crisis.

Shortly before his death, as he addressed the twenty-first session of ECLAC, he said: "This is a dilemma which must be clearly seen; no solution for it will be reached in the absence of a political decision on the part of the governments of the creditor countries. Why a political decision? Because the origin of this problem is political. The Eurodollar market was born of a political decision on the part of the larger countries, especially the United States. Leaving the Eurodollar market unregulated, despite the warning voices that were raised at the time, was a political decision. Covering the fiscal deficit of the United States, not in the traditional and orthodox fashion through an increase in taxes and a reduction of expenditure, but by absorbing domestic saving and gigantic quantities of saving from the rest of the world through astronomically high interest rates, is a political decision. How then can we do other than maintain that the debt problem is essentially political? Because of the

nature and origin of this situation, and because of the serious consequences that its persistence will imply for all the countries affected and, in the last resort, for the industrial centres, too, it calls for a forward-looking approach and for understanding of the dangerous threat to the world economy that it involves, since it is not only the problem of the debt that is at issue, but also, as has been said over and over again at the present session, other problems which are superimposed upon it" (Prebisch, 1986a, pp. 14-15).

On the same occasion he underscored the imperative of clarifying the role of ECLAC in respect of the import substitution policy which the countries of Latin America began to apply during the crisis of the 1930s. His words on this topic are revealing. They not only constitute a testimony of the past, but also provide a clear outline of the role which import substitution could play, should the present international crisis deepen:

"I should also like to comment —since we are talking of the renovation of ideas, of ideas that lag behind events— on the foreign trade policy of the Latin American countries. When did import substitution begin in Latin America? During the great world depression, when the monetary policy of the United States and the enormous rise in customs duties shattered the whole system of multilateral trade and payments that had been working very well. The slump in our countries' exports was formidable, and import substitution was the only way out. I had an active part to play at that time, and I do not remember that in the prevailing situation there was anyone crazy enough to say 'The thing is not to substitute domestic production for imports but to export manufactures'. Export manufactures where? To a world that was out of joint and where protectionism was a normal way of safeguarding economies? Import substitution was the only solution possible. It was not a doctrinaire imposition. It was imposed by force of circumstances. Then came the difficulties of the postwar period, until at last, with Europe reconstructed and the world economy set on its feet again, the opportunity and the need to export manufactures did arise" (*ibid.*, p. 15).

After recalling that in 1961 ECLAC had already put out a warning regarding the asymmetry of Latin American industrial policy and

the need to promote the export of manufactures, Prebisch made a number of further observations regarding the present situation, which, on account of their undeniable relevance, deserve to be quoted in full:

"This is not a question of doctrinaire preferences. The extent to which our countries should go on combining import substitution with exports depends upon the receptive capacity of the centres. If the growth rate of the centres remains far below what it was in the past and protectionist measures continue to proliferate, the need for import substitution will be much greater than if thriving developed economies throw open their doors to exports not only of manufactures but also of primary products from the developing countries. As I said, everything ultimately depends on the receptive capacity of the centres; the need to export is not a whim of the developing countries, but a requirement of their growth" (*ibid.*, p. 15).

6. The issue of integration

However, Prebisch tended to take a pessimistic view of the possibilities for greater dynamism and openness on the part of the world economy, and in particular the United States economy, to exports from the periphery and from Latin America in particular (Prebisch, 1986, p. 210). Hence his insistence on import substitution (although now at the regional level) in connection with his well-established ideas and recommendations regarding the desirability of Latin American integration, which date back to the 1950s. In respect of this subject —to which he returned in, *inter alia*, an essay written in 1986—he put forward a number of recommendations which, putting aside any considerations relating to their validity or practicability (aspects that we shall not attempt to examine here), reveal him to be a thinker who was turned towards action and who possessed unswerving faith in integration as a factor of Latin American unity. What he said was this:

"It must be recognized, however, that the effort expended over more than two decades has produced very scanty results. Accordingly, the reasons why we have not advanced as much as in

the early days might have been thought possible should be subjected to careful scrutiny. A retrospective review leads me to the following conclusion: in ECLAC we allowed ourselves to be seduced by the idea of a Latin American common market, which gradually cleared a way for itself and took shape in the arrangements generally known. What I am saying is not that this idea must be abandoned, but that there should be a change in the form and timing of its materialization. The crux of the matter always has been and still is the trend towards an imbalance with the centres which must necessarily lead us to substitute domestic production for imports from the central countries. It is there, in my opinion, that efforts should be concentrated, leaving other measures, aimed at trade liberalization, for a later stage. Thus, for example, the preferences that our countries could grant one another in respect of importing consumer goods are not going to resolve that basic problem to which we alluded. Nor is this all; I think that import substitution under a preferential régime comes up against major obstacles. The countries whose industrial development is farthest advanced are in a position to export capital goods or intermediate goods to the relatively less or least advanced countries while the latter cannot participate to the same extent in trade of this kind. It is on their shoulders, however, that the cost of such operations tends to fall, since they are made to pay higher prices than are quoted on the international market for the capital goods and inputs which they import from the more advanced countries. For this and other reasons, I am more inclined to think that the advanced countries should grant their exports subsidies equivalent in significance to their customs protection. Of course the subsidies régime would have to be established by common accord under a new agreement, but it would not suffice in itself to ensure a relatively balanced trade. The least or relatively less advanced countries would still be in an inferior position unless special corrective measures were taken; one of these would be for the countries benefiting most by the trade in question to share with those that gain least the investment required to facilitate a satisfactorily balanced trade not bilateral but multilateral among all the participant countries" (Prebisch, 1986, p. 208).

We have deliberately left these rather lengthy references to the topic of Latin American integration until the last. We have done so, first of all, because the style in which these paragraphs are written illustrates Prebisch's constant quest for concrete economic policy measures that could serve as a means for putting the results of his diagnoses into practice, and secondly, because the issue of import substitution on a regional scale, within the context of a more intense drive for Latin American integration, attests to the congruency and continuity over time of his main lines of thought. These

ideas take on particular importance within the present international crisis situation in that they call up dilemmas which the region faced once before —although under different historical circumstances— between 1914 and 1945.

Finally, by way of conclusion, there is perhaps room for one last remark. The ideas of Prebisch, which we have reviewed all too briefly here, are not only a part of the history of Latin American economic and social thought. They also constitute *idées-force* which continue to help shape history.

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Prebisch: A classic and heterodox thinker

*Benjamin Hopenhayn**

In this tribute to Raúl Prebisch, the author seeks to highlight two of the outstanding features of Prebisch's written legacy: the classical nature of his thinking, and his heterodoxy as a combatant, armed with the lessons taught by concrete historical experience, against conventional myths. Both of these traits are to be found in many of the thinkers who have made landmark contributions to the development of the sciences and the realm of ideas, as did Prebisch in the field of economic development and societal change.

I

Prebisch: a classical thinker

Starting from his experience and his identity as an Argentine, as Prebisch developed his ideas he focused first on Latin America and then on the world economy. He thus followed in the steps of many classical thinkers in the most varied fields of philosophy, literature and the humanities in general whose theories carried them from a reality firmly set in a specific time and place to a much vaster universe. In economics, to turn to the basic discipline with which Prebisch was concerned (although his ideas overflowed its bounds with increasing frequency as time passed), it may be remembered that the physiocrats opened up new analytical and theoretical frontiers on the basis of their observation of conditions in France, that Ricardo did the same on the basis of the situation in England during his lifetime, as did List in Germany, and that the thinking of Keynes himself took as its starting point the new situation facing England during the decline of the British Empire.

This is not the only path for the development of knowledge, in economics or in any other discipline. There are those whose ideas have sprung from theoretical reflection, as in the case of the founders of neoclassicism, Walras and Pareto, and of Samuelson. Other thinkers, such as Karl Marx, have looked to history for their sources. Thus, social thinkers have chosen many different paths. Carl Menger, the founder of the Austrian school and one of the first to be concerned—as are so many today—with method in the social sciences, drew a distinction among three methodologies in economics: the theoretical/abstract, the empirical/realist and the historical approaches.¹ Indeed, all the significant thinkers have drawn on one or another of these three methodologies at different times and for different purposes. In the case of Prebisch, his personality was such as to cause him to have a general preference for empirical realism with an historical cast, i.e., theoretical reflection whose

*This article is a revised version of a paper presented in Buenos Aires in September 1987 at the Seminar on Latin America in the World Economy, which was organized as a tribute to Raúl Prebisch by INTAL, the Raúl Prebisch Foundation and ECLAC.

¹Carl Menger, *Principles of economics*, New York, New York University Press, 1981.

basis was an analysis of real-life situations and whose aim was the formulation of proposals for practical action. In this sense he followed in the steps of the classicists.

Indeed, Raúl Prebisch himself was a "classical" figure in both senses of the word: in the more general sense of being a "model worthy of imitating" and insofar as his thinking as an economist is concerned. Of Raúl Prebisch in the first sense, that is, as a man whose personality and life set an example to be followed, other friends have written and spoken with emotion and accuracy.

What I would like to do in this article is to resume my consideration of Prebisch both as a classic of economics and as a classical economist. I say "resume" because I have already undertaken something along these lines in a commentary I prepared on his book *Capitalismo periférico: crisis y transformación*, which, much to my satisfaction, Prebisch himself found to be relevant.²

In the light of the astute distinction which Hollis and Nell³ draw between the classical and neoclassical schools in the history of economic ideas, it becomes clear that Prebisch belongs to the former. These authors characterize classical economists as those whose attention is focused on production and distribution, on processes of change, whereas neoclassical thinkers tend to concentrate on the action of rational economic agents which generate demand and supply on interrelated markets.

Prebisch's thinking clearly stresses the dynamics of production and distribution, but he did not stop there. As he pursued his consideration of reality, his ideas also took in social and political phenomena and the ethics of development. He did not expand his field of study willingly. A man of rigorous scientific training and disposition, he preferred to address a methodically-defined and more precise field of research, rather than to try to encompass the entire universe. Nevertheless, his deeply felt need to understand the true nature of the situations he considered eventually led him to seek answers in other disciplines. Thus, his next-to-last book, on the crisis and transformation of

²B. Hopenhayn, *Algunas notas sobre el "Capitalismo periférico" de Raúl Prebisch*. Desarrollo Económico, No. 86, Buenos Aires, 1982.

³M. Hollis and E. Nell, *Rational Economic Man*, New York, Cambridge University Press, 1975.

peripheral capitalism, sets up an interpretative model in which economic, social and political factors are inextricably linked to one another. He himself gives us the explanation for this: "The time has now come to address [the various elements] in all their intricate complexity and to ascertain the nature of their mutual relationships. This must be done in order to gain a better understanding of the situation that we wish to change."⁴

This is one of the keys to Prebisch's thinking, and one which is also characteristic of the classical economists: the acquisition of knowledge and understanding as a basis for adopting a position and, when necessary, proposing changes. This is neither neutrality nor an attempt at "asepsis", but is instead a type of theoretical reflection marked by a strong ethical dimension in the tradition of Adam Smith, Marx, Pareto, Keynes and Myrdal. All these men used economic analysis as a means of supporting policies or proposing major changes, each in his own place and time, as did the renowned Latin American economist to whom we are paying tribute in this issue.

Prebisch himself was fully aware of his "classical" leanings (in the sense used by Hollis and Nell) or, rather, of his conflict with the neoclassical school. In one of the few of his writings that is in any way autobiographical (he always thought that so long as one could deal with the collective present and future, one should not waste time writing about one's own past), he identified five stages in his thinking about development, beginning with the serious doubts which the Great Depression led him to have about neoclassical theories.

It is worthwhile reviewing the main features of these five stages, faithfully following Prebisch's own summary of them.⁵

Prebisch's experience in Argentina in the practice and teaching of economic policy in the crisis years of the 1930s brought him face to face

⁴Raúl Prebisch, *Capitalismo periférico: crisis y transformación*, Mexico City, Fondo de Cultura Económica, 1981. This book, which is a true compendium of Prebisch's ideas concerning the theory of peripheral development, will be cited repeatedly throughout this article.

⁵Raúl Prebisch, *Cinco etapas de mi pensamiento sobre el desarrollo*, Trimestre Económico, vol. 50 (2), No. 198, Mexico City, 1983, reproduced in ECLAC, *Raúl Prebisch: un aporte al estudio de su pensamiento*, Santiago, Chile, 1987.

with "major theoretical issues". His consideration of these issues, he tells us, "paved the way for the next stage". During this stage, the first in which he was associated with ECLAC and one that is embodied in his classic work "The economic development of Latin America and its principal problems",⁶ Prebisch made a major theoretical contribution by describing the main characteristics of the asymmetry marking the economic relations between the centre and the periphery. This asymmetry is clearly manifested in the secular trend towards a deterioration in the terms of trade or, in other words, towards an unequal distribution of the benefits of technical progress, and is what provided the theoretical basis for his characterization of industrialization as a key element in the development strategy of Latin America.⁷

It is worth taking the time here to consider the fate of these ideas. They were taken up enthusiastically by movements striving to transform Latin American thought, while they were ignored or combatted by the prevailing circles in the centres and by their adherents in the periphery. Thirty years later, in the light of the experience of other countries (some of them mere enclaves) and as a partial response to the debt crisis, the policy of industrialization (but this time in an "outward-directed" form) was unveiled as a veritable "gospel" of development. Finally, in recent years there has been a growing recognition of the essential importance of industrialization based on the domestic market as a necessary phase in the effort to establish a position in international trade within the framework of a multi-faceted pattern of commerce that would overcome the disadvantages of the asymmetries which Prebisch had analysed as early as 1949. It was not in vain that Prebisch always sought to formulate his ideas "with an eye to the future". By doing so he managed to ensure that his thoughts, when read again now, would be of an astounding timeliness.

⁶Written in 1949 as the introduction to the *Economic Survey of Latin America, 1948* and later published in the *Economic Bulletin for Latin America*, vol. VII, No. 1, Santiago, Chile, February 1962.

⁷Prebisch himself was to define this theory a few years later in another of his main works, *Theoretical and practical problems of economic growth* (E/CN.12/221), Mexico City, 1951, United Nations publication, Sales No.: 52.II.G.1.

In retrospect, the essay written by Prebisch in 1949 seems much like a proposal for the productive research programme carried out by ECLAC in the years thereafter. Seen in this light, Prebisch's work performed two of the basic functions identified by contemporary theories of scientific progress: to refute (as Popper wished)⁸ prevailing theories, and to propose a new programme of research (after the style of Lakatos),⁹ while consistently combining theoretical inquiry with the pursuance of change.

This was followed by a third stage, beginning in about 1955, in which Prebisch once again took a position which he described as "critical of the [prevailing] economic policy and ideas in the light of the changes that were taking place in the development process and my better understanding of the problems involved". At this point the central topics with which he was concerned were the inadequacy of industrialization and of domestic markets as a means of resolving external bottlenecks, optimizing resource allocation, improving the distribution of income (or of the benefits of technical progress within Latin American societies), and overcoming the strong structural tendency towards inflation.

This third stage gave rise to a number of pragmatic proposals which bore fruit in the first agreements on Latin American integration as a basis for expanding domestic markets in connection with industrialization; in the Inter-American Development Bank, as an additional source of external resources concerning which Latin America was to have a decision-making role; in the ill-fated Alliance for Progress, which was conceived of as a means of substantially increasing the amount of external financial support made available to the region (chiefly by the United States) and linking it to a purposeful form of development involving structural reforms; and in the Latin American Institute for Economic and Social Planning (ILPES) as an instrument for augmenting the educational and analytical work being done in relation to development issues in the region.

⁸Karl Popper, *Conjectures and Refutations: The Growth of Scientific Knowledge*, London, Routledge and Kegan, 1969.

⁹Imre Lakatos, Falsification and the methodology of scientific research programmes, in *Criticism and the Growth of Knowledge*, I. Lakatos and A. Musgrave (eds.), London, Cambridge University Press, 1970.

From the standpoint of theory, this third stage in Prebisch's thinking is marked, above all, by the identification of problems of such magnitude as to call the system itself into question in terms of both its efficiency and its equity. This questioning of the system is clearly reflected in *Towards a dynamic development policy for Latin America*,¹⁰ in which Prebisch examines not only problems relating to external bottlenecks and insufficient dynamism, but also the very "functioning of the system and the social structure", as well as the "social background of inflation". This last idea had already made its appearance in another important work, "Economic development or monetary stability: the false dilemma".¹¹

Prebisch's 1949 essay had set out a veritable research programme for the development of economic thought in Latin America. Nearly 15 years later, this programme and the proposals it entailed had been shown to suffer from some shortcomings in relation to its explicative capacity. The creator of this first programme recognized these deficiencies in the realms of both reality and theory. Accordingly, in *Towards a dynamic development policy*, he proposed that more appropriate responses be sought in the form of more complex mechanisms linked to the very functioning of Latin American society and its interrelationships with the centres. This second systematic effort to identify the problems at hand and to propose a programme for addressing them embodied a different concept of effectiveness that went beyond the field of economics to encompass political effectiveness and ethical reasoning, areas which Prebisch was to explore in an increasingly explicit manner.

The fourth stage in his thinking, which may be said to have begun in 1963 and to have concluded around the end of that decade, was one in which he concentrated on problems relating to international co-operation between the North and the South. This was actually a much more action-oriented stage, although his intellectual curiosity was undiminished. Prebisch himself said that the intensity of these negotiations

caused him to interrupt his theoretical studies, but this interlude also gave this great observer of reality a chance "to gain a better perspective on the functioning of the system, both in the centre and in the periphery".

The fifth stage—and the last, as he himself was to foresee—was perhaps the longest, most complex and most productive stage in his long intellectual journey. Freed from political and executive responsibilities, he was able to devote himself fully to a consideration of questions—some old, some new—for which conventional theory provided no answers. He had come to see that the natural evolution of the system, the influence of powerful schools of independent thought and his own intellectual ascendancy and power of persuasion had done little to change the asymmetrical relationship between the periphery and the centres or the insufficient dynamism and structural heterogeneity of underdevelopment. The predominant circles of neoclassical thought of the past few decades continued (and continue) to look to the free operation of markets for solutions. Confronting these schools of thought, Prebisch turned back to the central concerns of the classicists: capital accumulation, the production process and distribution within the framework of a process of change taking place in each society and in its relations with the rest of the world.

In this culminating stage of the evolution of his theories, Prebisch explicitly cast doubt upon the basic postulates of neoclassical analyses, especially the contemporary versions thereof. His questioning of these ideas was developed in a series of articles, beginning with the first issue of the *CEPAL Review* in early 1976, which led up to the summation he presented in *Capitalismo periférico*. His differences with contemporary neoclassicism are set forth in a particularly interesting form in his socratic "Dialogue" with imaginary disciples of Friedman and Hayek.¹² This dialogue is based on his time-tested knowledge of neoclassical thinking, whose persuasive elegance and ethical foundations, based on the Pareto optimum and the theory of general equilibrium, had held an intellectual fascination for

¹⁰*Towards a dynamic development policy for Latin America* (E/CN.12/680/Rev.1), New York, 1963. United Nations publication, Sales No.: 64.II.G.4.

¹¹*Economic Bulletin for Latin America*, vol. 6, No. 1, Santiago, Chile, March 1961.

¹²Raúl Prebisch, Dialogue on Friedman and Hayek. From the standpoint of the periphery, *CEPAL Review*, No. 15 (E/CEPAL/G.1187), Santiago, Chile, December 1981. United Nations publication, Sales No.: E.81.II.G.4.

Prebisch during his years as a young professor of economics. This was the theory that had failed to provide him with any convincing explanations for the Great Depression and that he had abandoned when he came face to face with a real-life situation for which Keynes offered him more effective explanations and tools.

It is well worthwhile to re-read Prebisch's criticism of the neoclassicists. The basic postulates which he calls into question are those concerning the behaviour of economic agents and the way in which markets function. Markets are not effective because they are devoid of any social sense and lack an appropriate time horizon. In addition to these "functional disparities", the market does not provide any adequate solutions for the "problem of accumulation and that of the great structural disparities in income distribution". He also challenges the idea that the interests of rational economic men, guided by Adam Smith's "invisible hand" (the basis of neoclassical thought, much as rational expectations are for the "new classicists"), "leads the way to solutions which benefit the entire community". And he does not stop there. In his "Dialogue" Prebisch contends that "the ethic underlying neoclassical reasoning... is very far from being put into practice in real life". He then embarks upon an openly political discussion, in the best sense of this much-abused term.

Prebisch reaches the conclusion —in his "Dialogue", in his articles and in his book—that the application of neoclassical principles actually deepens the political crises of peripheral capitalism, serving the interests of privileged groups in underdeveloped societies and of the hegemonic centres worldwide. This statement is not based on an arbitrary reading of Prebisch's writing or on a subjective interpretation arrived at by reading between the lines. In the final pages of the "Dialogue", Prebisch states that "neoclassical principles can only be applied under a régime of force" (page 170), and he closes by saying: "I will end this dialogue here, for the time being, because I believe we must continue it and we must counteract the penetration of ideologies which have serious implications for Latin American development. We have an inescapable responsibility to do so. In this case we are not talking about just one of the many episodes of intellectual dissemination from the centres. This

is clearly a phenomenon of deliberate propagation. Visits, interviews and conferences, ardently supported by a free-spending and well-organized campaign in the mass media. There is more, much more, behind this than pure apostolic zeal. This is a systematic effort to turn back the clock, and it represents a tremendous step backwards intellectually, just at a time when we had managed to move forward, with great difficulty, in interpreting Latin American development" (page 174).

I have not dwelt on this criticism of contemporary neoclassicism solely for the purpose of highlighting the theoretical stance with which Prebisch drew to a close a long life rich in thought and action devoted to overcoming the Latin American societies' underdevelopment and dependence. I am convinced of the validity, right here and now, of his analyses and his proposals for dealing with the crisis of accumulation and inflationary social struggle which, within the context of the region's heightened dependence as a result of the external debt, are once again jeopardizing democratic régimes in Argentina and other Latin American countries.

This danger was pointed out again and again by Prebisch, and he associated it with the application of essentially neoclassical interpretations and formulas. This position is best summed up for me in the keen distress with which he concludes his extensive 1978 article (note the year) on the "Socio-economic structure and crisis of peripheral capitalism":¹³ "Be this as it may, however high the degree of intelligent virtuosity with which neoclassical principles are followed, there will be no possibility of simultaneously attaining the great objectives of economic efficiency, social efficiency and respect for fundamental human rights". It is disturbing to note how infrequently the tributes paid to Prebisch touch upon his substantive criticisms of fashionable schools of thought—criticisms whose bases are ethical and political as well as economic—when precisely what needs to be done is to restore the ethical essence of political discourse and to back it up with an economic policy that will reconcile effectiveness with equity.

¹³Raúl Prebisch, Socio-economic structure and crisis of peripheral capitalism, *CEPAL Review*, No. 6, Santiago, Chile, 1978. United Nations publication, Sales No.: E.78.II.G.4.

During his final years Prebisch used economic analysis as a tool for attaining a better understanding of social reality, the power structure and, ultimately, the philosophical foundations of the system in relation to both its ethic and its logic. Those of us who had the privilege of being with him know that for a long time he had been seeking to reconcile economic rationality with social equity and political freedom. This is one of the key elements of his "classical" ideas: a turning back to the moral and political philosophy which is the wellspring of economic theory.

There has been much talk of the crisis of economic theory. The established schools of economic thought have not been able to offer valid explanations or effective proposals for coping with the paradoxical trends towards stagnation and inflation to be observed in the world of today, hand in hand with the most explosive and widespread technological revolution in the history of mankind. If the theories developed in the centres cannot even provide an explanation for the situation as it exists there, then they can hardly be suited to the current situation in the Latin American periphery, plagued as it is by a colossal external debt, stagnation, a steep decline in investment and the ever-present threat of hyperinflation.

In the face of this crisis of established economic theory, as Prebisch's thinking evolved through its various stages he forged beyond the bounds of economic analysis with increasing frequency. He did not do so because he was a dilettante or because of any methodological slovenliness on this part. The exacting analytical discipline for which he is known invariably led him to delimit the boundaries of his ideas. Nonetheless, his observation of real situations—the only fitting laboratory for an economist—prompted him to incorporate social, cultural and power-related factors more and more as time went by. This process, whereby his ideas were enriched and he moved closer and closer to a comprehension of a highly complex reality, culminated in his final works which, for this very reason, clearly constitute a return to the very sources of economics as a social and political science based on the principles of moral philosophy.

His criticism of the system was not merely the result of reading, reflection or observation by a removed bystander. Prebisch devoted decades of intense work to proposing reforms, propounding them with missionary zeal and attempting to sway various groups of governors and of the governed in both the North and the South. He was unflagging in using his powerful oratory as a tool of persuasion—a tool which he wielded in virtually every part of the world. He was convinced that ideas could have a force of their own, that they could alter designs and overcome self-interest. Indeed, this is so, if one considers the history of mankind; but historical time is not easily bent to the will of individuals.

Viewed in retrospect, Prebisch's life as a man of action with a mission was marked by many disappointments. This is yet another paradox: the facet of Prebisch which is best known and most admired the world over is that of the propounder of proposals which, in large part, have not been put into practice: industrialization, integration, international co-operation, structural reforms, planning. Be this as it may, the intelligence, tenacity, fervour and negotiating skill with which he strove to overcome the shortcomings of the system from within are certainly to be admired, even though they may have borne meager fruit.

But Prebisch as a man of action set within his own time always walked hand in hand with the theoretician whose thought evolved so vitally from its neoclassical beginnings in his early youth, passed through the Keynesianism which he embraced during the years of the Great Depression, ripened into the development theories he formulated at ECLAC as he analysed the relations between the centre and periphery, and culminated in his interpretation of the systemic crisis of peripheral capitalism. This side of Prebisch is reflected in a great many of his writings, most of which are clearly relevant to the current situation in Argentina and in Latin America in general.

Strangely enough—or perhaps not, if we re-read his conclusions in the above-mentioned "Dialogue" with Friedman and Hayek—Prebisch as a theoretician, who was very likely one of the most original economists ever produced by Latin America and perhaps by the entire developing world, does not figure as promi-

nently as he should in university programmes intended to teach young people how to interpret the real-life situations existing in the region and how to go about changing them.

The fact that so little attention is paid to Prebisch's writings in academic discussions and university programmes reflects some measure of resistance to the idea of regarding him as a "professional" or "scientific" economist. I do not believe that the absence of more or less elegant mathematical proofs is sufficient justification for this position. It may be recalled that writers who deservedly enjoy great prestige in leading universities of the North, such as Hicks, Myrdal, Mrs. Robinson, Shackle and Kingleberger, did not provide mathematical formalizations of their later theoretical contributions. Nor is this criticism of an alleged lack of "scientific" precision justified in the light of what Schumpeter regarded as being the distinctive feature of scientific economists, i.e., the mastery of techniques of economic history, statistics and theory. It is well-known that Prebisch made an important contribution to the development of statistics in Argentina; the support he provided for the same purpose in ECLAC and UNCTAD is less well-known but just as significant. Insofar as theory is concerned, he taught the classics and neoclassics for almost two decades as a university professor; he wrote a fine book which served as an introduction to Keynes; and he did not fail to study the main theoretical contributions which came thereafter.

No one can deny that (especially from the time of his previously-mentioned 1949 essay) as Prebisch developed his ideas, while he did not abandon his preference for the "empirical-realist" approach, he did devote an increasing amount of attention to what Schumpeter considered to be the most important field for the application of economic techniques: history. And he did so for the three reasons which Schumpeter himself outlined: "First, the subject matter of economics is essentially a unique process in historic time. Nobody can hope to understand the economic phenomena of any, including the present, epoch who has not an adequate command of historical *facts* and an adequate amount of historical *sense* or of what may be

described as *historical experience*. Second, the historical report cannot be purely economic but must inevitably reflect also "institutional" facts that are not purely economic: therefore it affords the best method for understanding how economic and non-economic facts *are* related to one another and how the various social sciences *should* be related to one another. Third, it is, I believe, the fact that most of the fundamental errors currently committed in economic analysis are due to lack of historical experience more often than to any other shortcoming of the economist's equipment" (the underlinings are those of the original author).¹⁴ How is it possible to doubt the importance played by a vivid and exceptional historical experience in the writings of Prebisch?

I knew and admired the man of action, the high-ranking official and the international negotiator. I firmly believe, however, that his most important work and legacy reside in the books and articles he wrote on development issues —from the noteworthy contribution represented by his theory concerning the deterioration of the terms of trade as a key element in gaining an understanding of the relationships between the centre and periphery, to his theory concerning the generation, use and distribution of surpluses as a basis for understanding the interconnected economic, social and political processes which are the fabric of the internal realities of peripheral capitalist societies.

The purpose of this article is not to provide a critical exposition or review of Prebisch's ideas. I have confined myself to pointing out certain characteristics which identify Prebisch not only as a classicist among those economists who have concerned themselves with underdevelopment, but also as an economist of a classical theoretical lineage, and to stressing the way in which his ideas contribute to a better understanding of some of the most serious problems affecting the region in the economic, social and political spheres.

¹⁴Joseph Schumpeter, *History of Economic Analysis*, London, George Allen and Unwin, 1954, pp. 12-13.

II

Heterodoxy and myths

As the classicist he was, Prebisch was a heterodox thinker in that he did not accept conventional theory unquestioningly but instead consistently subjected it to the test of historical experience. If the theoretical models did not conform to this experience, then he sought other explanations for the situations under consideration. In this intellectual quest, too, the methodologies he used were of a recognized scientific lineage.

As suggested by Popper, Prebisch often relied on the method of refuting pre-existing theories. One notable example is his refutation of neoclassical postulates and proposals which was cited earlier.

Let us now see how these postulates and proposals reflect certain myths which Prebisch systematically exposed. Two such myths are dealt with extensively in *Capitalismo periférico*: the myth of imitative development linked to the "spontaneous expansion of capitalism", and the myth of the benevolent operation of market laws.

Along with Prebisch, let us consider the significance of the survival of these mythical beliefs in relation to the actual economic situation in Argentina, Latin America and probably the world. Celso Furtado, in his criticism of prevailing ideas concerning economic development, said that "... myths are like lanterns which illuminate the social scientist's field of view, providing him with a clear picture of certain problems, while the very existence of others goes entirely unnoticed. At the same time, they afford him ease of mind since his own value judgments appear to him to be a reflection of objective reality".¹⁵

In formulating his ideas, Prebisch always brought the preconceived ideas associated with such myth-based beliefs face to face with the lessons to be learned from an objective (but not value-less) observation of reality. In doing so he had to (and, in a certain sense, he continues to)

do battle with a number of myths fostered by the "ideology" of international economic power which are presented as revealed truths by the mass media and defended as an article of faith by most of the "pragmatic and realistic" spokesmen who represent the seats of economic power in the countries of the region.

These same myths are accepted without hesitation by certain schools of economic thought which, while their formulations appear attractive, have led to the adoption of standards and policies that have proved to be dangerous to the societies where they have been applied. In essence, these new schools or circles constitute a resurgence of those existing during the last century in the dominant ruling centre which proclaimed the advantages of laissez-faire policies and free trade. As Marshall himself observed, this was no more than a projection of the national interests of Britain at that time.

1. The myth of free markets

One of the basic theoretical assumptions made by these schools, which has also been taken up by their newer versions, was the possibility of there being perfect competition, with a full mobility of factors in free and transparent markets in which relative prices would move swiftly and so provide guidance to economic agents as regards the optimum allocation of resources. Despite the fact that the actual state of affairs consistently demonstrated the fragility of such assumptions, the main body of this theory seems to burst into new life after each crisis that it has undergone down through history.

Markets do not operate in the vacuum of perfect competition, but rather in an environment warped by conflicting interests and pressures governed by both the "laws" of the market and the "laws" of power, as pointed out by Prebisch. Strangely enough, while the great crisis of the 1930s resulted in a stronger regulatory role and increased intervention on the part of the State, the crisis of the 1970s —which has proved to be as serious as the earlier crisis for the Latin American periphery— has led to a vigor-

¹⁵Celso Furtado, *El desarrollo económico: un mito*, Mexico City, Siglo XXI Editores, 1975.

ous resurrection of laissez-faire theories. The new orthodoxy starts out by blaming State intervention and the regulations advocated by Keynesianism for the disturbances which have taken place and then goes on to propose, with dogmatic fervour, a diametrically opposed solution. What is now proposed is that markets be freed from the hindrances placed upon them by the State which prevent them from serving to regulate and optimize the economy. It is said that what must be done is to "privatize and deregulate" the economy, to permit agents' "rational expectations" to function and to trust in their capacity for optimization, both individual and social. This old laissez-faire stance is a many-headed dragon: when the real world or theory cuts off one head, the dragon always has another to offer up. Is its astounding vitality a result of ideological perseverance or is it due to other reasons?

Before attempting to answer this question, however, a brief epistemological digression is in order. Economic theory is built, as are other sciences, upon the foundations provided by axioms or basic assumptions. The first of these is that of rational economic man, which John Stuart Mill recognized early on as an arbitrary and abstract concept.¹⁶ Another axiom is that markets are assumed to exist in which labour, merchandise and—possibly—money circulate freely. In order for a scientific study of such circulation to be possible, it appears necessary to assume that markets are free of non-economic influences which could reduce their competitiveness and transparency and curb their "natural" tendency towards equilibrium and Pareto's optimum.

However, we all know that there is no such thing as a purely economic and rational man. Nor is there such a thing as a pure or "free" market. At another level, less removed from the values governing real behaviour, it may well be asked whether "homo economicus" corresponds to some human optimum and whether or not the actions of such individual beings in free markets would be such as to ensure an optimal social situation. To claim that man should, in the real

world, behave as an economic optimizer is not only futile but also diminishes him to something quite different from what a complex human being actually is. In this case, it is obvious to all that the axiom should not be confused with reality. The same is true of free markets, although this may not be quite so obvious, especially in view of the constant bombardment of the public with propaganda touting the virtues of such freedom. Confusing the laws of a theoretically "free" market with the way in which markets actually function reduces our chances of understanding the real economic situation and of influencing it so as to improve the human condition—the ultimate goal of all positive social sciences. To confuse the axiom required for abstract thought with reality is tantamount to attempting to squeeze the latter into a strait-jacket, and it makes little difference how elegant the "model" of the jacket may be. Since it cannot withstand such treatment, only theories based on myths could entertain such an idea. It must then be asked why, at every turn, such a point is made of maintaining this myth of making free markets a reality. Is this an innocent myth or is there some purpose behind it?

Some case might be made for its innocence, as a result of the confusion of the three spheres of economics identified by, *inter alia*, some of the founders of neoclassicism such as Walras and Wicksell: economic theory, economic policy and social economics. At a purely abstract theoretical level, these assumptions have proved to be both valuable and useful. When one oversteps this boundary and attempts to apply these assumptions to economic policy and social economics, however, then the consequences are such that it may rightfully be suspected that this myth is being used to serve other, less pure, ends. At this point it might be well to recall what Robert Graves has said concerning the functions which myths have fulfilled during the course of man's history, when he observed that they confer an enormous amount of power to the deities believed responsible for the creation and care of souls and, by extension, to priests. He went on to say that the second function of myths is to justify an existing social system.¹⁷

¹⁶John Stuart Mill, *On the Definition of Political Economy and the Method of Investigation Proper to It*, 1936. Reproduced in David M. Haviman (ed.), *The Philosophy of Economics. An Anthology*, New York, Cambridge University Press, 1984.

¹⁷Robert Graves, *Introduction to the New Larousse Encyclopedia of Mythology*, New York, Hamlyn Press, 1978.

Prebisch did not fall into the trap of regarding the free market as the Supreme Maker of economic relations within human societies. He was consistently concerned with the market in his writings, concerned both with combatting its false image and with conserving its potential as a sphere for the essential element of individual initiative and as an allocator of resources, but, as with any major source of energy, he saw it as a force which had to be subjected to a certain measure of discipline. Of course, he by no means proposed that the market should be suppressed. The problem is of another sort, and he stated it as follows: "Individual decisions in the marketplace must be combined with collective decisions outside it".¹⁸ But how is this to be done?

Forever seeking the best possible state of affairs, Prebisch attempted to hit upon some optimal combination of political liberalism and economic socialism. What, if not this, is meant by the social management of the surplus in a smoothly-running market? This combined framework would serve to reconcile, in each instance and at each point in time, the advantages of an orienting and decentralized type of planning with the use of indirect economic policy tools for the purpose of guiding and regulating, with a view to social ends, the actions of economic agents in the market. It is a question, he tells us, of integrating the action of the State with activity in the market and directing them towards the attainment of "a lofty vision, a vision of change ... inspired by far-sighted ethical concerns in which forward-looking economic, social and economic considerations all play a part".

The market alone cannot be the "supreme regulator" of the progress made towards the achievement of these objectives. It quickly becomes clear what Prebisch's main theoretical and practical reasons were for discounting the idea that the market can be made to fulfil this role of supreme regulator merely by freeing market forces.

His argument starts with demand and goes on to the formation of supply or, if the reader prefers, the allocation of productive resources. The demand which is the basis for the operation of the market "emanates from a particular patt-

ern of income distribution which, in turn, is the product of a specific socioeconomic structure and of the power relations stemming from that structure and from the changes it undergoes". The laws of the market, then, represent "a rational solution, but only for the privileged strata [which are the most powerful]... It is by no means rational from the standpoint of the community at large".

Competition is not a sufficiently effective corrective factor for distortions in demand. On the contrary, consumers' desires are manipulated by means of the "art of collective suggestion... [practised] by the mass media". While Galbraith had already exposed the aberrations created by this type of pressure in post-industrial society, Prebisch pointed out the flaws existing in societies which had just barely crossed the threshold into the industrial era. Moreover, in *Capitalismo periférico* he emphasized that transnational corporations, whose role in disseminating technology is well known, also help to propagate consumption patterns in the periphery which may prove useful in maintaining the level of economic activity and even improving living standards in the centres, but which are clearly premature for the periphery. This also exacerbates the shortcomings of the market as the nucleus for a system which accumulates very little, is bad at using what it accumulates and is even worse at distributing it.

Prebisch did not overlook the defects of the market as an allocator of resources either. In *Capitalismo periférico*, he dealt primarily with two of these: its lack of an appropriate time horizon, and its inability to overcome the "ambivalence of technology", a subject with which he had been concerned for a long time. As regards the first of these shortcomings, he maintained that individual enterprises' calculations of what is in their best interests are based on a concept of economic efficiency that "generally does not extend much beyond their immediate interests, which must be distinguished from the long-term interests of the community". Here Prebisch applied the historical experience which Schumpeter emphasized as being one of the important tools of economic analysis, as he also did when he noted the inoperability of the market in terms of the need to cope with the "ambivalence of technology". In this connection, he argued that tech-

¹⁸*Capitalismo periférico*, op. cit., p. 39.

nology "has made an invaluable contribution to material well-being, but it has also resulted in the irresponsible exploitation of natural resources and a striking deterioration of the biosphere".

In addition to these specific criticisms of the market as an allocator of social resources, Prebisch also made other criticisms of a more general nature: "Nor have the laws of the market corrected the serious flaws in centre-periphery relations, much less the exclusive and conflictive tendencies of peripheral development". With this statement he masterfully summed up the way in which his own thinking had evolved from the time he wrote "*El desarrollo de América Latina y algunos de sus principales problemas*" in 1949 to his writing of *Capitalismo periférico* in 1982.

Prebisch does not question the role of the market as a basic instrument of economic activity. Instead, he was more concerned with exposing this central myth of primitive liberal neoclassicism which continues to cause confusion in the periphery. At the theoretical level, he contended that "it is a mistake to blame the market for the flaws in the system; rather, the market is an expression of these flaws". He took an equally positive stance in his proposals: "Individual decisions in the marketplace must be combined with collective decisions outside of it which override the interests of the dominant groups".

In all societies, collective decisions taken outside the market are implemented through the agencies of the State. This does not mean that the deformed State which has gradually taken shape in the course of the crisis of peripheral capitalism can serve as an instrument for transforming the peripheral societies. The overwhelming ineffectiveness of this State and the need to make through-going reforms in it also concerned Prebisch. He devoted many pages to this subject in *Capitalismo periférico* because he was fully aware of the imperative need to change the State so that it might effectively fulfil its essential role as a regulator of accumulation and of the social use of the surplus.

This does not, however, satisfy those schools of thought whose theories are based on myth or the interests which thrive under their protection. These circles attempt to identify the watch-

words of "privatization and deregulation" with objectives fundamental to the rationality and ethics of the system. As regards the former, they contend that anything which restricts or influences the free operation of market forces makes production and distribution less efficient. In connection with the latter, they maintain that, without market freedom, there can be no genuinely democratic society.¹⁹ As noted earlier, the theoretical underpinnings for these positions go hand in hand with a harsh criticism of Keynesianism, which, in the view of these circles, represents a historical deviation from the classical postulates. As often occurs, heterodox views are in this case attacked more fervently than are the orthodox positions "on the other side of the fence". This is all the more true in this instance, because Prebisch, as Keynes before him, cast doubt upon the very ethics, rationality and effectiveness of the laissez-faire proposals of orthodox neoclassicism.

2. The myth of the mirror

Prebisch referred to this other type of myth when he impugned "imitative capitalism", i.e., that form of capitalism by which the periphery would, in Prebisch's words, develop "in the image and likeness of the centres". The historical experience of the central countries themselves demonstrates the mistaken nature or, at least, the ambiguity of this aspiration. Countries in the process of joining the ranks of the centres have always followed different paths from those countries already in a position of dominance. In the eighteenth century, England departed from the agriculturally-based model of the countries of the European continent; in the nineteenth century, the United States and Germany, albeit separately, also followed a different course, one which was founded primarily on protectionism rather than on the free trade advocated by the British Empire. The same may be said of Japan, with its quite singular characteristics, in the twentieth century. All these countries carried

¹⁹The former is of more concern to the followers of Friedman, while the latter is of more central interest to the adherents of Hayek. In this regard, see "Dialogue on Friedman and Hayek...", *op.cit.*

forward their development within a capitalistic framework, but in no case was theirs an *imitative* capitalism.

The myths of central capitalism and those of the periphery are not separate but are instead quite closely co-ordinated with one another and, indeed, form a coherent whole. The theory underlying imitative capitalism in the periphery has been imported from the dominant centres and conforms to the interpretation of the situation which best serves the interests of the dominant centre of the day. We have already seen that Marshall himself acknowledged that the free trade doctrines of the last century served the interests of Great Britain. In like manner, the free trade doctrine of the present era, in both theory and practice, is in the interests of the dominant centre of technology, which is also the home country of the majority of the transnational corporations that hold sway over the international capital market and imperiously exercise, as noted in a recent work,²⁰ hegemony over international monetary matters.

The form of free trade espoused by the schools of economic thought then in vogue served as an effective spur to world trade during the long-lived economic boom which followed the Second World War. It has not, however, helped to curb the protectionist leanings exhibited by most of the industrial countries since the onset, in the early 1970s, of a period of stagnation and instability in the world economy. Nor has the growth of this centripetal protectionism prevented the policy of opening up commercial and financial spheres in the periphery from thriving in both theory and practice during this latter period. As is well known, the consequences of this have been ominous indeed for the development and industrialization processes of countries which have either allowed themselves to be seduced by the self-seeking advocates of these theories or have been forced to embrace them during those authoritarian and repressive stages that Prebisch described as typical of the "swing of the pendulum" of peripheral capitalism, of which Argentina has inherited only the vestiges.

The theory of economic openness goes hand in hand with those doctrines which maintain

that all that is needed in order for the periphery to develop as did the centres is to rid market forces of the shackles and deadweights imposed by a State whose economic weight and excessive regulatory zeal have caused its presence to become onerous. This point has already been touched upon earlier in this article. I repeat that this is not a defence of the deformed and ineffective State which has also taken shape in Argentina, as in other Latin American countries, largely as the result of a long history of "social inefficiency on the part of the system", as Prebisch described it.

If the periphery is not to develop in the "image and likeness of the centres", then how is it to do so? This opens up a field of inquiry about which much has been written, at least in Latin America, both in the literature on economic growth and in the more recent and imaginative writings concerning *styles* of development. Allow me to amend that last statement. For some time now this issue —of such great importance for Argentina and for other peripheral countries— has been pushed to the sidelines of public and academic discussions, as well as of political discourse, which, in its best sense, consists precisely of the search for, proposal and shaping of societal models or styles. In the last few years, following the failure of economic liberalism in combination with political authoritarianism, the controversy now raging over the correct way to manage the economy during a time of serious crisis has relegated matters more closely related to the economy's long-term course to the fringes of the economic debate.

It is understandable that a crisis as deep and complex as is the external debt crisis would arouse the greatest concern and give rise to the most determined efforts to resolve it. Nevertheless, the manner in which this crisis is confronted should not be divorced from a more comprehensive, longer-term policy. It is imperative that the countries resume their examination of long-term options, be they regarded as models, styles, or political plans. Prebisch's ideas constitute an original and important contribution in this regard which is based on the historical experience of the region. We must keep his ideas alive, presenting them and debating them, out of love and respect for the memory of Prebisch and for the future of the region's peoples.

²⁰M. Dinenzon and B. Hopenhayn, *El régimen monetario internacional y la crisis de la deuda*, Buenos Aires, CISEA, 1987.

Prebisch devoted his life to the search for valid explanations and constructive proposals. In one of his last writings, which was probably one of his most comprehensive and ambitious contributions as well, he strove "to put forward, for theoretical discussion, the outlines of a possible transformation" of peripheral capitalism. His chief concern was to find ways "of eliminating the exclusive and conflictive tendencies of the prevailing system" which would be "compat-

ible with our concept of democracy and of human values".

In bringing this tribute to Prebisch to a close, I would like to quote a statement of his which sums up, with great clarity, both the problem and his proposal for overcoming it: "Equitable distribution, vigorous development and new institutional patterns in a genuinely participatory democracy: these are the major objectives which have guided me in formulating my theory of change."

Raúl Prebisch, central banker*

Felipe Pazos**

This article covers a little-known period of Raúl Prebisch's life, when he was Chairman of the Central Bank of Argentina. In order to set the stage for the discussion that follows, the author first provides background information concerning Argentina's economic policy, the creation of the Central Bank and the tasks assigned to it during the period in question.

Particular attention is devoted to the steps that were taken to put the banks on a sounder footing and to streamline the banking system, as well as the banking law and the supervision of banks, the formation of a securities market, open-market and rediscounting operations and exchange policy. The effects of these policies during the upswing and downswing of the 1935-1939 economic cycle are examined, as are their relationship to the new conditions created by the Second World War.

Finally, the author takes a look at the lessons to be drawn from Prebisch's handling of monetary affairs with a view to their application to the present situation.

Introduction

Raúl Prebisch's achievements during the course of his international career are widely known by all economists, in Latin America and elsewhere, and by many Latin Americans outside the profession, but his work at the national level is virtually unknown, even by Spanish-speaking economists who specialize in monetary theory and policy. Nonetheless, the work he did during this phase in his life was just as extraordinary and productive as were his subsequent activities in the United Nations. When Raúl Prebisch was appointed as a consultant to the Economic Commission for Latin America in 1948, he was already 47 years of age and had a brilliant career to his credit, spanning the years from 1930 to 1943, first as an Under-Secretary of the Treasury and later as the General Manager of the Central Bank of the Argentine Republic. Between 1944 and 1948, Prebisch worked as a professional consultant and advised various governments and official agencies, including the Banco de México. It was there that in 1945 he held his talks on the central banking system that were to be published many years later, together with the annual reports for the years 1935-1943, by the Central Bank of the Argentine Republic in two volumes which should be required reading for all students of monetary policy.¹ During his time as a consultant, Prebisch's services were also contracted, in 1947, by the Central Bank of Venezuela, to which he submitted a report that was later published in the *Revista de Hacienda* (Treasury Review) of Venezuela.² In his report, Raúl Prebisch placed great emphasis on the need to regularize Venezuela's economic growth. To this end, he recommended the creation of a fund of 100 million bolívares, which at that time was equivalent to around 8% of fiscal revenues, for the purpose of offsetting cyclical fluctuations. These resources were to be provided by the Treasury, but the fund was to be administered by the Central Bank. In 1949 Prebisch began to work as an adviser to the Economic Commission for Latin America,

*Prepared for inclusion in a book in tribute to the memory of Alfredo Machado Gómez.

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¹Central Bank of the Argentine Republic, *La creación del Banco Central y la experiencia monetaria argentina entre los años 1935-1973*, Buenos Aires, 1972.

²Raúl Prebisch, Dictamen acerca de los anteproyectos sobre Banco Central y Bancos, *Revista de Hacienda*, Caracas, September 1948.

where he launched his international career with the writing of his famous treatise on the deterioration of the terms of trade. He later became the Executive Secretary of the Commission itself, of UNCTAD and of ILPES and served as an adviser to the Secretary-General of the United Nations. In this article, however, I will speak only of his career in the Central Bank.

1. Background

I first heard Raúl Prebisch's name in April or May 1945 from Robert Triffin, who referred to him as one of the best economists he had ever met. Since Robert Triffin knew all the great economists of the period, I thought he was exaggerating, but I later came to see that this was not so. In any event, the fact that I heard Prebisch's name for the first time 11 years after I had begun studying economics and five years after I had written a book on monetary issues testifies to the lack of communication among Latin American economists at that time and, of course, does not speak well of the comprehensiveness of my scholarship either. In my own defense, however, I should point out that I did know that around 1940 the Central Bank of the Argentine Republic had applied a number of innovative anti-cyclical policies which had been praised on numerous occasions by the League of Nations in its Yearbooks on currency and banking. I was thus aware of Argentina's outstanding monetary policies, but I did not know the name of the person who had devised them, had put them into practice and had explained their purpose and import in the terse and clear prose used in the annual reports of the Central Bank of the Argentine Republic.

A year and a half later, I met Prebisch in Mexico City at the First Conference of Central Bank Technical Experts of the Americas, which was held in September 1946. This was the beginning of a friendship that was to last for very nearly 40 years and which was ended only by his death in April 1986. As I have said on repeated occasions, my admiration for him was as great as that which any man can feel for another.

2. The effectiveness of Argentina's economic policy from 1930 to 1943

From 1930 to 1935 Raúl Prebisch served as Under-Secretary of the Treasury and as the chief economic adviser to the Government of Argentina. From 1935, the year in which the Central Bank was founded, to 1943 he was its General Manager, its head economist and the person who formulated and determined its policies. Between 1930 and 1943 Argentina's economic policy was largely under his direction, and it is he who deserves the credit for its success. Argentina was one of the countries most severely affected by the Great Depression. As shown in table 1, the country's export earnings and capital inflows declined so sharply that by 1933 its imports had dropped to 42% of their 1929 level in real terms. However, the economic policy applied in the country succeeded in lessening the decrease in the real gross domestic product, which only fell to 86% of the record high it had reached in 1929. By 1939 the real domestic product was 15% greater than it had been ten years earlier. Argentina's policy was thus much more effective than that of the United States, where real income had fallen 31% in 1933 and had barely recovered by 1939, when its real level was just 1.3% higher than before the depression.

Table 1
ARGENTINA: ECONOMIC TRENDS,
1929-1943
(1929 = 100)

	1929	1933	1935	1939	1943
Exports	100.0	51.7	72.4	72.6	101.3
Imports	100.0	42.2	60.4	74.0	47.2
Industrial output	100.0	101.9	116.9	153.8	176.4
GDP in real terms	100.0	85.6	88.7	114.7	153.6
Cost of living	100.0	78.6	82.1	92.9	103.6
Wholesale prices	100.0	89.6	100.4	112.5	201.2

Source: Carlos F. Díaz-Alejandro, *Essays on the Economic History of the Argentine Republic*, New Haven, Connecticut, Yale University Press, 1970.

Between 1932 and 1939 Argentina's manufacturing industry grew at an average rate of 7.1% per year or, if the calculations are based on the peak level achieved in 1929, at an annual rate of 4.4%, which was much higher than the 2.5% rate recorded in 1944-1955, the years that are generally considered to have been those of the greatest industrial progress in Argentina's modern history. In concluding this brief review of the Argentine economy during the Great Depression, it should be noted that in 1939 wholesale prices were only 12.5% higher than they had been in 1929, while the cost-of-living index stood at virtually the same level.

3. The founding of the Central Bank

During Raúl Prebisch's tenure as Under-Secretary of the Treasury, much of his time was devoted to the preparation of legislation providing for the creation of a central bank, an institution which did not exist in Argentina at that time. In its stead, there were two agencies which, between them, performed its functions in a not entirely satisfactory fashion: the Conversion Fund, which issued the local currency in exchange for foreign currency and which, on an exceptional basis, was authorized to buy government securities; and the Banco de la Nación Argentina, which was the depository and fiscal agent of the Government and which on exceptional occasions made loans to other banks. In addition, the Exchange Control Office had been established at the start of the Great Depression, and this agency also carried out activities which were closely related to central banking functions. Nonetheless, it was generally agreed that this system did not work well and, in spite of the fear that the creation of a central bank would cause inflation, the establishment of such an institution was felt to be necessary.

In 1932 Raúl Prebisch was the most active member of a commission that had been organized to prepare legislation for the purpose of creating a central bank. The commission was apparently unable to complete its work because a new Minister of the Treasury decided to entrust the task to a foreign expert. He asked the Bank of England to make available the services of Sir Otto Niemeyer, who drafted a bill which was sent to Congress, after it had been modified and

supplemented by Argentine experts, the most notable among them being Raúl Prebisch, who, once the law was passed, was appointed as the first General Manager of the institution. I am convinced that the provisions in this law that made the Bank so extraordinarily effective, as well as the supporting institutions which contributed to its success, were the work of Prebisch.

In the talks he gave at the Banco de México in 1944 on Argentina's experience with monetary affairs (which, as I said earlier, should be required reading in all university classes on monetary and banking matters), Raúl Prebisch was too much of a gentleman to claim credit for the modifications made in Niemeyer's draft legislation, but this fact nonetheless comes across implicitly in his narration of the process, in words that deserve to be quoted both because of the light they shed on the paternity of this legislation and because they demonstrate the extraordinary foresight with which it was prepared. Prebisch said:

"Mr. Hueyo, the Minister of the Treasury, who had been a member of the Commission which drafted the plans for the Central Bank during Uriburu's tenure as Minister, abandoned the idea of revaluing gold and confined his efforts to drafting a banking law and some reforms to the Law on Rediscounting aimed at providing funds to banks with locked-up capital. At the same time he requested the advisory services of Sir Otto Niemeyer of the Bank of England, who in early 1933 prepared draft legislation for the creation of a central bank and for a law on banks. In 1934 Dr. Pinedo arrived at the Ministry and undertook the reform of the monetary and banking system. The draft legislation he sent to Congress conformed to the structure and technical provisions of the bills prepared by Sir Otto Niemeyer but differed radically from them as regards the concept of bank policy which it embodied in relation to both the present banking situation and the future course of this policy. Let us see exactly what these differences were:

"In so far as the banking system was concerned, Niemeyer's draft legislation did not propose any steps aimed at putting the banks on a sounder footing. In contrast, the new bills provided for the creation of the Mobilization Institute for this purpose using funds obtained from the revaluation of gold, as discussed earlier. The

financial rehabilitation of the banking system was regarded as essential in order for the Central Bank to be able to commence its operations without hindrance or distraction. In addition, whereas the new legislation also relied on the revaluation in order to pay the floating debt, Niemeyer's draft proposed that 130 million pesos in Treasury funds be used for its amortization along with a portion of the Central Bank's profits.

"The main differences with respect to Central Bank policy were the following:

"Firstly: The new legislation provided for the creation of the Bank Inspection Office as an organ of the Central Bank and gave it broad powers for examining the standing of credit institutions. The bills drafted by Niemeyer, however, would have required only that the banks submit financial statements to the Central Bank.

"Secondly: The new legislation gave the Central Bank a means of absorbing excess funds in the market so that it might influence the cyclical process. Niemeyer's legislation made no reference whatsoever to any instrument of this sort.

"Thirdly: Whereas under Niemeyer's legislation the Central Bank's holdings of foreign exchange would not have been subject to any limitation whatsoever, the government's new draft legislation stipulated that the Central Bank could have no more than 20% of its total holdings of gold and foreign exchange in the form of foreign exchange, while the rest would have to be held entirely in precious metals; furthermore, only one-half of this 20% in foreign exchange could be counted in the calculation of the Central Bank's legal reserves.

"Fourthly: Under Niemeyer's bill, the Central Bank's discount rate could be raised if the level of monetary reserves fell to less than 33% of cash holdings. The government's new legislation eliminated this restriction, which would undoubtedly have had serious repercussions on the overall economic situation if it had been applied during a cyclical downturn at a time when gold was being exported.

"Fifthly: While the government's new legislation, bearing in mind the nature of the portfolios and operating procedures of Argentine banks, allowed for the discounting of unsecured paper, i.e., paper having a single signature, plus

the signature of the discounting bank, Niemeyer's draft called for two signatures in addition to that of the bank and eliminated industrial discount paper.

"The above comparison clearly shows that Argentina's Central Bank Law represents an adaptation of Niemeyer's draft to the Argentine context which modified it so as to bring it into line with the actual circumstances in Argentina."³

As may be seen, the Mobilization Institute, the Central Bank's banking inspection unit, and the authorization of the sale and repurchase of consolidated treasury bonds, i.e., the original aspects of this law and the instruments which allowed the Central Bank to perform its work so well during its first eight years, were the creations of Prebisch.

4. The economic situation at the time of the creation of the Central Bank and the tasks it faced

In 1935 when the Central Bank began its operations, Argentina had, for the most part, come out of the 1929-1930 crisis thanks to the government's industrialization policy and to the partial recovery of the external market. By that year, the government had balanced its current income and expenditure as a result of its reduction of public spending, the institution of tax reforms and the greater receipts made possible by the expansion of the national product. The balance of payments was also once again at equilibrium, and the exchange system had been stabilized with the operation of a dual exchange system in which the free rate fluctuated around a level only slightly higher than the official exchange rate.

All of these advances, which pre-dated the creation of the Central Bank, had in large part been made possible by the work of the man who was to become the Bank's first General Manager. As Under-Secretary of the Treasury and chief economic adviser to the government, Raúl Prebisch had played a decisive role in the adoption of a moderate policy of tariff protection which had promoted the creation of new indus-

³Central Bank of the Argentine Republic, *op. cit.*, p. 267.

tries, in the reduction of public spending, the establishment of an income tax, and the organization of the dual exchange system whereby the free exchange rate rose enough to discourage capital outflows but not so much as to produce economic distortions.

These successes notwithstanding, a considerable part of bank portfolios remained immobilized, and no public securities market, either short- or long-term, had yet been developed; such a market was needed so that a portion of savings could be channelled towards public investment and so that open-market operations could be conducted for the purpose of absorbing excess liquidity during economic booms and feeding it back into the economy during downturns. The immobility of bank portfolios had been caused by the excessively open-handed credit policy followed by the banks during the pre-crisis period, by the decrease in the prices of agricultural export products and in farmers' incomes, and by the saturation of government paper. The absence of a public securities market, for its part, was to some extent a natural consequence of the country's stage of economic development. A much more significant factor, however, was the imbalance in public finances which had existed until one or two years before, inasmuch as Argentina was already generating enough savings so that a portion of these funds might be channelled to the purchase of securities issued by the public sector.

By virtue of its very creation, the new institution brought under one roof the central banking functions which had previously been scattered among the Conversion Fund, the Banco de la Nación Argentina and the Exchange Control Office, thereby making it possible to conduct these operations more efficiently. In addition to its routine functions, however, the new institution was confronted with the following tasks: a) to put the banking system on a sound footing, b) to create a public securities market, and c) to use this market, in conjunction with the exchange system, in order to apply an anti-cyclical policy aimed at preparing the country for the slump in external inflows which was expected to occur within the next two or three years. As will be discussed below, the Central Bank accomplished these tasks fully and extremely efficiently.

5. Putting the banking system on a sound footing and freeing its assets

The position of the banking system was improved and the banks' assets were freed for use by means of the revaluation of gold reserves at the time they were transferred from the Conversion Fund to the Central Bank and the allocation of the resulting profits to the creation of a new body, the Bank Investment Mobilization Institute, which bought up the banks' public securities and the overdue private loans they had in their portfolios. The the Mobilization Institute was thus created in a thoroughly heterodox manner which was potentially extremely inflationary. Instead of sparking a rapid price and wage spiral, however, this measure had highly positive effects: it served to unblock bank portfolios, made possible the establishment of a public securities market and gave the Central Bank the ability to carry out transactions on the open market.

The value of the Conversion Fund's gold reserves had been set in the 1920s, before the devaluation of the pound sterling and the dollar and before the depreciation of the Argentine peso in relation to these currencies; hence, the revaluation of these gold reserves nearly doubled their value and rendered an accounting profit of 701.1 million pesos, which was equivalent to one and one-half times the value of the cash reserves (485.3 million pesos), maintained by the banks prior to the freeing of their assets. The use of this sum to purchase blocked assets more than doubled cash reserves and could have led to a huge increase in bank credit; this increase did not actually occur, however, because the Central Bank reabsorbed one-third of the growth in cash reserves through the sale of securities and persuaded the banks to refrain from expanding their lending activity. The Central Bank's power of persuasion was reinforced by the fact that, as shown in table 2, cash reserves had fallen to such extremely low levels that even this enormous increase only raised them to a level just slightly higher than those recorded in the three-year period from 1926 to 1928. In addition, yet another factor was that the troubles experienced by the banks during the years that their assets had been tied up caused them to adopt a much more conservative attitude.

Between December 1934 and December 1935 bank reserves rose from 14.0% to 24.7% of their deposits; however, loans increased by just 1.7%, the money supply expanded by less than 10% and the cost of living climbed only 4.5% (see table 3). Wholesale prices dropped 1.0% and the price of the pound sterling on the free market went down from 19.48 to 18.09. The financial "explosion" which some had feared did not occur. In creating the Bank Investment Mobilization Institute, Raúl Prebisch was playing with dynamite, but he knew how to keep it from going off!

6. The Bank Law and banking inspection

Together with the laws that created the Central Bank and the Mobilization Institute, Congress passed a General Bank Law which prohibited banks of deposit from making long-term loans and from owning real estate or corporate stock. These operations had been permitted up until that time and they had been part of the reason why the banks' portfolios had become immobilized. With a view to enforcing these regulations and monitoring bank operations, the Central Bank Law provided that this institution should form an inspection department.

The General Bank Law was an orthodox law which conformed to the standard provisions contained in the legislation on this subject. The

Table 2

ARGENTINA: BANK DEPOSITS AND RESERVES, 1926-1935

(Year-end balances in millions of Argentine pesos)

	Deposits	Cash holdings	Reserves (percentage)
1926	3 347	618	18.5
1927	3 477	635	18.3
1928	3 836	909	23.7
1929	3 986	705	17.7
1930	3 913	528	13.5
1931	3 731	484	13.0
1932	3 536	596	16.9
1933	3 514	609	17.3
1934	3 465	485	14.0
1935	3 357	827	24.7

Source: Central Bank of the Argentine Republic, annual report for 1935.

Table 3

ARGENTINA: COMPARATIVE FIGURES, 1934-1935

	December 1934	December 1935	Difference (percentage)
Cash holdings	485	827	70.5
Deposits	3 465	3 357	-3.1
Reserves	14.0	24.7	76.4
Loans	2 821 ^a	2 870	1.7
Money supply	2 010	2 190	9.0
Cost of living	100.0	104.5	4.5
Wholesale prices	100.0	99.0	-1.0
Pound sterling	19.48	18.09	-7.1

Source: Central Bank of the Argentine Republic, annual report for 1935 and the statistical supplement of August 1937.

^aTotal loans minus loans absorbed by the Mobilization Institute in May 1935.

organization of a bank inspection system was, *per se*, also an orthodox step. However, the decision to make it a unit of the Central Bank was not at all orthodox, but was instead a complete departure from the customary practices of that period. In countries where the inspection of banks was practiced at that time, this function was performed by an independent agency, which generally reported to the Ministry of the Treasury. Raúl Prebisch understood, however, that such supervision would be much more effective if it were backed up by the economic pressure that the lender of last resort could exert. In addition, he took into account the fact that the inspectors could be paid higher salaries and enjoy greater stability if they were staff members of the Central Bank. This approach, which was an exceptional one in 1935, has come into more general use over time, as may be seen by the fact that in 14 out of 22 Latin American countries the corresponding Superintendency is now part of the Central Bank or Monetary Board.⁴

7. The formation of a securities market

The main tool of monetary policy used by the Central Bank of the Argentine Republic during Prebisch's time was the purchase and sale of

⁴Centre for Latin American Monetary Studies (CEMLA), *Informe sobre supervisión y fiscalización bancaria*, Mexico City, 1982, p. 21.

securities on the open market. This policy has also been the one most commonly employed by the central banks of financially developed countries since the late nineteenth century and especially since the end of the First World War. It is generally believed, as I myself thought until quite recently, that Prebisch had been able to make use of this instrument because a securities market was already in existence in Argentina. As we have seen, however, this was not so. The money market in Argentina was created at the same time that the Central Bank was established. Its formation was made possible, first of all, by the greater liquidity resulting from the revaluation of gold and from its use to unblock bank portfolios; an equally important factor, however, was the policy of empowering the Central Bank to issue and sell share certificates in the consolidated treasury bonds which the Bank had received from the Conversion Fund as part collateral for its monetary issue, since these certificates were easier to sell on the market due to their short term and the fact that they were backed by both the government and the Central Bank.

Before Argentina took this step, the experts on such issues thought that a central bank should not issue or sell bonds as a means of reducing the money supply because it could diminish the confidence of the public, which might think that the Central Bank was in need of resources. So strong was this belief that in 1941 the White Mission, which conducted the studies concerning the organization of the Banco Nacional de Cuba, recommended a complex mechanism for absorbing funds whereby bonds would be issued by the Currency Stabilization Fund, which was an account of the Central Bank rather than an institution as such.⁵ Raúl Prebisch did not share this fear, and from the very start of its operations in May 1935, the Central Bank of the Argentine Republic issued and sold share certificates in consolidated treasury bonds. Nobody thought that these securities were issued because the Central Bank needed resources, and everyone felt confident about the creditworthiness of the

certificates, which met with immediate acceptance.

The most important factor of all in the creation of the securities market, however, was the enormous stock of money injected into the economy by the Mobilization Institute. This was what put the banks in a position to purchase share certificates in consolidated treasury bonds and, later on, other Central Bank securities and treasury bills. The operations undertaken by the Institute in order to free up the bank's assets virtually doubled their reserves and provided them with more than enough funds to purchase securities from the Central Bank.

8. Open-market operations

In 1935 the Argentine economy was growing at an annual rate of 4.5% and was generating a gross domestic product equal to nearly 90.0% of its 1929 level. Neither the growth rate nor the degree of utilization of the production apparatus made it advisable to apply a monetary policy aimed at curbing the expansion, but the huge amount of liquidity that was fed into the economy in order to place the banking system on a sounder footing could have sparked a large increase in lending activity, in the means of payment, in aggregate demand, imports and prices. It was therefore necessary to absorb the excess liquidity. Accordingly, the Central Bank immediately initiated the issue and sale of share certificates in the consolidated treasury bonds it had in its portfolio. The certificates were issued for a 90-day term and with an annual yield of 2.75% and were offered in competitive bidding with a guarantee that they would be repurchased at the sale price. From the very beginning they were sold at a premium, which lowered their yield to 2.52%, 1.98% and 1.72% in December 1935, 1936 and 1937, respectively.

Before the end of 1936, the Bank's sales volume had reached 400 million pesos, which was equal to the amount of consolidated bonds it had in its portfolio; it therefore began to offer treasury bills (with the proceeds from these sales being used to retire public debts) and subsequently issued gold and foreign exchange certificates. By August 1937 it had sold 741 million

⁵These recommendations were acted upon seven years later when the Banco Nacional de Cuba was created. However, this bank never issued bonds in either its own name or in that of the Currency Stabilization Fund.

Table 4
ARGENTINA: LIQUID ASSETS AND ABSORPTION, 1934-1938
(*Millions of Argentine pesos*)

		Liquid assets	Absorption by Central Bank	Cash holdings	Deposits	Percentage of reserves	Loans
December	1934	485	-	485	3 465	14.0	3 424
May	1935	926	-	926	3 338	27.7	2 821
December	1935	1 022	195	825	3 357	24.7	2 870
June	1936	1 036	343	723	3 510	20.6	2 960
December	1936	1 237	464	772	3 668	21.0	3 010
July	1937	1 543	713	830	3 915	21.2	3 140
December	1937	1 297	607	690	3 881	17.8	3 075
June	1938	1 133	482	651	3 829	17.0	3 160
December	1938	1 005	374	631	3 790	16.6	3 290

Source: Central Bank of the Argentine Republic, annual reports and statistical supplements.

pesos worth of the three types of securities.⁶ However, as shown in table 4, the banking system's liquid assets had begun to drop from their level of the month before, when they had reached a peak of 1 543 million pesos. The Central Bank therefore moved swiftly to reduce its sales of securities, bringing them down to 373 million pesos in December 1938 and to progressively lower levels during the following years. In late 1941, the Central Bank was still issuing and selling certificates (in the amount of 30 million pesos), but its reason for doing so was probably to retain the use of a tool which it might need again in the future.

In the talks he gave at the Banco de México, Prebisch explained that the Central Bank authorities understood that it would have been much better to sell these securities to depositors rather than to the banks because this would have reduced both the public's purchasing power and the banks' lending capacity at one and the same time and because it would have been a more effective means of diminishing the banks' lending capacity, since it would then have been beyond the banks' power to recover this capacity

later merely by deciding to do so. The sale of short-term securities to banks allows the latter to regain their lending capacity upon the expiration of the securities simply by refraining from repurchasing them, something which they cannot do if the securities have been sold to the public; the banks' liquidity will nonetheless have been reduced because the public will have withdrawn money from its bank deposits in order to buy the securities. The Central Bank of the Argentine Republic was unable, however, to sell securities to the public because, in the case of share certificates, the law prohibited it from doing so and because, in the case of other securities, the banks opposed such a step on the grounds that the Central Bank should not compete with them in attracting the public's resources.

This is an extremely interesting aspect of Argentina's experience with monetary affairs because the argument that the Central Bank should not compete with other banks has been the major obstacle to the use of so important a policy tool as is the sale and purchase on the open market of securities issued by the Central Bank itself. The argument is not a valid one because the sale by a central bank of its own securities is not a form of competition but rather a means of monetary regulation which can be used as an alternative to raising bank reserve requirements. Nevertheless, this argument has been employed successfully to prevent the use of this instrument.

⁶In addition to selling certificates and treasury bills, the Bank had bought 207 million pesos worth of dollars using resources from the Foreign Exchange Fund; this also involved a sterilization of funds. According to the figures available to the author, such sterilization operations amounted to a maximum of 948 million pesos. According to Nurkse, however, these operations totalled over 1 billion pesos as of June 1937.

9. A policy of persuasion

Even though it was brilliantly conceived and executed, the authorities' policy of absorbing excess funds could not have prevented a sharp increase in bank loans if it had not been for the Central Bank's effectiveness in persuading the banks to follow a prudent credit policy. Indeed, at no time did the sale of securities manage to bring down the banks' cash holdings to less than 21.0% of deposits, which was almost double the legal minimum reserve requirement.⁷ This made it possible, as soon as their reserves increased for the banks to engage in such keen competition among themselves that they even took up the practice of visiting the clients of rival institutions in order to offer them credit at lower rates of interest. This was a cause of serious concern for the Central Bank authorities, not only for monetary reasons but also because their knowledge of the situation told them that this was not the right time to lower profits and enter into high-risk operations, since there were many severe financial problems that had yet to be resolved. The Central Bank called upon the banks to co-ordinate their policies and to reach an agreement among themselves by which they would pledge to refrain from lowering the interest rate to below 4%. At first the banks resisted the idea, but the Central Bank persevered and the agreement was ultimately signed.

Along with its successful effort to curb any undue expansion of lending activity, the Central Bank made a recommendation to the banks (which they accepted) that they not pay dividends of over 5% so that they might build up their reserves. Thus, without the aid of any legal provision, but merely by means of its powers of persuasion, the Central Bank managed to convince the banks to use most of their profits to increase their capital.

10. Rediscounting

During Prebisch's tenure as General Manager, the Central Bank of the Argentine Republic

refrained from carrying out rediscounting operations except during a brief period in 1940, and even then the amounts involved were relatively small. In May of that year, the intensification of the fighting in the world war sent shock waves through the stock market and created a very uneasy situation for the banks, which feared a steep decline in foreign trade. The Central Bank intervened aggressively in the stock market. It bought up a considerable amount of securities, thereby stabilizing the market quotations, and asked the banks to "avoid placing restrictions on credit which might disturb the flow of business and cause unnecessary selling", telling them that "if, despite the banks' greatly improved cash position, they find it necessary to resort to the instrument which the law has made available to the Central Bank for facilitating banking operations, then the banks shall be permitted to discount as much of the eligible paper in their portfolios as they deem necessary". In response to this invitation, "major banks communicated their decision to carry out such rediscounting operations immediately, despite the abundance of liquid assets at their disposal, as an express means of showing their willingness to provide the marketplace with all the resources it might need".⁸ In June, the Central Bank carried out rediscounting operations totalling 79 million pesos (equivalent to around 10% of the banks' cash holdings at that time), with payment being made in full before the beginning of the following year.

In the talks he gave at the Banco de México, Prebisch did not speak about rediscounting until one of the final sessions, and then said that he had not mentioned it as an expansionary policy tool because "during the downswing of the cycle, private enterprises are not inclined to use more credit to expand their businesses since, generally speaking, the mood is one of reluctance rather than optimism".⁹ Prebisch did not speak of rediscounting as a tight-money policy either because, in its early days, the Central Bank of the Argentine Republic could not have made use of this tool due to the huge amount of excess liquidity created by the policy aimed at putting the banks on a sounder footing.

⁷The law provided for a minimum reserve requirement of 16.0% on demand deposits and of 8.0% on time deposits. Since the former amounted to around one-third of the total and the latter to about two-thirds, the average minimum reserve requirement was between 10.0% and 11.0%.

⁸Central Bank of the Argentine Republic, *op. cit.*, p. 127.

⁹Central Bank of the Argentine Republic, *op. cit.*, p. 499.

11. Advising the government

During the first two years of its existence, the Bank does not seem to have exercised its function as an economic adviser to the government, at least not in regard to sufficiently important issues to warrant mention in the Bank's annual reports or in the talks given at the Banco de México; however, when the country entered into the next downturn of the economic cycle, the Central Bank then began to perform this function in a very thorough manner indeed. When exports slumped during the second half of 1937 and this decrease began to have an effect on domestic activity, the Bank recommended that steps be taken to counteract the slowdown. In this connection, Prebisch said the following: "Should the Central Bank help to reduce domestic economic activity so as to bring the balance of payments into a perfect state of equilibrium, or should it give priority to domestic economic activity and seek other means of influencing the balance of payments? This was the question we asked ourselves beginning in the second half of 1937, and it was posed with increasing urgency as the cyclical downturn deepened. The Central Bank was quick to understand its domestic responsibility in the face of this economic situation, especially in view of the new fact of Argentine life represented by what had only in recent years become a hard-working industry. The tendency, then, was to protect domestic economic activity and to resort once again to exchange control measures in order to prevent the increased purchasing power created by the Banco de la Nación to aid farming activities (and which was later to spread to the other sectors of the economy) from going to imports and to ensure that it would instead continue to circulate within the local market."¹⁰

In order to offset the slump, the Bank recommended that the government should tighten its exchange controls, which had become virtually negligible during the final stages of the upswing in the cycle. The Bank also supported the government's policy of purchasing harvest surpluses and played a decisive role in drafting an economic reactivation plan, whose text reflected,

according to Carlos Díaz-Alejandro, "the unmistakable style of Raúl Prebisch".¹¹

12. Exchange policy

In 1931 the foreign exchange crisis and capital flight made it necessary for Argentina to establish exchange controls, initially under a rigid system providing for a single exchange rate and directed at regulating all transactions, and later under a differential exchange system that covered around 85% of all transactions, with the remaining 15% being allowed to take place on the free market. This system provided for three exchange rates: one of 15 pesos to the pound sterling for major exports, another of 16 pesos to the pound sterling for essential imports, and a floating rate for all other current transactions and capital movements. The Bank intervened actively in the free market in order to keep the exchange rate within a range of 17-20 pesos to the pound sterling, i.e., a range of from 0.6% to 25.0% above the exchange rate for imports on the official market.

Without going into a detailed description of either the system or the modifications made in it in 1935-1943, it can be maintained that exchange controls were handled with extraordinary effectiveness in order to stimulate exports, curb imports, promote national industry and supplement the anti-cyclical effect of the country's domestic monetary policy. During periods when exports were on the rise, the inflow of foreign exchange pushed the free exchange rate down, lowering it to 17, but at that point the Central Bank would start buying in order to prevent the rate from dropping below that level. When exports were declining, the exchange rate climbed, thereby helping to staunch the outflow of foreign exchange, but the Bank would then start selling and would thus keep the rate from going above 20.

During the period under examination, the free market in Argentina served to regulate both domestic and foreign capital movements and to hold down imports during cyclical downswings,

¹⁰Banco Central de la República Argentina, *op. cit.*, p. 400.

¹¹Carlos F. Díaz-Alejandro, *Essays on the Economic History of the Argentine Republic*, New Haven, Connecticut, Yale University Press, 1970, p. 105.

and, since exchange rate fluctuations were kept within a narrow band, no price distortions were created and no appreciable incentive was provided for violating the controls. The moderate nature of these fluctuations was due to the Central Bank's policy of intervening in the market, but market expectations were the factor which made this policy's success possible. Throughout the period, domestic and foreign investors' faith in the Argentine economy remained unshaken; investors might feel that temporary capital transfers were advisable when the economy was undergoing transitory difficulties, but the tendency to withdraw capital slackened when the free exchange rate rose by 10%, 15% or, at the most, 25% since they felt confident that these difficulties would pass and the price of the pound and of the dollar would drop once again.

The talks he gave at the Banco de México demonstrate that Prebisch understood quite clearly that it did not make sense to place quantitative restrictions on the imports of a product that would reduce the supply to below the existing level of demand while at the same time selling foreign exchange inexpensively to importers of that same product because the low price of the foreign exchange would benefit importers rather than consumers, inasmuch as such restrictions would push the product's sale price on the domestic market above the import cost, thereby providing intermediaries with undue profits. In 1944 Prebisch had already grasped the significance of the Sohmen effect, thus called because it was first described by that author in 1958, even though Triffin had used the same concept many years before as the basis for his recommendation that the authorities lift the quantitative restrictions applying to imports in Ecuador in 1947.¹²

13. The effects of the anti-cyclical policy

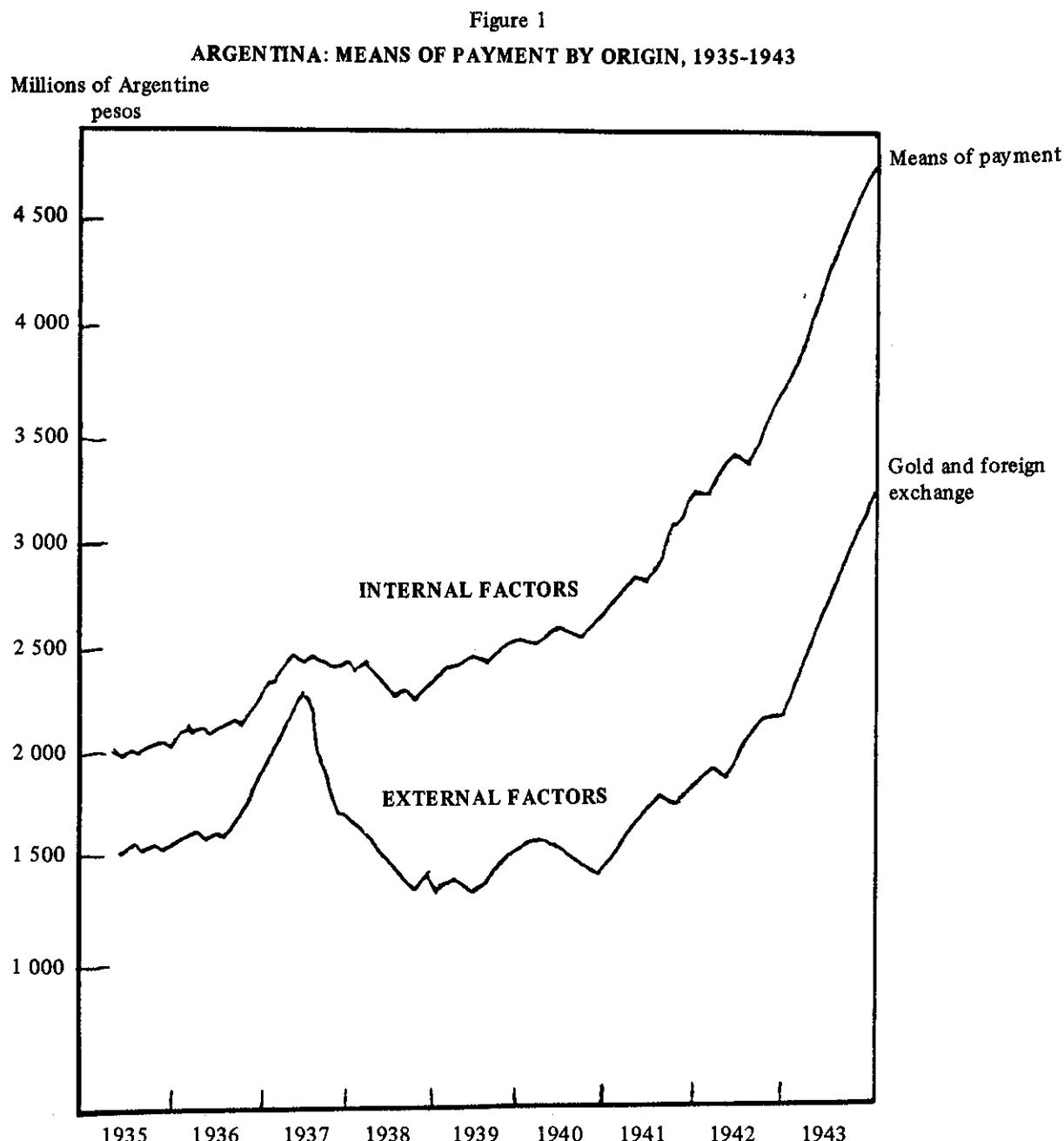
In the preceding sections we have examined, one by one, the policies applied by the Central Bank of the Argentine Republic during the period

under examination (i.e., open-market transactions, rediscounting, the persuasion of the private sector and the provision of advisory services to the government). Now let us see what the effects of these policies were during the course of the period in question: first, in the cyclical upswing of 1935-1937, when they were used to counteract inflationary pressures; later, in the cyclical downswing of 1938-1939, when their use was aimed at preventing a slowdown in the real economy; and, finally, in the years 1940-1943, when the Bank was faced with the task of counteracting, supplementing and rectifying the serious distortions produced by the Second World War.

Strangely enough, the first policy implemented by the Central Bank was not an anti-cyclical measure, but rather a potentially pro-cyclical one. As we saw earlier, the first step taken by the Bank (through its auxiliary institution, the Mobilization Institute) was to improve the quality of the banks' portfolios by purchasing from them government securities and doubtful private credits. This measure might have had explosive repercussions, but did not because its potentially inflationary effects were offset (or even more than offset) by the sale of securities and by the Central Bank's success in persuading the banks to follow its recommendations. In fact, the objective of the Central Bank's anti-cyclical policy was not so much to counteract the expansionary effect of the increase in exports and in capital inflows as it was to sterilize the banks' excess liquidity. Fortunately, this policy prevented the improvement of the banks' portfolios from having an explosive impact and thereby made this a cost-free measure of enormous benefit to the nation.

The effectiveness of the Bank's anti-cyclical policies is clearly illustrated in figure 1, which shows the trends observed in the means of payment and in gold and foreign-exchange reserves during the period in question, as well as the effect on the former of variations in the latter, with the residual representing the effect of changes in domestic credit. Figure 1 and table 5 have been taken, with slight adaptions, from the annual reports of the Central Bank, in which Raúl Prebisch first applied a technique of analysis that was later systematized and refined by Robert Triffin. This technique is used today, with a number of variations and refinements, by

¹²Egon Sohmen, The effect of devaluation on the price system, *Quarterly Journal of Economics*, May 1958. For Prebisch's explanation of this concept, see Central Bank of the Argentine Republic, *op. cit.*, p. 308.



central banks and international monetary institutions.¹³

Figure 1 and table 5 show that the anti-cyclical policy entirely cancelled out the potential

impact of the increase in liquidity generated by the unblocking of bank portfolios and largely offset the monetary effect of the growth of reserves resulting from the rise in exports. Between May 1935 and July 1937 the country's international reserves climbed by 840 million pesos, whereas the money supply rose by only 590 million pesos; this means that the sale of securities and the public's saving habits steril-

¹³Robert Triffin, *Esbozo general de un análisis de las series estadísticas monetarias y bancarias de América Latina sobre bases uniformes y comparables*, First Conference of Central Bank Technical Experts of the Americas, Mexico City, 1946.

Table 5
ARGENTINA: MEANS OF PAYMENT BY ORIGIN, 1935-1943
(Millions of Argentine pesos)

	May 1935	De- cember 1935	De- cember 1936	July 1937	De- cember 1937	De- cember 1938	De- cember 1939	De- cember 1940	De- cember 1941	De- cember 1942	De- cember 1943
External factors ^a	1 460	1 480	2 000	2 300	1 700	1 300	1 480	1 400	1 870	2 360	3 650
Internal factors ^b	3 210	3 250	3 300	3 280	3 470	3 620	3 840	3 850	4 650	4 980	4 960
Total ^c	4 670	4 730	5 300	5 580	5 120	4 920	5 320	5 250	6 420	7 280	8 610
Less absorption ^d	2 670	2 540	2 900	2 990	2 450	2 420	2 560	2 430	2 860	2 990	3 350
Money supply (M ₂) ^e	2 000	2 190	2 400	2 590	2 670	2 500	2 760	2 820	3 560	4 310	5 760

Source: Central Bank of the Argentine Republic, annual reports.

^aInternational reserves in gold and foreign exchange.

^bLoans and investments of the banking system.

^cSum of the above two quantities. The total is equivalent to money plus quasi-money (M₂).

^dSavings and time deposits, other term obligations of banks and absorption of funds by the Foreign Exchange Fund.

^eCurrency outside banks plus demand deposits.

ized 250 million pesos of the potential expansion of the money supply. These results are truly astounding, even for those of us who already have a boundless admiration for the work of Prebisch.

In July 1937 exports began to drop and continued to do so until late 1938. This decrease in exports, which reduced their value by around 40% in the space of one and one-half years, affected domestic economic activity and resulted in a decline in reserves. Faced with this situation, the Bank recommended that the government tighten its exchange controls and require licenses for those imports which had been entering the country without them through the free market. At the same time, the Bank started to repurchase the securities it had sold during the upswing of the economic cycle, thus permitting the banks to maintain and even slightly increase their lending volumes. The economic slowdown also led to a reduction in time deposits, and the spontaneous absorption of the money supply by the public therefore diminished. Between July 1937 and December 1938 the money supply declined by only 6.8% despite the fact that international reserves were drawn down by 43.5%. The following year, export values regained some of the lost ground and the money supply increased by approximately the same amount as did international reserves. In 1938 the gross

domestic product shrank 2.8%, but in 1939 it recovered, growing by 4.5%.

In May 1940 the intensification of the war had the effect of shutting down the market for Argentine products in the European continent, shifting import trade towards the United States, and creating an imbalance between the inflows and outflows of foreign exchange, with the result that there was an abundant supply of pounds sterling and a serious shortage of dollars. This made it necessary for Argentina to establish controls which discriminated against imports from the United States. Later on, the United States' purchases of Argentine products increased sharply, but its sales remained very low due to war shortages. As a result, Argentina's reserves in gold and foreign exchange soared. Between 1940 and 1943 its reserves grew at an average annual rate of 37.5%, which pushed up the money supply by an average annual rate of 23.0% during the three years in question. Despite the difficulties caused by the war and the need to finance harvest surpluses, the Central Bank was able to hold down the growth of the money supply to a rate far below that of the increase in international reserves.

The Central Bank's policies during the war were just as efficient as its anti-cyclical measures of 1935-1939 but it was the latter which, because of their technical beauty, attracted international

attention. In his well-known analysis of the international monetary situation between the two world wars, Ragnar Nurkse referred to Argentina's monetary policy in the following terms:

"Argentina provides the most striking example of the neutralization of cyclical phenomena of both types (economic booms and recessions) during the three years between 1936 and 1939. Here, once again, mid-1937 was a critical period. The changes then occurring in the world market had a particularly strong effect on Argentina's balance of payments because they were reinforced by an inflow of external funds before this critical juncture and by an outflow of such funds after it, as well as by weather conditions which produced an exceptionally good harvest before and a very poor harvest immediately after this point in time. These events had surprisingly little effect on the domestic credit situation due to the quite notable policy of monetary 'isolationism' that was applied during both the economic boom and the depression. The inflow of foreign exchange in 1936 and in the early months of 1937 was sterilized, firstly, by the Central Bank's sale of securities and, after November 1936, by the transfer of treasury certificates and bills to the market for purchases of foreign exchange on behalf of the government.... The total amount of [foreign] exchange absorbed by these means reached a peak of over one billion pesos in June 1937, which were sold during the following 18 months. The proceeds from these sales were used to pay for the treasury bills and certificates which had been issued to finance them... Thanks to the neutralization policy, the monetary expansion observed in 1936-1937 was moderate in comparison to the rise in exports and the inflow of funds; analogously, the decline in domestic credit during 1937-1938 was slight in comparison to the turnaround in the balance of external payments."¹⁴

14. Model banking laws

Argentina's experience served as an inspiration for Robert Triffin's work concerning the revision of the structure and functions of central

banks in developing countries, which was reflected in the laws of Paraguay, Guatemala, the Dominican Republic and Ecuador. These, in their turn, served in part as a model for the laws which created the central banks of Chile and Honduras and for the modifications made in the banking laws of El Salvador and Venezuela. The work of Raúl Prebisch can thus be said to have been the basis for the contemporary central banking system in Latin America.

The beauty of the theories underlying the new banking laws and the promise these laws held out for neutralizing the economic cycle sparked the enthusiasm of Latin American economists. As a result, we placed our faith in monetary and exchange policy as the key tool for solving many of our problems and concentrated our efforts on refining the techniques of monetary analysis and the central banks' instruments of control as much as possible. This was a time during which we spent long hours discussing how to compute the revaluation of reserves in the classification of the means of payment by origin and attempting to create controls of all sorts that would make central banks better able to offset external fluctuations.

Latin American economists' enthusiasm for the new banking laws and especially for their exchange provisions was not due so much to the contribution they might make to a more complete neutralization of the economic cycle as it was to the fact that they offered a possibility of speeding up industrialization by making it possible to continue investing and growing during cyclical downswings: when exports declined, we freed the exchange rate for luxury imports, restored our balances of payments to equilibrium and continued investing in industry and infrastructure. Our eagerness to apply the new monetary policy was due to the fact that it provided an indirect instrument for promoting industrialization. However, once we had found a more direct route to our goal (thanks in large part to Prebisch), it was then no longer necessary to take such a roundabout path, and we devoted our full attention to development theory and policy. Moreover, development policy could be applied in an anti-cyclical manner by intensifying the construction of infrastructure projects and the acquisition of external loans when exports were decreasing, thereby providing at least a partial

¹⁴Ragnar Nurkse, *La experiencia monetaria internacional*, IMF/IDB/CEMLA, Mexico City, 1968, p. 90.

substitute for monetary policy as a neutralizer of the economic cycle. The actual circumstances involved were yet another factor, since trade fluctuations were much less notable after the war than they had been before it, and there was thus much less need to apply an anti-cyclical monetary policy.

Latin American economists' enthusiasm for monetary policy reached its height shortly after 1945, attaining its maximum expression at the First Conference of Central Bank Technical Experts of the Americas, to which a number of references have been made. It rapidly waned during the 1950s as interest shifted to the theory and policy of economic development and to the study of the causes of inflation, which had already become a very serious problem in various Latin American countries before it made its appearance in the rest of the world. Partly because of this shift in interest and partly due to other causes, the rest of the tools which the new legislation made available to central banks were never used, either at the time of their creation or in subsequent years. In fact, during the past 40 years no central bank has applied an active anti-cyclical policy such as that implemented by Raúl Prebisch in Argentina in 1935-1943.

15. Factors militating against the application of an anti-cyclical monetary policy in Latin America during the postwar period

The loss of interest by Latin American economists in anti-cyclical monetary policy and the scant use made of this tool by financial authorities during the four decades that have passed since the end of the war appear to be due to a variety of reasons. The most important of these seem to be the following: a) the predominance of development policy; b) the possibility of applying development policy in an anti-cyclical fashion; c) the absence of sharp fluctuations in international trade; d) the fact that the new type of inflation that has emerged seems to be largely unaffected by credit restrictions, which have caused severe economic contractions; e) the impossibility of applying a consistent monetary policy in the presence of a combination of inflation and unemployment; f) the increase in interest rates in industrial countries; g) the

tax-exempt status of foreign deposits in the United States; and h) the debt crisis.

As a result of the sharp inflationary surges observed in various Latin American countries around 1950, a great deal of importance was initially placed on monetary policy. However, this inflation proved to be highly resistant to monetary restrictions, which had a much greater effect on production than on prices; these restrictions therefore gave rise to a steep increase in unemployment, but prices continued rising in spite of this. Such restrictions thus produced a situation of "stagflation", with the economy suffering from both unemployment and inflation at the same time. Given this situation, which is entirely contrary to the teachings of economic theory, What monetary policy should be followed? Should a tight credit policy be continued in the hope that, after a sufficiently long period of time, prices will drop, or should the constraints on credit be lifted in order to stimulate production and employment? "Stagflation" has thus prevented the application of a consistent monetary policy, and it continues to do so today.

The above-mentioned factors which have discouraged or hampered the application of monetary policy have been compounded, more recently, by the rise in interest rates in the industrial countries, the tax exemption of foreign deposits in the United States, and the debt crisis. The first two of these factors have augmented the outflow of capital from Latin America, already greatly encouraged by exchange instability, and have created additional difficulties for monetary policy-makers by presenting them with the dilemma of whether to raise domestic interest rates, which would keep capital within the region but would also slow down the economy, or to lower them, which would stimulate the economy but would also intensify the outflow of capital from the region. The third factor, the debt crisis, has created extremely severe problems for monetary policy by siphoning off an enormous amount of resources.

16. What lessons are to be learned from Prebisch's handling of monetary affairs?

This brief examination of the difficulties in relation to monetary policy which have been encountered in the past 40 years might, at first

glance, give the mistaken impression that Raúl Prebisch's admirable performance at the helm of the Central Bank of the Argentine Republic offers relatively few lessons that could be of use in resolving today's problems. What greater benefit could we hope to derive, however, from a study of his performance than to gain an understanding of the economic and financial changes that have occurred in Latin America and the world during those 40 years? What better way of grasping the essential importance which monetary policy still has for economic development and social well-being than to understand how the situation in which such policy is to be applied has changed?

An analysis of the eight factors listed above indicates that the teachings of Prebisch remain valid, because the first three factors are not obstacles as such but rather circumstantial factors which caused a higher priority to be placed on other policies, while the last five factors, although they do represent real obstacles, have their origin in international problems which, even though they have gone unresolved for a number of years, will, we should trust, be solved in the not too distant future. We can and should, therefore, re-examine the techniques used by Raúl Prebisch and use them to promote the region's economic development within a context of financial stability.

Two of the real obstacles have their roots in inflation, and their future significance will therefore depend on how much progress we make in our struggle to halt this process. In recent years this problem has grown worse as a result of the heavy blow dealt to the region by the debt crisis. Nonetheless, the better understanding that economists both in Latin America and elsewhere now have of the mechanisms of persistent inflation and of stagflation gives us reason to believe that not much more time will pass before we have practical and effective formulas for overcoming this critical problem.¹⁵ This optimism

¹⁵In this connection, see *Inflación, aceleración y contención*, *Pensamiento Iberoamericano*, No. 9, Madrid, January-June 1986; Rudiger Dornbusch, *Inflation and Indexation. Comments on Brazil*, Institute for International Economics, Washington, D.C., 1985; and, by the author, *Inflation, Exchange Rates and Stabilization. Essays in International Finance*, Princeton University, 1986; and Michael Bruno and Jeffrey Sachs, *Economics of Worldwide Stagflation*, Harvard University Press, 1985.

does not, however, mean that we should desist in our efforts to fathom the remaining enigmas posed by inflation.

The next two obstacles to an effective application of monetary policy stem from the greater attractiveness for Latin American savers of the possibility of making deposits in industrial countries due to the increase in interest rates in these nations. Making such deposits in the United States is the most attractive option of all because there such deposits are tax free. Latin American savers thus have the choice of holding their liquid funds in securities denominated in weak and depreciating currencies and of paying taxes on the interest earned, or of acquiring securities denominated in dollars which are rising in value in terms of the national currency of the purchaser, provide returns at a relatively high rate of interest and are exempt from taxes. There can be little doubt as to which alternative they will choose! It is to be hoped, however, that in the not too distant future the United States will levy a heavy tax on financial deposits made by residents of developing countries or, even better, offer to sign tax agreements with these countries whereby it would undertake to charge, on their behalf, the taxes they levy on foreign financial deposits by their residents. The transfers of capital now being made by poor countries to rich countries constitute a process which is so thoroughly illogical and so contrary to the most basic principles of equity that this hope ought not to be entirely illusory.

The last of the obstacles mentioned above, the debt crisis, concerned Prebisch during the final years of his life. Indeed, just five days before his death, he said "the present bilateral negotiations cannot drag on indefinitely because, so long as the region's economies are being drained in order to generate resources with which to pay the service on the debt, there will be no investment, either domestic or foreign, since capital is not invested in economies that are not growing or are declining and that are subject to increasing social pressures".¹⁶ The debt crisis cannot be

¹⁶Raúl Prebisch, Address delivered by Dr. Raúl Prebisch at the twenty-first session of ECLAC, *CEPAL Review*, No. 29 (LC/G.1427), Santiago, August 1986.

allowed to continue to hold back Latin American and world progress for much longer.

Once the obstacles which have stood in the way of an effective application of monetary pol-

icy are overcome, as they will have to be in the fairly near future, Raúl Prebisch's teachings concerning monetary and banking affairs will once again come into their own.

Dependence, interdependence and development*

Raúl Prebisch

This posthumously published work by Prebisch poses the following question: What is ECLAC's attitude on the topics of dependence, interdependence and development? In order to answer this question, Prebisch analyses a number of issues.

First of all, he examines the role of the periphery and the weight of the dominant centres in various periods, taking into account some variables which help in the interpretation of the resulting development. An issue of great importance in this respect is that of the internal faults of peripheral development, including superficial imitation of external models and the low priority given to technical development.

Secondly, Prebisch emphasizes the need to analyse peripheral capitalism within the context of a global theory of capitalist development, eschewing the danger of lapsing into intellectual dependence in this respect. Import substitution, he notes, was not invented by technocrats, but was a response to changing international conditions: there was never any bias against exports in ECLAC's thinking. The deterioration in the terms of trade, for its part, was due to technical change and its differential impact on industrial goods and primary commodities.

In the last part of the article, Prebisch analyses various recipes formulated in the centres for the developing countries but not applied in the industrial countries and emphasizes the need to achieve new world trading arrangements which will permit the countries of the periphery to advance in their development process.

*This article is based on a lecture delivered by Dr. Prebisch at the Economic Development Centre of London University in 1986. It is to be published by Basil Blackwell, together with other articles, in a book entitled *The State of Development Economics*.

I

Centre-periphery and dependence

Among the burning questions of the 1960s were dependence theories and concern about the problems —longstanding, of course— which they brought to the fore. In retrospect, now that the ferment of ideas has settled, two broad approaches are discernible. One of these, corresponding to more traditional thinking, identified the problem of dependence with the well-known hegemony of the stronger over the weaker countries; the dependence relation was seen as unilateral and invariably negative, and was held responsible for all the ills of the periphery. The other school of thought took for granted the existence and the important implications of the said hegemony, and sought to advance a step farther by shedding light on its foundations and on its complex manifestations as they figured in the centre-periphery concept. Thus, for example, one of the points emphasized was that the nature of the downward trend of the terms of trade clearly illustrated the disadvantageous position of the periphery. Later, the centre-periphery concept gained much from the valuable contributions of sociologists, political scientists and economists who took pains to point out internal phenomena inherent to the periphery which strengthened dependence relations. In this connection, special mention should be made of the work of Fernando Cardoso and Enzo Faletto¹ carried out under the aegis of ECLAC.

What is the nature of ECLAC's thinking on this subject now, enriched as it has been by the aforesaid contributions? A reply to this question should be preceded by a review of the major changes in the situation that have taken place.

First I will examine the part played by the periphery in capitalist development in pre-industrialization days. By the very dynamics of the centres, the periphery had been left on the

¹See Fernando H. Cardoso and Enzo Faletto, *Dependencia y desarrollo en América Latina. Ensayo de interpretación sociológica*, Mexico City, Siglo XXI Editores, 1974, 166 pp.

sidelines of the industrializing process, in its appendicular role of producer and exporter of primary commodities. The benefits of the increase in productivity that technical progress in the centres brought in its train did not spread to the rest of the world through a fall in the prices of manufactured goods, but were felt in the centres themselves, with the augmentation of income, of demand for goods and services and of capital accumulation wherewith to satisfy it. Demand for primary goods produced by the periphery also expanded in this process, generally very fast, and the corresponding income increments were transferred back to the centres for the purchase of manufactured goods.

This pattern began to crack up during the First World War. But the decisive impulse to industrialization stemmed mainly from the crisis of the 1930s. It was not a doctrinaire requirement, but was imposed by unfavourable circumstances which likewise made import substitution a matter of necessity. In those days nobody could have dreamed of exporting manufactures to the centres; nor could anyone have done so during the Second World War or the difficult years of the postwar period. Later, however, these were succeeded by propitious times for the export of manufactures. Some of the countries of the region made good use of the offered opportunities, whereas others, such as Argentina, were unable to exploit them with sufficient drive and steadfastness of purpose.

Because the periphery had not participated in industrialization from the start, large sectors of the population had been left out of the development process, in consequence of the dynamics of the centres and the mutations and diversification of demand. The periphery's demand for manufactured goods tends to increase rapidly, whereas its primary exports follow a relatively slow upward trend. There is an enormous disparity between the central and the peripheral countries as regards income from demand for imports. Hence the significance of exporting manufactures. As it happens, however, the manufactures that the periphery is in a position to export are precisely those for which the growth of demand in the centres is comparatively slow. This is why the centres not only display reluctance to do away with their protectionism, but rather tend to accentuate it. The

great liberalization of trade brought about by the Kennedy and Tokyo rounds of negotiations barely touched the periphery, since the goods covered were those for which demand gains impetus from the technological innovations introduced in the centres. The conclusion may therefore be reached that once again, the dynamics of the centres does not afford anything like the same benefit to the periphery as to the centres themselves. I shall revert to this point later.

I stated at the outset that the dependence controversy had enriched the centre-periphery concept. Perhaps its most important contribution has been the incorporation of power relations in the concept in question. In the course of the appendicular development of the periphery, the dominant groups in the centres had linked up with their counterparts in the periphery; there was a certain community of interests between these social groups, although the subordinate position of those in the periphery was manifest. The hegemony of the centres, and especially of the main dynamic centre, was based on their economic, financial and technological superiority, on the fragmentation of the periphery, on the trend towards imbalance in trade, and on the aforesaid subordination or dependence, call it what you will.

The superiority of the centres continued to make itself apparent during the industrialization of the periphery, and to take new forms. To the siphoning-off of income from the enterprises producing and exporting primary goods and importing manufactures, prior to industrialization, as well as from the public utility enterprises, was added the drainage of income through the transnational corporations, as they came to play a more and more active part in industrialization, often sheltering behind an exaggerated degree of protection. I do not, of course, exclude banking and financial corporations. Thus a change took place in the composition of the dominant peripheral groups linked up with the centres and a web of relations favourable to their economic, political and strategic interests was woven.

These are transparent or subtle ways in which the hegemonic weight of the centres makes itself felt. And when the periphery reacts against this dependence and jeopardizes the interests concerned, a whole constellation of

dominant elements in the centres loses no time in marshalling its forces to apply penal measures.

A distinction, not always presented in clear and definite terms, should be drawn between these dependence phenomena and the nature of those centre-periphery relations, referred to above, which are the consequence of the time lag in the integral development of the periphery, of its economic, financial and technological inferiority and of its economic fragmentation.

There is yet another body of ideas respecting dependence, among whose most significant expressions is the contention that the high level of living in the centres is basically due to systematic exploitation of the periphery, through diverse forms of transfer of income to the centres, and through the deterioration of the terms of trade to the disadvantage of the periphery's primary products. In the past there have undoubtedly been elements of exploitation to which ECLAC has repeatedly called attention. But this conclusion as to the peripheral origin of the centres' well-being overlooks the influence of the giant strides made by the latter in technology.

It is therefore not surprising that some have gone so far as to recommend delinkage from the centres, a more or less drastic severance of relations with them, so that the periphery, by taking full advantage of its own potentialities, can give decisive impetus to its development.

It is true that the centres, and above all the main dynamic centre of capitalism, have concerned themselves with the development of the periphery only in so far as it has served their own interests, and generally without looking very far ahead. They have sought neither the development of the periphery in social depth nor formulas for a convergence of interests.

It will take an immense and enlightened effort, a tenacious and protracted impulse of its own, to lift a peripheral country into a different category. This was what took place in the United States, until that country came to be the main dynamic centre. And in this way too Japan has become an exceptionally thriving centre, despite its lack of natural resources, other than the power of its mind and will.

Their endeavours were not directed towards cutting off relations with the centres, but

towards cultivating them intelligently in the interests of their own development.

As a general rule, the above-mentioned school of thought has laid very little stress on the internal flaws in peripheral development. Just as the periphery displays a persistent trend towards external disequilibrium, so likewise it exhibits an internal dynamic imbalance between the rate of expenditure and the rate of accumulation of reproductive capital, that is, the capital indispensable for the multiplication of employment, productivity and total income in the economy. This imbalance brings to light, especially in the Latin American region of the periphery, a fundamental defect.

With a lower average productivity than that of the centres, we hurry to imitate their ways of life, to boost demand for diversified goods and services. Thus a privileged consumer society has grown up in those social strata that are best able to appropriate the fruits of technical progress, to the obvious detriment of reproductive capital investment. And in the course of the structural changes in society, with the development of the distributive power of the labour force, its private and social consumption gradually increased as well, while at the same time the State considerably raised its own civil and military expenditure.

These outlays do not entail any containment of the expenditure of the well-to-do strata, constantly stimulated as it is by technological innovations, but are superadded to their privileged consumer spending. Sooner or later this adversely affects the rate of reproductive capital accumulation, with the consequent ill-effects on the tempo of development and on distributive equity. And this dynamic imbalance inevitably ends in a new type of inflation which cannot be effectively combated by monetary restriction which, moreover, is counterproductive by reason of its economic, social and political consequences.

The fact that all these forms of expenditure —private and social, civil and military— constitute a manifest imitation of the centres might induce the theorists of the above-mentioned stream of opinion to blame dependence likewise for the weakening of the rate of accumulation and for its inflationary effects: a conclusion which would imply carrying delinkage to an extreme hardly conceivable in the praxis of development.

II

Intellectual dependence

I also want to refer to another conspicuous symptom of dependence. I mean the unconditional subordination of some circles in the periphery to theories worked out in the centres. I do not mean to deny the value of these theories, but I maintain that generally speaking they are not in keeping with the peripheral situation that I have attempted to describe in a number of studies. It is not surprising, therefore, that the concept of periphery should be regarded as a mere change of name, or that it should be attributed to the design of the countries concerned to formulate a theory of their own which differs from the thinking of the centres. Nothing of the sort: the phenomena of peripheral capitalism must be inserted in a global theory of capitalist development. I feel it is very important to clear up this point in order to dispel misconceptions.

When the force of international circumstances first began to drive the periphery into becoming industrialized, an attack was launched in the centres against the very idea of this deliberate industrialization, based on protection and on import substitution. It is worth while to recall this, for despite the time that has gone by, substitution is still being attacked as a sort of monstrosity spawned by ECLAC.

I remember how in the early 1950s Professor Jacob Viner took up the cudgels against us in the University of Rio de Janeiro, attributing to us the fantastic idea that agriculture was symbolic of poverty. Shortly afterwards I had an opportunity of retorting. How could I uphold such an idea if my country, Argentina, had attained, thanks to agriculture, an extremely high level of per capita income at the beginning of the present century? Instead of becoming industrialized, Professor Viner said, what ought to be done was to introduce technical progress into agricultural activities, in order to step up productivity and expand exports. I agree, said I in my turn, but technical progress in agriculture would leave redundant manpower. And it was for industry, as for other activities that develop alongside it, to perform, among other roles, that of absorbing this

redundant labour force at rising levels of productivity. Otherwise, there was a risk of expanding primary exports beyond what was called for by the growth of international demand, with the consequent deterioration of the terms of trade. Protection of industry would help to rechannel capital and labour from agricultural to industrial activities, counteracting the downward trend in question. The fact that there has been exaggeration and abuse of protection does not invalidate this thesis. Although this has indeed happened, and in certain cases —and once again I will cite Argentina— it has been prejudicial to agriculture and exports.

The theoretical defence of an appropriate degree of protection was very simple. In view of the excessively low income-elasticity of international demand for agricultural products —and also for primary products in general— the expansion of exports of such goods was apt to depress upon their relative prices. Protection was desirable if the increase in costs for a country turned out to be less than the losses caused by the fall in prices of agricultural products.

But that was not the end of the argument. Imports had to be replaced by domestic production and, at the same time, the export of manufactures had to be undertaken and encouraged by incentives similar to those accorded to import substitution for the home market. I believe that ECLAC was among the first to defend this thesis in a study presented to the governments a quarter of a century ago. The tenor of the relevant passage was as follows:

The need for import substitution and for consequent protection of substitution activities has been unavoidable. But there has been a failure to boost exports to the same extent. There has been discrimination in favour of industrial substitution and against exports, mainly industrial exports. The ideal policy would have been to promote exports in order to place them on an equal footing again with substitution activities, which does not necessarily mean equal incentives.

This aspect is sufficiently important to merit examination; in a nutshell, it is the following. Limitation of external demand for primary exports makes it necessary to devote part of the increase in the factors of production to substitution activities. As their productivity is lower than in the industrial centres, they need to be given a certain subsidy in the form of tariff protection. Yet there would be possibilities of using a smaller subsidy to develop new industrial export activities, whereby a greater quantity of industrial goods could be obtained through trade than those that could be manufactured by substitution production.

By subsidizing substitution production rather than production intended for new exports (industrial or primary), export opportunities have been lost which, had they been properly used, would have reduced the scope of substitution policy or made more rapid economic growth possible.²

ECLAC emphasized the fact that industrialization was asymmetrical: besides being based on a generally excessive degree of protection, it failed to provide the appropriate stimulus to encourage exports of manufactures. And yet it was repeatedly affirmed that ECLAC ignored the need to combine import substitution and exports of manufactures.

And now that I have mentioned Professor Viner, I will also refer to Professor Bela Balassa, who has always reproached us with having overlooked the need to bring about that combination. And what is more serious, in a recent report he ascribes to this supposed onesidedness of ECLAC all the ills of Latin American development.³

Obviously he has had only a nodding acquaintance with our work, based on second- and third-hand quotations, in general mutilated and incomplete. For instance, he refers to a paragraph in the 1961 study of mine to which I

alluded above, and in which I denounced exorbitant protection, but does not include my recommendation that exports should be combined with import substitution in broader markets than those of the individual countries concerned. Nevertheless, I am glad that Professor Balassa has at last come to share my opinion. And I hope that in the study which he is preparing on Latin American development he will remedy his omission.

If I allude to this case it is not only because of the influence that Professor Balassa wields in the World Bank, for which he acts in an advisory capacity, but also because he is representative of certain attitudes that would appear to reflect displeasure at our—at ECLAC's—endeavours to interpret peripheral development phenomena in the light of a criterion of our own. Generally speaking, no genuine effort is made to understand ideas before attacking them. No recognition has been accorded to our determination to free ourselves from a persistent intellectual dependence which has serious effects on development praxis.

Since the earliest days of ECLAC—to adduce an important example—no objective consideration has been given to our theoretical reasons for maintaining that, in consequence of technical progress, there was a trend towards deterioration of the terms of trade. We have said so already: if the increase in productivity raised production above demand, such a downward trend would occur. Why did not the same thing happen in respect of manufactured goods? Simply because when deterioration supervened, the flexibility of industry was conducive to a redeployment of capital and labour in response to the diversified demand that technological innovations always bring in their train. But where agricultural products are concerned, this does not take place, except to a limited degree. It was contended, then, that deterioration was a mere illusion. The price of diversified goods rose because of the improvement in their quality and efficiency; if a farmer had to pay a higher price for a tractor, it was on that account. However, deterioration does not occur when for similar reasons the price of a machine used by industrial producers goes up. It does not occur, because diversification (together with other factors) pre-

²See Raúl Prebisch, "Economic development or monetary stability: the false dilemma", in *Economic Bulletin for Latin America*, vol. VI, No. 1, Santiago, Chile, ECLAC, March 1961, reproduced in A. Gurrieri, *La obra de Prebisch en la CEPAL*, Mexico City, Fondo de Cultura Económica, 1982, vol. II, p. 19.

³See R. Prebisch, "Notes on trade from the standpoint of the periphery", *CEPAL Review* No. 28 (LC/G.1392), Santiago, Chile, April 1986.

vents prices of industrial goods as a whole from falling as productivity rises. Herein lies the fundamental difference between agricultural and industrial prices, which is of so much importance for the development of the periphery.

As regards other primary products, there are cases in which, in addition to the adverse effects of the aforesaid trend, demand is also weakened as a result of the technological innovations which replace a natural product by new industrial goods. Technical progress thus operates adversely at both extremes. Adversely for the periphery, but not for the centres.

The peripheral countries do not have the same possibilities of counteracting the trend towards deterioration as the United States do, by restricting production of grain, or as the European Economic Community does, by flooding the world market with the production surpluses caused by the fixing of high prices, to the serious detriment of other producer countries, especially those of the periphery. And nevertheless, critics of the deterioration theory still go on insisting that it is a fallacy.

This double standard of judgement is by no means uncommon. We are seeing it now applied to protection. The periphery has been impugned on account of the protection it accords to the production of manufactures. There is no denying, of course, that its costs, at least to begin with, are higher than those incurred in the centres, because of the latter's economic and technical superiority. Why not devalue, is the cry, instead of resorting to measures that represent arbitrary interference with market laws? Devaluation, however, would mean, cheapening the prices of primary products which have come to be internationally competitive, and this, which, while benefiting the centres, has unfavourable effects upon the development of the periphery.

By the centres, then, as already said, we have been persistently counselled to export manufactures instead of undertaking import substitution. Some peripheral countries have followed the advice, acquiring the necessary technology and exporting goods which, thanks to that acquisition and to lower wages, compete favourably with goods from the centres. These then resort to protection. Why are they not advised to devalue

in order to cope with the problem? I think commonsense considerations prevail: among others, the realization that such a measure brings down the prices of their competitive exports, with the ensuing loss of some of the fruits of their technical progress.

The effects of all this intellectual dependence have generally been very serious, owing to the academic authority that is usually attributed to the advocates of certain ways of thinking. The damage is still fresh that has been done by the so-called Chicago theories in several Latin American countries, especially my own. All the more so when these theories become operative, as in the conspicuous case of the International Monetary Fund. This institution took several years to recognize that external imbalances stemmed not only from an inappropriate internal monetary expansion, but also from international factors, as we in ECLAC have long been maintaining. And in face of these disequilibria, a squeeze on economic activity is recommended in order to reduce imports, since respect for market laws discountenances the pursuit of a selective import policy. The economic, social and political effects of such a squeeze do not seem to have entered into the picture as far as the Fund is concerned, much less import substitution policy, which it has resolutely impugned.

Very serious, too, have been the consequences of resorting to monetary contraction as a means of combat inflation: an efficacious formula in those bygone days of capitalism when the labour force bowed to market laws and the State took a *laissez faire* line with respect to income distribution. To avoid, or at least attenuate, such extreme monetarism, an indispensable requisite would be an income policy which accorded capital accumulation the importance it deserves. The Fund did once mention this idea, but unfortunately it would seem to have continued to adhere to its inveterate orthodoxy.

Another measure now advocated is the reduction of imports in order to cope with the payment of interest on the external debt, very greatly to the detriment of internal activity and employment. It must be recognized that the Fund is not responsible for the debt. It was simply ignored when the large banks, guided by the profit-making motives, availed themselves

of the plentiful resources of the Eurodollar market to issue loans to countries that took those resources without even an elementary degree of foresight. There was a convergence of irresponsibilities on both sides, except in so far as an attempt was made to face up to the petroleum shock. The private banks loudly asserted the worth of their own wisdom and of market laws in respect of resource allocation, and made much of their superiority over intergovernmental institutions.

It is playing with fire to shy away from a political solution for the debt problem. To all the foregoing have been added the deterioration of the terms of trade and the increasing difficulties of expanding exports in present circumstances. The Baker Plan signified an acknowledgement of the political character of the problem. But it can be only a beginning, as long as astronomically high interest rates continue to prevail. The debt has accentuated our countries' dependence. The financial factor has always been outstandingly important, and now it is still more so in countries whose capital accumulation has plummeted, above all because of the inflationary crisis and debt service payments, and which are going to need foreign capital. Hence the necessity of a political arrangement which, besides resolving the problem, will pave the way for a selective investment policy.

The foregoing considerations bring us to the subject of conditionality. Conditionality is a requisite of international credit operations. But what sort of conditionality? This question must be posed now that the World Bank is talking of conditionality too. True, it has not been observed by those private banks I have just mentioned. Conditionality ought not to consecrate our dependence upon the thinking of the centres; on the contrary, its content should be discussed with the participation of independent economists from the periphery, until a reasonable body of ideas were arrived at to guide the action of the above-mentioned institutions, as well as that of the Inter-American Development Bank.

Similarly, conditionality could have constructive meaning only in the framework of a clear-cut policy of economic expansion. And that necessitates highly significant changes. International financial co-operation, however liberal and enlightened it might be, would not have lasting positive effects on the peripheral countries unless these took effective measures to correct the tendency for the growth rate of expenditure to outstrip that of reproductive investment. Nor would these effects be fully brought about unless measures were likewise taken to correct the trend towards external disequilibrium. Herein lies the key role of the centres, especially the main dynamic centre.

III

Dependence and interdependence

I have spoken of dependence. But not of interdependence. We are all interdependent but some are less interdependent than others, as in the case of Orwell's equality in which some are less equal than others.

Interdependence may be positive or negative. And in it the role of the dynamic centre is of primordial importance. A vigorous and sustained expansion of this latter would spread its positive effects over the rest of the world, and especially in the countries of the periphery, if they made up their minds to respond energetically to the stimulus thus provided. But other-

wise, if the growth of the centre were weak and fluctuating, a disturbing case of negative interdependence would occur.

I do not say that a peripheral country would have no means of attenuating the adverse consequences, but it would not be able to counteract them altogether. And in so far as, whatever its intentions, it was unable to expand its exports at an adequate pace, it would find itself obliged to push its import substitution policy farther than would otherwise have been necessary.

Would this import substitution policy be prejudicial to the centres? It would merely

change the composition, not the quantity of imports from them, the growth of which would have to keep pace with the rate of development.⁴ It is an interesting case of asymmetry which is seldom clearly understood. The imbalance, as we have already explained, is basically due to the disparity caused by the relatively slow growth rate of primary exports as compared with that of imports of diversified goods, which is relatively rapid. If, then, a peripheral country substitutes domestic production for certain imports it implies increasing others. Contrariwise, when it is the main centre, primarily, that does the same thing and restricts its imports, it deprives the peripheral countries of the means of continuing to import as much as or more than before, with the consequent slackening of the rate of development.

Readily understandable, therefore, is the adverse significance of the waning rate of development of the centres in these days, aggravated as it is by the recrudescence of an inveterate protectionism. Multilateral formulas will have to be devised which will enable the peripheral countries to share, without disturbances, in the increase in the centres' consumption, as long as their persistent unemployment situation precludes measures of more far-reaching scope. Be that as it may: could it be contended that this would provide a solution in depth for the problem of disequilibrium?

Those of us who remain unconvinced must continue insisting upon the need to combine exports with import substitution. It is to be hoped that understanding on the part of the centres and emancipation of the periphery from its intellectual dependence will facilitate the application of this policy.

Import substitution will impel our countries to undertake new lines of production which will

call for technological co-operation from the advanced centres. This will open up a promising field for exploitation of a technology which the centres have already developed, and which they are improving upon by virtue of new forward strides in technology.

An indispensable condition for the success of this policy would be for those new lines of production, those changes in its structure, to have access to broader markets than those of the individual countries. We have hammered at the centres' doors to obtain a favourable reception for our exports. But we have not been able to promote them among ourselves. Here too formulas must be found that are more effective than those conceived a quarter of a century ago.

For the first time in capitalist development, the periphery —passive hitherto— could exert dynamic influence on the centres, always providing that new forms of co-operation were arrived at. Expanding exports of goods based on a less advanced technology than that of the centres and exchanging them for more complex goods would mean that both parties obtained well-recognized advantages with the consequent increase in productivity. While exploitation in the periphery of a technology that is being constantly improved upon in the centres would also offer undeniable reciprocal benefits.

It has been said elsewhere that the centres have concerned themselves with peripheral development only just so far as it suited their interests. No one can blame them. We ought to blame ourselves for not having been able to shake off the intellectual dependence which has blindfolded us to our own interests. We have, however, come to a stage in our relations with the centres at which there are great possibilities that a convergence of interests may be reached.

These converging interests, however, are not only economic, but also political, and of vital importance. Our Latin American countries —to continue confining ourselves to them— are passing through an acute structural crisis whose implications are plain to be seen. To the problem of the broad masses of human beings that have been relegated to the bottom of the social structure at very precarious income levels, is now superadded the question of unemployment and a

⁴Aníbal Pinto, the eminent Latin American economist who has contributed so much to the evolution of ECLAC's ideas, in a study published under the title "La apertura al exterior en la América Latina", in *El Trimestre Económico*, No. 187, Mexico City, July-September 1980, expressed the opinion that Latin America, if it were to keep up until the year 2000 the growth rate of 6.4% recorded between the years 1955 and 1974, would have to double its imports every 10 years. Thus it is not a question of reducing imports but of increasing them and making the appropriate changes in their composition, in accordance with the demands of development.

growing distributive struggle, which inevitably leads to inflation and in some instances to hyper-inflation. The life horizon of the new generations is narrowing and their dynamic elements have a profound sense of frustration which sows potent seeds of resentment and rebellion. The problem, however, is not so much one of foreign ideologies, but one of a hotbed of violence of every kind. The political orientation is of course important. But much more so is the inherent

likelihood of a perturbation of social coexistence and of the democratization process.

The hegemonic power of the United States is a fact which it is not in our hands to alter. It can be exerted in two ways: one is to allow Latin American events to drift along and confront the consequent disturbances with penal measures or the use of force; the alternative is to pursue a far-sighted and enlightened policy of positive interdependence. There is no other choice.



A list of ECLAC publications

PERIODIC PUBLICATIONS

CEPAL Review

CEPAL Review first appeared in 1976 as part of the Publications Programme of the Economic Commission for Latin America and the Caribbean, its aim being to make a contribution to the study of the economic and social development problems of the region. The views expressed in signed articles, including those by Secretariat staff members, are those of the authors and therefore do not necessarily reflect the point of view of the Organization.

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1984, vol. I 702 pp.
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1984, vol. II 216 pp.
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- 1 *Manual de proyectos de desarrollo económico*, 1958, 5^a ed. 1980, 264 pp.
- 1 *Manual on economic development projects*, 1958, 2nd. ed. 1972, 242 pp.
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