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Review

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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, eg., 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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Address delivered by the Executive Secretary of ECLAC, Mr. Norberto González, when opening the Meeting on Growth, Adjustment and the Debt in Latin America*

Our purpose in organizing this meeting is to hold an informal exchange of views on the recent evolution and future prospects of the Latin American economy, taking into account the effect of the external debt. It is not our aim that this meeting should give rise to commitments or consensuses, but simply that this exchange of views should help us to understand better the challenges faced and the possible options available for responding to them.

In order to open the discussion, I should like to refer briefly to the way we ourselves see this past evolution and future prospects. In the ECLAC document "A preliminary overview of the Latin American economy in 1985", which has been distributed to participants at this meeting —and especially in part III entitled "Some reflections on the immediate challenges"— the items which I shall go over in a very summary manner here are dealt with at greater length.

Since 1981 Latin America has been going through its severest and most protracted crisis since the Great Depression of the 1930s, and this has been all the more dramatic because it came after a long period of solid and sustained growth, which began after World War II.

Between 1970 and the onset of the crisis, the volume of Latin America's exports of manufactures grew by 15% per year. Thus, the region appeared to be reducing some of the structural shortcomings which had so long held back its development, and seemed on the way to narrowing the technological, organizational, educational and management gaps which separated it from the developed world. Education became more universal; business managers became increasingly professional; and the efficiency of government action improved, so that productivity began to grow significantly. Indeed, Latin America's success in riding out the post-1973 oil crisis with only a slowdown in growth (unlike the OECD countries, which suffered a recession) was quite striking.

This promising progress came to an abrupt halt in 1981. In the last five years the gross domestic product has fallen or stagnated, so that by 1985 per capita income was 9% below 1981 levels, while open unemployment has increased sharply (aggravating the region's already serious problem of underemployment) and real wages have fallen in most countries. All this in order to achieve a turnaround (albeit monumental) in the region's external accounts.

What are the main factors that led to the heavy accumulation of external debt and to the consequent crisis?

To be sure, internal factors played an important role. In some cases, policies encouraged excess expenditure; often, exchange rates were overvalued; and in yet other cases, financial liberalization was accompanied by lax regulation. All of these factors tended to encourage excessive foreign indebtedness.

The single most important factor explaining the severity and duration of the crisis, however, was the OECD's recession of 1981 onwards, one of whose main causes was the simultaneous application of anti-inflationary policies in most of the industrialized countries. Thus, the world recession led to a slowdown in demand for the Latin American countries' exports. The region's terms of trade declined very sharply (more than 16% during the period 1981-1985), while interest rates rose to an unprecedented level.

*Held at United Nations Headquarters, New York, on 13 January 1986. The meeting was attended by representatives of the financial authorities of the United States, Argentina, Brazil, Mexico, Peru, Uruguay and Venezuela; representatives of the private banking system; high officials of the United Nations, representatives of economic journals and private consultants.

In view of the resulting external disequilibrium, from 1982 onwards most countries of the region started applying very severe adjustment policies. Big devaluations were made in an effort to promote exports and reduce imports. Likewise, real wages and investment were cut back sharply to dampen demand and reduce imports. At the same time, unemployment grew substantially.

These efforts proved very costly, because of the unfavourable international conditions and the simultaneous pursuit of similar adjustment policies in many developing countries. Thus, adjustment was largely based on a sharp decline in imports rather than the expansion of exports. In only two years the volume of imports fell 40%, and it has remained at this low level throughout 1985. Obviously, such a dramatic cutback of imports had to be recessive, for it not only reduced luxury imports or postponable purchases of capital goods, but also affected imports of raw materials and intermediate inputs indispensable for production.

The burden of these costs was made all the heavier by the fact that at the same time the region was obliged to adjust its economy to deteriorations in its external accounts that were seen as permanent in some cases and temporary in others. Higher energy prices were taken to be a permanent feature of the world economy and, as such, called for an adjustment, but a special credit facility was created to make such an adjustment easier. In contrast, the OECD recession, the sharp decline in the prices of most basic commodities and the unprecedented high level of interest rates—which were, to most observers, transitory and unexpected developments—came together with the paralyzation of foreign lending.

As is well known, a country must adjust to permanent deteriorations in its external accounts but ought largely to finance transitory ones. Yet this latter option was foreclosed as of mid-1982, when banks sharply cut back their lending, despite the fact that the change in circumstances was then seen as transitory. Thus, this forced the region to adjust both to the permanent and to the supposedly transitory deterioration of its external position, accounting for the undue severity of the recession.

Because of this radical reversal of past trends between 1982 and 1995, instead of being a net importer of financial resources—as is normally the case for developing countries—the region has become a net exporter. Thus, the net transfer of resources abroad during the last four years amounted to the staggering figure of US\$ 106 billion.

The effectiveness of the efforts to adjust and to direct the allocation of resources towards tradeable goods has been impaired by external conditions. Violent fluctuations in the exchange rates of the main world currencies have introduced new uncertainties into international trade-related activities; protectionism is a growing menace looming over the developing countries' exports, and the hardships of the adjustment process itself create social, political and economic tensions which militate against the desired reallocation of resources and stimulate the flight of capital. Such a substantial reallocation of resources and such a far-reaching adjustment cannot work in a short space of time. A rational and efficient redistribution of resources, under the present circumstances, requires a relatively lengthy period.

As regards the future, in our view there will be a recovery in the economies of the region, but it will be only gradual and will take several years. The favourable spillover effect of the recovery of the developed countries on the economic situation of Latin America seems to be operating less effectively than in the past because of the smaller availability of financing and the effects of protectionism. For example, during 1985 the expansion of the developed economies did not prevent a further fall in the region's terms of trade, nor did it obviate a reduction in the value of its exports. As a result, economic growth rates slowed in most countries of the region and the balance-of-payments situation deteriorated.

Consequently, if the recovery of the Latin American economies is left to the play of spontaneous forces, it will probably not take place sufficiently rapidly to avoid a further increase in domestic social tensions, which are a source of serious concern to governments. It is difficult to compress consumption and investment for long without affecting social and political stability and the potential growth rate.

In these circumstances, I think this is an appropriate time to exchange ideas on possible ways of carrying out the adjustment in the context of economic growth of the debtor countries.

There would seem to be two schools of thought regarding the adjustment. One of them is based on the assumption that the present difficulties will only be of short duration, because the recovery of the world economy will solve them spontaneously. In this case, there might be a temptation to try to win time by taking measures designed merely to postpone the payment of debts or to capitalize a significant proportion of the interest at market interest rates.

The assumption underlying the other scenario is that the recovery will be slow and will take several years: that is to say, the adjustment will be a lengthy matter. In this case, delaying measures will not be sufficient and it will also be necessary to take other measures to lighten the crushing burden of debt.

Each of these two scenarios has different implications as regards conditionality. When the external disequilibrium is of a relatively transitory nature and affects only a few countries, the conditions normally imposed on the use of external resources are less harmful, for they were, in fact, designed to cope with precisely this type of situation. However, when, as in the second scenario, the external disequilibrium is protracted and adjustment policies need to be pursued in a large number of countries, the conditionality must be modified to take into account the problems of composition. Hence, in this latter situation—which we believe to be the case today—when many countries are affected, the conditionality ought to recognize explicitly some minimum growth targets; it should also recognize the implications of such targets for economic policy and for the external sector of the economy, so as to ensure that those minimum rates of growth are achieved. Otherwise, protracted adjustment in a recessionary environment might become socially intolerable and the efficiency of the traditional adjustment instruments would be impaired.

For this reason, under the present circumstances many Latin American countries, including those of the Cartagena Consensus, base their approach on the principle that the debt problem must be faced in a context of economic growth and not of recession. To examine the options that may be open for combining adjustment with growth, it will be necessary to give continued attention to internal policies. Internal discipline will continue to be essential in the countries of Latin America and in their economic policies. It will also be necessary to achieve macroeconomic equilibria while at the same time giving relative priority to the objectives of growth, employment and expansion of exports.

Domestic policies alone can hardly suffice to achieve these results, however. I therefore believe that we should also look at ways of securing favourable changes in the volume and terms of the present financial flows, in order to bring about a real alleviation of the debt service burden, as measured in terms of the consumption and investment sacrificed to pay these commitments.

The initiative recently announced by the United States Secretary of the Treasury has the merit of acknowledging the importance of growth and the need for action on the part of creditors to tackle the debt problem. However, the amounts announced by him are not sufficient to make the servicing of the debt consistent with economic growth, and his proposal hints at additional elements of conditionality.

It is necessary to achieve a reduction in the net transfers of resources to the exterior. At their last meeting, in Montevideo, the Cartagena Consensus countries adopted a plan of action in which they propose concrete measures for achieving this purpose.

The challenges currently faced by the Latin American countries are difficult and complex, but they are not insuperable. On previous occasions, the countries of the region have tackled adverse conditions in a positive manner, giving rise to processes of economic change and industrialization which enabled them to grow strongly for a long period. At this present moment, they have potentially favourable conditions for facing these challenges: a diversified economic and export structure, skilled labour, and a high level of entrepreneurial capacity.

If we face up to the present circumstances with a combination of realism and imagination, and this is accompanied by adequate international co-operation, we can gradually increase the elbow

room for applying our economic policies, reactivate our economies, and prepare them to compete in the conditions that will be prevailing in the world economy in the years to come.

With regard to this meeting, I think it would be useful to exchange views on the following central issues or topics:

1. Your views on the economic outlook, both worldwide and in the region.
2. The likelihood of additional flows of new funds to Latin America.
3. Actions which the developed countries' governments should take to stimulate flows of funds and contribute to adjustment with growth.
4. Actions which the governments of the less developed countries should take to stimulate flows of funds and help to adjust in a framework of growth.
5. Changes in regulations that could help banks to provide additional resources to debtor countries.
6. Actions that could be pursued in the area of trade to promote exports from debtor countries and avoid protectionism.
7. Measures that should be taken by multilateral institutions to enhance the flow of funds to debtor countries.

Of course this is not an exhaustive list: it would be very interesting to hear any other comments you might wish to make on the subject matter of this meeting.

Central America: Bases for a reactivation and development policy*

*ECLAC Mexico
Subregional
Headquarters*

Since the beginning of the present decade, and not withstanding a slight revival recorded in the majority of countries in 1984, Central America has been sunk in the deepest economic depression and shaken by the most serious political upheavals of the last half-century. The climate of instability and confusion which is prevailing seriously hampers the search for solutions to political as well as social and economic problems, yet the search for such solutions is the greatest challenge facing Central Americans today, and one which cannot be put off any longer.

This search should be begun by examining the outstanding features of the evolution which has taken place in the Central American economies and societies since the war and finding out why these features underwent so sharp a change towards the end of the 1970s. This analysis is presented in chapters I and II. Chapter III makes some observations on the short-term prospects for the region's economies, while finally chapter IV sets out a number of proposals designed to form the basis for a policy of regional reactivation and development.

With regard to the latter aspect, the resources available in the region are identified and the role which intra-regional co-operation could play in bringing a process of reactivation and development into being is specified, the interaction between the economic and social spheres and the political sphere is investigated, and finally some observations are made on the the role of the State.

*This article was prepared as part of the basic documentation for the Expert Meeting on Crisis and Development in Latin America and the Caribbean (Santiago, Chile, 29 April-3 May 1985), organized by the Secretariat of ECLAC.

I

Main features of the style of development in Central America since the war¹

The origin, scope and possible consequences of the crisis cannot be understood without analysing the main features of the evolution of the economies and societies of Central America since the war. The first aspect which strikes one is the dynamic growth achieved over a thirty-year period —naturally with differences from one country to another— within an atmosphere of financial and monetary stability. A second striking aspect is the decisive influence of external factors, which have been essential determinants not only of economic behaviour, but also of the mutual influence of many political factors. Here lie the historical roots of the repeated propensity of Central Americans to seek abroad the explanations and solutions for the problems affecting them. Furthermore, the fragmentation of Central America since the short-lived federation broke up has also contributed to the fact that each of the countries has resigned itself historically to having a scanty margin of action with regard to its own fate, due to the preponderance of factors beyond its control.

A third noteworthy feature is that, in the thirty years since the end of the Second World War, most of the considerable changes undergone by the economies of the region have been simply superimposed on the economic and social structure that already existed, without bringing about any essential changes in it: a process referred to in the present study as "superimposed development".

Finally, the fruits of the long period of economic expansion which took place after the war were distributed in a flagrantly inequitable

¹Sections I and II of this paper are updated versions of part of the text of ECLAC (1983a).

manner between the different strata of the population, within the framework of a concentrative (or at least exclusive) process, thus preventing any significant relief of the extreme poverty which persists in the region.

1. Economic growth

The first feature of the development of the Central American countries during the last three decades was undoubtedly its sustained dynamism. The gross domestic product of the subregion as a whole grew at the rate of 5.3% per year in real terms between 1950 and 1978, although of course there were differences of

degree between the various countries, with the highest rates corresponding to Nicaragua and Costa Rica and the lowest to Honduras. As a result, the per capita real income practically doubled during this period. Even between 1970 and 1978, when the subregion had to face particularly severe problems—the rise in hydrocarbon prices, imbalances in the international monetary and financial field, shortages of raw materials and of some foodstuffs in 1974-1975, various droughts and three large-scale natural disasters—the real average growth rate exceeded 5.6% per year.

Some other features of this growth may also be noted. First of all, during the 28 years in

Table 1

CENTRAL AMERICA: GROWTH RATE OF GROSS DOMESTIC PRODUCT^a

(Percentages)

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
Average annual rates					
1950-1960	6.4	4.8	3.7	2.8	5.4
1960-1970	5.9	5.5	5.2	5.0	6.5
1970-1978	6.3	5.4	6.0	4.7	3.9
1978-1983	-0.4	-4.6	0.8	1.7	-2.0
Annual rates					
1970	7.2	3.4	5.5	3.5	-0.2
1971	6.8	4.9	5.5	5.8	3.4
1972	8.2	5.4	7.5	4.4	2.8
1973	7.5	4.7	6.6	5.8	5.3
1974	5.4	6.7	6.1	-0.3	13.5
1975	2.2	5.8	2.4	-3.1	1.5
1976	5.5	3.1	7.6	6.5	5.8
1977	8.5	6.1	7.4	9.6	6.1
1978	6.2	6.8	4.9	9.3	-5.9
1979	5.3	-1.2	4.7	6.0	-24.5
1980	0.9	-8.1	3.8	3.3	8.3
1981	-2.3	-7.9	1.1	0.6	5.4
1982	-7.1	-5.2	-3.3	-0.2	-0.6
1983	2.3	-0.1	-2.0	-1.1	5.2
1984 ^b	5.0	1.5	0.2	2.8	-1.5

Source: ECLAC, on the basis of official data.

^a At constant 1970 prices.

^b Preliminary figures.

question negative growth rates were recorded on only a very few occasions, almost always associated with some natural disaster (twice in Honduras and once in Nicaragua and Costa Rica). Secondly, while there were frequent—almost annual—cyclical fluctuations, these took place against an overall background of notably stable growth. Cyclical drops were only brief, and only exceptionally did the product fall for two years running in any of the countries. Finally, the cyclical evolution of the gross domestic product of the five countries showed great similarity, reflecting both their common form of insertion in the international economy and the high degree of economic interdependence achieved through the integration agreements of the 1950s and 1960s (see table 1 and figure I).

The most dynamic sector was generally manufacturing, propelled by the expanded market and the industrial development policies created as part of the integration process. As a result, the degree of industrialization of the subregion rose from 12.3% in 1960 to 16.8% in 1978.

2. The decisive influence of the external sector

The sustained manner in which the Central American economies grew largely reflected the long boom in the international economy which followed the Second World War. During that period, the industrialized countries grew at a cumulative annual rate of 5.0%, while the volume of world trade expanded at the rate of 9.0%. Albeit in different degrees, all the countries of the region managed to take advantage of the situation: the value of their exports of goods and services to the countries outside the subregion increased by a factor of thirteen between 1950 and 1978, rising from US\$ 250 million to US\$ 3.2 billion, while the export sector diversified significantly, both as regards the composition of its products and their geographical destination.² The boom in the

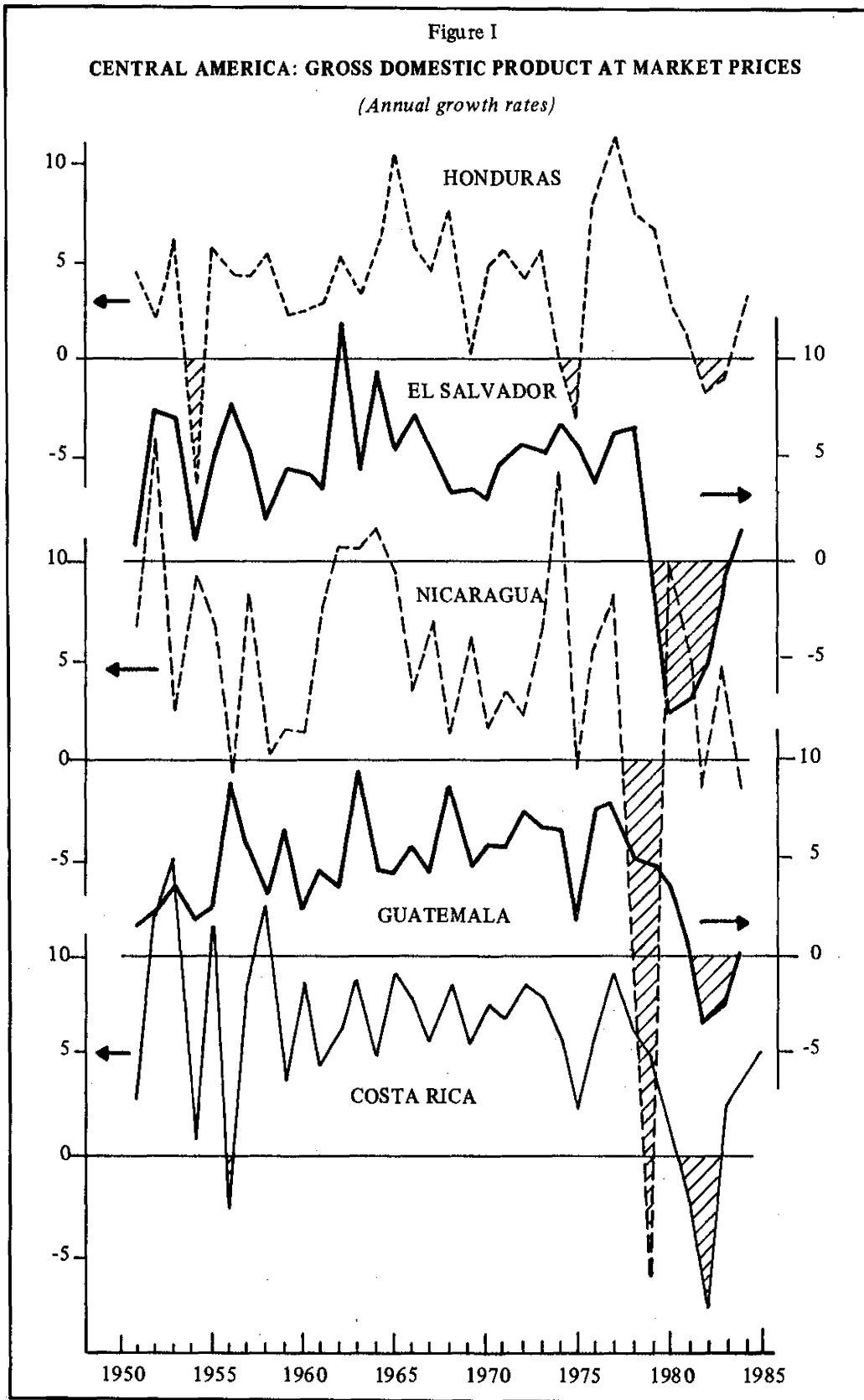
²For the region as a whole, the main export product of each country in 1950 contributed 70% of total foreign exchange income from exports of goods. This percentage declined by almost half by

traditional export sector also created sufficiently easy conditions to facilitate the bold decision to adopt mutual free trade in virtually all products originating from the subregion within a space of not more than five years. This was responsible for the intensive industrialization process which eventually became a second source of growth, although this never ceased to depend ultimately on the evolution of the traditional external sector. The comfortable economic situation referred to, together with the intensive process of modernization in the subregion, also helped to create consumption patterns in certain strata of the population which imitated those of more advanced societies and accentuated demand for imported goods.

During the 1960s and 1970s, the external sector of the Central American countries underwent significant changes. The relative importance of foreign trade tended to grow—the export and import coefficients for the subregion as a whole rose from 18.6% and 16.3% respectively in 1950 to 30.4% and 33.6% in 1978;³ the structure of exports and imports changed radically—the former included a growing proportion of non-traditional articles, while within the latter the proportion of intermediate and capital goods increased; intra-Central American trade grew rapidly until it accounted for a high and growing portion of the total exports of each of the countries, while at the same time also accounting for an increasingly high proportion of their total imports; and movements on the capital account became more and more important as the gap on current transactions tended to widen and new sources of international financing, both public and private, became available. As a result, the

mid-1970 (36.1%), thanks to the diversification of the export sector, although it rose again to 45% in 1978 as a result of the high prices of coffee which predominated that year, since the weight of this commodity in the total value of exports is high. Furthermore, in 1950 80% of Central America's external trade was with a single country (the United States of America), but this percentage declined to 35% in 1978.

³If reciprocal trade is excluded from these figures, the export coefficient for the region as a whole evolved from 18.5% in 1950 to 16.7% in 1960 and 23.5% in 1978; the coefficients of extra-regional imports in these same years were 16.2%, 19.8% and 27.3%, respectively.



servicing of the external debt began to absorb an increasingly large proportion of the foreign exchange generated by exports of goods and services.

Even so, throughout this period of growth, diversification and change in the external relations of the region, the essential features of those small agricultural export economies persisted: the evolution of the external sector largely explained the global economic behaviour of the economy, while the restrictions originating in that sector set the limits on the rate of domestic economic activity. A direct relationship is thus observed between the level of exports on the one hand and the rates of economic expansion, capital accumulation, investment, procurement of fiscal revenue, level of employment and import capacity on the other.

External financing acted as a shock absorber during periods of contraction, preventing drops in the value of exports from being reflected automatically in a restriction on the capacity to import (and hence on the growth capacity of the economy), and at the same time it facilitated the process of "superimposed development" referred to below. When weakening of external demand coincided with restrictions on the flow of external financing (which served at least partly to make up for the drop in exports), however, the restrictions originating in the external sector had the effect of slowing economic growth and even bringing about a contraction in economic activity in real terms.

The influence of external factors on events in the countries of the subregion was not limited to the economic sphere. Some of the consequences of Central America's dependence on exports profoundly affected the shaping of its societies and the political order prevailing in them. It is well known, for example, that the cultivation of one or two basic export products had a decisive influence in fixing the division of labour, because of the intensive and seasonal nature of labour requirements for such crops. The availability of labour has thus played a vital role in the economic development of the region as well as in defining the dual and interdependent nature of export and subsistence

agriculture, and these facts largely explain, in turn, the inequitable income distribution structures.

The organization of the Central American economies around one or two export products profoundly influenced also the "patterns of authority": the symbiotic relation between the dominant economic groups (agricultural exporters and traders) and governments, the legacy of corruption from colonial times, and the repressive methods used historically to ensure the availability of labour have helped to consolidate the authoritarian and non-participative systems characteristic of the period since the war, which have taken different forms from one country to another, or within a single country at different times (the main exception being Costa Rica).

Furthermore, factors of external origin have also decisively influenced the political interaction in the countries of the subregion. The virtual hegemony exerted by the United States since the signing of the Clayton-Bulwer treaty in 1850 has found a new expression in the period since the war because of the latent conflict existing between the two main superpowers of the world. This is not the place to go into detail about the role of United States foreign policy in Central America—a topic which has been the subject of many studies in recent years—but it is worth stressing the considerable influence which the United States has achieved in the region. It is not a question, of course, of claiming that the United States has an omnipotent role or of insinuating that Central American events depend largely on the designs of one or other of the superpowers, since the interaction between the national political actors has its own dynamics, but it may nevertheless be maintained that the United States has shown a capacity for fixing the limits of political interaction in the countries of the region by putting its weight on the side of the national actors whose position is closest to the objectives of its own foreign policy.

The preferences of United States policy have not always formed a coherent set of objectives: some administrations have been mainly concerned with security—above all the "containment of communism"—while others have been more interested in gradual orderly change towards more pluralistic and equitable

societies. In this respect, United States governments have sometimes supported national actors who advocate orderly and peaceful changes, within the framework of a foreign policy *vis-a-vis* the Latin American countries which some authors have called "idealistic". This happened, for example when the United States favoured the heterogeneous alliances which overthrew dictatorships in Guatemala, El Salvador and Honduras in the period following the war, or the governments which promoted changes under the "Alliance for Progress" in the 1960s, as well as the possibly somewhat reluctant support given to the similarly heterogeneous alliance which took power in Nicaragua in 1979. On other occasions, the United States Government has preferred to help national actors who, in its opinion, have the best qualifications for ensuring a minimum of stability in the face of radical challenges to the *status quo*. The best example of this more "realistic" policy might perhaps be the support given by the United States Administration to the forces which overthrew the elected government in Guatemala in 1954.⁴

At all events, when contradictions have arisen in United States foreign policy—as happens fairly often—between the objective of

promoting orderly change and that of avoiding threats to security, the United States Government has invariably preferred to support those actors in each country which it has considered most capable of defending its own interests. It is in this way that the various Administrations of that country have managed to fix the geopolitical limits referred to earlier.

3. *Superimposed development*

The economies and societies of the Central American countries are very different from what they were 30 years ago, not only in quantitative aspects—the gross domestic product rose from US\$ 1.95 billion to US\$ 7.52 billion (at 1970 prices) between 1950 and 1980, while over the same period the population rose from eight million to over twenty million inhabitants—but also because important qualitative changes have taken place. The societies are much more segmented and pluralistic, a noteworthy feature being the appearance of middle-income strata attributable partly to the progressive urbanization (only 16% of the population lived in urban areas in 1950, compared with 43% in 1980); the importance of secondary sector activities in the economies has increased (their relative participation rose from 14.6% to 24.1% between the two periods in question), and in general the system of production has been modernized and diversified year by year. The different geographical regions of the countries are now much better integrated, thanks to heavy investments made in the physical transport and communications infrastructure, and advances have also been made in the provision of education and especially health services. These changes are to be attributed essentially to the "spillover" caused by the style of development which has prevailed in all of the countries—albeit with specific characteristics from one to another—over the whole period under analysis. It may be considered that these changes have generally speaking been the only ones permitted by those who have had the possibility of keeping changes within certain limits, outstanding among these actors being those who obtain their economic power from the agricultural export pattern which is so vital for this type of historical

⁴It has to be acknowledged that the swing from "realism" to "idealism" in United States foreign policy is a simplified description. Nevertheless, it is based on deep analyses such as the description provided by Dexter Perkins (1962, pp. 136-155) of cycles of "quietism" and "activism". On other occasions it is based on what Stanley Hoffmann (1968, pp. 177 and 178) describes as "dualism" in the United States approach to foreign policy, one of whose expressions involves speaking two distinct languages, neither of which is completely convincing and which are hard to reconcile. The first of these is the language of power, the second that of shared interest and harmony. Hoffmann himself observes rather more graphically that only a symbolic eagle is capable of easily holding both arrows and an olive branch at the same time. Finally, the realism alternation between "realism" and "idealism" in foreign policy also finds support in the recent description made by Huntington (1981, pp. 3, 42, 64 and 68) of the United States political system, one of whose essential features is the distance between political ideals and political reality. Huntington acknowledges that this "distance" exists in all societies but asserts that the United States is special in the way it deals with the problem, namely, through four different responses which nonetheless form part of a "cyclic pattern" beginning with "moralism", which seeks to eliminate it; then falls into "cynicism", through which it tolerates it, moves on to "complacency", which seeks to ignore it, and ends with "hypocrisy", in which it denies the existence of such a problem and thus returns to the beginning once again with "moralism".

development in the region. Consequently, it may be seen that the considerable changes which have taken place in the three decades since the war are characterized essentially by the way in which the new economic and social strata have simply been juxtaposed with the existing ones, within a process of change and modernization which has not threatened in essence the existing economic structure.

The foregoing is simply another way of explaining a process of gradual peaceful change: as long as the pre-existing structures are not eliminated, then all the changes which take place in patterns of development must, by definition, be of an additive or superimposed nature, although this does not mean that they should necessarily be scorned for this reason.

What it is desired to stress here, however, is that when these changes have seriously threatened the existing structures and vested interests, they have almost invariably encountered their limit, above all when the interests of the dominant groups have been identical—as has frequently, but not always, occurred—with those of the main international actor in the Central American political arena in the terms already referred to in previous paragraphs. Thus, peaceful and orderly changes or reforms have had to comply with very tight limits in most of the countries of the region. To put this another way, economic progress has led to substantial social change, with many groups rising in the income scale and the formation of

middle classes, but the maintenance of this historical pattern of development has meant that there has been only a slow and halting advance by the political institutions.

This essential characteristic of "superimposed development" has frequently obliged governments to seek substitutes for changes which perhaps run the risk of exceeding these limits. Thus, for example, recourse was had to external financing partly in order to postpone or take the place of increases in the tax base; State land was distributed in programmes called "colonization" instead of reorganizing land tenure systems, and external saving was used as a substitute (instead of a complement) to the inadequate machinery for tapping national saving.

By the same token, the tax burden came to be an interesting indicator of the limits which "superimposed development" had to face in Central America. Although important changes took place within the taxation system in all the countries—as a reflection of the changes which were taking place within the system of production—it is curious that the amount of fiscal resources procured, as a percentage of the gross domestic product, remained constant in some countries or only grew very slowly in other (see table 2). Furthermore, this coefficient of taxation was extremely low compared with that of other countries of similar economic and social structure, and this circumstance should not be considered a mere accident: organized business

Table 2

CENTRAL AMERICA: TAX COEFFICIENT

	1955	1960	1965	1970	1975	1980	1981	1982	1983	1984 ^a
Central America	9.5	9.3	9.4	9.7	11.3	11.4	10.9	9.2	11.5	12.7
Costa Rica	10.1	10.0	11.8	12.1	12.7	11.4	11.8	12.9	15.7	17.0
El Salvador	10.8	10.9	9.9	10.3	12.0	11.1	11.3	10.7	11.1	11.7
Guatemala	8.5	7.8	7.6	7.8	9.5	8.6	7.5	7.2	6.3	5.3
Honduras	7.3	10.1	9.7	11.2	12.1	14.0	13.2	12.8	12.0	13.8
Nicaragua	10.8	9.4	10.2	9.4	10.6	18.4	18.5	20.7	25.0	31.5

Source: ECLAC, on the basis of official data.

^aPreliminary figures.

Table 3

**CENTRAL AMERICA: COEFFICIENT OF TOTAL CENTRAL
GOVERNMENT EXPENDITURE**

	1955	1960	1965	1970	1975	1980	1981	1982	1983	1984 ^a
Central America	10.6	11.2	11.3	11.6	15.8	19.3	20.2	20.4	23.3	22.7
Costa Rica	11.2	13.3	13.8	13.7	17.9	20.0	16.9	16.8	21.9	21.8
El Salvador	10.9	12.2	10.9	10.3	13.4	17.2	19.8	20.5	28.0	22.1
Guatemala	9.5	9.3	10.6	9.9	12.5	15.2	16.9	14.4	12.1	11.2
Honduras	10.0	12.2	10.8	14.7	21.0	24.9	24.1	28.1	26.2	29.7
Nicaragua	12.4	11.1	11.2	11.8	19.4	29.5	32.4	37.4	56.4	55.1

Source: ECLAC, on the basis of official data.

^aPreliminary figures.

circles in all the countries —albeit to different degrees— stubbornly resisted rises in levels of taxation, especially taxation on production and income. The financial restrictions due to the smaller procurement of fiscal revenue severely limited the capacity of the public sector to play a more active role in development, while the modest increases achieved in the coefficient of public expenditure (see table 3) were increasingly financed through greater indebtedness, especially of external origin.

The limited participation of the public sector in the gross domestic product, as measured through the procurement of tax revenue and central government expenditure, also fitted in with the "anti-dirigisme" position of the dominant groups in Central American societies. In the 1950s and 1960s, the public sector was gradually taking control of such public services as the generation and distribution of electricity, telephone communications, rail transport and the management of ports, while State activity was also strengthened with the establishment of public development banks and institutions for regulating the prices of commodities. In all countries, however, the public sector scrupulously avoided participating in activities of interest to private enterprise, the main exception to this rule being the Costa Rican financial intermediation system.

Another example of the persistence of prior structures in these processes of change was the

low level of backward or forward integration of traditional agricultural export activities, in the sense that the sectors depending on these have not tried to diversify systematically in order to invest in more complex activities. The new agricultural export activities (cotton, sugar and beef) were thus limited to repeating the pattern of traditional commodities, with their scanty linkages with other productive activities. In other words, the traditional producers diversified very little, and the State shared only slightly in the surplus generated by them. It will thus readily be understood how the traditional economic and social structures persisted and the changes mentioned were simply superimposed on them without succeeding in altering them in essence. In other words, the changes occurred only within relatively narrow limits (although these varied somewhat from country to country). Thus, despite the considerable expansion and change which took place in the Central American economies and societies in the 30 years following the war, that change was, paradoxically, not sufficient to meet the growing expectations of numerous sectors of the population. Furthermore, the instinctive desire to preserve vulnerable social systems led to the maintenance in most of the countries of the existing economic patterns—which were able to take advantage of the boom in the international economy— based on political institutions that were of an exclusive nature, at least as regards

the distribution of power and of the fruits of economic development. Consequently, the social mobilization and mobility which accompanied the postwar boom were not able to offset the backwardness of some political structures.

4. *The exclusive nature of development*

As a result of this, despite their economic dynamism the countries of the subregion were not capable, during the 30 years after the war, of significantly improving income distribution or of reducing the number of Central Americans living in a state of extreme poverty. According to household surveys carried out in recent years, towards 1980 for example the poorest 20% of the population shared less than 4% of the national income, while at the other extreme the richest 20% of the population shared more than 55%. There were considerable differences from one country to another, the most untypical features corresponding once again to Costa Rica (see table 4). In countries where surveys were carried out at different times, although the methodologies used were not always comparable the available evidence indicates that the gap between the groups at the two extremes of the scale widened, even though the relative share of the intermediate strata may have tended to

increase (see table 5). In the case of Guatemala and Costa Rica, the per capita real income of the poorest 20% of the population actually went down. In addition, as is pointed out below, there is evidence that further deterioration occurred in the distributive structure between 1980 and 1984, as a result of increasing levels of unemployment and declines in the value of real wages.

In absolute figures, out of a total of over 20 million Central Americans in 1980, some 13.2 million (64%) were living in a state of poverty—in the sense that their income did not cover their basic needs—while over 8.5 million (41%) did not even have sufficient income to cover the value of the minimum shopping basket of food considered necessary in order to meet their biological nutritional needs (see table 6). The situation was much more serious in rural areas than in urban ones, though there were considerable differences from one country to another (in Costa Rica, less than 25% of the population lived in poverty, whereas in Guatemala the proportion was over 70%). Moreover, although it is very likely that the percentage of Central Americans living a state of poverty nowadays is less than it was 30 years ago, it is nevertheless true that in absolute terms, because of population expansion, there are now more poor people (and also more people who

Table 4

CENTRAL AMERICA: STRUCTURE OF INCOME DISTRIBUTION AND LEVELS OF PER CAPITA INCOME, BY COUNTRIES, TOWARDS 1980

(1970 dollars)

Strata	Costa Rica		El Salvador		Guatemala		Honduras		Nicaragua	
	Per- cent- age	Aver- age income	Per- cent- age	Aver- age income	Per- cent- age	Aver- age income	Per- cent- age	Aver- age income	Per- cent- age	Aver- age income
Poorest 20%	4.0	176.7	2.0	46.5	5.3	111.0	4.3	80.7	3.0	61.9
30% below the mean	17.0	500.8	10.0	155.1	14.5	202.7	12.7	140.0	13.0	178.2
30% above the mean	30.0	883.0	22.0	341.2	26.1	364.3	23.7	254.6	26.0	350.2
Richest 20%	49.0	1 165.2	66.0	1 535.5	54.1	1 133.6	59.3	796.3	58.0	1 199.8

Source: ECLAC, on the basis of official data provided by countries.

Table 5

**CENTRAL AMERICA: EVOLUTION OF FAMILY INCOME DISTRIBUTION
DURING THE 1970s**

(1970 dollars)

Strata	Guatemala ^a			Costa Rica			Honduras		
	1970	1980	Growth rates (annual average)	1971	1977	Growth rates (annual average)	1968	1979	Growth rates (annual average)
Poorest 20%	1 088	996	-0.9	572	528	-1.4	85	287	6.4
30% below the mean	2 014	1 962	-0.3	1 167	1 495	3.7	206	564	5.8
30% above the mean	3 702	3 865	0.4	2 269	2 639	2.3	522	1 055	4.6
Richest 20%	9 098	12 393	3.1	5 756	6 465	1.8	2 476	3 958	3.4
Richest 10%	12 081	12 970	4.0	7 874	8 737	0.9	3 649	11 395	6.2
Average income	3 752	4 426	1.7	2 297	2 639	1.3	731	1 338	4.1

Source: ECLAC, on the basis of official data provided by countries.

^aUrban sector.

are not poor) than in the period immediately after the Second World War.

In short, the characteristic style of development of the region has been concentrative, or at any rate of an exclusive nature in the sense that it has favoured the different strata of the population in a flagrantly inequitable manner, accentuating the degree of income concentration in some countries. Likewise, although 30 years of rapid and sustained economic expansion have gone by, over half the inhabitants of Central America—and three-quarters of those living in rural areas—do not have sufficient income to cover their essential needs as regards food, housing, clothing and basic services.

It should be noted that the exclusive pattern of development is not limited to the economic and social sphere. If it were possible to speak of a truly typical characteristic of the type of political interaction prevailing in most of the Central American countries, then this characteristic would be the absence of broad popular participation, reflected in the virtual exclusion of the masses (and especially the rural masses)

from political activity. Neither the industrialization nor the urbanization which have taken place since the end of the war have been able to bring about a decisive change in the still essentially agricultural nature of these societies. With a few exceptions, the masses working in rural areas continue to be passive observers instead of organized actors in the evolution of the political systems. This exclusive feature has had a decisive influence both on the characteristics and the scope of various modernization projects attempted in the subregion.

Thus, with a few exceptions, the lack of effective participation on the part of the emerging social classes has meant that they have not been in a position to counterbalance the weight of the traditional élites in the handling of public affairs, and this has sometimes further increased the tensions between the rapid social development and the slow institutional development in the political sphere. To put this in another way, the gap between the transformation which has taken place and the reinforcing of the political practices and

Table 6
CENTRAL AMERICA: ESTIMATED INCIDENCE OF POVERTY TOWARDS 1980

	Whole of Central America			Costa Rica			El Salvador		
	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural
Thousands of persons									
Total	20 696	8 315	12 381	2 213	1 011	1 202	4 747	2 119	2 678
In a state of poverty	13 178	3 738	9 440	549	138	411	3 267	1 221	2 046
Extreme poverty	8 647	2 130	6 517	300	75	225	2 427	943	1 484
Basic needs not satisfied	4 531	1 608	2 923	249	63	186	840	278	562
Not in a state of poverty	7 518	4 577	2 941	1 664	873	791	1 530	898	632
Percentage breakdown									
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
In a state of poverty	63.7	45.0	76.2	24.8	13.6	34.2	68.1	57.6	76.4
Extreme poverty	41.8	25.6	52.6	13.6	7.4	18.7	50.6	44.5	55.4
Basic needs not satisfied	21.9	19.4	23.6	11.2	6.2	15.5	17.5	13.1	21.0
Not in a state of poverty	36.3	55.0	23.8	75.2	86.4	65.8	31.9	42.4	23.6
Thousands of persons									
Total	7 262	2 485	4 777	3 691	1 229	2 462	2 733	1 471	1 262
In a state of poverty	5 166	1 168	3 998	2 515	540	1 975	1 681	671	1 010
Extreme poverty	2 879	418	2 461	2 092	376	1 716	949	318	631
Basic needs not satisfied	2 287	750	1 537	423	164	259	732	353	379
Not in a state of poverty	2 096	1 317	779	1 176	689	487	1 052	800	252
Percentage breakdown									
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
In a state of poverty	71.1	47.0	83.7	68.2	43.9	80.2	61.5	45.6	80.0
Extreme poverty	39.6	18.8	51.5	56.7	30.6	69.7	34.7	21.6	50.0
Basic needs not satisfied	31.5	30.2	32.2	11.5	13.3	10.5	26.8	24.0	30.0
Not in a state of poverty	28.9	53.0	16.3	31.8	56.1	19.8	38.5	51.4	20.0

Source: ECLAC, on the basis of data from the countries and CELADE (1981).

^aUrban/rural population breakdown corresponds to figures from the 1979/1980 family income and expenditure survey.

^bUrban/rural population breakdown corresponds to figures from the 1978/1979 family income and expenditure survey.

institutions of a more complex society has contributed to the underlying instability of Central America.

To sum up, except in the case of Costa Rica the political interaction in Central America has generally been of an élitist nature and it has not been able to bring the most numerous population groups of the subregion into the project for the modernization of its societies.

Doing so would have meant perhaps the elimination, although possibly only gradually, of the factors of authoritarianism already referred to, and it would have been necessary to undertake the consistently postponed reforms aimed at fulfilling the legitimate aspirations of the groups which have so far been virtually excluded from the benefits of development.

II

Recent events and the current economic crisis

As already noted, Central America is experiencing a crisis of unprecedented depth and proportions. Economic activity has fallen off, considerable external imbalances exist as well as imbalances in the public sector, levels of saving and investment have slumped and there is increasingly less margin of action to overcome these imbalances and direct economic policy.

It may be assumed, in view of the increasingly high levels of open unemployment and underemployment, that the historical inequalities in Central American economies are becoming even more pronounced. The length of the depression and the limited capacity of some countries to contract external debt have made it necessary to adopt readjustment programmes—some of them within the framework of commitments with the International Monetary Fund—involving the adoption of unpopular economic policies.

Moreover, the aforementioned political upheavals affecting the region are closely linked with the economic phenomena described above, and perhaps all this means that there will be a breakdown in the "superimposed development" without there being any indication as yet of the likely characteristics of an alternative type of development. Moreover, the far from encouraging economic prospects already described hinder the social changes without

which the political stability of a number of countries in the region is in jeopardy.

The depth of the crisis has generated a seemingly insuperable climate of demoralization. Awareness of the fact that many problems surpass the capacity of action of the constituted governments has given rise to uncertainty and even confusion, and the very foundations of the process of Central American integration are being worn away.

1. *The break with historical trends*

In 1977-1978 the trends briefly described above reached a turning point, at least as regards sustained economic growth. Since that two-year period, a progressive slowdown has occurred which finally led to negative rates in most countries in 1981 and 1983 and in all of them in 1982 (see figure 1 and table 1). The duration, intensity and peculiar characteristics of this situation have no precedent in the period since the war. Suffice it to say that, after 30 years of expansion of the five countries' per capita income (with only sporadic interruptions), there has been a sharp and generalized fall during the last five years. Although the shrinkage recorded in the economies in the preceding years came to an end in 1984 (with the exception of

Nicaragua), in the case of most countries the outlook could in no way be described as one of reactivation. Thus, real per capita income at the end of 1984 in Costa Rica and Guatemala was barely equal to the 1972 figure; in Honduras it was equal to that for 1970, and in El Salvador and Nicaragua—where the situation was even more dramatic—it was similar to that of 1960 and 1965 respectively. It should be pointed out that the overall deterioration in the material standard of living is reflected not only by these figures but also by less tangible indicators, such as social harmony, personal security and the quality of life of the Central American population.

In addition, the process of economic integration, which had earlier allowed the downward fluctuations in the international economy to be offset, underwent a complete turnaround and became a factor which magnified the crisis. Due to the depth of the crisis—together with the prevailing political conditions and the lack of a strategy of subregional scope—the economic interdependence of the five countries has tended to become a mechanism which transmits recessionary economic forces.

The fact that the pronounced deterioration in the evolution of the economies has coincided with a period of increasing political upheaval may be functionally related to some of the characteristics of Central American societies which were mentioned previously. One of the many manifestations of those characteristics has led to a questioning of the social order, involving violent challenges to the *status quo*, and these, in turn, have given rise to violent responses which have contributed to a rapid polarization of positions in some countries, especially El Salvador and Nicaragua. There are many complex and mutually reinforcing interrelationships among the local political and economic factors and the way in which both intermix with external influences.

2. *The impact of exogenous phenomena*

It is no coincidence that the economic crisis has affected all of the countries, regardless of the level of social peace or upheaval prevailing in

them, the economic policy objectives pursued or the different relations between the public and private sectors. All have been seriously affected by factors of external origin. This has been inevitable, because the common denominator affecting all the countries has been the deep recession in the international economy, which, as already noted, to a great extent determines the overall behaviour of the Central American economies and even imposes a limit upon their ability to grow. Now, the economic effect of the political crisis—discouragement of private investment, flight of capital, difficulties in attracting external financing—has been added to the effect of the world recession, and these have combined and reinforced one another to the point where they have produced an economic breakdown unlike any seen in Central America since the 1930s.

With respect to the effects of the disarray in the international economy, it may be recalled that, in addition to the industrialized countries' difficulties in 1978-1979—low growth rates, high rates of inflation, decreased savings, lags in the application of technological innovations—there was also a further increase in hydrocarbon prices in 1979. Even more importance should perhaps be attached to the attempts to modify economic policy made by some industrialized countries which have stressed the fight against inflation—with some success—and have resorted, *inter alia*, to restrictive monetary measures that have resulted in high interest rates. These policies have undoubtedly contributed to the slowdown of economic activity in the countries where they have been implemented, as well as in the world economy in general, with the resulting impact on the levels of international trade. This situation has weakened the demand for the Central American countries' traditional exports. Given the persistent international inflation (although since 1982 it has begun to decline), this weakness of demand has produced a marked deterioration in the terms of trade. An additional factor is that, in the financial sphere, the Central American countries have been affected by the high interest rates on their massive foreign debt and by their recent difficulties in gaining access to new external financing.

Table 7

CENTRAL AMERICA: MAIN FOREIGN TRADE INDICATORS

	1976	1977	1978	1979	1980	1981	1982	1983	1984 ^a
	Growth rates								
Exports of goods									
Value	29.7	35.3	-2.4	15.8	4.9	-10.3	-12.2	-1.0	5.2
Volume	5.1	-0.9	2.6	13.0	-6.4	-2.7	-8.3	0.8	-1.4
Unit value	23.4	36.5	-4.9	2.5	12.1	-7.8	-4.3	-0.9	6.7
Imports of goods									
Value	20.1	27.0	8.9	6.3	15.0	-2.7	-19.3	-0.9	9.0
Volume	22.0	20.5	-1.6	-5.5	-3.3	-7.1	-23.7	-1.8	6.0
Unit value	-1.6	5.4	10.7	12.5	18.9	4.7	5.8	0.9	2.8
Terms of trade (goods)	25.4	29.5	-14.1	-8.9	-5.7	-11.9	-9.5	-1.8	3.8
	Indexes								
Terms of trade	100.4	130.0	111.7	101.8	96.0	84.6	76.6	75.2	78.1
Purchasing power of exports of goods	140.0	179.7	158.4	163.0	143.8	123.2	102.2	100.3	102.6
Purchasing power of exports of goods and services	147.9	181.3	163.5	169.4	151.1	126.9	108.2	106.6	108.5

Source: ECLAC, on the basis of official data.

^aPreliminary figures.

The figures in tables 7 and 8 speak for themselves. With the decline in the prices of virtually all the products exported by Central America and the continued upward pressure on the prices of imports (especially hydrocarbons in 1979-1980),³ by the end of 1984 the subregion's terms of trade had deteriorated by almost 50% since 1977, while the purchasing power of its exports had fallen by 30%. In general terms, the foregoing means that if the 1977 purchasing power of exports had been sustained, the total value of exports in 1984 would have been 40% greater than it actually was, which would have added approximately 2.0% to the gross domestic product in the latter year.

Between 1978 and 1983, the terms of trade in goods have gone down in all of the countries,

while the slight revival which occurred in 1984 (3.8%) proved insufficient to reverse the decline which had taken place over the previous six years. In addition, there was a decline in the export volumes of some countries (and even the complete disappearance of some export products, such as nickel in Guatemala, which ceased to be exported because of lack of demand), as well as increasing difficulties in incorporating new lines of products into external sales, due to the market restrictions and protectionist measures which some industrialized countries have put into effect, and a considerable decrease in the exportation of some services such as tourism, due not only to the world economic recession, but also to non-economic factors in Central America.

On the other hand, productive activity in the Central American countries required imports, in spite of the recession, especially in order to meet the demand created by the increased public spending which was promoted by the

³For the subregion as a whole, the relative share of petroleum in total imports rose from 4.4% in 1970 to 10.7% in 1976, 18.7% in 1980 and 21.6% in 1981 before falling to 16.1% in 1984.

Table 8

CENTRAL AMERICA: TERMS OF TRADE (GOODS)

	Growth rates								
	1976	1977	1978	1979	1980	1981	1982	1983	1984 ^a
Total	25.4	29.5	-14.1	-8.9	-5.7	-11.9	-9.5	-1.8	3.8
Costa Rica	19.7	30.6	-17.7	-1.6	-2.8	-14.8	-10.2	-4.5	-0.7
El Salvador	39.6	47.3	-26.2	-8.2	-15.4	-12.6	-0.8	-7.1	13.1
Guatemala	28.6	33.4	-5.1	-15.7	-2.7	-8.7	-13.0	-2.4	1.2
Honduras	8.2	15.4	-0.4	-9.1	-1.8	-13.0	-5.1	-1.0	1.1
Nicaragua	21.9	16.2	-13.8	-16.0	-3.4	-11.7	-10.4	-12.7	8.1

Source: ECLAC, on the basis of official data.

^aPreliminary figures.

Table 9

CENTRAL AMERICA: BALANCE OF PAYMENTS TRADE DEFICIT IN MILLIONS OF DOLLARS AND AS A PERCENTAGE OF GDP

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984 ^a
Millions of dollars										
Total	570	427	432	887	653	1 323	1 572	906	898	1 044
Costa Rica	166	146	164	269	425	460	127	-73	16	73
El Salvador	79	12	-29	234	-2	51	237	218	151	207
Guatemala	77	227	99	354	320	228	570	323	141	151
Honduras	101	60	74	89	99	185	177	56	120	139
Nicaragua	147	-18	124	-59	-160	399	461	382	470	474
As a percentage of GDP										
Total	6.0	3.5	2.8	5.4	3.5	6.4	6.8	5.1	4.8	5.3
Costa Rica	8.7	6.1	5.3	7.6	10.5	10.1	4.8	3.0	0.5	2.1
El Salvador	4.4	0.5	1.0	7.6	0.1	1.5	7.3	6.9	4.6	6.1
Guatemala	2.4	5.2	1.8	5.8	4.6	2.9	7.2	4.3	1.8	1.9
Honduras	9.7	4.7	4.8	4.9	4.6	7.4	7.0	2.2	4.5	5.5
Nicaragua	9.5	1.0	5.5	2.9	7.7	17.1	18.2	18.7	23.0	20.0

Source: ECLAC, on the basis of official data.

Note: Minus sign equals surplus.

^aPreliminary figures.

governments during the first year of the recession, partly in order to counteract the sluggishness of private investment. As a result, the trade deficit of the five countries went from US\$ 432 million in 1977 (equal to 2% of GDP) to nearly US\$ 1.6 billion in 1981 (8.7% of GDP), subsequently stabilizing at around US\$ 1 billion per year between 1982 and 1984 (5.4% of GDP in this latter year, albeit with considerable differences from one country to another) (see table 9). There was also a spectacular increase in debt servicing, attributable not only to increased borrowing but also —at least until mid-1984— to soaring interest rates. External factor payments for the subregion as a whole rose, for example, from US\$ 280 million in 1977 to US\$ 980 million in 1984. This explains why the current account deficit grew from US\$ 573 million to more than US\$ 1.8 billion during the same period (3.8% and 9.3% of GDP respectively) (see table 10).

During 1979-1980, Central America had considerable access to public and especially private international financing. The external support for Nicaragua's reconstruction programmes contributed significantly to this phenomenon, and these resources partially replaced internal savings, which tended to disappear rapidly due to public sector deficits and the flight of private capital. In 1977 only 12.6% of total savings came from external sources, but that figure had increased to 38.8% by 1981 and remained in excess of 35% in 1984 (see table 11). During the same period, the subregion's external public debt rose from US\$ 2.4 billion to slightly less than US\$ 15 billion, and limitations on several countries' capacity for additional borrowing became evident.

This last circumstance, combined with the constraints on the availability of new resources (the commercial banking system considers the

Table 10

**CENTRAL AMERICA: BALANCE OF PAYMENTS CURRENT ACCOUNT DEFICIT
IN MILLIONS OF DOLLARS AND AS A PERCENTAGE OF GDP**

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984 ^a
Millions of dollars										
Total	700	455	573	1 088	880	1 690	2 152	1 715	1 608	1 806
Costa Rica	218	203	226	364	554	654	408	305	358	371
El Salvador	95	11	-21	249	24	117	271	271	239	276
Guatemala	65	79	37	271	180	178	567	376	224	314
Honduras	125	115	139	170	212	331	321	249	260	311
Nicaragua	197	47	192	34	90	407	585	514	527	517
As a percentage of GDP										
Total	7.4	3.7	3.8	6.6	4.7	8.1	11.6	9.6	8.6	9.3
Costa Rica	11.4	8.4	7.4	10.3	13.7	14.3	15.6	12.6	11.9	10.9
El Salvador	5.3	0.5	0.7	8.1	0.7	3.4	8.1	8.6	7.3	8.1
Guatemala	2.1	1.8	0.7	4.5	2.6	2.3	7.2	5.0	2.9	4.0
Honduras	12.0	8.9	9.0	9.3	9.8	13.1	15.8	9.6	9.9	12.3
Nicaragua	12.7	2.5	8.6	1.7	4.3	17.4	27.1	25.1	25.8	21.8

Source: ECLAC, on the basis of official data.

Note: Minus sign equals surplus.

^aPreliminary figures.

Table 11
CENTRAL AMERICA: EVOLUTION OF INVESTMENT AND SAVING
(Millions of constant 1970 dollars)

	1977		1978		1979		1980		1981		1982		1983		1984 ^a	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
<i>Central America</i>																
Gross domestic product ^b	10 091	100.0	10 519	100.0	10 535	100.0	10 624	100.0	10 492	100.0	10 049	100.0	10 015	100.0	10 170	100.0
Gross domestic investment	2 218	22.0	2 231	21.2	1 893	18.0	1 969	18.5	1 808	17.2	1 405	14.0	1 439	14.4	1 529	15.0
Domestic saving	1 939	19.2	1 719	16.3	1 548	14.7	1 409	13.3	1 106	10.5	871	8.7	949	9.5	993	9.7
External saving	279	2.8	512	4.9	345	3.3	560	5.2	702	6.7	534	5.3	490	4.9	536	5.3
External saving/total saving		12.6		22.9		18.2		28.4		38.8		38.0		34.1		35.1
<i>Costa Rica</i>																
Gross domestic product ^b	1 975	100.0	2 099	100.0	2 202	100.0	2 220	100.0	2 170	100.0	2 012	100.0	2 059	100.0	2 159	100.0
Gross domestic investment	554	28.0	552	26.3	603	27.4	643	29.0	400	18.4	298	14.8	373	18.1	423	19.6
Domestic saving	443	22.4	399	16.0	386	17.5	421	19.0	270	12.4	204	10.1	266	12.9	315	14.6
External saving	111	5.6	153	7.3	217	9.9	222	10.0	130	6.0	94	4.7	107	5.2	108	5.0
External saving/total saving		20.0		27.7		36.0		34.5		32.5		31.5		28.7		25.5
<i>El Salvador</i>																
Gross domestic product ^b	2 176	100.0	2 316	100.0	2 276	100.0	2 079	100.0	1 906	100.0	1 800	100.0	1 786	100.0	1 813	100.0
Gross domestic investment	531	24.4	547	23.6	422	18.5	287	13.8	276	14.5	234	13.0	240	13.4	257	14.2
Domestic saving	542	24.9	409	17.7	428	18.8	287	13.8	185	9.7	148	8.2	165	9.2	165	9.1
External saving	-11	-0.5	138	5.9	-6	-0.3	-	-	91	4.8	86	4.8	75	4.2	92	5.1
External saving/total saving		-2.1		25.2		-1.4		-		33.0		36.5		31.2		35.8
<i>Guatemala</i>																
Gross domestic product ^b	3 571	100.0	3 750	100.0	3 926	100.0	4 074	100.0	4 101	100.0	3 957	100.0	3 850	100.0	3 858	100.0
Gross domestic investment	611	17.1	674	18.0	585	14.9	499	12.2	575	14.0	465	11.8	384	10.0	386	10.0
Domestic saving	592	16.6	544	14.5	498	12.7	440	10.8	385	9.4	347	8.8	316	8.2	294	7.6
External saving	19	0.5	130	3.5	87	2.2	59	1.4	190	4.6	118	3.0	68	1.8	92	2.4
External saving/total saving		3.1		5.2		14.9		11.8		33.0		25.4		17.7		23.8
<i>Honduras</i>																
Gross domestic product ^b	1 116	100.0	1 199	100.0	1 281	100.0	1 316	100.0	1 331	100.0	1 307	100.0	1 301	100.0	1 337	100.0
Gross domestic investment	203	18.2	323	26.9	342	26.7	383	29.1	315	23.7	208	15.9	224	17.2	261	19.5
Domestic saving	139	12.5	248	20.7	258	20.1	267	20.3	209	15.7	127	9.7	139	10.7	163	12.2
External saving	64	5.7	75	6.2	84	6.6	116	8.8	106	8.0	81	6.2	85	6.5	98	7.3
External saving/total saving		31.5		23.2		24.6		30.3		33.7		38.9		37.9		37.5
<i>Nicaragua</i>																
Gross domestic product ^b	1 253	100.0	1 155	100.0	850	100.0	935	100.0	984	100.0	973	100.0	1 018	100.0	1 003	100.0
Gross domestic investment	319	25.5	135	11.7	-59	-6.9	157	16.8	242	24.6	200	20.5	218	21.4	202	20.1
Domestic saving	223	17.8	119	10.3	-22	-2.6	-6	-0.6	57	5.8	45	4.6	63	6.2	56	5.6
External saving	96	7.7	16	1.4	-37	-4.3	163	17.4	185	18.8	155	15.9	155	15.2	146	14.5
External saving/total saving		30.1		11.9		-62.7		103.8		76.4		77.5		71.1		72.3

Source: ECLAC, on the basis of official data.

^a Preliminary figures.

^b At market prices.

subregion to be of high financial and political risk, while official sources have tended to diminish due to the austerity policies of the donor countries), has created serious difficulties since 1981 in obtaining net financing, and in 1982 external savings —far from offsetting the drop in national savings— showed the same downward trend.

It should be mentioned that the majority of the countries' balance of payments have recorded increases in net capital inflows since 1981, particularly in 1983 when these came to almost US\$ 2 billion. Approximately half such income did not represent injections of currency, however: it was the result of renegotiations of payments due on the existing external debt, particularly in Costa Rica and Nicaragua (ECLAC, 1985).

Moreover, those countries which obtained access to a greater flow of official funding, particularly of a bilateral nature (Costa Rica, El Salvador and, to a lesser extent, Honduras), have had to accept increasingly strict conditionality, basically with regard to economic policy, but on some occasions even affecting other aspects of national activity too. During 1984 the International Monetary Fund, which is supporting readjustment programmes in three countries, ceased its disbursements to two of them (Guatemala and Honduras) because they had failed to meet the quantitative goals set, while in the case of the third country (Costa Rica) no final agreement had yet been reached at the time of writing (March 1985) on the renewal of the programme which had come to an end in December 1984.

Finally, a further phenomenon of considerable importance which made itself sharply felt during this period was the intense and persistent flight of capital throughout the subregion (in some countries more than in others) due to economic and especially non-economic factors. The identifiable deposits of Central American citizens in United States banks alone (excluding their branches in the Bahamas, Panama and other banking havens), grew by more than US\$ 1.4 billion between mid-1979 and 1984. The breakdown by countries is given in table 12.

It should be noted that the fluctuation in the size of these deposits provides a rough indicator of the scale of capital flight in the five countries mentioned. On the one hand, part of the increase represents the reinvestment of interest earned by these same deposits. On the other, this figure naturally fails to include investments made by Central Americans during the last five-year period in real estate and securities in the United States, or any other type of investment made in other countries open to capital.

At a rough estimate, between 1979 and 1984 this flight represented between US\$ 2 billion and US\$ 2.5 billion for the five countries in the region. Naturally, this worsened each country's external position, and had a decisive influence in the slump in economic activity. Paradoxically, the exhaustion of the countries' international monetary reserves at the beginning of the recessionary period and the high level of external indebtedness recorded facilitated this capital flight.

Table 12

**CENTRAL AMERICA: DEPOSITS OF CENTRAL AMERICAN CITIZENS IN
THE UNITED STATES FINANCIAL SYSTEM**

(Millions of dollars)

	Total	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
June 1979	1 104	318	265	147	171	203
June 1984	2 525	850	536	471	140	528
Variation	1 421	532	271	324	-31	325

Source: Federal Reserve System (1979 and 1984) and Treasury Department (1980 and 1984).

Furthermore, exogenous factors not only had an impact on the evolution of the economies, but also influenced political events. Towards the end of the 1970s significant changes occurred in the political interaction of the subregion, especially in Nicaragua. Just as the long period of postwar economic expansion had reached a turning point, the social and political structures too had to undergo a major shift. These events gave rise to a heterogeneous alliance which challenged the ruling régime in Nicaragua. It was no accident, however, that the changes in Nicaragua —like those in Guatemala, El Salvador and Honduras in the 1940s— coincided with a United States foreign policy aimed at promoting orderly change based on principles prized by the latter country. Thus, during a brief interlude the geopolitical boundaries referred to earlier were extended, and the challenge launched in one of the countries against the traditional development model became viable.

3. *The challenge to the "superimposed development" model*

The programme adopted by the Government of National Reconstruction of Nicaragua departs from the traditional norms. In a different context, the events in El Salvador also deviate from the model of "superimposed development", since they have given rise to changes which, in one form or another, alter the pre-existing structures. It could even be said that, under the twofold onslaught of the economic crisis and the threat to the *status quo*, it is unlikely that the pre-existing structures in some countries will be able to survive without fundamental adjustments. This in no way predetermines the nature of the social organizations which might eventually replace the preceding ones, nor their ideological leanings; it only means that the postwar model which has been in effect for more than 30 years may have run its course.

Some of the economic phenomena which are the subject and object of the crisis clearly illustrate the above. One such phenomenon is capital accumulation. Investment has been shrinking markedly since 1978 both as a result and as a cause of the contraction in economic activity, the drop in domestic savings, the flight

of capital and the reaction of the private sector to the political and social tensions affecting the subregion. Table 11 shows that the domestic savings of the five countries fell from 19.2% to 9.7% of the gross domestic product between 1977 and 1984: a serious situation for countries which are attempting to develop. Private investment also suffered a marked setback, and it diminished in all of the countries. The subregional coefficient of private investment fell from 13.4% in 1977 to less than 8% in 1984, while in the countries experiencing civil unrest, the coefficient of private capital formation has fallen by more than 50% in the last seven years. The public sector made an effort to counteract this decrease (thereby accentuating another long-standing imbalance in the Central American economies: the public finance deficit) but it was not enough; the coefficient of total investment declined in all the countries and tended to create bottlenecks in areas where public spending cannot substitute for private investment.

The deliberate efforts made by governments to counteract the reduction in economic activity, at a time when there was a downward trend in tax revenues, caused the portion of the subregional GDP represented by public spending to increase from 17.7% in 1977 to 21.3% in 1981, while the taxation rate decreased from 12.9% to 11.6% during the same period. As a result of the asymmetry in the patterns of expenditure and income, the aggregate deficit of the five governments rose from 460 million Central American pesos in 1977 (3% of GDP) to approximately 1.6 billion in 1984 (8.0% of GDP) (see table 13). Since there was not enough external financing to cover the deficits, domestic financing was used, but this expedient indirectly exacerbated the disequilibrium in the balance of payments —through the imported component of expenditure— and in some cases absorbed most of the expansion in domestic credit, thereby taking away resources from the private national sectors. Thus, forces came into play which are tending to destroy, or already have destroyed, the traditional stability of prices and exchange rates in the countries of the subregion. This is another manifestation of the gradual functional impoverishment of the pre-existing structures.

Table 13

CENTRAL AMERICA: CENTRAL GOVERNMENT DEFICITS

	1976	1977	1978	1979	1980	1981	1982	1983	1984 ^a
Millions of Central American pesos									
Total	579	459	789	910	1 470	1 609	1 462	1 709	1 571
Costa Rica	150	136	211	324	418	113	78	157	113
El Salvador	27	-60	52	36	198	232	249	313	244
Guatemala	225	98	138	254	446	674	459	301	316
Honduras	84	102	150	140	243	248	382	343	374
Nicaragua	93	183	238	156	165	242	294	595	524
As a percentage of GDP									
Total	4.7	3.0	4.8	4.9	7.1	8.7	8.2	9.1	8.0
Costa Rica	6.2	4.4	6.0	8.0	9.2	4.3	3.2	5.2	3.3
El Salvador	1.1	-2.1	1.7	1.0	5.7	7.1	7.9	9.6	7.2
Guatemala	5.2	1.8	2.3	3.7	5.7	8.5	6.0	3.9	4.2
Honduras	6.5	6.6	8.2	6.5	9.5	9.9	14.8	13.0	14.8
Nicaragua	5.0	8.2	11.7	7.5	7.1	11.2	14.4	29.1	22.1

Source: ECLAC, on the basis of official data.

Note: Minus sign equals surplus.

^aPreliminary figures.

4. The consequences for intra-Central American co-operation

The constraints of the external sector —reflected in the shortage of foreign exchange— have worsened to such an extent that, as from 1981, the countries with deficits in intra-regional trade have even had difficulties in covering their debit balances. Initially, the central banks of the surplus countries extended bilateral lines of credit, and later a subregional mechanism was established to deal with the same problem multilaterally (the Central American Common Market Fund). However, when these avenues were exhausted⁶ —and

when sufficient backing from the international community was not forthcoming— the lack of foreign exchange began to limit intra-Central American trade.

The response of some countries to the constraints on their external sector was to adopt exchange measures (variations in parity, adoption of multiple rates or of controls on the movement of foreign exchange) which affected the terms of trade at the inter-Central American level and in some cases limited the volume of commercial transactions. As a result of all these phenomena, intra-regional trade ceased to play its traditional role as a factor capable of offsetting cyclical lows in extra-regional trade and became one more victim of the crisis in the external sector. Thus, the value of this trade has declined systematically —from 1.13 billion Central American pesos in 1980 to 742 million in 1984— and its relative share of the

⁶At the end of December 1984, the bilateral debts contracted by the countries in order to keep up their trade in previous years came to over US\$ 380 million, a debt so large that it exhausted the financing capacity both of the countries enjoying a surplus in this trade and of the multilateral mechanisms mentioned. See the periodic reports of the Central American Clearing House.

subregion's total exports shrank from 23.1% to 18.5% in the same period (see table 14).

One of this situation's innumerable effects on the productive apparatus was that the degree of industrialization—which, as already noted, had increased consistently between 1950 and 1978—stagnated, diminishing from 17.1% in 1978 to 16.2% in 1982 and 16% in 1984. In other words, after its expansion had been more dynamic than that of the economy as a whole during the boom, industrialization performed even less dynamically than the economy as a whole during the recession.

Despite the fact that the Central American governments have traditionally been, and

continue to be, successful in keeping the sphere of economic co-operation separate from the sphere of political relations, the growing ideological heterogeneity now poses a latent threat that political differences will overflow into the sphere of economic co-operation precisely at the time when intra-regional co-operation is most needed in order to mitigate the effects of the external sector problems. In addition, the danger of internationalization of intra-regional conflicts could lead to a greater fragmentation of Central America and a repetition of painful historical episodes.

Table 14

CENTRAL AMERICA: TOTAL VALUE OF INTRA-REGIONAL TRADE AND RELATIVE SHARE IN TOTAL EXPORTS

	1977	1978	1979	1980	1981	1982	1983	1984 ^a
Value of exports to the rest of Central America (millions of Central American pesos)								
Total	785 355	862 720	891 731	1 129 160	936 792	762 850	757 706	742 138
Costa Rica	173 802	178 679	175 354	270 328	238 023	164 592	187 089	175 459
El Salvador	211 653	233 569	266 601	295 796	206 484	174 229	168 101	176 515
Guatemala	222 465	254 971	299 602	403 728	355 501	320 067	308 155	289 851
Honduras	43 449	49 199	60 011	83 889	65 912	51 876	61 377	57 830
Nicaragua	133 986	146 302	90 163	75 419	70 872	52 086	32 984	42 983
Ratio of value of exports to the rest of Central America to value of total exports (percentages)								
Total	19.0	21.4	19.1	23.1	21.3	19.8	19.8	18.5
Costa Rica	21.0	20.7	18.6	27.0	23.7	18.9	21.5	18.3
El Salvador	21.7	29.1	23.5	27.5	25.9	24.7	23.0	23.3
Guatemala	19.1	23.3	24.5	26.6	27.4	26.7	28.2	25.5
Honduras	8.2	7.9	7.9	9.9	8.4	7.7	8.8	7.5
Nicaragua	21.1	22.6	14.6	16.7	14.0	12.8	7.7	11.0

Source: SIECA.

^aPreliminary figures.

III

Short-term prospects

As indicated in the previous chapter, the majority of Central American countries have been suffering for five or six years in succession from negative rates of growth and pronounced imbalances both in the external sector and in public finances. Almost all of them undertook adjustment programmes towards 1981, once their international monetary reserves had been exhausted. These policies have been applied with varying intensity and in different fashion from one country to another. Generally speaking, imports fell off sharply—in some cases as a result of exchange adjustments, in others simply as a reflection of quantitative restrictions and depressed demand—public expenditure fell off, and restrictive credit policies were applied together with tight wages policies. In a number of cases, tax procurement also increased and payments due on the external debt were restructured. Even Nicaragua adopted a set of measures after 1984—belatedly and without International Monetary Fund approval—which pursued the same aims.

Nevertheless, in 1984, two or more years since the adjustments were undertaken, the outlook remains unpromising. In four out of the five economies the per capita gross domestic product has recorded continual declines, and in all of them (albeit to differing extents) domestic and external financial imbalances continued to be recorded (in the case of two countries the IMF even interrupted disbursements of the stand-by credits which had been granted, as the countries had failed to comply with the programmes agreed upon).

At the beginning of 1985, then, what is the likelihood of the subregion's economies adjusting to the new international circumstances and succeeding in constructing a new platform for reactivating production?

1. *External and domestic constraints*

As 1985 began, the future of the Central American economies was fraught with

uncertainty. The brisk revival which had taken place in the United States economy during the previous two years had not as yet been transmitted with similar intensity to the remaining industrialized countries, and even less so to the developing countries, especially the small agricultural export economies such as those of Central America. Doubt was also harboured as to whether the revival would prove lasting.

These phenomena could not fail to have a powerful influence on the evolution and features of the Central American countries' external trade. During 1983 and 1984, despite the recovery in the United States, no significant improvement occurred in the region's terms of trade. This is an exception to historical experience, as generally the prices of commodities have risen during the upward phase of international economic cycles.

These phenomena may be linked to the transformations which have taken place in the international economy. New technologies—particularly the application of microelectronics and biogenetics, together with the introduction of new materials (fibre optics and high-temperature ceramics and plastics)—alter comparative advantages throughout the world, transform trade flows and probably have an adverse impact upon small agricultural export economies, such as those of Central America. One illustration of this is the reversal which has occurred in the redeployment of the textiles industry from the developed countries towards the Third World, which may be attributed to technological innovations in the automation of manufacturing processes. This phenomenon is in addition to the well known income-inelasticity of the demand on international markets for the commodities exported by Central America. In addition, the overvaluation of the dollar, in which the prices of the commodities exported by Central America are quoted, further aggravated this trend.

The uncertainty affecting the subregion's external trade is also reflected in the financial sphere. It would seem likely that in the foreseeable future the capital accounts of Central America's balances of payment will display quite different features from those recorded in previous decades. Firstly, there is little likelihood of net external funds of similar size to those of the 1970s being mustered. On the one hand, international private banks appear to be extremely reluctant to commit fresh funds in a subregion in which high risks are considered to prevail; on the other hand, commitments originating from external debt servicing are so high that the possibility of the region becoming a net exporter of capital cannot be discounted.⁷

Secondly, even if the countries of the subregion obtain access to increased external public financing, the funds would probably be subject to even stricter conditions, with a consequent impact both on economic policy and other policy areas outside the economic sphere. This circumstance represents a far clearer trade-off in the application of economic policy than has hitherto been the case: the cost of formulating a reactivation policy without having access to sufficient external funds, as against the possible costs—naturally of another kind—of obtaining such funds, but on such terms that the vulnerability of the economies would be maintained and perhaps even increased.

Finally, the majority of countries are facing an equally unprecedented problem regarding the restructuring of commitments deriving from the external debt. The conditions on which agreement is reached with regard to servicing the debt will be one of the factors determining the capacity of the Central American economies to import and consequently to grow. Here again, it is hard to make any predictions in this respect.

Uncertainty over factors of domestic origin comes on top of the unsettled trends in the international economy. Perhaps the most

significant of these factors are the social and political conflicts taking place in the subregion. It would be utopian to consider reactivating the economies on the basis of a revival of domestic savings and investment—which are in themselves inadequate—without having succeeded in correcting the prevailing climate of political instability. This in turn requires changes in the patterns of political interaction in most Central America countries.

Consequently, as long as ideological polarization persists and spills over into violent conflict, and as long as no success is achieved in integrating and improving the participation of the various sectors of the population in political activity, there is little likelihood of a return to the social harmony which, today more than ever, is a pre-requisite for achieving targets of material well-being. Unless this is achieved, the flight of private capital will continue together with the erosion of the capital stock, thereby threatening the continuity of domestic mechanisms for generating savings and investments.

In such circumstances, neither is it feasible to envisage a simple process allowing for concerted support for the policy of economic reactivation. The present climate of ideological and conceptual polarization, together with the widespread tendency to resort to violence in order to settle conflicts in a number of countries, and the increased intensity of struggles for a share in the declining profits furnished by the economies, make it singularly difficult to achieve even minimum consensuses on any development project. Moreover, the tensions described above have led to a considerable diversion of resources towards expenditure on defence and security at a time when the subregion's governments should utilize a maximum of their meagre resources in protecting their populations' standards of living. In this respect, domestic friction as well as dissension between countries hamper economic revival and prevent any improvement in the climate for intra-regional co-operation.

To sum up, it is difficult to make any forecast as to the likely evolution of the Central American economies. On the one hand, the exhaustion of their international monetary reserves, the burden of the external debt, the shrinkage in imports and the depressed levels of

⁷This phenomenon is aggravated by the fact that as a result of the application of various mechanisms which vary from one country to the next (stabilization bonds, guarantee funds, underwriting of loans) the public sector has virtually taken over the risk for the external private debt, and consequently, in one way or another, governments have assumed responsibility for servicing the total external debt.

all macroeconomic variables (consumption, savings, investment, employment) considerably narrow the margin of action available to economic policy; on the other hand, the restrictions of external and subregional origin affecting Central American development are subject to a whole range of factors which further heighten the uncertainty looming over all the countries. Thus, the domestic and external economic and non-economic circumstances which determined the evolution of Central American economies and societies during the 30 years after the Second World War have undergone a change, and this will undoubtedly call for different responses from those adopted in the past if the subregion is to overcome the obstacles which nowadays virtually cancel out any possibility of expansion and transformation of its economies.

2. The growing conceptual polarization

One of the many consequences of the international economic crisis has been the collapse of historical paradigms. Thus, just as doubt is being cast on the Keynesian theses which dominated governmental action in the industrialized countries for more than 30 years, the outmoded methods used to stimulate the development of the Third World economies are also being questioned. A major debate is underway over the supposed decadence of the "discipline" of development. It is asserted by some that developmentalist patterns—which would appear to include the "idées-force" repeatedly set out by the Secretariat of ECLAC—have proved ineffective, and consequently a variety of credos of either neoclassical or Marxist bent are being put forward (Hirschman, 1981, pp. 5 to 19). With regard to Central America, the debate follows lines parallel to the already mentioned ideological polarization.

Moreover, in a number of industrialized economies, and particularly in the United States of America, there has occurred what some see as a reaction to the excesses committed since the 1930s with regard to welfare policy, the expansion of public services, the rise in tax coefficients and increasing regulation of a variety of private activities (Gilder, 1981 and Murray, 1984). This growing conservatism in

the sphere of economic policy advocates the reduction of the State's role (which, among other things, leads to a lower tax burden and a shrinkage of public services); increased reliance upon the market in resource allocation; the encouragement of saving and private investment, together with the elimination or at least the reduction of controls and regulations. In the cultural and civic spheres policies which make an appeal to traditional values are being advocated (Kristoal, 1978 and Podhoretz, 1980). Naturally, this set of ideas has found supporters and imitators in other parts of the world, including of course the countries of Central America.

These two phenomena—the collapse of established paradigms as a result of the economic crisis and the gradual rise of the attitudes towards social and economic organization prevailing within some advanced societies—point to a clear conceptual polarization over the way in which the process of economic development should be handled. Not only does this produce new cleavages between the various social groups, but it has also led to a number of international financial bodies—both multilateral and bilateral—taking part in the debate and recently propagating in Central America variations of the fashionable theory as to how to adjust and reactivate the economies.

The conjunction of these phenomena has given rise to two opposing strategies for bringing about reactivation. The first of these proposes "opening up" the Central American economies to international trade and financial flows and adopting a set of macroeconomic policies designed to give the productive apparatus an export-oriented bias, in order that the market forces may direct it towards increased insertion into the international economy, on the basis of the comparative advantages possessed by the region. This "opening up" would ideally go hand in hand with the encouragement of private investment as well as, on occasion, a reduction in the role of the public sector, especially with a view to eliminating obstacles to the market signals. The advocates of this approach claim that the recovery of the industrialized economies would spread vigorously to the Central American economies

through the many linkages which would be established.

Advocates of the opposing view are to be found among those who, after having observed the magnitude of the adverse factors in the Central American external sector during recent years, propose that the subregion's economies should be further isolated from the vicissitudes of the international economy, and that the State should play a greater role to counterbalance the performance of the private sector and offset the recessionary impact of the depression.

To sum up, what is taking place is the age-old debate, but under new circumstances, with perhaps more extreme and doctrinaire approaches than in the past. These circumstances further worsen the climate of uncertainty so often mentioned.

3. Alternative prospects

Forecasts as to the likely evolution of the Central American economies depend at least partly upon the stance adopted by the author. In the view of some authors, the logical outcome of advocating the unrestricted operation of market mechanisms in resource allocation, of reducing the various ways in which the State plays a guiding role, of encouraging both national and international private investment and eliminating any barriers to such investments, would be for the Central American economies to be pulled along by the renewed expansion of the international economy—mainly under the pull of the developed economies and in particular that of the United States of America—towards a new era of prosperity, founded this time on advanced technology and a number of tertiary activities. In other words, the same reasoning that would bring about the reactivation of the central economies would cause its dynamizing impact to spill over into the peripheral economies, through a new worldwide scheme of comparative advantages (Nau, 1984-1985). Of course, it is acknowledged that there are obstacles which might mean that not all countries could reap maximum benefits from this momentum (for example, the high level of external indebtedness of some countries), but it is claimed that it is possible to lower and overcome these hurdles by means of timely

negotiations and the application of suitable policies.

A different forecast would involve recognizing the possibility that the recent expansion in the economies of the Organization for Economic Co-operation and Development (OECD) might fail to maintain itself,⁸ or that its dynamic impact might not necessarily be felt in the peripheral economies. At least as far as Central America is concerned, there are factors of domestic origin which decidedly upset the free operation of the market mechanisms. The dynamizing effects traditionally associated with economic integration have gradually dwindled away in recent years as a result of the very depth of the crisis. It follows that in view of the uncertain outlook for the region, it would be realistic to assume that the period necessary for the Central American economies and societies to adjust to the new circumstances—in the external and regional environment as well as within each country—might be quite long. Indeed, if it turned out that the international economic crisis was merely a depressive cycle—albeit the deepest since the war—the positive impact, as already noted in Central America in 1984, would be extremely limited during the next two years, in view of the heavy burden of external indebtedness, the exhaustion of international monetary reserves and the major upsets which the recession has caused to the subregion's productive capacity and social structure.

The vital need to undertake structural transformations in order to adapt to a changing international economy will necessarily take a long time. In recent years the Central American countries have realized that the development of new export activities cannot be achieved either by decree or instantaneously: it requires changes of attitude on the part of entrepreneurs and workers, trial periods which may occasionally be long, changes in methods of production and marketing, and lengthy periods before new investment bears its fruit. Even if an economic strategy with a smaller element of self-

⁸Nau (1984-1985) indicates that, if the United States fiscal deficit is not brought down, that country's economy will shortly enter a new recessionary cycle, caused by high interest rates and the shrinkage of private investment.

determination were chosen, it would also require a long period before making itself felt. The need to simultaneously address the whole set of problems facing the region—moving forward in the painful but unavoidable task of adjustment, restoring acceptable levels of saving and investment, reactivating production and providing even a minimal response to popular demands which have long been put off—merely serves to complicate the outlook and confirms that the task will be a long one.

It is for this reason that a realistic outlook would involve assuming that, in view of the magnitude of the problems, the subregion's

economies are likely to stagnate for a fairly long period of time, in differing degrees and with ups and downs from one year to the next, but nonetheless within an overall framework of quasi-stagnation. This in no way means that countries are condemned to wallow in a permanent slump, but it does mean that it will be vital to carry out a vigorous policy of reactivation and development allowing the Central American subregion to reorganize its considerable natural and human resources in order to lay the foundations for sustained development.

IV

Bases for a policy of reactivation and development

It would be just as absurd to assert that there is no way out of the crisis—there is a way out of any problem facing human activity—as to imagine that there are ready-made or copybook solutions at hand for reactivating the economies of Central America and setting them on the path towards generalized prosperity. Between that vision which predicts a permanent depression and the other which is utopian, there is a whole range of intermediate situations which could gradually pave the way for a policy of development. The following pages provide an examination of some critical areas for laying down those foundations, in the hope of stimulating debate on the response to the many sided and complex challenge facing Central Americans.

1. Observations on the aims of the reactivation and development policy

It is the Secretariat's view that one of the first issues with the Central American governments ought to tackle is the set of aims to be pursued in a reactivation and development policy. As is well known, the conventional aims of development

involve growth, improvement of income distribution, reduction of the economies' vulnerability to external factors, and promotion of changes not only in the economic, but also in the social and political spheres. It is thus sought to establish societies which are more pluralistic, participative and democratic.

It is vital to establish an order of priority among these aims, not only because it is doubtful whether they can be pursued simultaneously—even during periods of prosperity, and even more so during times of austerity—but also because espousal of one of these objectives in preference to the others will determine the nature of the set of economic policies to be adopted. For example, if a particular government resolves to give priority to social justice, it could decide to favour particular instruments of economic policy (agrarian reform, greater expenditure on social services, periodic wage adjustments) which could have the counterpart effect of discouraging private investment and thwarting the achievement of growth. In other words, regardless of the neoclassists' conclusion that the aims of distribution and growth are compatible (by

means of the proverbial "overspill" of the fruits of growth), the experience of Central America, and indeed of Latin America as a whole, during the three postwar decades indicates that considerable trade-offs are involved between the various aims of development. There is very little empirical proof to support the idea that good things come in packets (Packenham, 1973, p. 123) or that it is possible to simultaneously grow, improve income distribution, acquire autonomy and advance towards more democratic societies (see Wolfe, 1984).

Naturally, this does not mean that the oft-mentioned aims are in no way laudable and worth pursuing. Nor is it necessary to pursue only one or a few of them at the expense of the others. However, it is necessary to clarify the relative importance of each of them—and their mutual relationship—in the light of the programme of reactivation or development which the circumstances require. Thus, under present circumstances in Central America, some governments might single out the target of social justice, even if this involved sacrificing growth targets; others might seek to maximize growth, possibly in an attempt to recover part of the ground lost in recent years and to meet the need to create jobs for a rapidly-growing economically active population. Still others might prefer to promote social harmony, together with pluralistic and democratic institutions.

All these objectives are worthy in themselves. Nevertheless, the diagnosis made in the first two sections of this article would seem to suggest—at least as a basis for discussion in governmental forums in each country as well as in intergovernmental ones at the subregional level—that under present circumstances, what the Central American countries require above all, both in the economic and social spheres, is a broadening of the extremely narrow leeway which is available at the present time for them to formulate economic policy and forge their own destiny: that is to say, reduction of their external vulnerability.⁹

⁹The following ideas are deeply influenced by the posthumously published work of Professor Dudley Seers (1983). The author makes frequent use of the terms margin of action almost as a synonym for acquiring autonomy or lowering external vulnerability.

In the economic field, the practical pursuit of this aim would, for example, involve the following: seeking relative self-sufficiency with regard to food supply, without neglecting considerations of efficiency; development by the subregion of its own technologies for those activities of greatest importance to the Central American economies; diversifying and expanding exports; encouraging patterns of consumption less dependent on the use of imported goods; adoption of less capital- and energy-intensive production patterns; and intensive use of labour, the region's most plentiful resource. There is not necessarily anything novel about these ideas, but they bear a new sense of urgency. Outside the purely economic field, this aim would be expressed by asserting the historical and cultural identity of Central Americans and consolidating the concept of the nation-State.¹⁰

These concepts need to be carefully defined. First and foremost, acquiring greater autonomy or reducing external vulnerability should by no means be equated with autarky. The small scale of the Central American economies, even taken as a whole, and their vocation as exporters leave no doubt that their behaviour will remain closely linked to the performance of the external sector. It will be necessary, however, to seek a new, dynamic, diversified and selective insertion within the international economy, and not merely an indiscriminate "opening-up" which instead of reducing vulnerability would probably tend to increase it. In other words, the aim of diversifying and expanding the export sector is not to further increase dependence on the vicissitudes of the international economy, but rather to obtain greater leeway for the external relations of the Central American countries.

Secondly, greater autonomy should not be pursued at the expense of the conventional aims of development, but rather an effort should be made to achieve those other aims through the central objective, while attempting to ensure

¹⁰Seers (1983, p. 9) states that this involves promoting the supposed interests of a group possessing cultural coherence, which displays at least a certain degree of ethnic and linguistic homogeneity, and which generally lives within a political unit, or nation-State (it may occasionally apply to a group of nation-States).

that they provide mutual support for one another. If, in pursuing the central objective of increasing the leeway available for economic policy, an effort is also made to pursue growth, improve distribution and encourage greater participation in the societies, it is perfectly possible that not all these aims will be optimized—it has already been observed that even in the best possible circumstances this would be impossible—but neither will they be left aside. Thus, attempting to achieve a relatively self-sufficient food supply would not only help to reduce external vulnerability, but would also contribute to growth and even to redistribution, since food production is largely in the hands of small and medium-sized farmers. Likewise, stressing the interdependence of the Central American economies is not merely a means of fulfilling the oft-mentioned central objective; it could also appeal to cultural and historical values which would facilitate the subsequent establishment of the foundations of more participative and pluralistic societies.

Moreover, seeking greater leeway at the national level is functionally linked to the socio-political aims of improving income distribution and progressing towards societies with greater participation and pluralism. Thus, since governments are not only unable to use public expenditure as a means of exerting pressure on the agents of production, but also face social demands which have intensified as a result of the global decline in income, they will have to seek the consensus needed to obtain increased economic autonomy by trying to gain the agreement of a variety of social groups and incorporating them into the decision-making process. Similarly, they will need to set up mechanisms for improving social justice, both with regard to sharing out the burden of the economic recession and distributing the benefits of reactivation. The ability to use consensus as a course of action varies from one political régime to the next, and depends on the institutional traditions and structure of each country, but in every case there is a real chance that the central aim of broadening the margin of action available for national policy and the secondary aims of seeking greater social justice, consensus and participation in the decision-making process will provide mutual support for each other.

There is a social and cultural aspect to the heightening of Central American identity, which overlaps into the economic and political sphere. It is indeed tempting to propose that Central American development should be not merely a mirror image of an international pattern which is probably alien to the region's traditional values (and to the resources at its disposal), but rather the reflection of its own considerable historical and cultural heritage. This could have an influence upon the patterns of production and consumption, once again as a more autonomous attempt to tackle the problems of development.

Finally, favouring the acquisition of autonomy in preference to other aims possesses the additional advantage, in the case of Central America, of being a target with which all the governments of the region, without exception, can wholeheartedly identify. In view of the increasing diversity of approaches being adopted in Central America on the one hand, and the clear need for a minimum platform of common objectives to facilitate the formulation of joint action as part of the effort to achieve intra-regional co-operation, on the other, it is perfectly logical to pursue the common and ideologically neutral aim of expanding the margin of action.

To sum up, this objective is capable of mobilizing all the Central American governments around an "idée-force", around which other subsidiary elements of equal importance for the revival of the economies, such as economic dynamism, social justice, participation and democratization, could revolve.

2. Features of the desired productive structure

The first requisite of a policy for reactivation and development is a precise definition of sectoral and sub-sectoral priorities. In this respect, the countries of the region could adopt a pragmatic approach designed to make maximum use of the possibilities which the international market continues to offer, while simultaneously giving a determined impetus to efficient import substitution.

Central America possesses a range of resources on which to base economic

reactivation and long-term development. Although the size of the resources has occasionally been exaggerated, there is no doubt that they are capable of satisfying the basic needs of the whole of the population of Central America and even providing a fairly comfortable standard of living for most of them. However, in order to make maximum use of them, major investments are required, together with a big effort of mobilization and organization.

Thus, preparation of the labour force to adjust it to the changing circumstances of the international economy involves a major effort of training at all levels. This would involve the educational system both in and out of school. Moreover, there is no reason why Central America should resign itself to exporting five or six commodities; in view of its resource endowment and its geographical location, notwithstanding the uncertain outlook on the international market, there are opportunities for expanding and diversifying sales of a range of agricultural products (including fruit, vegetables, meat, fibres, marine products and chemical inputs of vegetable origin, all capable of undergoing gradually increasing degrees of processing). In addition, exploitation of forestry resources represents considerable potential in a number of countries. In this respect, the specialized evolution of the manufacturing sector in the northern European countries during the present century could provide a number of worthwhile lessons, as could the progress achieved by a number of Asian economies in the export of manufactures involving a high labour input.

It is within these branches of activity, that the stimuli for future growth, which could be classified into four major categories, are to be found. First of all, it is necessary to consolidate the know-how which the region already possesses: with regard to exports, we must strengthen production of traditional crops; with regard to domestic consumption, that of basic foodstuffs. This will require an increase in productivity and efficiency, the achievement of a better agricultural and ecological balance between the various crops and production areas and, in the case of a number of products, an increase in supply if national economic autonomy is to be increased.

Nevertheless, it would be difficult for the subregion to achieve a process of sustained expansion upon the basis of past practice. Traditional export products are subject to well-known restrictions in world demand originating in the features of the markets for most of them (the one exception might be meat); on the supply side, the easily expandable agricultural frontier has been near its limits since the end of the 1960s. This does not mean that a ceiling has been reached in the production levels of coffee, cotton, sugar cane and bananas, but it does mean that any further expansion of this frontier will involve increasing marginal costs in the future.

Secondly, it would be desirable to encourage greater selective integration (both backwards and forwards) of traditional products, so as to increase Central America's share of their added value. In spite of the protectionist measures adopted in the developed economies, which, for example, restrict the access of plain textiles and clothing manufactured in Central America to their markets, there is still room for increasing the degree of processing of a number of commodities produced in the region with a reasonable degree of efficiency. At the same time, Central American entrepreneurs will need to take a more active role in marketing their products, even to the point of establishing firms in those developed countries whose markets they wish to penetrate. There is potential in this sphere for associating private Central American capital with capital in the industrialized economies in an effort to broaden markets and develop more complex productive processes.

Thirdly, it is possible to selectively encourage new export lines, particularly on the basis of exploitation of the region's natural resources. Products which show promise and which, in addition, are capable of being integrated into secondary activities include vegetables, citrus fruits, tropical fruit, hard fibres, pharmaceutical products, forestry and wood products, and seafood, including shrimp farming. In addition, subcontracting is a potential source of productive work as well as of foreign exchange.

Fourthly, the potential for expanding and diversifying the manufacturing sector is far from exhausted. On the contrary, as a result of the abnormal way in which the Central American

Common Market has been operating in recent years, there is a backlog of projects whose viability depends on an improved climate for intra-regional co-operation, not only in order to supply demand on the subregional market, but also to penetrate outside markets, including of course the other Latin American countries. In this respect, mention should be made of the fact that Central America has already achieved a certain amount of success in transforming integration into a platform for extra-regional exports of manufactured goods (ECLAC, 1983b). In other words, today as in the past, import substitution under reasonable conditions of efficiency represents a means of enlarging the margin of action available to economic policy as well as of diversifying and increasing production.

Finally, the region possesses potential for expanding its tertiary activities, including transport, tourism and financial services. The last of these may be of particular importance in restoring former levels of saving and investment, which will need to be tapped by more flexible and innovative instruments than those which exist at present.

To sum up, and by way of an initial conclusion, it is possible to assert that the region possesses a human and natural resource base capable of permitting the sustained expansion of production. The central task will be to create the necessary institutions and forms of organization to take full advantage of this potential.

3. Requirements of a policy of reactivation and development

In the present climate of uncertainty and of sharp turnarounds in the international economy, and under the heavy burden of the accumulated lags described above, any policy of reactivation and development involves a set of minimum requirements which include pragmatism, selectiveness, austerity, efficiency and the search for means of satisfying the minimum requirements of those groups which constitute the majority of the population.

a) Pragmatism

One of the main problems which arises when formulating an economic policy is the

uncertainty which largely stems from factors outside the control of the governments of the region. Reference has already been made to the doubts which have arisen as to the future evolution of the international economy, the changes which the industrialized economies must face, or the results of the policies being implemented in some of the main industrialized countries. It is not yet known what influence these factors could have in the countries of Central America, nor is there any clear perception of what the final outcome of the grave political and social tensions present in some countries of the subregion will be.

The foregoing means that the economic policy of the Central American countries must be designed and applied with flexibility and realism so that it can be progressively adapted and adjusted to changing, unpredictable and basically unprecedented circumstances. This pragmatism will take various forms. First of all, flexibility and effective responses imply some degree of break with the past, because traditionally policies have tended to react passively or with considerable delay to the vicissitudes of the international economy. Today, in view of the risk that what we are facing is not so much a recessive cycle as a structural change in the world economy, it will be necessary to build a response capacity which will make it possible to take advantage of even the slightest opportunities and reduce as far as possible the factors limiting the development of the countries of the subregion: aspects which have particularly important repercussions as regards the role corresponding to the State.

Secondly, notwithstanding the increasing conceptual polarization which prevails as regards the way in which economic development should be tackled, the pragmatic approach must, by definition, be anti-doctrinaire. This is not the moment to be trying out particular economic doctrines, as recent experience in Latin America has shown so eloquently. It is far more important to break with historical stereotypes: those governments which desire to give a leading role to the State cannot afford to refuse to provide incentives and their full support for private investment, nor should those which place their confidence in the market as the ideal resource allocation mechanism be scared of

assigning a more active role to the State. In other words, what present circumstances require is a search for the happy medium between extreme propositions for economic policy management (for example, between "liberalization" strategies and "inward-looking" strategies; between "distribution" and "growth"; between governmental and private action; between the application of policies in the financial field and in the real economy), as well as an innovative mixture of these. For example, there is no reason why a government should not return inefficient public enterprises to the private sector while simultaneously increasing the tax burden so as to tap greater funds in order to provide the population with basic services, or introduce agrarian reform designed to create a larger number of small agricultural entrepreneurs, while simultaneously encouraging saving and private investment by granting tax incentives.

Thirdly, in view of the changing condition in the international economy, economic policies will need to take these new circumstances into account. It will be necessary to become reconciled to the fact that the era of fixed exchange rates and stable interest rates has given way to quite different systems, making it necessary for the application of those policies in Central America to be flexible and consistent with the aims pursued.

Fourthly, and precisely as one means of adjusting the application of economic policy to changing circumstances, it will be necessary to cease insisting on universal approaches in favour of more pragmatic criteria of limited scope, designed to solve critical problems associated with reactivation and development, rather than to be a general panacea. This in no way means abandoning overall guidelines for efforts to achieve the aforementioned objectives, but it does involve placing greater reliance than in the past on a selective method of trial and error, as a means of advancing towards reactivation and adjusting economic policy as circumstances require.

b) *Selectiveness*

It will not be sufficient for the policy of reactivation and development to be applied pragmatically; it will also need to be selective.

This concept too is many-sided. For example, the disarray in the international economy means that it is just as risky to direct the whole of economic policy towards encouraging dynamic insertion into world trade as it would be to adopt a policy which would make it impossible to take advantage of this trade. Economic policy should be sufficiently flexible and selective to be able to adjust to changing circumstances on external and domestic markets. Thus, contrary to what is generally assumed, the greatest threat nowadays to the efficiency of Central American industry is not so much exaggeratedly high tariff protection as the high levels of idle capacity which exist as a result of the fall in overall demand in each country and the barriers to intra-regional trade. Consequently, export promotion measures should not be adopted at the expense of destroying the hard-earned achievements of recent decades, but rather by selective and gradual application, in order that those articles with greatest potential access to international markets receive special incentives, while existing industry and a number of new activities may develop within a framework of reasonable protection in order to substitute imports.

In the same line of ideas, economic policy in general, and public expenditure policy in particular, will need to be applied in a far more selective fashion than in the past, in keeping with the aims chosen. For example, it would be preferable to completely eliminate low-priority programmes from the national budgets rather than to cut all budget items by a fixed percentage. The same selectiveness could be applied to credit, fiscal and tariff policy.

Finally, given the prevailing lack of confidence among the main economic agents, it would be unwise to leave reactivation policies at the mercy of the evolution of the international economy and solely dependent on the interplay of market forces. Thus, for example, in view of the acute shortage of foreign exchange affecting all the subregion's economies, it would be quite inappropriate to simply rely upon the interplay of supply and demand for foreign exchange as a means of setting exchange parity, especially since repressed needs and speculative pressures tend to value "hard" currencies above the level they deserve. Similarly, it would be equally risky to rely solely on administrative controls and

excessive centralization in the application of economic policy as a means of tackling maladjustments of external and of domestic origin.

c) *Austerity*

The widespread depression in Central America has been reflected in a number of restrictions associated with the need to reduce imports and ultimately levels of economic activity. The resulting austerity has by no means had an equal impact on the different strata of the population, however. The shortage of foreign exchange, the need to mobilize domestic saving in view of the restrictions on external financing, and the need to satisfy the most basic needs of the population make it necessary to ensure much more selective and careful use of the resources generated by exports and, in general, to follow a pattern of expenditure which closely respects priorities. In short, the new economic circumstances mean that the structures of expenditure and saving must also be adapted to them, and this should be reflected in austerity consumption patterns in both the private and public sectors.

This austerity should have a dual aim: to save foreign exchange through the reduction of consumption of non-essential goods and services which are either imported or have a high imported content, and to increase the coefficient of saving. As regards the first of these aspects, the countries of the region must use the foreign exchange they manage to obtain from their exports with the greatest care and strictest selectivity, which will involve, among other features, realistic exchange rates. As regards consumption, governments will need to discourage the consumption of non-essential goods and services of external origin, while they should take maximum advantage of national and subregional potential for supplying demand. Setting a high value on thrift rather than extravagance could be reflected in a different life style from that of the past, particularly among the middle- and high-income groups of Central American societies. There is of course no question of further lowering the living standards of the majority of the population who already live on the threshold of poverty. On the contrary,

the reactivation policy also involves an effort at redistribution which among other features, should provide greater support for the satisfaction of the population's basic needs.

As regards investment, everything points to the desirability of looking once again at the possibilities of using more labour-intensive technologies, not only because of the pressing need to create jobs, but also because of the need to reduce the imported component in new fixed capital.

Improving the selective utilization of the foreign exchange generated by exports means that the governments of the subregion must do their utmost to rationalize public expenditure and reorient it towards truly essential activities. The foregoing assumes particular importance because, on the one hand, the persistence of the international crisis and other factors of a domestic nature foreshadow the intensification of social pressures on governments and, on the other hand, the markedly open nature of the Central American economies imposes strict limits on the deficit financing of public expenditure because of its inflationary impact and its repercussions on the balance of payments. In this respect, it will be necessary to suppress luxury or non-essential expenditure and to seek to advance in the political détente of the region, so as to be able to transfer part of the resources now devoted to military purposes to the promotion of development.

Furthermore, public expenditure itself could help to reduce the external imbalance if, in selecting investments, preference is given to projects which require a high proportion of national or subregional imports. At all events, the public sector will have to increase its procurement of revenue in line with its expenditure, in order to prevent financial deficits from contributing to inflationary demand for imported goods.

d) *Efficiency*

Another basic requirement of a reactivation policy is that it should defend growth based on increased efficiency and productivity. In the present circumstances, improving efficiency is absolutely essential, both from the macro and micro economic point of view, in order to

increase the multiplier effects of savings and investments, to substitute imports on reasonably competitive terms, or to maintain and expand exports to international markets. It is the duty of the State to improve the efficiency of those services which it provides and to encourage the improvement of the productivity of enterprises through fiscal and credit measures.

A significant increase in efficiency and employment in the subregion can be achieved without having to resort to imports of capital goods, by making full use of the existing installed capacity. There is considerable idle capacity, above all in almost all branches of the manufacturing sector. There is also ample room for considerably increasing the productivity per hectare in the case of most agricultural products, even those where the countries have had the greatest success with their exports.

e) *Reducing poverty*

If it did not prove possible to bring about any significant reduction in extreme poverty even during the thirty years of dynamic expansion of the Central American economies (although broad sections of the population were integrated into modern economic activity during that time) it is inevitable that the situation should grow worse as the economic crisis persists, since there is a direct interrelation between levels of employment and marginality. In recent years, open unemployment and underemployment have increased, and unless some way of avoiding this is found, this tendency will be aggravated in the future, in view of the rapid rate of growth of the economically active population.

Unless the State takes clear measures in favour of the masses, the depressive effects of the crisis —and of the austerity policies accompanying it— will tend to have a disproportionately severe impact on these groups, which are the least well organized to defend themselves, and among other consequences, this will bring about a widening of the gulf between the governing and the governed.

The spread of absolute poverty is unacceptable from any point of view. However, a policy aimed at satisfying the basic needs of the masses is hard to implement even in times of

rapid economic expansion, and still more difficult to achieve at times of severe restrictions, including those affecting public finances. At all events, the elimination of poverty is an essential part of the development approach which is called for. Without it, all efforts to overcome the crisis would be meaningless, since the spread of social discontent could make social tensions unmanageable and make it impossible to retain savings and thereby revive the process of investment and development.

It is necessary to find some way of satisfying the basic needs of the populations which involves a relatively low imported component, in order to keep within the foreign exchange restrictions. At all events, and quite apart from considerations of equity, the political crisis in many countries of Central America has reached the point at which it is absolutely indispensable to restore a minimum of peaceful understanding among the population. If this is not done, then the social instability will inevitably be transformed into economic instability by paralyzing, for example, the process of capital formation and leading to a kind of State-dominated expenditure which would be of little help in expanding productive activities.

4. *The role of intra-regional co-operation*

Beyond any doubt, intra-regional co-operation offers the best possibility of loosening the constraints imposed by the external sector on the Central American economies, in line with the need to establish bases for reactivation and development set forth in this article. Today, more than ever, it is necessary to press on with the programme which was begun in Central America nearly thirty years ago and which has borne such valuable fruits and experience. It is necessary to do so not only in order to take advantage of the more dynamic impulses which could be expected from domestic demand (understood on a subregional basis) but also in order to face up jointly to certain specific features of the subregion's relations with the rest of the world. This aspect has been dealt with on a number of occasions in ECLAC documents, but it acquires fresh interest in the present circumstances.

The aim would be, through intra-Central American co-operation, to increase the scanty room for action available to each of the individual countries of the subregion, in order to thus lessen the effects of the depression of the external sector. In the short term, the only effective way of expanding local demand seems to be that connected with co-operative efforts at the subregional level. There is nothing new about such a procedure, since as long ago as in the 1950s it was successfully put into practice in order to overcome the same obstacle, namely, the bottleneck to growth constituted by international demand. Now, however, it would be adopted in a different situation. If it were possible to increase intra-regional trade to the maximum, this would make an effective contribution to economic reactivation by making maximum use of installed capacity, reducing the influence of the adverse effects of external sector phenomena, increasing efficiency —both for import substitution and for improving competitiveness on international markets— and even taking joint advantage of the opportunities which the international market may continue to offer.

In recent years all of this has been hindered by the barriers standing in the way of intra-regional trade. It would be unrealistic to defend unrestricted free trade which did not take account of the greater or lesser importance of the goods being traded, but it would be desirable at all events to keep restrictions to the minimum and even to adopt mechanisms to give preference to reciprocal trade over similar trade flows with third countries. In this way alone could optimum use be made of the installed capacity of the subregion, while even perhaps also promoting some new activities based on subregional demand. For this purpose, the countries would need to adopt new procedures for financing the intra-Central American trade debit balances, to do away with certain restrictions at present resulting from the exchange controls adopted, and, in general terms, to give essentially the same treatment to products originating from any other Central American country as to those produced domestically. There is no shortage of concrete ideas in the subregion for bringing this about.

Furthermore, as already noted, regional co-operation is the best way of improving the use made of the opportunities offered by the international economy, both in order to increase exports —on the basis, for example, of common marketing systems— and in order to obtain additional external financing for projects and initiatives which are of interest to all. The strengthening of the Central American Bank for Economic Integration and of the machinery available through the Central American Monetary Council are examples of some measures which would give real force to this latter idea. It should be remembered that lack of intra-regional co-ordination in such a vital area as external financing not only has a high opportunity cost —if the possibilities for joint mobilization of a flow of resources which could not be obtained through individual negotiations are lost— but also represents a risk for the survival of intra-Central American co-operation. It has been noted that various actors on the international scene seem to be interested in providing co-operation to the Central American countries on a selective basis, with the exclusion of one or more countries from their programmes. In this respect, external co-operation would tend to separate the Central American countries rather than uniting them.

Making intra-regional co-operation one of the pillars of reactivation and development will call, in the first instance, for the simple preservation of the degree of economic interdependence already reached, while subsequently promoting joint action to correct or relieve common problems. There would be no question, of course, of seeking to promote instant integration of the economies of the region or co-operation in every single one of their activities. What would be sought for would be rather to make integration a useful instrument for tackling the reactivation of each country. Thus, for example, tariff policy —which has traditionally been the subject of joint action— could play a key role in the application of a more selective and flexible system, simultaneously ensuring both protection of existing industrial plants and the promotion of exports. In addition, although there is no question of establishing regional commitments

which restrict each country's possibility to formulate its own exchange policies, it is clear that the existence of the common market will call for a minimum of co-ordination in this sphere, which will further facilitate the adoption of decisions to meet the needs of reactivation.

The schedule of integration activities over the next two years will need to incorporate measures which, while preserving the economic interdependence already achieved between the countries of the subregion, will facilitate the adoption of policies linked to the programme under discussion. Noteworthy among these issues are: i) the continuation and perhaps intensification of joint action *vis-a-vis* the international financial community in order to mobilize external funds so as to provide foreign exchange liquidity for those regional mechanisms which ensure the fluidity of intra-regional trade; ii) increasing the flow of external funds for industrial reactivation; iii) transforming the Central American common tariff into an instrument of the reactivation and development policy, taking advantage of the recent signing of the agreement on the Central American Tariff and Customs Régime;¹¹ iv) stimulating joint action to improve the access of Central American products to the markets of third countries; v) drawing up partial agreements, in co-ordination with other countries in Latin America, so as to harmonize the steps towards Central American integration with the need to expand the geographical area of this integration; vi) coming to grips with the specific problem of those countries which do not reap the full benefits of intra-regional trade, by devising means for allowing Nicaragua's exports to the rest of the region to increase as well as for the gradual and progressive incorporation of Honduras into the multilateral integration commitments; vii) carrying out joint projects of multinational interest, such as the interconnection of electricity systems and co-operation in the exploitation of marine resources and, viii) strengthening the Central

American integration institutions so that they can help to carry out the activities in question.

5. The political expression of development and the role of the State

Although this article has focused on the role of economic policy—and by implication, on that of economists—in reactivation and development, it is clear that this is not the exclusive preserve, or even the main one, of economists. The transformations inherent in any development process affect all areas of national life (and all of the social science disciplines) and it is hardly possible to design programmes of reactivation and development without incorporating considerations of a social and political nature. Thus, should it not prove possible to overcome the persistent tension in a number of Central American countries, it would be pointless to consider reactivating their economies. In other words, it is necessary to adopt a multidisciplinary approach to development so that economics can incorporate such issues as participation, political interaction, the role of the various economic agents and democratization.

This does not mean that the multidisciplinary approach must be adopted in all activities connected with the development effort. The formulation of economic policy proposals remains principally the task of economists, the study of political interaction that of political scientists, and research into social stratification that of sociologists. Nevertheless, there will be numerous areas of contact and overlapping between economic, political and social factors, and a reactivation and development programme will consequently need to tackle at least some of the non-economic factors present in the region, as already indicated in this article.

This is no place to develop this issue in depth. Nevertheless, it is necessary to make a few remarks concerning the role which the State could play, merely in order to provide an illustration of the complex interrelations between economic and non-economic factors in this great task facing the Central American governments and peoples. Why should particular attention be devoted to the role of the

¹¹Signed in Guatemala on 14 December 1984 by the governments of Costa Rica and El Salvador, and on 27 December 1984 by the governments of Guatemala and Nicaragua.

State? Firstly, because this article is intended essentially for the region's governments, and it would be incomplete if it failed to examine the role incumbent upon them in reactivation and development. Secondly, the issue is highly controversial —sometimes with marked ideological overtones— and deserves both broad debate and deeper subsequent research. Finally, irrespective of the ideological and conceptual framework surrounding the issue, each of the generic functions carried out by any State —preserving order, defending sovereignty and ensuring the well-being of the population— is reflected in the central preoccupations underlying this article, such as how to overcome the social and political tension in the region, to reduce the marked influence exerted by phenomena of external origin on all aspects of national activity, and to reactivate the economies. The issue is thus clearly of considerable importance.

Nevertheless, the role played by the State may vary considerably in detail from one country to the next, or within a single country at different periods of time, depending upon the existing institutional and political organization, historical and cultural tradition, the result of political interaction and a number of diverse circumstances.

This question also involves ethical and philosophical considerations (for example, if it is accepted that the State plays a leading role, is it entitled to use any means, including force, to influence events? What bounds are to be set to the procedures which the State may adopt to achieve this end?). These problems are all clearly evident in present day Central America, in view of the heterogeneity of the situations existing in the region.

In a number of countries the power of the State is perceived as the result of permanent tensions between different agents within society, with its bounds being set by other centres of power and by the rule of law. In other countries, there is a tendency to endow the State with a hegemonic (but not necessarily absolute) role, in certain cases as the representative of particular sectors of society. It is consequently impossible to define a single formula, applicable to each and every one of the countries, regarding the precise role which the State should assume in

the process of reactivation and development, that is to say, with regard to its generic role as guardian of the population's well-being. Indeed, the very same criteria applicable to reactivation policy, as referred to earlier (pragmatism, selectiveness, efficiency and austerity), are relevant to defining both this role and the relations of the State with the other economic agents in society. In addition to these criteria, it is necessary to take full account of the heterogeneity of situations and to ensure that there is capacity to adjust the role of the State to changing circumstances.

Thirty years of Central American experience would seem to indicate that there is no universal rule to permit an *ex ante* definition of the degree of State intervention desirable for maximizing the population's well-being. It has to be acknowledged that the performance of the State during this period has not always been satisfactory, as is illustrated by the cases of a number of public enterprises or official industrial development institutions. The fact that a number of these enterprises have been victims of bureaucratization, sinecures, and even occasionally corruption and ineptitude in their administration, should not automatically lead to the conclusion that they are perforce inefficient. Nevertheless, it has to be acknowledged that the fashionable trend during these thirty postwar years towards the systematic expansion of the scope and depth of State action has not always proved intrinsically desirable, and in general the State's activities should have to meet the same requirements of efficiency, honesty and flexibility as those of other economic agents. On the other hand, it would be equally wrong to conclude from this performance that the State must withdraw from playing a major role in development, and instead rely on the market as the sole arbitrator of this process.

It would be more consistent with Central American circumstances to accept that the degree of State intervention in the economy or the influence allowed market forces should depend on the prevailing conditions in each country. Basically, apart from the family and the home, the two most important organizational institutions in the world are the market and the State (Lindblom, 1977, p. II). For this reason, once the necessary presence of both these

"organizational institutions" in any political system—including socialist economies—has been acknowledged, the greatest distinction between one government and the next lies in the degree to which the market replaces the government or to which the government replaces the market (Lindblom, 1977, p. IX).

One way of perceiving the role played by the State, then, would involve observing the tense and dynamic relationship between the two organizational institutions—the market and the State—described above: tense because they are constantly face to face, each sounding out the limits of the other; dynamic because changing circumstances lead to modifications in the relative weight of each, as well as to changes in their interrelationships. For this reason, during periods of intense change such as those which Latin America is experiencing at the present time it is unavoidable that both the role of the State and that of the market will also undergo changes. Both interact with one another in a creative state of tension.

Once this approach has been accepted, it is neither possible nor necessary to put forward a universal rule for the role which the State ought to play in a region containing situations so diverse as those in Central America. There would be no point in abstractly proclaiming either a hegemonic role for the State or the universal virtue of the market. The relative share of each of them in the evolution of events will depend on the dynamics of the development process itself as well as on the prevailing circumstances in each country.

However, if the features of the present situation are scrutinized it is apparent that the public sector possesses room for action which it should use not only to soften the harmful impact of the crisis, but also to orientate the effects of the crisis in a constructive direction. For example, the shortage of foreign exchange requires the establishment of an order of priority for the different importing sectors and means, moreover, that income from exports should be specifically devoted to essential imports. In addition, present circumstances require a major effort directed at exports. It seems logical that the central banks and the offices responsible for external trade should assume responsibility for

these functions. At all events, the obligation to rationalize the use of foreign exchange requires greater State intervention than is required under normal circumstances of external relations.

Moreover, the shortage of foreign exchange leads to conflicts of interest and, consequently, pressures from the various groups of importers and exporters. The clashes which invariably arise as a result of these situations can only be solved through the arbitration of a higher authority. In this respect, regardless of the combination of exchange, credit or fiscal formulae adopted in order to face the crisis, the shortage of resources automatically intensifies the struggle between the interest groups and thereby opens up—as a result of the fragmentation of demands—a broader area for public-sector intervention.

Another qualitative change in the role played by the public sector springs from its lesser dependence on international trade as a direct source of tax income. The decisive role which exports have played in the past has led to taxes on external trade being of considerable weight in public-sector income, but this situation will change as the external depression restricts the possibilities for exports and, as a counterpart, those for imports. Consequently, financial problems will arise until new domestic sources of taxation can be found, but, simultaneously, the State will become less vulnerable to specific pressure groups.

These considerations all illustrate the way in which the prevailing situation affects the role of the State, regardless of the conceptual and ideological framework of each Central American society. Naturally the exact nature and scope of its responsibilities will vary from one country to the next as circumstances dictate in each country, as a result of the interaction between the State and the other economic agents. In this respect, the execution of its activities by the State in the manner described would be the natural counterpart of the pragmatic approach put forward earlier with respect to the management of economic policy, with less emphasis on global and universal frameworks, but instead selective methods involving a process of trial and error in order to achieve given development aims.

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Thoughts on industrialization, linkage and growth

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This article discusses some issues which ought to be taken into consideration in the preparation of a new industrialization strategy that will make it possible to deal with internal disequilibria and face up to the predictable international situation in the coming years. The first section expounds the concept of linkage, which is regarded as the most significant of the attributes differentiating the productive and social structures of the advanced countries from those of the countries of the Latin American region. In the former, the characteristic feature is organic and interdependent growth of the various parts of the industrial complex, and in the latter, a transplantation of fragments of that structure which leaves in external hands complementary aspects of crucial importance for the functioning of the whole.

In the second part a definition is given of the concept of "nucleus of technological dynamization" which comprises a positive valuation, by those exercising leadership, of the national significance of filling internal gaps and of promoting firmly-based insertion in the world economy; a *modus operandi* characterized by fluid communication and linkage between the various agents and sectors; and a generalized social attitude of esteem for creative activity and for the entrepreneurial function.

In the third section examples from countries in other regions are adduced to show that there is no such thing as a contradiction between import substitution and exports. All the countries that have been successful in their industrialization have made complementary use of both, but what has been peculiar to Latin America in the import-substitution process has been the lack of creativity.

Other aspects are next explored which would be of help in forming a strategy, such as the dichotomy between State and market, and the supposed leadership of the services and communication sector, and the article concludes with some general observations on the need to revivify industrialization strategy in order to overcome the debt crisis.

Introduction

In the coming years the countries of Latin America will have to face, *inter alia*, the challenges posed by the imperative need to gradually resolve the disequilibria in the structure of domestic production, as well as the accumulation of social needs that were shelved during the preceding period of rapid growth and are now beginning to clamour for attention; by the change of sign in the external financing situation, which used to be a source of stimulus and support for growth and which has become, at least over the short and medium term, a factor of inhibition and an obstacle to internal economic growth; and by the industrial and technological restructuring in the advanced countries which in some sectors could radically reduce the possibilities of international competition open to the production of the various Latin American countries. On these three spheres the topic of industrialization has a direct bearing.

Latin America's particular development and industrialization pattern is to a large extent a legacy of the great crisis of the 1930s. There seem to be no grounds for assuming that this pattern could persist during the present crisis without undergoing structural modifications. Rather is it urgently necessary to seek a new industrialization strategy which will make it possible to cope with internal imbalances and take a clear-sighted view of the predictable international situation in the coming years. Something will next be said on the subject of linkage between sectors, agents and markets, which is considered of key importance for reflection upon strategical adjustments in Latin American development.

I

Industrialization patterns and concept of linkage

The concept of linkage (like its opposite, delinking) serves to characterize both the structure of national production systems and its side-effects in the social, spatial and even cultural spheres. This concept is perhaps the most significant of the attributes that differentiate the productive and social structures of the advanced countries from those of the countries of the Latin American region.

From the standpoint of their gestation, linked structures reflect the transformations initially undergone by agricultural production processes, and based, in the first stage, on biological and organizational changes that made it possible to generate surpluses against which the process of industrialization was begun. This industrialization process was characterized by its functionality in relation both to the demands of subsequent agricultural expansion—in a phase when inputs and equipment of industrial origin came to play a role of growing importance in productivity increments—and to the demand for simple consumer goods that can be mass produced, resulting from the population's enjoyment of a sufficiently large share in the increase in income which the dynamics in question generates. The technological path chosen—which was different and specific in every case of linked development and consistent with the relative scarcities of national resources—enabled agricultural and industrial demand to reinforce each other. It started, in the pre-industrial phase, with simple and relatively low-cost innovations, which were susceptible of incorporation by the great majority of producers, and which gradually became more complex as industrial development allowed them to do so, thanks both to the supply of inputs and equipment and to the growth and expansion of diversified demand for consumer goods.

The dynamic effect of this creation of reciprocal demands was not confined to the sphere of relations between agriculture and

industry, but was extended to relations between different branches of industry (consumer goods-capital goods), different types and sizes of production units (large firm-medium-sized and small firm) and different regions, giving rise to a process of relative homogenization of levels of productivity in all the above-mentioned spheres, allowance being made for the disparities necessarily created by the technological leadership that certain firms or branches of production exercised.

In by far the majority of cases, the evolution of these linkage processes called for greater flexibility of social structures and radical changes in the State-civil society relationship, such as those generated by the Puritan revolution in England, the French Revolution, enlightened despotism in the Netherlands, the Civil War in the United States and the restoration of the Meiji Empire.

In contrast to these processes of gradual linkage characteristic of the advanced countries, the countries of Latin America are witnessing a dynamic movement which bears the stamp of the basic structural matrix forged during the colonial period; the impact of this was felt, above all, in the critical phase when relations between agriculture and industry were shaped and the domestic markets were formed and developed. The mining enclaves and the *hacienda* and plantation structures superimposed in many instances on peasant communities of a different origin gave rise to patterns of demand, both for consumer goods and for equipment, which were incapable of encouraging mass production of simple standardizable goods; they inhibited, along with these, the creation of a "virtuous circle" of agro-rural and urban-industrial demand comparable with that described by the advanced countries. The technological path adopted in modernization processes accentuated the original bimodality of the structures of production and was influential in the passive

assimilation of options gestated in other contexts and divorced from what the relative shortage of national resources would have made advisable. In this way the multiplier effects of demand were diverted out of the region or conditions were created for a form of industrialization designed to meet the needs engendered by premature adoption of consumption patterns proper to advanced countries with no such possibility as existed there that they might spread to the great majority of the population. The organic and

interdependent growth of the different parts of the industrial complex, which had taken place in the advanced countries, under the spur of the market in some (cases of "modernization from below") or under the guidance of the State in others (situations of "modernization from above"), was replaced in the Latin American region by transplantation of fragments of that structure, while complementary aspects which proved of crucial importance for the functioning of the whole were left in outside hands.

II

The concept of an endogenous nucleus of technological dynamization

As has been said before, growth is not sufficient in itself to breed creative capacity, and Latin America can produce plenty of concrete examples to bear this out. One of the predominant features of industrialization in Latin America has been, in countries with different characteristics, its rapid growth since the Second World War, and at the same time, as a trait complementary to this growth, it is precisely the lack of creative capacity that may be mentioned, albeit certain spheres of relative excellence have existed in most of the countries (Katz, 1980).

It may well be asked, then, what are the other conditions required to ensure the development of the inventive spirit, since it can be seen that growth is not enough. To start with, there is the fact that creation is a complex process in which a wide variety of agents and motivations take part—large industrial plants linked with small and medium-sized ones, institutes of technology, institutes of basic science, organizations that train skilled personnel at the various levels, the mass communication media and the Ministries and central agencies which define policies and norms—, and for which the interaction of these agents and motivations is decisive. Accordingly,

it may be inferred that among the factors which can help to develop or to frustrate this activity an important role should be played by the type of relations established between the various agents of economic activity and between the individuals participating in each of the said activities and the place of work in question. Consequently, creation would also be influenced by the pattern of labour relations within each of these agencies or entities and the nature of the relations established between those various activities. It is highly unlikely that an industrial model which derives its impulse from subsidiaries of firms whose centres of gravity are located in other countries will unleash an internal creative process because such a thing is not functional, generally speaking, for those firms' long-term expansion strategy. Nor has a development model essentially based on the mere export of natural resources any need for creative activity to be developed either by individuals or by producer enterprises. In addition, therefore, to the nature of the agents and the relations established between and within them, another important explanatory factor of creation is the structure of production through which economic activity is given concrete expression.

Outstanding among the various factors that affect the process of creation is the degree of decentralization of economic life. One of the major conditions would seem to be that the interacting units should have a wide enough margin of autonomy as regards fomenting the creative faculty both to take the offensive or assume the defensive with respect to innovations, and to encourage their inventors.

When communication, interaction and smooth linkage between these decision-making agents, institutions and levels are consolidated as an everyday practice on the national plane, it will signify the formation of what is defined hereinafter as an "endogenous nucleus of technological dynamism". If this concept is to be applicable in practice it must be broken down by its basic dimensions, namely:

a) Positive valuation, by those who exercise leadership, of the national significance of meeting internal needs and of promoting firmly-based insertion in a world economy characterized by increasing transparency and intercommunication;

b) A *modus operandi* characterized by smooth communication and linkage between the various economic and social agents and sectors which participate in the production of goods and services; and

c) A generalized social attitude of esteem for creative activity and the entrepreneurial function, irrespective of the set-up as regards forms of ownership (which will be conditioned by the specificity of the historical processes that moulded the different societies concerned). This valuation of the creative faculty presupposes a spirit of great openness towards the rest of the world, both in relation to the learning process and the assimilation of knowledge generated outside the region, and with respect to the identification of those activities in which a country can attain levels of relative excellence that will enable it to generate the foreign exchange indispensable for purchasing the goods and services it requires, in conjunction with those locally produced, to meet its own needs. This systematic learning process implies an obsessive concern with the permanent training of the population, through educational media, specialized institutions, and the mass communication media, as well as an exhaustive

knowledge of local potentialities comprising both the natural resources available and the possibilities of modernizing the organizational patterns and the traditional techniques at the country's disposal. Genuine modernization is that which enhances the wealth and potential of the patrimony inherited on the various planes: the legacy of the past, values and aptitudes, forms of organization and know-how associated with local specificities. This kind of modernization permits insertion in international markets, because it adds intellectual value and efficiency to the production designs, processes, techniques and organizational patterns which already existed. Modernization which does not take the local common property into account and fosters the mere physical transplantation of objects could be described as spurious or window-dressing modernization, since it allows of the ephemeral reproduction of imported modernization, at a cost in foreign exchange that would be difficult to finance in the coming decade, but does little to spark off local innovation processes, without which participation in international markets becomes essentially precarious.

It is important to point out that in the foregoing description of the "endogenous nucleus of technological dynamization" no mention has been made of the size of markets or natural resource endowments. This is due to the conviction, corroborated by past experience, that there is no clear correlation connecting the dimensions of leadership and of economic and social linkage with size, much less with the endowment of natural resources. What has been said does not invalidate the importance of economies of scale and of concentration in specific activities, but seeks to underline how decisively important it is that the structure of productive activity, as a reflection of domestic creative effort, should be functional to specific national needs and potentialities. It is in this concrete sense that the term "endogenous" is applied.

The necessity of competing, reinforced by the limitations of domestic market size, and the learning process required, should inevitably be reflected in production profiles more specialized than those existing in advanced economies. The concept of "endogenous nucleus of technological

dynamization" is favourable to the identification of lines of specialization and the creation, on the basis of these, of more and more closely-knit systems which strive to reach levels of international excellence in the various links that

make up the specialization chains. The particular development pattern of the industrial sector in the Latin American region is obviously at variance with this criterion of selection and specialization.

III

The false dilemma: import substitution strategies or export-oriented strategies

The assertion that Latin America would seem to have witnessed the failure of "import-substitution strategies" and that it is expedient to enter upon the phase of "export-oriented strategies" is a simplification of the debate and of the economic reality, in connection with whose normative repercussions some reservations should be formulated.¹

The merits of industrial exports are indisputable: they promote economies of scale and growth; they strengthen the capacity of adaptation, through the technological learning process, *inter alia*, to the changing conditions of the international economy; they help to improve the terms of trade; and, in a period marked by shortage of foreign exchange as a constraint on growth, they obviously acquire even more importance. What is less obvious is the mode of procedure whereby, starting from a situation characterized by the dearths and the assets accumulated in Latin America's previous industrialization phase, the requirements can be met that empirically and theoretically condition the possibilities of international competition.

For this construct, which sets "import-substitution strategies" and "export-oriented strategies" against each other, as if they were mutually exclusive options, to be substantiated

with a minimum of rigour, it would be necessary to show in the first place that import substitution has been a specific feature of industrialization in Latin America and that, in that sense, the region would seem to have diverged from the traditional industrialization route followed by the economies which are mature today or by other late-industrialization economies. Secondly, it would be necessary to prove that this potential specific feature has been the most important of the factors accounting for the unsatisfactory results achieved in such spheres as employment, income distribution, external vulnerability and the absence of autonomous technological innovations (a determinant of the possibilities of competing on the international market). Thirdly, it would be necessary to demonstrate that those successful instances of late industrialization, particularly in South-East Asia, which are the tacit or explicit frame of reference for the recommendation in vogue today, are essentially attributable to an export vocation, and to relegate other economic, social, political and cultural factors which formed the context in which that industrialization was introduced—and in respect of which there are striking differences from Latin America's experience—to a marginal role in the explanation of the results obtained. Lastly, consideration would have to be given to the feasibility of a possible mass outflow of exports from the semi-industrialized countries in face of an international market which looks likely to be

¹ It is not only in Latin America that the criterion of simplicity is applied in seeking economic options; the same thing happens in the advanced countries, where Manchesterian utopias compete with those that are turning Japan into a paradigm, and this reflects the perplexity and the existential need behind the search alluring formulas which would make it possible to surmount, not only the crisis in the real economy, but also the crisis of theoretical thinking.

less dynamic than in the past. Attention is concentrated, however, on the factors mentioned above, inasmuch as internal requirements are deemed to play a bigger part than international demand conditions in determining the notable national differences in the capacity to export manufactures. To assume that the international market could have room for a large number of "Koreas" is an obvious fallacy, but that is not an argument which refutes, in relation to national cases, the generic thesis positing that import substitution should be shelved and that the economy should become export-oriented, i.e., the question which is at issue here. The experience of the past, real cases of recent date, and the theoretical baggage available, suggest that simple and precise answers to the foregoing problems could hardly be found. Accordingly, this proposition needs toning down, and to that end it must inevitably be postulated that the complexity of development strategies is such that simplified versions, which contrast the "virtues" of exports (frequently in association with the pre-eminence of market principles) with the "nefarious" connotation of import substitution (which would seem to reflect excessive intervention by the public sector) are an inadequate framework for thinking about strategy in the conditions currently prevailing in the regional and international economy.

Attention will next be devoted to certain aspects of the problem which are sometimes omitted or confused, with the result that the normative repercussions of the debate are distorted. In the first place, it should be pointed out that a basic feature of "export-oriented strategies" is their markedly industrial character, which finds expression both in the high growth rates of manufacturing output and in the speed with which changes take place in the structure of production under the leadership of the industrial sector. In countries like Japan, Korea and Taiwan average annual industrial growth rates in the 1950s and 1960s attained approximately 15%, i.e., doubled that of the countries with the greatest industrial dynamism in our region (Brazil and Mexico). This explains the fact that the degree of industrialization of the Asian countries (measured by the share of the industrial product in the total product), which at

the beginning of the 1950s was lower than or comparable to that of the most industrialized Latin American countries, was significantly higher at the dawn of the 1970s and that, owing to the industrial setback experienced by Latin America in the early 1980s, this difference had been considerably accentuated by 1983, when the degree of industrialization in Japan, Korea and Taiwan exceeded 40%, whereas it reached 25% in the larger Latin American countries and 23% in the region as a whole.

The rapid growth of the industrial sector in the countries with an export vocation, linked to the internal learning process, set in motion the "vicious circle" of industrial growth, upswing in productivity and technical progress, and increasing participation in the world market for manufactures. It must be stressed that the part played in international markets cannot be understood unless account is taken of background material such as the industrial dynamism and technical progress of the structure of production in the countries concerned.

This last question is directly connected with another that has sometimes been the object of simplifications bordering on confusion. The terms "import substitution" and "home-market orientation" are often used indiscriminately, which gives the impression that the dynamizing effect of expansion of the domestic market is conditional upon the intensification of import substitution, whence the inference is that if the possibilities of carrying import substitution farther seem to be limited, the international market becomes the only dynamizing option. The indiscriminate use of the terms "import substitution" and "domestic market" may be conducive to ambiguities. It may happen that the dynamizing effect of expansion of domestic demand is accompanied by an intensification of import substitution (decrease in the import coefficient), by a reduction of import substitution (increase in the import coefficient) or by a neutral import substitution process (constant coefficient). In the first case, the dynamizing effect on domestic production produced by the expansion of final domestic demand is reinforced by the incidence of import substitution; in the second, from the contribution made by the increase in domestic

demand must be subtracted the effect of the more than proportional increase in the import component; in the third, influence is exerted only by the growth of the domestic market, unadjusted by any import component effect. Consequently, import substitution is of help, particularly during the initial phases of the industrialization process, in dynamizing local production, but the latter can expand in the absence of import substitution and even in the presence of its reduction.

Some empirical examples may be of assistance in shedding light on this question in the case of Japan, which is the most notable example of dynamism and penetration into the international market for manufactures; throughout the whole industrialization process the increase in final domestic demand accounted for at least 70% of the production increment and, in some recent periods, for more than 80% (Kubo and Robinson, 1984). Between 1915 and 1955, the contribution of import substitution to the growth of production was positive and as from that date negative, although marginal. That of exports, positive before 1935 and after 1955, fluctuated between 10% and 20% of the increase in local production.

In the case of Korea and that of Taiwan, up to 1970 the dynamizing effect of the growth of the domestic market did more than export expansion to step up production. In Korea, the import substitution effect was equivalent in the period 1955-1963 to four times the contribution of export expansion to the growth of local production, and subsequently became negative, although marginal. In the case of Taiwan, the incidence of import substitution was comparable in the period 1955-1961 to that of export expansion, and both fell short of the contribution made by the increase in domestic demand. In the following period, 1961-1966, the home market stayed in the lead, but the import substitution effect was reduced, although it was still positive; in the period 1966-1971, during which the most important dynamizing factor was export expansion, followed by the enlargement of the domestic market, import substitution continued to make a positive, although marginal, contribution.

The upswing in domestic demand was responsible for over 80% of the increase in local

production in Mexico as from 1960, while over the period 1950-1970 import substitution accounted for approximately 10% of the production increment, a proportion slightly more than double the contribution of industrial exports; from 1970 onwards, the contribution made by the expansion of industrial exports exceeded that of import substitution (8% and 3%, respectively). Colombia, the other country of the region for which comparable estimates have been made, shows a similar profile.

The foregoing data, besides bearing witness to the importance of use of the terms "import substitution" and "domestic market" and highlighting their different contribution to the dynamism of production, suggest the existence of a time linkage between "import substitution" and "outward-directed development" incompatible with those simplifications that present them as mutually exclusive options. To this third aspect of the question attention has been repeatedly drawn by ECLAC in earlier studies. But behind the successes referred to (export-oriented strategies) there lay a period of extensive import substitution and technological improvements during which domestic industries developed and strengthened their capacity for international competition. Without this preparatory stage, perhaps industrialization could not have been successfully consummated through export expansion in the economies concerned (Kubo and Robinson, p. 245. See also ECLAC (1959 and 1977)).

The recent increase in Brazil's industrial exports would be incomprehensible without the effort previously expended on constructing an industrial base, notwithstanding the inadequacies of the industrial pattern, a subject to which reference will be made later.

It should be pointed out that even in the periods when the export of manufactures has been the main factor accounting for the increase in local industrial production, import substitution has coexisted with export expansion. At the world level mention has already been made of the cases of Japan and Korea, Taiwan, Mexico and Colombia, and, at a disaggregated level, it is interesting to single out the situation of Korea, where, in 1965-1970, approximately 60% of the increase in exports derived from sectors in which import

substitution made a positive and simultaneous contribution to the rise in industrial output. In the period 1970-1975 the proportion in question was reduced to 30% (Tori and Fukasau, 1984).

Another aspect worth taking into account is the level of aggregation at which the analysis is carried out, both for methodological reasons and because of the types of conclusion to which it may give rise. Since import substitution is measured, for analytical purposes, by the variation in the corresponding import coefficients, it may happen that an import substitution process appears with a positive sign at one level of aggregation of the analysis and with a negative sign at another, the explanation of which lies in the variations occurring in the structure of domestic demand. Thus, for example, it may also happen that measurement by branch of industry suggests an intensification of the import substitution process (the import coefficient has decreased), whereas for the economy as a whole import substitution has undergone a setback. For this, it would be enough for those branches with a high, although declining import coefficient to show a growth rate considerably outstripping that of branches with a lower import coefficient, a phenomenon, moreover, which is common in Latin America.

But what matters more than this optic effect associated with the level of aggregation is to stress the enormous importance that for the purposes of policy interpretation and design attaches to analysis of the modifications undergone by the structure of production, whence it necessarily follows that at least as much significance must be conceded to the sectoral as to the global level of analysis of import substitution and of export promotion. Economic development implies changes in the structure of demand and of production, accompanied by technical progress. Consequently, analysis of import substitution and of export promotion, partial constituents of the development process, must incorporate this transformation of the production system as one of its elements if the dynamics of development is to be more thoroughly understood. It is evident at a glance, for example, that in post-war growth the changes in the structure of production were characterized by the greater dynamism of intermediate inputs in common use —steel and

petrochemical products—, of the capital and durable consumer goods included in the non-electrical and electrical machinery branches, and of the transport equipment sector. Once this basic feature of the industrialization process in recent decades has been recognized, analyses and recommendations in respect of import substitution and export promotion will prove inadequate if they fail to incorporate the evolution through time of the changes introduced and the policies adopted in these branches which are of strategic importance both from the standpoint of transformation of output and from that of dynamism in the international market and of trends in the incorporation of technical progress.

To illustrate the combined effect of the various aspects mentioned, it is of interest to revert to the case of Korea. If the period 1955-1973 is considered as a whole, export expansion figures as the engine of growth of local production, accompanied in the second place by the expansion of domestic demand and followed by a marginal but positive contribution from import substitution. If the analysis is broken down by three subperiods, a closer approximation to reality is obtained, but with different indications for interpretation purposes: in the period 1955-1963 the growth of the domestic market, strengthened by import substitution, accounted for almost 90% of the increase in industrial production; in 1963-1970 the domestic market was still a spur to growth, now followed by export expansion, and import substitution appears as negative. Only in the final subperiod, 1970-1973, which witnessed the culmination of the foregoing process, did export expansion become the engine of growth, followed by the enlargement of the domestic market and a negative import substitution effect for the economy as a whole. If to this breakdown by periods of time the sectoral dimension is added, new indications are obtained which are of importance for the interpretation of this industrialization process. Although in the period 1966-1970 import substitution was negative for the economy as a whole, in 14 out of the 25 branches of production the import substitution process was pursued in greater depth. Yet more important, however, is the fact that the main import substitution effort was concentrated in

branches which are strategical from the three points of view mentioned above: petrochemicals, iron and steel and the production of transport equipment. In the two last-named, import substitution did more than exports to boost industrial production. In the next period (1970-1975), the import substitution effort continued less vigorously in the petrochemical and iron and steel branches and was accentuated in non-metallic minerals and metal products, a major import substitution effort being launched in capital goods. In the case of non-electrical machinery, which properly speaking is a capital good, the contribution of import substitution was similar to that of export expansion, and together they were equivalent to approximately 80% of the contribution to the growth of industrial production made by the increase in domestic demand.

If the images obtained from the aggregate analysis, without differentiation of the periods in which industrial policies undergo modification, are contrasted with the indications deriving from the analysis broken down by periods of time and sectors, it is obvious how far simplifications in analysis may introduce distortions into recommendations. The situation becomes even more serious if the case in question constitutes the basic argument for the construction of a paradigm susceptible of universal application.

From all that has been said above it can be inferred that the use of import substitution as an instrument of industrialization is neither peculiar nor specific to Latin America. Rather was it the basic expedient used by the economies which are mature today in building up their industrialization process (with the obvious exception of the United Kingdom at the end of the eighteenth century and the beginning of the nineteenth, since it had nowhere to import manufactures from) and the same is true of a late-industrialization economy participating more dynamically in the international market, like that of Japan. Even in the case of some countries of Southeast Asia, such as Korea, the combined use of selective import substitution and export promotion is a *fait accompli* in practice today. What is specific to Latin America is the particular modality, marked by the absence of creation, adopted in the import substitution

process. The following are among the features wherein Latin America's industrialization specifically displays striking differences from that of the countries with mature industrialization and the late-industrialization countries of Southeast Asia: the high and indiscriminate level of protection afforded, which, in conjunction with exchange policies, has fomented higher rates of return in the domestic than in the international market, with notable and permanent differences; the types of sector to which protection has been given; the agents that have been bearers of industrial growth; the atomization of the structure of production; the acritical reproduction of a consumption pattern which has not been functional to the needs of the region and its existing potentialities; the asymmetry between industrial and agricultural development, which has made for the persistence and, in some countries, the accentuation of structural heterogeneity, especially with regard to the production of basic foodstuffs for domestic consumption; the dysfunctional energy base utilized; the relative lag in the capital goods sector; the partial distortion of financial intermediation in the direction of short-term financing; and the insufficient weight carried by the domestic entrepreneur in the more dynamic industrial sectors.

This list, however incomplete and schematic, suggests that any appraisal of the results of Latin American industrialization must take into account a wide range of economic, social, political and cultural factors, which together would explain the gestation of this very special mode of growth. Apparently, the basic feature of industrialization in the mature economies of today, and also in those of Southeast Asia which carried out the process more belatedly, can be said to lie less in the use of specific policy instruments—which, in general, are reproduced in Latin America, although with different weightings—than in the closely-knit character of these societies, the result of historical processes which in the political sphere are typified by a clear leadership, accepted and recognized by the rest of society. Although this leadership, whose origin and nature vary according to political systems and different periods, as do also the social sectors and

institutional modalities by which and through which it was exercised, was not exempt institutionally from conflicts and even breakdowns, it was favourable to the definition and relative stability of long-term strategic options.

These options, combined with the existence, at the social level, of minimum norms of solidarity—which for the sectors exercising leadership implied the assumption of certain responsibilities towards the subordinate social sectors, associated with a sense of belonging to the national entity—helped to spread belief in the prospect that the inequitable initial situation would gradually be set to rights. The projection of this evolution in the economic sphere took the form of a linkage between State and society, with modalities that obviously varied with systems, histories and periods and that fostered the acceptance of an order in the framework of which a gradual process of cultural integration and technological learning was generated. Thus each country's national objective of strengthening its relative importance in the international economic concert was made viable.

In the determination of the international competitive potential of the aforesaid development processes in closely-knit societies with leadership, gradual construction of a consensus, minimum norms of solidarity and linkage between State and society, a basic feature was precisely the existence of the "endogenous nucleus of technological dynamization" defined above, which ensured the continuity of a process of assimilation, learning, adaptation and innovation functional to meeting internal needs and turning local potentialities to advantage. This "endogenous nucleus of technological dynamization" guided import substitution and accounted for its simultaneous progress alongside gradual generation of exports on the basis of a systematic learning process.

In countries endowed with an abundance of certain natural resources, even though the domestic markets were small, the learning process implied an intellectual value added which made it possible to reach levels of excellence in the sphere of manufacturing techniques and of the equipment required to exploit and process the natural resources in question, as well as to find new uses for them and

new designs associated with their utilization. This is the situation, for example, in the Scandinavian countries, which carry considerable weight in international trade in manufactures, technologically linked to the endowment of natural resources. The comparative advantage built up with the help of domestic creativeness, making the most of natural resources in small markets, is the practical expression of the existence in those countries of the element which has been defined as an "endogenous nucleus of technological dynamization", and which serves as a mainspring of viability for the national objective of survival and ever-increasing relative importance in the international context; the same thing is observable in countries that are lacking in natural resources.

Cases in point are afforded by countries like Japan and its former colony, Korea, in which it was precisely the relative shortage of natural resources that constituted the main mobilizing factor in the process of innovation required to make up for that insufficiency through the capacity to compete internationally in the processing and manufacturing phase. It was a matter of facing the challenge to survive and defend their existence as national entities; in those countries, the process of modernizing agriculture, with differences in pace and intensity, preceded and then accompanied the industrialization process, just as in the Scandinavian countries and in those that gave impulse to the first and the second industrial revolution, the United Kingdom and the United States. But in this second group of countries, which followed the path of modernization from below, the relative participation of the market with respect to the State was greater than in the first group. In the case of Japan, whose industrialization was late, and in that of Korea, where it was still more belated, the State fulfilled a decisive function in the linkage and modernization of the activity of the various agents and sectors from above, which proved functional for this transcendent national aim of survival and betterment of the population's level of living, strengthened, in both instances, by obvious geopolitical motivations. The initial export of light manufactures involved, like protection, a learning process which was to

make it possible gradually to evolve towards technology- and capital-intensive manufactures, but the decisive factor in that evolution was the association, learning, adaptation and subsequently innovation effort, of fundamental importance for competing in the international market, in turn a determinant of national survival.

The participation of these countries in international markets is largely explained by the higher priority they conceded to the learning process and to the building-up of a technological infrastructure, as well as to the latter's linkage with the production sector, and by a systematic policy of support for small and medium-sized

firms organically linked with leading enterprises. One of the basic requisites in all these experiences was the way in which the private interests of the social sectors that exercised leadership were subordinated to the national interest, making it easier for the rest of the society to take the view that although to begin with the wages and income distribution situation was inequitable in comparison with that of Latin America, there was room for hope that under this conduct, not exempt from coercion but bold, austere and self-identified with the national interest, the subsequent evolution of the economy and of society would gradually tend to even matters out.

IV

Industrialization strategies and the curious State or market dilemma

Financial intermediation, which has indubitably followed different institutional patterns in Western Germany, Japan and Korea, nevertheless has in common in those cases the fact of having been systematically at the service of a resolute policy of industrialization and innovation aimed at upgrading the possibilities of international competition. This common feature seems to be of greater importance than differences with regard to the public or private character of the financial sector or to the practical pattern of linkage between it and the industrial sector; in one case industrial development was conducted by a financial sector committed to industrialization and the long term; in others that sector functioned as a support service for the leadership exercised by the industrial groups themselves. In the case of Korea, up to the beginning of the 1980s, it performed an almost exclusively public supporting function of preferential channelling of subsidized resources towards the strategic objective of promoting the growth and technological learning process of the private

national groups which gave impulse to the country's industrialization. As an example worth quoting of the pre-eminence of investment over consumption, up to 1981 colour television sets that the country manufactured and exported were not sold on the domestic market to prevent a decline in family rates of saving.

What has been said of the linkage between financial intermediation, the State and the industrialization process constitutes a special illustration of the reservations that should be borne in mind with respect to precise recommendations on the paradigmatic function of the market. Its function has in fact been important in those historical experiences in which modernization from below generated forms of social organization characterized by relative symmetry in access to economic and political power and culminating in democratic institutions compatible with the political alternation which is based on the existence of a high degree of consensus respecting the merits of the existing system. In cases of late industrialization, the weight carried by the

State in the development process has been decisive and much has been written on the subject. It is interesting to stress that in those instances —among which appear some European countries and Japan— where democratic institutions were introduced after the Second World War, political alternation is not yet an established practice.

When attempts are made, in societies that are characterized by asymmetry in access to knowledge, to information and to economic and political power, to impose it from above, or on the basis of doctrinaire considerations assigning the central role to the market and a subsidiary function to the State, dynamics of concentration and speculation are generated. These have destabilizing consequences which, paradoxically, induce the State to intervene and to expand its role, and even to overstep the limits by which that role was bounded in the preceding phase.

In the light of these considerations, the linkages between State, market and industrialization strategies are patently subjects in connection with which it is hardly possible to formulate narrow recommendations in which no heed is paid to national sociopolitical specificities. The diversity of situations within Latin America is so obvious that, given the level of abstraction and generality at which the present article is written, all that can be offered is a very modest methodological suggestion, prompted by recent events: namely, that as regards encouraging the insertion of national firms in international markets and making it technologically and financially viable, a decisive function of guidance and catalysis is incumbent on the State. With specific reference to the technological sphere, it might be asserted that in view of the peculiar qualities of technology, which is at once merchandise and service, and of the acknowledged distortions that characterize the international market in which it is traded, it is the function of the State to guide and link up the innumerable private agents that participate in the technological development process on which competition at the international level is based. On the financial side, the contribution made by the governments of the OECD countries to the adjustment process in their industrial-technological systems is an unmistakable

pointer which Latin America cannot afford to ignore.²

It is obvious at a glance that the capacity to generate industrial exports clearly reflects the quality of industrial development, and that an industrialization process which is capable of gaining and keeping a foothold in the international market with its manufactured products is better than one which does not succeed in doing so. It is not to be inferred, however, from this virtually redundant assertion, that the problem can be resolved by assigning to export promotion a quasi-magical function in supplying the inherited wants that have been accentuated in the recent period of crisis. Even if the criterion were adopted that industrial exports measure, in a sense, the success of industrialization, the real problem posed (theoretical and practical) consists in identifying the combination of measures, instruments, policies and institutions, at the macroeconomic, sectoral, regional and even microeconomic levels, which can gradually shape production systems and institutional frameworks with learning and innovating capacity, a highly relevant issue in this transitional phase of industrial-technological patterns at the international level. Neither chance nor greater or lesser knowledge on the part of the respective economists can account for the very small number of cases of late industrialization that are export-oriented.

The non-existence of an "endogenous nucleus of technological dynamization" in some countries of the region and its precariousness even in the countries of larger size and a more advanced degree of industrialization explain why the designing of products, processes and manufacturing techniques has not been functional to the satisfaction of domestic needs and the exploitation of local potentialities. It likewise accounts for the existence of structures of production that are fragmented in relation to

²A suggestive and vigorous analysis, from a neoclassical standpoint, of the function of the State and the limitations of the market in the industrial and technological development of semi-industrialized countries appears in Howard and Westphal (1985). For the most recent quantitative data on the public contribution to the financing of research and development activities in the OECD countries, see OECD (1984).

the size of the domestic markets, the failure to take sufficient advantage of the agricultural, forest, fishing and mining resources available and the inadequate energy base which has supported the industrialization process. This and other factors, which in the last analysis are linked with the process of gestation of the Latin American societies and with their evolution in recent decades, suggest that with a few exceptions in individual countries and particular periods, the industrialization process has been inserted in a setting characterized by precariousness of internal consensus and leadership, by predominance of private interests over the national interest, by a generally high degree of social fragmentation and economic exclusion which accounts for the frivolous nature of import substitution, and by the relative insignificance of industrial exports (the industrial exports/industrial output and industrial exports/total exports ratios are notably lower even in the more advanced countries of the region, like Brazil, than in other countries and regions with a comparable degree of industrialization).

In short, when there is no "endogenous nucleus of technological dynamization" or when it is insufficiently consolidated, an industrialization process is generated in which the foreign exchange balance is much more unfavourable than it might be in conditions in which the size, market and resource endowment of the various protagonists were the same, but in which the value and incidence of entrepreneurial function, whether public or private, were definitely appreciated. This more unfavourable foreign exchange balance stems from the relative incapacity of local production to compete internationally against potential imports from foreign markets, an incapacity which, in consequence of insufficient internal creative effort, is reflected in and reinforces unnecessary use of foreign exchange. In practice, this means the consolidation of a structure of production which uses imports that are unnecessary under the head of design and information, a statement applicable both to the design of energy, transport, health, communications, housing, education and food supply systems, and to that of industrial products functional to local conditions; the deficiencies at

this level make themselves very keenly felt in the following respects: i) inputs, since local raw materials, foodstuffs and energy resources are not exploited; ii) manufacturing techniques, as regards both the inappropriate use of manpower and the failure to take advantage of traditional organizational patterns which could be modernized without losing their value; and iii) capital goods, both through the importing of goods that could be locally produced, and through the waste of capital goods immobilized in an atomized structure of production with a high degree of idle capacity, besides over-spending on armaments.

Insufficient industrial exports and unnecessary imports are head and tail of the same coin: the absence of creative activity. They join forces and converge to account for the external bottleneck. It is idle to cherish the illusion that a high exchange rate, together with institutions specializing in export promotion and a marked contraction of domestic demand, will be enough in themselves to supply the deficiencies mentioned, although obviously they help to discourage imports —not necessarily those that are non-essential— and to stimulate the promotion of exports which do not require domestic technological effort and the release of surpluses by virtue of the decline in domestic consumption. Rationalization of the existing structure of production, correction of the industry-agriculture asymmetry, selective channelling of financial resources into the sectors that give impulse to industrialization (which obviously vary according to the countries concerned), and linkage of the educational system, the mass communication media and the scientific-technological infrastructure with the productive system, are some of the basic requisites for setting in motion an internal innovating process capable of contributing to the sound and sustained enhancement of the capacity for international competition, on the part both of import-substituting products and of those intended for export.

The advanced and late-industrialization countries which have successfully made their way into the international markets have clearly understood that concerted and sustained national action, with long-term projections on the technological level, is a *sine qua non* for

building up future comparative advantages. It is worth while to quote recent and irrefutable examples, totally different in nature, in which action of this kind has been taken (in addition to the current national technological policies of the advanced countries, mentioned above): Korea's ongoing policy (Chon, 1984) in the electronics sector and, in the United States, the policies of the various states (Brody, 1985) which compete for the location of high-technology enterprises in their territories. These instances reveal a long-term outlook, the participation of the public sector at the level of definition of priorities, the channelling of financial resources on preferential terms, and the existence of fiscal incentives, of a scientific and technological infrastructure and of human resource training activities, and all this in close linkage with the large, medium-sized and small national firms which are giving impetus to industrial development today or might do so in the future. Some countries in the region are beginning to awake to the necessity, in face of the economic crisis and external constraints, of introducing innovations into the industrialization pattern in a direction compatible with what has been said here: this new awareness is exemplified in the rationalization of the motor-vehicle sector, which acted as a stimulus in the preceding phase of industrialization and whose central objective is to improve the foreign exchange balance; the initiation of rationalization programmes in energy consumption, a sphere in which the region, with the exception of Brazil, has displayed great inertia; support for local production of basic foods for domestic consumption, a matter which must be taken into account both in relation to external constraints and in connection with its contribution to the viability of democratization processes; the establishment of systems of concertation between the public sector and entrepreneurial activity, particularly in the sphere of export promotion; a lowering of protection in countries where a certain inertia in this respect predominated and an increase in it in those cases where a radical and indiscriminate reduction had taken place; and, lastly, a generalized conviction that linkage between the scientific and technological systems and productive activity is vital for surmounting external constraints. These measures and convictions are auspicious

signs, although fragmentary, partial and insufficient, of incipient internalization of the idea that action must be taken on a number of fronts all at once, in order to evolve in the direction of a new industrialization pattern, functional to the task of meeting needs on the basis of systematic development of domestic potentialities, compatible, at the same time, with the requirements of the international market. To this end, it must be recognized that the complexity of the challenge transcends both the proposition that eliminates the inefficiencies of industrialization by questioning their existence, and that which pins the hope of overcoming them to the perpetuation of the previous industrial pattern for as many decades as it might require to make up its leeway from biological causes. The first of these options has given empirical proof of its results, and the second is totally non-viable, even if only on account of the familiar external constraints.

Education, and the use it has made of the mass communication media, on the basis of the most modern techniques available, may exert an influence on the attitude of the various social agents that participate in the economic process, exceeding in importance each of the individual instruments of commercial policy. This subject, which is analysed in the section on technology development, illustrates the need to tone down the simple and therefore attractive options which make individual instruments of trade policy the centre of attention. The view held by society as a whole of the national vocation of those who exercise leadership, the social valuation of innovation and of the entrepreneurial function in a broad sense of the term, are factors determining the possibility that the economically difficult conditions in which most of the Latin American population will live during the coming decades may be accepted as a legitimate period of transition leading to a more favourable future prospect. Whatever may have been the initial income distribution conditions in the various Latin American countries, the decisive factor is the achievement of modes of social concertation which will legitimate leaderships, so that in this period of economic hardships it may be possible to prevent fragmentation from being accentuated and, in some cases, the very survival of national States from being called in question.

V

On the supposed emergent leadership of the services sector

1. *Twilight of industry or complementarity*

Wide currency has been gained by the idea that a transition is taking place from an era in which the driving force has been the industrial sector to a future in which this role will correspond to services, the agriculture-industry-services sequence being thereby completed. This notion is based on two simple and for that very reason beguiling observations: the rise in income generates a more than proportional demand for services; and as the expansion of employment in services thus exceeds that of total employment, a growing proportion of jobs is to be found in the services sector.

On the basis of this idea policy recommendations have been formulated in Latin American countries which have favoured the dismantling of industrial plant in order to hasten the advent of the new era. In this connection, however, several comments are called for which, taken as a whole, alter the linear image of an agriculture-industry-services time sequence, and some of which are briefly outlined below. In a high proportion of services the reason for their expansion lies in the changes undergone by the manufacturing sector as a result of income increases, keener international competition, and the growth of the public sector. The services generated by these changes maintain close technical linkage with the industrial sector, with which they build up relations of complementarity, not, as might be deduced from the original thesis, of substitution.

The following are some of the changes in the industrial sector which give rise to the expansion of specific services:

i) The increase in consumption of durable goods, motor-vehicles and electrical household appliances, leads to the expansion of financing, marketing, maintenance and publicity services, and the jobs generated in these activities quickly outnumber those required in the production phase;

ii) The decline of the rate of return in the industrial sector, which began at the end of the 1960s, accounts for the channelling of resources towards those services associated with the so-called "paper entrepreneurialism", with the consequent growth of the commercial, financial, legal advice and real estate intermediation sectors. A recovery in the rate of return would tend to modify the proportions observed during the crisis period;

iii) The shift of focus of competition from prices to differentiation of products is a stimulus to publicity and marketing services;

iv) Technical progress in the industrial sector cuts short the working day, which demands increasingly less physical effort, both at the place of work and in household activity. Consequently, there is an increase in demand for entertainment services, which incorporate, furthermore, consumption of industrial goods and equipment (television sets, sports equipment, tourist facilities, etc.).³ The leadership of the United States in the entertainments "industry" is a factor of vital importance in evaluating its future insertion in the international economy;

v) The stepping-up of competition at the national and international levels encourages specialization in activities producing goods and in those services that were formerly incorporated in firms, and that are becoming independent entrepreneurial activities: computer services, engineering firms, management of financial activities, etc.;

vi) The internationalization of industrial activity fosters the internationalization of the services activities connected with it, which explains why it is just those countries whose services activity abroad is greatest that are the

³It is estimated that at the beginning of the century the annual number of working hours per man was 140 000, and that today it has probably been reduced to 72 000 hours per year (Tsuru, 1983).

most enthusiastic promoters of the liberalization of international trade in services;

vii) The systematic expansion of the public sector in industrialized economies, resulting from a complex process in which legitimization and accumulation requirements proper to industrialization and to urbanization are combined, generates, on the one hand, the expansion of specific public services such as education and public health; on the other hand, through increasing regulation, it leads to an entrepreneurial reaction which is reflected in a wide variety of advisory services supporting firms in their linkage with the State.

Hence the inference is that there is no magical relationship between rising income and demand for services; in contrast, an economic and social transformation is taking place which simultaneously modifies the industrial sector and a variety of services that are linked with it in relationships which differ in kind, but nevertheless point towards complementarity (Stanbaek, *et alii*, 1983, p. 40).

2. Incidence on employment

A major share of the increase in employment in the services sector is located in activities whose level of productivity is low and static; retail trade, health and education. In these activities, price levels have shot up much faster than in industrial activities. Thus they have become a source of inflationary pressure that is by no means negligible and a factor which partly accounts for the decline in the growth rate of global productivity.

In the case of the health sector, mentioned as one of the most outstanding examples of the relation between rising incomes and demand for services, the growth rate of prices has been so high (especially in the United States, but also in other industrialized countries) that there is a growing awareness of the imperative need to introduce institutional and regulatory changes which will make it possible to raise productivity and contain price increases.

Generally speaking, services activities where productivity is low and stationary can be said to be representative of the initial phase of an industrialization process, i.e., the introduction of industrial logic, with the consequent presence of

production equipment and processes deriving from industry. This can be clearly seen in marketing, health and training services, and even in such tertiary activities as hairdressing establishments and psychiatric clinics (Druker, 1984).

In so far as the industrialization of low-productivity services continues, with an ever-larger contribution from information sciences, these activities will tend to do less and less to expand employment. Services in which productivity is high and increasing, such as communications, financial services or wholesale trade, are characterized by their high degree of industrialization, with much less and more slowly-growing employment than is found in low-productivity services.

3. Leadership of communications

From the standpoint of supply, the basic factor accounting for the so-called revolution in information sciences is the rapid technological progress recorded during the 1970s in the microelectronics, telecommunications and computer spheres; this explains the steep fall in costs of transmission, processing, storage and reproduction of information. In other words, it is the technical progress generated in a few branches of the industrial sector that makes it possible to sustain the simple and alluring slogan that in the future information sciences will take the place of capital and labour as basic factors of production. It is not by chance that the communications sector, the most industrialized of services, is the one that seems to be assuming the leadership in the transformation that is being undergone by the structure of production of goods and services as a whole. Indeed, as regards the attributes of leadership —growth rates of output, of employment, and of productivity, the level of productivity and the rate of decline of relative prices— the only sector of production that shows more favourable levels than the economy as a whole in all those five indicators at once is the communications sector.

In the manufacturing sector, this privileged situation of the communications sector is shared by activities in which hardware is strengthened (the physical component of the so-called information technologies, microelectronics,

computer sciences and telecommunications). If an attempt were made to identify the sector that stands out as having most drive, it would be located at the point where linkage occurs between those industrial sectors that produce information technology equipment and the service activities that transmit, process and disseminate information. Starting with these sectors, ongoing technical change spreads, at different rates and in different forms, to the whole set of activities producing goods and services. It is a question of leadership of what might be termed the information sciences system, which comprises a symbiotic combination of hardware and software.

4. Insertion in the international economy and industrial competitiveness

The countries' possibilities of international competition and their prospects of long-term insertion in the world economy are still essentially determined by the efficiency of their respective industrial sectors, generators of the technical progress which spreads to other

activities and influences their levels of productivity. In a period of recession, a country may cope with the problem of unemployment by expanding services not exposed to international competition, an option in which Latin America has plenty of experience; nevertheless, over the medium and long term the question of international insertion is still determined by the competitive capacity of industry and of the industrialized services linked to it.

Hence can be inferred the importance of incorporating into medium- and long-term analysis of the new industrialization the changes under way within the industrial sector, the increasing complementarity between the industrial and services sectors, the trend towards industrialization of activities previously classified as tertiary, the emergence of a leadership of the information sciences system with its hardware and software components articulated around the axis of communications, and the consequent importance of the competitiveness of the manufacturing sector in determining the degree and form of Latin America's insertion in the international economy.

VI

Concluding remarks

From all that has been said it may be deduced that in analysing the present financial crisis of the Latin American countries it is indispensable to take into consideration, in addition to the above-mentioned external factors, the structural aspects of the strategy pursued hitherto. The fragility of the external situation is closely bound up with this industrial pattern; the precarious leadership exercised by the motor-vehicle industry, combined with the dearth of capital goods and the lag in their production, the asymmetrical relationship between industry and agriculture, the dysfunctionality of the energy base, are the fundamental reasons for

vulnerability to external causes and, consequently, for external indebtedness. An indispensable requisite for overcoming this vulnerability is the transformation of the industrial pattern in question, as well as of its linkages with the agricultural sector and environmental resources, with the energy base, with the financial intermediation mechanisms by which it has been supported, and with the various components of the services sector, especially the social services (health, education, housing) and communications.

In general, instead of a faithful but technologically dephased image of the

industrialization of the advanced countries, what is to be found is a stunted and distorted reproduction of that original model, which in part at least is ill-fitted to meet the needs of a large proportion of the population and which at the same time is incapable of developing its creative potentialities and taking full advantage of the abundant natural resources available. It would seem obvious that the neoliberal proposition, which deals with the inadequacies of industrialization by questioning their existence and backtracking to outdated schemes of an international division of labour under which the Latin American countries would figure as resigned to the dull and relatively insignificant function of exporters of natural resources, does nothing to solve the problem of accumulated social needs.

The assignment of strategic priority to the development of industrial exports, and to the rationalization of the inherited structure of production as a prerequisite for the viability of the foregoing objective —points on which there is a consensus— must be carried to the utmost extreme, in full awareness of the fact that a task of national dimension is being undertaken, which far transcends the sphere of trade policy and even that of economics. It is a matter of embarking upon a new development style which will promote both inward-directed linkage and the enhancement of external competitiveness. International experience suggests that the question is not one of options at opposite poles, but one of requirements which reinforce each other.

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Inflation and stabilization policies

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Inflation, even at moderate rates, is not innocuous, since it is generally associated with erratic variations in the level and structure of prices. Nevertheless, if it is kept within certain bounds, the economy is able to find ways of adapting itself and activity can develop without undue uncertainty.

The nature of the problem changes in situations of high inflation, such as those that have affected several countries in recent years. In these cases economic activity is seriously disturbed. The public sector and the private agents shorten the time horizon of their decisions; the authorities are harassed by the difficulty of administering an almost unpredictable economy, while the public makes great efforts to safeguard itself against the changes in prices or to take advantage of them. When speculation becomes rife, it is more likely that the measures taken will be mutually inconsistent; the abrupt fluctuations in prices also help to aggravate social conflicts. The economies subject to this turbulence have serious problems in dealing with the issues of growth. Thus the control of inflation seems to be a *sine qua non* for the reasonably effective functioning of the economic system.

Few questions have been so much debated, from both theoretical and practical angles, as the phenomenon of inflation. Nonetheless, the controversy persists. The aim of the present article is to comment on these debates, indicating some of the problems underscored in the analysis of the causes and consequences of inflation and in the designing of stabilization policies. The last part briefly reviews one particular stabilization policy: the *Plan Austral* applied in Argentina since the middle of 1985.

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I

The debate on the causes of inflation

1. Statement of the problem

There have been many controversies on the origin of inflation.¹ This is due in part to the ambiguity of the question itself. In an inflationary situation there is a simultaneous, though not always equal, rise in the different categories of prices, in wages, in the exchange rate and in monetary aggregates. What is the cause of the rises in the general level of prices? The question may refer to issues which are very diverse from an analytical standpoint: to the immediate determinants of prices (i.e., in econometric terminology, to an equation of the model in structural form); or to the ultimate causes of inflation (i.e., to an equation in a reduced form, in which only exogenous variables would be taken into account).²

As regards the first point, there is at present no well-established theory on price formation: both the equilibrium models and those that postulate fixed margins over costs give only an imperfect idea of the complexity of the functioning of the market. The question is not merely academic, because this lack of knowledge prevents precise determination of the speed and scale of the transfer of cost increases to prices in different circumstances, or of the reaction of prices to changes in demand. This raises some doubts about hypotheses on inflation based on very rigid assumptions as to the mechanisms of price formation.

¹There are several widely disseminated studies that present a picture of the state of theory at different points of time (Bronfrenbrenner and Holzman, 1963; Laidler and Parkin, 1975; Lipsey, 1981; Frisch, 1983). A comparison of these works clearly shows the diversity of the approaches, as well as the changes that have taken place in theory in the course of time.

²The distinction appears in Addison, Burton and Torrance (1980). In the models applied the character of the price equation is not always clear. For example, an equation that relates prices to wages, the exchange rate and the money supply belongs in principle neither to the structural form (because the money supply can hardly have a direct effect on decisions about prices; at all events it will act through its effect on global demand or expectations) nor to the reduced form (because it does not seem that all the independent variables can be treated as exogenous).

At all events, decisions on prices depend not only on directly observable variables but also on the agents' conjectures as to the conduct of others. This implies that the more clearly-defined are individual forecasts, the more orderly the variation in prices will be. It also seems that the response of prices to a given stimulus will depend on the perceptions and expectations of those who fix the prices. Above all, the pattern of price adjustment will vary according to the public's estimation of future decisions on economic policy.

This does not mean that everyone has the same perceptions, or that these coincide with the "real" mode of action of the authorities or of the other agents. Indeed, one of the features of high inflation would seem to be the inconsistency of expectations. In that case, price-fixing behaviour patterns too would be difficult to describe systematically. If these vary with the inflationary régime, there will probably be no need for a precise explanation of the price changes in a given régime in order to analyse the transition to another (because the change itself would make behaviour vary). For example, in considering stabilization policies, it would seem to be less important to have an idea of the way in which prices are fixed in inflation than of the behaviour patterns observed once the policies in question have been introduced. Of course, there remains the problem of recognizing when a change of régime has actually taken place.

In analysing the ultimate determinants of inflation, the function of the authorities' reaction must likewise be taken into account, because, depending on this, certain variables might be regarded as exogenous, while others (including some policy instruments) would be determined as a result of those. But the concept of the exogenous is ambiguous, since it depends on how far the explanation is to be taken: for example, in monetary models it is customary to regard the money supply as a datum, but, generally speaking, monetary policy will probably react (perhaps differently with the passage of time) to the fiscal situation, to the level of activity, etc.; in turn, an attempt may be made to explain the changes in these variables as a response to other influences (economic and extra-economic), and so forth and so on. This gives rise to two symmetrical risks: on the one

hand, the postulation of simplistic explanations (e.g., the assumption that certain instruments may be varied at will, when this is not the case); and, on the other, the pursuance of the argument to a point at which no reasonably precise affirmations can be made.

It is, in the end, a matter of criterion. Nevertheless, since inflation can in principle arise in different ways, with different consequences in each case, it is necessary to consider the process that gives rise to price increases. This argument can be illustrated by an example which has little to do with the inflations observed in practice, but which, for that very reason, points up a contrast with the theories under discussion.

Let us assume an economy with the following characteristics. There is a benchmark or reference price, fixed arbitrarily in each period; it is immaterial for the exercise whether this price is determined by the public sector or by some private-sector agent (or group). Each time that the price varies individuals receive a transfer of money which raises their holdings of monetary assets in the same proportion (k) as the benchmark price.³ The debts of the public sector, if any, and prices controlled by the government are also modified proportionately. In the last instance, when the price of the benchmark product changes, a sort of monetary reform occurs; probably the private agents will realize that, if all prices are multiplied in the proportion k , markets will prove to be in the same real situation as before the change. Nor, moreover, will pre-existing contracts be affected if (as is reasonable to expect in this case) individuals include an indexation clause in their future payment contracts. In other words, even though the general level of prices (determined by the benchmark price) may evolve erratically, with a rising trend more or less pronounced, inflation will have a neutral effect in practice. Furthermore, if inflation had these

³The example (which is suggested by Leijonhufvud, 1983 b) assumes an explicit policy of inactive money. The conclusions would be exactly the same if the initiative came from the monetary authority. It should be noted, on the other hand, that with the hypotheses of the example there is no inflationary tax on stocks of money and therefore there is no reason why demand for real balances should depend on the variations expected in the benchmark price.

characteristics, it would be easy to eliminate: it would suffice to fix the price of the benchmark product once and for all. (No notice is taken here of the variations in nominal prices due to changes in the relative price of the benchmark product. For the merely illustrative purposes of the present example, this does not significantly affect the argument.) Since no group of agents gains or loses as a result of this and since presumably prices would immediately be adjusted to the fixed benchmark price, the measure would not cause resistance or upheaval.

This elementary example has a negative purpose: namely, to show how strict are the conditions in which inflation has a well-defined cause and innocuous consequences. In fact, in the exercise it is postulated that:

i) Monetary policy is extremely restricted, since it is confined to increasing the money supply, with all due notice, in the same proportion as the price of the benchmark product;

ii) Fiscal policy is also subject to a major restriction: it has no access to monetary financing except to make transfers in proportion to cash holdings. In other words, there can be no deficit financed by a money issue over and above these transfers;

iii) Prices regulated by the government (public service tariffs, exchange rate) must rise in line with other prices;

iv) Workers and firms are accurately acquainted with the functioning of the system, adapt their behaviour to that knowledge and rely upon other agents' doing the same. This implies, in particular, that there has been a previous learning period which has led to the adjustment of decisions on prices and of ways of drawing up contracts;

v) Given these assumptions, the origin of price variations can be found, straightforwardly enough, in the price of the benchmark product. There is no specific motivation, however, for this inflation: the authority that fixes the reference price at any given time has no particular interest in whether it has this or that value.

None of these conditions is fulfilled in practice. Inflationary processes appear to be due to a complicated interplay of action and reaction between economic policy and the different parts

of the private sector, which cannot be represented in the simple and well-defined terms of the foregoing exercise. At all events, to try to understand this interplay, and the persistent rise in prices that ensues, it is necessary to introduce simplifying assumptions. Several types of general hypotheses on the origin of inflation have been proposed, differing with respect to price formation mechanisms and to the direction of the causality they postulate between prices, wages and money.

2. Monetary-fiscal theories

According to the most traditional concept, inflation is always and everywhere a monetary phenomenon (Friedman, 1968). Monetarism today differs from the former construct of simple quantitative theory and of demand inflation models (in which inflation was associated with conditions approaching full utilization of capacity): the theory does not postulate a necessarily close relationship, period by period, between money and prices, since it admits various anticipations or lags and also rationalizes situations of price acceleration with simultaneous declines in activity. But these effects would be explicable, in any case, as resulting from changes in the money supply. Monetarism is, in the first place, a methodological position: the level of prices is analysed through money supply and demand. Secondly, traditional monetarism considers the money supply as an exogenous variable, which regulates global demand⁴ and, through this, real output and prices.⁵

In the most typical simple model, demand for money is expressed as a stable function of nominal income and the rate of interest, which, in turn, is equivalent to the sum of the real

⁴Except where otherwise stated, the terms "global demand", "aggregate demand" and "demand for goods" are used here to designate a variable that defines the position of a demand curve (i.e., they refer to the function that determines the ratio between prices and global quantities). This can be approximately assimilated to nominal income. An increase in global demand, defined in this way, is compatible with a variation, either positive or negative, in quantities of output.

⁵The conventional analysis can be extended to include monetary régimes in which the money supply is an endogenous variable. A case in point would be the monetary model of open economies with a fixed exchange rate, which is discussed later.

interest rate (assumed to be more or less constant) and the anticipated inflation. A global supply function is postulated, which links output with current prices and expected prices.⁶ These depend on the evolution of the money supply, or, at all events, on price trends in the past.⁷ Output and the general level of prices in the current period are simultaneously determined, therefore, by the present value and the expected value of the money supply.⁸

The theory has two components: the association between money and prices, on the one hand, and the hypothesis of the exogenous nature of the money supply, on the other. Respecting the first point, a distinction can be made between the closed-economy monetary models and those of an open economy. In the closed-economy models prices respond to the conditions prevailing in the domestic markets, which, in their turn, would be governed as a whole by the money supply. The open economy models (Frenkel & Johnson, 1976 and 1978) are based on the single-price rule for tradeable goods: the trade-off between purchases or sales in the country and abroad would cause prices to be governed by international prices and the exchange rate (once the effects of taxes on external trade had been discounted). In the simplest hypothesis, the level of prices is directly determined by the condition of parity of purchasing power; generally speaking, it is recognized that the real exchange rate can vary owing to relative price changes as between tradeable and non-tradeable goods. The more open the economy (in the sense that the share of tradeable goods is greater), the closer will be the linkage between domestic prices and the exchange rate. The way in which money and prices are associated will depend on the

⁶See Friedman (1974), Lucas (1973 and 1981), Cagan (1956) replaces the supply curve by the assumption that the quantities produced are constant.

⁷The difference in assumptions on formation of expectations among the authors who accept the monetary interpretation of inflation is reflected in different attitudes towards stabilization policies. For the purposes of the present discussion this difference is not essential.

⁸The monetary model recognizes that the exogenous variations in the supply of goods (caused, for example, by random changes in primary production) can affect price levels. However, a distinction is also drawn between once-for-all changes in prices and their persistent increase; the latter would have a monetary origin.

international payments régime. With a floating exchange rate the money supply will affect prices (through its effect on the value of foreign exchange in local currency), whereas with a pegged exchange rate (when there is parity of purchasing power), the causality, moment by moment, will be reversed.⁹ Nevertheless, whether the exchange rate floats or is handled as an instrument of economic policy, the trend of prices will be determined by the money creation of domestic origin.¹⁰

Writers differ in their positions regarding the supposed exogenous character of the money supply (or of domestic credit, if an open economy model is applied). For some, the monetary authorities can regulate the volume of their domestic assets. Others, on the contrary, contend that this capacity is small: even if a close relationship exists between money and prices, it is not monetary but fiscal policy that will determine the rate of inflation. These authors point out that the financing of the government limits the autonomy of monetary policy: the public-sector deficit can be temporarily covered by securities against the debt, but, if funds are not generated to service this debt, in the last resort it will have to be monetized. In other words, the fiscal deficit has repercussions on the money supply, whose increase determines that of prices.¹¹

⁹Writers do not agree on the capacity assigned to the Central Bank to sterilize reserve flows; i.e., to control the money supply in the short run by fixed exchange rates (Darby, 1980).

¹⁰The connection between domestic credit and prices would be more indirect with a fixed exchange rate, especially if there were marked capital mobility, because the variations in international reserves would offset those occurring in the Central Bank's internal assets, so that the latter would have little effect on the money supply and prices. Nevertheless, the monetary models emphasize that this independence is limited; in the long run, the exchange rate must vary at the same rate as domestic credit (because, if not, the flows of reserves would become insupportably great), so that this latter regulates the average value of the rate of inflation (Rodríguez, 1979).

¹¹See Sargent and Wallace (1981); for the Argentinian case: Cavallo and Peña (1983). In the original argument, there is no essential linkage from period to period between deficit and prices: it is not the temporary but the permanent credit requirements that will cause inflation. The fiscalist position is sometimes expressed as an assumption that prices grow in proportion to the public debt in a broad sense (i.e., including both money and other assets that produce interest). This point of view ignores the possibility of changes in demand for assets, and it is assumed that an open-market operation (which replaces one form of debt by another) would be irrelevant, which is not obvious.

Analysis of the determination of the money supply has recently been extended in an attempt to represent the interaction between the behaviour of the monetary authorities on the one hand, and that of the public or of other sections of the government, on the other. The following would be an example of these models.¹² The economy is represented by a Phillips curve amplified by expectations: if global demand (which depends solely on the money supply) grows at the pace predicted, prices are adjusted in the same proportion and output remains at its equilibrium value; unexpected increases in demand give rise for a time to greater activity, while prices react less than proportionally to the variation in expenditure. Individuals know this and incorporate the datum into their price expectations; they are also informed as to the behaviour of the economic authority, whose measures give preference to conditions of low inflation and high output. Below a certain level of inflation, the authorities are willing to increase demand if this implies greater activity; beyond that point they consider a decline in the real product acceptable in exchange for a lower inflation rate. There is consequently an equilibrium which consists in maintaining the rate of inflation at that critical figure, since any other situation would be unstable; if, for example, the rise in prices were lower than that figure, the public would expect the government to try to raise global demand, and would adjust their expectations accordingly. Only at the critical point of the inflation rate are the government and the public without incentives to change their behaviour.

It will be seen that, in this model, the rate of inflation is determined, in the last analysis, by the preferences of the authorities (one of the weaknesses of models of this type is that they do not define how these preferences are formed and how they come to be known by the public), and

the parameters of the economy, particularly quantity-price elasticities over the short term. In other words, although the hypothesis of a relatively simple association between money and prices is maintained, an exogenous explanation is sought for the changes in the money supply, so that the cause of inflation is identified with the determinants of this supply.

The models of this type are of obvious interest, since they show how the rate of inflation depends on the nature of the responses that the evolution of the economy evokes in the authorities, and *vice versa*. They also lead to conclusions that are useful for the discussion of stabilization policies: to a large extent, a sustained change in the inflation rate may be seen as a modification of the game that determines price increases. In contrast, these models also demonstrate the complexity of the analysis, even when it is based on clearly-defined assumptions as to behaviour. Inasmuch as they are based on relatively simple games and impose conditions of equilibrium and rational expectations, the models probably give an oversystematic interpretation of the inflationary process. Both from the standpoint of the study of causality and from that of the description of price formation mechanisms, the monetary and fiscal models leave problems unresolved.

In point of fact, the association between money and prices seems difficult to reduce to a simple formula. In a sense, the monetary models do not offer an independent explanation of prices: these would be deduced residually from the money supply and the other determinants of demand for money. Between changes in the money supply and in prices there is an implicit sequence of effects, passing through global demand and the public's expectations with respect to this, which is not described precisely. To begin with, the very concept of money is not defined with exactitude: there is a variety of assets, each of which has its own yield and its own characteristics in respect of risk, greater or lesser ease of transfer, etc. In principle, the supply of each of these assets affects demand for the rest and demand for goods, through changes in its explicit returns and in the liquidity services that it offers. Hence, the financial determinants of global demand would consist in a vector of

¹²In the case mentioned in the text (which derives from models of Thompson (1981) and Barro and Gordon (1983) the interplay takes place between the Central Bank and the private sector as a whole. Models have also been proposed which aim at describing the interaction between the Central Bank and the wage-earners (Gale, 1981; Horn and Persson, 1984) or the fiscal authorities (Tabellini, 1985).

assets rather than in a single aggregate.¹³ Indeed, it would seem that the relation between nominal income and the money supply cannot be represented in general as a simple function of the interest rate.¹⁴ Besides, as is generally recognized, the public's disposition to keep money in their hands depends on predictions which, if the monetary theory with rational expectations is not literally adhered to, may be an autonomous source of changes in demand for goods in relation to given *M*. Moreover, it seems evident that real shocks can affect expenditure. In brief, the relation between money and demand is not automatic.

Furthermore, there has still been no clear answer to the problem of the reaction of prices to present or predicted changes in expenditure. In the typical monetary equilibrium model, the equation between money supply and demand is combined with an aggregate supply curve, according to which output responds to unexpected changes in expenditure.¹⁵ This implies the adoption of highly categorical hypotheses, both on the formation of expectations and on the operation of the markets. From this latter standpoint, it is frequently left unclear whether the effect of demand on prices would occur directly or through the price of the factors of production. On the other hand, the hypothesis of price flexibility (subject to information on the current

state of the economy) gives rise to certain questions. Many interchanges seem to have a contractual character (explicit or not), which implies slow price reactions to changes in demand. These rigidities are probably not mechanical, but would depend on conditions in the economy and on the agents' conjectures on the subject. There has not yet been any thorough study of the rules of decision-making that would result in the fixing of prices; the assumption of equilibrium, however, is no more reasonable than that of complete rigidity.¹⁶

It would seem, therefore, that a purely monetary analysis does not answer the question as to the cause of inflation and can hardly describe the movements of prices from one period to another. Nevertheless, as the growth of the money supply is a typical component of inflation, any theory should take the monetary aspect of the phenomenon into account. At the same time, if the economic authority reserves the right to issue non-interest-bearing assets, all inflation accompanied by increases in the money supply will have a fiscal component.¹⁷ In other words, a complete description of inflation must consider why the inflation tax is collected and how it is used. This almost inevitably leads to questions of a social and political nature: when certain limits have been exceeded, financing

¹³Tobin (1974) in his comments on Friedman, has insisted on the non-neutrality of money owing to the existence of various assets in the public's portfolio.

¹⁴The development of models of demand for money with partial adjustment (Chow, 1966) or with the hypothesis of cushioning of shocks (Carr and Darby, 1981), in which demand for real cash balances approximates only gradually to that which results from the classic demand functions, indirectly reveals the difficulties of linking, period by period, the movements of the money supply and of global demand.

¹⁵In other words, the prices observed in a period are equal to the prices expected (or to the estimation of the general level of prices that people formulate at the time, with incomplete information) plus a correction that depends on the deviation of real output from its "normal" value. There are other possible hypotheses on price formation compatible with a money-prices causality; in particular this is in keeping with assumptions of a fixed margin over costs. Alchian and Allen (1964) present an analysis of this type, according to which an increase in expenditure acts first on the prices of productive resources with a relatively inelastic supply, and repercussions on the prices of the other goods and services then ensue. This model, however, leaves the explanation of how factor prices are determined pretty much in the air.

¹⁶This analysis is valid in principle for closed economy models. However, neither does the hypothesis of parity of purchasing power seem to be clearly demonstrated in the case of open economies, not only because of the existence of non-tradeable goods, but also because the single-price law is not strictly applied to many goods that play their part in trade (Machinea, 1983). Here also, therefore, it is essential to use hypotheses of behaviour regarding the determination of domestic prices. The current equilibrium models make the general level of prices depend on the exchange rate and global expenditure (because of their effect on the markets for non-tradeable goods); thus the same observations apply as in the case of closed economy equilibrium models.

¹⁷This is valid even if the inflation has a real origin. Consider, for example, a system with a fixed exchange rate (for the sake of simplicity it is assumed that the external prices of tradeable goods are also fixed), where technical progress is greater in the industries linked with the external market than in those producing non-tradeable goods (Aukrust, 1977). The relative price of the non-tradeable goods increases over time; this in itself implies a rising trend in the general level of prices. The demand for money also increases. If the Central Bank does not modify credit to the government, it accumulates assets against the rest of the world or against the domestic private sector, which can be interpreted as a use of the inflation tax to augment the net assets of the public sector. If at some point the public sector decides to make use of these funds, it will have a spending power which is not the counterpart of tax revenues.

through a currency issue indicates that the government is forced to use a somewhat haphazard method of resolving the discrepancy between its capacity to obtain resources and the pressures that determine its expenditure. Reciprocally, to achieve a steady fall in the inflation rate the public sector must at some point renounce part of the credit it obtains from the Central Bank:¹⁸ this implies losses for certain groups against benefits for those most affected by the inflation tax.

3. Models based on the distribution struggle

According to the monetary or fiscal theories, inflation results in the last resort from increases in nominal expenditure induced by the economic policy pursued. Another explanation associates inflation with persistent rises in production costs. This relationship can be understood, in the first place, with reference to the way in which prices are fixed: the theory would then be identified with the assumption that the prices of goods are directly determined by factor prices. Nonetheless, although there is clearly a close connection between costs and prices, this still does not define the cause of inflation: it is necessary to explain how these costs are established and what is the set of exogenous variables that determines the price system.

In distribution struggle models, prices are established as the result of a social conflict (Kalecki, 1943; Aujac, 1954; Jackson and Turner, 1975; Moore, 1979). Competition among social groups is manifested in fiscal policy. As mentioned above, the existence of high and persistent deficits might generally be regarded as reflecting the difficulty of reconciling the demands of public expenditure with resistance against taxation. The models discussed here focus on another aspect of the distribution question. It is clear that changes in relative prices

have effects on distribution: the suppliers of a product, or productive resource, benefit if their sales price increases in relation to the rest (and the amounts sold are not too much reduced). In traditional equilibrium analysis, prices (and the resulting distribution) derive from the operation of the markets, in competitive conditions. According to other theories, some basic prices, such as wages, are determined by the action of social groups. The attempts of the various groups to improve their real income would give rise to increases in costs and prices (since each group can only influence its own price); in some periods wages would be in the lead and in others the prices of the different categories of goods, according to the relative power of workers and entrepreneurs.¹⁹ The sequence of actions and reactions of these groups would bring with it inflation. In other words, inflation would result from a collective interplay in which wages and margins over costs are determined without equilibrium being reached. The more intense the conflict, the faster will prices rise, that is, if the groups simultaneously try to obtain marked improvements in their real income.²⁰ Moreover, if there are indexing instruments (defined institutionally or applied as implicit rules), the price variation in one period will be transferred to subsequent periods: an exacerbation of the distribution struggle would produce not only a rapid rise in prices but also a persistent increase in inflation.

To complete the model the behaviour of monetary policy would need to be defined. Given the assumption that prices and wages respond mainly to costs and distributional considerations, the conflict would confront the authorities with an awkward dilemma. A

¹⁸The reduction in the deficit financed by issue need not be simultaneous with the fall in the inflation rate, because with the fall in the rate of price increases there will presumably be a rise in demand for money. The argument in the text ignores the possibility (theoretically conceivable) that inflation has exceeded the level that maximizes the inflation tax; i.e., that the rise in prices is such that an additional increment in the inflation rate will produce a more than proportional decrease in holdings of real cash balances. It does not appear that this possibility is of practical importance, except perhaps in cases of hyperinflation.

¹⁹In the case of Argentina, three broad groups are traditionally distinguished (workers, urban entrepreneurs, agricultural entrepreneurs) which, in varying alliances according to the moment, would define the characteristics of the conflict. According to these studies, the bargaining capacity of the groups and the structure of prices would be particularly influenced by the external payments situation (see, among others, Ferrer (1963); Brodersohn (1974); Canitrot (1975); Mallon and Sourrouille (1975)).

²⁰Or when there are pressures to obtain an increase in the relative prices of some products with flexible prices, which generate resistance to the fall in the real income of the groups affected. In this context, moreover, the government might also initiate or accelerate the sectoral struggle by applying policies aimed at increasing the real value of the prices it controls.

restriction of demand would have an effect on the amounts produced and only very gradually on prices. Prices and wages can respond to expectations, but these last would not be based on announcements of monetary policy as in equilibrium models positing rational expectations. Thus, when a rise in prices occurs, the options for the government would be either to confirm the rise by expanding global demand or else to accept a decline in activity. From the standpoint of these models, monetary policy is generally endogenous: the level of prices is "decided" by private groups or individuals and the government adjusts its conduct (though not necessarily immediately) to this decision.²¹ In other words, distribution struggle theories are associated with a hypothesis on the economic policy régime which postulates that government action follows in the wake of the private sector, in opposition to the monetary and fiscal hypotheses which assign the leadership to the authorities.

The hypotheses summarized above highlight the distributive aspect of price and wage variations, which is obscured in equilibrium models. They also underline the limitations of traditional analyses in describing the relations between firms and workers: production generates quasi-profits, whose distribution is a matter of bargaining, especially in the case of short-time horizons. At all events, distribution-struggle models frequently fail to clarify the hypotheses of behaviour which would explain the conduct of groups and individuals (Hirschman, 1985). This poses a number of interrogatives. Even if nominal wages are established for a group of enterprises (or for the economy as a whole), in principle each firm determines its prices individually: real wages, therefore, are not the result of collective bargaining. How are the strategies of the different parties determined when wages are settled, and how are prices established once costs are known? In any case, it seems to involve a complicated game, in which the participants

²¹The money supply might also vary with an endogenous response of the fiscal deficit to prices owing to the existence of lags in the collection of taxes (Olivera, 1967; Dutton, 1971; Tanzi, 1977; Canavese, 1985). In this case, a once-for-all increase in prices might give rise to a persistent acceleration of the growth of the money supply.

have to act on the basis of conjectures as to the measures likely to be taken by the other agents and by economic policy, without much precise knowledge of what will happen in the end. In view of the complexity of the problem it is probable that rules of behaviour are adopted which do not incorporate all the information potentially available (since that information is not necessarily reliable and since it is difficult to draw inferences on the basis of the data).²² But it is still a moot question how mechanically such rules will be applied as the transfer of costs to prices or the increasing of wages on the basis of past inflation, and how these rules will be adjusted in face of abrupt changes in circumstances, produced, for example, by a modification in the economic policy régime.²³

The impression derived from the hypothesis of a price-wage spiral is that of an economy which does not succeed in determining a fairly stable set of relative prices: if a group wishes to improve its relative situation, its action is neutralized after a time by the reaction of other prices, so that the succession of moves does not achieve a well-defined result. An immediate question is: how does the inconsistency in the price system arise?²⁴ An initial possibility appears if some group attempts to take advantage of lags in price adjustment to obtain a temporary improvement in its real income; in the short run, demands are relatively inelastic, and, although the action of the said group may be counteracted at some moment by a rise in other prices, there may at any rate be a potential gain. This line of conduct calls for several conditions: co-ordinated action (more easily sustainable over short terms), the absence of anticipatory reactions on the part of other agents; and a not very vigorous response as regards the quantities demanded. This last appears the more probable,

²²Okun (1981) discusses the problems associated with price formation and attempts to rationalize the existence of rigidities. Frenkel (1984a) contends that wages respond to institutional conditions and that if these conditions are established, the resulting indexation of past inflation is a system that saves the parties the labour of procuring and processing information.

²³Frenkel (1983) points out that the margin over costs applied by firms would not remain fixed in face of such changes.

²⁴This refers to the case in which it is assumed that the distribution struggle initiates the acceleration of price increases. It should be noted that this case is different from that which results from the defensive reactions produced when wages and prices vary in order to adapt to an already rampant inflation.

the more erratic is the movement of overall prices. Thus, in conditions of already manifest instability more frequent price rises of this type can be expected.

A second form of distribution struggle may occur if prices and wages are established in an expectation of permanent relative improvements, which is later disappointed. This would happen, for example, if the real wage envisaged by the workers became incompatible with the profit margin policy of the firms. The quest for a viable system of relative prices may give rise to successive increases in wages and prices. In a situation of this type the struggle would be a symptom not only of social tension but also of economic imbalance. These incongruities seem more likely to occur when some exogenous factor distorts relative prices or reduces real income. The real wages demanded and the margins over costs presumably depend on the estimates made on the basis of normal values, sustainable in accordance with experience. Although it may be recognized that there has been a change which diminishes global income, its repercussions on prices and remunerations as regards particular groups may not be easy to establish in advance. There is no guarantee that the incomes hoped for will be equivalent to potential income. Attempts to maintain relative prices that were normal in the past may push nominal values above ordinary levels. In other words, the learning process which leads to a new price system would accompany the effective appearance of surplus supply or demand on the markets, and would imply a rise in prices as a whole.

At all events, although the distribution struggle may be an autonomous source of price increases, it is obvious that this inflationary mechanism would function the more intensely, the more flexible was economic policy. Although it is true that acute distribution conflicts hamper the regulation of nominal demand, it is no less certain that a purely passive policy has an evident bias towards inflation. In setting prices, each individual or group will take it into account that, if the rest determine a higher inflation rate, demand will grow as a result. An upsurge of some prices, or a threat that this will happen, will therefore cause reactions in the other prices. Hence it is probable that inflation will

accelerate. The limit would be reached when price increases attained a rate which the authorities were not disposed to support. This would mean that economic policy could not escape the implicit dilemma; there must be a point at which the unconditional maintenance of activity will be renounced in order to avoid bigger price increases.

4. *Structural inflation models*

The term "structural" is ambiguous. Both the mechanisms of price formation and the stimuli that in the last instance act on them depend on the specific features of the economy, on its social composition and on the way in which economic policy is determined. A high and persistent fiscal deficit, for example, can undoubtedly be attributed to structural causes, if this is the term used for the group of pressures by which it is originated. Structural inflation hypotheses, however, refer to a specific class of models, with well-defined assumptions as to the non-monetary origin of inflation (Sunkel, 1958; Prebisch, 1961; Seers, 1963 and 1964; Ruggles, 1964; Olivera, 1964; Frisch, 1983, chapter 5).

According to the distribution struggle hypothesis, inflation is symptomatic of a maladjustment in the determination of relative prices. In contrast, for some models inflation can be interpreted as a mechanism that facilitates the establishment of relative equilibrium prices when there is variation in sectoral supply and demand. In the event of downward rigidity of nominal prices,²⁵ it is impossible to achieve a balance by keeping the general level of prices fixed: there are no forces tending to eliminate excess supply of those goods whose relative price should decrease. In contrast, if global demand increases at least to the point at which the nominal prices of these goods remain fixed (which implies that the other prices rise) the constraint caused by rigidity can be avoided. In other words, when changes occur in technology, in preferences, etc., which would require a modification of relative prices, this can occur

²⁵ A distinction is frequently made among goods according to the degree of excess demand-elasticity in their prices. In some cases, the response would be relatively rapid; in others it would occur very slowly (Hicks, 1974).

without distortions only if certain nominal prices are not forced downward. If the authorities adopt a policy of maintaining output volume, the result is a rising trend in prices as a whole. The greater is the frequency and the larger the scale of intersectoral transfusions, and the more inelastic is sectoral supply and demand, the more severe will inflation be; this depends on the structure of the economy. From this viewpoint, therefore, the chain of causality would extend from the variation of relative prices—due to real factors—to inflation, through a régime of *laissez-faire* policy, which permits a price slide in order to facilitate the transition from one set of prices and quantities to another.

These theories indicate that some generalized price increases do not necessarily derive from global variations in supply and demand, but may also originate in shifts between sectors. Although the argument is based on a very schematic theory of price formation (and the downward rigidity of nominal prices seems to lose importance as inflation rises), it is evident that in many markets equilibrating price responses occur only slowly. In the case of some goods, the initial reaction to an excess of supply is a reduction of the quantities produced, whereas in respect of others (such as agricultural products) there are more pronounced price adjustments. Consequently, it is probable that an increase in the relative prices of the second group of articles will lead to a rise in the general level of nominal prices; these increments may be transmitted in due course if there is a diffusion mechanism (such as indexation rules or induced changes in the fiscal deficit) or if the prospect of reduced activity leads the authorities to ratify the increases.

In the initial expositions of the structural inflation hypothesis emphasis was laid on the inelasticity of agricultural supply, which was attributed to technological and institutional rigidities and to inflexibility in respect of a reduction of nominal prices. A group of more recent studies (Canavese, 1982; Frenkel, 1983 and 1984a; Lopes, 1984; and L. Taylor, 1983, chap. 6, 10) also adopts a non-monetary conception of inflation, but with different characteristics. The hypotheses on price formation have two main elements. In the first

place, goods are divided into two classes: those with flexible prices (typically, raw materials) and those with 'managed' prices; the prices of the latter would be determined by the application of relatively constant margins over costs. Secondly, it is assumed that wages follow an indexation rule based on the variation of prices in former periods, and are little influenced by predictions of future prices and excess demand for labour.²⁶ Hence the rate of inflation has a pronounced component inertia, since the indexation of wages transmits price increases into the future;²⁷ upswings in inflation would be mainly due to increases in the relative values of the goods with flexible prices.²⁸ It can also be deduced that real wages would vary in inverse proportion to the inflation rate and that the changes in global demand would bring their effects to bear almost entirely on the amounts produced and very little on prices.

From the analytical standpoint, these models show how difficult it is, with the equilibrium approach, to explain price formation and especially wage formation. In the first place, they call in question the implicit assumption of instantaneous wage-setting: labour relations tend to be long-lasting and their renegotiation costly; wages would therefore form part of a contract (perhaps implicit) which is not constantly reviewed. Hence nominal wages would show appreciable rigidity over short periods. Furthermore, attention is drawn to the costs in terms of information and conflict that would be implied by complex wage regulations, using data which are not generally available or easy to obtain (Frenkel, 1984b). From this standpoint indexation in respect of past inflation would be, in a context of rapid price rises, a reasonable method of stabilizing

²⁶This type of model can be combined with the distribution struggle hypotheses through episodic changes in the margin over costs or in the degree of indexation of wages.

²⁷Inflationary inertia has also been emphasized by Gordon (1981) and Tobin (1980). Fisher (1977), Phelps and J. Taylor (1977 and 1980), among others, have discussed the effects of contractual rigidities, although, in the models in question, wages are determined on the basis of forecasts.

²⁸This conclusion is similar to that of the traditional structuralist model. In the latter, however, an attempt was made to explain price increases, whereas here the analysis refers to changes in the inflation rate. Moreover, recent models differ from that of Olivera (1964) in that no reference is made to general equilibrium.

labour relations, without resorting to procedures inapplicable in practice. For this reason, wages would be set with retrospective criteria, as a function of the price changes taking place between occasions of adjustment, and not on the basis of expectations concerning future inflation.

Wage indexation is current practice in inflationary economies; it facilitates the fulfilment of contracts in conditions of rapid price variation and is a relatively inexpensive formula to negotiate and apply. Obviously, in an economy in which indexation is widespread, inflation presents an inertia which is a particular obstacle to the application of stabilization policies based exclusively on restriction of demand.

Some questions, however, remain to be answered. When nominal wages are fixed, one of the main variables taken into account is the rise in prices since the preceding adjustment. But the indexation system based on past inflation is imperfect, since it fails to maintain the purchasing power of the contract if the price trend is modified, nor does it incorporate other real influences on wages. It would be of interest to specify in what conditions indexation is used as a means of avoiding frequent renegotiations, and how and with what frequency the wage base is reviewed. To do this, it would be necessary to define with some precision the objectives of the parties, their attitudes and the costs of negotiation and application of different types of contract, in addition to the institutional context.²⁹ The theory has not yet been clarified on this point: the current models have reached firm conclusions, although various hypotheses have been put forward which would account for a certain rigidity in wages.³⁰ In particular, it remains to explain the existence of different ways of drawing up contracts according to the economy and the period in question (wages fixed in nominal terms with adjustments varying in

frequency, more or less complete indexation subject to price indexes or other variables, with different lags and adjustment periods) and, above all, the transition from one mode of procedure to another.³¹ In this connection, it would seem that methods of wage (and price) fixing depend on the economic policy régime. In particular, indexation with a retrospective criterion stabilizes the real wage expected, if the past rate of inflation is a good indicator of that which will prevail in the period covered by the contract. The fulfilment of this condition will depend on the anticipated behaviour of the prices fixed in the public sector and on the monetary aggregates (through their effect on flexible prices, margins over costs or the actual expectations of other sectors). Although it is a fact that the costs of transaction might account for the continuance of certain rules even though they imply a margin of error, it is no less true that methods based exclusively on the extrapolation of past behaviour patterns will probably not be applied at moments of visible change in economic conditions. In other words, it would prove impossible for a theory of prices and wages to omit consideration of expectations (that is, prices, in the last instance, are fixed prospectively) and this would reintroduce (albeit at moments of pronounced variations) global demand into the explanation of 'managed' prices. In any case, since it is very probable that the response of flexible prices and of expectations to demand may be neither complete nor uniform, and renegotiation has its costs, the presence of contractual rigidities will be an important element in the analysis of stabilization policies.

5. Summary

The debate on the causes of inflation is often presented in terms of an option between different typologies: inflation would appear to have a well-defined nature that would need to be

²⁹The importance of institutional conditions has been underlined, among others, by Cortázar (1983) and Frenkel (1984a). The latter author avers that wages theory is necessarily historical and that it is not possible to formulate an explanation of a general type.

³⁰For a summary of the current discussion on the theory of contracts and price- and wage-fixing, see Azariadis and Cooper (1985), Azariadis and Stiglitz (1983), Flanagan (1984), Klein (1984), Lazear (1984), Weitzman (1984) and Yellen (1984).

³¹A particularly interesting topic is that of the speed with which the rules for price and wage formation adapt themselves to the current rate of inflation. Gerchunoff (1985) comments that, after the German stabilization of 1923, wages were once again fixed in nominal terms (in local currency) with considerable promptitude, but their period of validity remained for many years shorter than that observable in other European countries.

discovered. This attitude is not absurd from an analytical point of view; besides, a precise explanation of inflation would assist the design of policies. It happens at times, however, that the discussion assumes a somewhat methodological aspect: while some demand an explanation of the creation of money and its effects, for example, others insist on taking wage variation into account. In point of fact, a reasonable complete theory should incorporate all these issues at one and the same time, so as to identify exogenous influences and show the mechanisms by which they are transmitted to prices. There is no theory sufficiently developed to permit precise inferences of this type.

Single-cause explanations have their dangers. It is true, for instance, that there are no cases of sustained inflation in which there has not been a rapid increase in the money supply. It also seems clear that predictions on the behaviour of monetary policy play a part in the formation of prices: these last will be the more volatile and resistant to downward movements, the greater the likelihood that global demand will adjust itself passively to prices. But these observations do not explain inflation. A purely monetary model oversimplifies decisions on prices (in assuming that these are determined according to an equilibrium in which the agents take into account only the predicted evolution of the money supply) and leaves unanswered the question as to the nature of the pressures that act on monetary policy. In like manner, the models that postulate mechanical rules for price- and wage-fixing do not clearly explain how individuals or groups would arrive at these decisions, nor how economic policy would react to them. Obviously, it is not that the factors that cause price increases are totally unknown, but that the knowledge is vague. The more erratic the inflationary régime or the more sudden the changes in economic policy, the greater will be the uncertainty (both for the purposes of analysis and for decision-taking by the agents).

It is sometimes possible to identify specific circumstances that may step up the rate at which prices rise. In this connection, it would appear that the marked increase in external debt services has created conditions highly propitious to inflation. In the first place, the transfers abroad imply a higher real exchange rate, which

tends to be reached by means of nominal devaluations which push up prices. Moreover, as long as no new structure of relative prices has been established (and to some extent accepted), the defensive reactions of the sectors most affected may give rise to price-fixing inconsistencies of the type mentioned. Lastly, as a large part of the debt has been contracted or taken over by the public sector, an additional pressure on the budget is created. When, furthermore, taxation capacity is limited (a situation which is aggravated by the fall in real income), it is to be expected that greater recourse will be had to the inflation tax.

Again, as another example, internal financial crises (due in part to real factors or to weaknesses in the banking systems) might give rise to intense demand for inflation to reduce the real value of liabilities. The mechanism by which inflation is generated in this case may initially imply greater monetary expansion or an increase in certain prices. According to where the accent is placed, attention will be concentrated on these mechanisms or on the particular origin of the inflationary pressures. This once more illustrates the ambiguity of the question concerning the origin of inflation.

In effect, the eagerness to discover a single explanation may suggest that inflation (above all when it is intense) is a more systematic phenomenon than it really is. Large fiscal deficits, inconsistencies in price-fixing and resistance to a reduction in the rate of price and wage increases tend to go together and to influence one another: once inflation begins to soar it seems difficult to assign it a clearly-defined cause. Something similar happens when price variation is considered from one period to another. It is frequently observed that the money supply increases over and above prices; at other times wages take the lead, or the exchange rate, or another group of prices; and on some occasions prices rise for no apparent reason. These sporadic advances or lags do not define the type of inflation at each moment in time, but reflect the erratic nature of price-fixing.

An inflationary economy is different from a stable economy and not only because the nominal variables grow at a greater speed in the one case than in the other. The haphazard rise in prices, whether because the government can find

no means other than a money issue to finance its expenditure or because there are irreconcilable claims which lead in their turn to a policy of accommodation, points to a state of more general perturbation. It seems significant that many of the major instances of inflations have occurred in circumstances of political instability or economic crises, that is, when there are exacerbated distribution conflicts or when the economy is in a condition of manifest disequilibrium. In the last instance, an acute inflation seems symptomatic of a problem of

social functioning. From this standpoint, the most important consequences of inflation would be associated with the difficulties in decision-taking which characterize a state of great uncertainty. In the same way, stabilization appears not only as a change in the handling of certain policy instruments, but as a process which results in modifications of the different types of conduct (on the part of both the government and the private sector) which generate inflation.

II

Effects of inflation

Analysis of the consequences of inflation is usually based on models in which inflation is neutral (in the sense that the nominal variables—prices, wages, money supply—grow at the same rate) and completely predictable. Hence the main effect of a continuous rise in prices would be a distortion in money holdings: the higher cost of maintaining assets without interest reduces demand for real balances so that individuals lessen their consumption of liquidity services (Bailey, 1954; Friedman, 1969). Attention has also been drawn to the distributional implications of unforeseen changes in prices (Kessel and Alchian, 1962). These effects are by no means negligible, but they do not constitute an exhaustive list of the consequences of inflation (Leijonhufvud, 1977).

One of the features of situations of price volatility is that the agents are involved in a game of complex conjectures, in which they possess little reliable information. In such cases neither the conduct of the private agents nor economic policy is easy to predict. Economic policy tends to be influenced by a variety of requirements (to sustain the level of activity, to maintain external equilibrium, to regulate credit, to influence prices, to distribute income or net wealth in a particular way), whose priorities vary according to the aims of the authorities, the state

of the economy or the interpretation placed on the latter. If policy is unstable it is more probable that the expectations of the public will be volatile and differ for different individuals,³² a factor which affects decisions on prices and asset holdings. The diversity of expectations, frequently associated with erratic changes in public sector prices, is reflected in the haphazard evolution of the different categories of prices.³³ Then neither the private agents nor the government can predict with accuracy the behaviour of the markets. This in turn creates problems for economic policy. In these circumstances there will probably be no clear-cut system of policy determination, and private decisions will be unsystematic and mutually incompatible. The costs of inflation derive not only from price increases in themselves but also, and mainly, from this disorderliness.

³²Leijonhufvud (1981) distinguishes between well-constructed expectations, that can be described as based on the past conditions of the economy and would be characteristic of relatively stable situations, and ill-constructed expectations, which do not conform to a well-defined model applied by the agents as a whole.

³³It is well established that the variability of relative prices increases with inflation (for the Argentinian case, see Helman, Roiter and Yoguel (1984)). The explanations put forward range from structural inflation models to those in which the variation of relative prices is a function of the variation in the random component of the money supply (Cukierman, 1979).

How far inflation disturbs economic activity will depend on its intensity. The greater the existing instability, the more appreciable will be its effects.

i) The rise in prices stimulates demand for liquid assets distinct from the means of payment, whose real value rapidly depreciates. One of the effects of the flight of money is the increased importance acquired by foreign exchange, not only as an accounting unit to express prices, but also as a means of maintaining purchasing power and even making payments. As a counterpart to the larger holdings in foreign currency (which do not produce interest in the country of issue), residents need to dispose of goods or other assets, which represents a cost for the economy as a whole. Moreover, the attempt to reduce the amount of the monetary balances diverts resources into short-run financial operations and into the quest for methods of synchronizing payments and collection, and creates difficulties in the organization of trade transactions. Besides, not everybody has the same facility for avoiding the inflation tax: this probably falls mainly on the lower-income groups;

ii) The volatility of prices leads to an active quest for information. But despite this effort (which withdraws resources from productive activities), the agents are faced with much greater uncertainty than in conditions of stability. They run the risk of incurring heavy losses and at the same time have the chance of making large profits, which depend solely on the forecast of inflation. This generates a boom in speculation in which most people find themselves induced (or obliged) to take part. Many transactions are based entirely on the existence of different opinions on future price trends: similarly, trade operations are not effected which would be carried out in more normal circumstances. At the same time, the difficulty of making forecasts is all the greater, the more extensive is the time horizon of decisions. People then prefer to take up flexible positions which can be modified as new information is received. This may probably lead to the postponement of investments which take time to produce results. Something similar occurs with economic policy: measures aimed at promoting growth are less likely to be

considered lasting when, as happens in cases of high inflation, the conduct of the government is regarded as unstable; this entails an increase in the incentives required to obtain a specific response;

iii) The contraction of the time horizon of decisions is more evident in financial markets. As uncertainty over prices increases with the length of the term, contracts with fixed interest are negotiated for short periods. The possible options for longer-term financing also have their drawbacks: variable interest systems involve the risk that the real interest rate will change, while the variability of relative prices makes it difficult to find appropriate indexes for debt adjustment. Hence the provision of funds for investment is adversely affected;

iv) Frequent price changes quickly invalidate the information available to consumers. The cost of seeking better buying opportunities rises with inflation. Hence price competition becomes a less expedient strategy for business firms than when conditions are more stable;

v) In preferring flexible measures, the agents strive to safeguard themselves against the effects of unexpected changes in prices. Nevertheless, inflation inevitably produces random redistributions of incentives and income. Price instability may reflect a distribution conflict, but also acts as a feedback to it. When systems of automatic wage adjustment are applied, their imperfections produce unexpected changes in real remunerations and thereby constitute a cause of friction; when they do not exist, adjustments become more frequent. Since it is impossible to set up a well-defined system of contracts in real terms and frequent and pronounced changes occur in relative prices, each round of negotiation becomes a source of conflict.

In situations of erratic inflation, therefore, measures directed towards growth and permanent income redistribution are relegated to a secondary plane in face of a chaotic short-term game with no precise solution. Given that the problem lies in the behaviour pattern of the public sector and the private agents, its correction implies a change in those lines of conduct. In other words, stabilization means the achievement of a situation in which the

economic actors are in a better position to formulate plans for the future and in which it is more probable that decisions will be mutually compatible. To put it another way, price trends should be more predictable; which calls for an economic policy such that will guide private decision-making towards this end. It will be difficult to attain this result with high inflation rates. Consequently, one of the conditions for

stabilization is that the velocity of price increases should be "reasonable". To reduce instability it is also essential that inflation should be relatively predictable, so that the agents can formulate fairly trustworthy expectations. The problem of stabilization is therefore twofold: to reduce the rate of price increases and at the same time to ensure that this reduction shall be lasting.

III

Stabilization policies

1. *Stabilization as a problem of economic policy*

The designing of stabilization policies poses several difficult questions: to what point is it desirable and possible to undertake unconditional economic policy commitments; what price track is it expedient to choose as a goal for stabilization; what does this imply for the management of policy instruments; and what should be done to ensure that the transition to a lower and more stable inflation rate involves the least possible cost.

An initial question relates to the time horizon of policies. Economic models tend to represent decisions, in relation to time, as the solution of problems in which strategies are formulated to cover all future periods: the line of conduct to be adopted at the present time forms part of a sequence of measures and depends on the contingencies that are expected to arise in time to come. These models are not entirely in keeping with reality. In point of fact, the usual behaviour pattern is quite different: decisions are adopted one by one, without any precise definition of future measures. It is natural that this should be so, in view of the difficulties of obtaining and processing information. Stabilization policies clearly pose a dilemma between predetermining (and announcing) the evolution of certain instruments throughout a

fairly long period, or allowing a flexible adjustment of policies to circumstances.

Latin America has known what it is to embark on numerous programmes that have proved impossible to sustain: the alternation of attempts at disinflation, crisis and new attempts has been a major factor of instability. This suggests the undesirability of basing policies mainly on temporary expedients, since this may affect confidence in their results (and thereby hamper the transition towards lower inflation rates) and make programmes, once initiated, more difficult to keep up. Neither is it probable, however, that a stabilization programme can propound a complete set of permanent policies. On the one hand, if it starts with a situation of high inflation, the confusion that this implies will preclude the fixing of too extensive a time horizon. On the other hand, since stabilization in itself represents an appreciable change in the economy, it is impossible to make accurate forecasts of the conditions that will exist during and after the period of transition. From this standpoint, it seems reasonable to regard stabilization as a preliminary step, frequently indispensable but not necessarily definitive, towards the establishment of lasting policies.

Although it is clear that changeable policies are very costly, in the longer term a question also arises as to the expediency of defining strict rules for the management of certain instruments. A

case in point is monetary policy. It has been proposed that the Central Bank should act in such a way as to hold constant the growth rate of some monetary aggregate.³⁴ According to the advocates of this system, this monetary regulation would solve the problem of price instability and at the same time eliminate a large part of the fluctuations in aggregate output; if the means of payment grow at a predictable rate, there will be a reduction in the unforeseen component of global demand which, according to the traditional hypothesis, causes the cyclical changes in production

These arguments, however, are based on very categorical assumptions as to the association between money and prices. In actual fact, a régime of fixed monetary growth would have several disadvantages. To begin with, the establishment of the rule in question as part of a stabilization programme (and, therefore, accompanied by an appreciable change in the growth rate of the money supply), may have a considerable initial impact on prices, since it will presumably increase demand for real balances. In these conditions it is almost impossible to know what the equilibrium price level would be. Thus the régime, instead of facilitating the formation of expectations, would be adding a further element of uncertainty. After a transition, the function of demand for money varies according to the changes in the type of assets available and the customary forms of payment. Even assuming perfect adjustments to equilibrium, predetermination of the increase in the money supply is not a necessary or sufficient condition for making the inflation rate predictable. Besides, it does not seem advisable to restrict the monetary authorities' capacity for action to a point where they cannot apply anticyclical measures in the credit markets in response to disturbances of real origin.³⁵

Thus, although the definition of a more predictable monetary system is undoubtedly an important part of a stabilization process, it

would not be appropriate to aim at establishing a rigid policy rule. In general, there is a dichotomy between making policies less predictable, and taking the risk of announcing strict commitments on the future course of policy instruments, which reduce the flexibility of policies and may be uncertain of fulfilment. In practice, it seems difficult to have unconditional rules relating to an indefinite time horizon. Even though it might be useful to announce (and fulfil) specific objectives in the case of some instruments, the stabilization of expectations for a fairly prolonged period should probably be based on something rather more vague, but at the same time simpler: a consensus clearly expressed by the government and shared by a large part of society, to the effect that price volatility is very costly and therefore efforts should be made to hold prices to a less uncertain course. Rather than a unilateral announcement of unchangeable political rules, this would imply the existence of an implicit agreement on an objective and public confidence (warranted by events) that the authorities will endeavour to achieve that objective and maintain it.

At all events, a stabilization policy requires that the target set (even though imprecisely) for the inflation rate should be attainable with reasonable certainty throughout a period that stretches beyond the immediate future. To a large extent this is a fiscal problem: the inflation rate established as a target must be compatible with an amount of inflation tax revenue that covers the needs of the public sector. It is certainly not easy to foresee the future pressures that will be exerted on fiscal policy, or the evolution of demand for assets. Clearly, however, when the aim is to mitigate inflation, it is also admitted that a limit must be set to financing through money issues: policy should therefore aim at making a lower inflation rate defensible, taking these restrictions into account. That is to say, the fiscal system must find a substitute for Central Bank credit and, throughout the stabilization process, the income redistributions that are effected through the budget should be kept in line. The capacity to generate tax revenue must correspond to the volume of expenditure; among other requisites, this presupposes fairly accurate identification of the groups that would contribute resources.

³⁴See Friedman (1959) and Lucas (1980). The general argument in favour of policy rules (as against discretionary management of the instruments) is developed in Kydland and Prescott (1977).

³⁵Leijonhufvud (1983 a and b) discusses the problems stemming from a monetary system without rules and those which would arise in systems without flexibility.

Moreover, the distribution struggle by way of prices should be waged coherently: obviously, unless cost variations are accommodated through rises in global demand, if one group attempts to augment its share of real income with a nominal increase, others will suffer a loss.

In the last resort, stabilization policies always involve decisions on distribution: it is a matter of replacing redistribution mechanisms that create inflationary pressures by others that do not produce these effects. As a result, while stabilization is not a zero-sum game, in all likelihood some groups will be adversely affected. This political aspect of stabilization is probably one of the most complex, especially if it is borne in mind that acute inflation goes hand in hand with serious distribution conflicts. In Latin America the quest for price stabilization is often linked with policies of a conservative type, indifferent to income distribution, or producing transfers detrimental to the lower-income groups. In theory this distributive bias does not seem to be a necessary condition of stabilization policy. In fact, the latter will be more likely to succeed if it can be reconciled with a socially acceptable income distribution.

... In the general terms of this discussion, it would appear that a programme is the more solid, the more clearly defined are the inflation targets that are set up and the policies that will be applied over a fairly extensive time horizon. But these conditions are often difficult to meet. And in any case the final result of policies depends basically on the handling of the transition. This poses two very controversial questions: at what speed and with what instruments should a stabilization programme be tackled.

2. *The transition*

For stabilization to be effective, an indispensable requisite is that nominal prices and wages, on the one hand, and global demand, on the other, should increase at a lower rate. The problem is to define how and at what speed this deceleration will take place on reasonably synchronized lines and with the least possible disturbance of economic activity. The debate on the subject usually assumes that the authorities regulate demand; hence an attempt is made to learn in

what way price adjustment will be brought about. In traditional analysis the relation between prices and quantities is expressed with a short-term Phillips curve: prices depend on expectations and on excess demand for goods. If expectations are based on past inflation or if there are contractual (or other) rigidities which hinder price variations, a reduction in nominal demand will necessarily create a decline in activity. The weaker the response of prices to the decrease in output and the more abrupt the deflation sought, the greater will be the decline. This type of argument favours a slowing-down of inflation through a gradual policy,³⁶ particularly through successive reductions in the growth rate of the money supply; during this process, there would in any case be a period of diminished production.

This view has been questioned by writers who use the hypotheses of rational expectations and market equilibrium. This line of thought assumes that contracts, explicit or implicit, tend to be flexible, and adjust themselves to changes in economic conditions. Thus there would be no curb on price adjustments other than the deficiencies of current information. Inflationary inertia would disappear if the forecasts of the public varied with global demand. In that case, stabilization could be rapidly achieved and there would be no reason for it to be accompanied by a recession. Moreover, the analysis is based on the hypothesis that expectations incorporate all useful information (in so far as the data are available). If inflation ultimately depends on the money supply, price forecasts would be based on the monetary policy anticipated. Consequently, if the government is in a position to create a belief that there has been a permanent change in the monetary system, of such a kind that global demand will be from that moment compatible with price stability, expectations and prices themselves will be immediately adjusted. Monetary expansion must not necessarily be curbed abruptly, since the reduced expectations of inflation stimulate demand for money. But

³⁶On this point authors holding different theoretical positions seem to agree. See, for example, Laidler (1975, chap. 4) and Gordon (1982). Cagan (1979, page 224) suggests that the best possible policy is halfway between a very slow reduction and the opposite extreme.

there will certainly have to be a visible change in fiscal policy: a marked reduction in current deficits and especially in those foreseen for the future will be essential, to demonstrate beyond question that the government will not need to have recourse to the inflation tax.³⁷

Aside from the specific details of this debate, it seems clear that the choice between gradual or shock approaches depends on the initial conditions. When inflation is moderate it is probable that many relatively long-term contracts (in respect of wages or credit) have been negotiated in nominal terms and on conditions which reflect the growth observed in prices. Irrespective of the pace of adjustment of expectations, a slow deflation would affect the real value of such contracts less than a rapid one. Furthermore, gradual policies are potentially flexible: they permit the use of information progressively obtained in accordance with the reaction of the economy. But these possible advantages are not equally patent if inflation is very high at the start. In these cases the inertia of the contracts is less (although it does not disappear completely, except perhaps in hyperinflations), because the very instability of prices leads to a shortening of the periods covered by agreements. Furthermore, a prolonged transition may signify a lengthy period of uncertainty in which the public will continue to take *ad hoc* decisions for want of a well-defined longer-term prospect. The very flexibility of the measures, moreover, may create the impression that they are reversible, which would make a change in expectations harder to bring about and would increase the pressures on policies.

The shock approach avoids these problems, although it imposes strict conditions for obtaining good results. Once it has been announced that inflation will drop abruptly, it is essential that this effect should be produced, that the costs of the adjustment will be such as not to call in question the viability of the policies and that the government should use its instruments

to sustain the stabilization. There is little possibility of learning *en route*, especially in the initial stages of the programme: policies must be sufficiently well-defined and control over the instruments effective; the government, also, should perhaps be willing to subordinate some of its other objectives to the achievement of a lasting effect on prices. This underscores once again the need for social consensus on the anti-inflationary target, but it also implies a marked demand for consistency in the policies adopted: a shock programme, by its very nature, is difficult to reverse and its effectiveness depends in part on the public's perception of this fact; the costs of failure to obtain the desired results are consequently high. But consistency is defined in different ways by different theories, whose strict validity or invalidity may be in doubt. Uncertainty as to the "true model" of the economy is particularly important in shock strategy; in so far as this is taken into account, it is probable that policies may not correspond to a scheme that can be exactly fitted into any particular theoretical framework.

At all events, the rational expectations thesis brings to the fore several important questions. If the determination of the general level of prices can be represented as a result of action by the government and by private individuals or groups, which is influenced by the behaviour pattern that each agent hopes the others will adopt, one of the keys to stabilization will be that the authorities can assume the leadership in the game, or, in other words, that they can persuade the public to take the policy announced as a datum on which to base their decisions. This means, in particular, that the government must be able to regulate the money supply without being harassed by fiscal needs, so that it can progressively adjust liquidity in accordance with demand for money at a lower inflation rate. The more convinced the public is that the government has this capacity, the less will be the risk that prices will not respond to the policy.

However, this reasoning does not define the whole set of conditions for successful stabilization. To begin with, the conditions of credibility would need to be determined: when can the authorities be assured that their announcements will be incorporated into the decisions of the public? Although an opinion on

³⁷The argument has been developed by Sargent (1981 and 1982), who bases it on the experience of the European hyperinflations, and also by Bomberger and Makinen (1983). However, Dornbusch (1985) has raised doubts as to whether this model is strictly applicable to the case of German inflation in the 1920s.

this might be given in each specific case, credibility is a somewhat vague concept.³⁸ Moreover, it does not seem clear that an announcement of a radical change in fiscal or monetary policy, even though credible, will give rise to an appreciable modification of expectations and prices.³⁹ Aside from the possible existence of contractual rigidities, there remains for the agents the problem of inferring prices on the basis of the instruments established by the government.

An announcement on monetary and fiscal measures must be interpreted and converted into expectations of price variations and these, in turn, into decisions on prices and quantities. Each firm is interested not only in the behaviour pattern that it expects the government to adopt but also, and mainly, in what it assumes its suppliers and competitors will do and in how wages will vary. Uncertainty as to these questions does not disappear even though there has been a credible change in policy.⁴⁰ The same

³⁸The problem of credibility in relation to stabilization policies has been discussed by Schelling (1982) and Koromzay (1982). Recently models have been produced in which the public gradually modifies its appraisal of the future conduct of the government in accordance with the policies actually applied (see, for example, Di Tata (1983), Backus and Driffill (1984)). One of the findings of these models in which expectations depend on the reputation of the authorities is that, even when the latter are disposed to slow down nominal demand unconditionally, there is some likelihood that expectations might not be adjusted immediately: it would not be realized that a change in the policy regime had taken place until a recession occurred.

³⁹The credibility of fiscal policy also depends on price expectations. When inflation declines, real tax revenue increases, because the effect of the lag between the moment of payment and the point in time when the tax is imposed diminishes. In other words, the fiscal deficit is partly endogenous (see Olivera, 1967; Dutton, 1971; Tanzi, 1977; Canavese, 1985). The reduction of the fiscal time-lag has been particularly important in hyperinflations. It has even been claimed that in some cases stabilization would bring with it fiscal equilibrium, rather than *vice versa* (League of Nations, 1946, in relation to the Austrian and Hungarian hyperinflations). The interdependence between deficit and inflation, on the other hand, introduces an ambiguous situation: a fiscal policy credible for a public sceptical towards stabilization prospects would imply overadjustment (i.e., would prove highly restrictive) once inflation had effectively slowed down.

⁴⁰Much of the macroeconomic discussion on the role and formation of expectations is based on the contrast between adaptive and rational expectations; that is, between forecasts that depend solely on the past history of the variable and those in which people act as though they knew the process that determines the variable. This dichotomy is fallacious. To assume that individuals are capable of realizing when a change has taken place in the conditions of the economy (and therefore do not mechanically extrapolate the past) does not imply the hypothesis that the results of the said change are accurately assessed or that the agents make uniform predictions on the basis of a given model.

problem confronts the workers. An abrupt change in the inflation rate calls for a synchronized movement in prices as a whole. If each agent does not clearly perceive that the rest will adjust their prices in response to the policy, he will have no incentives to make sufficient changes in those that he controls.⁴¹ In other words, even if there is some confidence that the government will maintain the course announced, there is no guarantee that a sudden change in monetary and fiscal policy will be wholly reflected in prices.⁴² It is probable that the rate of inflation will not fall at the same pace as nominal demand and that the change in relative prices will be erratic. The confusion that this can produce might endanger the continuity of policies. In these conditions inflation may possibly not approach the value that would be appropriate to an equilibrium response.

It seems reasonable that a stabilization programme should try to avoid these risks. An instrument for achieving this is income policy. The intervention of the public sector in price- and wage-fixing is sometimes equivalent to a stabilization policy; other opinions regard it as a source of unjustified distortions. Neither of these two positions seems correct. The function of income policy should be to facilitate the transition to a lower rate of inflation so that prices, taken as a whole, would vary approximately in accordance with global demand. There is no guarantee that market forces by themselves alone will produce this result; nor can a policy create a system of prices by administrative decision. The efficacy of direct measures respecting prices undoubtedly depends to a large extent on the conditions and the way in which they are applied:

i) Income policy is complementary to the regulation of global demand and does not replace it. When controls are applied or price guidelines

⁴¹Di Tata (1982) and Phelps (1983) have analysed this problem by applying the concept of "expectations of expectations": people have to foresee in what way the rest will make their predictions; if each individual is confident that the rest will modify their expectations in face of a policy change, prices will move towards equilibrium, but if this is not the case, there will be an imbalance.

⁴²Hyperinflations are special cases: in so far as most prices are adjusted in response to a benchmark price (such as the exchange rate) it is sufficient for this price to stabilize for all the rest to follow (Lopes, 1984). The problem of synchronization would not then be so acute as in the case of less rapid inflations.

are announced, the public must be confident that they will be respected. The administrative system may concern itself with specific deviations, but cannot exert full control over transactions.⁴³ Hence the policy's chances of success are dependent on the fact of the programme as a whole being regarded as feasible. To this end, the government must show that it is in a position to prevent immoderate demand at the prices indicated. Experience shows that the spread of black markets or the existence of great discrepancies between regulated and non-regulated prices end in the last resort with the abandonment of attempts at stabilization. To avoid this it is essential that those who have to do with pricing should find that they will not gain very much by eluding the controls: demand should be such as not to create disturbances in supplies or stimulate unofficial price increases. In other words, the information received by market agents should be such as to confirm the possibility of sustaining the price trend implicit in the programme;

ii) For this reason, global demand policy has a central role in the transition towards a régime of lower price increases. Basically, there would need to be harmony between expenditure and prices, so as not to generate great surpluses or insufficiencies of demand. Clearly, however, exact harmony in this respect could not be achieved, not only because of the well-known difficulties in controlling nominal expenditure but also because throughout the transition period there may be uncertainty as to the response of output to a stimulus from demand. At all events, the management of specific instruments will probably vary according to the criterion of those responsible for the policy. In particular, if there has been an appreciable change in the inflation rate, there will be modifications in demand for assets which cannot be accurately foreseen. In such cases, it does not seem desirable to adopt strict targets for the monetary aggregates. In this connection there is still the problem of distinguishing the movements in the interest rate which are attributable to changes in inflation expectations

⁴³In this regard, it would seem that the management of income policies with high inflation rates is extremely complex. These policies would therefore be more viable with low inflation rates.

from those which are due to the state of liquidity;

iii) When prices and wages are regulated the economy is being overdetermined: the resulting state cannot be described as one of equilibrium. Relative prices are not allowed to vary in response to market conditions. This is not unharmed. But the contention that an income policy is undesirable because it produces distortions in prices carries little weight. What is the alternative? In a state of erratic inflation relative prices emerge from a guessing game that bears little resemblance to equilibrium; it is highly probable that price adjustments in the face of a slackening of demand will occur in equally haphazard fashion. In these conditions relative prices determined by the market will not be a useful standard of reference. The stabilization of prices as a whole seems to be a requisite for embarking on the formation of a coherent price system; the initial overdetermination is then a way of accelerating the process which leads to this.

In any case, the constraints imposed by price control on the movements of relative prices can present a problem for anti-inflationary policies if demand for some goods is in great excess or if some groups consider that they are carrying a disproportionate load. It is almost inevitable that some such cases will arise, without necessarily jeopardizing the policy as a whole. It is important, however, that lags should not occur that lead at any time to heavy increases in some nominal prices. This means, on the one hand, that strict control over prices should have a limited duration, until such time as there can be confidence in the incorporation of the lower inflation rate into decisions on prices. On the other hand, it is important that the point of departure for relative prices, especially those of greater macroeconomic significance (real exchange rate, real wages, public sector prices) should be such as to avoid major imbalances. This is a particularly complex aspect, especially when the initial situation makes it difficult to apply historical norms as a frame of reference and when there are sharp conflicts over income distribution. Nonetheless, this fact must be faced: it would once again be utopian to imagine that the quest for an acceptable set of relative prices will not suffer disturbances in a climate of high inflation.

In any event, at some time or other relative prices must change and this will imply upward movements in some nominal values. It also seems certain that the application of an income policy may create uncertainty as to the possibility of maintaining low inflation rates, especially when there has been previous experience of abrupt price increases when the controls are removed. This underlines the need for a demand policy compatible with the price track chosen, so as to create confidence that the above effect will not be produced. The learning process may also take place in the reverse direction: if for a time the managed prices are maintained without appreciable upsets, expectations will be reinforced: if this happens, the adjustments required in relative prices will not necessarily imply a major upswing in nominal prices as a whole. In addition, it is likely that with an interval of relatively stable prices, the demands made on each individual firm will become more elastic, since, when prices are less volatile, it costs purchasers less to look for what they want. This, if the firms perceive it, may become an incentive for keener competition in respect of prices.

The application of an income policy in conjunction with demand policies is intended to reduce the negative effect of stabilization on activity. It is difficult, however, for disturbances to be avoided entirely. In so far as expectations are not rapidly and completely adjusted, the real interest rate may rise, as frequently happens on the inception of stabilization programmes. Additionally, it is possible, especially when rapid

deflation is the aim, that a period may ensue in which uncertainty as to prices will cause a contraction of supply. Besides, both from the fiscal point of view and from that of relative prices, an anti-inflationary policy is necessarily non-neutral: there will be sectors whose real income is reduced, and, even if others improve their position (especially those that were most affected by the inflation tax), the effects on expenditure may not be totally and immediately offset. At the same time stabilization can bring to light losses which certain individuals or sectors were incurring, but which they did not clearly perceive or which they were hoping to recoup at some time or other. Over a longer term, some activities whose profits were linked with price instability, or which were organized in relation to this, would also have reason to contract.

When starting with high inflation, therefore, the transition to a more stable economy can hardly take place without some distortions. In the conditions facing many Latin American economies, the reduction of inflation is particularly difficult because of the burden of external debt weighing upon real income and the budget. Moreover, an economy with high inflation cannot function with a reasonable degree of co-ordination. Without some price stability there is little room for policies aiming at the growth and orderly redistribution of income. Basically, stabilization would be an attempt to enable such policies to be implemented; in the longer run, stabilization depends on them for its preservation.

IV

A stabilization policy based on shock: The case of the Plan Austral

The preceding sections were focused on inflation from an analytical standpoint. Although in dealing with this subject it is impossible not to refer, albeit implicitly, to actual situations (and the foregoing exposition was perhaps influenced

by the Argentinian experience), the discussion was kept on a general plane. The present section has a different purpose in view: namely, to comment on a specific stabilization programme with its own particular features. The interest of

the *Plan Austral* applied in Argentina derives, on the one hand, from the magnitude of the inflation which gave rise to the programme (around 1% per day) and, on the other, from the set of instruments used to curb it to an abrupt halt. Our intention here is to describe the conditions that carried inflation to extremely high levels, to comment on the content of the programme and to mention some of its initial effects.⁴⁴

Argentina has a long tradition of inflation. It is not that there have been no efforts at stabilization. Indeed, since the 1950s a variety of policies for moderating inflation have been put into effect. These experiments were of different types, according to the characteristics of the governments that tried them out and also in relation to the theories in vogue on each occasion. The programmes included restrictions on demand of the conventional type (in 1959 and during a brief episode in 1977/1978), income policies (in the form of a generalized freeze in 1952 and 1973; freezing of wages and pegging of the exchange rate with a voluntary price agreement in 1967; a brief truce on prices in 1977) and, more recently, in 1978-1981, a "crawling-peg" policy (based on pre-announcement of the exchange rate with a decreasing devaluation). These programmes, however, had no lasting effects, although in some cases there were temporary (sometimes marked) decreases in the rate of inflation.

The recurrence of experiments in stabilization, the breakdown of policies and new attempts, have had various consequences. To begin with, the repetition of the sequence implied serious instability in policies. This volatility, besides, has been incorporated into expectations; in Argentina, there is less public confidence in policies than in countries with a less turbulent economic history, all the more so since the previous programmes have already tried out a wide variety of potential stabilization instruments. Nevertheless, the costs of inflation are widely recognized. Hence there is a pressing

demand for stabilization and at the same time great obstacles in the way of its achievement.

The inflation rate in Argentina has been exceptionally high in recent years, even in relation to the country's customary levels. Since 1974 the velocity of price increases has never been less than 100% annually in any year (with a brief exception in 1980); in the last five-year period, there has been a persistent acceleration, culminating in inflation rates in the order of 30% per month or even higher by mid-1985. This rapid upswing was associated with the profound crisis which derived from the failure of the economic liberalization programme and the pre-announced exchange rate.

Towards the end of 1980 the real exchange rate was abnormally low; although the rise in domestic prices was less rapid it was far from approaching parity in purchasing power. At the same time, the external debt had increased appreciably. The public sector in particular had contracted heavy debts in foreign exchange, which financed the current account deficit and a rapid outflow of private capital (although part of the private sector had also increased its indebtedness). The activity of the sectors producing tradeable goods had already begun to diminish, mainly owing to competition from imported goods. The domestic financial system, which had greatly expanded in the preceding years, was experiencing serious difficulties because of the irregular recovery of credits. Furthermore, it was predictable that social tensions would become more acute, despite the fact that real wages had partly recovered after the sharp fall recorded in 1976-1978.

The state of the economy involved a very marked inflationary potential. Devaluation, which was inevitable in view of the balance-of-payments situation, was bound to be reflected in domestic prices, not only because of its direct impact, but also through the secondary repercussions typical of an economy adjusted to inflation. An increase in the real exchange rate, on the other hand, would have a direct effect on public finances (by raising the real value of debt services) and would also generate pressures for subsidized transfer of the private debt to the public sector. At the same time, the high level of domestic indebtedness was creating demands for a reduction in the financial burdens of

⁴⁴The description given here of the economic evolution of Argentina in recent years and in the initial months of the application of the programme is qualitative and very brief. More detailed descriptions can be found in ECLAC (1980 to 1984) and in one of the essays contained in ECLAC (1986).

enterprises, either through subsidies or through increased inflation.

In this way, successive spurts of inflation were produced as government measures went on being adjusted, in a climate of great political and economic instability, to the accumulating pressures. In the course of 1981 the exchange rate rose five times, without any appreciable improvement in the external payments situation: there was no halt in the fall of reserves and the debt, especially that of the public sector continued to rocket. At the end of the Falkland Islands conflict, midway through 1982, it was decided to introduce a new and heavy devaluation and a reform in the financial system aimed at improving the debtors' situation. Among the chief measures of this reform was the decision to extend the deadlines for the repayment of bank credits and the Central Bank took over the fixing of the interest rate in the most important segment of loans and deposits. As this rate was far below anticipated inflation, there was an abrupt fall in demand for liquid assets, which had repercussions on the goods markets. This produced a "watering-down" of debts (which continued in the following years), at the cost of a new increase in the rate of inflation.

Throughout this period several events combined to augment the fiscal deficit. In the first place, the servicing of the public external debt shot up (from less than 1% of the GDP in 1980 to over 6% in 1982), not only as a result of the increased indebtedness of the government itself and the high interest rates, but also because the public sector was gradually assuming responsibility for the private debt. Although the measures adopted in 1982 included the redeeming of domestic government securities in the hands of the public (particularly Treasury bills and adjustable bonds), the financial reform led to a significant increase in interest-bearing bank reserves, which created large cash deficits for the Central Bank (or "quasi-fiscal deficits", as they were generally called in Argentina). Moreover, the drop in activity (which reached its lowest ebb in mid-1982) and the rapid price increases themselves reduced tax revenue; the decline amounted to over 5% of the GDP in two years. In other words, both the absorption by the government of potential capital losses in the

private sector and the burden of external interest payments plus the existing recessive and inflationary conditions combined to debilitate the public finances. In this situation the authorities had progressively increasing recourse to Central Bank credit. At the same time demand for money was appreciably declining. Thus the need for inflation tax revenue was growing, while the tax base was contracting.

In 1983 inflation soared still higher, until it reached an average of 17% per month in the last quarter. This was a confused process, influenced by the joint effect of an extremely large fiscal deficit (public sector financing by the Central Bank and the variation in short-term liabilities exceeded 17% of the GDP), heavy wage pressures and the government's attempt to maintain the real value of the exchange rate and of public service charges. This period saw an intensification of the instability of economic policy. The military government was now seriously weakened, and the chief aim of its economic management was to absorb the different pressures until the time of the elections fixed for the month of October. Thus, in a climate of great turbulence, the constitutional authorities took over the government at the end of 1983.

At that time there was a variety of demands requiring attention. Following the external crisis of 1980 (aggravated by the burden of interest on the debt, the interruption of credit flows and the fall in export prices) the economy had carried out a radical adjustment, although with special characteristics. Between 1980 and 1983 imports of goods shrank to less than half, so that an appreciable surplus was generated on the trade balance. This adjustment affected domestic production, although as from 1982 there had been a marked revival of import substitution, which contributed to the recovery of industrial output after a slump. From the standpoint of expenditure, the most significant event was the sharp drop in investment: not only was financing scarce, but also the investment spirit was depressed. The flight of capital in the early 1980s had apparently reflected not only a short-term speculation movement, but a widespread lack of confidence in the future of the economy. This, coupled with the magnitude and urgency of

debt commitments, severely restricted growth. In addition, there were pronounced social tensions: practically all groups were claiming improvements in their income. At the same time, inflation had soared, and its costs were manifest, but it was equally clear that it would be difficult to control the fiscal deficit and moderate the distribution struggle which was finding expression through the price system.

Initially, the government attempted to reconcile an increase in output and in real wages with a gradual slackening of inflation, while negotiations with the external creditors were attempted. A policy of reduction of the fiscal deficit was announced, based on the contraction of expenditure on defence and security and greater efficiency in tax administration. At the outset, however, anti-inflationary policy consisted mainly of the establishment of monthly guidelines for the main prices (exchange rate, wages, public service charges, industrial prices, regulated interest rate), in an attempt to influence costs and expectations. This policy turned out to be ineffectual: inflation overstepped the guidelines set, with the result that there was a maladjustment between the prices regulated by the authorities and those that were not controlled.

Throughout the year the authorities showed increasing concern for the control of global demand. This was reflected in a reduction in the government's current expenditure on non-personal goods and services and in a fall in public investment, although, as counterpart, the hoped-for increase in tax revenue did not materialize. There was also a change in price and wage policy: whereas the wage guidelines (whose application was limited more and more to the public sector) became more restrictive, the government tried to restore the real value of the exchange rate and the prices of public services. Towards the end of 1984, moreover, after the signing of a stand-by credit agreement with the IMF, there was a hardening of monetary policy.

In short, output and real wages increased in 1984, and at the same time a significant surplus was achieved in foreign trade, while progress was made in external negotiations. Nevertheless, towards the end of the period there were visible signs of an interruption in real expansion. Additionally, the rate at which prices

rose showed no tendency to decrease. Inflation rates remained in the region of 20% per month and most of the public probably expected an acceleration to even higher rates.

The policy of gradual adjustment applied in 1984 did not succeed in producing a simultaneous slowdown in costs, global demand and expectations in such a way as to have a definite effect on prices. Although the intention was to curb price increases, no change had been produced in the inflationary régime. Income and demand policies, acting separately and with differing intensity according to the point in time, had not shown themselves effective in guiding prices. Price resistance was accentuated by the apparent reversibility of the policies and by the generalized (although imperfect) indexation. Both through its impact on public finances (owing to the fiscal lag and the operational losses of the Central Bank) and through the price and wage adjustment mechanisms to which it conduced, inflation tended to persist or gather speed, especially when rises occurred in basic relative prices: meat, the exchange rate, public service charges. This in turn stepped up the probable costs of the anti-inflationary measures and detracted from their credibility; the situation thus assumed the characteristics of a sort of vicious circle. Moreover, the effects of the extremely high inflation were patent: there was an obvious spread of speculative behaviour associated with price volatility. Hence an effort at stabilization became a matter of urgency.

The experience of high inflation produced considerable changes in wage- and price-setting procedures and in debt contracts. These were particularly evident in the shortening of the periods between decisions. In recent years, public service charges and wages were adjusted every month.⁴⁵ Wage indexation based on the price increases of the previous month was

⁴⁵Frenkel (1984 a) found evidence that wage increases were applied quarterly up to 1982. With the upsurge of inflation the adjustment period was reduced to a month. It should be noted, however, that the payment period for wages and salaries (monthly for employees, almost invariably fortnightly for manual workers) remained in general unchanged in relation to what it had been in periods when inflation was much lower. As wage-earners in general had probably little access to the use of money substitutes, this situation tended to maintain demand for money. It may be conjectured that, if inflation had continued at rates in the region of 1% per day, payment practices would have been modified, which would have still further accentuated the rejection of money.

probably a current practice; it is difficult, however, to be precise about how widely and how systematically this rule was applied. Little is known about price formation in the private sector, apart from the fact that, towards the middle of 1985, increases were taking place several times a month. Probably decisions on prices stemmed from complex and somewhat irregular process which, besides the transfer (more or less automatic) of current costs, were also influenced by the conjectures that each firm formed as to the future evolution of the prices of its inputs and its demand. Prices reflected the headlong course of inflationary instability. In contrast to what occurred in the European hyperinflations, no generally accepted referent (such as the value of foreign exchange) had been established for pricing purposes. All this implied that, although price and wage adjustments had tended to synchronize, the factors of inflationary inertia had not entirely disappeared; nor was it possible to identify a single basic variable capable of guiding the price system in such a way as to break the inflationary trend.

The credit markets also concentrated on very short-term operations. In general financial operations were carried out with payment terms of only a few days and at interest rates that reflected average expectations of the variation in prices. For contracts of a certain duration (such as leases), different indexation clauses were used. Apparently the practice of monthly adjustments had become general, price indexes for the preceding month being applied. In other words, in most credit contracts, price fluctuations were rapidly, but not immediately, incorporated.

These conditions were propitious for abrupt deflation, since there were no major lags in prices adjustments and in contracts. Nonetheless, in order to achieve a marked fall in the inflation rate a system had to be defined to tackle the elements of inertia that were still present and thus to bring about a very rapid change in the behaviour of the public, as well as to influence public finance.

At some point early in 1985, the government would seem to have begun to consider a shock stabilization policy. One of the main features of this programme was an attempt at the simultaneous control of all the potential

elements of inflation. From this standpoint, the stabilization plan was consistent with a variety of hypotheses on the sources of price increases and, according to many of these hypotheses, some of its instruments would prove redundant. In this way, the government was probably attempting to diminish the risks of not attaining a definite result, which would have saddled it with very heavy costs.

The authorities' analysis, expressed in the speeches that accompanied the announcement of the programme in June 1985, was based on the experience of earlier attempts at stabilization. The government discarded the possibility of a new attempt at gradual deflation, since it deemed the prolonged maintenance of inflation rates of the current magnitude unacceptable. It also rejected the unilateral employment of price and wage policies: if these were not harmonized with global demand, the result would sooner or later be chaos in the price system. According to this same analysis, therefore, there had to be a visible change in fiscal and monetary policy, not only to ensure that global demand would be adjusted to much less rapid changes in prices, but also to guide the expectations of an important group of the public. This last objective made it desirable for the government to explicitly announce that there would be a modification in the handling of policies. But it was also thought that the announcement would not suffice: if the inertia of prices were not overcome and if it were not clearly shown that these would effectively cease to rise, there was a risk of a feeble initial response which would jeopardize the fulfilment of the fiscal and the monetary announcements (given that the fiscal lag would continue in operation), and the recession would be intensified. To income policy was assigned the role of calling an abrupt and simultaneous halt to the growth of costs and prices in a manner sufficiently definite for it to be incorporated into expectations. Finally, in view of the proposal to cut inflation short, it was necessary to foresee the possible redistributions that would occur with the sudden transformation of high nominal interest rates on operations already agreed upon into equally high rates, or with the use of indexations based on former inflation for the adjustment of payments after the brake had been applied to prices. The programme included a

system of debt conversion (from the old currency to a new one) which, in effect, functioned by translating into terms of nominal values, decreasing over time, the deterioration in the purchasing power of future payments that would have resulted from a rise in prices such as had been taking place before the programme. This mechanism sought to neutralize the effect of the sudden change in the price trend on payment commitments previously contracted.

In the months before the announcement of the programme, the government devoted special attention to improving the fiscal situation and increasing the real values of public service charges and the exchange rate. There was also a rapid liberalization of industrial prices, and stimulus was given to the recovery of the price of beef cattle, which had lagged appreciably behind. These policies, which aimed at establishing sustainable values for the main relative prices, implied an acceleration of the growth of prices and also had repercussions on activity and real wages (especially in the public sector). Since there were few signs of an imminent stabilization programme, inflationary expectations probably soared in a climate of acute tension. This became critical in the fortnight of June, when an unexpected rise occurred in the price of fuels, a devaluation was announced (with mainly fiscal aims, since it was combined with new foreign trade taxes) and rumours (often inaccurate) circulated on the content of the plan.

The programme was promulgated on 14 June, in a manner which clearly conveyed that the government had adopted it as an "all or nothing" option. A sharp reduction was announced for the fiscal deficit forecast for the second half of the year;⁴⁶ this would enable the Treasury to cease asking for Central Bank credits. In other words, there was a suspension of government financing through money issues;⁴⁷

⁴⁶Perhaps the magnitude of the fiscal adjustment envisaged in the programme can be better appreciated if it is borne in mind that, discounting interest payments on the external debt, the projection implied an excess of income over expenditure.

⁴⁷Before the announcement, the Central Bank had granted large amounts of credit to the government, which were used to form a financial buffer, assigned in part to the payment of the June half-bonus in the Civil Service. The use of an initial money issue to finance a temporary imbalance in the government accounts was a general practice in the programmes combating the hyperinflations of the 1920s.

this commitment was to be of indefinite duration. At the same time it was decided to institute a general freeze of prices, wages, the exchange rate and public service charges. Prices would be frozen at their 12 June values (which implied that the numerous price increases applied in the days just before the announcement would not be confirmed); wages would be fixed after the increase in remunerations for the month of May which was due under the indexation rule previously applied. The freezing would be temporary, but its duration was not fixed. The interest rate on deposits in the regulated segment was established at 4% per month; i.e., at a much higher value than the inflation rate implicit in the freeze, but much lower than the rate of 28% per month previously in force. Lastly, the creation of a new monetary unit (the austral) was announced: money in circulation and demand deposits would be automatically converted in the proportion of one austral per thousand pesos; debts fixed in pesos (or adjustable according to indexes which reflected the inflation in pesos prior to the reform) would be paid according to the application of a conversion scale which implied a daily depreciation of the peso in relation to the austral.

The features of the stabilization programme required an abrupt change in the attitude of the public. Actually, although the initial reaction of the principal social groups was one of caution, or opposition, there was a notable turnaround in the expectations of the public in general. It is difficult to distinguish the part played in this by the specific announcements (such as the monetary-fiscal commitment or the freeze) but it was undoubtedly influenced by the fact that the programme showed a clear determination on the part of the authorities to use their instruments to bring down inflation: the reaction of the public revealed that there was a strong desire for stability. This does not mean that expectations were immediately adjusted to a zero increase in prices, but it does show that a spell of marking time was introduced during which the possibility of a hyperinflationary explosion could be discounted. For the moment, this attitude showed itself in a keen price hunt on the part of consumers, in a widespread renewal of bank deposits at much lower interest rates than some

days earlier, and in a fall in the parallel exchange rate.

At the outset the application of the price freeze ran into certain difficulties: for some weeks there was uncertainty as to the prices of many products. This had a disturbing effect on transactions and (together with the contraction of consumer demand) was probably one of the causes of the sharp fall in activity during the months of June and July. Following this, a very marked attenuation was observed in price increases, and the markets, with certain exceptions, functioned normally. The wholesale price index rose by less than 1% per month between July and November. Consumer prices varied more rapidly (around 2.5% per month on average, eliminating the after-effect of the substantial increases in the first part of June on the indexes of the following months), owing to the rise in the prices of services and of some primary commodities. In point of fact, there seems to have been a certain slide in prices (and in wages); at all events, the downturn in inflation was abrupt and well-defined.

The reduction in the fiscal deficit was due to several causes. In the first place, in the months before the programme there was a marked upswing in the real value of public service charges. Moreover, the fall in the inflation rate itself eliminated much of the effect of the fiscal lag, so that there was a notable increase in tax revenue. The cash income of the government also increased, thanks to the larger taxes on foreign trade and the application of a forced loan (linked with the 1984 taxable income and net wealth). Secondly, public-sector wages and salaries remained lower than in the previous year, and investment expenditure was reduced. As a result, the central government Treasury achieved an approximate balance between outgoings and income and was able to abstain from requesting Central Bank credits. The adjustment was less marked in the provinces and in the State enterprises. Thus the fall in the public-sector deficit as a whole, although striking, was apparently somewhat lower than had been predicted.

The creation of money slowed down markedly in the last part of 1985, although much less than prices. Monetary expansion was fed by the accumulation of reserves (owing to the

surplus on the trade balance and the inflow of capital, encouraged by the great difference between the domestic interest rate and the zero variation in the exchange rate), the rediscounts to the financial system and Central Bank payments on the reserves; creation of money via these sources was partly sterilized (at a high cost for the Central Bank) through increases in cash requirements. There were significant changes in the portfolios of financial assets: demand for means of payment and interest-earning deposits increased, alongside a reduction in deposits adjustable in accordance with price indexes, while the parallel exchange rate (with some fluctuations) maintained a stable trend. This was apparently a reflection of the brusque change in inflationary expectations. Non-regulated interest rates, however, varied above 5% a month; this suggests that, after some months, considerable inflationary expectations persisted.⁴⁸

Once the initial maladjustment was over, there was a certain recovery in global demand. Although the level of activity towards the end of 1985 remained far below previous maximum levels, an increase in production was observable in relation to the meagre figures recorded in June and July of that year, and stocks were relatively normal. Thus the decline in the number of hours worked and in employment was halted. With regard to real wages, a comparison between periods with very different price increase rates is difficult, since in conditions of high inflation the purchasing power of a given nominal income is critically dependent on the point in time when it is received and on the time profile of its expenditure. In general terms, real remunerations seem to have declined slightly since the beginning of the programme; at the end of 1985 they were below the values corresponding to the previous year (especially in the public sector), although they exceeded the minimum levels recorded at the beginning of the decade.

⁴⁸Of course the level of the interest rate may have had other causes: one of the problems posed by the state of the economy was to identify how far the *ex ante* real interest rates were as high as appeared from the comparison of the nominal rates with the effective rise in prices. Moreover, the high costs of financial intermediation implied very wide margins between the rates on deposits and on loans, and thus increased the price of credit.

It would be premature to attempt a precise appraisal of the results of the programme.⁴⁹ Nevertheless, it evidently produced an appreciable fall in the rate of inflation, at a relatively low cost in terms of production losses in the wake of the abrupt change. Moreover, some months after the announcement of the programme, signs were observable —still incipient (because uncertainty has not disappeared), but significant— of a modification in economic behaviour: consumers could take advantage of the greater facility of comparing prices, there was a certain increase in consumer credit and, apparently, firms were devoting more attention to the calculation of their costs. Generally speaking, the time horizon for decisions seemed to have extended beyond the few weeks that represented the foreseeable future during the period of great inflation.

Some questions naturally remain unanswered: to what extent will the low inflation rates be sustainable, and what can be expected of the performance of the economy in the new conditions? The aim of the stabilization programme was to control a situation of emergency. As such, it had some components that were of a temporary character. The freezing of prices and wages was useful in cutting short the inertia of prices and giving a frame of reference to expectations. As the memory of inflation could not be blotted out in a few months, it will probably still be necessary to give income-policy guidelines for the orientation of price formation. At the same time, a prolonged freeze (even as it was used, without rigid application) inhibits the movements of relative prices and, in the light of the country's previous experience, may also create unfavourable expectations. Hence it would seem necessary to define rules for income policy which will allow the time horizon of the programme to be extended without the rigidity of a freeze. It is probable that upon this may partly depend the reduction of interest rates, which still remained very high towards the end of 1985. Similarly, it appears important that the government should be able to demonstrate its capacity to maintain, on a more permanent basis, a smaller fiscal deficit.

⁴⁹This document was completed in December 1985.

Both from the fiscal point of view and from the price and wages angle questions of distribution arise. The incipient stabilization has enabled the economy to develop in a more rational manner: even so, this in itself does not imply that the crisis has been overcome. Predictably, an economy that had reached the brink of hyperinflation will find recovery difficult. In Argentina's present circumstances, it is to be expected that there will still be heavy unsatisfied demands for higher wages, bigger profit margins and transfers through the budget. The stabilization programme involved a radical change in the way in which economic decisions are made: the government took the initiative in formalizing its announcements, a proceeding which was implicitly accepted by the other actors. This may have been due to the seriousness of the state of the economy and probably also to the government's effort to distribute the costs (and the benefits) of stabilization. Indubitably, however, some sectors have suffered losses. In the long run, the social groups will not abandon their claims: the problem still lies in achieving a smooth evolution of the distribution struggle, without successive sectoral thrusts that generate inflation. In this connection, the threat of a return to high inflation may serve to moderate the conflict, if this takes place in a framework in which the actors clearly perceive the limits imposed on the improvement of their incomes by the conditions of the economy and the resistance of the rest. At the same time, a state of stagnation fosters the distribution conflict: there will be fewer obstacles to the achievement of stabilization, the more clearly it is recognized that a trend towards growth can be regained.

Much depends, of course, on the behaviour of the domestic agents, both public and private. But the economy is also subject to a pronounced external constraint. Payments on the debt (combined at present with an abrupt deterioration of the terms of trade) impose severe pressure on public sector finances and reduce national income; both these elements hamper stabilization. Although the anti-inflationary programme was the offspring of the costs that price instability imposed on the domestic economy, one of its consequences has been an improvement in external bargaining

capacity. Nonetheless, the problem posed by the debt continues to be extremely complex and to some extent transcends the sphere of negotiation between the country and its

creditors. Aside from the domestic effort, the prospects of growth and stability basically depend on the conditions that are ultimately established within this sphere.

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Transnational corporations in Argentina, 1976-1983

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The purpose of this article is to analyse the more salient features of the performance and evolution of foreign capital in the Argentine economy during the military government which was in power from 1976 to 1983. In the introduction, a brief summary of the long-term situation is given, with emphasis being placed on the fundamental role which foreign capital has played in the economic development of Argentina throughout its history. Section One contains a discussion of the evolution of foreign investments authorized to establish themselves in the country, special aspects of their capital contributions and their distribution by sector and country of origin and, finally, an analysis of those investments which were channelled to the financial sector and those which originated in the United States.

In Section Two, the international presence in the manufacturing industry is discussed. The situation is analysed at two levels. Firstly, background information is given to throw light on the position held by the transnational corporations in the structure of industry, and secondly, their evolution within the sector during the past decade, when the Argentine economy underwent a far-reaching process of deindustrialization, is discussed.

With regard to the period under study, the authors stress that, although considerable incentives were offered to encourage foreign investments, such investments did not come in on a large scale, mainly because of the recessive conditions which prevailed from the mid-1970s onwards and because of misgivings about the possible duration of the policy of openness. When the opportunities offered by the market over the short and medium term are limited, it is not enough to set up an institutional framework designed to encourage foreign investment.

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Introduction

Since it began to take part in the international division of labour, Argentina has been a major recipient of foreign investment, and foreign investment has, in turn, played a major role in building the country's structure of production. Both when the country was mainly an exporter of agricultural products and during the period of import substitution—either during the early stage of light industry or the later stage when the process was extended to the production of intermediate and durable goods—foreign corporations have played a strategic role, and have acted as the moving force behind the structural changes which have taken place in the economy.

During the period of crop and stock production for external markets, foreign capital controlled the linkages which guaranteed the internal operation of the accumulation model and the provision of foods and raw materials for the metropolis (England), the country of origin of most of the investments. Investors concentrated their attention on refrigeration plants, commercial activities pertaining to imports and exports, the ports and, especially, the railways because of the role these activities played in the model and the potential for accumulation which they offered.

As the agroexports model began to decline—even before the definitive crisis of 1930—, there was a contraction in the flow of new investments associated with that accumulation pattern. The few firms which did establish themselves in the country were mostly from the United States and they tended to do business in fields other than that of agricultural exports.

During the transition between periods when agricultural exports prevailed and the stage when the industrial sector became the dynamic nucleus of capital accumulation, foreign investment was oriented towards specific sectors. New investments were concentrated on import-substitution manufacturing activities. At first, they were oriented towards industries which produced final goods associated with the consumption patterns of those strata of the population which, having a high average income, represented a heavy and growing

demand for manufactures. That was the case with many food industries —fundamentally agroindustrial ones, reflecting the transition between the two models— textiles, construction materials and some final chemical products and electrical consumer goods. These were mainly light industries in whose development foreign capital played a major role, without actually dominating or controlling the industries concerned.

Nevertheless, it was not until the late 1950s or early 1960s that the transnational corporations began to play a hegemonic role in the substitution process, which by then had been extended to intermediate and durable consumer goods. Industries such as the petrochemical, automobile, machinery and equipment or metal products and engineering industries were at the fore during this second stage of the substitution process; they were set up through foreign enterprises which, soon after establishing themselves, became part of the entrepreneurial élite of the country.

Although the total amount of investments approved between 1958 and 1962 did not

represent a significant contribution to capital accumulation in industry (around 10% of capital formation in the sector), the fact that they were concentrated in a few strategic activities (the relatively more dynamic ones, which had modern technologies, markets controlled by an oligopoly and a high accumulation potential) brought a profound transformation of the industrial structure and meant that the transnational corporations played a leading role in those industries which by their very nature, give impetus to the development of manufacturing in the country.

The new accumulation pattern of the Argentine economy was based on the industrial sector and hence, as foreign investments matured, they became one of the main foundations of this accumulation. Although, in quantitative terms, foreign capital did not reach the magnitude it had at the beginning of the century (before World War I it represented 51% of gross investment), it did play a fundamental role because of the degree to which it controlled the dynamic poles of capital accumulation and reproduction.

I

The transnational corporations and the opening-up policy of the last military government

1. *Trends in direct foreign investment and investment patterns, 1976-1983*

After the brief period of the Peronist government (1973-1976), which regulated the central aspects of the management of transnational corporations in the country, the military government eliminated the main restrictions which had been placed on foreign investment, by establishing the new system provided for in Act 21382.

The new authorities' aim —in which they partly succeeded— was to dismantle the classical

protectionist system, to change the economic structure of the country and thus to modify the role of the various economic agents and sectors. Argentina thus embarked on a new experiment which dramatically changed the accumulation model which had become firmly established after the Second World War. According to Kosacoff (1984), the policy put underway in April 1976 consisted, in essence, of trusting in the market mechanisms for the allocation of resources —thus making it necessary to carry out a programme designed to liberalize the market— and of seeking to establish greater

Table 1

**ARGENTINA: AUTHORIZED FOREIGN DIRECT INVESTMENT BY FORM
OF CONTRIBUTION, 1977-1983**

(Thousands of dollars at current prices, and percentages)

	New capital contribu- tions	Capitaliza- tion of credits	Total authorized investment	Reinvest- ment of profits	Automatic contribu- tions	Total investment (3) + (4) - (5)	Total invest- ment in terms of thousands of dollars at 1983 prices
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1977	40 518	80 602	121 120	132 435	1 419	254 974	398 155
1978	201 534	55 504	257 038	118 253	11 697	386 988	560 859
1979	374 269	86 364	460 633	193 186	16 973	670 792	863 540
1980	633 359	30 130	663 489	399 364	97 918	1 160 770	1 310 511
1981	790 011	96 652	886 663	344 597	180 069	1 411 329	1 460 486
1982	252 915	711 126	324 041	181 651	98 734	604 426	612 564
1983	131 155	9 848	141 003	131 248	11 045	283 296	283 296
Total	2 423 761 (50.1)	430 226 (9.7)	2 853 988 (59.8)	1 500 733 (31.4)	417 854 (8.8)	4 772 575 (100.0)	5 489 411

Source: Prepared by the authors on the basis of information supplied by the Foreign Investment Department of the Ministry of Economic Affairs.

links with the exterior. With regard to the latter, tariff reforms —aimed at opening up trade— and financial reforms were implemented in order to remove restrictions on the inflow and outflow of capitals. In addition, import duties, the exchange rate and the real interest rate were used jointly as basic tools in the struggle against inflation. This anti-inflationary objective was constantly given priority over the medium-range accumulation process and the improvement of income distribution. The axes of economic policy were the establishment of a more realistic price system (which entailed eliminating regulations, taxes, subsidies and privileges) and the consideration of comparative advantages taken in a static sense. These two elements were the central indicators to be used in the estimates to be made by corporations in measuring the efficiency of the investment process.

We have quoted from this passage at length because it provides a useful macroeconomic

frame of reference for assessing the response of direct foreign investment to the great variety of incentives which were offered from 1976 onwards and for studying the development of the foreign corporations established in the country.

As a result of the incentives received and of the consolidation of a favourable environment for carrying out certain highly profitable operations with a minimum amount of risk and a rapid rate of return on capital, direct foreign investments authorized to set up business in the country grew steadily up to 1981, and then declined sharply in 1982 and 1983 (table 1).

Up to 1983, authorized foreign investments amounted to a total of US\$ 4 772.6 million, i.e., at an annual rate of US\$ 681.8 million during the period under study (1977-1983), or US\$ 784.2 million in constant 1983 dollars.

This influx of direct investments took place during two clearly differentiated subperiods. During the first, from 1977 to 1981 —coinciding

with the tenure of Dr. Martínez de Hoz and the full application of the policy of openness—direct foreign investment rose steadily to a level of approximately US\$ 1.5 billion. During the second stage (1982 and 1983), on the other hand, investment fell considerably; this phenomenon was associated with a series of events, such as the departure of Dr. Martínez de Hoz, the discontinuation of the openness policy and the successive devaluations of the peso, which created an atmosphere of insecurity for foreign investors. In brief, the economic programme announced in April 1976 was gradually abandoned.

As regards the forms taken by direct foreign investment, table 2 shows that of the investments authorized between March 1977 and December 1983, a little over half (50.1%) consisted of new capital contributions, 9.7% represented capitalization of external credit, 31.4% came from reinvestment of profits and the remainder (8.8%) represented automatic capital contributions.

In view of the different ways in which these investments were made, the actual significance of the nearly US\$ 5 billion worth of foreign investments entering the country over a period of seven years is relative. A partial review of some of these investments brings to light a

series of aspects and special situations which give a much better picture of their magnitude and nature during the period considered.

New capital contributions brought in during the seven years (US\$ 2 423.8 million) included US\$ 702.3 million worth of temporary contributions to the production of oil and natural gas and an unspecified—but significant—amount of external resources for the denationalization of companies financed by local capital (La Isaura, Calera Avellaneda) or, in other cases, a simple increment in the share held by parent companies in the capital of local firms in which they already held the majority of stocks.¹ In either of the two cases—either denationalization or increased participation in the capital of a local subsidiary—even though, *formally* speaking, the investment involved a particular type of "new capital contribution" from abroad, there was no increase in the

¹Some of the most noteworthy examples are: Corning International Corporation, to increase its participation in the capital of Cristalerías Rigolleau S.A.; Química Hoechst in Indur S.A.; Massey Ferguson Limited in Perkins Argentina S.A. and in Massey Ferguson Argentina S.A.; Westinghouse Electric Corporation in Galileo Argentina C.I.S.A.; Federal Mogul Corporation in INDECO Minoli SAIC; Renault Argentina S.A. (controlled in turn by Régie Nationale des Usines Renault) in Metalúrgica Tandil S.A.; Philips Argentina S.A. (controlled in turn by NY Philips Gloeilampert) in Salvo S.A.

Table 2

ARGENTINA: AUTHORIZED FOREIGN INVESTMENT, 1977-1983

(Accrued total and annual averages. Thousands of 1983 dollars)

Item	Accrued total			Annual averages		
	1977-1981	1982-1983	Total	1977-1981	1982-1983	Total
1) New capital contributions	2 369 755	387 475	2 757 230	473 951	193 738	393 890
2) Capitalization of credits	451 523	81 932	533 455	90 305	40 966	76 208
3) Total authorized investments (1) + (2)	2 821 278	469 407	3 290 685	564 256	234 704	470 098
4) Reinvestment of profits	1 434 365	315 345	1 749 710	286 873	157 673	249 959
5) Automatic contributions	337 908	111 108	449 016	67 582	55 554	64 145
6) Total investment (3)+(4)+(5)	4 593 551	895 860	5 489 411	918 710	447 930	784 202

Source: Prepared by the authors on the basis of information supplied by the Foreign Investment Department of the Ministry of Economic Affairs.

production capacity of the country and no more than a mere transfer of ownership of already existing capital.

A similar case which deserves separate treatment, however, because of its implications and the magnitude of the resources involved, is that of the purchase by Volkswagen of the assets of Chrysler Fevre Argentina. This transaction actually represented an inflow of external resources which at the same time entailed a repatriation of capital by Chrysler (a United States firm) and a displacement of national capital (51.3% belonged to local parts dealers and agents). Nevertheless, the official statistics only show the investment authorized for Volkswagenwerk A.K. of West Germany —US\$ 102 million— with Chrysler Fevre Argentina as the receiving corporation.

The magnitude and evaluation of the direct foreign investment authorized between 1977 and 1983 only serve as a partial and inadequate indicator when it comes to assessing the results obtained during the period in question; moreover, the absence of official information on the repatriation of external capital makes it impossible to quantify the net effect of the policy aimed at attracting direct foreign investment and thus invalidates any appraisal of its successes and failures.

2. Distribution of direct foreign investment by sector and by country of origin, 1977-1983

The changes in the accumulation model which were brought about as a result of certain characteristics of the country's economic development from the late 1970s onwards are reflected in the sectoral distribution of direct foreign investment authorized between 1977 and 1983. As during the period when agricultural exports were predominant or during the different stages of import substitution the orientation of foreign capital was associated with the role played by the various sectors of activity at the macroeconomic level and with the accumulation pattern concerned. Thus, during the period when the industrial sector was no longer the dynamic pole of capital accumulation and reproduction and that role was assumed by tertiary activities in general and by the financial

sector in particular, the manufacturing industry ceased to be almost the only centre of attraction of direct foreign investment in the country.

The sectoral composition of foreign investment between 1977 and 1983 reflected a turnaround in the historical trends of the postwar period, as there was a sharp decline in direct foreign investment in industry which was offset by the increasing importance of the services, commerce and finance sectors. The resulting profile thus tended to be a reflection of the policy of opening up to the exterior, under which most of the goods-producing sectors were subordinate and the dynamic axis was transferred to financial circuits and to service activities.

Among the investments authorized (not those actually made) up to December 1980 (402 proposals were approved out of a total of 508 for the period 1977-1983), the sectoral distribution of the 166 new firms which would have been established under the 402 proposals clearly shows the sectoral preferences of the foreign investors and the importance of non-production activities (table 3); only 29 would be industrial firms (17.5% of the total), i.e., the same as the number of marketing firms and fewer than the number of firms in the services sector (34).

Complementary facts may be ascertained from an analysis of the distribution of authorized foreign investment by sector of destination, for which purpose the capitalization of loans and new capital contributions channelled towards new or existing firms must be considered as part of such investments (table 4).

Almost 60% of the investments were concentrated in only three areas, i.e., temporary investments in oil operations (24.6%), the automobile industry (17.4%) and the finance and banking sector (16.6%). If investments in oil are left out, the automobile industry becomes the main receiving sector (US\$ 495.4 million). Of investments authorized for the sector, 33.7% (US\$ 167 million) were for "capitalization of loans", in most cases, these were used to improve the structure and the economic and financial situation of the receiving firms, which had been seriously affected by the setback suffered by the sector as a whole. New capital contributions (US\$ 328.4 million) were accounted for by the entry of a new international firm (Volkswagen)

Table 3

**ARGENTINA: SECTORAL DISTRIBUTION
OF NEW FIRMS SET UP ON THE BASIS
OF FOREIGN DIRECT INVESTMENT
AUTHORIZED BETWEEN 1977
AND 1980**

(Number of firms, and percentages)

Sector	Number of firms	Percentages
Financial institutions and banks	15	9.0
Services	34	20.5
Marketing	29	17.5
Agriculture and fishing	19	11.4
Construction	9	5.4
Manufacturing	29	17.5
Machinery and equipment	5	3.0
Chemicals and plastics	11	6.6
Cement	1	0.6
Others	12	7.2
Other activities	31	18.7
Total new firms	166	100.0

Source: Ministry of Economic Affairs (1981).

and the investment plans of Ford (a new truck plant) and Fiat. Within the context of a far-reaching sectoral reorganization, these investments were offset by the closing down and the consequent repatriation of capital (in the first three cases) of General Motors (1978), Citroen (1979) and Chrysler (purchased by Volkswagen), Industrias Mecánicas del Estado (1980) and the merger of SAFRAR and Fiat (Sevel).

The greatest net inflow of external capital took place in the financial sector and, more specifically, the banking sector. Authorized investments amounted to US\$ 473.6 million, thanks to the entry of fifteen new foreign banks, which is evidence of the growing interest of international financial groups in setting up operations in the country.

On the other hand, the relative lack of interest shown by foreign investors in putting their capital into the manufacturing sector one of the most affected by the policy of openness, may be seen in the figures showing the number of industrial firms established up to December 1980. Table 4 shows that —despite the influence of the automobile sector— the various branches of industry as a whole represent slightly less than half the authorized investments (48.3%); during any other subperiod of the last three decades, industry had always accounted for over

Table 4

**ARGENTINA: SECTORAL DISTRIBUTION
OF FOREIGN INVESTMENT
AUTHORIZED BETWEEN
1976 AND 1983**

(Thousands of dollars at current prices, and percentages)

Sector	Amount	Percentages
Exploitation of gas and petroleum	702 319	24.6
Primary activities (agriculture, fishing and mining)	79 683	2.8
Motor vehicle industry	495 441	17.4
Machinery and equipment	173 437	6.1
Petrochemicals	172 995	6.1
Food, beverages and tobacco	138 291	4.8
Chemical products	99 129	3.5
Pharmaceutical products and perfumery	81 176	2.8
Other industrial activities	217 738	7.6
Construction	49 410	1.7
Financial institutions and banking	473 569	16.6
Business and services	143 580	5.0
Others	27 220	1.0
Total	2 853 988	100.0

Source: Prepared by the authors on the basis of information supplied by the Foreign Investment Department of the Ministry of Economic Affairs.

90% to 95% of all direct foreign investment established in the country. There is no question that the manufacturing industry ceased to be the predominant sector as far as the attraction of foreign capital is concerned.

Contrary to what happened in the case of changes in the sectoral composition of foreign investments the distribution by country of origin of these investments did not vary greatly with respect to the legislative trends of the last few decades. As regards the high concentration in a few countries and the relative share represented by each of them, the structure did not differ substantially from that of any other postwar period, nor —except in the contrasting cases of the United Kingdom and Italy— was there much variation with regard to the stock of foreign capital accumulated in the country around the mid-1970s (table 5).

Table 5

**ARGENTINA: FOREIGN INVESTMENTS
AUTHORIZED BETWEEN 1977
AND 1983, BY COUNTRY OF
ORIGIN OF INVESTMENT**

*(Thousands of dollars at current
prices, and percentages)*

Country	Amount	Percent- ages
United States	1 264 244	44.3
Italy	455 867	16.0
France	266 079	9.3
West Germany	252 458	8.8
The Netherlands	126 042	4.4
Switzerland	117 789	4.1
Spain	97 289	3.4
Canada	56 014	2.0
Sweden	44 611	1.6
Japan	41 152	1.4
Others (19 countries)	132 442	4.7
Total	2 853 988	100.0

Source: Prepared by the authors on the basis of information supplied by the Foreign Investment Department of the Ministry of Economic Affairs.

Almost 70% of the total amount of direct foreign investment authorized between 1977 and 1983 was accounted for by firms from only three countries (United States, Italy and France); if investments from four other countries (West Germany, Netherlands, Switzerland and Spain) are included, the figure increases to 90%.

Of the remaining countries of origin, the only ones worth mentioning would be the negligible presence of Japan (1.4%) and the United Kingdom which, with only 0.7% of the total, ranks thirteenth in the listing of countries of origin of investments.

*3. Direct foreign investment in the
financial sector of Argentina*

The substantial amount of direct foreign investment that was placed in the financial sector may be explained, to a large degree, by the fact that the high degree of liquidity of the financial market coincided with the search for new investment opportunities and the application, at the local level, of a policy of openness, which involved an effort to attract the attention of the world banks. The financial reforms of mid-1977, the widespread liberalization of the capital market, the exchange lag policy and its effect on the spread between domestic and external interest rates were some of the main factors which created favourable conditions for arousing the interest of the foreign banks. These local phenomena occurred simultaneously with the high liquidity of the international market and the intensification of oligopolistic competition among the world banks, essentially as a result of their growing transnationalization.

As a result of this combination of circumstances, there was a considerable influx of foreign capital to the financial sector of Argentina, especially to the banks. Hence, direct foreign investment in the sector had the greatest economic impact during the period, because of its effect on the shaping of the financial market. Around 1983, total authorized investments in the sector amounted to US\$ 473.6 million, as a result of the approval of fifteen investment proposals which, in every case, had to do with the establishment of new banks in the country.

This influx had two interesting features, i.e., its distribution over time and the forms of establishment involved. The investments were highly concentrated in time; thus, slightly over 95% were authorized within a three-year period—between late 1978 and late 1981—and the fifteen banks were actually established in 1979 and 1980 (table 6).

The concentration of these investments in time had to do with the fact that around the end of 1978, the openness policy took a new turn; thus, with a "monetary approach to the balance of payments", the financial market was opened up completely, thanks to the elimination of barriers to international capital flows. In addition, an exchange lag policy was applied which provided opportunities for highly profitable investment, essentially in the financial circuits. The combined effect of the new legislation on foreign investment, the financial reform of 1977 and the liberalization of the capital market was to arouse increasing interest among the international banks in establishing themselves in the country.

As regards the way in which the new banks set up their operations in the country, in only three of the fifteen cases did they purchase local banks, i.e., Irving Trust purchased Banco

Austral; Bank of America purchased Banco Internacional, and Crédit Lyonnais purchased Banco Tornquist. The remaining banks (12) which started business during the period in question established new local firms.

This method of penetration, which was different even from that used by the foreign banks towards the late 1960s, had to do with the type of business carried out by the new banks (foreign transactions and non-traditional services for a small core of users), which was different from the type of activities carried out by most of the local banks (receiving deposits and granting loans).

Although the number of firms almost doubled, the influence of the foreign banks on the local market showed hardly any variation between 1976 and 1983 (table 7).

In late 1976, when the neomonetarist goals of the economic authorities had become clearly evident, the foreign banks had recovered part of the share in total deposits on the commercial circuit which they had lost during the Peronist government. Thus, while in 1974 they received 15% of the total, by the end of 1976 they controlled 16.5%.

Towards the end of 1978, as a result of the restrictions imposed by the Central Bank on the opening up of new subsidiaries, the foreign banks' share fell back to the levels of the early 1960s. Suffice it to say that, while between 1970 and 1977, the foreign banks reduced the number of their branch offices from 223 to 219, the banking system as a whole increased them from 2 298 to 3 152 (table 8).

This loss of the foreign banks' share in total deposits received and the decline in the number of branch offices had to do with the type of business in which they engaged, inasmuch as they chose to compete in the area of interest rates while at the same time, as a result of the institutional reclassification brought about by the reforms and the different style of competition prevailing, in which there seemed to be a ranking of the banks' spatial capacity to attract deposits, there was a substantial increase in the total number of commercial banks and their branch offices (Feldman and Sommer, 1984).

At any rate, with the new influx of direct foreign investment in the banking sector

Table 6

**ARGENTINA: DISTRIBUTION OVER
TIME OF AUTHORIZED FOREIGN
DIRECT INVESTMENT IN THE
FINANCIAL SECTOR**

(Thousands of dollars, and percentages)

Subperiod ^a	Thousands of dollars	Percent- ages
1-III-1977 to 31-VIII-1978	17 256	3.7
1-IX-1978 to 30-IX-1981	452 111	95.5
1-X-1981 to 31-XII-1983	3 932	0.8
Total	473 569	100.0

Source: Foreign Investment Department of the Ministry of Economic Affairs.

^aThe dates of the subperiods correspond to those of the periodic reports issued by the Foreign Investment Department.

Table 7

**ARGENTINA: INDICATORS OF PARTICIPATION OF FOREIGN BANKS
IN THE PESO DEPOSITS MARKET**

(Number of entities, and percentages)

Indicator	1974	1976	1978	1980	1981	1982	1983
Number of foreign banks	17	17	17	32	32	32	32
Share in total commercial bank deposits	15.0	16.5	13.3	17.0	17.0	14.2	16.8
Share in total private commercial banks deposits	39.4	31.5	22.1	28.4	28.4	26.8	29.7
Share of private commercial banks (national and foreign) in total private and State commercial bank deposits	45.8	52.3	60.3	59.8	59.8	52.9	56.7

Source: Central Bank of the Republic of Argentina.

Table 8

**ARGENTINA: EVOLUTION OF QUANTITY OF BANK BRANCH OFFICES
BY SOURCE OF CAPITAL**

(Absolute figures and percentages)

Year	Foreign banks		Total banks		Percentage	
	Number of branch offices	Average number of branch offices per bank	Number of branch offices	Average number of branch offices per bank	Of number of branch offices	Of average number of branch offices per bank
1970	233	13.7	2 296	19.3	10.1	71.0
1977	219	12.9	3 152	26.3	6.9	49.0
1978	222	13.1	3 339	18.5	6.6	70.8
1979	238	11.9	4 060	19.2	5.9	62.0
1980	241	9.3	4 050	19.6	6.0	47.4
1981	373	11.7	4 075	19.8	9.1	59.1
1982	379	11.5	4 242	20.9	8.9	55.0
1983	373	11.7	4 528	21.7	8.2	53.9

Source: Central Bank of the Republic of Argentina.

towards the end of 1980, the transnational banks recovered a good deal of the ground they had lost between 1971 and 1978. From a 13.3% share of all deposits in the hands of commercial banks, in 1978 they managed to attract 17%.

It was not until 1981 that the foreign banks also began to apply a policy of opening up branch offices as a way of improving their competitiveness; in just one year, the number of branch offices rose from 241 to 373. To a large extent, this proliferation of branch offices seems to have been a residual effect of the succession of bankruptcies and interventions of national private firms which began with the closing down of the Banco de Intercambio Regional in March 1980. Several of the foreign banks belonging to the "retail and diversified" sector purchased some of the branch offices of liquidated institutions from the Central Bank.

The results of 1982 also reflect, to a large extent, the impact of the Argentine-British dispute over ownership of the Falkland Islands (Islas Malvinas) and the Georgia and Southern Sandwich Islands. Part of the deposits sought refuge in State entities and part of the deposits in foreign banks were channelled to firms that were less vulnerable, in the users' view, to the hazards of the armed conflict. Between 1981 and 1982, the transnational institutions' share in total resources handled by commercial banks fell from 17.0% to 14.2%. In 1983 —when expectations centred on the restoration of the country's institutional stability—, there was a slight improvement in the level of deposits accumulated by the foreign banks. As regards the total amount in the hands of commercial banks, their share rose from 14.2% to 16.8%, two points below the record set in 1969.

In addition to discussing the position of the transnational banks in the local market (either in peso deposits or in number of bank offices), it is worthwhile analysing the ways in which their influence was exercised within the banks themselves. To this end, table 9 shows the share of the major firms in total deposits received by the transnational banks up to December 1983 —with the corresponding figures for June 1976— as well as their distribution according to country of origin of the capital, with the banks which started during the recent military régime shown separately.

Some of the salient features of the transnational presence in banking activities are the following:

a) The high degree of concentration of deposits in a small group of banks. One third of the banks (11) attracted a little over 80% of all deposits and four of them accounted for almost half (49.3%) of the total.

b) None of the eleven firms entered the country during the recent military régime. That group includes two banks that were denationalized during the period in question, i.e., Tornquist (purchased by Crédit Lyonnais) and, indirectly, Internacional, absorbed by the Bank of America, which had already been doing business in the country.

c) The absence of major changes, with respect to 1976, in the composition of the leader group or, at least, its size, which —one might assume— would entail almost doubling the number of firms set up by foreign capital.

d) The average represented by the United States banks, both as regards the number of firms (11) and as regards their share in total deposits channelled to the foreign banks (51.2%); hence, 45.4% of the total is concentrated in only four banks.

e) Finally, the clear difference between banks which entered the country before the recent military régime and those which entered during that period, as regards their ranking in the peso deposit market. While the former accounted for 82.9% of those deposits, the latter only accounted for the remaining 17.1%, if the analysis is confined to the new banks established during those years, the figure falls to 9.6%. This uneven participation once again shows up the different characteristics of the two groups, i.e., the former were predominantly "retailers" and "diversified", while the ones begun under the policy of generally open markets were predominantly "wholesalers" and "specialized".

4. *United States investments in Argentina*

The direct foreign investments which entered the country during the recent military régime may also be analysed in the light of the official statistics of the countries of origin of those capitals. It is thus possible to compare the rate at

Table 9
**ARGENTINA: SHARE OF EACH OF THE VARIOUS FOREIGN BANKS IN
 TOTAL PESO DEPOSITS IN THEIR HANDS**

(Percentages)

Entity	Sources of capital	Share in deposits (percentages)		Ranking June 1976
		December 1983	June 1983	
Ranking by deposits at December 1983				
The First National Bank of Boston	United States	19.8	13.9	2
Citibank	United States	14.5	11.3	3
Banco de Londres y América del Sur	United Kingdom	7.5	14.3	1
Bank of America	United States	7.4	2.3	15
Banco Tornquist ^a	France	6.5
Supervielle Scoiété Générale	France	6.3	6.4	7
Banco Popular Argentino	Spain	4.2	7.1	6
Banco Sudameris	France/Italy	3.9	7.9	5
Chase Manhattan Bank	United States	3.7	3.0	13
Deutsch Bank	Germany	3.7	5.0	8
Bancò Europeo para América Latina	Belgium/Italy	3.1	3.4	11
<hr/>				
Country		Number of entities	Share in total	
Distribution of deposits by source of capital				
United States		11	51.2	
Brazil		4	0.4	
Spain		3	7.8	
France		3	13.2	
United Kingdom		2	7.5	
Italy		2	1.0	
The Netherlands		1	1.9	
Japan		1	2.3	
Uruguay		1	3.0	
Canada		1	1.0	
West Germany		1	3.7	
France/Italy		1	3.9	
Belgium/Italy		1	3.1	
Total		32	100.0	
Distribution of deposits by date of incorporation of the transnational bank				
Banks installed before 1976		17	82.9	
Banks installed under the military government		15	17.1	
New banks		(12)	9.6	
Denationalizations		(2)	7.5	
Denationalization and absorption ^b		(1)	...	

Source: Prepared by the authors on the basis of data supplied by the Central Bank of the Republic of Argentina.

^aIn 1976 the Banco Tornquist was owned by local capital. Subsequently it was purchased by Crédit Lyonnais.

^bRefers to the Banco Internacional, purchased by the Bank of America and transferred in 1983 to its local subsidiary.

which capital was channelled to Argentina with its evolution at the global level, sectoral profile, profitability and the specific application of the benefits obtained from those investments (reinvestment or repatriation). With this information, a clear picture emerges of the place which Argentina occupies among all countries receiving foreign investments.²

The first aspect to be studied is that of the changes that have occurred in respect of the stock of United States capital established in Argentina. Between 1976 and 1983, direct foreign investments of United States capital in Argentina rose from US\$ 1 366 million to US\$ 3 054 million; this represents an average annual growth of 12.2% (4.4% per year in constant 1976 dollars). During the same period, total United States investments abroad, measured in constant values, declined slightly (table 10).

Some comments are in order in connection with this sharply contrasting performance. Between 1976 and 1979, Argentina followed the trend noted at the international level, i.e., the export of United States capital continued to slow down, a phenomenon which had begun with the recession of 1974-1975. The dramatic increase in United States investments accumulated abroad between the end of World War II and the early 1970s was a result of the dynamic evolution of the world economy and the steady expansion of production capacity at the international level. That growth was interrupted during the crisis of 1974-1975, which seriously affected capital flows, especially those directed towards production.

This behaviour fits into the overall picture of the evolution and cycles of the international economy. Within this framework, the rate of growth of United States investments in Argentina between 1976 and 1979 (1.7% per year) was quite similar to the rate recorded at the international level.

² An analysis of the information supplied by the United States Department of Commerce will show the destination, at the international and local levels, of most capitals established outside their countries of origin. The statistics published by the Department in its *Survey of Current Business* make it possible to study the evolution and the main characteristics of direct foreign investments in each receiving country and hence to study those directed to Argentina in the last few years.

This had not been the case during the preceding years. As a result of the recessive environment prevailing in the world economy, the general instability of exchange rates and of financial and monetary markets and the absence of a recovery of satisfactory rates of return on investments abroad (which fell steadily between 1979 and 1983), on the one hand, and, on the other, of the domestic policies followed by the Republican Administration, there was a steady decline, in real terms, of direct United States investments abroad (the cumulative rate was -1.6% per year between 1979 and 1983). On the other hand, United States investments in Argentina during the same period showed a real cumulative growth of 6.4% per year. This performance reflects the interest of United States investors in establishing their capitals in the country. An analysis of the sectoral content of this growth shows that it was spearheaded by two activities, i.e., oil and finance. Whereas in global terms, cumulative direct foreign investment increased 2.2 times between 1976 and 1983, investments

Table 10

ARGENTINA: EVOLUTION OF UNITED STATES INVESTMENT IN ARGENTINA AND THROUGHOUT THE WORLD, 1976-1983

(Millions of 1976 dollars^a, and percentages)

End of year	Investment in Argentina (1)	Total direct investment (2)	Percentage (1)/(2)
1976	1 366	138 809	0.98
1977	1 403	137 467	1.02
1978	1 460	142 243	1.03
1979	1 436	145 852	0.99
1980	1 699	146 713	1.16
1981	1 707	142 535	1.20
1982	1 835	135 399	1.35
1983	1 842	136 379	1.35

Source: Prepared by the authors on the basis of data supplied by the United States Department of Commerce (several years).

^aDeflated by the United States wholesale price index.

Table 11

**ARGENTINA: ACCRUED UNITED STATES DIRECT INVESTMENT, BY SECTORS
OF ACTIVITY, 1976-1983**

(Millions of dollars at current prices)

Sector	1976	1977	1978	1979	1980	1981	1982	1983
Mining	53	55	54	48	...	69	71	72
Petroleum	174	223	265	305	395	483	645	808
Manufacturing								
Food products	49	51	64	81	168	264	279	288
Chemical products	207	220	243	299	416	360	371	332
Primary metal products	72	67	73	64	72	67	77	79
Machinery	143	152	172	205	204	271	274	229
Transport equipment	221	228	242	289	409	308	380	381
Others	206	203	205	247	315	301	348	342
Total manufacturing	898	921	1 000	1 184	1 584	1 570	1 729	1 651
Business	104	132	157	136	216	202	167	128
Finance	72	86	108	113	145	304	300	298
Others	65	73	86	64	...	107	90	97
Total	1 365	1 490	1 670	1 850	2 494	2 735	3 002	3 054

Source: Prepared by the authors on the basis of data supplied by the United States Department of Commerce (several years).

in oil rose more than 4.5 times and investments in financial activities grew more than fourfold. On the other hand, investments in manufacturing industry, which historically had been preferred by United States investors, did not double, in current values, during those seven years, in constant values, the cumulative annual rate of growth fell to 0.7% (table 11).

As a result of this difference in growth rates, the sectoral structure of direct United States investments in Argentina changed substantially. Over a period of only seven years, the petroleum sector more than doubled its share of the total —12.7% in 1976 and 26.5% in 1983— and the share of the financial intermediation sector rose from 5.3% to 9.8%. As a result of the channelling of capital towards banking activities between 1979 and 1981, seven of the fifteen banks entering the country were of United States origin.

In both cases, the growing participation of United States investments reflected the trends

occurring at the international level, where, during the same period —1976 to 1983—, the share of the petroleum sector rose from 20.8% to 27.0% of cumulative United States investments abroad and that of the financial sector rose from 12.3% to 12.7%; investments in manufacturing, on the other hand, fell from 44.8% to 39.9% (United States Department of Commerce, several years).

It would appear that the nature of the process whereby the Argentine economy was opened up and, in that context, the economic activities which appealed most to foreign investors, were completely in line with the trends as regards sectoral distribution which prevailed in the export of United States capital, i.e., petroleum exploration and production and transnationalization of banks. This growth was offset by a decline in the manufacturing industry which, over the seven-year period, fell by more than 11 points in its ranking within the scheme of total direct foreign investments from the

United States accumulated in Argentina. The relative lack of interest in investing in one of the activities most seriously affected by the military government's economic policy appears to have been a constant phenomenon throughout this period and it affected almost every sector of industry.

As regards the subsidiaries operating in Argentina, the census of direct foreign investments carried out by the United States Commerce Department in the late 1970s shows that in 1977, there were 279 subsidiaries of United States firms in Argentina; their total assets were equivalent to US\$ 3 966 million, they employed 113 389 persons and their annual sales amounted to US\$ 3 615 million.

Although several intermediate combinations were possible, two extreme situations prevailed as regards the operation of transnational corporations established in relatively less developed countries, i.e., some produced for the domestic market and some were oriented towards the market of their country of origin or the world market in general, in the context either of the internationalization of production processes or of the supply of

goods, essentially primary ones, at a lower relative cost. Table 12 shows the high proportion of total sales accounted for by the local market (84.6%), which was a result of their having been established under the import-substitution model. Exports were almost marginal with respect to production for the domestic market.

The low coefficient of local exports (15.4%) with respect to the world rate (38.1%) leads to the conclusion that most of the United States transnationals operating in Argentina were organized in terms of local demand and that, in general, exports represented surplus production beyond the levels of local demand (U.S. Department of Commerce, 1981).

The captive trade of United States transnational corporations operating in Argentina was negligible. Whereas at the international level, 33.1% of the sales of the United States subsidiaries was accounted for by intrafirm trade, in Argentina, that trade amounted to no more than 9.3% and, as might be expected, it was only significant in the case of the small volume of exports to the United States, where it represented 87.5% of the total.

Table 12

ARGENTINA: SALES OF UNITED STATES FIRMS, BY GEOGRAPHICAL DESTINATION AND LINKAGE WITH THE PURCHASER, 1977

(Millions of dollars, and percentages)

Linkage	Domestic market		Exports to:				Total	
	Amount	Percent- age	United States		Other countries		Amount	Percent- age
			Amount	Percent- age	Amount	Percent- age		
Intrafirm sales	37	1.2 (11.0)	21	87.5 (6.2)	279	52.5 (82.8)	337	9.3 (100.0)
Sales to non-affiliated firms	3 022	98.8 (92.2)	3	12.5 (0.1)	252	47.5 (7.7)	3 277	90.7 (100.0)
Total sales	3 059	100.0 (84.6)	24	100.0 (0.7)	531	100.0 (14.7)	3 615	100.0 (100.0)

Source: Prepared by the authors on the basis of data supplied by the United States Department of Commerce (1981).

Table 13

**ARGENTINA: SECTORAL DISTRIBUTION OF EMPLOYMENT IN
UNITED STATES TRANSNATIONAL CORPORATIONS
AND AVERAGE ANNUAL WAGE COST, 1977**

(Number employed, dollars and percentages)

Sector of activity	Number employed	Percentage	Average annual cost per worker	Index total sectors = 100
Petroleum	4 158	3.7	8 899	167.6
Manufacturing industry	91 141	80.4	5 124	96.5
Food products	8 834	7.8	4 188	78.9
Chemical products	20 454	18.0	5 427	102.2
Metal products	3 146	2.8	5 722	107.8
Machinery	12 573	11.1	6 601	124.3
Transport equipment	23 867	21.1	5 363	101.0
Other manufactures	22 267	19.6	4 042	76.1
Business	6 255	5.5	5 596	105.4
Banks	5 231	4.6	5 544	104.4
Finance	643	0.6	4 666	87.9
Others	5 961	5.2	5 200	97.9
Total	113 389	100.0	5 309	100.0

Source: Prepared on the basis of data supplied by the United States Department of Commerce (1981).

The United States firms did not play a major role in creating employment in the country. In 1977, they employed a total of 113 389 persons (table 13), i.e., 2.2% of total urban employment in the country (excluding the agricultural sector). As regards the sectoral composition of the jobs concerned, the manufacturing industry accounted for a high share, as it absorbed a little over 80% of all workers employed by the United States transnational corporations. Almost half those jobs were concentrated in two industries, i.e., transport equipment (basically, the automobile industry, which, at the census date, included three United States firms) and chemical and petrochemical products. Even though these are capital-intensive industries, between the two they generated more than 44 300 jobs in 1977.

As regards the sectoral cost of labour, statistics compiled by the United States Department of Commerce show a wide scattering of wages among the different sectors

in which the transnationals operated. Apart from the differences that can be attributed to a difference in the average skills of personnel employed, the magnitude of wage variations among sectors would appear to have been due to factors associated with the circumstances prevailing at the national level during the year when the Commerce Department census was taken. In 1977, the second year of the military régime, there were already clear signs of many of the effects of the economic policy applied after March 1976, which were later accentuated. Although the widespread contraction of real income of the wage-earning sector appears to have been one of the fundamental results of that policy, its impact differed depending on the economic sector concerned. Jobs in the manufacturing industry were the most seriously affected by the policy of "social discipline", inasmuch as in 1977, real wages in that sector were equivalent to only 66.3% of the real wages

for 1975. The contraction was not so sharp in most of the other economic sectors. This uneven evolution partly explains the structure of average costs of labour employed by United States subsidiaries operating in Argentina.

In addition, around 1977, the sharp drop in wages which had occurred during the early years of the economic openness policy had a strong impact on the relation between average wage costs in the country and those prevailing in other regions where subsidiaries of United States firms operated. Indeed, in 1977 (table 14), the average annual cost per person employed by United States subsidiaries operating in Argentina was lower than it was in any other grouping to which Argentina belonged (Latin America and the underdeveloped nations) and, of course, it was lower than the cost paid by those same subsidiaries in the developed countries. As a matter of fact, if the comparison is confined to the manufacturing industry, in which the country has a higher degree of industrialization and development than the rest of Latin America

or the underdeveloped countries as a whole, wage costs prove to be higher than the average in the underdeveloped countries as a whole but lower by almost 10% than the cost at the Latin American level. These results appear to tarnish the traditional international image of Argentina and, specifically, to detract from its position among the relatively less developed countries, whether these be defined as countries having an intermediate degree of industrialization or semi-industrialized countries, or as the countries of the underdeveloped world in general.

According to some indicators, Argentina may be compared to developed societies; according to others —the majority—, it may be compared to backward economies. However, very few of the latter comparisons are based on wage costs. If the Argentine economy has in any way been different from most of the underdeveloped world, that has been the case precisely in the area of wage costs, which could hardly be considered one of the country's comparative advantages at the international level.

Although it is impossible to establish a direct correspondence between wage costs and the rate of profitability of United States investments on the basis of the information available, there is no question that the year 1976 marks a breaking point in the prevailing medium- and long-term trends as regards the profit margins of direct United States investments in the country. At the beginning of the 1970s, that rate never amounted to more than 6.5% of cumulative investment and, if one takes the analysis back to 1960, the margin was never higher than 15% per year. Between 1976 and 1980, however, this percentage was surpassed during four of the five years and, during two of those years (1979 and 1980), profitability rose to more than 30% per year.³ By comparison with the levels recorded at

Table 14

ARGENTINA: AVERAGE ANNUAL WAGE COST IN UNITED STATES FIRMS IN ARGENTINA AND IN OTHER REGIONS, 1977

(Dollars at current prices, and indexes)

Sector	Region	Average annual cost	Index Argentina = 100
Total sectors			
	Developed countries	12 874	242.5
	Underdeveloped countries	5 601	105.5
	Latin America	5 873	110.6
	Argentina	5 309	100.0
Manufacturing			
	Developed countries	12 731	248.5
	Underdeveloped countries	4 676	91.3
	Latin America	5 629	109.9
	Argentina	5 124	100.0

Source: Prepared on the basis of data supplied by the United States Department of Commerce (1981).

³The sharp lag in the exchange parity during those years generated a doubly positive effect on the profitability in dollars of transnational corporations. On the one hand, as a result of the maladjustment of exchange parity, the benefits obtained in local currency were increased, in real terms, at the world economy level, when expressed or converted into dollars or any other foreign currency. On the other hand, the lag in the exchange parity and the fact that the dollar was the only merchandise whose future price was known made it possible to apply highly profitable mechanisms in the local financial circuits to increase the disparity of interest rates with respect to those prevailing on the international markets.

Table 15

**ARGENTINA: COMPARATIVE EVOLUTION OF SOME INDICATORS CONNECTED
WITH UNITED STATES DIRECT INVESTMENT THROUGHOUT THE
WORLD AND IN ARGENTINA, 1976-1983**

(Percentages)

Year	Rate of return ^a			Annual growth rate of accrued direct investment			Rate of reinvestment ^b		
	World total	Argentina	+/-	World total	Argentina	+/-	World total	Argentina	+/-
1976	15.3	21.3	+	11.9	18.4	+	40.5	74.4	+
1977	14.2	16.8	+	5.2	9.1	+	37.0	35.0	-
1978	17.4	10.4	-	11.5	12.1	+	45.1	-32.9	-
1979	23.5	31.1	+	15.4	10.8	-	49.5	46.7	-
1980	19.8	37.6	+	14.6	34.6	+	45.8	67.2	+
1981	15.1	4.5	-	6.0	9.7	+	41.6	-200.9	-
1982	9.8	13.9	+	-3.0	9.8	+	28.6	59.3	+
1983	9.4	10.5	+	2.1	1.7	-	43.8	37.3	-

Source: Prepared by the authors on the basis of data supplied by the United States Department of Commerce (several years).²

^a Profits in year *i* in relation to accrued investment in year *i-1*.

^b Reinvested profits in relation to total profits.

the international level during those same four years, the profit margin for operations in the country was more than 30% higher than at the world level (table 15).

Despite these different levels of profitability, the reinvestment rate for Argentina was lower than for the world as a whole during five of the eight years under study. In other words, despite the higher profit margins and the encouragement given to reinvestment within a framework of increasing permissiveness, the United States subsidiaries established in the country were, by comparison with those in the rest of the world, relatively more disposed towards remitting their profits to their parent companies, i.e., they tended to

prefer rapid recovery of their investment over the incentives offered. It is not surprising, therefore, that at the end of eight years, the influx of direct investment from the United States to Argentina was much lower than the outflow of profit remittances and, on a lesser scale, the repatriation of capitals to the United States. Even without looking at other possible channels of transfer—royalties, administrative prices of captive trade—the net flow of capital to the United States arising from direct investments in Argentina amounted to US\$ 781 million; in 1983 values, this represents an average annual flow of more than US\$ 100 million (table 16).

Table 16

**ARGENTINA: CAPITAL FLOWS ASSOCIATED WITH UNITED STATES
DIRECT INVESTMENT, 1976-1983**

(Millions of dollars at current prices)

Year	Accrued investment at end of year (1)	Annual increase in accrued investment (2)	Profits (3)	Reinvested profits (4)	Profits remitted (3)-(4) (5)	Capital inflows (2)-(4) (6)	Net flow of capital (6)-(5) (7)
1976	1 366	212	246	183	63	29	-34
1977	1 490	124	257	90	167	34	-133
1978	1 670	180	155	-51	206	231	25
1979	1 850	180	520	243	277	-63	-340
1980	2 494	644	695	467	228	177	-51
1981	2 735	241	113	-227	340	468	128
1982	3 002	267	381	226	155	41	-114
1983	3 054	52	314	117	197	-65	-262
Accrued 1976-1983		1 900	2 681	1 048	1 633	652	-781

Source: Prepared by the authors on the basis of data supplied by the United States Department of Commerce (several years).

II

The transnational corporations and the Argentine manufacturing industry

The participation of transnational corporations in the manufacturing industry was studied at two distinct but complementary levels. Firstly, its structure within the sector was identified; because the census information used refers only to one year, the picture that emerges is a static but complete one. Secondly, the trend in respect of the transnational presence during the past decade was studied, by comparing the performance of transnational corporations and that of similar national-capital corporations (table 17).

1. *Economic impact and main characteristics*

a) *Participation of transnational corporations in industrial production*

One of the main indicators of the magnitude of transnational participation in industry is the contribution of these firms to overall production in the sector (table 18). Firms with foreign-capital participation controlled 30.8% of all industrial production reflected in the most

recent economic census carried out in the country (1974).

This participation varied considerably among the different divisions of industry; it was relatively greater in those sectors which, because of their dynamism, rate of adoption of new technology and dynamic effect tended to be at the head of the entire industrialization process. The only sectors in which the transnational corporations played only a minor role were those which played a marginal role in the industrial profile of the country and which historically had the lowest growth rate. The difference in the participation of foreign-capital firms in the various sectors of industry were closely related to

their growth rate and the degree to which they adopted new technology.

As regards the link between the degree of oligopolization of the different branches of industry (five-digit classifications, ISIC, Rev.2) and the extent of the transnational presence in them, table 18 shows that most of the production of foreign-capital enterprises was generated in highly concentrated branches⁴ (oligopolized) and that it tended to decrease as the competitiveness of the various strata of

⁴All analyses of the degree of concentration of industrial markets are based on the methodological criteria set forth by Khavisse and Aspiazu (1983).

Table 17

ARGENTINA: SHARE OF TRANSNATIONAL CORPORATIONS IN INDUSTRIAL PRODUCTION, BY SECTORS OF ACTIVITY, 1973

(Millions of 1973 pesos, and percentages)

Sector	Value of production of transnational corporations	Value of total production	Share of transnational corporations
Food, beverages and tobacco	13 994.9	60 592.3	23.1
Food products	6 675.3	44 374.8	15.0
Beverages	3 492.2	12 245.8	28.5
Tobacco	3 827.4	3 971.7	96.4
Textiles, clothing and leather goods	4 263.1	29 550.3	14.4
Wood and furniture	161.4	4 800.5	3.4
Paper, printing and publications	1 837.9	8 829.4	20.8
Chemical industries	15 735.1	35 565.5	43.0
Oil refineries	2 859.8	12 672.4	22.6
Other chemical products	12 875.3	23 893.1	53.9
Non-metallic minerals	1 936.4	6 952.5	28.2
Basic metal industries	5 319.1	18 813.7	28.3
Iron and steel	4 309.0	16 054.9	26.8
Non-ferrous metals	1 010.1	2 758.8	36.6
Metal products, machinery and equipment	24 259.9	52 353.6	46.3
Other manufactures	95.1	870.3	10.9
Total	67 602.9	219 328.1	30.8

Source: Prepared by the authors on the basis of data from the National Institute of Statistics and Censuses (Instituto Nacional de Estadística y Censos - INEC) (1974).

concentration increased. Thus, whereas 62.1% of the production of transnational corporations was accounted for by highly concentrated branches, only 14.1% was generated in low-concentration markets.

In addition, the share of transnational corporations in industrial production declined as the concentration of the markets declined. Whereas the participation of transnationals in the manufacturing industry as a whole was slightly over 30%, their production in the highly concentrated branches was 47.9% and in competitive markets it was barely over 15%.

The transnational presence in the Argentine industry was characterized by a preference, on the part of the transnational corporations, for highly concentrated markets, and it was in these that they placed a large share of their overall production—the largest share, in the case of highly concentrated branches having few establishments.

As regards their sectoral distribution, table 19 shows that the preference of foreign-

capital firms for the more highly concentrated markets is to be seen in almost all industrial activities. In almost every case, the transnationals' share in the production of the highly concentrated strata was higher than their share in sectoral totals, and it declined as the competitiveness of the different strata increased.

Table 20 shows the distribution and participation of transnational corporations in industrial production by type of goods, according to their functional destination and the type of market in which production was generated.

In the first place, the table shows that transnational corporations were disseminated throughout the industrial spectrum. It was only in the area of non-durable consumer goods, which may be associated with relatively less complex technology, that the transnationals' contribution (22.6%) was lower than its share in industry as a whole. On the other hand, their highest level of participation was in the area of durable consumer goods (59.2%); it should be noted

Table 18

ARGENTINA: PARTICIPATION OF TRANSNATIONAL CORPORATIONS IN INDUSTRIAL PRODUCTION, BY CONCENTRATION STRATA, 1973

(Number of branches, millions of 1973 pesos, and percentages)

Concentration strata ^a	Number of branches	Value of production of transnational corporations (millions of 1973 pesos)	Distribution by concentration strata (percentage)	Value of total industrial production (millions of 1973 pesos)	Participation of transnational corporations (percentage)
HCB (F)	9	20 343.8	30.1	35 314.0	57.6
HCB (M)	35	21 662.0	32.0	52 424.8	41.3
HCB (1) + (2)	(44)	(42 005.8)	(62.1)	(87 738.8)	(47.9)
MCB	38	13 971.7	20.7	60 519.7	23.1
LCB	26	9 504.2	14.1	61 827.2	15.4
Others	64	2 121.1	3.1	9 242.4	22.9
Total	172	67 802.8	100.0	219 328.1	30.8

Source: Based on Khavisse and Azpiazu (1983).

^aHCB (F): high-concentration branches with few establishments; HCB (M): high-concentration branches with many establishments; MCB: medium-concentration branches; LCB: low-concentration branches.

Table 19

**ARGENTINA: PARTICIPATION OF TRANSNATIONAL CORPORATIONS IN
THE VALUE OF PRODUCTION, BY INDUSTRIAL SECTORS
AND CONCENTRATION STRATA, 1973**

(Percentages)

Sector	Total	Strata ^a		LCB	Others
		HCB	MCB		
Food, beverages and tobacco	23.1	48.3	11.9	11.3	26.8
Food products	15.0	27.9	11.5	6.5	34.0
Beverages	28.5	76.6	28.0	18.9	-
Tobacco	96.4	97.1	-	-	-
Textiles, clothing and leather goods	14.4	28.0	19.4	5.2	4.3
Wood and furniture	3.4	22.7	-	0.1	2.2
Paper, printing and publications	20.8	36.2	3.1	6.4	-
Chemical industries	43.0	39.3	54.8	41.1	46.8
Oil refineries	22.6	22.6	-	-	-
Other chemical products	53.9	63.8	54.8	41.1	46.8
Non-metallic minerals	28.2	36.9	24.8	-	21.2
Basic metal industries	28.3	26.8	36.6	-	-
Iron and steel	26.8	26.8	-	-	-
Non-ferrous metals	36.6	-	36.6	-	-
Metal products, machinery and equipment	46.3	78.0	25.2	21.8	33.6
Other manufactures	10.9	-	6.1	-	16.0
Total	30.8	47.9	23.1	15.4	22.9

Source: Based on Khavisse and Aspiazu (1983); INEC (1974).

^aHCB: high-concentration branches; MCB: medium-concentration branches; LCB: low-concentration branches.

that a large group of transnational corporations contributed to the development of this industry during the second stage of the substitution process. As regards capital goods—which play only a minor role, both globally and within the production of the transnational corporations—they were concentrated in a small nucleus of industries (tractors, communications equipment, electrical conductors) which, in most cases, were comparable to durable consumer goods, both because of their relatively recent development in the country and because of the possibilities of scale offered by the size of the market and the introduction of new technologies. On the other hand, the transnational presence was negligible

in a wide variety of industries producing capital goods. The share of the transnationals in the production of capital goods (31.9%) was not very different from their share in total production of the manufacturing industry.

One element which the four categories of goods had in common was the association between the magnitude of transnational participation and the level of oligopolization of the markets. Regardless of the type of goods concerned, the foreign-capital corporations always had a greater share in the highly concentrated markets and that participation tended to decline in direct proportion to the decline in the degree of oligopolization of the remaining strata.

b) *Plant size and degree of control of foreign capital*

Table 21 shows the distribution, by strata of concentration, of the transnational corporations and of their establishments employing less than and more than 100 workers. It also shows their relative contribution to transnational production and their ranking in the manufacturing industry as a whole.

Of the total number of establishments (824) belonging to foreign-capital firms (724), almost 60% employed more than 100 persons at the time of the census. The prevalence of larger plants tended to increase in direct proportion to the degree of concentration of the markets concerned. Establishments employing more than 100 persons in the highly concentrated branches having few establishments represented 73.3% of the total, whereas in the competitive branches of industry, they represented less than half (49.0%). These disparities show that, in general, and even

without taking into account potential production capacity, plant size requirements for operating in the more concentrated markets were not similar, even considering only the transnationals, to the requirements for markets that were not very concentrated. Thus, there appears to be a relationship between the transnational presence in industry and the formation of oligopolistic market structures and between the latter and the relative size of manufacturing establishments.

The predominance of larger plants is even more pronounced in respect of the contribution of foreign-capital enterprises to total production, which is also higher in the more concentrated strata. At the global level, establishments employing more than 100 persons generated 93.4% of transnational production, and the percentage rose to 97.9% in the highly concentrated branches of industry with few establishments, while it fell to 84.3% in the less concentrated industries.

Table 20

**ARGENTINA: PARTICIPATION OF TRANSNATIONAL CORPORATIONS
IN INDUSTRIAL PRODUCTION BY TYPE OF GOOD AND
CONCENTRATION STRATUM, 1973**

(Percentages)

Stratum ^a	Non-durable consumer goods	Interme- diate goods	Durable consumer goods	Capital goods	Miscel- laneous ^b	Total
HCB (F)	58.8	25.0	97.0	-	-	57.6
HCB (M)	26.7	43.9	21.1	61.8	-	41.3
HCB	(41.9)	(38.6)	(86.6)	(57.0)	-	(47.9)
MCB	18.0	27.1	29.1	27.7	6.1	23.1
LCB	14.9	18.3	12.7	10.1	-	15.4
Subtotal	(22.6)	(31.6)	(62.0)	(33.0)	(3.3)	(31.2)
Others	22.4	27.0	20.5	15.0	-	22.9
Total	22.6	31.4	59.2	31.9	3.3	30.8

Source: Prepared on the basis of Khavisse and Azpiazu (1983); INEC (1974).

^aHCB (F): high-concentration branches with few establishments; HCB (M): high-concentration branches with many establishments; MCB: medium-concentration branches; LCB: low-concentration branches.

^bIncluding branches 38434 "Rectification of motor" and 39099 "Miscellaneous manufacturing industries".

Table 21

ARGENTINA: ESTABLISHMENTS UNDER THE CONTROL OF TRANSNATIONAL CORPORATIONS, BY CONCENTRATION STRATA, AND THEIR PARTICIPATION IN THE TOTAL

(Absolute figures, and percentages)

Strata ^a	Trans-national corporations	Establishments		Relative contribution to production		Participation in total industry						
		Total	-100 em- ployed	+100 em- ployed	-100 em- ployed	+100 em- ployed	Establishments		Value of production			
							Total	-100 em- ployed	+100 em- ployed	Total	-100 em- ployed	+100 em- ployed
HCB (F)	40	45	12	33	2.1	97.9	18.9	8.4	34.7	57.6	53.4	57.7
HCB (M)	175	190	61	129	3.8	96.2	2.5	0.9	27.9	41.3	8.9	48.3
HCB	(215)	(235)	(73)	(162)	(3.0)	(97.0)	(3.1)	(1.0)	(29.1)	(47.9)	(12.4)	(52.5)
MCB	244	259	101	158	9.5	90.5	1.4	0.6	19.4	23.1	6.5	31.7
LCB	191	247	126	121	15.7	84.3	0.3	0.1	18.2	15.4	4.0	33.1
Others	74	83	35	48	17.7	82.3	0.6	0.3	34.5	22.9	7.0	55.5
Total	724	824	335	489	6.6	93.4	0.7	0.3	22.5	30.8	6.1	43.4

Source: Prepared by the authors on the basis of Khavisse and Aspiazu (1983); INEC (1974).

^aHCB (F): high-concentration branches with few establishments; HCB (M): high-concentration branches with many establishments; MCB: medium-concentration branches; LCB: low-concentration branches.

Because establishments of transnational corporations represented only a small percentage of the total for industry as a whole -0.7%, it is advisable to find out why the two totals were so different. The units of production covered by the census included a large number of crafts or semi-craft activities and small shops —85.6% of the establishments counted employed less than 10 persons— in which the transnational presence was virtually nil. This had a decisive effect on the comparison between the two totals, while the heterogeneity which was characteristic of the industrial sector and the national-capital firms as a whole was not evident in the case of transnational industry. This explains the very minor role played by transnational firms whose plants employed less than 100 persons (0.3%). On the other hand, transnationals controlled more than one fifth of all establishments (22.5%) comprising the subgroup of plants which employed more than 100 persons.

Regardless of the size of the plant considered, the extent of the transnational presence was clearly related to the level of oligopolization. The percentage of plants belonging to transnational corporations tended to increase in direct proportion to the degree of concentration of the different strata.

The fact that the transnational presence was greater in the larger plants and that their contribution increased in proportion to the level of oligopolization of markets was also reflected in the value of manufacturing production. All industrial firms which used foreign capital were considered on the same terms, i.e., without any distinction being made with regard to the level of foreign-capital participation or the degree of control such participation entailed. The study represents a preliminary analytical estimate which does not disregard the fact that foreign capital did not always hold majority ownership of local firms nor did it always exercise actual control over management. On the other hand, it

does not take into account criteria which might be adopted to identify a local firm as a subsidiary of a transnational corporation.

In order to determine the type of ownership structure which characterized the presence of transnational capital in industry, three different groups of firms were listed, on the basis of whether foreign capital participation was above 50.1%, between 10.1% and 50%, or below 20% (table 22). It was found that in 580 of the 724 industrial firms using foreign capital, foreign investors controlled the majority of the capital and that foreign participation was below 20% only in 29 firms.

As regards their share in the value of total production, it was found that 80% was generated by firms in which foreign capital controlled a majority of the capital, while only 7.6% of the total was accounted for by those having less than 20%.

No matter which indicator is considered—firms, plants or production—it is obvious

that the transnational corporations preferred to operate where they could maintain a position of hegemony, of real control, without mediation, over their investments in local industry, to the detriment of any forms of association with national capital. This phenomenon also occurred, without major variations, in all strata of concentration and, independently of plant size, it was most evident in establishments employing more than 100 persons which operated in the most highly concentrated branches of industry where there were few enterprises.

c) *Diversification and specialization of production*

Another distinctive feature of transnational corporations in the manufacturing sector was the composition of enterprises at the local level. This differentiation within the sphere of the transnational corporations was a factor of

Table 22

ARGENTINA: FOREIGN-CAPITAL FIRMS AND ESTABLISHMENTS, BY DEGREES OF CONTROL AND CONCENTRATION STRATA, 1973

(Absolute figures, and percentages)

Stratum ^a	Number of firms				Number of establishments				Production of transnational corporations, by degree of control			
	Total	Percentage of foreign capital			Total	Percentage of foreign capital			Percentage of foreign capital			Total
		<20	20.1 to 50	>50		<20	20.1 to 50	>50	<20	20.1 to 50	>50	
HCB (F)	40	1	3	36	45	5	3	37	1.4	3.2	95.4	100.0
HCB (M)	175	11	29	135	190	13	32	145	14.3	15.4	70.3	100.0
HCB	(215)	(12)	(32)	(171)	(235)	(18)	(35)	(182)	(8.0)	(9.5)	(82.5)	(100.0)
MCB	244	11	53	180	259	12	55	192	11.2	18.5	70.3	100.0
LCB	191	6	25	160	247	7	27	213	2.2	10.5	87.3	100.0
Others	74	-	5	69	83	-	5	78	-	7.4	92.6	100.0
Total	724	29	115	580	824	37	112	665	7.6	11.4	81.0	100.0

Source: Prepared by the authors on the basis of Khavisse and Azpiazu (1983).

^aHCB (F): high-concentration branches with few establishments; HCB (M): high-concentration branches with many establishments; MCB: medium-concentration branches; LCB: low-concentration branches.

Table 23

**ARGENTINA: DISTRIBUTION OF TRANSNATIONAL CORPORATIONS AND
OF THEIR SUBSIDIARIES, BY DEVELOPMENT OF
THEIR INDUSTRIAL ACTIVITY, 1973**

Subsidiaries linked to each transnational corporation	Total		With some industrial activity		With no industrial activity	
	Transnational corporations	Subsidiaries	Transnational corporations	Subsidiaries	Transnational corporations	Subsidiaries
From 1 to 3	504	709	268	412	237	297
From 4 to 6	74	347	59	277	15	70
From 7 to 9	22	167	18	137	4	30
10 or over	33	530	28	457	5	73
Total	634	1 753	373	1 283	261	470

Source: Basualdo (1985).

decisive importance during the tenure of Dr. Martínez de Hoz, when potential for growth and entrepreneurial development were linked to the extent to which the transnational firms diversified their activities, both within the manufacturing sector and in other economic activities. During the different stages of the import-substitution process, the different transnational corporations found their place within the economic structure of Argentina according to the dynamics of capital accumulation and reproduction. These firms may be classified in two groups, according to the number of local firms they controlled, either totally or partially. The first group would include those which controlled or had a share in the capital of a few subsidiaries operating in a small number of markets and which usually tried to remit abroad a considerable portion of the profits earned in the country. The second group would be made up of transnational corporations which had majority or minority control over the capital of a variety of local firms, whose activities were integrated—vertically or horizontally—or diversified, through the formation of conglomerates. In the latter case, reinvestment of profits represented a substantial proportion of direct reproduction, allowing for the opening up of new subsidiaries in the country (Basualdo, 1984).

The importance of the role played by diversified or integrated transnational corporations becomes clearly evident from an analysis of their distribution in terms of the number of local subsidiaries (table 23).

Table 23 shows that 55 transnational corporations (8.7% of the total) which had a majority or minority participation in the capital of seven or more subsidiaries together owned 697 firms, i.e., 39.7% of all subsidiaries established in the country. When transnational corporations which controlled an industrial firm are considered separately from those which only controlled non-manufacturing local firms, it becomes evident that only nine of the 55 firms which had seven or more subsidiaries did not control any industrial firm.

Industrial production was the central activity not only of the diversified or integrated transnational corporations, but also of those which had very few subsidiaries in the country, even though their relative importance was quite different. The relative importance of industrial subsidiaries fell sharply as the number of subsidiaries controlled by each transnational corporation increased (table 24). In the case of transnationals which owned from one to three local companies, the industrial firms represented 75.5% of their subsidiaries in the country, while in the case of those which owned

10 or more local firms, the industrial ones only represented 34.1% of the total.

The low proportion of industrial subsidiaries and the high participation in overall production of the diversified or integrated transnational corporations can only be explained by differences in production scale, in which the larger relative size of those subsidiaries played an important part. The predominantly industrial insertion of foreign capital, based on oligopolistic control of a number of manufacturing markets, was concentrated in a small number of transnational corporations

which accounted for 43.5% of the industrial production of foreign firms and controlled the relatively larger industrial companies. Essentially, these were foreign capitals which had a share in the capital of major local industrial corporations started during the first or second stages of the import-substitution process.

The most important non-industrial activity for transnationals which controlled ten or more local firms was the financial and insurance sector, in which 23.0% of the firms in question operated. Transnational corporations which had a larger number of related companies controlled

Table 24

ARGENTINA: DISTRIBUTION OF SUBSIDIARIES AND OF INDUSTRIAL PRODUCTION OF TRANSNATIONAL CORPORATIONS WITH ACTIVITY IN THE MANUFACTURING SECTOR, 1973

(Number of firms, millions of 1973 pesos, and percentages)

Subsidiaries linked to each transnational corporation	Trans-national corporations	Total	Subsidiaries		Industrial production of transnational corporations ^a		Average industrial size ^b (Index = 100.0)	
			Non-industrial	Industrial	Amount	Percentage	Transnational corporations	Industrial subsidiaries
From 1 to 3	268	412 (100.0)	101 (24.5)	311 (75.5)	20 514	30.4	42.2	56.9
From 4 to 6	59	277 (100.0)	124 (44.8)	153 (55.2)	9 916	14.7	92.8	65.9
From 7 to 9	18	137 (100.0)	72 (52.6)	65 (47.4)	8 464	12.5	259.6	132.0
10 or over	28	457 (100.0)	301 (65.9)	156 (34.1)	20 927	31.0	412.7	136.0
Total	373	1 283 (100.0)	598 (49.6)	685 (53.4)	67 540	100.0	100.0	100.0

Source: Basualdo (1985).

^aThe industrial production of transnational enterprises (67 540 million 1973 dollars) includes the production generated by subsidiaries whose parent firm is unknown. This represents 7 719 million 1973 dollars, a sum equivalent to 11.4% of the total.

^bAverage industrial size is obtained by dividing total production by the number of firms and of subsidiaries with industrial activity, respectively.

a significant group of firms organized under a strong process of conglomeration and integration in which industrial production acted as the axis. Finance, insurance and other services were the most important non-industrial activities as they provided an essential structural link between production and the circulation of the economic surplus.

2. *The evolution of transnational industrial corporations during the past decade*

a) *Evolution of the production of transnational corporations and their relationship with sectoral development*

The economic policy applied under the military régime set up in 1976 brought about a profound change in the orientation of and the trends followed by the development of manufacturing in the country, as well as in its role as the accumulation model of the economy. The results, i.e., the so-called "deindustrialization" of the Argentine economy, speak for themselves (Kosacoff, 1984; Sourrouille, Kosacoff and Lucángeli, 1985). Thus, between 1975 and 1982, the industrial GDP fell by 23%, which means that the level recorded in 1982 was lower than that of the late 1960s; industrial employment fell by approximately 35%, which means that approximately 400 000 wage-earners lost their jobs; almost 20% of industrial establishments closed down, real wages in industry declined by around 40%, labour productivity rose substantially as a result of the elimination of over-employment, "disciplining" of personnel and an increase in the number of intensity of hours worked, and investments in durable production equipments fell, on average, at a cumulative rate of 5% per year, to a level lower than that of capital depreciation values.

The disarticulation of the industrial apparatus and the profound and prolonged sectoral recession led to a series of structural transformations which entailed the disappearance of many small, medium-sized and large firms, as well as a number of transfers and mergers of companies and, to a lesser extent, the addition of new factories.

The industrial transnational corporations were not unaffected by these structural changes.

On the contrary, they appear to have been the most active agents, particularly if one takes into account the qualitative implications of those changes which they were instrumental in bringing about. Table 25 shows that there was a slight decline in the share of foreign corporations in manufacturing production. While in 1973, the transnational corporations accounted for 30.8% of the value of industrial production, in 1981 they accounted for 28.6% and in 1983 for 29.4%.

One major factor in the irregular evolution of the participation of transnational corporations in industrial production, characterized by a slightly downward trend, was the closing down of some large-scale foreign corporations (General Motors, Citroen, Otis Elevators, Insud, Metalúrgica Austral and Olivetti), which more than offset the relatively higher participation of the remaining firms. Depending on the nature of the industrial goods concerned (non-durable consumer goods,

Table 25

ARGENTINA: SHARE OF TRANSNATIONAL CORPORATIONS IN INDUSTRIAL PRODUCTION, 1973-1983

(Thousands of 1973 pesos, and percentages)

Year	Value of total production	Value of production of trans-national corporations	Share of trans-national corporations
1973	219 328.1	67 602.9	30.8
1981	182 707.6	52 234.1	28.6
1983	196 718.3	57 922.8	29.4
Cumulative annual growth rate			
1973-1983	-1.1	-1.6	
1973-1981	-2.3	-3.2	
1981-1983	3.8	5.3	

Source: Khavisse and Aspiazu (1983) and Basualdo (1985).

durable goods, intermediate goods and capital goods), this evolution provides another viewpoint and allows for a more accurate interpretation of the results to be made. Table 26 shows that the overall trend was due to the sharp deterioration in the share of foreign capital in the production of intermediate goods. While the participation of these firms in the production of non-durable consumer goods, durable goods and capital goods increased, their share in the production of intermediate goods fell from 31.5% to 25.8% between 1973 and 1981 and recovered slightly in 1983 (27.3%).

This phenomenon is related to the structural changes which took place in some major branches, such as the steel industry, which underwent —especially before 1981— substantial changes as regards the profile of

production and the presence of transnational corporations. In this regard, it is worth mentioning the decline in the number of factories (especially sheet metal plants, but also some large establishments); the transfer of the participation of Belgium and French capitals in leading firms such as Tamet and Santa Rosa; the integration of the production process by the national firm Acindar and its notable growth in the steel market (absorbing firms such as Gurmendi, Santa Rosa, Genaro Grasso). As a result of this, and despite the slight recovery recorded between 1981 and 1983, the participation of foreign capital in national production fell by almost 40% with respect to 1973.

There was a similar decline in the production of non-ferrous metals, in which there

Table 26

ARGENTINA: SHARE OF TRANSNATIONAL CORPORATIONS IN PRODUCTION OF THE DIFFERENT TYPES OF INDUSTRIAL GOODS

(Millions of 1973 pesos, and percentages)

Type of good ^a	1973	1981			1983		
	Percent- age of total pro- duction generated by trans- national corpora- tions	Value of total produc- tion	Value of production of trans- national corpora- tions	Trans- national corpora- tions (percent- ages)	Value of total produc- tion	Value of production of trans- national corpora- tions	Trans- national corpora- tions (percent- ages)
Non-durable consumer goods	22.6	67 442.1	16 422.5	24.4	68 761.7	17 148.0	22.9
Intermediate goods	31.4	83 402.3	21 532.6	25.8	97 693.4	26 651.7	27.3
Durable consumer goods	59.2	13 966.6	9 201.8	65.9	12 537.6	8 433.8	67.2
Capital goods	31.9	12 330.9	3 787.5	30.7	12 032.2	4 201.7	34.9
Total	30.8	182 707.6	52 234.1	28.6	196 718.3	57 922.8	29.4

Source: Khavisse and Azpiazu (1983) and Basualdo (1985).

^aExcluding the two branches producing "miscellaneous goods".

Table 27

ARGENTINA: SHARE OF TRANSNATIONAL CORPORATIONS IN INDUSTRIAL PRODUCTION, BY CONCENTRATION STRATA

(Millions of 1973 pesos, and percentages)

Stratum ^a	1973	1981			1983		
	Percent- age of total pro- duction generated by trans- national corpora- tions	Value of total produc- tion	Value of production of trans- national corpora- tions	Trans- national corpora- tions (percent- ages)	Value of total produc- tion	Value of production of trans- national corpora- tions	Trans- national corpora- tions (percent- ages)
HCB	47.9	79 856.9	32 084.0	40.2	86 926.3	35 621.8	41.0
MCB	23.1	50 548.9	10 766.5	21.3	57 793.9	12 007.9	23.1
LCB	15.4	46 736.1	8 093.9	17.3	46 304.7	8 805.5	19.0
Total	30.8	182 707.6	52 234.1	28.6	196 718.3	57 922.8	29.4

Source: Khavisse and Aspiazu (1983) and Basualdo (1985).

^aThe concentration strata considered are: HCB: high-concentration branches (eight establishments generated more than 50% of production in the branch); MCB: medium-concentration branches (eight establishments account for between 25% and 50% of production in the branch); LCB: low-concentration branches (the eight biggest establishments contribute less than 25% of production in the branch).

was also a sale to national capital of firms such as KICSA and National Lead, the withdrawal of large foreign corporations (Insud and Metalúrgica Austral), and an increase in the importance of national capital as a result of the production of primary aluminium by Aluar S.A.

As far as the other goods are concerned, there was an increase in the participation of foreign capital, which reached its peak in industries producing durable consumer goods (rising from 59.2% to 67.2% between 1973 and 1983). This increase took place within the overall context of a serious decline in the production of durable goods which was associated with the crisis of the automobile industry and the electrical home appliances industry. In both cases, the contraction of the local market and the strong competition of imports led to a sectoral readjustment which, contrary to the case with intermediate goods,

entailed an increase in transnational participation. The reorganization of the automobile industry (the withdrawal of General Motors and Citroen, the purchase of Chrysler by Volkswagen, the merger of Fiat and Peugeot and the closing down of the only non-transnational firm, Industrias Mecánicas del Estado), and the purchase of some local firms or of stocks in the area of electrical home appliances brought about an increase in the participation of foreign capital.

When the industrial sector is broken down according to market structure, as shown in table 27, it appears that transnational participation in production generated in intermediate forms of concentration was relatively stable, while there was a considerable increase in the more competitive markets and a notable reduction in their contribution to production in the highly concentrated branches

which are essential for its structural predominance in local industry.

The growing transnational participation in the less concentrated branches of industry occurred in a few activities in which that greater share probably entailed changes in the degree of concentration of those branches with respect to the results of the most recent industrial census (for example, the production of medicine).

The decline in foreign participation in the highly concentrated branches of industry is one of the most noteworthy aspects of the period under study. A combination of two factors explains the loss of almost seven points in foreign participation (from 47.9% to 41.0%); firstly, the side-effects of the reorganization of the steel industry and secondly, the development of the different oligopolistic branches, which depended on the magnitude of the transnational presence in them. In the first case, the structural reorganization of the steel industry led to a decline in the importance of foreign capital, as a result of its deinvestment in the sector and its having taken a different course from that taken by the major national-capital firms.

In the second place, the highly concentrated branches in which foreign capital represented a substantial share of production suffered, in most cases, a more far-reaching contraction than those equally oligopolistic branches in which the foreign presence was less significant.

If a simplistic two-category classification is applied to the study—dividing the transnationals into those which controlled a small number of subsidiaries and operated in a limited number of markets, on the one hand, and, on the other, those which controlled a large number of local companies operating in a number of markets under an integrated or diversified system—it will be noted that the participation in industrial production of the latter type of corporation increased considerably by comparison with that of the transnationals which controlled a smaller number of subsidiaries in the country (table 28).

The predominance of diversified or integrated transnational corporations in the industrial production of foreign corporations as a whole increased generally, with slight variations, regardless of the type of goods considered. With the sole exception of those producing intermediate goods, the corporations which controlled more subsidiaries increased their share while the share of those operating in a limited way fell, except in the case of the ones producing capital goods. This confirms the view that one of the main changes which occurred during the last ten years as regards the performance of foreign corporations in the manufacturing sector was the growing leadership of the diversified or integrated corporations. This phenomenon was a result of

Table 28

**ARGENTINA: INDUSTRIAL PRODUCTION OF TRANSNATIONAL CORPORATIONS,
BY NUMBER OF SUBSIDIARIES, 1973, 1981 AND 1983**

(Millions of 1973 pesos, and percentages)

Subsidiaries	1973		1981		1983	
	Percentage	Value	Percentage	Value	Percentage	Value
From 1 to 3	30.4	13 580	26.0	15 118	26.1	15 118
From 4 to 6	14.7	7 469	14.3	8 457	14.6	8 457
From 7 to 9	12.5	9 141	17.5	7 935	13.7	7 935
10 or over	31.0	16 924	32.4	20 852	36.0	20 852
Total	100.0	52 234	100.0	57 923	100.0	57 923

Source: Basualdo (1985).

the economic policy applied from the mid-1970s onwards. In that regard, the special characteristics of the diversified or integrated transnational corporations were precisely what gave them a different growth potential than that of the firms which only operated in a few markets.

The performance of the transnationals was decisively influenced, in the first place, by the fact that the banking and financial sector began to play a leading role in their makeup. Only 4.9% of the firms controlled by less diversified transnationals were engaged in financial and insurance activities, while 23% of the firms controlled by highly integrated or diversified corporations operated in that area. As regards the substitution process, that structural difference did not mean there were differences of substance, since most of the industrial firms only needed to resort to self-financing in order to operate normally in their markets. On the other hand, after the financial reform of 1977, with the generalized liberalization of interest rates and the role played by the financial liquidity of the different corporations and their ease of access to financial circuits, that structural difference became fundamental for determining the growth potential of corporations. The financial connections of the diversified or integrated transnationals gave them several advantages —as well as high profit rates— during years when the shortage of financial resources or their high relative cost meant bankruptcy or going out of business for many enterprises engaged in production.

Another factor which explains the growing predominance of diversified transnational corporations is the wide range of economic activities in which they engaged, which enabled them to constantly readjust their management to fit the macroeconomic circumstances, since after 1976, a succession of non-industrial activities proved to be the most dynamic and profitable sectors of the economy (the agricultural sector, construction, services in general and finance in particular). In addition, there was a structural difference which had to do with the defensive capability provided by the degree of vertical integration of the firms.

In brief, the changes that took place within the structure of the transnational corporations had to do with the special nature of the deindustrialization process, and the hegemony of the diversified or integrated transnational corporations increased to the extent that it pervaded the entire economy. This trend contrasted not only with the evolution of the limited transnational corporations but also with that of industry as a whole and of the national-capital industrial enterprises in particular (table 29).

The diversified or integrated transnational corporations comprise the only subgroup of firms which did not suffer a decline in production between 1973 and 1983.

b) *The industrial élite and the transnational presence*

In order to analyse the evolution of manufacturing enterprises after the breakdown of the democratic process (March 1976) and the subsequent application of a new economic policy, a group of 300 of the largest industrial

Table 29

ARGENTINA: CUMULATIVE ANNUAL GROWTH RATE OF INDUSTRIAL PRODUCTION, BY CHARACTERISTICS OF PRODUCER FIRMS, 1973-1983

(Percentages)

Industrial group	Cumulative annual growth rate
Total industry	-1.04
National firms ^a	-0.83
Diversified or integrated transnational corporations ^b	0.16
Restricted transnational corporations ^c	-3.42

Source: Basualdo (1985).

^aComprising firms owned by State and private domestic capital.

^bControlling seven or more local subsidiaries.

^cControlling fewer than seven local subsidiaries.

firms, in terms of annual invoiced sales, was selected. These represent a little over half the industrial value added and reflect the changes which took place in the leadership of the sector.

A comparison of the lists of the 300 largest industrial firms for 1976 and for 1983 shows sharp differences in the number of firms making up the élite and in their share of total sales for the group. In order to get a more accurate idea of the actual nature of these changes, the 300 firms were divided into three subgroups according to their ranking in the list (first, second and third hundred); in addition, a distinction was made, at the top, between the first 25 and the first 50.

The results show that, over the seven years, foreign participation in sales of the industrial élite rose slightly (table 30).

Nevertheless, this picture of relatively stable performance, in which the growing importance of the transnational corporations appears to have been no more than an adjustment to the historical trends recorded since the early 1960s, covers up certain major modifications in the composition of the rankings of the firms, which only because of the contrasting effects, from the point of view of the source of the firms' capital, reflect that relative stability at the global level, albeit with a slight increase in the participation of the transnational corporations.

Thus, for example, the fact that the transnational corporations comprising the group of the 100 largest industrial firms fell from 54 (1976) to 53 (1983) does not only imply that only one of those firms left the élite as a result of having gone out of business or having dropped in rank. On the contrary, of the 53 firms which occupied some of the first 100 places in 1983, only 31 (58.5%) had also held those places in 1976, while then ranked between 101 and 200 in 1983, another three were in the third hundred and two ranked below the 300. Three firms were added as the result of mergers or takeovers during the period (Sevel, a merger of Fiat and Peugeot; Nobleza-Piccardo, the product of the takeover of Piccardo by Nobleza; and Massalin-Particulares, the product of the takeover of Particulares and Imparciales by Massalin and Celasco); another three were new firms added to the industrial part (Volkswagen: Río Colorado—an oil consortium including the Italian firm SAIPEN— and Equitel, belonging to Siemens); and one was Isaura, an oil firm denationalized during the period.

This phenomenon occurred, to a greater or lesser degree, regardless of the position held by the firms (table 31).

The industrial élite underwent substantial changes which, although not fully reflected in

Table 30

ARGENTINA: PARTICIPATION OF TRANSNATIONAL CORPORATIONS IN SALES OF MAJOR INDUSTRIAL FIRMS, BY RANKING SCALE, 1976 AND 1983

(Percentages)

Ranking scales, by sales	Total			Excluding Yacimientos Petrolíferos Fiscales		
	1976	1983	Percentage increase	1976	1983	Percentage increase
First 25	36.6	49.0	33.8	56.6	66.1	16.8
First 50	42.0	49.6	18.1	57.9	62.6	8.1
First 100	43.5	49.3	13.3	55.9	59.6	6.6
First 200	45.4	49.0	7.9	55.7	57.3	2.9
First 300	44.8	49.0	9.4	54.1	56.6	4.6

Source: Prepared by the authors on the basis of data from *Prensa económica* (November 1977 and October 1984).

Table 31

**ARGENTINA: TRANSNATIONAL CORPORATIONS AMONG THE 300 LARGEST
INDUSTRIAL FIRMS IN 1983. CHANGES WITH RESPECT
TO THE 1976 RANKING**

Previous situation	1983 ranking scale			
	In the first hundred	In the second hundred	In the third hundred	In the first three hundred
Ranking scale				
First hundred	31	14	2	47
Second hundred	10	17	14	41
Third hundred	3	3	12	18
After position No. 300	2	9	21	32
New firms	3	3	1	7
New firms resulting from absorption- fusion of preexisting establishments	3	-	-	3
Denationalization of firms with local capital	1	1	-	2
Total	53	47	50	150

Source: Prepared by the authors on the basis of data from *Prensa económica* (November 1977 and October 1984).

the transnational presence, represented a profound change, at the global level, in the composition of foreign-capital enterprises holding a hegemonic position in local industry. These changes were, fundamentally, the result of

significant shifts among the transnational corporations set up in the country before 1976; the impact of new foreign-capital firms was negligible.

III

Conclusions

By the end of the past century, one of the salient features of the Argentine economy was the strong presence of foreign capital. Because of its importance to the vital activities of the agricultural exports model (transport, services pertaining to foreign trade, cold storage), it played a leading role in the development of the economy and had a high accumulation potential.

As the agricultural exports model gradually declined and the first signs of the new accumulation pattern —based on import substitution— appeared, foreign investment took on new forms, i.e., the export-related sectors tended to be displaced by activities that were primarily related to manufacturing and aimed at meeting domestic demand.

Both during the first stage of the substitution process, when the emphasis was on light industry, and during the second stage, when the substitution of intermediate goods and durable consumer goods began, foreign capital took over the areas having the greatest potential for growth. As in the case of the agroexports model, the foreign presence tended to become polarized towards the more dynamic nuclei of capital accumulation.

Between the mid-1960s, when the investments brought in during the late 1950s had matured, and the mid-1970s, the transnational corporations took full advantage of the opportunities provided by a domestic market that was heavily protected from international competition, without there being any need of a new influx of large direct investments.

From 1976 onwards, however, the conditions under which the Argentine economy developed changed radically. In that context, despite the strong incentives offered—essentially, the general opening up of markets, with the concomitant guarantees that entailed—new direct investments were not significant. The relatively small amount of foreign capital that was brought in was mainly directed toward the exploitation of natural resources, especially oil and gas, and toward banking and financial activities pertaining to the provision of specific services to a limited clientele and to the new opportunities arising from the opening up of the capital market.

The trends followed by United States investments in the country tended to corroborate those sectoral trends. Also, it is evident that the transnational corporations established in the country, especially those operating in the aforementioned sectors, made large profits. Nevertheless, despite these high profits, the corporations did not follow an active policy to reinvestment. Quite to the contrary, it appears that, at the global level, priority was

given to rapidly recovering the capital invested—through remittances of profits and even repatriation of capital—rather than to reinvesting in the country beyond the levels of profit that such reinvestment might generate.

This performance which, in principle, may seem to depart from what is considered typical, was due to the profoundly recessive conditions which prevailed from the mid-1970s onward, in the country's economy, especially in its manufacturing sector. To this was added a climate of uncertainty as to how long the policy of openness would be followed. In that regard, it seemed logical to assume that most of the transnational corporations would give priority to remitting their profits to their parent companies and would minimize new investments in the country. This was especially true in the industrial sector, where to the scanty flow of new external capital was added the withdrawal from the market and subsequent repatriation of capital of large transnational corporations, as well as a high level of remittances of profits to parent companies. This can be explained by the exhaustion of market opportunities, without which the legal and institutional incentives offered to the transnational corporations were not enough to induce the foreign firms to make investment and reinvestment decisions that were closely linked to the market (Sourrouille, Gatto and Kosacoff, 1984).

In any event, within the far-reaching process of deindustrialization that took place, the transnational corporations did not follow any set pattern. Even though their overall share of total industrial production fell slightly, a significant group of those firms—those having a greater degree of diversification or integration of production—tended to account for an increasing proportion of total production and even more so of the production generated by the transnational corporations.

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Social security and development in Latin America

*Carmelo Mesa-Lago**

This article is a summary of a longer study by the author which was commissioned by ECLAC, on the financial situation of social security in 20 Latin American countries. These countries are grouped according to their social security situation, and their similarities, differences and trends with respect to financing and financial equilibrium are examined. Of the wide variety of topics covered in such a vast area of study the author focuses on the historical evolution of social security, problems of coverage, benefits, financing and costs and the impact of social security on development.

As a result of his study, the author concludes that urgent reform of social security is needed: in the pioneer countries, in order to face problems of short-term financing, the vestiges of stratification and the maintenance of the level of basic benefits; and in the countries which have newer social security systems, in order to extend the coverage through a system of financing that can guarantee long-term benefits.

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Introduction

During the hundred years since the introduction of social security in Germany—the predecessor of the modern programmes—significant progress has been made in this area in many Latin American countries. These programmes have played a fundamental part in preventing loss of income by the head of the family through social risks and in advancing curative medicine. By the end of the last century programmes already existed in the region for protecting public employees and the military, and from the beginning of this century, groups of workers in strategic sectors such as public services enjoyed this protection. In 1984, 70 and 60 years, had elapsed respectively since the first laws were enacted in the hemisphere to cover workers against occupational accidents and diseases (Uruguay) and against the risks of old age, disability, death and ordinary illness (Chile). These countries were ahead of the United States in introducing this type of programme and are ahead of that country even today in programmes such as mother and child health and family allowances. As in other areas, Latin America leads the Third World in its development of social security.¹

But progress in social security has not been consistent throughout the region and faces serious problems, even in countries which have achieved greater development. While it is true that several countries have succeeded in providing coverage for the entire population, when Brazil (where more than half of the persons covered are concentrated is excluded), the overall coverage of the region falls short of 43% and in the majority of the countries it is lower than 25%. To this must be added the significant inequalities in coverage by occupational category, sector of economic activity and geographical unit. In many countries the cost of social security is excessive compared with their economic capacity. At the beginning of the 1970s, the social security burden in the two

¹A summary of the progress made in social security in Latin America during this century appears in Tamburi (1984). See also Frank (1982).

pioneer countries reached 14% and 17% of the gross domestic product: a proportion which, at the world level, was only exceeded in the most industrialized countries of Europe. At the beginning of the 1980s, that burden approached or surpassed 10% of the gross domestic product in five countries, equalling the percentage in Japan and being comparable to that of the United States, the USSR, Spain, Australia and New Zealand (13-14%).

During the 1960s, social security in the pioneer countries showed an actuarial and sometimes financial imbalance which worsened in the 1970s and was complicated even more by the economic crisis of those years. In an attempt to resolve this situation, a number of Latin

American countries have restructured their social security, the most important —and diametrically opposed— reforms being those bringing the Cuban system under State control and putting the Chilean system in private hands.

Apart from the economic importance of social security, the way in which it is financed can affect the replacement of labour by capital, the generation of savings and investment and income distribution. It is only recently that certain regional or international development agencies have begun to study social security in Latin America from the economic standpoint and to include this subject in some of their country studies.

I

The historical evolution of social security

For purposes of simplicity, the term 'social security' is used systematically throughout this article and encompasses five main programmes: occupational hazards (health and money coverage against occupational accidents and illness); old age, disability and survivors, pensions (as well as seniority, and lay-off or dismissal pensions in some countries); health care and money benefits in case of illness, ordinary or non-labour accidents and maternity; family allowances; and unemployment benefits. In addition, social security frequently includes other benefits such as funeral assistance, personal and housing loans, day-care centres for children, as well as public assistance or social programmes (health care and pensions for low-income groups which cannot join the contributory programmes).

Technically speaking, the majority of the countries of Latin America have mandatory social insurance systems or are between the stage of social insurance and the more advanced stage of full social security, which are two different concepts of social protection. Only a few

countries have systems with features that are more typical of social security than of social insurance. Social insurance, which was introduced into Germany by Otto Bismarck in the 1880s, is based on employment relations which shape the system: i) separate programmes to cover different social risks (especially occupational hazards, pensions and sickness); ii) coverage of the essentially urban labour force employed in a relationship of dependence (wage-earners); iii) tripartite salary-based contributions (paid by the person insured, the employer and the State); iv) benefits directly linked to contributions; and v) technical/financial capitalization systems.

Social security, which started out in the United Kingdom with the ideas contained in Sir William Beveridge's report at the beginning of the 1940s —with a strong Keynesian influence— is based on a series of innovative principles which promote: i) unification —under a single managing or co-ordinating body— of the various social insurance programmes with public assistance and health care (combining

preventive and curative medicine) and with employment programmes and family allowances (principle of unity); ii) uniformity of the conditions for acquiring rights and elimination of unjustified inequalities among the persons insured (principle of equality); iii) total coverage of the population, whether employed or unemployed (principle of universality) and of all social risks (principle of comprehensiveness); iv) financing through taxation, minimum basic but adequate benefits—not linked to contributions—and progressive distribution of income (principle of solidarity); and v) technical/financial distribution systems (Mesa-Lago, 1959).

1. *The pioneer countries and stratification*

In a small group of pioneer countries, which were the most developed ones (Chile, Uruguay, Argentina, Cuba, Brazil), the social security system emerged at an early stage (during the 1920s) but it did so in a gradual and piecemeal fashion, giving rise to a multiplicity of managing institutions which protected different occupational groups through independent subsystems, with their own legislation, administration, financing and benefits. The State contributed to the financing of the subsystems through the creation of specific taxes or direct budgetary support. The subsystems gradually incorporated broader occupational groups or labour sectors as well as their dependents, but generally with more scanty benefits and more stringent conditions for acquiring the right to benefits. The process by which the subsystems made their appearance was approximately as follows: first they were extended to the armed forces, public employees and teachers; then to employees and workers in transport, energy, banking, communications and other public services, much later to the mass of urban workers and employees (frequently separated into two large groups), and finally to agricultural workers and self-employed (independent) workers, small farmers and entrepreneurs, and domestic servants.

This type of evolution resulted in a stratified social security system, since it acquired a

pyramidal structure, with relatively small groups of persons protected by privileged subsystems at the apex of the centre and the majority of the population with subsystems providing less protection at the base. There were significant and usually unjustified differences between the subsystems and the overall system lacked co-ordination. The stratified system had negative effects: legal confusion, administrative complexity, high operating costs, difficulty in establishing a single register and effective control of evasion, obstacles to combining length of service and contribution accredited in various institutions, and considerable inequalities.

The theories seeking to explain the evolution of social security identify among its basic causes economic development² and the dissemination or demonstration effect generated by international agencies and pioneer countries (Collier and Messick, 1975), but those theories do not explain the phenomenon of stratification. Considerable debate has been going on for a decade now about the two main driving forces of this phenomenon: the pressure groups and the State. The power base of the occupational groups described lies in their military strength, their administration of the government, the scarcity of their skills on the labour market and their union organization, and they bring pressure to bear on the State—sometimes in conjunction with political parties—in order to obtain social security concessions. Studies on various countries in the region show that, in general, the more powerful the pressure groups are, the greater the extent to which they enjoy earlier and more comprehensive coverage, more generous benefits and more advantageous means of financing (Mesa-Lago, 1977a and 1978). The State cannot be a mere passive receiver of pressures from groups. It must also exercise its

² Pauker (1968) has tried to prove that the financial burden of social security is a result of economic development and that the greater that burden, the greater will be the redistribution function of the system. Zschock (1985) also contends that social security extends and becomes less inequitable with economic growth and growth of the size of the government. In contrast, Aaron (1967) has produced evidence that refutes the above viewpoint and sustains the theory that the age of the system is the most important variable explaining the level of expenditure on social security.

own initiative by using social security as the instrument to co-opt, neutralize and control those groups in order to maintain some sort of social order (Malloy, 1979). The evolution in which the role of the pressure groups have been preponderant is typical of the populist and democratic-pluralist political systems such as those in Chile and Uruguay during the first seven decades of the twentieth century. The evolution in which the role of the State has been preponderant is more typical of political systems which, while also populist, have an authoritarian and corporatist inclination such as those in Brazil under Getulio Vargas and Argentina under Juan Perón. In practice, both forces (the pressure groups and the State) have worked hand-in-hand in both types of political systems and it is sometimes difficult to determine which was the predominant one (Mesa-Lago, 1977b).

As economic development, urbanization, trade union and political mobilization processes advanced in the pioneer countries, the groups which enjoyed no protection gained enough power to secure coverage within already existing or new subsystems. In some countries, they were even able to secure some benefits that had been reserved for the old systems, thereby achieving some extension of privileges to the masses. The cost of the process of making coverage universal, combined with the generous benefits and the liberal conditions for acquiring them, became excessive and created a financial imbalance in many subsystems.

Social security reform, promoted by national and international technical studies, advocated the unification and uniformity of the subsystems and the elimination of costly privileges. But the groups were so powerful that the State was compelled to postpone the reforms, sometimes for decades. The political changes that occurred in these countries during the 1960s and 1970s reinforced the State power *vis-a-vis* the pressure groups (which in many cases were disbanded or had their power significantly reduced) and facilitated the process of reforming social security (Borzutsky, 1984).

In some countries (Cuba, Brazil), virtually the entire system was unified, in others (Argentina, Uruguay) a central integrating or co-ordinating agency was formed which

combined different organizations under a uniform system and finally in one country (Chile) some measures were taken to make the old system uniform and eliminate privileges, but above all a new system was created, strongly influenced by private insurance and favouring individuality and multiplicity.

2. Countries with relatively unified systems

The second form of evolution of social security took place in countries whose main systems were established since the 1940s and were influenced by the new trends inspired by the International Labour Organisation and the Beveridge report, which sought to avoid the problems created in the pioneer countries. At the time, some of the countries in question were relatively developed (Mexico), but most of them had a low level of industrial development and in almost all of them the rural sector predominated over the urban sector. In these countries, a general managing agency was established which was responsible for eventually covering the entire population, although at the start the system was limited to the capital and the main cities.

In the more developed countries of this second group, before the establishment of the general managing agency there had been a number of social security institutions which protected the most powerful pressure groups: the armed forces, public employees, teachers, and energy and railroad workers (Colombia, Costa Rica, Mexico, Paraguay, Peru, Venezuela). Furthermore, in some countries (Mexico, Costa Rica) a number of exceptions were made after the general managing agency was created, with a view to establishing separate subsystems for certain groups (almost always in the public sector). However, these groups were usually small and (except for the armed forces and public employees) represented only a small percentage of the coverage provided by the general managing agency.

In any event, although there is a certain degree of stratification in all these countries, it has never approached the level it reached in the first group. Because social security was introduced later in this second group, and also

because of its relative unity and uniformity and its lower coverage of risk and population, these systems generally did not face the administrative and financial problems of the first group and therefore no radical changes were needed. Even so, however, the countries heading this group (those with the highest coverage, growing maturity of the pension programme and high costs) are beginning to face the financial problems typical of the first group. Costa Rica is the most serious case since, because of its policy of speeding up population coverage in the 1960s and 1970s, its social security costs are close to those of the countries in the first group even though its pension programme has still not fully matured.

3. Countries which introduced social security at a later stage

Lastly, we can identify a third group of countries which also have relatively unified social security systems: indeed, to a greater degree than those of the second group. These are the least developed countries of the region: Central America (except for Costa Rica and Panama) and the Latin

American Caribbean (except for Cuba). In this group, social security did not generally appear until the 1950s and 1960s, and the general managing agency covers virtually all the persons insured (although the armed forces and sometimes public employees have separate subsystems); population coverage is very low and sometimes limited to the capital city and the most heavily populated cities. These countries are not usually faced with short and medium-term financial difficulties, and their main problem is to extend coverage to the population at large.

Although in general the unification process has advanced in the region, there are still stratified systems or systems whose unification process has not been completed. Furthermore, the integration of the health institutions (social security, the Ministry of Health, etc.) and their policies is urgently needed in the majority of the countries. Finally, with very few exceptions, social security has not been incorporated into the national plans. This incorporation would facilitate the processes both of unifying social security and of uniting social security and health.

II

Problems of coverage, benefits, financing and costs

1. Coverage

In general, the figures on statistical coverage of the population by social security are very inadequate. The ECLAC study—based on a survey and relatively uniform calculations—shows that in 1980, 61% of the total population and of the economically active population (EAP) were covered for health and pensions respectively. However, when Brazil is excluded from the calculations, the regional coverage falls to 43% and in the majority of countries does not even reach 25%. The most developed countries of the

region were the first to introduce social security and currently have the highest coverage of the population, whereas the least developed have the lowest coverage: 100% to 75% in Cuba, Brazil, Argentina and Costa Rica; 74% to 50% in Uruguay, Chile, Mexico and Panama (the first two countries would probably fall in the first group if coverage of indigents and coverage by mutual funds were to be added); 49% to 25% in Venezuela and Bolivia; and 24% to 1% in Paraguay, Peru, Guatemala, Colombia, Nicaragua, Ecuador, Dominican Republic, Honduras, El Salvador and Haiti (the countries

are placed in descending order of coverage).

In the majority of the countries, the persons insured are urban wage-earners (and their close dependents) whereas agricultural workers, independent workers (or the self-employed), domestic servants and the unemployed (as well as the dependence of all these) are not insured. In approximately a quarter of the countries—the least developed ones—coverage is limited to the capital and the most important cities. The economic crisis of the present decade has caused a decline in coverage in several countries because of the increase in unemployment, self-employment and evasion.

There seems to be a positive correlation between the degree of coverage by social security, on the one hand, and the labour skills, income and level of development of the regions of a country, on the other. A recent study of Brazil shows a positive correlation between the degree of coverage and level of skills or employment status and income, with the lowest coverage being recorded among the unemployed, unskilled workers (especially agricultural or self-employed workers) and those with the lowest income. The information from four countries (Chile, Colombia, Costa Rica and Mexico) on the level of coverage (1979-1981) of the economically active population by sector of economic activity indicates that the highest coverage is recorded in electricity, gas and water (75% to 100%), manufacturing (51% to 90%) and transport and communications (34% to 71%), whereas the lowest is found in agriculture (4% to 59%, with the highest percentages being registered in Costa Rica and Chile, the countries which come closest to total coverage). Finally, information from six countries (Chile, Costa Rica, Guatemala, Mexico, Panama and Peru) on the differences in the level of geographical coverage (1979-1981) shows that the most developed states/provinces/departments (industrialized, unionized, urbanized, with the highest percentage of wage-earners and highest per capita income) have significantly higher coverage than the least developed states/provinces/departments (agricultural, little unionized, rural, with the highest percentage of independent workers and the lowest per capita income). The extremes of

geographical coverage fluctuate between 39% and 95% in Chile, 54% and 100% in Costa Rica, 0.2% and 33% in Guatemala, 5% and 100% in Mexico, 13% and 73% in Panama, and 3% and 27% in Peru. With one exception, the province/state/department in which the capital city is located has the highest coverage. To summarize, the most needy groups are not provided with social security protection in the vast majority of the countries and so the key question is whether it is feasible to extend coverage to include those groups (ECLAC, 1985; Isuani, 1984, pp. 96 and 97; Isuani and Mesa-Lago, 1981).

The low coverage and its slow extension in the region appear to have a relation with the Bismarckian model, imported from Europe, which is financed by the wage contributions of the persons insured and employers. In many Latin American countries, it is not wage-earners who constitute the majority of the labour force but rather unpaid independent or family workers. It is not surprising, then, that the most developed countries of the region have the highest percentages both of the wage-earning labour force and of social security coverage, whereas the least developed countries have the lowest percentages of both. As a general rule, coverage does not exceed the percentage of the urban formal sector (in some countries it also includes the rural modern sector) leaving the urban informal and rural traditional sectors without any protection. A few countries have succeeded in changing the system of financing and in incorporating the sector not covered, through public assistance programmes (Chile, Costa Rica, Cuba) or transfers from the urban to the rural sector (Brazil) or special programmes to cover the peasant population (Ecuador, Mexico).

One of the most serious problems facing social security in the region is how to speed up extension of coverage and reduce its inequalities despite the structural and conjunctural obstacles.

2. Benefits

The pioneer countries in social security (Argentina, Brazil, Chile, Uruguay) cover all the social risks with different programmes:

pensions, health/maternity, occupational hazards, unemployment and family allowances (Cuba has no official programme of family allowances or unemployment benefit, but the latter does not appear to be necessary because of the virtually full employment situation). The older the social security system of a country, the more generous are the benefits and the more flexible the conditions for acquiring rights: the retirement age is relatively early because the original legislation was enacted when life-expectancy was lower; pensions are granted on the basis of length of service—regardless of the age of the person insured—which makes it possible to retire at a very early age; very costly health benefits are granted such as contact lens, orthodontics, and treatment abroad; and there are "social benefits" such as housing programmes, mortgage and personal loans, co-operative stores and sports and cultural services. In the pioneer countries, the bulk of the expenditure on benefits is for pensions, reaching 80% in Uruguay, and this proportion is on the increase because of the maturity of the pension programme and the increasing longevity of the pensioners. This tendency, combined with demographic and financial factors, appears to lead eventually to financial imbalance.

The stratification of the typical social security system of the pioneer countries (at least until the unification and uniformity processes were introduced) has led to significant inequalities in benefits, since the most powerful groups receive more and better benefits than the least powerful. In a study of five countries, the legal differences between the five groups covered were measured on the basis of six criteria: conditions for acquiring the right to benefits; base salary used to compute benefits; amount of benefit; pension cost-of-living adjustment; possibility of obtaining several pensions or combining one pension with a paid job; and time required to apply for and receive the benefit. The study also compared the availability of health services (hospital beds and doctors per insured person) and their quality for the various groups. The groups were placed on the following order, from best to worse: i) armed forced, ii) public employees, iii) élite of the working class, iv) private non-manual workers and v) rank and file manual workers.

The study points out, however, that a process of extending privileges to the masses frequently occurs in the pioneer countries, so that the groups at the base of the pyramid are sometimes able to secure some of the benefits that were previously reserved for the groups at the top (Mesa-Lago, 1978).

The countries where social security was introduced later do not usually have as many programmes as the pioneer countries. Moreover, many of these countries have given priority to vertical rather than horizontal expansion of social security. The small percentage of the population covered receives more and more benefits and this has increased the difficulty of extending coverage to the bulk of the population. Hence, the greatest source of inequality in these countries is the low population coverage. In this group of countries, up to 80% of the expenditure on benefits is allocated to the health programme and the increasing reserves of the pension programme are often used partly to finance the construction and equipment of hospitals. Although it may be justifiable from a social point of view, this investment is not financially profitable and gradually whittles away the capital of the pension fund, so that when the pension programme matures, the entire system is faced with financial disequilibrium.

3. *Financing and costs*

Social security in Latin America is financed basically by contributions calculated on the basis of the nominal salary which, according to the law, are paid by the person insured and his employer and also by the State in some countries. The older the social security system of a country and the wider the coverage, the higher the percentage of total wage contributions, and the larger that portion which, by law, must be paid by the employer (the effect of this contribution is discussed in the following section). In the pioneer countries, the total wage contribution fluctuates between 26% and 46% and was even higher before several countries reduced it or replaced it by a value-added tax.

Depending on the percentage of the wage contribution and the breakdown of the income collected by source, the insured person pays less

than one-third of the social security burden. The remaining two-thirds are paid by the employer and to a lesser extent by the State; income from investments represents less than one-tenth of the income. Consequently, according to the law (without taking incidence into account) the insured person finances only a fraction of the benefits, and this situation is made potentially more unfair in countries with very low population coverage. In the Dominican Republic, for example, coverage is lower than 8% and the insured person contributes 17% of the total wage contribution, which would suggest that the uninsured population (through possible transfers to prices and taxes) helps to finance the social security of the small percentage which is covered.

Another serious problem is the evasion of payment by employers, resulting from poor techniques of registration, identification and control of payments. Inflation has aggravated this problem, since any delay in making contributions reduces their real value. Furthermore, the State frequently fails to fulfil its obligations not only as a tripartite contributor but also as an employer. In countries like Costa Rica, Ecuador and Peru, the State debt has reached alarming proportions and has sometimes even threatened the financial balance of the social security system.

Social security costs in Latin America are the highest of the developing countries and are close to those of developed countries like Japan. According to the 1985 ECLAC report, in 1980 social security costs, as a percentage of the gross domestic product, fluctuated between 1% and 11% as follows (the countries are placed in descending order of percentages): 11% to 10% in Uruguay, Chile and Argentina; 9% to 7% in Cuba, Costa Rica and Panama; 6% to 4% in Brazil and Colombia; 3% in Mexico, Peru, Venezuela, Ecuador, Bolivia and Honduras; 2% in Paraguay, the Dominican Republic, Guatemala, Nicaragua and El Salvador; and 1% in Haiti. In many countries of the region, social security is faced with an actuarial imbalance and, in some, even with a short-term financial crisis.

The pioneer countries with the oldest systems usually have the highest costs and are in the worst actuarial and financial situation. The

expenses systematically increase for the following reasons: the almost universal population coverage; very generous benefits; the maturity of pension programmes; the growing numbers of pensioners who retire early and live longer than initially projected; the cost-of-living adjustment of pensions, and the growing expenses of curative medicine (in proportion as the pathological profile comes to resemble that of the developed countries). Furthermore, the system's revenue is proportionately smaller because of the impossibility or difficulty of extending the coverage beyond the point reached; evasion and delay in payment of contributions (especially in countries with high inflation); failure by the State to fulfil its obligations; the difficulty of increasing contributions (since they are already very high); and the very low or negative profitability of the investments.

The economic crisis of the current decade has aggravated the financial problems. The increase in unemployment, the decline in real wages and the bankruptcy of many enterprises have reduced the income of the social security system. The cost of servicing the external debt and other domestic priorities exercise strong pressure on the State to reduce or postpone its social security obligations. In some countries, the costs of the system are still growing because of the structural and conjunctural reasons stated.

In the countries with the oldest pension programmes, a gradual change has occurred in the method of financing. There has been a shift from the "uniform average premium" method to the "phased average premium" method and then to the "distribution" method. This means that capitalization (aimed at ensuring the payment of future pensions for a long period ahead) is replaced by distribution (which tends to ensure payment only on the basis of the costs of the current year). Since costs increase every year (because of the growing numbers of pensioners) the burden is being transferred to future generations, where an increasingly small proportion of active workers must pay growing contributions. The viability of this transfer is politically and economically doubtful. The country in the worst situation in the region is Uruguay, which in 1983 had a demographic

burden ratio of 0.8, in other words, approximately one active person had to finance one non-working person (in contrast, the actuarial calculations of the United States project that, at the beginning of the twenty-first century, the ratio will be two active persons financing one non-working person.) If these countries were unable to achieve actuarial and financial balance when the ratio of the demographic burden was much lower, they will be less able to do so in the future when the ratio will be much higher.

The Latin American countries with the most recent social security systems are not threatened with financial imbalance in the short and medium term (their main problem is how to extend the coverage of the population). Nevertheless, their social security systems basically follow the model of the pioneer countries, with the shortcomings described, so that they will eventually face similar problems. These countries, however, have more time to change the model for one which can extend the coverage on a more solid financial base.

III

The impact of social security on development

This section examines the impact of Latin American social security on three decisive aspects of development: savings and investment, distribution and employment. It should be noted from the outset that neither the theory nor the empirical studies are conclusive in these matters and that their analysis is made even more difficult in the case of Latin America because of the absence or unreliability of information on the functional distribution of income between labour and capital, the impact of social security contributions and taxes, the proper measurement of benefits (especially health benefits) and the various effects on the conduct of employers and workers (Musgrove, 1984). Nevertheless, a summary is given here of the stage that the theoretical discussion has reached, the empirical evidence (which was almost always obtained from outside the region), and some studies carried out on specific countries and the criticisms of them.

1. *Savings and investment*

The impact of social security on savings and investment depends on the surplus in the social security accounts and the effect that this excess

can have on other sources of domestic savings (private and public sectors) and external sources (Arellano, 1984; Wallich, 1982). The social security surplus or deficit derives from the factors of the system itself (for example, type of programmes, technical and financial system, degree of maturity, administrative costs) as well as exogenous factors (age structure of the population, rate of wage increases, general state of the economy). Short-term risk programmes (sickness, maternity, unemployment) usually follow the system of year-by-year distribution and generate a deficit rather than a surplus, whereas the long-term programmes (pensions), which use capitalization systems, generate sizeable reserves which are used as a basis for investment. Reference has already been made, however, to the general trend in the region to replace capitalization systems by distribution ones. Moreover, as will be seen subsequently, the region has a very poor record in respect of efficiency in investing the reserve funds.

The impact of social security on investment also depends on the sources of financing and the incidence of the contribution; a recent IDB/INTAL study expresses the view that the investment rate declines more when social

security really is financed by the employers than when it is paid for by the person insured or consumer (Arroba and others, 1980). The maturity of a pension programme depends *inter alia* on how long it has been in existence, the qualifying age for pensions, and the relative youth or age of the population; therefore, the older the programme, the lower the retirement age and the older the population, the greater will be the passive/active ratio and the smaller will be the surpluses and *vice versa*. A young population tends to grow rapidly, expanding the labour force, and if the coverage of the system increases its income will also increase; in contrast, in an aging population the potential number of contributors is reduced and the number of pensioners increases. If real wages are increasing, then the base of social security contributions is also increasing. On the other hand, a deep recession which reduces employment and real wages will have a negative impact on income and can reduce the surplus.

The traditional approach is that social security reduces individual saving and the demand for private insurance, since the person insured expects that his contributions will be returned to him in the form of a pension and that therefore he does not have to accumulate a surplus during his working life. On the other hand, earlier retirement extends the period of retirement and this can stimulate savings during the active working life. The planning horizon of an insured person and his perception of the social security contribution (as a mere tax or as payment for future benefits, guaranteed by a healthy actuarial system) influence his attitudes towards saving and his preferences for a particular type of social security programme (short or long term). In the developed countries with older populations and more solvent social security, the horizon appears more distant than in Latin America, where, because of a younger population, financial imbalances in social security and high inflation, more relative importance is given to the short-term plans such as health and family allowances (Arellano, 1984 and Musgrove, 1984). Social security and the government are competing for the same tax base and some assume that there is always a trade-off between them. But if there is not enough private saving and the State establishes a minimum

income level, social security may eliminate State social assistance payments and reduce the public deficit. Social security can increase the cost of exports and make them less competitive (compared with those countries that have no social security or which have a smaller social security burden) and can thus contribute to a possible reduction of potential external saving.

Debate and research on these subjects, carried on primarily in the United States and in other developed countries, have yielded contradictory results. A study of 16 OECD countries found no evidence that social security affects private savings or slows down development (Break, 1981; Koskela and Virén, 1983). If it is so difficult to assess this impact in developed countries, where statistics are more accurately kept and social security coverage is universal, it is even more so in Latin America. Even within the same country interpretations are different: thus, in Chile one study (Wallich, 1982) found that social security had had a negative impact on saving, but another later study (Arellano, 1984) took the view that after the necessary adjustments were made, social security was seen to have generated a surplus (albeit a declining one) instead of a negative saving.

But if uncertainty exists over the above-mentioned aspects there is no doubt, at least, about the inefficient investment of social security reserve funds in Latin America. In 1977, in 14 countries studied by ILO (1981), the percentage of social security income derived from investments was lower than 3.5% in nine of them. In almost the whole region, social security agencies are not designed to act as financial intermediaries, their staff has no investment experience, they have not developed an investment plan and they have not coordinated their investments with national plans. Furthermore, there is little development of the capital market and inflation has whittled away the value of the reserves and given an incentive to employers to withhold their contributions and those of their employees, because by delaying payment their real value is reduced (Diéguez, 1978).

Reserves have usually been invested in: a) bonds and other State securities that are often not negotiable and in fact have been compulsory

loans to cover budgetary deficits, so that the agencies have wasted their funds on "worthless securities"; b) personal loans and mortgages, usually to the persons insured who, thanks to inflation (and the lack of loan adjustments) have obtained capital practically free and depleted the social security capital; c) loans to health programmes to cover their deficits, which are plausible from a social point of view but not profitable; d) loans for housing construction, very often to the persons insured themselves, which yield a very low or negative return, because of rent freezes, inefficient collection and amortization with depreciated money and e) in a few cases, investment in agriculture, industry, commerce (co-operative shops for the insured persons) and services (cinemas, theatres, sports) which also have a very low return (ILO, 1966). In virtually the whole region, the rate of return on the social security funds is only a fraction of the bank interest rate, and in many cases the real return has been negative.

In practice, many of the investment programmes have amounted to disguised subsidies to insured persons and have caused the gradual decapitalization of the social security reserves. This, in turn, has had a serious impact on the financial and actuarial equilibrium of social security in many countries of the region.

2. *Distribution of income and employment*

The impact of social security on income distribution is also a much discussed topic, on which there are few empirical studies in Latin America. A leading aspect is the ratio between coverage and distribution; in general, it can be said that the most universal systems are less regressive than those which provide low coverage. However, with very few exceptions, persons below the critical poverty line are not covered by social security; this is usually the case of the unemployed, of workers who work without pay for a relative or are self-employed, agricultural workers and domestic servants. A study conducted during the 1970s pointed out that while the most developed countries with a higher coverage were also those with the smallest proportion of poor people, the percentage of their economically active

population which was not covered (except in Cuba) exceeded the percentage of the critically poor (Mesa-Lago, 1980).

The manner of financing can be another cause of regression. In many countries, the insured person's wage contribution has a ceiling, so that, proportionally, those who gain more contribute less. It has already been said that more than two-thirds of the legal contribution is the responsibility of the State and the employer. The State contribution is sometimes made through a specific tax on the services or goods produced by the group that is covered, but which is paid by the entire population; thus, when social security coverage is very low, the effect of that tax is probably regressive, since the persons not covered, who are those with a lower income, contribute to the system without receiving anything in exchange. In other cases, the State deducts its contribution from its overall revenue; if the bulk of this revenue comes from sales taxes and these are imposed on both essential and luxury consumption alike, the effect must also be regressive when the coverage is low. It has been argued, on the other hand, that if there are State subsidies on basic goods and services or the bulk of the sales tax is levied on non-essential or luxury goods, the impact will probably be neutral, since the covered group is also the one on which the tax falls heaviest (Musgrove, 1984). But even in this case, the group without coverage—which is the lowest income group and does not benefit from social security—will be contributing something to the system (for example by purchasing manufactured goods) and the possibility of its acquiring goods or services encumbered by the tax would be even more remote. Furthermore, in stratified social security systems, the State usually assigns a larger contribution (or pays a larger contribution itself) in the case of the relatively higher income groups, whereas it assigns a smaller contribution (or does not pay any contribution itself) in the case of the lower income groups. For example, the State covers the growing deficit of the subsystems of public employees and the armed forces, but delays or reduces its contributions to the general subsystem that covers the mass of workers.

The incidence of the employer's contribution may be of three different types: the

employer may actually pay it; it may be "passed back", that is to say, the person insured may actually pay for it through a reduction in his real wages; or it may be "passed on": in other words, to the consumer through higher prices (Arroba and others, 1980, pp. 320-330). The theory is that in the long run the entrepreneur calculates not only wages but also all the additional benefits (including his contribution to social security) as his production cost and takes that total cost into account in his calculation of marginal productivity.

Let us take the case of the initial introduction or subsequent increase of the employer's contribution to social security. It is assumed that in developed market economies, the labour supply is inelastic (at least with respect to the normal working day and the main family wage) and that the worker negotiates with his employer a wage compensation packet including additional benefits such as the social security contribution which the worker perceives as part of his salary. If, furthermore, social security coverage is almost universal and the employer's contribution is uniform (so that the worker cannot avoid its incidence by taking a job that is not covered or one with a lower contribution), it may be concluded that the worker absorbs that contribution by a reduction in his real wages. On the other hand, it is assumed that in developing economies the labour supply is elastic, because labour is plentiful and because the low social security coverage (or different contributions in stratified systems) make it possible for the worker to take jobs without coverage or with a lower contribution. It is assumed further that the worker does not perceive the employer's contribution as a part of his salary and that, therefore, there is no backward transfer. In this case, the employer has two options: he may transfer the contribution to the consumer by increasing prices, or reduce employment in line with the marginal productivity. Whatever he does, the impact is always regressive, either because employment is reduced or because the transfer to the consumer makes the person who is not covered contribute to the system of the person who is.

The empirical evidence with respect to the transfers is very contradictory and is almost always based on the experience of the developed

countries. Musgrove (1984) took into account both the employer's and the worker's contribution and found that in the short term the workers absorbed 75% of the cost and the employer 25%, whereas in the medium and long term the burden was shared equally between workers and consumers. Break (1981), in a study of 64 countries which took only the employer's contribution into account—but assumed that the labour supply was inelastic and that the workers regarded the employer's contribution as part of their salary—concluded that the worker absorbed the entire burden. Break also maintains that in the developed countries the transfer to the consumer can occur in the short term but not in the long term in a situation of equilibrium, whereas in Latin America, with less competition, it is not known what would occur in the long term. Empirical simulations indicate that absorption by the worker has a less regressive impact than transfer to the consumer, although the difference is not great.

According to the above, in the developed countries the insured person absorbs the employer's contribution through a cut in real wages and therefore the impact on employment and distribution is neutral (assuming that the contribution is uniform). In the developing countries, in contrast, the insured person does not absorb the employer's contribution and therefore either the employer absorbs it himself, or he reduces the labour demand, or he passes on the cost to the consumer. In the latter case the negative impact on employment would be less but not neutral, since there are some employers who could transfer it more easily than others (and the employer with no coverage would not have to transfer it).

The most developed Latin American countries are closer to the first model. In these cases, we have high or almost universal coverage and according to some, an inelastic or less than perfectly elastic labour supply.³ But on the other hand, there does not appear to be any backward

³Musgrove (1984) feels that even in the developing countries skilled labour is not plentiful and he assumes that in negotiations with the State or the employers the latter's contribution is included as part of the wage package. Consequently the skilled labour supply is not perfectly elastic and the workers probably pay a part of that contribution.

transfer in the short term (or at least this effect is very small), because of institutional and economic barriers and different patterns of behaviour (Foxley and others, 1977; Wilson, 1984). In the first place, State intervention through labour and social security legislation is much greater in these countries than in many developed market economies; thus, for example the law sets a minimum wage which operates as a lower limit for wage reductions. Moreover, in some countries the employer must even pay the insured person's contribution when the latter's wage is only equal to the minimum (Mexico), or must pay the difference with the minimum contribution when the wage of the person insured is lower than that corresponding to that contribution (Peru), which considerably increases the labour cost of this group. In the second place, in several of these countries (such as Chile, at least up to the mid-1970s) the price fixing method most frequently used is the average cost plus a profit margin, which facilitates the forward transfer of costs. In the third place, in countries where there are measures to protect the consumer goods industries this also facilitates price increases. In the fourth place, the workers do not appear to perceive the employer's contribution as part of their wages, since the unions usually pressure the State to assign a heavier burden to the employer than to the person insured, and those issues are not included in collective bargaining since they are already regulated by law. In the fifth place, the law and the unions make it extremely difficult to dismiss anyone for economic reasons and the processing of such dismissals is lengthy and costly; the employer can of course avoid hiring additional labour. All of this suggests that transfer of costs to the consumer—at least in the short term—is the most normal procedure in these cases and it is also facilitated by oligopolistic structures although the elasticity of substitution of products whose prices are raised in this way must be close to zero if it is to have any major effect. The impact of this transfer on distribution must be regressive, since it affects the low-income group, which has no coverage and receives no benefits from the social security system but nevertheless contributes to it. In the few countries which have almost universal

coverage, this regressive effect would diminish, if the contribution were also uniform. In this case, it could also happen that in the medium and long term there was a reverse or backward transfer with an effect similar to that in the developed economies. Although not all employers would be equally able to transfer the contribution to prices (because of differences in competition, substitution elasticity, etc.) there might be a sufficiently widespread increase in prices to accelerate inflation and reduce real wages. This could be the case in the countries with the most highly developed social security systems and high inflation rates.

Another point of view stresses the differences, which are more marked in the least developed countries, between the formal sector (with total or partial coverage by social security) and the informal sector (no coverage). In this case it is assumed that the employer's contribution is transferred neither forward nor backward, so the effect would be a reduction (or stagnation) of the demand for labour in the formal sector. According to this approach, social security (sometimes linked to a policy of capital incentives) increases the relative cost of the labour factor as against capital which gives an incentive to replace labour by capital. This distortion triggers off a chain reaction: less labour is used in the formal sector, fewer workers move from the informal to the formal sector, the growing labour surplus has a depressive effect on wages in the informal sector, the wage differences between the two sectors grow, and since there is less available capital in the sector which receives no coverage, its productivity and economic growth decline compared to those of the sector which receives coverage (Kornevall, 1977). A change from wage-based contributions to a neutral financing system (or one which draws no distinction between the factors, such as value added tax) could correct this problem.

It has rightly been pointed out that when the employer's contribution has a regressive effect, this cannot be double—there cannot be both a reduction in the demand for labour and transfer of the burden to the consumer, for both effects cannot operate with equal force or simultaneously (Tokman, 1984). It is quite possible, however, that one effect may occur in

the short term and another in the medium and long term in a single sector or in different sectors, for example as follows: a) a reduction in the demand for labour in the covered formal sector can in the long run result in a decline in real wages in the informal sector which has no coverage; b) transfer of prices can in the long term reduce the demand for products of the covered sector and affect employment, and c) a generalized transfer of the prices due to almost universal coverage can result in a cut in real wages in the medium or long term.

Although it is not possible to make generalizations on such a weak theoretical and empirical base, everything that has been said suggests that when there is greater economic development and social security coverage, the impact seems to be greater in the direction of reducing real wages and possibly less as regards employment and the transfer to prices. The regressive impact seems to be greatest in the least developed countries.

In general, benefits appear to have a more progressive impact on distribution than contributions but this largely depends on the extent of the coverage, the legislative uniformity and the type of programme: when there is wider universality and uniformity there is greater progressivity; furthermore, social assistance, health and family allowances programmes usually have a more progressive impact than pensions. Pensions are calculated, in almost all countries, in proportion to the income of the person insured and therefore reproduce the inequality in the general income distribution. In contrast, health benefits are basically equal, that is, they are not proportionate to income although in the stratified systems there are differences with respect to the availability and quality of the services. Moreover, the poorest groups have the greatest incidence of illness (because of poor nutrition and hygiene), and since private medical care is too expensive for them, the poor use the health services more often than the high-income groups; these latter, although they are covered by the health services usually prefer to use private doctors and clinics and only resort to the social security services in extreme cases. Notwithstanding this, it has been argued that the health programmes appear to be

more progressive than they would have been if the benefits provided were measured not by their cost but by what the user would be prepared to pay for them (Musgrove, 1984). Family allowances also have a more progressive impact than pensions, since in many cases they are granted to low-income families and are almost always fixed (that is, an equal amount is paid in respect of each child) rather than being proportionate to wages. Furthermore, the poorer families are generally larger than middle-income families. Finally, social assistance programmes are directed towards the poorest sectors of the population, so that they probably have the most progressive impact on income distribution. It has already been indicated that as the social security systems grow older, a larger percentage of the costs is allocated to pensions, thereby increasing the regressive impact; however, this is compensated for by extending the coverage and the social assistance programmes to those not previously covered (Mesa-Lago, 1980).

3. Empirical studies in Latin America on the impact on distribution

The empirical studies in Latin America on the global impact of social security are confined to a few countries, namely, the most developed ones (Argentina, Brazil, Chile and Costa Rica), and do not always cover every programme. Moreover, because they use different methodologies and are of different dates it is not possible to make a strict comparison.

The oldest study (ECLAC, 1969) is on Argentina and it measures the redistributive impact of the pension programme (1950-1960), showing a slightly progressive net effect: 1.7% was transferred from the top income strata (highest 10%) to the rest, combined as the lower strata. It would have been more appropriate to break down the redistributive effect within the 90% lower strata in order to investigate the transfer between the 30% poorest (not covered at that time) and the intermediate sector with better protection. Diéguez and Petrecolla (1974) compared the average benefits between different groups covered in 1952 to 1972,

showing an almost perfect positive association between the amount of the benefit and the insolvency of the system: throughout the entire period, the armed forces paid the highest benefit but showed the largest deficit, which was covered by the State.

Rezende's study (1974) on Brazil, conducted in 1973, reveals the most progressive effect of all the countries for which information exists: within the covered urban sector, the poorest group received benefits (sickness, maternity and pensions) that were double their contribution, whereas the highest income group received from one-third to one-fifth of what it contributed. This did not take into account the assistance programme which covers the rural sector and is partly financed by a contribution from the urban sector (and which should therefore have had a sharply progressive effect), nor did it include the armed forces and public employees (who probably received more than they contributed). Although the net effect of the overall system on distribution is not known, it was probably progressive (see also Rezende and Mahar, 1974). Two studies have been conducted in Costa Rica on the redistributive impact of the health and maternity programme. The study by Green (1977) on personal income was conducted in 1973, when contributions still had ceilings and half of the population was not covered and it showed an almost neutral effect. The study by Briceño and Méndez (1982) on family income, carried out in 1978 (when the ceilings had already been removed and coverage had been considerably extended) indicated a regressive

impact on financing but a very progressive one on benefits, and there was a slightly progressive net effect: 2% was transferred from the 20% highest income group to the 40% lowest income group.

Chile is the country with most studies on the subject, and the majority of them indicate a regressive effect on income distribution because of transfers from the non-covered population to the covered and, within the latter group, transfers from lower income groups to higher income groups (Mesa-Lago, 1978). The most recent study (Foxley and others, 1977), conducted in 1969, shows a regressive effect on financing and a progressive effect on benefits, with a net or slightly progressive impact: 0.5% is transferred from the 2% with the highest income to the 30% with the lowest income. But this study excludes both the sector without coverage and the armed forces and other privileged groups, so that the net overall effect was probably regressive. During the same year a study on the health programme alone showed the only progressive transfer: the lowest income group received an average benefit 1.6 times greater than that of the highest income group (Arellano, 1976).

While the studies on the more developed Latin American countries show a neutral or slightly progressive impact by social security on income distribution, it is logical to assume that in the least developed countries, with a much lower coverage, the impact is regressive. However, it will not be possible to substantiate this assumption within the limits of this article.

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Changes of social relevance in the transplantation of theories: The examples of economics and agronomics

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The penetration of scientific and technical knowledge from the developed into the underdeveloped countries has often led to the latter's acceptance of theories and techniques which are totally remote from their realities and interests, and are of no use to them as tools of interpretation or transformation.

According to the main thesis of the present essay, the dominant theories in various disciplines reflect the conditions prevailing in the countries where they originated; changes in them are generally hastened when conditions in their countries of origin alter. This mechanism ensures the social relevance of the dominant theories at different times in the countries that blaze the trail of scientific progress, even though that may not have been the scientists' intention. In the underdeveloped countries, on the contrary, scientists draw their nourishment from the science of the developed countries which generate the theories, and changes in these occur irrespective of their social relevance for the recipient country. If in the theory-importing country there is no such phenomenon as gave rise in the creator country to the dominant theory, science, a potent factor of development in the latter, may become, in dependent countries, a potent factor of underdevelopment, if this is interpreted as a process taking place in a direction that is undesirable from the standpoint of the welfare of the majority.

The author maintains that this thesis can be abundantly corroborated, and in the present article he deals with the establishment and modification of certain theories of special importance in economics and agronomics.

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I

The epistemological thesis

This essay is based on the theory of scientific dynamics expounded by Kuhn (1962) and later formalized by Sneed (1971) and Stegmüller (1973, 1974, 1975). For several reasons, and particularly because the world theory has so many acceptations, Kuhn prefers to speak of development and change in "paradigms". The reference is to what Schumpeter (1954, p. 41) calls the preanalytic vision that of necessity precedes theoretical work. As this "vision" is at once the focal point of theoretical work and the guiding principle of research undertaken in the framework of a theory, I shall continue to use the term "theory" instead of "paradigm"; according to this conception, what is often called "theory" is equivalent to interpretations or hypotheses within the framework of a theory.

1. *The progress of a theory*

A theory, in this sense, is a structure which allows of manifold interpretations, and requires one to relate it to concrete reality. In its general form it says nothing in concrete terms and, accordingly, can be neither corroborated nor refuted by experiment. In the structure of a theory, however, there is no room for interpretations of other structures. The first successful interpretations of a theory often account for phenomena that had previously met with no satisfactory explanation. These paradigmatic interpretations encourage researchers to look for further valid interpretations of reality within the framework of the theory in question.

By virtue of this effort, theory develops and becomes a potent instrument of explanation. In their endeavours to deal with new phenomena, researchers gradually discover the limitations of this frame of reference. When these become increasingly numerous and occur in relation to important problems, a few researchers to begin with, and afterwards the majority, abandon the dominant theory and look for another that can offer a better explanation of phenomena which

have not been satisfactorily interpreted by that dominant theory and which are of importance for a society, a social class or a scientific community.

Given that this, in synthesis, were the evolution of science, it would be impossible to demonstrate that in the course of scientific progress one good theory is replaced by another even better, and that we are gradually approaching the "truth"; there is no atheoretical criterion whereby the degrees of truth in different theories can be impartially compared.

2. The transfer of a theory to a different historical and social context

If the change from one theory to another is not an ahistorical and universal process, but something directly related with the historical and social situation of a group of researchers, the effect of exporting theories from one historical and social context to another of a different nature must give food for serious thought. Kuhn stresses that research work isolates the scientist from his social environment: his disappointment in a theory is occasioned when it does not—in spite of his efforts—provide satisfactory explanations for important problems in his own field of work. A case in point is afforded by Newton's attempt to find an interpretation in Newtonian theory for the phenomena of light. If a theory is exported to a different historical and social environment, some researchers in that environment will probably try to apply the theory to phenomena which in its original context were non-existent or of no importance. If, after years of work, the new theory does not meet the hopes pinned on it, researchers in the new environment may be disillusioned and begin to look for another theory to grapple with their old problem.

As historico-social conditions influence changes of theory, the export of theories to cope with other conditions constitutes a source of frustration for the scientist. A similar case occurs when conditions in a society change so radically that a theory up till then quite fruitful no longer provides valid interpretations.

In this limited sense, historico-social conditions influence the abandonment of a theory. Social influence in respect of what theory

ought to take the place of the one discarded is much more direct. Normally, several options present themselves, each one with its paradigmatic interpretations exemplifying how that particular theory suggests that problems be resolved. For instance, after the decline of classical economic theory, the historical school vied, fairly successfully at first, with the incipient neoclassical theory. As these two represented radically different approaches to economic phenomena, there was no possibility of making a logical comparison of one theory with the other to decide which was the more promising. Apparently neoclassical theory gained the day over the historical school because it was more academic and less concerned with the social question.

A theory like that of Clark (1981, p. 313) which holds that "what a social class gets is, under natural law, what it contributes to the general output of industry" will be more kindly received by the power structures, in times of labour unrest, than the classical theory which takes into account the class struggle; according to Ricardo, for example, in marginal land, that is, when rent is not paid, profits are the leavings of wages. When the dominant theory was this, which of course incited labour conflicts, it was not as yet the working class but the landowners that put the development of British industry at risk. Once the landowners had joined forces with industry and the threat to international competition and the profitability of British industry stemmed mainly from the demands of the working class, an atmosphere favourable to a change of theory was created.

I should like to make it clear that such a decision in favour of one theory or another, because of this or that historical condition, is not an explicit option. Social and class conditions determine the priorities of researchers as regards their field of work and only in relation to that field could one theory seem more interesting than another.

The dynamics of science, rather than representing an everlasting process of approximation to a final state—"truth"—, much more closely resembles a Darwinian process of evolution, in which a new theory proves to have an explanatory capacity better adapted to a specific natural or social ecosystem.

II

The sociological thesis

Normally it is not society in general, or a representative sample of it, but well-defined social groups that engage in the pursuit of science. That is why the determination of the problems that will be tackled by researchers and the methods that they will use are subordinated to the interest and social situation of this group, not to the general interest. The medieval monks satisfactorily resolved their own problems of horticulture and of fermentation of milk, wheat and grapes to make cheeses, beer and champagne. To the solution of the problem of the peasants who worked with the Egyptian plough, so unsuited to the heavy soils north of the Alps, they contributed nothing; the peasants solved it by inventing the mouldboard, and for want of the support of systematic knowledge, they did so very slowly.

1. *Classical economic theory*

Classical economic theory was concerned with the wealth and the development of nations; those who put forward this theory constitute a representative sample of all urban classes (O'Brien, 1975, p. 8) —excluding, of course, the workers. As each of their interpretations related to a different period of history or a different nation, the social class which this theory identifies as the enemy of future development varies according to the interpretation.

An ahistorical comparison of the assertions of the physiocrats, of Adam Smith, of Ricardo and of Marx would show how contradictory are their declarations with respect to the coincidence between the interest of one social class and the social interest; unfortunately an ahistorical position is the rule among scientists, not the exception. For the physiocrats the bourgeoisie was a "sterile class" and its work unproductive because it manufactured and marketed mainly "non-basic products" (Sraffa, 1926) for the French nobility. Adam Smith (1937, pp. 248 to 250), in contrast, identified the social interest of landowners with the general social interest,

since in his day what was needed was to break down the monopolies and privileges built up by traders and entrepreneurs during the period of mercantilism. Ricardo (1951, I, p. 77 and IV, p. 21), on the other hand, asserts that landowners grow rich at the expense of the other social classes because —with the ban on imports of cereals in force— the high price of grain raises the nominal wages of workers and reduces the rate of profit and the competitive capacity of industrialists. Marx accurately describes the antagonism between capital and labour in a world where the rate of profit is low because of keen inter-capital competition, and where a worker aristocracy exists which has closer ties with the national capital that ensures it privileges than with the poorer workers within and outside its own country.

The different interpretations of classical theory have been capable of describing the most widely varying systems of exploitation of one class by another that have occurred in the development of capitalism. If the researchers who continue using classical theory as a working tool today have failed to offer a satisfactory interpretation of existing systems of exploitation, it is because of their tendency to take their stand on interpretations of classical theory which deal with other historical situations, instead of reinterpreting the old theoretical framework in innovative fashion with reference to the conditions in force.

2. *Neoclassical economic theory*

Neoclassical economic theory, in contrast, contributed nothing in its earliest decades to the discussion of economic policy (Stigler, 1972, pp. 571 to 578), and taught that all classes get what they deserve. That this theory has nothing to say on the major themes of the classical economists is not a matter of chance but the result of its own structure. Those who sponsored it were almost all university professors and the theory clearly reflects this social group's

aesthetic values, remote from political debate. Just as the political recommendations of the classical thinkers are ascientific positions for the neoclassicists, because they imply an impossible comparison of subjective benefits, so the impossibility of making recommendations of this type within the framework of neoclassical theory is for the economists of the classical school "very conducive to the euthanasia of our science" (Hicks, 1939, p. 697). Harrod (1938, p. 396) remarks in this connection: "If the incomparability of utility to different individuals is strictly pressed ... the economist as an adviser is completely stultified, and unless his speculations be regarded as of paramount aesthetic value, he had better be suppressed completely".

3. *A Herodianized science*

With respect to the social classes that concerned themselves with science in Latin America —the future middle classes— J.B. Alberdi (1836, iv, p. 62) expresses the opinion that "the Argentinian gaucho, the owner of an hacienda, the businessman, are better fitted for practical politics than our students of Quinet and Michelet, masters whose knowledge embraces everything but South America". On the relationship between this class and its own country Alberdi comments (1886, iii, p. 80): "Civilized Latin America could be defined by saying that it is Europe established in America", and (1916, p. 134): "Every sizable South American city aspires to be a *petit Paris*". Even if the cultural and intellectual bond between this Latin American class and Europe and the United States were less strong in the countries north of the Southern Cone, it would seem, nevertheless, that in the rest of Latin America too the intellectual link with the centre was decisive enough. On the mood of scientists in the time of Porfirio Díaz, L. Zea says (1968, p. 317): "What is essentially Mexican is important, perhaps its realization would be desirable; but this would be a misguided course, and might imply its destruction. The predominant, the powerful influence is that of the Saxon spirit; Mexico, if it wants to survive, will have to adapt itself to that spirit, Saxonize itself, there is no other road open, and even if there were, the decision has

already been taken and the impulse given; now there is nothing to be done but follow the chosen path and await the outcome."

The phenomena to which the quotations allude reflect a well-known process. The first description of it comes from Toynbee, when he refers to the Jewish groups in Herod's Palestine, to whom, as to Herod himself, events in Rome were of more interest and better-known than those in their own country. With regard to the Herodianized classes in Latin America Vekemans writes: "As Herod lived physically in Jerusalem but mentally in Rome, so the Latin American upper classes live physically in Latin America, but mentally in Europe or the United States" (quoted in Steger, 1971, p. 30).

Now, if these are the classes that engage in the pursuit of science, it is not very likely that the importing of theories which could be less socially pertinent in the new environment will lead to frustration and in time to the repudiation of the theory. As these classes belong to the intellectual world of the countries whence the theory comes, and as the places where they study and carry out research seem to be cultural enclaves compared with the rest of the country, processes of adjustment of an unsuitable theory take place more slowly or not at all. It is to be hoped that these classes will choose, out of the supply afforded by the countries to which they look for intellectual guidance, the theory that is most appropriate to their country, but there is little likelihood that they will risk a rupture and a change of theory that involves making themselves independent of their spiritual homeland.

An evaluation of their intellectual and scientific contribution would necessarily lead to the same conclusion reached by Medina Echavarría (1955, p. 65) on what they bring to economics: "Considered as a whole, it is improbable that the Latin American middle class, with its current structure, will be able to react in the best possible way and to the extent required by the economic development targets."

4. *The progress of Herodianized science*

A reminder must be given of what was said above on scientific progress and on the comparative irrelevance of Herodianized science

must be given a more precise shade of meaning. The dynamics of scientific development comprise two types of progress: normal scientific progress within the framework of a given theory and scientific progress via changes of theory. The sociological thesis on the Latin American scientists relates only to progress through changes of theory. It does not preclude the possibility that these scientists may so radically interpret a dominant and structurally unsuitable theory that at the pragmatic level it has more or less the same degree of social pertinents as another apparently more suitable, but as yet somewhat amorphous. A case in point is afforded by the interpretation that Prebisch and ECLAC placed on neoclassical theory (Dubiel, 1984).

But it was not the demonstration effect alone that encouraged inappropriate imports of theories. In the course of industrialization through import substitution, the institutions of higher education in Latin America performed

the function of producing national technical experts who knew how to manufacture the products hitherto imported. That implied the importing of machine-tools and textbooks in order to form the necessary physical and human capital. This type of industrialization and the role of the universities in the process also account for its outward-directed slant.

Industrialization and the expansion of State and entrepreneurial bureaucracy were favourable to the middle classes. Without possessing either land or military or financial power, these classes were able to justify their participation in power through the value of their knowledge, which was continually rejuvenated with new imports. Imported knowledge long warranted the political importance of their own class and their high income levels in the eyes of other social classes. From the standpoint of their contribution to national development, however, the social value of this imported knowledge was often insignificant (Dubiel, 1981; 1982).

III

The example of economic theory

In order to obtain an overall idea of a theory and of its predecessors, it is sometimes of little use to have recourse to the opinion of the adherents of that theory because "though many scientists talk easily and well about the particular individual hypotheses that underlie a concrete piece of current research, they are little better than laymen at characterizing the established bases of their field, its legitimate problems and methods" (Kuhn, 1971, p. 86). The ahistorical outlook observable in all developed scientific disciplines is attributable to the fact that "partly by selection and partly by distortion, the scientists of earlier ages are implicitly presented as having worked upon the same set of fixed problems and in accordance with the same set of fixed canons that the most recent revolution in scientific theory and method has made seem scientific" (Kuhn, 1971, p. 215).

1. *Classical theory is not protoneoclassical*

By way of these processes, the name neoclassical theory has now come to be applied to the theory born in 1870, which has nothing to do with the earlier classical theory. As the neoclassical economists found in volume IV of the *Wealth of Nations* (1776) a proposition compatible with their own theory, it was in vain that Adam Smith expounded in the Plan of the work and in the early volumes a line of thinking quite different from and incompatible with that of the neoclassical school. For them, the aphorism that individual interest guarantees economic progress as if it were guided by an invisible hand (Smith, 1937, p. 423), became the pith and marrow of their own theory (Blaug, 1964, p. 57).

Very few economists are aware of the deep chasm between classical and neoclassical theory. Almost the only one who does not cherish an illusion that neoclassical theory is the complement or the consummation of classical theory is Schumpeter as a young man. In his vigorous defence of neoclassical theory he admits (1908, pp. 182 and 1983): "Statics and dynamics are completely different areas: not only do they deal with different problems, but they use different methods and materials. ... With respect to development phenomena and the "major problems" of economic progress we are completely at a loss." Accordingly, in 1911 he published his *Theory of Economic Development* in which he described the imbalances in that process. To explain the difference between this book and the equilibrium systems presented in his 1908 text, Schumpeter (1961, p. xi) asks: "But is it really untrue of life or artificial to keep separate the phenomena incidental to running a firm and the phenomena incidental to creating a new one?"

Robbins and Hicks too appreciated this difference. Robbins (1974, p. 35) noted that neoclassical theory gave rise to a tendency on the part of economists to concentrate their attention on the distribution of the means of production rather than on development. Hicks (1975, p. 325) compares Schumpeter's observations (1954) on the classical economists with his comments on Jevons, Walras and Menger, and with reference to the former says: "Why does he write them down? Because they belong to the other party!"

Without embarking on discussion of the neoclassical tergiversations of classical theory, which present the classical economists as if they were protoneoclassical, suffice it to recall a few of the many elements that distinguish the two parties. "Capital" in the classical sense comprises the heterogeneous inputs of production including variable capital: wages; "neoclassical capital" excludes wages and assumes that physical installations are malleable, i.e., for the neoclassical theorists capital is a homogeneous mass, something that can be remodelled like plasticine. "Interest", "rent" and "wages" constitute for the classical school the income of the three most important social classes of their day, while for the

neoclassical economists they are the remunerations of the universal factors of production: capital, land and labour. According to classical theory, market competition forces prices down as technology makes progress, an element incompatible with neoclassical theory; for the neoclassical school, competition ensures that the factors of production receive their "marginal product", an element incompatible with classical theory. The classical theorists determine distribution among the social classes before fixing the prices of goods, since these latter vary with distribution; neoclassical economists do the opposite, determining distribution as the result of supply and demand in respect of "factors of production", while demand is the result of demand for goods and of their prices. These examples may suffice to show that the classical and neoclassical theorists, although they may use the same words, are referring to different theoretical concepts.

2. *The structure of classical theory*

If economic theory began as a science with the classical school, the reason is that only from that time onwards did its explanations cease to be disconnected. This systemic approach is attributable to Madame Pompadour's physician, François Quesnay, who became famous when, using a hydraulic model, he refuted the thesis that bleeding had to be applied at the point farthest from the inflammation. In later years he applied this concept of circling flows to the movements of goods and money in order to analyse the French economy and the obstacles in the way of its development.

The first principle laid down in this model is that what has been consumed in the course of a production cycle must be replaced at the end of it. The second is that only if a surplus over the quantity of goods consumed in the production process is ensured can there be economic development. Thus the subsequent analysis focuses upon the factors that exert a positive or negative influence on this surplus: technological progress stimulated by the large and increasing size of the market; productive or unproductive consumption as the way in which the surplus is used; distribution of the social product among the different classes, as a determinant of the

percentage of unproductive work. Price-fixing—the major concern of the neoclassical theorists—is a secondary question for the classical economists compared with aspects relating to economic development.

The general model of classical theory has met with several interpretations. The first is the *tableau économique* of Quesnay and the physiocrats; the second the corn-corn model that Ricardo expounded in a lost text and that Sraffa was able to reconstruct. The third is the interpretation which Ricardo uses in his *Principles* (1817), and which is more appropriate for an economy that is based on the hiring of labour. But in the first sentence of the *Wealth of Nations* too—"The annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes"—Adam Smith refers to the recirculating fund of the classical model and not as the neoclassical economists take it, to factors of production. The most recent interpretation of classical theory is the input-output analysis of Leontief, who introduces his study with the words (1966, p. 9): "The statistical study presented in the following pages may be defined as an attempt to construct ... a *tableau économique* of the United States for 1919 and 1929." Leontief himself calls attention to certain differences between his input-output matrix and his studies in the tradition of neoclassical theory, but not to the deep-seated antagonism between the two that Schwartz points out (1961, pp. 196-197). Apart from the direct relation with Quesnay's work, the intellectual sources drawn on by Leontief—a Russian student in the 1920s—must be sought in the "material balances" of Soviet planning and in the reproduction schemes of Marx, both descendants of the *tableau économique*.

3. *The classical structure and the problems of underdevelopment*

As interpretations have been found for classical theory whereby to analyse the development process in different countries and at different times—the theory guided England's economic policy for decades—, likewise for the problems

of the underdeveloped countries today it will presumably be able to offer interpretations of great explanatory power.

Thus it was that W. Arthur Lewis (1954) said: "This essay is written in the classical tradition, making the classical assumptions, and asking the classical questions. ... The student of such (underdeveloped) economies has therefore to work right back to the classical economists before he finds an analytical framework into which he can relevantly fit his problems." W. Arthur Lewis, a professor at Manchester who came from Jamaica, belongs intellectually to a group of English economists concerned for the lot of the former colonies, who, followers as they were of A. Marshall, felt themselves more strongly committed to the classical school (Dubiel, 1984, pp. 79 to 96).

In Latin America Raúl Prebisch developed a model similar to that of Lewis but with much wider repercussions, since he was at the head first of ECLAC and then of UNCTAD. In contrast with Lewis, Prebisch says practically nothing in favour of classical or against neoclassical theory. He seems convinced that the classical economists are really protoneoclassical (Prebisch 1979, pp. 171 to 172) as they are presented in neoclassical interpretations. Nevertheless, an analysis of the elements that Prebisch uses in his explanations of the cause of Latin American underdevelopment reveals that he handles the same concepts and the same themes as classical theory. This was achieved—partly perhaps in unawareness of the relation with classical theory—by means of *ad hoc* hypotheses and ancillary assumptions. The result was sufficiently different from the standard interpretations of neoclassical theory for many United States economists (Viner, Haberler, Bronfenbrenner, Powelson, Flanders, etc.) to consider that "CEPAL's theoretical writings were not up to the professional standards of academic economists" (Pollock 1978, p. 78; see Prebisch 1963, p. xi).

Prebisch's is a macroeconomic theory like that of the classical school, and antithetical to neoclassical theory of which the core is microeconomic. Like the classical economists, Prebisch refers to a development problem clearly defined by historical circumstances, and does not present a universal and timeless theory

like the neoclassical economists. For Prebisch, as for the classical school, capital is something heterogeneous; the disastrous implications of this assumption for neoclassical theory are familiar enough. On the basis of his postulate that different generations of technology exist side by side, Prebisch constructs a concept of "surplus" which serves the same purpose as the concept of "profit" in classical theory. Like the classical economists, Prebisch is concerned about the effects of non-productive consumption on development. His discussion of the terms of trade, the subject which economists in the industrialized countries found most exasperating, can only be understood in the framework of classical theory which distinguishes between the increasing yields of manufacturing industry (the dominant sector in the central countries) and the diminishing yields of raw materials production (the dominant sector in the peripheral countries). Until "CEPAL doctrine had... achieved quite widespread academic respectability in the United States", some lively criticism continued, "mainly centering around CEPAL's earlier terms-of-trade presentation" (Pollock, 1978, p. 78).

4. *Prebisch's thesis*

Economic competition, which according to neoclassical theory ensures that each "factor of production" receives fair payment, i.e., its "marginal product", according to classical theory is necessary in order that the prices of reproducible goods may vary with production costs. In the processing sector, production costs fall more quickly than in the primary sectors because of the greater possibility of division of labour and technification (Adam Smith, 1937, p. 6). In industry, therefore, an increase in market size is conducive to reorganization of production, whereas in agriculture and in mining costs do not decrease or may even increase because of the need to make use of marginal land and mineral deposits in order to step up output.

In this process, the beneficiaries of the technological progress deriving from an increase in market size are the national and international consumers of a now cheaper product. The

deterioration of the terms of trade for industrial products is necessary to compensate consumers in non-industrialized countries for the advantage enjoyed by industry in respect of the technological progress induced by a larger market. In practice, the world market operated in accordance with classical theory until 1815 and to a lesser degree up to 1882 (Imlah, 1950, p. 183). As from that date a reversal of the process began. Technological progress in agriculture resulted in low prices for domestic and international consumers, while the fruits of technological progress in industry were distributed mainly among domestic producers: one part increased the profits of firms and their technological research and development capacity, while another part made it possible to improve the workers' daily wages. Despite the fact that these wage increases are costs for an enterprise, from an economic standpoint they would have to be entered on the books as profit or rent on behalf of workers, because they originate in the greater facility with which industrial workers—as compared with agricultural labourers, peasantry and other sectors—can form an effective trade union and exert pressure (Adam Smith, 1937, p. 126). It should be pointed out that the deterioration of the terms of trade has been a decisive factor not only in international relations, but also in national social relations (for England, see A. Smith, 1937, p. 126; for the United States, see Krieg, 1984, pp. 61 and 64; for Maoist China, see Aubert, 1981, p. 100).

In this discussion on a misunderstood thesis of Prebisch, many "refutations" assume that statistics can explain or refute something without being interpreted by a theory. This empiricism is a feature common to several social sciences in the United States, where recourse is had to the computer, but not so much to theory. For this reason, the statistical data presented to refute Prebisch—"there is no evidence of a systematic deterioration of the terms of trade for raw materials"—in reality corroborated Prebisch's thesis, namely, the infringement of world market rules to the benefit of the industrialized countries, inasmuch as the terms of trade had not varied as they should have done if all the participants in the system had enjoyed the same opportunities.

5. *The conflict between representatives of different theories*

This controversy between Prebisch and the neoclassical economists may usefully be considered in the general framework of the discussions among scientists holding different theories. The reasons why these discussions tend to be conflictive have been set forth by Kuhn (1971). However, not only in debates between physicists of the Aristotelian, Newtonian or Quantum Theory schools, but also in discussions among mercantilists, classical economists, neoclassical economists or institutionalists, the arguments show a tendency to go round in circles; each party seeks to demonstrate that its theory satisfies the scientific norms which that theory itself prescribes and which another violates. The neoclassical economists can hardly grasp an argument of Prebisch which assumes the existence of increasing yields, when their own theory is incompatible with this assumption (Sraffa, 1926; Kicks, 1957, pp. 83 to 85).

Since Prebisch's positions can only be understood in the framework of classical theory, it is not surprising that this anti-Prebisch controversy shows a close correlation between ignorance of the content of classical theory and a militancy of attack which sometimes actually violates academic rules (see Bronfenbrenner, 1976). In this sense, the polemic in question is another illustration of Stigler's ideas (1969, p. 222) on the lessons to be learned from some of the early controversies on economic theory: "The inevitable lesson is that after studying previous controversies one cannot become so engaged in the current controversies. ... The more subtle lesson is that it does not pay to learn the first lesson: the temperate, restrained, utterly fair-minded treatment of one's own theories does a disservice to these theories as well as to one's professional status and salary."

The chief opponents of Prebisch were Haberler, Viner and Bronfenbrenner. Haberler (1957, pp. 335 and 336; 1964, p. 126) is so far from understanding what he criticizes that he contrasts Prebisch's thesis with the thesis of the classical economists. Viner (1953, p. 44) writes: "All that I find in Prebisch's study ... is dogmatic identification of agriculture with poverty." For

Viner (1953, p. 12) classical theory has a static character, when even one reading of Samuelson could have shown him the contrary. Bronfenbrenner (1976, p. 825) reports on "UNCTAD's progress from international joke to international menace. ... It was all more important, and quicker by a generation, than the Mafia's expansion from the Two Sicilies to New York and Chicago!"; the resolutions adopted by UNCTAD I and II were largely the result of Prebisch's personal action (Nye, 1972). Furthermore, Bronfenbrenner (1971, p. 142) imputes to Adam Smith a position of *laissez-faire* and harmony among social classes, as if he had never read anything in the *Wealth of Nations* on the antagonism between those who produce raw materials in the countryside and those who produce manufactures in the town (Smith, 1937, pp. 124 to 127), or the conflict, according to Smith (1937, p. 248), between society and traders.

This list of correlations between militancy and ignorance could be made longer, but it is more important to stress that these are not isolated deficiencies on the part of certain scientists. The experience of Prebisch is the same as that of Keynes with the Harvard economists. Keynes wrote in 1938: "It may be worth while to defend what one has said, if one still sticks to it. But a controversy arising from somebody attributing to one what one has not said and does not hold can scarcely be fruitful. A number of articles have been published in Harvard ... which do not seem to run counter to anything I have said, but, on the contrary, exemplify it. Yet the authors seem to suppose that they are controverting something I have said, imagining, apparently, that what I thought were quite straightforward statements mean something different from their face value!... At any rate, I beg for an occasional re-reading of what I did say!" (quoted by Gilboy, 1939, p. 634).

These experiences, and others even worse which fall outside the academic frame of reference, have, nevertheless, a long history in economic theory. From Adam Smith's time to the present day mercantilist theories —this derogatory epithet was invented by Adam Smith— have been and still are being refuted that no prominent mercantilist has ever upheld (Ingram, 1888, p. 37; Cannan, 1903, p. 3). With

import control and export promotion measures the mercantilists endeavour to create an increase in profits which by means of multipliers and accelerators would promote national industrial development; the industrialized countries were able to exploit these promotion measures in the last century thanks to the evolution of the terms of trade in their favour, without having to resort to government measures. A dispassionate appraisal of these policies could have pointed out that Adam Smith's argument (1937, p. 415) to the effect that the external market makes it possible to lower production costs when the domestic market is small constitutes a perfect justification of mercantilist policies, as in fact was noted by J.S. Mill (1909, p. 579). Most economists, in contrast, preferred to admit no modifications in the defence of "economic rationality" and, in the case of some participants in this controversy, of the bases for a free society; in the heat of these debates the omission of quotations and acknowledgments of sources is forgivable.

Within this tradition Haberler (1957, p. 335) refutes the hypothesis of the secular deterioration of the terms of trade. As "Prebisch's thesis" to this effect is "well-known" (Haberler, 1957, p. 331), Haberler and others see no need to indicate where Prebisch maintained it. Others criticized Prebisch's use of such-and-such an index instead of another, when Prebisch used none at all because what he had done was to republish some League-of-Nations statistics published by the United Nations in 1949. Apart from this, Powelson (1977, p. 19) asserts that "the terminal years for the Prebisch study (!) were during the world depression", when the statistical series quoted by Prebisch ends in 1946-1947. A member of the OECD expert committee for the evaluation of methods of determining the aid requirements of the underdeveloped countries criticizes "the bases of the calculation presented by Prebisch with respect to the increasing balance-of-payments deficit of the underdeveloped countries" (Duerr, 1977, p. 207), without stating where Prebisch presented the said calculation; whereas Prebisch (1962, p. 17) affirms that these financial needs of the underdeveloped countries could not be even approximately quantified. The writers referred to could be confident that their

periodicals would publish their "refutations" but never Prebisch's "pamphlets" (Haberler, 1964, p. 136). Given such a state of affairs, it seems normal that James Conant should have had to threaten to resign from his post as President of Harvard before the Board of Governors of that University would approve the appointment to a professional chair of so eminent, albeit non-traditional, an economist as Galbraith; Haberler submitted a protest in writing against his admission (Kemton, 1981, p. 24).

Most of these neoclassical authors were well aware that their "refutations" of the "Prebisch thesis" had been warmly welcomed by the politicians of their countries (Haberler, 1957, p. 325; Powelson, 1977, p. 17). The most outstanding essay of this kind was undoubtedly that of Bronfenbrenner (1976) who ended his comments on Prebisch and UNCTAD with the remark: "Such is the conspiracy (or lunacy, if you will) to be resisted. One can of course hope it will collapse on its own; this seems unlikely in the immediate future."

6. Changes in economic theory in the centre

The first attacks against classical theory were launched by Bailey and Cotteril in the 1820s; as neoclassical theory maintained 50 years later, they argued that value is not an objective entity, but is determined by the subjective judgement of each consumer. Their thesis that capital is as productive as labour suited a bourgeoisie which felt itself menaced by the socialists: the Ricardians first, and later the followers of Marx. With J.S. Mill classical theory gave ground before this pressure and lost the logical coherence which it had in Ricardo's interpretation. But only when at the end of the nineteenth century the English bourgeoisie considered the country definitely developed was it prepared to discard a theory which focused on development problems. Cairnes remarked in 1870: "I seem to observe in the literature and social discussion of the day, signs of belief that political economy has ceased to be a fruitful speculation;... It is not denied that the science has done some good; only it is thought that its task is pretty well fulfilled" (Ingram, 1978, p. 6). It was

not until this conviction that development had been achieved struck root in the politically most important segment of the population that neoclassical theory proved more attractive, because it asserted that all participants in the economic process were in the best possible situation when the development process took place in competitive conditions.

Hobsbawm (1969, p. 220) characterizes this intellectual *volte-face* in relation to the situation in the preceding decade when he says that "establishing an industrial economy is not the same thing as operating one already in existence" (with these words Schumpeter (1961, p. xi) distinguishes the content of his neoclassical book of 1870 from his 1911 text). On the *zeitgeist* (spirit of the age) Hobsbawm (1969, p. 126) remarks: "The British middle-class citizen who surveyed the scene in the early 1870s might well have thought that all was for the best in the best of all possible worlds. Nothing very serious was likely to go wrong with the British economy." Keynes (1971, II, pp. 5 to 7) agrees: "In this economic El Dorado, in this economic Utopia, as the earlier economists would have deemed it, most of us were brought up. ... But most important of all, he (the Londoner) regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable." In such a situation to preserve a theoretical system which aimed at shedding light on how to emerge from underdevelopment would have been absurd and futile. Classical gave way to neoclassical theory.

As the structure of classical theory focuses attention on the dynamics of development and its simplest interpretation is Ricardo's corn-corn model, so the structure of neoclassical theory highlights the homostatic problems of equilibrium and its simplest interpretation is an auction sale. In it all the merchandise to be auctioned and all the purchasers are brought together. Every purchaser has a fixed sum of money and specific preferences. The problem is how to distribute the goods assembled in such a way that no other distribution pattern could be of greater benefit to all those present as a whole. This shift of the question from "how to produce more in each cycle" to "how to distribute what is

already produced in the best possible way" reflects the evolution of a developing society to one which feels itself to be developed.

7. *Changes in economic theory in the periphery*

Both in classical and neoclassical theory a relation can be established between the structure of the theory and the society that adopts it. This relation is not obvious in underdeveloped countries. Confronted with development problems, it should be classical theory that is of interest to them, but since intellectual and academic ties with the industrialized centres largely determine the researcher's social prestige, he sacrifices the country's development on the altar of his own advancement. These decisions on theories are seldom consciously taken.

Goodwin (1972, p. 561) maintains that "Marginal utility theory ... is a luxury good which will be produced only at an advanced stage of economic development. So long as the marginal utilities of all goods are very high, ... as they must be on the frontier or in underdeveloped countries, it is unreasonable to expect economists to spend their time analysing the phenomena of declining utility". In this sense, the importing of neoclassical theory is yet another instance of the importing of luxury goods for the well-to-do classes, detrimentally to the interests of the majority.

If in view of the low marginal utility of neoclassical theory in conditions of underdevelopment not only Prebisch but also Allyn Young, Arthur Lewis and Nurske resorted to classical theory as the frame of reference for discussing development problems, it might well be assumed that Latin American economists had availed themselves of this recourse. It is not by chance that Prebisch shares Adam Smith's definition (1937, p. 397) of the task of political economy as being "To provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves and ... to supply the State or commonwealth with a revenue sufficient for the public service". But to take a favourable reception for granted would be

to overlook the intellectual orientation of most social scientists in Latin America. Instead of being appreciated and outdone, Prebisch was attacked not only by economists in the industrialized countries, but also by those of Latin America, both on the right and on the left; it is ironical that it should have been a sociologist (Cardoso, 1977) and not an economist who best grasped Prebisch's theoretical originality. The right wing preferred neoclassical theory, dominant in the industrialized countries and incapable of dealing with development problems (Schumpeter, 1908, pp. 182 and 183). The left, as from the 1960s, chose to explain the underdevelopment of two-thirds of the world by means of the labour theory of value in the Marxist sense, which focuses upon the exploitation of one social class by another and which, in that context, encompasses the possibility of exploitation of countries of one type (of the capitalists and workers of these nations) by those of another. If the spirit of Marx were respected rather than his texts, this last aspect might appear more important. Marxist theory, however, even in its commonest form, almost always confined to a few concepts from the first volume of *Capital*, is an interpretation of classical theory and therefore is structurally more capable of explaining phenomena in

underdeveloped countries than is neoclassical theory.

The argument put forward in the present chapter has been that the developed countries of today generated and changed economic theory in face of the modification of their problems. Economists in the underdeveloped countries of today swung from one theory to another when the economists of the developed countries did so. These changes of theory in relation to the problems of one type of country, and irrespective of the country's own situation in a different type, are doubtless explained by the differences in economic and scientific development between one group and the other. The behaviour of economists in the underdeveloped countries is explicable because they live intellectually outside their own country. To this has contributed their theory of modernization—taking as a model country the country that is most advanced, whether capitalist or socialist—which has imbued them with the idea that conditions in developing countries can only be transient, and has invited them to follow the path signposted by that model. For want of a model, in contrast, the more advanced countries had to map out their own courses, in relation to their own problems and historical conditions, in order to continue making progress in science.

IV

The example of agronomics

It was explained above that scientific progress is related to the changing needs of the countries of origin of new theories, because inevitably the interest or indifference of scientists reflects—almost always unconsciously—the constellation of problems of their area of work and of their country. According to Weizsacker (1974, pp. 10 to 18), "the biotope of a scientific idea is made up of the ideas that exist alongside it. The survival of a species reveals, so to speak, the existence of an ecological niche. The survival of a paradigm

reveals a structure of reality". As in other processes of Darwinian evolution, scientific progress, rather than a series of cumulative steps towards "truth", is a process of changes in no teleological order, a series of revolutions which break with the older theory instead of surpassing it in the Hegelian sense.

The foregoing chapter shows this dynamics at work in economic theory. The same holds good for agronomics. Although agronomists feel themselves more nearly related to the natural sciences, the methodology of their science more

closely resembles that of the social sciences, since in both cases the phenomena depend upon countless interacting factors, and theories and experiments that focus upon only isolated factors are of very little explanatory value. Keynes (1971, X, p. 186) stresses this point when he relates and comments on the observations of Max Planck with respect to these methodological differences: "Professor Planck of Berlin, the famous originator of Quantum Theory, once remarked to me that in early life he had thought of studying economics, but had found it too difficult. Professor Planck could easily master the whole corpus of mathematical economics in a few days ... but the amalgam of logic and intuition, and the wide knowledge of facts, most of which are not precise, which is required for economic interpretation in its highest form, is, quite truly, overwhelmingly difficult for those whose gift mainly consists in the power to imagine and pursue to their furthest points the implications and prior conditions of comparatively simple facts...". The tendency to mathematicize economics and the reductionist approach in agronomics, irrespective of the problem that has to be resolved, are a major source of both the progress and the social unproductiveness of the two sciences.

1. *Evolution of agronomics*

The evolution of agronomics is similar in many respects to that of economic theory. Up to the mid-nineteenth century the guiding principle of agronomic research was the theory of humus or vegetable mould: the earth was regarded as the stomach of plants; the biological life in the soil converted organic material into food for the crops and the formation of vegetable mould kept these nutrients at the disposal of the plants by preventing leaching. Agricultural technology fostered these natural processes, inasmuch as it consisted in preserving and increasing the vegetable mould in the soil.

The theory of humus, linked with the names of Dombasle, Hasenfratz, de Saussure, Sennebier and Thaer, was discarded when first Sprengel and later Justus von Liebig maintained that the minerals to be found in ash —with the

methods of analysis of the time— and those that escape in the form of gases are all that plants need. Experiments which showed that plants apparently grow well in mineral solutions, devoid of organic matter, corroborated the new minerals theory. A change of theory is generally characterized by a change of slogan: instead of "feed the soil with organic matter", "feed the plants with salts".

The knowledge of chemistry developed in the eighteenth century led to the installation of the chemical industry, especially in Germany. Von Liebig placed this knowledge and this productive capacity at the service of agriculture; his new theory of agronomics was a response to a new situation in the industrialized countries and, without this new situation, it could hardly have been a success. The findings of research under the old theory on the effects of organic matter and the formation of the topsoil were forgotten, and their place was taken by research on levels of application of mineral fertilizers. The new theory had so resounding a success that few agronomists know that Justus von Liebig, the "father of modern agronomics", was also its first critic, since he had observed that the new way of feeding plants detracted from their vitality and increased the incidence of pests (von Liebig, 1979, pp. 95 to 98). His contemporary disciples still think that this disadvantage of feeding plants with chemical substances can be counteracted by greater use of chemical products in the form of pesticides.

Although the theoretical and ideological bases of modern agriculture date from the last century, only since its mass application as from the end of the 1930s in the United States and ten years later in Europe has it been possible to determine the potential viability of this agriculture over the long term. In Europe, where in order to compensate for a per capita land endowment equivalent to barely half that of the United States it is customary to apply twice as much energy in the form of inputs per hectare (*Global 2000*, pp. 261 to 280), there are increasing numbers who doubt whether this type of agriculture will be viable for another 20 to 50 years. Just as a "return to the classical school" is observable among economists, opinion is swerving back to many of the technologies of the former organic agriculture.

2. *The drawbacks of imported agricultural technologies*

An attempt will next be made to show the drawbacks of the minerals theory as well as of the humus theory, in underdeveloped countries, since both theories, different though they are, reflect the social and ecological conditions of their countries of origin. The argument will begin with a criticism of the economic repercussions of modern agriculture and will go on to its ecological sequels. This second part of the argument is incomplete, since it singles out only the difference between temperate zones and the humid tropics, whereas the majority of the underdeveloped countries are located in the tropics, but not exactly in the humid tropical zone. The discussion is confined to this sector for methodological reasons, inasmuch as it is easier to emphasize the special relation of modern agriculture with the temperate zones by contrasting it with the performance of vegetation in the humid tropics. The dry or semi-dry tropics, at least as regards soils, are not so very different from the temperate zones, and the dry season fulfils some of the ecological functions of winter. Analysis of modern agriculture in the dry tropics should include the subject of salinization of soils and the difficulty of applying artificial fertilizers when the amount of rainfall may vary greatly from one year to the next.

a) *The economic disadvantages*

Clement *et al.* (1973, p. 23) begin their book with the assertion that agriculture is an artificialization of the environment and its progress is always in the direction of a triumph over natural conditions. This orientation contrasts with the former view of progress in agronomics as an ever-improving imitation and intensification of the processes of nature. Technologies conceived in the light of the new principle call for more and more capital and for cheap energy, their ideal being an automatic lettuce factory that has become independent of weather conditions. In *Global 2000* it is stated that increases in productivity in the past generally depended upon a marked increase in

input of fuels. In the United States, inputs to produce 1 000 calories of maize rose between 1945 and 1977 by 33% according to Pimental *et alii* (1973, p. 444) and according to Hampicke (1977, p. 53), using the same data but different conversion coefficients, by 78%. In West Germany consumption of energy in agriculture doubled between 1950 and 1975 (Weber, 1979). To produce one unit of energy in vegetables by traditional methods costs 0.05 to 0.1 units of energy, while production in greenhouses in Northern Europe costs 572 units (Luenzer, 1982, p. 53). Agriculture of this type is from every point of view less appropriate in countries where capital is in very short supply. Consequently, for many of the poorer countries the achievements of modern agriculture are virtually meaningless.

b) *Drawbacks of the use of chemical fertilizers in the humid tropics*

In soil development as related to climatic factors, the rate at which weathering takes place depends upon the temperature and humidity of the environment. Because of their high temperatures and heavy rainfall, in the humid tropics the pace of weathering is a hundred times faster than in temperate zones (Weischet, 1981, p. 20). The soils typical of the humid tropics are therefore much more developed than temperate-zone soils, except in flood areas and highlands, where weathering is slower, and in the case of young soils, the product of recent volcanic activity or of landslides that have swept them down from high altitudes. In the weathering process the parent rock disintegrates and ultimately forms a new element, clay, which is a laminar crystal. In temperate zones, stones which indicate the original material are usually found, almost always only a little below the surface; tropical soils are generally much deeper, with no traces of the parent rock. Weathering likewise alters the state of the clay. At first, clay soils are formed mainly in three layers (illites, vermiculites, montmorillonites), but the high temperatures and rates of precipitation desilicate them and lead to the formation of clay soils with two layers (kaolinites). As a result of these processes, in temperate zones as a rule

chiefly three-layer clay soils are found, whereas in soils in the humid tropics those of two layers predominate.

The difference in the quantity of traces of the original parent rock in mineralization processes, plus the difference in precipitation, plus the difference in types of clay, explain why the minerals theory gives better results in temperate-zone soils than in tropical soils. The weathering of the traces of the parent rock in temperate zones affords mineral nutrients which in tropical soils are no longer present. The mineral nutrients existing in the soil and those added by man will be retained in a larger proportion and washed out to a lesser extent in temperate soils, because the lower temperatures have less mineralizing effect and because the material mineralized is washed out less by the lower precipitations. Clay soils can absorb in their negative-load fibres the positive mineral ions and prevent them from sinking to the subsoil, out of reach of the plants. This retention capacity —quantified as capacity for cation exchange— is normally from three to ten times greater in three-layer clays than in those with two layers. Because of the difference in precipitation and in clays, application of chemical fertilizers has to be on a bigger scale in humid tropical areas, and may even prove useless, because for want of cation exchange capacity most of the chemical product is leached with the next fall of tropical rain. It is not only research on chemical fertilizers that is of little significance in a large part of the tropics, but also research leading to the production of improved seeds, which make a positive response to copious doses of chemical fertilizers. The most notable agricultural research effort, known as the green revolution, has doubled the harvests in industrialized countries, and they continue to increase. In tropical countries, on the other hand, the increases obtained when these seeds were used in the areas most appropriate in respect of humidity and cultivation subsequently came almost to a standstill, despite the continuous increases in inputs such as chemical fertilizers and machinery (Weischet, 1981, pp. 11 to 13). The seeds which were at first called "high-yield varieties" and then, more modestly, "improved seeds" ought to be designated —if researchers were disposed to replace their ideological labels

by others of a more technical character— "high-response seeds" (Mooney, 1981, p. 54): highly responsive, that is, to optimum conditions of humidity, soil management and application of chemicals (fertilizer and biocides). The list of optimum conditions for these seeds is a description of the conditions prevailing on the experimental farms of agronomists in temperate zones. Where these conditions are not present, the response of the improved seeds, the product of very costly research, is not nearly so good as that of the local peasants' seeds (Muñoz *et alii*, 1976). When the rainy season is short and precipitation uncertain, when soils are rather shallow and the ground is sloping, it would be irrational for the peasant farmer to use improved seed even if he had the economic capacity to buy the commercial inputs which they require.

Justus von Liebig has already noted that modern crops are less pest-resistant than those fertilized by the traditional methods. Few agronomists are aware of this phenomenon, because of the difficulty of observing it on the relatively small experimental stations where agronomists play at the exact sciences. This general problem becomes more acute in the humid tropics where there is no winter or dry season to keep down pests. In temperate zones insecticides now have to complement the effect of low temperatures, since the natural equilibrium attained in past centuries by the greater heterogeneity of crops, grown in smaller fields, encircled by bushes and hedges, has been destroyed by industrial agriculture. In the humid tropics, to combat the pests attacking the less resistant modern crops, only pesticides would be available; expense apart, experience with respect to the increasing resistance of insects to pesticides of every type suggests that to attempt their use would be to fight a losing battle.

In the humid tropics nature defends itself with the greater heterogeneity of the vegetation and the distance between one plant and another of the same species. On the long journey from one plant to another an insect runs much more risk of falling a prey to its natural enemies. The machinery pertaining to modern agricultural technology, specialized in the expeditious harvesting of large single-crop areas, has not yet an incorporated intelligence —as much modern

industrial machinery has— to enable it to work with heterogeneous crops and thus adapt itself to the requirements of tropical agriculture. The lesser heterogeneity of natural vegetation in temperate zones would seem to suggest that modern single-crop agriculture is more viable there than in the humid tropics. Because of this linkage of modern agriculture with temperate zones, a region that produces forests with a biomass 2.5 times greater than the woods of the temperate zones is regarded by agronomists as so infertile that it can be left at the disposal of stock-farmers and their cows. The characteristics of a specific technology are confused with the characteristics of a zone. Today nobody would say, as the Romans said, that the areas north of the Alps were, generally speaking, infertile because they could not be tilled with the techniques of the Egyptian plough, which in the deforested Mediterranean basin had given good results. But in the humid tropics infertility is still identified with the ecological characteristics of this zone instead of with a technology that is inappropriate for it.

c) *Drawbacks of organic technologies in the humid tropics*

Because of the similarities between the situation of the underdeveloped countries today and that of the industrialized countries prior to the second industrial revolution, the humus theory with its appended technologies seems to present several positive aspects. It offers a whole gamut of technologies, ranging from the capital-intensive to the labour-intensive, and utilizes mainly local materials, which reduces the vulnerability of a region. For a variety of reasons, crops grown under a system of organic agriculture are generally somewhat more dependable, which suits a rural population that has no guarantee of survival and therefore does not aim at maximum average output over the years, with good harvests in the fat years and poor ones in the lean years, but tries to reduce the risk of bad harvests on the basis of small-scale but stable production.

Adequate applications of organic material increase the fauna in the soil, and this degrades the organic material and leads to formation of the humus-clay complex, in which the organic

and the inorganic are closely intermingled. These soils, of a spongy texture, with 50% of additives and 50% of open spaces, a third of which fill up with water, afford optimum conditions for the growth of plants. The high cation exchange capacity of the humus could make up for the low exchange capacity of the tropical clays. This solution has its limitations, however, due to the rapid degradation of humus in conditions of high temperature and humidity. If from 10°C to 20°C decomposition advances slowly, as from 20°C it increases exponentially, and at 30°C proceeds at a rate four times higher than at 20°C. To keep the humus at the same level it would be necessary to apply ten times the amount of organic material required in temperate zones (Weischer, 1977, pp. 14 to 96). Notwithstanding the more abundant production of biomass in the humid tropics, in many cases the application of technologies suggested by the humus theory will at least be more costly than in temperate zones.

Despite their disadvantages in the humid tropics, organic technologies seem of much more interest in underdeveloped countries than chemical technologies. In this connection the incipient switch-over in some industrialized countries towards research on and practice of organic technologies might be useful for tropical agriculture, but it is not a solution. The principal source from which to learn how to create an efficient and durable method of agriculture in tropical conditions would be an analysis in depth of traditional techniques, especially in regions that have been densely populated for centuries. These techniques have demonstrated their long-term viability, and agronomists, after obtaining a grasp of the details, should attempt to do the same thing, but with the full support of a technology which incorporates the latest scientific knowledge. The description of the drawbacks of agricultural theories imported from regions with different ecological and social conditions has mainly served to point out that the scant social utility of the dominating economic theory is not an isolated case: the same thing happens in agronomics and perhaps in many other sciences. Comparison between the economic and agronomic arguments shows that although the metatheoretical structure in both sciences betrays the same deficiencies, the

technical argument in each case is entirely different. Anyone wishing to make the same sort of demonstration in respect of other disciplines,

should abandon general discussion and penetrate into the technical arguments specific to each field.

V

Conclusions

The attempt to explain the establishment of the latest dominant theories in economics and agronomics signifies a rigorous examination of the metatheory propounded, i.e., that the dominant theories in various disciplines reflect the conditions prevailing in the countries where they originated. Nevertheless, it is unlikely to find acceptance, not because it would imply a radical change in ways of thinking, as regards both the specific theories or disciplines and the objective of science in general, but mainly because in science there is none of the instantaneous rationality which withdraws from positions when it sees them to be justly criticized. Lakatos (1974, p. 74) is referring to this when he asserts: "One must understand that even an adversary who appears to be defeated may return to a strong position." Max Planck (1948, p. 22) had already noted that "new scientific truths ... gain acceptance when their opponents are dead".

In some cases the differences between the industrialized countries themselves and between the creators of theories give rise to different theories and classifications and other countries have at least the opportunity to make an

intelligent selection between two or more options, even though none may completely meet their national needs. In disciplines in which not only a theory has been imported, but also the definition of the problem to be resolved and the means of resolving it the phenomenon of underdeveloped but developing science does not—apparently—arise, because the whole corpus has been imported and that in itself is internally coherent; a case in point might be civil engineering. But when an increase in the price of some input makes it necessary to resort to local materials not envisaged in traditional technologies, or when a rise in fuel costs prevents the correction of flows in the architectonic conception by artificial cooling or heating, the prescientific relation between types of knowledge and types of climate, landscape and environment is re-established. Or rather, this specificity of knowledge would be established, always providing that scientists in the country concerned had the intellectual capacity to perceive their country's specificity and the creative capacity to make an effective response with knowledge and technologies.

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The preparation of natural and cultural heritage inventories and accounts

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The present article explores the difficult problem of natural and cultural heritage inventories and accounts. First of all, it defines the concept of overall heritage and then states the aims that these programmes must pursue for the countries of Latin America and the Caribbean. It then suggests some types of nomenclature or classification of heritage.

The study proposes a classification which could serve as a reference for the countries of Latin America and the Caribbean. It explains how to calculate the elements that constitute the heritage and how to situate them in relation to the national information and assessment systems. Because it is difficult to quantify and assess cultural heritage resources, this essay limits itself to an analysis of the natural heritage. The approach used is based on the need to establish three dimensions for assessment: ecological, cultural and economic, on the understanding that very few resources could be classified into all three.

The integration of natural heritage accounts into systems of national accounts is then examined and recommendations are made for the formulation of a comprehensive natural and cultural heritage programme.

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Introduction

For many years now, in almost all the countries of Latin America and the Caribbean, various programmes have been carried out which deal on a partial basis with the protection of the natural and cultural heritage. For the natural heritage, systems of protected areas have been created which are usually made the responsibility of national parks and reservations or institutions for protecting specific resources, such as forestry and fisheries resources. With respect to the cultural heritage, the countries have developed programmes through special institutions such as the National Cultural Heritage Institute of Ecuador, the Historical-Cultural Heritage Commission of Argentina, and agencies responsible for museums and archives, as well as the numerous initiatives taken separately in various institutions, secretariats and ministries.

There is a variety of legislation on the protection of the natural and cultural heritage in the region, focussing above all on the conservation of natural resources (countries such as Colombia and Venezuela have enacted special codes on the subject) and the preservation of historical and architectural monuments.

However, there are no comprehensive programmes for keeping or maintaining inventories of the natural and cultural heritage, nor are there initiatives of any importance for including these aspects into the national accounts although there is increasing concern about the subject, in the face of the depletion of many resources because of the high rates of extraction and the long-standing spoliation of natural resources, the institution of systems of exploitation which are at variance with the rules of medium and long-term resource conservation; the sudden implementation of a method of development which, because it has a strong acculturating effect, tends to despise and therefore neglect the cultural resources of each country; the lack of knowledge about each country's heritage endowment, and the scanty knowledge of the ecological costs to the heritage that development processes entail.

I

Definitions and goals of a natural and cultural heritage programme

Several definitions of the concept of the global heritage have been put forward. The French Interministerial Commission on Natural Heritage Accounts defines it as "that collection of goods that has been bequeathed to us by previous generations and which we must also pass on to future generations without adversely altering the possibilities for its use" (France, 1979, volume I). This definition adheres to the general concept of what should be considered as heritage, but other questions arise as to what is meant by the transmission to future generations "without adversely altering the possibilities for its use". If development is the transformation of the natural environment, into an artificial one, in actual fact, then the possibilities for its future are in fact being altered. For example, the extension of the agricultural frontier is done in a number of ways, based on different systems and technologies, and its consequences obviously alter the possibilities of use of the ecosystems in the future. One form of transformation which has a low ecological cost in the light of the scientific and technological know-how existing at a given moment in history may have serious consequences for the future if, because of a new scientific or technological invention discovery, the ecological cost takes on a new and different value. Whatever definition is used for the concept of the possibilities of future use will come up against this problem.

A more general definition is that adopted by the Australian Heritage Commission (1982) which defines the natural heritage in broad terms as "those places which are components of the natural environment of Australia or the cultural environment that have aesthetic, historic, scientific, or social significance or other special value for future generations as well as for the present community". The heritage is classified into three main groups: the natural environment, the national aboriginal heritage and the built environment. The "built environment" is associated with historical

constructions of European origin (residential, religious, commercial or industrial buildings) and the national aboriginal heritage includes places of importance to the indigenous traditional culture. These two aspects, built or aboriginal, together constitute what may be called "the cultural heritage".

The definition proposed here for the concept of heritage is: that set of goods which has been bequeathed to us by previous generations and which it is our responsibility to conserve in their fundamental attributes or to transform in a suitable manner so that they may be passed on to future generations. Obviously "to transform in a suitable manner" is a relative concept which depends on the idea held at a particular time of the projected use of specific goods.

The heritage is not synonymous with a set of public goods but with a set of goods for community use, many of which may be in the private domain. The State must lay down rules and regulations for the social function of the heritage, either by regulating private use in terms of use by the community or by expropriating goods when the community's needs so require.

Some currents of thought tend to identify the heritage with goods that cannot be evaluated in economic terms. Although many heritage goods do not enter into the economic circuit there are in fact many that do. Consequently, heritage goods are classified as such, not on the basis of the type of ownership or of their incorporation into the economic circuit but in terms of a social function or purpose which is of importance to several generations.

The countries that have established natural and cultural heritage programmes have done so with different aims in view: some are directed towards learning about the goods, others towards their management or (in some cases) the preparation of heritage accounts, or simply towards protecting and preserving those

resources. The United States National Heritage Program, which was established in 1977, aims at identifying, protecting and where necessary, acquiring national heritage resources and co-ordinating Federal programmes. In France a report of the Interministerial Commission was expressly requested for the establishment of a system of natural heritage accounts. In Norway, the accounts have concentrated on fishery resources, energy and land use. In Australia, the aim has been to establish a register of places of interest, using scientific, aesthetic and socio-cultural criteria. In this case, the built environment is also included. Definitions of the natural and cultural heritage are, therefore, contingent in each case on the objectives pursued by the various national programmes.

In the countries of Latin America and the Caribbean, the aims must be geared to the dynamic situation prevailing there as regards changes in natural resources and their loss and over-exploitation. For the cultural heritage programmes, the aims must be to counteract the under-valuation of pre-Columbian and creole cultures and the imposition of foreign values which tend to reinforce this under-valuation.

The main obstacle to defining the natural heritage is the difficulty of setting the limit between what is natural and what is man-made. The artificialization to which nature is subjected in the development process is a continuum which spans the whole spectrum from minimum to maximum. It is necessary, therefore, arbitrarily to fix a point in this continuum as a demarcation line between the natural and the non-natural. In Latin America, this difficulty is made worse by the accelerated and virtually unchecked transformation of virgin or almost virgin ecosystems until very soon they have to be reclassified as artificial.

The natural heritage should include the natural goods which have undergone no changes or which have been artificialized to such a slight degree that their natural behaviour has not been changed in any significant way. To these must be added the "naturalized" goods which help to maintain the attributes of specific resources such as soil and water. These are man-made goods of

historic interest, bequeathed from generation to generation, such as land development works: terraces, drainage systems and even old country roads.

The cultural heritage would be composed of inherited goods, places of historic and pre-historic interest, points of contact between aboriginal and foreign cultures, pre-Columbian, colonial and post-colonial art, buildings and houses of historical or architectural interest, ancient industrial, mining and commercial installations, means of transport and typical villages.

Within the framework of these definitions, and on the basis of certain features which are common to the Latin American countries, the programmes on the determination of the natural and cultural heritage should be oriented towards:

a) Acquiring knowledge both of resources and systems so as to apply them in the definition of development options and in creating an awareness of how the state of resources changes according to the use that society makes of them;

b) Regulating property rights by incorporating legal instruments which take into account the social purpose that these resources fulfill, their long-term projections and, for many goods, their use to the community as a non-economic good. These instruments will include the drafting of new regulations, giving public agencies supervisory and punitive powers. Legal instruments which strengthen the State's authority to acquire heritage resources deserve special mention;

c) Establishing a system of inventories and accounts of the natural and cultural heritage in order to determine, periodically, the changes that have taken place and to ensure that the problems of heritage are taken into account in development planning, above all in the exercises aimed at harmonizing short-term with medium and long-term planning processes;

d) Disseminating information about the main problems of deterioration of natural and cultural resources and trying to ensure that the relevant registers and accounts form part of educational systems and reach the domain of public opinion.

II

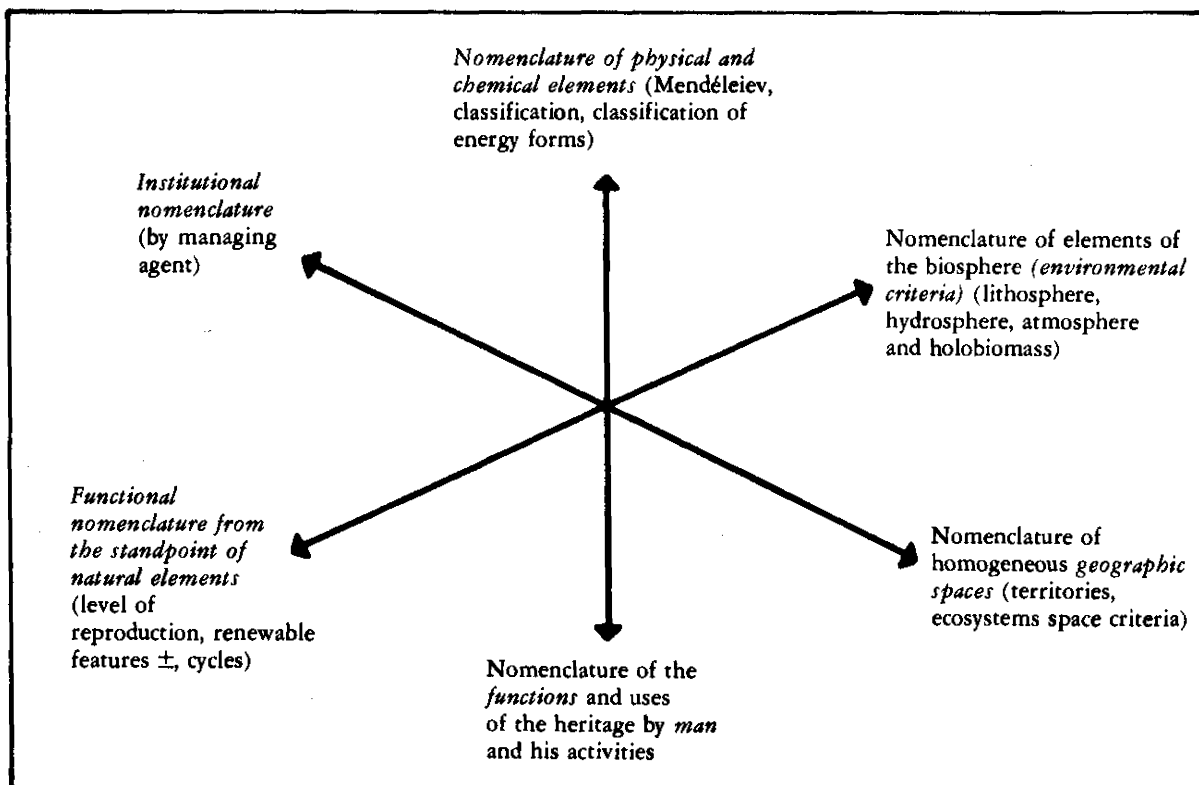
Classification of the natural and cultural heritage

On the basis of the definition of the natural and cultural heritage and its objectives, it is possible to arrive at a classification well adapted to concepts which are appropriate for each country. The programmes currently in operation give an idea of how some countries have developed these classifications. In the United States, the classic division was made between the natural and cultural heritage. As the objectives were, essentially, conservationist, in the breakdown of the natural heritage importance was given to ecological and geological resources, while landscapes and wilderness areas were also highlighted. With respect to the cultural heritage, not only was there an attempt to protect places and constructions of interest, such as archeological sites and buildings of historical or artistic value, but also arts and crafts (annex I).

The Australian register is based on criteria for determining which places or constructions are of interest. A national register of places was set up to determine their level of preservation and to formulate the relevant policies. Each criterion is explained by means of examples of places or constructions. In the division made by the Australian Heritage Commission into natural heritage, built environment and national aboriginal heritage (these last two fall under cultural heritage), scientific, aesthetic, historical and social criteria were given particular weight (annex II).

In trying to develop their nomenclature, the French authorities, as shown in figure I, summarized the six main options (France, 1979, Volume III). An analysis of these options showed the need to establish a single nomenclature which would encompass the most

Figure 1



essential dimensions, linking them with the concepts set forth in the system of accounts (annex III).

In the three examples given in the annex, several approaches and levels are suggested for the classification and grouping of these goods which make up the natural and cultural heritage.

Legal institutions and regulations governing specific aspects of the natural and cultural patrimony have existed in all the Latin American and Caribbean countries for many years. Furthermore, some of the goods in the natural heritage have been investigated by special agencies, either sectoral (energy, mining, agriculture, forestry) or comprehensive. The natural and cultural heritage programmes must not duplicate those functions, but should integrate and supplement them. For example, the mining sectoral agencies usually study specific mining resources, leaving aside those that have no current economic value. What is needed now, is to supplement the information already gathered with what now needs to be acquired in order to complete the knowledge of the heritage.

The preparation of a register or a system of accounts for the cultural heritage should be based on a series of definitions and decisions which will depend on the objectives pursued. To this end, it is proposed to explore the functioning of a classification based on two levels of analysis. It is suggested that at the first (general) level the distribution of the main biomes¹ should be defined, in order to understand their interaction with the ecosystem or the reaction of specific natural attributes if they are subjected to a high degree of artificialization. At this level, one can readily determine how far one particular biome rather than another constitutes "a natural heritage" and which physical and functional resources have an impact on their assessment. The French call this concept "geographical space".

At the general level, it is necessary to include "naturalized" resources, which, although they involve a high degree of artificialization, are considered part of the natural heritage because

they are incorporated into a natural resource and enhance it.

At another level, the elements of the biosphere would be combined with their function from the point of view of the natural elements, so as to simplify the nomenclature as much as possible.

The classifications may be broken down to the level of physical and chemical elements, but it is recommended that the line should be drawn at the ordinary resources which enter into the economic circuit, such as minerals and species of flora and fauna.

With respect to the cultural heritage, this classification is to be recommended because the determination of places facilitates action on the resources which form part of this heritage and which are to be protected. In addition to its practical advantages, the system makes it possible to include everything that the countries have already established, such as laws and regulations governing protected areas, national monuments and buildings of architectural interest.

The identification of places should not prevent the inclusion in the cultural heritage of a number of activities such as folk music, which are not localized but are carried out throughout the whole country or an entire region.

On the basis of the foregoing, a proposed classification of the natural and cultural heritage is set out below which could be useful for the countries of Latin America and the Caribbean.

1. *Natural heritage*

1.1 *Global level*

1.1.1 *Main biomes*

1.1.1.1 *Deciduous forest ecosystem*

1.1.1.2 *Tundra ecosystem*

1.1.1.3 *Cold steppe ecosystem*

1.1.1.4 *Warm savanna ecosystem*

1.1.1.n

1.1.2 *'Naturalized' transformations*

1.1.2.1 *Irrigated agrosystems*

1.1.2.2 *Canal and drainage infrastructure*

1.1.2.3 *Terraced areas*

¹A biome is a system composed of biotic and abiotic components, each of which characteristically corresponds to a typical physiognomical or functional model (definition by Gast6, 1979).

- 1.2 *Specific level*
- 1.2.1 Climate
 - 1.2.1.1 Rainfall
 - 1.2.1.2 Temperature
 - 1.2.1.3 Relative humidity
 - 1.2.1.4 Wind
 - ||
 - ||
 - 1.2.1.n
 - 1.2.2 Solar radiation
 - 1.2.3 Continental water resources
 - 1.2.3.1 Rivers
 - 1.2.3.2 Lakes, lagoons
 - 1.2.3.3 Ground water
 - 1.2.3.4 Mangrove swamps
 - 1.2.3.5 Glaciers
 - 1.2.3.6 Snow
 - 1.2.4 Geological resources
 - 1.2.5 Geomorphological resources
 - 1.2.6 Soils
 - 1.2.7 Mineral resources
 - 1.2.7.1 Iron
 - 1.2.7.2 Copper
 - 1.2.7.3 Aluminium
 - ||
 - ||
 - 1.2.7.n
 - 1.2.8 Biotic resources
 - 1.2.8.1 Genetic heritage
 - 1.2.8.2 Terrestrial and aquatic flora
 - 1.2.8.3 Terrestrial fauna
 - 1.2.8.4 Aquatic fauna in inland continental waters
 - 1.2.8.5 Amphibious fauna
 - 1.2.8.6 Marine flora and fauna
 - 1.2.9 Marine resources
 - 1.2.9.1 The coastal sea
 - 1.2.9.2 The sea over the continental shelf
 - 1.2.9.3 Areas of special interest
 - 1.2.10 Energy resources
 - 1.2.10.1 Hydrocarbons
 - 1.2.10.2 Coal
 - 1.2.10.3 Hydroelectricity
 - 1.2.10.4 Biomass
 - 1.2.10.5 Wind energy
 - 1.2.10.6 Solar energy
 - 1.2.10.7 Nuclear energy
 - 1.2.11 The landscape
2. *Cultural heritage*
- 2.1 The archaeological heritage
 - 2.2 Buildings, constructions and gardens of aesthetic, historical or technological interest (churches, palaces, old public buildings, bridges, dams, mines)
 - 2.3 Arts and crafts
 - 2.4 Landscapes of aesthetic or historical interest
 - 2.5 Built environment showing lifestyles, customs, procedures and functions which are no longer in use or in danger of extinction (small villages, fortifications, mills or presses)
 - 2.6 Notable objects and collections
 - 2.7 Notable urban centres
- After the classification of natural and cultural heritage has been established and its components have been defined, consideration may be given to their enumeration and incorporation into the national information and evaluation systems.
- The characteristics of the cultural heritage make physical and economic quantification very difficult. In some cases, such as important collections and objects, works of art and constructions of architectural value they may have a market value, but as these cases are exceptional, the cultural heritage is normally confined to a description of places, constructions, goods or activities that are difficult to quantify but can be described in detail.
- Quantification of heritage goods would thus be confined to natural resources.

III

Heritage accounts in systems of national accounts

1. *Evaluation and accounts*

Because of the wealth of information and evaluations produced on natural resources, that are frequently duplicated or covered three times over, some experts believe that it is superfluous to develop an accounts system for natural and cultural resources. This point of view stems from a confusion between what the current information, prospection and evaluation systems are and what natural resource accounts should be.

When prospection and evaluation of natural resources is carried out, the concept of stocks is used and in this way information is provided, for example, on mineral resources, flora and the soil. Evaluations are usually confined to exploring the use potential. For example, soil evaluations are determined on the basis of suitability for use and current use, in order to determine the productive potential in terms of a specific technology and different levels of capitalization.

In Latin America, it is common to repeat evaluations periodically in order to determine how stocks have been evolving. So far, it cannot be said that these repeated evaluations have been done as frequently as is necessary in order to keep a close check. They are still photographs of different periods which on many occasions cannot even be compared with each other because of methodological problems (different scales and different remote sensors), while they cannot explain the balances of resources, either. They do give an approximate idea of the fluctuations in stocks, however.

The purpose of the accounts is to measure, with a given frequency, the flows associated with variations in stocks, so that the dynamic evolution of the heritage can be traced. This relation between flows and stocks may well appear to resemble the traditional assessments in the case of non-renewable resources, but the relation is much more complex in the case of renewable resources because of the deterioration and natural renewal that they undergo.

In a programme of heritage accounts, other indicators which will enhance their interpretation should be considered, such as assessment of the levels of disturbance or deterioration (for example, dumping of waste in water).

2. *The proper place of natural and cultural heritage accounts programmes*

There is much uncertainty regarding the incorporation of natural and cultural heritage accounts programmes into a system of national accounts. There are no structured and explicit systems of environmental and heritage accounting in any of the countries of the region. What we find instead is information on the environment included in the different information systems (ECLAC, 1980 and United Nations, 1980). The primary sources of natural resource information and evaluations are the different sectors of the economy and the sectors which obviously contribute the most are agriculture, mining and fishing. In some countries, information on natural resources is also generated in the industrial sector, to the extent that this sector maintains a close check on its inputs.

In addition, there are national, State, provincial or departmental agencies which are directly responsible for making surveys and assessments of natural resources and other agencies which are responsible for planning and need surveys and assessments of this heritage for this purpose.

A natural and cultural heritage programme must be intersectoral and must be located at a level which makes it possible to integrate the information provided by each sector. It must also be in a position to transmit its data to planning organizations and to those responsible for national accounts. This would mean that it should presumably be at a higher level than sectoral statistics and should even be at the level of more comprehensive information, such as

environmental statistics, studies on the status of the environment, the compilation of economic and environmental data and regional environment plans.

Its location will, of course, depend on the institutional organization of each country. In any

event, from the intermediate level recommended, the accounts must be channelled to higher levels like the macroeconomic models and the national accounts. It is particularly important to include the natural heritage accounts in long-term planning models.

IV

Criteria for preparing the accounts

1. *Three-dimensional orientation and criteria*

Concern over the deterioration of natural resources in Latin America has led to a series of initiatives aimed at creating an awareness of the dangers which threaten the natural heritage. Studies have been carried out on the general condition of the environment, as well as more specific studies on a particular endangered resource (for example, natural forests or soil erosion). Many of these studies include physical and in some cases economic quantifications.

On the whole, these initiatives have not been as successful as hoped, because they were not given the proper weight at the levels of global planning and executive management. This is due mainly to the fact that the "environmentalist sector" has presented its assessment and accounts in isolation, with the sole aim of warning about the deterioration of resources during the development process. The agencies responsible for planning development have not deemed it necessary to adopt a position which does not provide immediate help in tackling day-to-day problems.

Accordingly, the first duty is to define clearly the objectives that should be pursued in preparing heritage accounts. The heritage accounting must, first and foremost, be a tool to assist in development planning. This is done by periodically updating information on the availability and quality of heritage resources, their potential and the use made of them in the ecosystem. Since development is an integral

concept, the assessments must focus not only on physical and environmental resources but also, where possible, on cultural ones too.

Some authors contend that the purpose of preparing heritage accounts is to incorporate them into the national accounts. While this is important, such an approach could give the accounting a monetary bias which would mean setting a price on all heritage elements, thus leading to the omission of that part of the natural and cultural heritage which cannot be assessed in these terms (Farnworth and others, 1981). Multi-dimensional criteria are preferable, though monetary accounting should be done whenever possible. The right perception of the evolution of the heritage resources will make it possible to plan in such a way that the short-, medium- and long-term views are reconciled: a fundamental problem in incorporating the environmental dimension into development planning.

If the most important purpose of heritage accounts is their incorporation into the development planning process, it will be necessary to establish the links between natural resources, the economic system and socio-cultural aspects, and for this, they must be analysed in terms of these three dimensions. As there is no common denominator linking these three aspects, the heritage resources must be evaluated from three angles and an attempt made to establish the respective links. In other words, the same resource must, if necessary, be reassessed two or three times. Thus, for example, a forest may be evaluated ecologically,

as biomass; economically, in cubic metres of wood, and socio-culturally in hectares for recreational purposes, and the three assessments must all be interwoven. Hence, for example, any changes involving the exploitation of different tree species alter the ecological behaviour of the forest and affect its aesthetic aspect as regards its use for recreational purposes.

As a result, as suggested in the study by the Interministerial Commission on Heritage Accounts of France, there would be three basic areas in which to draw up accounts which must perforce be interrelated in order to give resources multi-dimensional treatment: nature, the economy and man.

If the sole aim of natural heritage accounts was to incorporate them into national accounts, it would be sufficient to link the sphere of nature with the economy by seeking to assign to the natural resource some monetary value. There are cases in which the link between these spheres is reduced to a statement of accounts on the exploitation of natural resources and the problem of evaluation is evaded, as is done by the Statistical Office of the European Community.

In the Australian report, the programme is confined to a register and a qualitative description of places and the man-made environment. In this case, the natural heritage is limited to the spheres of nature, culture and man, and only weak links are established between these.

In the United States, the sphere of nature is almost the only aspect dealt with.

2. Balances of exploitation of the natural heritage

Once the units of measurement for the three dimensions indicated above have been defined, it is possible to draw up natural heritage accounts. The difficulties inherent in quantifying the cultural heritage mean that inventories or registries are its only form of evaluation, so that the following considerations as to how the accounts are to be drawn up will refer solely to the natural heritage.

It is easy to keep physical accounts of non-renewable natural resources. In the first place it is necessary to determine the different types of reserves or resources, and here various forms of

classification are possible. The problem lies in the degree of inaccuracy involved in assessing reserves which are not exploited. In Latin America it is common to find that the information is either very limited or very inaccurate because prospection is currently carried in a very general way. Much information is maintained and handled confidentially by national or foreign enterprises.

Much effort has been made to discover and assess some resources. Specialized departments of mining ministries or special bodies such as geological and mining research institutes have made great strides forward in this respect in recent years, either because of the importance of a resource as a foreign exchange earner (copper in Peru and Chile), or because of the energy problem and the subsequent importance of oil prospecting.

As a rule, countries keep overall checks on production and consumption, so that they can deduce how long the reserves will last. The most usual ways of keeping checks on production, consumption and mineral reserves are set forth in annex IV.

Keeping accounts on renewable natural resources is much more complex. In natural ecosystems, the reserves can be modified naturally. If an ecosystem has not reached its peak, it tends to expand until some limiting factor acts upon it (law of the minimum).² Furthermore, stocks may decline when climatic or geographical conditions have changed and the optimum conditions for the peak do not exist. In this case, there is a natural backward process which can easily be speeded up by human action. The "qualitative" changes in stocks in the processes described above are very difficult to quantify.

In the systems, which have been subject to human intervention, the problems of renewable natural resources are compounded by the fluctuations which the development process creates. This is the case with forestry plantations, for example, that can grow or diminish depending on the balance between planting and exploitation.

²This law stipulates that, regardless of the endowment of resources, a biological system will always halt its growth under the impact of the most limiting resource.

Special attention should be given to changes caused in natural ecosystems through processes which apparently do not affect their conservation capacity. There are some who use the argument of general parameters of resilience and maintain that nature produces and restores the original ecosystem. For example, there is talk of the healing capacity of the humid tropics because of their high resilience. In that context, there is a tendency to believe that secondary jungle, or the altered jungles, have the same value as the original ones. Although it is true that its high resilience gives the humid tropical region a greater power of recovery, it has been proven that the original ecosystem does not necessarily reproduce itself. The time-lags between the optimum climatic conditions and the actual climate and geology and above all the ease of entry of new invading species—many of them aggressive—mean that many interventions, however slight they may be, damage the ecosystem.

There is no gainsaying that the quantification of the changes must be backed by scientific studies or by estimates based on these. In this way, the balance set out in table 1 could be drawn up for each resource, whether renewable or non-renewable. This table must be accompanied by complementary studies which determine the vulnerability, risks, irreversibility and other qualitative aspects in a scientifically indisputable manner. Furthermore, it would be very useful to show the links between a given resource and others and its role in a specific ecosystem. Thus, for example, the decline of one species of forest fauna has repercussions on the food chain of the ecosystem to which it belongs.

3. *The three dimensions of the balances*

There are resources which may be evaluated according to ecological, economic and socio-cultural criteria: i.e., according to all three of the

Table 1

MAIN LINKS BETWEEN STOCKS AND FLOWS WHICH AFFECT THE NATURAL HERITAGE

Resources	Uses
1. Stocks at the beginning of the period	
2. Increase in reserves	3. Reduction in reserves through a change in estimate of known reserves
a) Through a change in the estimate of the known reserves	
b) Through the discovery of new reserves	
4. Gross natural increase	5. Natural decline:
a) Natural growth of initial stocks (growth of the forest)	— Through spontaneous normal processes
b) Natural growth through reproduction (increase in a particular animal species)	— Through natural catastrophies
6. Increase through better technological development (construction of drainage works)	7. Reduction through use or exploitation
	a) National use
	b) Exportation
8. Imports	9. Reduction through other causes
	— Pollution
	— Different use (urbanized agricultural land)
	10. Adjustment (+ or -)
	11. Stocks at the end of the period

Source: France (1979), p. 26.

dimensions established. Others may be evaluated according to a combination of two or using only one criterion. Specific evaluation methodologies may cause a resource which is usually evaluated in one or two dimensions to have another added. It is recommended that evaluations should be selected that do not require a very complex or controversial methodology.

Mining resources can be assessed fairly easily according to physical/ecological and economic criteria. All three approaches can be used for both water and forestry resources.

Because of the great impact which it has in Latin America, the natural forest deserves special analysis. For the physical and ecological analysis, a suitable unit of assessment is the biomass of the type of forest in question, measured in kilogrammes per hectare. In this type of analysis it is very desirable to assess the vulnerability and extent of deterioration, as these concepts will help in the definition of the necessary policies. In addition, the forest must be analysed as a regulator of the water system and the climate and also as a protector of the fauna, although all these factors are very difficult to quantify. These evaluations may be included as a

supplement to the accounts in order to define the condition of the forest.

The economic assessment must be made on a physical and ecological basis. Since not all of the forest is an economic good, what is usually done is to quantify the stands in the forest that may be converted into timber, and then place a value on them. The distinction between stocks and flows is important here, because their analysis makes it possible to deduce the levels of over-exploitation and even under-exploitation (over-mature species). The current unit is the cubic metre per species and type of wood. The forest not only produces wood but also provides grazing for cattle, medicinal plants and wild fruits which must also be included in the calculation.

The socio-cultural assessment must be carried out in terms of what the forest represents for the population: for example, whether it is an area of educational, recreational or aesthetic interest. In this case the unit of measurement should be simply the surface area. Tables of visual sensitivity can also be made and classified according to their impact on the population. The method used in this case is that of carrying out surveys among the users of the forest.

V

The integration of natural heritage accounts into systems of national accounts

The incorporation of heritage accounts into systems of national accounts is of fundamental importance for the integration of the concept of the environment in development planning. National economic policy is based on the systems of national accounts: the inclusion of natural heritage assessment will therefore represent a decisive step towards the effective incorporation of the environmental dimension into planning, remembering, of course, that systems of national accounts are merely indicators of the rate of growth of goods and services and not of the well-being of the population (Huetting, 1984).

Many heritage goods fall outside the economic area of national accounting systems, while others fall within an area which covers both these accounts and the natural heritage. As Sejenovich and Sourrouille (1980) point out: "... the measurement of the costs of environmental protection and of the control of the discharge of pollutants (if there is agreement on the scope of the concepts) is included, in so far as it involves a cash outlay, in the national accounts".

What is important in this situation is that many of the natural heritage goods which are not included in the common area are directly related

with the well-being of the population. Only exceptionally can their shadow prices and the demand curve of their environmental functions be calculated (Huetting, 1980).

Accordingly, the main focus should be on expanding and completing the common area so that many heritage goods may be assessed and incorporated into the systems of national accounts. The use of some other goods, such as the atmosphere, which are considered "free goods", cannot be defined as an economic activity.

If no indicators of exhaustion or deterioration are included in the accounting of the production process, the assessment will be distorted. If, in fact, one good is produced at the expense of another environmental good or part of that good and if the cost cannot be evaluated, it is impossible to calculate a fair shadow price for the good in question (Theys, 1984).

The usual method of accounting imputes only the amortization of tangible reproduceable assets or permanent goods and not natural heritage goods, even if the latter can be evaluated economically (Sejenovich and Sourrouille, 1980).

There would be two solutions, which are not mutually exclusive but complementary. The first would be to make an economic evaluation of the

natural heritage goods and include it in the amortizations of tangible assets. The second would be to reconcile current registers of flows with heritage changes. This would involve maintaining parallel accounts for goods that are reproduceable (in an economic sense) and for heritage goods. The first account would be the current account, where initial stocks are added to the gross capital formation of the period and the amortizations are subtracted from them. As explained in the previous section the second would be a reconciliation in which the flows and stocks are physically related.

Establishing a link between systems of national accounts and systems of registers and accounts of the natural heritage would serve as an instrument for incorporating the environmental dimension into development planning, in so far as the environmental element continues to pivot upon economic policy. A different concept of development which calls for integrated planning in which the central purpose is to further the welfare of the population and ultimately of its environment and where economic policy is only a tool for achieving these ends will require a change in this strategy and the effort described above will not be needed, since the environment will be implicit in all development decisions.

VI

Recommendations for a natural and cultural heritage programme

In order to implement a programme for preparing inventories and accounts of the natural and cultural heritage, it will be necessary to define some fundamental stages and then to assess the various options for their institutionalization in the public sector.

1. *Proposed stages*

During the first stage, it will be necessary to define the national objectives pursued by the natural and cultural heritage programme and to formulate the relevant classification. During the

second stage, a national register of statistical inventories and other background information on natural and cultural heritage goods will have to be prepared. This register must include the following for each inventory: a) the title; b) its definition: whether it is a programme, a project or an institutional function; c) the institutional author; d) the geographical area to be covered, if the whole country is not included; e) levels of information; f) date of the last publication and frequency of issue.

Once the situation as regards the different natural and cultural patrimony goods is known the legal statutes governing them must also be ascertained, since in the countries of Latin America and the Caribbean there are a large number of regulations governing protected areas, national monuments, buildings of architectural interest and other goods. The effectiveness of these regulations must also be determined, since many of them are just a dead letter in practice.

The specific proposal must make it possible to formulate the programme for a register and accounts of the natural and cultural heritage. The general register must define the necessary complementary information. Once the general register has been prepared, a system of accounts specifically dealing with the natural heritage can then be elaborated.

It is recommended that the design of the system should not be general during its early stages, but that specific heritage should be selected according to the following criteria: a) importance in generating the national product (copper); b) importance in generating foreign exchange (tin); c) impact on employment of labour (water and irrigated land); d) extent of deterioration (soil erosion);

e) high ecological cost in the development process (native forests); f) strategic function (oil).

2. Institutions through which the programme is to function

There are many options open for the implementation of a programme of this kind, but it is important that it be given the right status in the public administration. It must be located above the sectoral levels, and this can be achieved by placing it in the central planning agency or as a direct branch of the executive or by appointing a special interministerial commission.

During the diagnostic phase, national natural resource agencies may be made responsible for the programme, if such agencies exist in the public administration (as for example the Ministry of the Environment and Renewable Natural Resources of Venezuela, the Special Secretariat for the Environment in Brazil, the National Office for Natural Resource Assessment in Peru and the National Natural Resources Assessment Institute of Chile).

Environmental agencies located in any sector or ministry can carry out this function, but to do this they need special intersectoral powers which are very difficult to institutionalize. This is the case of the National Institute for Natural Resources and the Environment of Colombia, the Secretariat of Housing and Environmental Organization of Argentina and the Subsecretariat of the Environment of Ecuador.

A sectoral agency should be responsible for running the programme. The enactment of a law stipulating the institutional mandates involved would give the programme the necessary force to make it effective.

Annex I

AREAS OF WORK OF THE UNITED STATES NATIONAL HERITAGE PROGRAM^a

1. Natural heritage

- a) Ecological resources
- b) Geological resources

- c) Landscape (aesthetic value)
- d) Unspoilt natural sites

2. Cultural heritage

- a) Archaeological heritage
- b) Architectural heritage and notable urban centres

^aTaken from France (1979), Volume III, p. 7.

- | | |
|---|--|
| c) Zones and landscapes of historical and cultural interest | e) Notable objects and collections |
| d) Arts and crafts | f) Popular traditional cultures (folklife) |
| | g) Contemporary culture |

Annex II

CRITERIA FOR ESTABLISHING THE REGISTER OF THE NATIONAL ESTATE OF AUSTRALIA^a

I. *Criteria for natural areas*

1. *Scientific*

- a) Representative of diverse ecosystems, land forms or features
- b) Habitats of endangered flora or fauna species
- c) Rare/outstanding ecosystems or land forms
- d) Fragile areas, vulnerable to impacts of man-made or natural disturbances
- e) Places of interest for the study of botanical, geological or geomorphological evolution

2. *Aesthetic*

- f) Outstanding natural or man-influenced landscapes

3. *Historic*

- g) Natural areas associated with early botanists or explorers or with significant scientific discoveries

4. *Social*

- h) Recreation and tourist values
- i) Educational value for the teaching of natural sciences

II. *Criteria for the built environment*

- a) Buildings representative of a great creative or technical accomplishment
- b) Demonstration of a way of life, custom, process or function no longer practised, in danger of being lost or of exceptional interest
- c) Strong association with an important figure or figures, development or cultural phase
- d) Outstanding urban or rural landscapes

III. *National aborigine estates*

- a) Scientific sites, places which have a potential for science or the study of pre-history or which have figured prominently in research
- b) Sites involving creative activities such as painting, ceramics, carved trees, etc.
- c) Contact sites relating to the history of contact between aborigines and Europeans, such as mission stations, massacre sites, etc.
- d) Traditional sites significant to aborigine people but not necessarily to the rest of the population (these are also termed living sites, mythological sites or sacred sites).

^aTaken from the Australian Heritage Commission (1982), pp. 37, 38 and 98.

Annex III

PROVISIONAL NOMENCLATURE OF THE NATURAL HERITAGE (FRANCE)^a

I. *Continental waters*

- 1.1 Lakes, lagoons
- 1.2 Salt marshes, wetlands

1.3 Estuaries

- 1.4 Rivers, surface waters, waterfalls
- 1.5 Water tables and underground waters
- 1.6 Glaciers and snows

^aTaken from France (1979), Vol. I.

- 2. *The sea*
 - 2.1 Continental shelf
 - 2.2 Seabed
 - 2.3 Sea water
 - 2.4 Areas suitable for marine and shellfish farming
- 3. *Atmosphere*
 - 3.1 Air
 - 3.2 Solar radiation
- 4. *Soil and subsoil*
 - 4.1 Natural non-built places. These include coastal and mountain areas
 - 4.2 Plant soil, humus
 - 4.3 Geological substratum, rocks, stripped soils
 - 4.4 Mineral resources (including sand and stone quarries)
- 4.5 Ancient rural improvement works (hed- ges, thickets, embankments, footpaths, etc.)
- 4.6 Landscapes
- 5. *Biotic elements*
 - 5.1 Genetic heritage of wild and domestic species
 - 5.2 Population of species
 - 5.3 Flora and plant species
 - 5.4 Wild aquatic fauna
 - 5.5 Wild land fauna
 - 5.6 Main biomasses
 - 561 Woods
 - 562 Meadowlands and mountain pastures
 - 563 Heaths and uncultivated places
 - 5.7 Unusual or isolated ecosystems

Annex IV

MINERAL CONTROL

1. *Reserves*
(10^x tons)

Proven	Probable	Possible

3. *Consumption*
(10^x tons)

National production		
+ Imports		
- Exports		
Availability for consumption		
± Δ Linking stocks		
Real consumption		

2. *Production*
(10^x tons)

Production (base year)	
Recycling (base year)	
Production + recycling (base year)	
Present annual production	
Present annual recycling	
Present production + recycling	

4. *Relations*

- a) *Production*
Reserve
- b) *Present annual production + recycling*
Production + recycling (base year)
- c) *Recycling*
Total production
Etc.

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Co-operativism and popular participation: new considerations regarding an old subject

*Roberto P. Guimarães**

As a result of the trend towards the replacement of military régimes by democratic governments, growing interest in the subject of popular participation is to be observed in various countries of the region. One of the aspects of this subject that should be considered is the importance of co-operatives as an organizational model for the production of goods and services which emphasizes the concepts of "popular participation", "self-management" and "co-management".

Taking the persistence and expansion of co-operatives in virtually all the Latin American countries as his starting point, the author first reviews the main issues which figured in the debate on co-operativism during the past decade, and then goes on to propose new methodological bases for an in-depth analysis of the subject. To this end, he discusses the relationships between co-operativism, popular participation, alternative development styles and democracy; the possibility that a "new" type of co-operativism may act as an important social agent in coming years; the specific features of co-operativism in the Latin American context; and, finally, the need to determine the geo-economic, cultural, social and political spheres in which co-operatives function.

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I

Introduction

If any one feature can be said to characterize the present situation, it is uncertainty —uncertainty in respect of development theory and uncertainty about the means of overcoming the severe economic, social and political crisis affecting all the countries of the region, regardless of their political forms of government, their initial levels of growth and the development styles or strategies they have adopted.

Especially since the 1960s, the debate concerning development has focused attention on the social and human aspects of this process. Development theory has evolved from a concept based almost exclusively on economic growth into the "unified approach" and the "integral development" proposed by the United Nations, in which the central idea is that development should be subordinated to human values, especially those of well-being and social justice.

Latin America's experience during the past thirty years, however, has only increased the uncertainty felt by politicians and experts. The data and analyses that are available for the period 1950-1980 (see, in particular, Rama and Faletto, 1985) reflect a region which is highly dynamic in economic terms, but, nonetheless, one in which this dynamism has failed to give rise to significant qualitative changes in the well-being of the population or in society's distribution of the benefits of growth.

The prevailing economic uncertainty has been compounded by political uncertainty inasmuch as what appears to be the end of an era of military régimes is occurring at a time when authoritarian, neo-liberal, developmentalist, reformist and revolutionary options are also losing their sway.¹

In short, if it was previously acknowledged that growth was necessary but not sufficient for a socially just type of development, today it must

¹For an analysis of the current shift away from military régimes and the viability of democratic or "social-democratic" alternatives, see Wolfe (1984b).

be realized that the prospects of very low or even negative growth rates pose an even greater challenge to efforts being made to build democracy in the countries of Latin America and the Caribbean, as well as to proposals for an alternative development in which popular participation would play a central role.

The ideals of liberty, social justice and equity have taken on renewed importance. However, these ideals must not be treated merely as abstract concepts to be used in establishing vague relationships in the frequently normative analyses of the possibilities for democracy in the countries of the region, for a society can only declare itself to be free and democratic if it enables these ideals to be put into practice by the institutions that regulate the lives of its citizens.

In view of the above, at some point during the discussion of alternative styles an assessment should be undertaken of the role to be played by a specific form of organizing the production of goods and services —namely, co-operatives— in the creation of a democratic development style in which concepts such as "popular participation", "self-management" and "co-management" are put to the test. The assessment of forms of association and their potential for promoting popular participation is of particular importance at a time of crisis like the present, because it provides a means of ascertaining what conditions do or do not lend validity to the hypothesis that "under conditions of scarcity, all forms of organization contain seeds of exclusion and discrimination, even if they profess egalitarian ideologies" (Wolfe, 1984a).

The acknowledged importance of the subject should not, however, feed false hopes about the possibility of collecting enough objective information (or, at least, a sufficient amount of data that is not overly laden with value

judgements) to form an accurate picture of the present status of co-operativism in Latin America and the Caribbean and to serve as a basis for proposing alternative government policies for the sector.

The controversy concerning co-operativism has become so ideologically charged during the past few decades, and co-operatives have been denigrated to such an extent (both by the left, which sees them as tools for manipulating groups that have been excluded from society, and by the right, which regards them as the hidden seed of communist subversion), that it is becoming increasingly difficult to distinguish facts from propaganda or to tell the difference between research results and what the opponents or apologists of co-operativism would like us to believe.

The following sections, which were developed as part of a project carried out by the Social Development Division of ECLAC,² review the recent trends and present features of co-operativism in the region and offer some conceptual and methodological guidelines for the in-depth exploration of a subject which is awakening renewed interest in many countries.

The following analysis is marked by an awareness of the fact that a course must be steered between the two conflicting extremes of apology and criticism, and that both humility and prudence will be required if we are to skirt the danger of creating a new "committee-made utopia" such as those which, according to Marshall Wolfe, frequently take the form of "declarations and 'plans of action' ... mainly as a consequence of the self-perpetuating rituals of international organization's" (Wolfe, 1984b).

²Subregional technical meeting on the present situation and prospects for co-operativism in Argentina, Brazil, Chile, Paraguay and Uruguay (Montevideo, 18-20 November 1985).

II

Recent quantitative trends in co-operativism in the region

In 1983 the Department of Social Affairs of the Executive Secretariat for Economic and Social Affairs of the OAS conducted a survey to determine what quantitative changes had occurred in co-operativism during the past twenty years, what type of governmental support has been provided to the sector, and what were considered to be the most important problems, constraints and needs in this regard (OAS, 1984). Of all the countries in the region, Uruguay, El Salvador, Haiti, Trinidad and Tobago and Barbados were the only ones which did not respond to the OAS questionnaire (see table 1).

The data shown in table 1 indicate that an estimated 33 000 co-operatives, with nearly 18 million members, now exist in Latin America and the Caribbean. This represents an increase of over 300% in the number of members since the beginning of the 1960s, while the number of co-operatives has nearly doubled during the same period.

On the one hand, the increase in the number of co-operatives was greater during the period 1963-1973 and declined during the following decade. This provides supporting evidence for the view that there was a boom in co-

operativism during the 1960s, with a subsequent decline (information on preceding periods which would provide a more accurate picture of trends in co-operativism is lacking). On the other hand, the staying power of co-operativism and its spread throughout all the countries of the region is worthy of note.

An analysis of the ratio of members to the total population and to the economically active population (EAP) in the countries of Latin America and the Caribbean (see table 2) provides a more refined measurement of the role played by co-operatives in the development of the region.

Except in Chile and Colombia, co-operatives have accounted for increasing percentages of the economically active population during the past decade. The number of co-operative members in 1973 equalled 11.7% of the economically active population as of 1970 and had reached 16.9% by the beginning of the 1980s. It should be noted that the data for Argentina have a great impact on the overall picture. If the statistics for this country are excluded from the calculations of the total, then the increase in the ratio of members to the EAP falls to 8.1% in 1970 and 8.7% in 1980.

Table 1

CO-OPERATIVISM IN LATIN AMERICA AND THE CARIBBEAN: NUMBER OF CO-OPERATIVES AND MEMBERS, 1963, 1973 AND 1983

	1963	1973	1983
Number of co-operatives	17 581	25 239	32 441
Number of members	5 671 456	9 553 343	17 964 511
Membership as a percentage of the EAP	8.7	11.7	16.9

Source: Based on OAS (1984), table 1, page 4; ECLAC (1983) (EAP, 1960); and CELADE (1982) (EAP 1970 and 1980).

The overall regional picture is a composite of a wide range of quite different situations. It includes countries such as Mexico, Venezuela and Paraguay, which had the lowest rates for 1970 (2.4%, 3.1% and 4.1%, respectively), and which had not changed their relative position by the end of the period. In contrast, Nicaragua, Guatemala and Honduras started with very low membership/EAP coefficients (3.3%, 3.5% and 5.0%, respectively) but managed to more than double those rates in the span of 10 years.

The upper end of the scale is occupied by the countries which have the highest rates and showed the most remarkable growth during the period. They include Costa Rica and Peru, where membership now represents between one-fourth and one-third of the economically active population.

Finally, members of co-operatives once represented a large percentage of the economically active population in Chile and Colombia, but membership has dropped quite sharply during the past ten years. In the case of Chile, this may be accounted for by the presence of the military government, which has helped to bring about the dissolution of over one-half of the co-operatives that were in existence when it assumed power in 1973. A more detailed analysis would be required in the case of Colombia, since the trend there has been quite irregular. Between 1963 and 1973, the membership of Colombian co-operatives increased almost fivefold, but it then fell by 20% during the following decade. The number of co-operatives increased during the period as a whole, however (by 286% between 1963 and 1973 and by 42% during the

Table 2

**LATIN AMERICA AND THE CARIBBEAN: MEMBERSHIP OF CO-OPERATIVES
IN ABSOLUTE TERMS AND AS A PERCENTAGE OF THE
TOTAL POPULATION AND THE EAP**

Countries ^a	Number of members (thousands, 1973)	As a percentage of total population (1970)	As a percentage of EAP (1970)	Number of members (thousands, 1983)	As a percentage of total population (1980)	As a percentage of EAP (1980)
Argentina	3 437	14.5	36.7	9 468	35.0	88.5
Bahamas	-	-	-	6	2.5	-
Bolivia	114	2.6	8.2	197	3.5	11.2
Brazil	2 064	2.2	6.9	2 936	2.4	7.3
Colombia	1 242	6.0	19.5	948	3.7	10.8
Costa Rica	76	4.4	14.4	200	9.0	26.0
Chile	695	7.4	23.7	562	5.1	14.8
Dominica	-	-	-	36	43.4	-
Ecuador	121	2.0	6.9	-	-	-
Grenada	-	-	-	6	5.4	-
Guatemala	56	1.0	3.5	175	2.4	7.8
Honduras	39	1.5	5.0	123	3.3	11.4
Jamaica	148	7.9	-	272	12.4	-
Mexico	326	0.6	2.4	510	0.7	2.6
Nicaragua	18	0.9	3.3	60	2.2	7.8
Panama	40	2.7	7.8	77	4.1	11.0
Paraguay	30	1.3	4.1	47	1.5	4.4
Peru	690	5.1	16.2	2 064	11.7	36.1
Dominican Republic	43	1.0	3.0	128	2.2	6.3
Venezuela	96	0.9	3.1	141	0.9	3.0
Total	9 235	3.6	11.7	17 956	5.4	16.9

Source: Based on OAS (1984), table A-5, page 37 (number of members); CELADE (1982) (total population and economically active population).

^a Represents 71% of questionnaire recipients while the statistics for the population and the EAP correspond to 92% of the regional total.

following ten years). Unfortunately, not enough information is available to permit a proper interpretation of what has occurred in that country.³

The annual growth rates for the region as a whole (see table 3) appear to confirm the significance of co-operativism in Latin America and the Caribbean, inasmuch as they are much higher than the growth rates for the total population and for the economically active population.

Table 3

**LATIN AMERICA AND THE CARIBBEAN:
ANNUAL GROWTH RATES OF NUMBER
OF CO-OPERATIVES AND THEIR MEMBERS**

	1963-1973	1973-1983	1963-1983
Co-operatives	3.7	2.5	3.1
Members	5.4	6.5	5.9
	1960-1970	1970-1980	1960-1980
Total population	2.7	2.7	2.6
Economically active population	2.7	2.9	2.8

Source: Based on OAS (1984), CELADE (1983) and ECLAC (1984).

³In contrast, Jaramillo (1984) underscores Colombia's favourable economic situation and the support its government has given to co-operatives: a state of affairs which is not reflected at all in the OAS survey data.

In and of itself, the above does not invalidate the conclusions reached in the various studies that have been conducted during the past decade. These studies will be analysed briefly in the following section.

Although the above data illustrate the strength of co-operativism in the region, they do not provide information concerning the role played by the low-income strata in this regard, nor do they provide a basis for assessing the significance of these growth rates in relation to the promotion of participation by broad sectors of the population in decision-making and in economic and social management.

Finally, table 4 provides information concerning the number of co-operatives and members in each branch of activity for 1983. These figures provide an indication, for example, of the co-operative model's potential for contributing to the resolution of one of the most pressing problems of our times: the production and distribution of foodstuffs. There are currently 12 000 agricultural and fishery co-operatives, with 2 000 000 members, representing 38% of all existing co-operatives.

The next largest groups, in descending order, are savings and loan (13%) and housing (11%) co-operatives. In terms of membership, the largest groups at present are savings and loan (33% of all members) and services (20%).

Table 4

**LATIN AMERICA AND THE CARIBBEAN: TYPES OF CO-OPERATIVES IN
EXISTENCE AND THEIR PERCENTAGE BREAKDOWN**

Types	Co-operatives		Percentage breakdown	
	Number	Members	Number	Members
Total	32 441	17 964 511	100	100
Agricultural	11 055	2 082 397	34	12
Consumer	2 739	2 790 397	8	16
Savings and loan	4 399	5 988 237	13	33
Housing	3 524	592 895	11	3
Electrification	944	1 589 667	3	9
Fishery	1 221	82 305	4	-
Transport	2 578	151 398	8	2
Miscellaneous services	1 571	3 613 419	5	20
Other	1 962	730 320	6	4

Source: OAS (1984), table A-4, page 36.

III

Between the reformist panacea and the manipulation of excluded groups

The data given in the preceding section attest to the growing interest in co-operativism and popular participation to be observed in various countries of the region. This observation is heightened by the fact that the three countries which have recently returned to a situation of democratic normality (Argentina, Uruguay and Brazil) have created special government departments to deal with co-operative affairs. This renewed interest in the subject, however, calls for a repostulation of the objectives of the research and activities carried out by public and private organizations concerned with co-operatives.

A first step would be to ascertain the exact significance of the various methods of democratic management and supervision provided for in alternative forms of economic organization such as co-operatives, self-managed enterprises and other types of associations. In addition, an assessment should be undertaken of co-operativism's potential for fostering popular participation and promoting the creation or consolidation of a democratic style of development.

1. The role assigned to co-operatives in the 1950s and 1960s

During the late 1950s and early 1960s governments, international organizations and financial institutions did a great deal to support the development of co-operatives.

Governments' motives for promoting co-operativism varied. Some regarded co-operatives as one more tool to be used in applying their development policies, as a means of regulating commercial intermediation, as a way of allocating government resources which would ensure that recipient groups also made a contribution, and as a vehicle for the dissemination of technology to the more backward sectors of the economy so that it would

be possible to carry out projects and provide services relating to the infrastructure and support for production. Others also saw political advantages in the growth of co-operativism because it provided a means of ensuring a State presence in rural zones as well as of counteracting unionization and the spread of independent grassroots movements.

Whatever the practical reasons for the strong support provided by the State, co-operatives were expected to perform a basic function in the development process. This idea was shared by all the actors involved: governments, international agencies and representatives of the co-operative movement around the world.

First of all, co-operatives were assigned a role as agents of change and, more specifically, as agents of modernization in accordance with the prevailing paradigm at that time. There was a strong conviction (still held by many) that co-operatives would lend greater rationality to social relations and were an ideal way of making the transition from a traditional society to a modern one. Seen in this light, co-operatives represented a transitional type of institution, a bridge between community activities and complex social organizations. From a cultural standpoint they would be virtually tantamount to a rite of transition towards modern rationality, impersonal relationships and the market.

In addition, and in one sense as a consequence of the above, a great deal of hope was pinned on co-operatives as a means of incorporating marginal sectors into the rest of the nation and into the growth process; in short, co-operatives were to be those sectors' passport to full social, political and economic citizenship. So it was that co-operatives constituted, for example, the main means of executing agrarian reform programmes in developing countries.

Finally, during the intensification of the cold war between the superpowers—which became

even more acute in Latin America after the success of the Cuban revolution—co-operativism seemed to provide a middle road between capitalism and socialism. In an effort to contain the advance of revolutionary movements (an effort which reached its height in the region under the Alliance for Progress) (Livinson and Onís, 1970), co-operatives were seen as an antidote: a way of satisfying demands for reforms (some of which were necessary for the very consolidation of capitalism in Latin America) without occasioning drastic changes or violent departures from the prevailing system of ownership.

However, the hopes placed in co-operativism early in the 1960s were offset by an equivalent degree of disenchantment in the late 1960s.

2. *The research conducted by the United Nations Research Institute for Social Development (UNRISD)*

Countless analyses were made of the results achieved by co-operativism. Of these, the study conducted by UNRISD in 1970 unquestionably had the greatest impact on the controversy about the subject. Direct research carried out between 1968 and 1970 as part of the project on rural co-operatives and related institutions as agents of planned change included 40 case studies of individual co-operatives and similar institutions in Asia (Sri Lanka, Iran, Bangladesh), Africa (Cameroon, Ghana, Kenya, Tanzania, Tunisia, Uganda and Zambia) and Latin America (Colombia, Ecuador and Venezuela).⁴ The title of the project's final report (*Co-operativism: its failure in the Third World*) (UNRISD, 1974) leaves no doubt about the nature of the conclusions set forth therein.

The main conclusion was that rural co-operatives in developing regions were providing few benefits to the poorer masses in such areas

⁴The results of the project were published between 1971 and 1972 in a number of volumes in the series *Rural Institutions and Planned Change*. Volume III of this series deals specifically with co-operatives and rural development in Latin America. The final report (UNRISD, 1974) contains the conclusions reached during the course of the project, in addition to presenting the reactions of researchers and representatives of the co-operativism movement around the world.

and, generally speaking, could not be regarded as agents of change and development for such groups (UNRISD, 1974).

In Latin America, according to Orlando Fals Borda, who was in charge of evaluating the co-operatives of the region for the UNRISD project, co-operatives received State support for political reasons, as a means of pacifying a rebellious peasantry and of softening the effects of economic crises. That explained, to some extent, why campaigns to promote co-operatives were usually conducted during periods of depression and violence.

Fals Borda felt that one of the main reasons for this overall conclusion (i.e., that co-operatives had not been agents of change and had provided the poorest sectors of the population with very few benefits) was that the majority of these sectors had neither a property base nor access to resources: a situation which resulted in their total exclusion from the proposed scheme. The most successful experiments had been those involving restricted-membership co-operatives which, by virtue of that very fact, tended to become cultural enclaves hemmed in by the dominant society. Furthermore, the strengthening of such co-operatives resulted in a heightening of the differences in income within the region: an effect which was diametrically opposed to the declared objectives of State support.

The study also demonstrated that open-membership co-operatives tended to mirror the structure of the community and even to transform it in the wrong direction by reinforcing and deepening pre-existing inequalities as the more affluent groups gained control of the committees and management of such co-operatives and managed to exert a decisive influence on the nature of the benefits derived from them as well as on the distribution of those benefits among the members.

Finally, in the few cases where co-operatives really were authentic organizations of the poor peasants of a community, they proved clearly ineffective in promoting their members' interests. The same thing occurred, ultimately, even in those cases where they were successful, because this meant that they represented a threat, as a source of competition, for established private interests. When this happened, attempts

were made to undermine them through the removal (at times, by violent means) of their leaders and to force them into bankruptcy by resorting to the traditional techniques of artificial price reductions or a tightening of credit, accomplished by making increasingly harsh demands in respect of collateral and other requirements; in other cases, they were simply transformed into capitalist enterprises.

In these circumstances, which reflected the unfavourable environment for the introduction of co-operatives as agents of structural change, the UNRISD recommendations stressed the belief that government efforts would be more useful if they were directed towards bringing about desirable social, economic and structural changes by methods aimed directly at overcoming the obstacles standing in the way of rural progress (UNRISD, 1974).

3. Results of other studies

Other research projects generally corroborated the UNRISD conclusions. In a highly acclaimed study on underdevelopment, for example, Gunnar Myrdal (1968) indicated that only the upper strata could take advantage of the benefits offered by co-operatives —and of the government subsidies provided for their development. The net result was greater inequality, not less.

The same conclusion was reached by another researcher who, on the basis of his observations in India, stated that the success of co-operatives presupposed a modicum of social equality, political democracy and economic viability. According to Thorner (1962), people liked to think that a comprehensive, well-supported, well thought out governmental programme of setting up co-operatives would change the power structures of a village, but the evidence suggested that a village's power structure imposed its own model upon co-operatives and would continue to do so.

The study by Uma Lele (1981) points in this same direction, inasmuch as it indicates that, for a variety of reasons relating to inequalities in the distribution of income and capital, it is more costly to provide services to the poor than it is to satisfy the upper strata. This conclusion is based on the assumption that the establishment of co-

operatives requires the fulfilment of a series of conditions, such as access to technological innovation, the existence of a physical infrastructure, and favourable pricing policies.

Other investigators have underscored the exotic nature of the co-operativist doctrine as an element of Latin American cultures. Emilio Willens (1963), for example, pointed out that the most successful co-operatives in the region were precisely those that were first set up in Argentina, Brazil and Uruguay (and which later spread to all the other countries) by European immigrants who brought the co-operative traditions and cultural characteristics of their countries of origin with them. The picture is further complicated by some ethnic factors which make assessment of co-operativist achievements in the Caribbean countries quite problematical, inasmuch as ethnic differences interfere with purely class-based distinctions and render them only relatively valid (Huizer, 1983 and Moreno, 1983).

A study carried out a few years ago at the request of ECLAC by Roberto Jiménez (1980) took a less critical view of trends in co-operativism in Latin America and the Caribbean. For example, it pointed out that co-operatives have had some positive impact on income differences among the lower strata, have introduced an element of stability in the employment of lower-income sectors and have provided an opportunity for incorporating women into productive labour. Jiménez also acknowledged, however, that participation has been of a formal nature and has often been dominated by the more affluent groups.

In concluding this brief analysis of the main assessments made of co-operativism during the past decade, it may be said that both the UNRISD study and those of other researchers provide plentiful evidence that while it is true that co-operatives can furnish some degree of protection for small-scale producers and consumers, it is equally true that, within these co-operatives, the more affluent members have managed to secure a much larger part of the benefits than the vast majority of low-income members, and frequently have done so at the expense of the latter.

The implication of the foregoing is that in the efforts now being made to apply the essential

elements of such forms of association to the creation of a participatory style of development, it is necessary to reformulate the approaches

that have been used to evaluate the present situation, analyse future prospects and propose government policies.

IV

Conceptual guidelines for the study of co-operativism and popular participation in Latin America and the Caribbean

1. *Co-operativism, alternative development styles and democracy*

It has already been stated that now, more than ever before in the recent history of Latin America and the Caribbean, the ideals of liberty, social justice and equity have taken on renewed meaning. It has also been asserted that a transition towards democracy can only be regarded as successful in so far as it promotes the application of these ideals in the daily life of each individual. Furthermore, it has been considered that different social actors, espousing a variety of projects for restructuring Latin America's economies and societies, will play a fundamental role in the search for means of overcoming the prevailing crisis, whose severity has increased during the past decade.

Indeed, a great deal of effort is now being made in the region to identifying the social actors that are involved, to determine their orientations and to ascertain the degree to which their designs for society would tend to consolidate democracy.

Alongside the current search for "magical" formulas aimed solely at doing away with the immediate manifestations of a much deeper crisis (all of which are in evidence in the issue of the external debt), an ongoing effort is being made to define at least the minimum rules of the democratic approaches whereby the social actors committed to strengthening pluralistic systems of government are attempting to ensure that

greater opportunities will be made available for participation and to promote independent or autonomous forms of organization.

No one still believes in formal, parliamentary democracy as an end in itself, which is a large part of the reason why support for traditional liberal, developmentalist, reformist and revolutionary models has been declining among broad sectors of the population.

Today, the call for democracy embodies a new outlook. Whereas it was previously believed that the demands of economic management and of the growth process placed "natural" limitations on participation by large social sectors because economic decisions were primarily based on a technical rationale to which the idea of participation was foreign (it being assumed that participation was a politically irrational form of resolving conflicts), it has now been demonstrated that these limitations are, for the most part, artificially created (and are therefore political in nature) rather than coming about naturally. The truth of the matter is that, either as a result of adherence to rigid market-economy criteria or as a result of economic planning being regarded as an image of an ideal society, such limitations have really been imposed on concrete social demands.

This has produced a marked change in the way in which the relationship between economics and democracy is viewed. Faletto (1983, p. 33) sums it up as follows: "present concerns are such that any economic option and,

hence, any alternative style is weighed on the basis of the following questions: What amount of freedom does it grant? and Is it oriented towards efforts to consolidate democracy or does it exclude them?". From the standpoint of the present discussion, the same is true of the ways in which issues relating to co-operativism are currently dealt with.

2. *The co-operative as a possible social actor*

For analogous reasons, the almost desperate search for "the" social group or "the" class that would act as a vehicle for the values underlying this or that model ceases to be of importance.

As Bennett (1983) has noted, if the clearly social nature of human needs is recognized and if, furthermore, the idea is accepted that the values assigned to them reflect the particular interests of a class or group, then it would be a backward step to propose that the "best" or the fairest option from a social standpoint (most participatory and most democratic in terms of the respect accorded to the rights of majorities and of minorities) can be the privilege of a single class or group.

The approach or focus outlined here as regards issues relating to forms of association and self-management is therefore based on the assumption that organizations such as co-operatives may become important social actors in the coming years.

It should be borne in mind, of course, that the choice of co-operativism is to some extent an arbitrary one. It should by no means be regarded as a solution, but rather as a working hypothesis. Any attempt to define social actors (co-operatives) on the basis of occupational categories (members of co-operatives) or of "objectively-defined" relative positions in the socio-occupational structure must be rejected out of hand, because actors do not first constitute a category of actor and then become proponents of a given line of action; rather, it is the line of action which defines a social category as an actor. This means that the persistence of co-operativism in the region is a necessary but not a sufficient condition for the transformation of co-operatives into significant social actors.

Approaches which would only lead to a repetition of past mistakes must be rejected just as forcefully. For example, it is not only misleading but false, as well, to assume *a priori* (as has frequently been done) that co-operatives are an alternative to capitalist enterprise and that their promotion will, by definition, provide greater opportunities for participation by lower-income sectors and for an improvement in their living standards. One of the factors which has promoted the spread of co-operativism is, precisely, the fact that these organizations can and do function under any type of economic and political system whatsoever so long as they are not expressly prohibited. Although their operations, efficiency and the benefits they can offer their members are influenced by the systems under which they function, there is no definite relationship between the type of social system and the number and size of co-operatives.

In the light of recent history, it must also be realized that co-operatives cannot represent the only solution for those immersed in poverty. Social problems of a structural nature can only be solved by society as a whole, by means of a process in which specific organizational models act as dependent variables.

3. *Co-operativism and popular participation*

An equal measure of caution is called for when discussing the relationship between co-operatives and popular participation, which often takes on a theological—and, hence, mystic—character.

First of all, there are a number of questions surrounding the very concept of participation and its present meaning for lower-income sectors. Despite the intense debate on this subject which has been taking place during the past few years, the question remains: What is the object of participation? Is its aim to overcome alienation or exclusion, especially exclusion from power (a co-operative movement which could sidestep the question of overall power and, therefore, strengthen its corporate aspects)? Is it designed to change the social division of labour at its corporate level? Is it a strategy for resolving conflicts among various social groups? Is it a demand for self-government or for greater

State intervention? Or is it a strategy for bringing the citizenry into its own?⁵

At this point in the discussion it would be well to remember that to this day the Third Reich is still considered to have had the most participatory organizational structures ever known. Indeed, many people regard them as the forerunners of modern theories of organizational development and participatory management (Singer and Wooton, 1976).⁶ Few, however, would wish to defend the results of such broad-based participation.

What appears to be more important, and less likely to be used as a fetish, is an accurate identification of the relationships between a given organizational model and the other institutions that form the context for the model (as well as the centres of power) inasmuch as these relationships are what determines the outcome, rather than the specific (or desired) characteristics of a particular type of organization.

What was once regarded as an accepted fact (i.e., that co-operatives promote popular participation and contain all the ingredients for a democratic and unified society) has now become a question: Can co-operativism satisfy current demands for democracy by giving citizens greater control over the State and over capital?

⁵The tensions underlying these and other issues relating to participation are analysed by Guimarães (1985), Wolfe (1984a), ECLAC (1982) and United Nations (1982).

⁶Many scholars posit the need to analyse processes of planned social change on the basis of actual results rather than on the basis of their stated objectives or the models that have been applied, because agents of change are always dedicated to working for those changes that will have meaning only in accordance with their personal paradigms of what the ideal order for social relationships is (Guerreiro Ramos, 1976, p. 268). For those who believe in the intrinsic qualities of models of social change and who justify their application despite any doubts that may be raised, there could be nothing more appropriate (and sobering) than to recall the words of Albert Speer: "There were many decent and well-meaning men in Nazi Germany, yet they were incapable of preventing the greatest bloodbath in history. The institutional and technological monster of mass destruction can very easily take on a momentum of its own and thereby lead the world towards total annihilation. Once the "beast" is set free, it can only move in one direction. The descent into hell can be an exciting and enjoyable trip, but unfortunately it is on a one-way ticket. I know, I was there, I still am" (interview by E. Norden, *Playboy*, June 1971, p. 202).

4. *General framework for an exploration of the subject and suggestions for future research*

It is not being proposed here that co-operatives and other forms of association should be regarded as an economic alternative to the traditional capitalist unit of production: an attitude that tends to polarize the distinctions between individual and collective ownership, growth versus distribution and other such issues, and in which the analysis is oriented towards determining what economic, political, cultural and institutional conditions are necessary for the establishment and development of co-operatives.

Instead, what is being proposed here is to take the mere existence of co-operatives as the starting point and then to determine their social and political implications while, at the same time, devoting special attention to microeconomic issues of efficiency and competitiveness. Special attention would be given to the social and political dimensions of co-operatives, viewed as a means of incipient socialization or of increasing the popular sectors' awareness. The analysis would thus focus on the role of co-operatives in the economy and in the national society, relationships among their members, relations between members and employees, etc.

To this end, the starting point for the analysis could be confined to a consideration of co-operativism not necessarily as a social movement, as defined by Enzo Faletto (1983) (that is to say, as a movement which generates counter-models of society inasmuch as it addresses problems that concern society as a whole: a feature which distinguishes it from pressure groups, which focus on individual or corporate problems), but rather as an educational process which may give rise to a collective identity and an increase in the popular sectors' capacity for organization and mobilization. Again, rather than starting from an analysis of co-operativism as a social movement, it becomes more important to specify the nature of the relationships between co-operatives and other related popular movements such as trade unions and

associations of poor urban sectors or the peasantry.

The treatment of this subject should thus be focused on two facets or dimensions. The first step would be to delve into the anatomy of the co-operative phenomenon in an attempt to ascertain where co-operatives operate, what organization of labour and production structure they use, to what extent their members participate in them, and how efficient they are. The second component would be to describe the "ecology" of co-operativism, i.e., to determine—on the basis of an analysis of the relations to which they give rise in their social, cultural, economic and political contexts— what repercussions they have on other spheres of life, such as political parties, unions and the market.

From this standpoint and using the entire preceding discussion as a conceptual frame of reference, suggestions will be made as regards some of the more immediate research needs. Firstly, the analysis should concentrate on the characteristics of associative, co-operative and local self-management movements, particularly their economic and social aspects.

The type of activities carried out by these organizations in each country would have to be described, as well as their distribution and geographical location, the scale and structure of production, income modalities and differences (mainly between technical and managerial levels and between members and employees) and,

finally, their mechanisms and opportunities for economic integration in respect of both markets and production units and the share of national and sectoral output and of exports accounted for by co-operatives. It would also be necessary to examine what impact these organizations have on the employment structure and the labour market, especially in relation to young people and women.

Another urgent task would be to determine the social composition of co-operatives (sex, age, social origin and occupational category) and the nature of the decision-making process, primarily as it relates to the introduction of technological changes and the distribution of surpluses. In connection with this last element, it would be interesting to analyse the function performed by external agents, not only in the creation and operation of associative, co-operative and self-managed organizations, but also as regards the limitations placed on the continued operation and autonomy of such organizations by the presence of a dynamic external agent.

Finally, given the approach used in this study, it would be particularly important to identify and analyse the main political demands to which associative, co-operative and self-management movements give rise, as well as the machinery and guidelines for their linkage with other popular movements (poor urban sectors, unions, peasants, community groups) and political parties.

V

Some methodological considerations

It is difficult to confine the discussion to only a few methodological aspects of the study of co-operativism and popular participation, for methodology is really the basic issue as regards the treatment of this subject and should be the subject of a specific research effort.

1. *Co-operativism, self-management and popular organizations*

There is general agreement that no-one has yet managed to identify approaches and strategies for understanding the actual situation with

respect to popular organizations without employing a logic and an arbitrary order which only have meaning for that observer and which, quite often, serve only to create confusion about the dynamics of these organizations rather than clarifying them.

It is therefore worthwhile, at this point in the discussion, to underscore the importance of seeking alternative strategies, such as the proposals for what has been called action-oriented or participatory research, which, in an attempt to de-mistify economic as well as sociological or anthropological research, transforming these activities into tools for societal change and fostering a commitment on the part of researchers to the real nature of the object of study, allow the groups involved in popular organizations to play a part in the research efforts on them.

From this standpoint, the use of a very broad or ambiguous definition of the concept of "popular organizations" (such as that employed here), which encompasses such apparently different models as co-operatives, associative (pre-co-operative?) forms of organization, self-managed enterprises, etc., does not appear to pose any major problem. This does not mean, however, that sharp differences do not exist between each organizational model and the others.

Nonetheless, once an as yet unresolved ambiguity is assumed to exist and, what is more, since the objective both of the analysis and of any action to be taken is not the model *per se* but rather its role in transforming the popular sectors' survival strategies into new types of social and economic relations (or, as some people might phrase it, an "alternative development style"), it is not felt that this position poses any methodological obstacle to the study of this subject.

On the contrary, it is felt that the further development of the proposals introduced in this article, combined with the results of maintaining a relationship with popular organizations themselves, will point the way to the methodological and other types of corrections which are likely to be required.

2. Co-operativism in Latin America

What does indeed call for immediate attention and discussion is not so much the distinction between different forms of organization, but rather those aspects relating to the environment in which popular organizations (rural or urban) operate, the class content of such movements and the value-based orientations of those seeking to become members.

This is particularly true in the case of Latin America and the Caribbean because, there, co-operativism has taken on a very different meaning from that which it possesses in other regions, especially in the Old World. Whereas the European forerunners of co-operativism, from Robert Owen (in the early nineteenth century) to Bernard Lavergue (in the early twentieth century), including the Fourier, Rochdale, Raiffeisen and other models, arrived at co-operativism on the basis of ideological concepts concerning the organization of social relations, Latin American co-operativism (if it can be referred to as such) relates, above all, to social practices which are not necessarily associated with any given world view (despite the fact that they certainly "create" a wide variety of ideological options).

In a historical context marked by a high degree of economic dependency and social and political authoritarianism, co-operatives take on different meanings at different points in history and for different social sectors. At times, they are no more than a temporary survival strategy for lower-income sectors, as is demonstrated by the growth of labour co-operatives during periods when urban unemployment is on the rise.

Often, they represent a defence strategy against political repression, serving as a means of keeping members of social movements organized. In such cases, members may not necessarily share the co-operative ideology of building a "new" society, but have instead formed a co-operative simply because it is the only method of participation that is still tolerated by government authorities.

Finally, co-operatives may provide a means—primarily for middle-class sectors—of gaining access to goods or services on more advantageous terms than those available in the

market, as is often the case with consumer or savings and loan co-operatives; in these instances, they are a way of democratizing a dependent and concentrative type of capitalism.

3. *Defining the space in which co-operatives function*

Because of the concern to deal with the subject within the Latin American context, emphasis has been placed on the need, from a methodological standpoint, to define the economic space (a helping hand to dependent capitalism?), the social space (a means of easing the tensions created by exclusive patterns of accumulation?) and even the geographic space (i.e., rural or urban) in which co-operatives function. This, first of all, involves distinguishing between co-operative units and co-operative movements.

In respect to the former, it also involves drawing a distinction between *de jure* co-operatives (capitalist enterprises which merely assume the legal form of a co-operative) and true co-operatives (where work is undertaken in a spirit of solidarity, members participate in decision-making, and the principle of "one man, one vote" prevails).

4. *Production, consumer and services co-operatives*

If what is important is not co-operativism in itself, but rather the relationship between co-operativism, democracy and the style of development, then the relations between co-operatives and the centres of power become a decisive factor. This means that there is a need to differentiate between production, consumer and service co-operatives, for example.

If one starts from the assumption, as has been done here, that the basic concept to be dealt with in a discussion of styles, democracy and co-operativism is the idea of democracy as a plurality of options, models and social practices, and if it is further assumed that this concept

should guide all efforts in this regard, then it is no longer a question of redefining all social relations on the basis of the co-operative doctrine, but rather of strengthening co-operative organizations as a means of democratizing the existing systems (both market-economy systems and those based on a controlled market and central planning —the two often being combined in a single society). In this respect, the operations of production, consumer and service co-operatives undoubtedly have very different types of impacts.

5. *Co-operativism and transnationalization*

One final methodological question which warrants special attention relates to the fact that analyses of co-operativism as well as proposals for disseminating and strengthening the co-operative model are often flawed by the assumption that they operate in a closed economy.

In view of the present trend, especially in the countries of the region, towards the predominance of financial capital, its internationalization and the internationalization of the circuit involved in the production and dissemination of technology (which, in its turn, buttresses national inclinations towards centralization, concentration and, ultimately, authoritarianism), an accurate description of inter-co-operative relations at the international level is called for. It is also necessary to identify the limitations which this trend places on the strengthening and possible predominance of the co-operative model and on its viability as an alternative model.

At the microsocial level, this would also involve identifying both the sectors in which co-operatives, given their organizational features and their economic rationale, would have the best chance of flourishing (those in which labour is the preponderant factor?) and those in which co-operatives are apparently not the best option (sectors where technological obsolescence is more rapid?).

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Notes on trade from the standpoint of the periphery

*Raúl Prebisch**

The necessity of generating foreign exchange in order to pay off interest on the external debt once again brings to the fore the topic of centre/periphery trade relations, of their implicit potential, and of the obstacles that hamper them.

The author begins by reverting to the persistence of the structural causes underlying the trade imbalance of the peripheral countries—causes that are directly linked to the evolution of the income-elasticity of international prices of manufactures and primary products (with the exception of petroleum)—and recapitulating the ways and means by which the countries in question have sought to deal with it. Among these expedients, the substitution of domestic production for imports from the centres and the export of manufactures to the central countries are singled out for particular attention.

The opening-up of the centres' markets to manufactures from the periphery would be a measure with enormous potential for the latter, but the varied range of hindrances and constraints that exists does not incline the writer to optimism. In the circumstances, therefore, he advocates a recrudescence of the old idea of import substitution in a broad framework of regional integration. It is not a matter of newly applying policies devised several decades ago; they can constitute a remedy for the external imbalance, always provided that they are adjusted to the current situation and that the mistakes made in the past are avoided. In face of an increasingly closed world trade, they represent an indispensable ingredient of any reasonable development strategy.

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I

Innovation and diversification in goods and services and their implications for trade

The technological revolution that is taking place in the centres, monetary events in the United States, and the substantial imbalances in international economic relations pose very serious problems for the Latin American region of the periphery.

In earlier articles published in this *Review* we have upheld a number of theses which bear very closely on the subject of the present article.

We have endeavoured to show that in the development of the centres during the past, as at the present time, the substantial increases in productivity which technical progress has brought in its train have not been correlatively reflected in a fall in prices. The reason for so important a discrepancy lies in the continuous diversification introduced by technological innovation in goods and services. As global income rises, owing to the increase in productivity, demand shifts in the main to new types of goods and services in preference to those already being produced. The diversification in question occurs in manufactured goods, not in foodstuffs and other primary products, where change and diversification are very limited.

This circumstance suffices to account for the tendency towards a deterioration of the relation between the prices of primary products and those of manufactured goods. Since its earliest days, ECLAC has explained that this trend in the terms of trade has a very serious effect on centre/periphery relations. What is more, in so far as technical progress gradually penetrates into the periphery and raises income, the aforesaid incessant diversification of demand makes its appearance there as well, generally in a guise accentuated by the great defects in income distribution.

Thus, as the development process advances the periphery becomes exposed to a situation of external disequilibrium which must be rectified if the process in question is to run its proper course. Owing to the impulse given by the diversification of demand, the growth of imports is generally very rapid, while exports of primary products, except those of petroleum, tend to expand at a relatively slow rate. This has been happening for some time back, always subject to cyclical effects transmitted from the centres.

In general, economists in the centres first attacked the industrialization of the periphery, which began during the great world depression, and subsequently execrated import substitution, recommending the periphery to cope with the trend towards disequilibrium by exporting manufactures instead.

There are countries in the Latin American region of the periphery which took this advice seriously and embarked upon a vigorous export effort. It so happened, however, that when these exports began to compete with the production of the centres, the latter lost no time in subjecting them to severe restrictions. To account for these restrictions they adduce the unemployment that has accompanied the dynamic weakening of the centres in recent times. Yet in the long years of prosperity which came to an end in the first half of the 1970s, and during which some countries not only had no unemployment problem but even admitted foreign workers, no manifest effort was made to lower the tariff barriers erected not only against primary products but also against manufactures from the periphery.

Strenuous efforts were made in UNCTAD to change this state of affairs, with little or no success. This leads me to suppose that there are very important factors that discountenance a liberalization policy for imports from the periphery. During the boom years in the major (Kennedy and Tokyo) rounds of GATT negotiations, customs tariffs were brought down to a very low level, but this mainly affected the centres' trade, which largely involves just the very goods in whose case the diversification process is highly intensive, thanks to the continuous technological innovations, and to the impulse given by the transnational corporations. These, in making the innovations, actively intervened in the trade in question, which

reached exceptionally high figures. It is not surprising, then, that the periphery, which had begun to export goods that were not very advanced technologically and whose degree of diversification was extremely slight, should have lagged far behind in this expansion of trade in manufactures.

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.¹ 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 affected 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 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

¹See, in particular, "The Latin American periphery and the global crisis of capitalism", *CEPAL Review*, No. 26, August 1985.

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.

The centres have been defending themselves with all sorts of restrictive measures which are adopted unilaterally in disregard of GATT commitments. Thus we are witnessing a phenomenon unprecedented in capitalist development: one which, in my opinion, is of a structural character, and which, although hitherto it has attained only moderate proportions, might become of major importance, as other peripheral countries join the few that have learnt to export manufactures. In view of this, it may well be asked whether the centres, even in the event of their dynamics being re-established, would be willing to liberalize imports from the periphery.

Nevertheless, they continue to proclaim the need for trade liberalization. There has been no backsliding in their adherence to the neo-

classical principles which have regained outstanding importance both internally and in international relations. Perhaps the purity of the doctrine is kept intact because that helps to ease the conscience of those who are violating it in practice. (God helps those who help themselves.)

All this is quite deplorable, because such restrictions deprive both sides of the benefits of trading technologically advanced goods from the centres against less advanced goods from the periphery, with indisputable reciprocal advantages. But what is the solution? Of course it lies neither in maintaining or tightening the restrictions nor in eliminating them completely, but in regulating trade in such a way that the periphery can share in the increase in consumer demand in the centres without disruptive effects. If the periphery wants to combat its tendency towards external disequilibrium, it will have to lower its prices in the corresponding industries, a step which would reduce its capacity for accumulation; the pertinent enterprises in the centres, too, would undergo the disruptive effects of which I have just spoken. Formulas must therefore be sought which will safeguard the advantages of reciprocal trade.

II

Importance of protection

But the centres have put up opposition, first to the peripheral industrialization and then to import substitution, by means of customs protection. In ECLAC we maintained from the very outset that protection was indispensable as a means of standing up to the centres' technical and economic superiority. Unfortunately, protection has as a general rule been greatly exaggerated, if not abusive and has been kept in force for a very long time, affording industries no incentive to reduce their production costs — a point to which we shall revert later.

Subscribers to the neo-classical doctrines impugn protection. In the end they have

accepted industrialization, always provided that it comes about spontaneously, not as the result of State interference in the play of market forces. The most they have ever recognized as admissible has been recourse to currency devaluation in order to achieve effects similar to those of protection. But perhaps they did not fully realize that in the wake of devaluation would come a fall in the international prices of the competitive primary goods. I remember that measures of this kind were recommended to our countries by technical experts from the International Monetary Fund; when their attention was drawn to this adverse effect on

prices they said that it could be countered by establishing export taxes, a proposal contradictory to their own liberal doctrine, since an export tax implies the same sort of State interference in market forces as import duties represent. If I recall this it is in order to point out that a clear understanding of our phenomena has not always been shown in the centres' thinking.

More than once of late I have wondered why instead of the restrictions which the centres apply to imports from the periphery devaluation is not recommended in order to place industries on the centres that are affected by competition in a position to withstand it, by bringing down real wages in this way. Mention of this fact alone is enough to reveal the nature of the recommendations under discussion since even in cases where such a measure would have been socially or politically viable, a reduction of wages would also have led to a fall in prices in all the competitive industries, i.e., to the deterioration of the centres' terms of trade.

In reality, when economic theories gain prominence, they do so not always on account of their scientific exactitude, but because of the interests they favour, and this consideration brings me to another aspect of the subject under analysis. I have referred elsewhere to the opposition of economists in the centres to the industrialization of the periphery. From its infancy, ECLAC maintained that industrialization was an unavoidable necessity of development. This postulate of ours was commented on in the early 1950s by Professor Viner, one of the most eminent authorities on international trade. As has often been our lot, Professor Viner had read second-hand versions of our ideas, and thus, in seeking to impugn the industrialization thesis, he ascribed to us the idea that agriculture impoverished peoples whereas industry increased their well-being. When a few weeks later I was invited to occupy the same Chair in the Universidade do Brasil, I asked: how could I uphold so fantastic a notion when at the beginning of the present century my own country, Argentina, had attained one of the highest per capita income figures in the world? Professor Viner maintained that, instead of becoming industrialized, the periphery ought to introduce technical progress into agriculture, an irrefutable proposition, of course, but one which was completely at variance with the experience

of every country, irrespective of its economic and social system. What really happened was that as technical progress raised productivity in agriculture, its capacity to absorb labour decreased, and other ways of employing redundant manpower had to be sought. Hence one of the basic dynamic roles of industrialization. Otherwise, the existence of redundant labour would have serious depressive effects on wages and, consequently, on the international prices of agricultural products.

In my belief, this last argument is conclusive; but on talking of it in the centres I became convinced that far from disturbing some of their economists, it helped to back up Viner's thesis, since it suited the centres to pay lower prices for the primary products they purchased from the periphery.

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 who purchase them, whereas a decline in industrial prices weakens their surplus and consequently their capacity for accumulation, as I observed before.

Let me now revert to protection in the periphery. I was saying that it was indispensable to introduce technical progress in agriculture and in primary production in general but that without industrialization a risk of deterioration of the terms of trade was incurred. Obviously, however, industrialization fulfils its labour-absorbing function relatively slowly, and what is needed is an attempt to curb the deterioration. It is precisely through protection that this is achieved, since the intensification of industrializing activity helps to shift capital and labour from primary to industrial production. But this does not mean that very grave mistakes have not been made in Latin America in this respect, protection having been applied in so exaggerated a form as to end by adversely affecting primary production; the opponents of industrialization frequently adduce this as an argument against it, instead of referring to an ill-judged policy for carrying it out.

III

The deterioration of the terms of trade

I should now like to pass on to consider the trend towards deterioration with which we were so much and so rightly preoccupied in ECLAC's early writings. Agricultural products, and primary products in general, do not allow of much diversification. It is true that the labour and capital allocated to producing a good whose price tends to decline could be used for producing other primary goods, but these, in their turn, are subject to the risk of a similar saturation problem. In the case of industrial output, on the other hand, such saturation is mitigated or prevented by the shift in demand and the corresponding investment of the surplus and of sinking funds to keep pace with it. Such is the situation of inferiority in which agriculture is placed in this respect, especially when technical progress makes for a rapid increase in productivity unaccompanied by an expansion of demand sufficient to prevent a fall in prices.

This is well-known to be the state of affairs in the industrial centres, where the considerable technical progress made in agriculture in recent decades has brought with it an exceptional increase in output; thus, for example, in the United States limits have been set in various ways to grain production, in order to prevent or moderate a fall in international prices, and this is happening even in times when neo-classical theories are prevalent. Much the same thing has occurred in the countries of the European Economic Community, and it is common knowledge that the trend towards deterioration has been combated by means of certain price subsidies or import bans. I do not fail to recognize the basic phenomena which are conducive to this policy, especially after the experience of two world wars which have taught the advisability of giving due importance to agriculture. There is also the question of the agricultural surplus, in accordance with the observations I have formulated elsewhere. But from thence to producing big surpluses and launching them at any price on the international

market it is a very long way indeed. Yet that has been and still is being done, thanks to internal subsidies, as in the United States under the famous law 280, which in practice implies a subsidy on external sales of grain, especially sales to the developing world.

All this has meant infringing the principles of GATT. And not only that, but the periphery, and ECLAC in particular, were attacked when we described the trend towards deterioration of the terms of trade in primary products. What is more, we have been charged with accusing the centres of deliberately exploiting the periphery through that deterioration. It is true that various ways of siphoning-off peripheral income have been and still are being practised, but ECLAC has never linked the aforesaid deterioration with any concept of exploitation. Such theses generally stem from political considerations.

After clearing up these theoretical issues we come to a problem of the greatest importance, i.e., how are we to combat the trend towards structural imbalance in our relations with the centres? It has already been said that exports to the centres ought to be encouraged and import substitutions undertaken. Now, exports depend basically upon the receptive capacity of the centres in terms of their rate of development and their willingness to find formulas which will allow the periphery a share in the increase in their consumption or ultimately in their consumption itself. In so far as this proves impossible, the only alternative is import substitution. Substitution, therefore, is not a doctrinaire whim but a response to objective conditions implicit in the realities of our relations with the centres.

The problem is distinctly complex, since it is necessary to determine what goods it would be expedient to replace by domestic production. This problem might be stated in the following terms: there are some goods in respect of which substitution has already taken place and we have

acquired competitive capacity. So much for one extreme; at the other extreme, there are other products —both capital goods and inputs, and consumer goods— which correspond to the continual advances of technology in the centres. For the moment, substitution in respect of such goods cannot be thought of, for obvious reasons. Between these two extremes there is a wide range of goods in which we have acquired or easily could acquire technological capacity, and it is in relation to these that substitution possibilities will have to be examined in the light

of a selective criterion, so that those most susceptible of being produced in economic conditions can be chosen in preference to others which it is not feasible for us to produce, because of our type of development.

Everyone knows that import substitution for the relatively small domestic markets of our countries, not only because of their population but also because of their relatively low income levels, encounters the obstacle of very high costs. Hence the necessity of expanding domestic markets by means of regional integration.

IV

The need for new integration formulas

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 gained least the investment required to possibilitate a satisfactorily balanced trade not bilateral but multilateral among all the participant countries.

This would have another very important advantage: under the existing régime, arrangements made by two countries to

specialize their production for the purposes of reciprocal trade could not be left open to the access of other Latin American countries without violating the terms on which such arrangements are based. In contrast, a subsidies régime would permit the incorporation of third countries prepared to observe the general principles governing an agreement of this kind.

It is common knowledge that the centres are opposed to a subsidies régime, notwithstanding the various disguised forms in which subsidies in respect of their exports are granted. But they could not object to arrangements of this nature among countries in the periphery. This idea is not in fact new. I remember that in the early 1960s we said in one of our reports that Latin American industrialization had developed asymmetrically, since the encouragement given

to import substitution was not paralleled by an equivalent incentive to exports of manufactures.

I believe that serious thought must be given to the desirability of reorienting integration policy in the direction I have just described. I am not making a concrete proposal but simply suggesting that it might be as well to diverge from the line of thought we followed more than a quarter of a century ago, when industrialization had barely attained moderate dimensions and we had not the advantage of a stock of experience that we now enjoy. I also want to point out that the relatively less and least advanced countries could participate in these new forms of trade via exports of consumer goods, which could be effected under arrangements or regulatory formulas similar to those I have mentioned in the case of our exports to the centres.

V

Possible co-operation of the centres

In the development of industries to meet the requirements of broader markets the co-operation of the centres might be of great importance. But what interest would they have in supporting our efforts to substitute domestic production for imports from the central countries themselves? The answer is very simple. Substitution would enable us to import technologically advanced rather than less advanced goods, which would clearly be to the benefit of both parties.

Furthermore, this would be a way of opening up a broad field for transfer of technology to the peripheral countries, with obvious advantages for the centres, which, besides making progress in diversification through new technologies, would have the benefit of negotiating with peripheral countries the transfer of technologies that are already being left behind by others which are more advanced, and thus expanding their sphere of action. These two considerations might perhaps lead the World Bank, as well as

IDB, to take an active part in financing the necessary investment. This would make it possible to strengthen the position of Latin American enterprises, whether private or public, in different forms of co-operation with those of the centres.

In the light of what has been said above, it is possible to understand the effort that is being made by the most important countries to clear a way for their advanced-technology exports. The most interesting case that has recently arisen relates to the trade and tariff act that has just been passed in the United States. The different branches of electronics and biotechnology constitute the most outstanding expression of the technological revolution that is taking place at the present time in the developed world, and it is natural that the United States, like other countries, should be anxious to broaden its markets, which are of course subject to keen competition. It would seem that to achieve this

end, the United States is intending to provide incentives which will promote the market for their products in the peripheral countries, and there is even talk of trade concessions which would be extended bilaterally. Should this happen, we should surrender one of the most important conquests that have been made in the international economy, i.e., multilateralism. I am inclined to believe, however, that it would mean bilateral negotiation to obtain advantages rather than a radical change. But apart from that, what, it may be asked, could the United States do to ensure that the peripheral countries' demand for imports of advanced goods can be accompanied by an increase in our exports to the United States? I have previously voiced my doubts as to this possibility, but I will admit to having been mistaken if we are offered concrete opportunities of trade expansion in appropriate conditions. But without disdaining such opportunities, should they arise, I still wish to urge—as I have done before—the advantages that peripheral import substitution would signify for the centres. It would be the most effective way of opening up markets for advanced-technology goods.

The endeavours of the United States are not confined, however, to the goods in question, but are also extended to services. There is a wide range of these which is experiencing the effects of the technological revolution, but what advantages would there be for our countries in accepting, for example, full liberalization of the United States banking system in competition with their own? I feel that in many cases we have already gone too far in this respect and that nothing would be gained by continuing to extend the facilities that have been given in the past. It is true that technological advances in bank operations represent indisputable advantages, but it is no less certain that measures could be adopted to promote technological progress in the national banking systems. There are various arguments in favour of measures of this kind, because the saving on remittances of profits that would be achieved in this way, thanks to the substitution of domestic for imported services, could be more advantageously turned to account in importing advanced-technology products, whether capital goods, inputs or consumer goods, which incessant diversification offers to our countries.

VI

The interest of the centres and the interest of the periphery

In face of these challenges, needs and possibilities must, I think, be carefully reviewed, with no succumbing to the allurements of ideas from the centres. They must be carefully reviewed, they must be sifted through the strict mesh of our own best interests with one essential concept always in mind: the centres have shown concern for peripheral development only in so far as it was in keeping with their economic, political or strategic interests. We cannot reproach any one country with promoting its own interests, but that does not

mean that ideas and suggestions coming from abroad have to be accepted at their surface value without a discerning eye for our countries' own interest. The reproach would be deserved by those who lightly adopt such ideas and suggestions without that prior review of what is and is not desirable.

I am convinced, moreover, that a stage has been reached in relations with the centres at which broad areas of convergence of interests can be found, and therefore I have ventured to make the observations set forth above. Such

broad areas of convergence exist in trade and in external investment. The requisite review must be made in the light of our own experience. I have already recalled the opposition put up first to industrialization and then to import substitution. We were advised to export manufactures instead of substituting domestic production for imports and when we learnt to do so obstacles were placed in our way. Import substitution was long regarded as a monstrosity spawned by ECLAC. But with the passage of time these ideas are changing. Last year Dr. Annie Kruger, an important World Bank official, on passing through Santiago (Chile), severely criticized import substitution; yet Mr. Clausen, President of the World Bank, in his most recent address to the Board of Governors, spoke of the need for exporting manufactures and also for import substitution, kindling the hope that a further mental stride will bring the Bank to recognize the necessity of promoting reciprocal trade in the Latin American periphery as well. What is more, Professor Bela Balassa, consultant to the World Bank, who had been systematically critical of ECLAC's position in this respect, is now likewise speaking of import substitution and exports of manufactures. Mr. Larossiere, Director-General of the International Monetary Fund, also accepts these ideas.

All the foregoing remarks are equally applicable to conditionality. We are now being told that the World Bank will establish a conditionality like that of the IMF in respect of loans for the purpose of structural changes. I believe that loan operations of far-reaching scope must be accompanied by conditionality, but what conditionality? Does a conditionality defined in accordance with the centres' own

concept of development meet the requirements of peripheral development? As far as I know, conditionality has never been discussed with Latin American economists, but has been decreed by the North. Here too an efficacious co-operation policy calls for a significant change. A real effort must be made in this direction, because of course the ideas that correspond exclusively to the interests of the centres are deep-rooted. Perhaps the most striking case in point is afforded by *The Economist* of London, which stated in the headlines of a recent issue (30 November 1985) that the poor countries had donated US\$ 65 billion to the developed countries as a result of the deterioration in the prices of primary products. This, according to *The Economist*, will make it possible for the centres to attenuate the price increases which might be caused by an expansionist policy, an effect that seems highly advisable. Yet no other reference to the periphery is made, such as, for example, the comment that a possible lowering of interest rates would be advantageous for it as well. There is no allusion, of course, to the seriousness of a fact which is severely prejudicial not only to the debtor countries, but to all developing countries, in that it deprives them of resources that are indispensable in order to raise their rates of growth.

Needless to say, the crisis of the centres drastically affects the periphery, accentuating the consequences of its own crisis, which are not only economic but also social and political. The significance of our countries' return to democracy is cried up, but the risks and problems implied by this crisis for the Latin American countries' political and social stability perhaps go unperceived.

VII

Post scriptum

After finishing this article I learnt that three institutions whose prestige stands very high have taken the praiseworthy decision to embark upon formulating a new development strategy

for Latin America. They are the Colegio de México, the Fundação Getulio Vargas and the Washington Institute for International Economics. I have received a copy of two

opening chapters setting forth the initial findings of an analysis in which the development of the Latin American countries is compared unfavourably with that of other developing countries. It is not my intention to go deeply into this analysis, but simply to refer to a statement made in it with respect to ECLAC's share of responsibility for the foreign trade policy of the Latin American countries included in the tripartite study. The following comment appears: "The early post-war years saw a policy shift from export orientation to import substitution in Latin America. The intellectual underpinnings of this shift were provided by the United Nations Economic Commission for Latin America, that saw scant possibilities for rapid economic growth through export expansion. The view was expressed that, due to a secular decline in their import coefficients, the developed industrial countries would not provide a sufficient stimulus for economic growth through primary exports; that Latin American countries were not in a favourable position to develop manufactured exports; and that there was a tendency for the external terms of trade of countries, indicating the relationship between export and import prices, to deteriorate over time."

This is a purely arbitrary assertion founded on imperfect acquaintance with ECLAC's work, as I shall go on to show, in the hope that in a subsequent version of the study the serious misapprehension entertained may be cleared up.

For instance, a report published in 1959² reads as follows:

"Import substitution is not a simple operation with boundless horizons. A persistent substitution policy which is unaccompanied by increases in productivity may be carried so far as to entail a reduction of exports, that is, a net loss of foreign exchange. Indeed, unless it is spontaneously generated, import substitution calls for the adoption of protectionist measures which have to be gradually intensified as possibilities are exhausted in those fields where differences in productivity between the country concerned and the rest of the world are not too marked. As a result of this increasing degree of

protection, internal costs rise, and affect the profitability of exports, which varies from one commodity to another. In the initial stages of the substitution process, the decrease in the profitability of exports may not be enough to cause a contraction in their volume, but it may perfectly well happen that, as further progress is made, marginal exports dwindle, and a point may be reached at which what is saved through substitution is lost on exports. Of course, the wider the margin of profitability of exports and the less the need for protection, the farther can import substitution be carried without the critical point's being reached..

"The analysis has led to the conclusion that the slow growth of demand for traditional export commodities and the maintenance of a rate of growth of the product formerly registered call for a substitution of domestic production for imports so rapid as to seem an impossible task, even if the external financing situation were to be very favourable.

"How, then, can the Latin American countries eliminate the bottleneck created by the shortage of foreign exchange? There are in reality two ways open to them. *One would consist in a considerable expansion of extra-regional exports of goods, other than the traditional commodities*; another would take the form of an expansion of inter-Latin American trade based on an accelerated substitution process in respect of imports from other parts of the world, but carried out at regional level and by means of more intensive trade in traditional commodities.

"The first of these alternatives would require a notable change of direction in the trade policy of the developed countries, in the sense that the tariff and other restrictions which they are in the habit of applying need to give way to a system under which the Latin American countries could exploit the comparative advantages afforded by their natural resources and their geographical position. The second method would entail a gradual reshaping of the bases on which inter-Latin American trade has hitherto developed, in such a way that full advantage could be taken of the potential benefits of a broad regional market, without prejudice to the development prospects of countries with lower income levels.

²See ECLAC, *The Latin American common market*, United Nations publication, Sales No.: 59.II.G.4.

"These two methods are not mutually incompatible, and a wise application of both would redound to the benefit not only of Latin America but also of the more developed countries of the rest of the world. The possible effect of a reform in the trade policy of the great industrial centres merits detailed study. Only the possibilities of eliminating the bottleneck through the organization of a common market will be studied here.

"The establishment of a common market would have the advantage of enabling the substitution process to be carried farther, without detriment to specialization possibilities, than would be possible within the sphere of each country's individual market. When Latin America is considered as a whole, demand for imports from outside the region falls to a level compatible with its supply of foreign exchange; and, at the same time, each of the members of the market could maintain a high coefficient of imports, although the proportion obtained from intra-regional sources would increase, in varying degrees."

Shortly afterwards, in 1961, when I was Executive Secretary of ECLAC, a study of mine was published, entitled "Economic development, planning and international co-operation", in which, to the best of my knowledge for the first time, industrialization policy was severely criticized, a quarter of a century in advance of the study in question on a new strategy. It is worth while to reproduce two or three relevant paragraphs:³

"The basic flaws in industrialization.

Although the *volume* of industrial production is not arbitrary, its *composition* has proved to be so in Latin American experience. From this point of view, *the process of industrialization suffers from three main flaws which have weakened its contribution to improving the standard of living. These are: (a) all industrialization activity is directed towards the domestic market; (b) the choice of industries to be established has been based more on circumstantial reasons than on considerations of economic yield; and*

(c) industrialization has failed to overcome the external vulnerability of the Latin American countries.

"The excessive channelling of industry towards the domestic market is a result of the development policy pursued in the Latin American countries and of the *lack of international incentives to exports of industrial goods from the region.*

"Development policies have been discriminatory as regards exports. Assistance has been given —through tariffs or other restrictions— to industrial production for internal consumption but not to industrial production for export. *The production of many industrial goods has thus been developed at a cost far above the international level, when they could have been obtained with a much smaller cost differential in exchange for exports of other industrial products which might have been produced more profitably.* The same could be said of new lines of primary commodities for exports and even of traditional export commodities within certain relatively narrow limits."

And in another study, also published in 1961, and concerned with the false dilemma between economic development and monetary stability, similar concepts were enlarged upon in the following terms:

"Discrimination against exports.

Obviously the development of new exports, in addition to traditional lines, would help considerably to achieve this aim. This brings us to the other fundamental error: an asymmetrical development policy. 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

³See A. Gurrieri (compiler), *La obra de Prebisch en la CEPAL*, Mexico City, Fondo de Cultura Económica, Part Two, pp. 84 and 85. The English version is quoted from *Economic Development, Planning and International Co-operation*, Santiago, Chile, United Nations publication, Sales No.: 61.II.G.6., p. 14.

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."⁴

The tripartite study on strategy (p. 12) also cites Santiago Macario, an ECLAC economist, who censured the abuses of the Latin American countries' protectionist policy and that of the developed countries too. In the words of Mr. Macario,

"With very few exceptions, the Latin American countries cannot be said to apply a protectionist policy, if by this is to be understood a systematic body of measures deliberately designed to permit and encourage the development of certain industries rationally selected within an overall framework of objectives established under a given economic development policy. What did and still does exist is protectionism, but as the largely indirect result of *ad hoc* measures, often adopted, at least initially or during a first stage, as emergency procedures, either in order to solve balance-of-

payments problems, or under the pressure of other exogenous factors. Such measures, temporary to begin with, became permanent in most cases and more general in their scope, giving rise to a form of protectionism which has been characterized by extemporaneousness, lack of autonomy (since it is primarily motivated by external causes), extremely high levels and indiscriminate application, and whose basic objective is import substitution at any cost, regardless of which industries it is most expedient to develop and how far the process should be carried."⁵

The tripartite study also remarks that "with additional subsidies and low import protection, exports in the manufacturing sector received, on the average, similar incentives as import substitution in the Far Eastern countries" (p. 19). In other words, these latter pursued a policy resembling that which ECLAC had recommended to the Latin American countries in the early 1960s.

In the light of the quotations from our writings, and of others of which mention would be redundant: is it possible to make such charges against ECLAC as are formulated in chapter I of the study in course of preparation?

ECLAC, in its desire to collaborate with the governments of the region, has put forward many suggestions and recommendations. Some have been followed, others have not. That is the fate of every initiative of this kind. If the countries do not heed these recommendations and suggestions, can the responsibility be laid at ECLAC's door?

⁴See A. Gurrieri, *op. cit.*, pp. 18 and 19. The English version is quoted from Raúl Prebisch, "Economic development or monetary stability: the false dilemma", in *Economic Bulletin for Latin America*, Vol. VI, No. 1, March 1961, p. 5.

⁵See Santiago Macario, "Protectionism and industrialization in Latin America", *Economic Bulletin for Latin America*, Vol. IX, No. 1, March 1964, p. 61.

Recent ECLAC publications

Economic Survey of Latin America and the Caribbean, 1983 (LC/G.1343). Santiago, Chile: 1985. Vol. I (686 pages) and Vol. II (166 pages).

This is the final combined version, in two volumes, of the 1983 Economic Survey, which originally appeared in 1984 in a number of fascicles. The first volume covers Latin America and is in three parts. Part One deals with the overall economic evolution of the region in 1983 and discusses the main trends, production, employment and unemployment, prices, wages and salaries and the external sector. Part Two examines the financial constraints, the transfer of resources and renegotiation of the external debt. Part Three, which is the longest, gives a country-by-country analysis of the situation of the 20 countries of the region.

The second volume deals with the Caribbean economies. Its first part describes the overall features of production, the external sector, inflation and unemployment, while the second part traces the evolution of 12 countries of this subregion in 1983.

Statistical Yearbook for Latin America, 1984 edition (LC/G.1337). Bilingual Spanish/English edition. Santiago, Chile: 1985. 765 pages.

The 1984 edition of the Statistical Yearbook for Latin America reflects the great effort that has been made to shorten the delay in submitting the statistics of the region.

On the whole, the format of the tables by item and sub-item used in previous editions of the *Yearbook* has been kept. The first part contains derived socioeconomic indicators (growth rates, shares, and coefficients or proportions), which summarize each area of interest and provide background information that can be used in more specific analyses. This set of indicators includes those used in the regular regional assessments of the International Development Strategy and of the Regional Programme of Action.

The second part gives the historical series in absolute figures, which can be put to a wide variety of uses. In the majority of the national statistical tables, data are provided on similar topics, arranged in such a way as to facilitate comparison between countries and between country and regional totals or averages. The only exceptions to this format are the balance-of-payments and national accounts tables, which were drawn up by the countries themselves. In the present edition of the *Yearbook*, two countries have been added to the series of national accounts, in an effort to continue extending the coverage of the *Yearbook* to the largest possible number of ECLAC member countries.

La juventud en América Latina y el Caribe (Youth in Latin America and the Caribbean) (LC/G.1345). Estudios e Informes de la CEPAL series, No. 47. Santiago, Chile: 1985. 181 pages.

It is now an established practice of the United Nations General Assembly to dedicate a particular year to a problem linked to development and to better international understanding, especially in their social aspects, in order to further knowledge of the situation and to encourage governments to formulate policies to promote social participation, equity and peace within nations and in international relations. To this end, 1985 was proclaimed International Youth Year.

The subject of youth has been particularly relevant in recent decades. In Latin America and the Caribbean, the 15-24 age group is relatively speaking one of the largest in the world (20.2% of the population) and one-third of the labour force is under 25. However, the incorporation of young people into the labour force is slow and their unemployment indexes are increasingly high, so that in some countries almost half of the unemployed are young people.

The young people of Latin America are not a homogeneous sector of the society. Although their incorporation into society was assisted by the modernization processes in previous decades, it was very uneven in the different social groups. For some, such as young illiterates or those who had received little schooling, it meant relatively greater marginalization, compared with those who had attended university. Moreover, the positive indicators of the incorporation of all groups have been seriously affected by the present economic crisis, which is not only causing high unemployment among the young and a deterioration of the social services designed to train them but has also created great uncertainty as to the future style of development and the role of young people both in today's society and in those which are in the process of formation.

With no clear picture of the direction that change is taking and with the realization that future society will be very different from the present one, there is concern as to what values to pass on to the youth.

For these and many other reasons, outlined in the texts included in this book, ECLAC has assigned high priority to the International Youth Year.

Desarrollo de los recursos mineros de América Latina (Development of the mining resources of Latin America) (LC/G.1355). Estudios e Informes de la CEPAL series, No. 48. Santiago, Chile: 1985. 145 pages.

The world crisis has had a negative impact on the evolution of mining activity in Latin America, especially during the period 1980-1983. There has been a decline in traditional mining exports, caused by the worldwide contraction in industrial demand, while at the regional level, the changes in consumption have led to a reduction of imports as a result of the heavy external debt accumulated by the region. Even so, imports of goods produced with mining inputs

account for about 40% of the region's total imports and these resources still account for more than 10% of the foreign exchange received from outside the region.

At the regional level, this situation calls for speedier complementation and integration of the various phases of mining, metallurgy and metal-working and requires both the active participation of the nations of the region and support from other countries and international institutions in order to facilitate the transfer and adaptation of technology and to secure adequate complementary financing. In this connection, it is vital that a series of joint measures should be undertaken to increase the knowledge of the region's mining potential and to improve the organization of its mineral production, processing and marketing.

In addition, measures should be taken to ensure that Latin America maintains or increases its share of the supply of several mining products to the international market by the year 2000 by boosting its exportable surpluses and its competitive capacity. If these objectives are to be achieved, new investments will be needed as well as long-term sales contracts which could include industrial and commercial complementarity clauses.

In order to highlight some basic aspects of the prospects mentioned above, this study examines the trends prevailing in 1984, the effects of the world crisis on these trends, the possibilities for the future development of the region's mining resources and some general ideas which could be used in devising the best possible policies for the development of mining resources.

Las relaciones económicas internacionales de América Latina y la cooperación regional (The international economic relations of Latin America and regional co-operation) (E/CEPAL/G.1303/Rev.1). Estudios e Informes de la CEPAL series, No. 49. Santiago, Chile: 1985. 224 pages.

From the beginning of the 1980s, the international economic order and Latin America's integration process have been shaken by events of enormous significance. A global crisis has been unleashed from which no one has been completely spared, and that crisis has revealed Latin America's external vulnerability. Among the problems besetting the region have been the decline in the regional product, the reduction in per capita income, the increase in unemployment, the deterioration of the terms of trade, the severe contraction in imports, the extraordinary increase in international interest rates and an external debt whose service has become increasingly burdensome. Similarly, in recent years recessive adjustment policies have been applied in the region and their negative effects have reduced the social and political tolerance of many of the countries of the region.

Furthermore, a clear bilateral trend has become evident in North-South political and trade relations, and multilateral institutions and mechanisms have been relegated to second place. This has given rise to a series of failures in international economic negotiations which have

fostered in the developing world justifiable feelings of frustration and distrust in the value of international co-operation.

In the region itself, the crisis has been reflected in a decline in imports, a weakening of regional co-operation and integration systems and, especially, a drop in mutual trade. However, in the most recent regional meetings it has been noted that despite the acute problems confronting it, the regional integration process continues to enjoy a high level of political support.

The situations that the countries of the region have had to face and the need to find a solution prompted the President of Ecuador to request ECLAC and SELA to prepare a background study on the bases for the specific measures that Latin America as a whole should take to cope with the crisis. This initiative culminated in the Latin American Economic Conference, at which the Quito Declaration and Regional Plan of Action were adopted.

It is in this context that the document under review summarizes the most significant features of the events referred to, concluding that it is absolutely necessary to strengthen regional co-operation and integration and to organize and exercise joint bargaining power at the international level. If it did this, the region could help to reorder North-South relations on a more equitable basis and embark again on the path of economic and social development with a longer-term perspective.

América Latina y la economía mundial del algodón (Latin America and the world economy of cotton) (LC/G.1353). Estudios e Informes de la CEPAL series, No. 50. Santiago, Chile: 1985. 122 pages.

The present international economic situation could be described as negative for the cotton-producing and exporting countries, both as regards the volume of demand and the level of international prices. In some countries the situation is so bleak that the survival of cotton as an export crop is in doubt.

After an examination of the global context, in which technical aspects of cotton, long-term world trends in production, consumption and prices, and the general features of the cotton industry as a whole in Latin America are analysed, case studies on Argentina, Paraguay, Mexico, Guatemala and Nicaragua are presented.

In view of the poor prospects for this product, the cotton-producing countries of Latin America must redouble their efforts simultaneously on various fronts.

Support mechanisms must be provided internally, especially for the weakest economic agents, and the possibility should not be excluded of promoting the replacement of cotton by other crops in cases where this is most justified.

At the regional level, nothing has been done so far, since up to now the cotton-producing countries of Latin America have had no consultations, except for the unofficial meetings of the Latin American group during the meetings to prepare for UNCTAD VI. Regional agencies such as SELA and ECLAC could provide a suitable framework for

these meetings, from which a more permanent institutional instrument, similar to the Group of Latin American and Caribbean Sugar Exporting Countries (GEPLACEA), could emerge to examine possible areas of co-operation (consultations, research and development, joint marketing, local processing).

With respect to production, it would be useful to participate in the deliberations of the Izmir Group and of the Association of Producers which has emerged from this group, bearing in mind that given the position of cotton in world markets and the minority share of the Izmir Group in world exports, it would be difficult to raise prices unilaterally.

With respect to research and promotion, the Latin American countries, except for Mexico and Brazil, have not participated very actively in the activities carried on at the world level (especially those of the International Cotton Institute). These activities must be strengthened, because the Latin American countries have not clearly perceived their importance so far. Furthermore, this aspect has the advantage of being less controversial than the others and could enjoy the support of many of the consumer countries.

The Latin American countries have taken an active part in negotiations for the establishment of mechanisms to support international prices, both in the preparatory meetings for UNCTAD VI and in the deliberations of the Izmir Group which was formed in the early 1980s by 18 producer countries. It would be advisable to press forward, despite the meagre practical results that have been achieved so far in strengthening unity among developing countries.

In this connection, the producer associations could be used to press for the creation of suitable international mechanisms to help to overcome present difficulties.

Comercio y cooperación entre países de América Latina y países miembros del CAME (Trade and co-operation among the countries of Latin America and the member countries of CMEA) (LC/G.1356). Estudios e Informes de la CEPAL series, No. 51. Santiago, Chile: 1985. 90 pages.

Although the Latin American countries made some progress in exporting manufactured goods to the different regions of the world, during the period from 1970 to the early 1980s, the volume of their exports of manufactures to the European member countries of the Council for Mutual Economic Assistance (CMEA) continued to be small and represented only a small proportion of the total imports of those countries, whereas basic commodities represented 92% to 95% of those imports.

A significant feature of the exports of manufactures from the Latin American countries to the CMEA countries was their lack of diversification, since they usually consisted of only three or four products. Brazil was the only exception, with 12 products.

Latin American imports from the socialist countries of eastern Europe have grown less than their exports. Their volume is relatively small; manufactures, with a high proportion of machinery and equipment, account for the

biggest share, with chemical products coming next in line. The secretariats of ECLAC and UNCTAD chose to analyse three topics in this area which are of greatest importance to the countries of Latin America.

Firstly, an analysis was made of industrial co-operation between the Latin American countries and the CMEA countries, with special consideration being given to the countries offering industrial co-operation and to the potential benefits thereby provided for the industrialization and development processes of Latin America. Two studies were prepared, assessing the experience gained by both parties in executing the intergovernmental agreements which serve as the institutional basis for industrial co-operation.

Secondly, a study was carried out on trade in manufactures between Latin American countries and the socialist countries of eastern Europe. It analysed the structure and evolution of this trade and identified some of the causes of the scant growth to date of Latin American exports of manufactures, in an attempt to rectify the present unbalanced trade structure. The problems affecting exports of manufactures and industrial equipment from the CMEA countries were also examined, as those exports had grown much less than Latin American sales to those countries in the last 20 years, giving rise to the sharp imbalance which is an obstacle to the future development of reciprocal trade.

The third subject studied was co-operation in hydroelectric energy. Because of the preference which the increasing development of hydroelectric potential should be given in the energy programmes of Latin American countries, it would be useful to take advantage of the experience gained in this area, by the European CMEA members. Two independent reports were commissioned so that a better evaluation could be made: one was prepared by a CMEA expert and another by an ECLAC consultant. It was thus easier to clarify the problems encountered in executing the hydroelectric co-operation agreements between the countries of Latin America and of the CMEA, and useful guidelines were drawn up for the more effective implementation of future agreements.

The water resources of Latin America and the Caribbean and their utilization (LC/G.1358). Estudios e Informes de la CEPAL series, No. 53. Santiago, Chile: 1985. 142 pages.

As a contribution to the United Nations Conference on Water, in 1977 ECLAC prepared a regional report entitled "The water resources of Latin America". Copies of that report have been out of print for some time now and it has been considered desirable to publish a new and revised edition reviewing the progress made in Latin America in applying the Mar del Plata Plan of Action adopted by the United Nations Conference on Water.

The Plan of Action is a broad compilation of recommendations and resolutions covering all aspects of water resources development and management. It is difficult to summarize because it is so vast and detailed, but

it does highlight the following: there should be greater knowledge of drinking water supply by upgrading the assessment of this resource; water should be used more efficiently through the application of price policies and other economic incentives; the environmental consequences of water use and the related effects on health should be evaluated; national policies should be developed to plan water use, management and conservation; the programmes designed to reduce water losses through natural risks should be strengthened; public information and education programmes related to water resources should be improved, and regional and international co-operation for the development of water resources should be strengthened.

In the years since the Conference, population growth has accelerated throughout the Latin American region, and this has led to a sustained increase in the demand for water, especially in the metropolitan areas and related industrial complexes.

At the same time, the pattern of income and economic activity in the region continues to be very varied, and this is also reflected in the demand for water. Thus, the needs of peasants in the highlands of Peru or Bolivia are very different from those of the urban middle and working classes in São Paulo, Buenos Aires or Mexico City. While the demand for water for recreational purposes is increasing, too many children continue to die —despite the progress made in this respect— from exposure to the risks of polluted water. Contamination of water from both domestic and industrial sources is also increasing. Although some progress has been made in treating waste water, much remains to be done before it can be said that the fight against pollution has been won.

Latin America and the Caribbean is the region with the most abundant water resources in the world, but it also has some of the most arid areas. The different ways in which needs and resources are combined give rise to very different situations, both nationally and regionally. Despite the differences, more and more, the countries of the region are making similar co-operation efforts to examine and resolve the issues which must be faced in the matter of water resource management. Perhaps the most positive result in the years since the holding of the United Nations Water Conference has been the increase in co-operation activities, such as the International Drinking Water Supply and Sanitation Decade, multilateral agreements for protecting the most important seas in the region and their related resources, and the general increase in activities involving shared water resources.

La pobreza en América Latina: dimensiones y políticas
(Poverty in Latin America: dimensions and policies)
(LC/G.1366). Estudios e Informes de la CEPAL series,
No. 54. Santiago, Chile: 1985. 154 pages.

In the year 2000, around 170 million Latin Americans will still be living in conditions of critical poverty if there is no change in the mode of development which has predominated in most of the Latin American countries and

if, at the international level, no account is taken of the need to find new forms of solidarity with the less developed countries of the region.

At the end of the century, the poor will be concentrated in the cities: one out of four urban inhabitants will be poor, and there will be 102 million poor people in the cities. Despite this, the impact of poverty will continue to be most keenly felt in the rural sector, because 50% of the rural inhabitants will be poor.

The situation with regard to poverty today is not very different from the prediction for the year 2000. There are at present around 130 million poor people in Latin America, which is equivalent to about 35% of the total population, and they are distributed equally between the rural and urban areas.

The relative decline in critical poverty in the present decade and in the next is expected to be less than in the past, since it is presumed that the economic growth rate will be lower and that there will be no changes in the current styles of development. Whereas between 1970 and 1980 the figures show that there was a decline in the poverty rate from 50% to 35%, between 1980 and the year 2000 the poverty rate will only decline from 35% to 30%. These figures are sufficiently eloquent to show the magnitude of a phenomenon which affects one of the most basic human rights: the right to a decent life.

It is therefore not surprising that ECLAC and other United Nations agencies have consistently denounced the extreme inequalities which have arisen and have persisted in the Latin American countries.

The lack of a theoretical framework makes analysis of the subject of poverty more difficult and some subjectivity inevitably enters into any attempt to define it. Without overlooking this shortcoming, this study proposes on the one hand to increase the existing knowledge of the phenomenon of absolute poverty in Latin America and, on the other, to suggest policy guidelines which could overcome it.

Bearing in mind those two main aims, the first part of the study examines some of the conceptual and methodological problems which arise when an attempt is made to define poverty; summarizes the extent and degree of poverty in the region; provides information on the development of Latin America and the growth of poverty in past decades; points out the main socioeconomic and demographic features of rural and urban poverty, and finally draws a number of conclusions.

The second part begins with some observations on recent strategies designed to meet basic needs or to alleviate poverty; it then specifies the strategy chosen and suggests guidelines for the formulation and execution of policies to eradicate poverty. This latter section of the report, which is also the longest, contains an analysis of the initiatives designed to increase the quantity and quality of jobs, to bring about a change in the structure of ownership of property, to increase the amount and productivity of the assets owned by the poor and examines measures to guarantee a minimum family income.

The third part of the report contains some observations on the political conditions and changes in State administration that must be included in any strategy

that proposes to overcome the economic, social and political conflicts that will be triggered by the changes that must be made in the traditional styles of development, in order to surmount the obstacles that have so far prevented any significant improvement in the situation of the poorest groups in Latin America.

La CEPAL, encarnación de una esperanza de América Latina (ECLAC, embodiment of Latin America's hopes), by Hernán Santa Cruz (LC/G.1349). Cuadernos de la CEPAL series, No. 50. Santiago, Chile: 1985, 77 pages.

Hernán Santa Cruz, who had a long and distinguished career in international organizations, especially as Ambassador of Chile to the United Nations and Deputy Director-General of FAO for Latin America, recently published the work "Cooperar o perecer: El dilema de la comunidad mundial", two chapters of which describe the period when ECLAC was being set up and review what he calls "the extraordinary work of ECLAC in its first fifteen years".

Because this work is so important for understanding and assessing the past work of the Economic Commission for Latin America and the Caribbean, ECLAC has published part of chapter six and chapter sixteen of Hernán Santa Cruz's book in this Cuaderno. Using the history of ECLAC as the guiding theme, these extracts from a much longer work constitute a harmonious whole and provide an informed and readable account of the theoretical interpretations of the economic and social situation of Latin America made by ECLAC, as well as little-known details of the difficult struggle to win the acceptance of governments and international organizations for the basic ECLAC ideas.

Origen y destino del comercio exterior de los países de la Asociación Latinoamericana de Integración y del Mercado Común Centroamericano (Origins and destinations of the external trade of the member countries of the Latin American Integration Association and the Central American Common Market) (LC/G.1365). Cuadernos Estadísticos de la CEPAL series, No. 9. Santiago, Chile: 1985. 546 pages.

This Cuaderno Estadístico is the first of a series of documents which the Statistics and Quantitative Analysis Division of ECLAC intends to publish regularly on the basis of information provided by the External Trade Data Bank for Latin America and the Caribbean (BADECEL), organized by ECLAC.

It provides information on the external trade of the countries of the Latin American Integration Association (ALADI) and of the Central American Common Market (CACM) at the most highly aggregated level (sections) of the Standard International Trade Classification (SITC). This information is presented separately for each country, for each subregional integration agency, and for all the sixteen

countries which comprise them and whose external trade accounts for over 90% of the region's total.

The countries have been chosen and the information is presented in the light, on the one hand, of the greater availability of data from these organizations and consequently the possibility of making more detailed subdivisions for future studies in specialized areas and, on the other, of the desire to provide an approximate quantitative basis for the macro-economic analysis of the structure and trends of the external trade of the region as a whole.

There are periodic United Nations publications which give more detailed information about the external trade of member countries according to the SITC.¹ However, because of the large number of countries included, these publications do not provide the analyst with a view in space and time which enables the figures to be used without further elaboration. This aim was achieved in a recent ECLAC publication on Latin American external trade,² although the information was presented on the basis of combined SITC sections and divisions in order to define some concepts of goods relating to particular years, with specific analytical aims.

The statistical tables of this Cuaderno refer to a number of exports (FOB) and imports (CIF) covering the period 1970-1982. The participating areas and countries and the share of each section in the participating zones and vice versa are presented according to the SITC sections. Similarly, the total value of trade in each participating area and each section of the SITC are included, in both cases with their respective structure in relation to the overall total for both exports and imports.

Industrialización y desarrollo tecnológico (Industrialization and technological development), Informe No. 1. Santiago, Chile: 1985, 69 pages.

This report is the first in a regular series. Its main purpose is to offer an updated but summarized view of the changes taking place in world and Latin American industry which may have an influence on the preparation and application of national industrial policies, on the taking of decisions at the enterprise level, on the development of research in the academic sphere and on the identification of regional co-operation initiatives and mechanisms.

The report will contain a number of permanent sections which are already mentioned in this issue:

i) basic statistics on the manufacturing sector in Latin America: to begin with, a quantitative description of the sector's evolution between 1950 and 1984 is given;

ii) industrial policies of the advanced countries: this contains an analysis of the policies and resource allocations for these countries for science and technology, and the relative position of Latin America;

iii) sectoral studies: this issue discusses the question of robotics;

iv) recently industrialized countries of other regions: the first topic examined is electronics in South Korea;

v) industrial policies in Latin America: in this first issue, the relative importance of public and private national

and foreign enterprises in the productive sector of a number of countries of the region is discussed;

vi) activities of the ECLAC/UNIDO Division: this outlines the regional capital goods project;

vii) observations of the joint ECLAC/UNIDO Joint Industrial Development Division: this includes a definition of the concept "endogenous technological dynamization nucleus" and the subject is explored in today's context;

viii) bibliography: this issue focuses on import substitution and export promotion.

Panorama económico de América Latina 1985 (Latin American Economic Panorama, 1985) (LC/G.1369). Santiago, Chile: 1985. 76 pages.

This report on the current economic situation, published towards the end of 1985, gives an overview of the Latin American economy during the first three quarters of that year on the basis of events in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay.

The report concludes that, despite the partial and provisional nature of the information available, certain central facts stand out clearly in this economic overview of the region. One is the setback in foreign trade, after the moderate recovery in 1984. The other is the importance of the agreements for rescheduling the external debt which have been reached between many countries and the private international banks. These agreements have taken a number of different forms but have usually been more favourable than the very onerous ones signed in previous years. One of their main features, however, has been the scant net additional financing granted by the commercial banks. As a result of this and of the decline in exports, the inadequate availability of external resources has continued to be the chief impediment to the recovery of economic activity and the growth rate has slackened in most of the countries of the region. Finally, the other fact highlighted was the increasing diversity of the inflationary processes and the considerable achievements made initially by means of unorthodox stabilization programmes in some economies where prices had soared most markedly.

Avances en la interpretación ambiental del desarrollo agrícola de América Latina (en colaboración con el PNUMA) [Progress made in the environmental interpretation of the agricultural development of Latin America (in collaboration with UNEP)] (LC/G.1347). Santiago, Chile: 1985. 236 pages.

This volume brings together most of the papers presented at the ECLAC-CIFCA seminar on agricultural processes which are of importance in Latin America from the environmental angle (Santiago, Chile, 28-30 June 1983) and represents the last stage in the extremely useful collaboration between the International Centre for Training in Environmental Sciences (CIFCA) of Spain and ECLAC.¹

Early in 1982, CIFCA added to its environmental training activities a programme of research, seminars and publications which (together with the activity carried out in this area by ECLAC and the Regional Office of UNEP for Latin America and the Caribbean) became a catalyst for environmental concern and reflection in the region.

Interest in rural matters was shown from the very beginning of this programme, and its research projects on the Latin American ecology included, in particular, that on the environmental dimension of the rural dynamics of Latin America and that on the coastal mountain range of Chile. This interest was also expressed in a joint UN/CIFCA publication (Madrid, 1983) of papers on the expansion of the agricultural frontier and the environment in Latin America.

Finally, CIFCA promoted work in this field through a regional research programme on agricultural processes of importance to Latin America from the environmental aspect. This programme was proposed as a medium-term activity. The different contributions of the participants, it was considered, should all merge into a comprehensive programme in which the following were especially important: a new approach to the rural environment, systematically highlighting the potential, limitations and priorities of the region; the interaction between social and natural processes; the occupation of new spaces on the rural frontier of the continent and its effect on the environment; the processes of deterioration or impoverishment, visible only in the long term, to which ecosystems of traditional occupation are exposed; and the role of the State in the occupation, deterioration and protection of rural spaces.

All these points were dealt with in the contributions presented in this volume, and though there was not the level of interaction among viewpoints that was hoped for in the original proposal, there was a definite area of agreement, within which the diversity of proposals may arouse the reader's interest.

External debt in Latin America. Adjustment policies and renegotiations. Lynne Rienner Publishers. Boulder, Colorado: 1985. 125 pages.

In 1982-1983 many Latin American countries were forced to apply adjustment policies and to take measures to renegotiate their foreign debt. In essence, in terms of economic policy, these two processes represented an initial short-term response to the challenge posed by the deep and protracted economic crisis which has beset the region since 1981.

In some cases, the adjustment policies, which were designed to reduce the external imbalance, were applied together with stabilization programmes aimed at slowing down inflation. In actual fact, the results achieved reflected both the effect of the policies and the impact of external factors over which the national economic authorities had little or no control.

Both the adjustment process and the renegotiation of the external debt have proved to be very costly for the countries of the region. Between 1981 and 1983 they

succeeded in considerably reducing the balance-of-payments current account deficit and thus met the basic aims of the adjustment policies; but this was due almost exclusively to the enormous decline in the volume of imports. Consequently, the adjustment was severely recessive in nature and in many countries was accompanied by a considerable decline in local economic activity and a drop in employment. At the same time, the agreements to renegotiate the debt, which have made it possible for the countries to avert even more serious balance-of-payments crises, have also contributed to a marked increase in the cost of external financing for the Latin American countries and, as a result, the benefits of this financing have been very unequally shared between the countries and the creditor banks. In many cases, also, the stabilization programmes have only succeeded in reducing the inflation rate slightly.

This book describes and analyse the policies applied and the results obtained through internal adjustments and the renegotiation of external agreements up to the beginning of 1984. Two aspects of the adjustment and negotiation processes which are considered to be generally valid are highlighted in the course of this report.

The first aspect is the severe restriction that the external environment places on economic policies in the vast majority of the countries of the region. It is obvious that unless the earlier dynamism of international trade is recovered and the recent trend towards marked

protectionism in many industrial economies is definitely reversed, it will be increasingly difficult and costly to promote the growth of Latin American exports. The same holds good for any attempt to overcome the present recessive adjustment, based as it is on an unsustainable compression of imports, in order to achieve a growth-oriented adjustment based on the expansion and diversification of exports. It is also obvious that if external financing continues to be as scarce as it was during the period 1982-1983, and if international interest rates remain close to the high levels that obtain today, the region will continue to make a real transfer of resources abroad and a greater proportion of the deficit on current account will have to be covered by onerous adjustment policies.

The second general aspect is the excessively broad nature of the economic policies applied to reduce the external imbalance and the heavy losses they have brought with them in terms of a slowdown of economic activity and the reduction of employment. In some cases at least, these costs could have been lower if the economic policy instruments had been used more selectively and pragmatically, having regard to the fact that the reassignment of resources is a more rigid and slower process, especially in the short term, in economies where the diversity of internal structures is as marked as it is in Latin America.

A list of ECLAC publications

PERIODIC PUBLICATIONS

CEPAL Review

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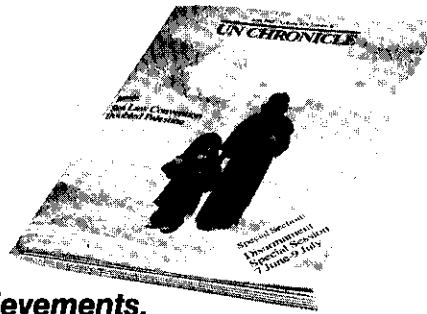
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