CEPAL
Review

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UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA
SANTIAGO, CHILE / APRIL 1980

UNITED NATIONS PUBLICATION

Sales N.° E.80.II.G.2

Price: US$ 3.00

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Number 10 April 1980

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E/CEPAL/G.1110

April 1980

Notes and explanation of symbols

The following symbols are used in tables in the *Review:*
Three dots (...) indicate that data are not available or are not separately reported.
A dash (—) indicates that the amount is nil or negligible.
A blank space in a table means that the item in question is not applicable.
A minus sign (-) indicates a deficit or decrease, unless otherwise specified.
A point (.) is used to indicate decimals.
A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.
Use of a hyphen (-) between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.
References 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 may not necessarily add up to the corresponding totals, because of rounding.

THE ENERGY CHALLENGE*

*Enrique V. Iglesias***

THE DEBATE ON STYLES OF DEVELOPMENT

The subject of styles of development is not foreign to us, nor has it only recently become one of CEPAL's concerns; it has been one for some time. Originally serving as an analytical category to dispel the anxiety of economists over the social failure or inefficiency of growth processes, it later acquired elements developed in the expanded international discussion of the various dimensions of development. The debate on development has thus been forced to follow the pronouncements of scientists which were publicized at a very opportune moment indeed by the work of the Club of Rome, through which the discussion on the meaning for humanity of the depletion of natural resources or the appearance of physical restrictions on the process of economic growth was brought up at the international level. These facts implied not only a scientific, but also an economic, social and political challenge, and at those levels the need to examine the styles of development which exert irrational pressure on natural resources and challenge physical restrictions was raised and discussed.

But the scientific questioning of development styles is not the only approach to them. Other discussions, from different vantage points, provide new angles from which to analyse in various ways the predominant style of development and to search for alternative styles.

I have just mentioned one of these approaches: the social angle. In discussing the social efficiency of growth, we condemn the inability of the reigning style of development to solve the social problems of Latin America and of the developing world in general.

Another angle from which both the economic and the social efficiency of styles of development in underdeveloped countries have been challenged vigourously is that of the "population problem"; that is, the explosive growth of the population and of urbanization, with all the concomitant problems that these phenomena have entailed.

The subject of technology functions in the same way. Conservationists, who have been concerned with this subject for many decades, have always drawn attention to the consequences that development styles based on the massive incorporation of modern technologies into backward societies could have as a potential source of aggression against their cultural patterns, leading consequently to the alienation of man from society and nature.

Another angle from which development styles in the developing world are being discussed is that of the autonomy of development, a subject which was not only raised at the ideological level in theories about imperialism and other related approaches, but has also been expressed in the political sphere through the process of decolonization and the explosion of the Third World onto the international scene. In the light of this concern, autonomy of development is another angle from which the particular characteristics of a certain development style can be evaluated.

But irrespective of the angle from which one views it —society, technology, culture or autonomy of development— the debate on development styles is extremely important in that it allows development to be appreciated fully and brings out the whole range and complexity of the subject. Even more importantly, it highlights the essentially political aspect of development

*The ideas presented in this article were formulated during a mission on co-operation in the field of energy with which the author was entrusted by the Secretary-General of the United Nations. They were presented at the CEPAL/UNEP Regional Seminar on Styles of Development and Environment in Latin America, held at CEPAL headquarters, Santiago, from 19 to 23 November 1979.

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processes. In reading the inspired reports prepared at the Founex and Cocoyoc meetings or by the Dag Hammarskjöld Foundation, in which alternative styles of development are discussed, one feels that they all have one basic limitation: although all are brillant in diagnosing the problem and analysing the various aspects of its possible solutions, none has stated that basic political definitions are at the root of it. The crux of the matter is whether social organization (and the basic political forces which uphold it) can truly bring about the changes which must be introduced in development styles in order to achieve the goals which these documents propose. It is precisely in the political capacity to achieve these transformations that the greatest challenge lies.

It is in this context that I wish to turn now to the subject of energy, which has recently concerned me personally, and which is another of the angles from which the styles of development currently predominating in the world can be examined.

THE ENERGY PROBLEM: GENERAL CONCERNS

To begin, I wish to clarify some of the remarks made previously. Firstly, I am not an expert on energy, and therefore I shall merely attempt to convey the impressions of one who examines the problem from the economic point of view. Second, I shall attempt to approach the problem by identifying the main challenges to be faced by developing countries in the years to come, and to consider the options these societies may have, with special regard to the Latin American countries.

The influence of energy on the prevailing style of development has already been pointed out by Osvaldo Sunkel.[1] There is no doubt that the type of energy which mankind has preferred to use in past years has set its stamp, in one way or another, on both the development style and the lifestyle of all the countries in the world. Under this style, economic development was stimulated mainly by technological achievements, which in turn depended closely on the energy base available. It was the development of these new technologies which facilitated the unprecedented flowering of the productive forces of humanity.

Obviously, this development style and the technological change which sustained it were made possible by the provision of a new type of energy, hydrocarbons, which for many decades was characterized by its relative abundance, the flexibility with which it could be used in various patterns of technology and, especially, its low cost.

This development style based on the introduction of new and cheap forms of energy facilitated the attainment by today's societies (or at least by their élites) of the levels of well-being which they currently enjoy. One quarter of humanity was thus able to reach unprecedented levels of living with extremely "sophisticated" technological advances based, of course, on the provision of cheap energy.

Clearly, the developing countries were influenced by a development style and type of technology based on these abundant and cheap sources of energy. And this life style gradually penetrated with particular virulence into certain groups of our societies, since the imitation of more opulent societies made us susceptible to all the forms of consumerism they had developed. In this way, Western civilization, or at the least its external trappings, penetrated to all corners of the earth, the every community and culture, and included all societies under identical rules of production and consumption which could thereafter no longer survive without the energy base which had sustained them for a number of decades.

In 1973 came the "energy crisis", which had two important effects. The first was that, through an intelligent association of the petroleum-producing countries, the above-mentioned cycle based on cheap energy was brought to an end. The industrialized world had developed over the

[1] See his report "Los estilos de desarrollo y el medio ambiente en el proceso histórico reciente de América Latina", presented at the regional Seminar mentioned earlier.

past thirty years through the continuous extraction, at greatly reduced cost, of a resource located mainly in the developing countries (the Arab countries produce 70% of the world's supply of hydrocarbons). The second effect of this crisis was to reveal for the first time the danger that the growth of hydrocarbon reserves would fall behind the growth rate of consumption of that resource and that during the next decade it would be difficult to maintain the world energy balance if the current growth rate of consumption continued. Indeed, if that rate is maintained in future years we will be in grave danger of facing an international fuel shortage and at some point before the end of the century the production curve could start to decrease. This situation raised a very serious quandary for a civilization which had drastically transformed its energy balance, was depending less and less on coal, and was nourishing its rapid expansion mainly on hydrocarbons. This was what was called the energy crisis.

All the consequences of this crisis, and not merely its impact on balance-of-payment positions, must be considered. It is undoubtedly one of the most complex and dramatic crises of the century, and should be approached from various angles.

Firstly, we are facing a *technical* problem, because essentially we must determine what humanity's options are when faced with the possible exhaustion of a source which is the mainstay of the current energy balance.

It is an *economic* problem, because whatever energy options the future may bring us, the price of the various sources of energy will be much higher than at present, since substitute sources of petroleum cost much more than the traditional sources on which humanity has based its development in the last few years.

It is a *political* problem because, for the first time, the developing world is reversing the traditional relations of dependency and is working together to obtain a higher price for one of its basic products through an exceptional demonstration of political organization which has allowed the Third World to react intelligently and to place North-South relations, also for the first time, on an interdependent rather than dependent basis.

It is also a *psychological* problem because, as I see it, either by the force of events or the will of the participants, one of the most formidable international information machines has been created and is forming images in the public mind which may distort the reality of the facts. Through these images, it is sought to attribute the responsibility for the current international economic crisis solely to the petroleum-exporting countries, which can only be explained as the result of an unfortunate distortion of international public opinion which fuels passions and makes any form of constructive international dialogue much more difficult.

Finally, it contributes to the generation of broader political problems, for we cannot ignore that behind the subject of petroleum lie political problems which transcend it. It is well known that petroleum has often been used as a weapon to achieve other political objectives, and that petroleum strategies are directly involved in the whole political crisis in the Middle East.

At all events, the balance of forces in the world has been changed, thus giving this discussion an entirely new character and making the question extremely complex. For it is not a purely technical problem; rather, it is at once an economic, political, psychological and information problem.

In spite of the numerous aspects of the energy crisis, I feel that its most important trait is the uncertainty which it has created on a world scale. It is precisely this uncertainty that makes an international dialogue essential, and the separate groups of countries must be brought together to discuss their respective interests and search for ways to co-operate for their mutual benefit.

FACTS AND UNCERTAINTIES OF THE ENERGY PROBLEM

Among this vast range of uncertainties, there are some facts which deserve special attention.

The first fact is that the production of hydrocarbons is approaching economic limits which could mean that in the next decade and until the end of this century, there will be a severe imbalance between supply and demand, with serious danger of temporary shortages and tremendous vulnerability to any type of international conflict. The political crisis in Iran has recently shown the extent to which we are treading an extremely narrow path between supply and demand, with severe fluctuations which could lead to permanent tension in the world markets during the coming years.

Second, the cost of energy resources will continue to rise throughout this period, and will approach the cost of replacing them. Naturally, the cost increase may take various forms and will not always continue at the same rate: it might be very rapid for the next two or three years, and then proceed slower and more gradually. But one fact which the entire world accepts is that energy costs will continue to rise in real terms. Up until three years ago, it was believed that the main goal in increasing prices would be to keep pace with the rate of inflation, but now I think that costs will continue to increase in real terms also. Some people contend that a real annual increase of 3 to 5% can be expected for the next decade; combined with the world inflation rate and the fluctuations in the most important currencies, this could lead to heavy increases in the world petroleum bill. This hypothesis presupposes that petroleum prices will double in nominal terms every few years and is certainly far from being the most pessimistic projection, if the recent behaviour of prices is taken into account.

Third, if the prices of energy resources climb faster than world inflation does, petroleum gluts and financial surpluses will become a common phenomenon in the future, especially in some countries. This will mean that international money markets will be influenced by surpluses of historically unprecedented magnitude which will play an important role in the world economy, depending upon what recycling machinery is adopted, either through the traditional methods of the past or through new ones which might be developed through international co-operation.

Fourth, increased prices will lead to conservationist policies, even though their results will not be immediately apparent. At best one can say that technology has shown that with appropriate policies, normal consumption levels can be reduced by 20 to 30% in future years. This reduction, although extremely important, will not solve the fundamental problems, however.

Fifth, everyone agrees that the developing world's ability to decrease its consumption of energy is greatly inferior to that of the developed world. Developing countries need much more energy than they are currently consuming, and will probably have to increase their rates of energy consumption much faster than their growth rates, which must be increased in the future if the developing world is to solve its economic and social problems. In other words, these countries cannot significantly contain or restrict their energy consumption without hampering their development processes. In the developed countries, on the other hand, the margin for reduction of energy consumption is much wider since, because of the degree of development achieved by their economies, their consumption of energy can increase more slowly than the product does.

Sixth, although there are other extremely important sources of energy, among which coal and nuclear energy are especially promising, it will take some time before they can be effectively utilized. Any investment in the nuclear field takes ten to fifteen years to start giving its fruits, and other foreseeable options, such as the liquefaction of coal, will also require fifteen years to affect the market supply. There are extremely promising possibilities in the area of renewable resources, but their effects are also difficult to forecast, at least in terms of commercial exploitation. In other words, there is no reason why petroleum should cease to be fundamental to the world provision of energy in the future, and consequently hydrocarbons will continue to make up over 50% of the world energy balance.

These are the facts which are generally accepted. Now let us consider the controversial matters.

No one knows exactly what the world's real capacity for hydrocarbon production is, in spite of the fact that there are said to be extensive as yet untapped deposits. Apparently, there are resources in many regions, including Latin America, but the economic and technical difficulties of exploiting them are still unknown. These resources would facilitate surmounting the limitations which the world is facing in the provision of energy products, but would not allow the present share of hydrocarbons in the total supply to be maintained.

We know that there are extensive resources in the world for use in the generation of atomic energy, but this is a field fraught with great uncertainty because of plant security, the advantages and disadvantages of the different technological options, the disposal of radioactive wastes and other related problems. In this field, we again confront not only an economic problem but also a technical, political and psychological one, as indicated by the great variety of opinions currently held on the subject in different countries.

The other great uncertainty involves the application of energy policies. The North does not agree as to what is the best way to handle this matter. There are two schools of thought: those who feel that the market will solve these problems and that prices should therefore be allowed to act as the main regulator, and those who demand more and more insistently that voluntary or interventionist measures should be adopted, including even rationing, as the President of the United States has proposed: a heresy that is hard to accept for those who worship the power of the market.

LONG-TERM PROSPECTS

Having said this, and without going into further detail, the problem seems to present itself in two phases: the long-term challenges, and those which we must face in the transitional period.

Looking at the long term, and assuming that my interpretation of what the technical experts say is correct, we can be fairly safe in taking a historically optimistic view. I think that mankind has begun and will greatly increase an unprecedented effort to acquire new technologies. Certainly, the twenty-first century will have a more solid energy base than the twentieth does, and it is very possible that we will then have solutions that are currently unavailable —firstly, because the technological progress and magnitude of investments currently being contemplated both in the public and private sectors are enormous, and second, because I feel that discoveries are being made, such as nuclear fusion and others, which will facilitate using renewable sources of energy that may have virtually unlimited possibilities. Therefore, it is perhaps not rash to toy with the hypothesis that the options which will be available to humanity in the future will be much better than we can currently anticipate. But this is a hypothesis that can be tested only when the twenty-first century arrives.

Another field in which important experiments are being carried out, especially in the Soviet Union, is the generation of hydroelectric power and its transmission over long distances. Man will soon be able to transmit electrical energy very efficiently over thousands of kilometers; he must merely await the dissemination of these technologies and the procurement of the investments necessary to put them into practice.

The progress being made in the technology of coal transformation is another promising fact, as is solar energy, which is developing in the same direction.

With regard to renewable sources of energy, the Brazilian "green energy" experiment is full of promise and one of the most outstanding options that I have seen. Brazil is using agricultural and forestry products or wastes to generate new forms of energy which could become a major substitute for current liquid fuels.

Nor must we forget the progress being made in social organization. The public is developing greater sensitivity to the need for conservation policies, and this will mean that in fields such as transport and urban organization, society will opt for technologies based on alternative energy solutions or, in the industrial sector, new, energy-saving techniques.

I feel that all these elements justify some historical optimism, based on the group of alternatives which will allow us to confront the energy problem on a long-term basis.

THE TRANSITIONAL STAGE

However, the energy problem is much more difficult during the transitional period. Let us consider the facts of this matter.

First of all, as just stated, there is no doubt that during this period the consumption of hydrocarbons will continue to be basic for the functioning of society. All the possible options will bear fruit only in the long term, with a few exceptions such as, perhaps, "green energy".

Second, prices will continue to increase, and increase they must. I think that a major error of recent years has been to have allowed prices to decrease in real terms after 1973. The world must become accustomed to the idea that with a scarce and non-renewable resource like petroleum, the only solution is to increase its price until it reaches that of other substitute forms of energy. If we agree that the price of these other forms of energy is higher than the current price of hydrocarbons, there is no reason, either economic or technical, to believe that prices should not continue to rise systematically. The question of how they should rise, at what pace and under what types of international agreements, is another matter.

Third, the importance of a less-discussed but perhaps more important subject should be stressed: the investments that will be required during the transitional period until a new type of world energy balance is reached.

Currently, the world has three major reference costs. There is the reference cost of light petroleum (Saudi petroleum), the extraction of which requires investments fluctuating around US$ 2,000 per barrel of daily production (in 1978 dollars). In addition to this type of petroleum, which constitutes the bulk of the world's production, we have petroleum from those countries that must pay intermediate costs ranging from US$ 6,000 to 8,000 per barrel. Finally, there is a small minority of cases, including that of Alaska and the countries which must extract fuels from submarine areas, which require investments already totalling US$ 20,000 per barrel.

The share of these different sources in the world provision of hydrocarbons is changing significantly. The most expensive sources of petroleum will continue progressively to replace the most inexpensive ones. Simultaneously, producers will have to take account of the investments, generally higher, required to exploit new sources of the resource, which will determine the price for replacing the resources currently being exploited. All of the above will strongly influence the cost structure of this product, and consequently basic costs will shift. According to some reliable estimates, the petroleum whose extraction currently costs some US$ 2,000 must generate resources to cover investments of approximately US$ 6,000 per barrel, while petroleum which currently costs US$ 8,000 must finance investments of US$ 14,000, and it will also be necessary to obtain petroleum through the third type of extraction, which will entail investments of approximately US$ 30,000 to US$ 35,000 per barrel. In other words, a production of 250,000 barrels per day, which in a country like Saudi Arabia currently requires an investment of US$ 500 million, will in ten years require investments of approximately US$ 5,000 million, both for new sources of energy and conventional ones.

This implies a spectacular change in the world's demand for hydrocarbon investment resources, which will be accompanied by similar changes in other fields. There is general agreement that the investment effort which mankind will have to make to confront the energy challenge in the future will assume spectacular proportions. Whatever hypothesis on the world energy balance is assumed, mankind will have to multiply by five or six the sums currently allocated to developing the sector. This is an extremely important fact which must be kept in mind when analysing the future of Latin America.

Simultaneously, another phenomenon exists: the persistence and growth of huge financial flows. Last year, all the countries in the world combined paid a petroleum bill of approximately US$ 240,000 million, of which OPEC received US$ 210,000 million. Of this amount, US$ 50,000 million went to the Euromoney market and the rest was spent on imports, primarily from the industrialized world, which is by far the greatest beneficiary of these surpluses because it capitalized intelligently on their growth. Of the US$ 50,000 million channelled through various forms of international recycling, the major part went to the Euromoney market, which naturally provided financing amounting to a much higher figure and received a significant portion of the financial surpluses obtained by the OPEC countries. Ultimately, the international private banking system was the main provider of the financial resourses used to balance the deficit in the external accounts of the various countries of the world, especially the developing countries. Last year, these financial requirements came to US$ 8,000 million in the case of Mexico, US$ 6,000 million in Brazil, US$ 3,500 million in South Korea and China, US$ 2,000 million in Argentina and Taiwan, etc.

This extraordinary state of international liquidity is currently one of the main problems of the world economy because of the uncertainty that it creates, but at the same time it has come to be the main source of financing for many countries in the world. The member countries of OPEC will continue to contribute a substantial portion of these resources, especially since some of them will have a permanent surplus because within their own frontiers they are unable productively to absorb investments of the size which their petroleum income makes possible.

This means that throughout the transitional period, balance-of-payments crises will be the order of the day for many countries. It is impossible really to predict what forms these crises will take, or what should be done to manage them, because the prices of other products are changing along with petroleum prices. Furthermore, the prices of food and other commodities, manufactured goods, and especially capital goods are also increasing. The developing countries have reacted differently to these situations: some, such as Brazil, India and Yugoslavia, which have large deficits, have launched ambitious policies for expanding their production and exports of manufactures. Others are exporting their manpower to the Persian Gulf and are receiving impressive sums from remittances made by their emigrants, which often exceed the yield of their exports. Both groups of countries are beginning to build their own defences, but other countries are in a completely hopeless situation because they have no manufactured goods, lack the conditions necessary to send their workers abroad and also lack access to international money markets. Thus, very different situations exist in the world and make this subject a multifaceted one at the international level.

At all events, today there is a very clear feeling that the new investment drive in the world will mainly benefit the developed countries, which are capable of developing new technologies and spearhead industries and using them to penetrate international markets.

The developing countries, in my view, fall into three categories. On the one hand there are the largest countries, which also have large solutions and are a category in themselves, such as Brazil, India, Yugoslavia, and to a large extent the countries of Western Asia and ASEAN, whose economies operate on the basis of schemes which have been successful so far. Certainly, these countries are not likely to become a general model, although they have brought their own solutions to the question, for instance increased exports and access to international money markets. At the other end are the smallest countries, the poorest of the world, whose consumption of energy is extremely low and will continue to be so in future years. These are in a sense the most helpless of all, although the rate of their development process does not create excessively high energy requirements and they may continue, at least in some sectors, to use non-commercial sources of energy. Finally, an intermediate group of countries, including the Latin American countries in general, are the worst off of all, because they have a development style imported from the industrialized countries, with an accelerated rate of urbanization and industrialization, an automobile-based civilization that has penetrated into their most remote areas, and cultural imitations of every kind, but without the ability to defend themselves which the larger countries have.

This explains why the initial reactions to this difficult international situation came from some Latin American countries which have experienced the consequences of the energy crisis more acutely than other developing countries. These reactions were provoked mainly by the public sectors and by those social groups which felt most heavily the weight of the adjustment measures required during the above-mentioned transitional period. As if that were not enough, this all took place within an international climate strongly affected by inflation and the stagnation of the industrialized economies. The growth prospects of the Organization for Economic Co-operation and Development (OECD) are bleak and disturbing, and because of the perplexity regarding the evolution of the world economy, solutions are uncertain or are constantly overtaken by events.

In sum, no machinery to confront these phenomena is in sight. The only solution put forward so far seems to be a slightly naive revival of neo-monetarism: an attempt to overcome the Keynesian rules of the 1930s which have been shown to be efficient in weathering the financial storm, but incapable of rebuilding the real economies of the countries of a world in crisis while simultaneously controlling inflation. They are excellent strategies for achieving deflation, but ineffective for promoting the ordinary and stable growth of the central economies.

Because of this, it is a source of great satisfaction to note that new trends which stress the structural adjustment of supply are now appearing. These theories, which seem novel in the United States, are well known here in CEPAL, where they were adopted many decades ago. But we live in a world of great complexity which is re-applying older formulas that do not give the desired results and is heading uncertainly towards the search for new solutions.

We must prepare ourselves to face a decade which is dominated by a difficult economic situation and throughout which inflation and stagnation will probably continue to coexist. This will mean a much more serious situation than that of 1973, because it must not be forgotten that in that year the economic situation was comfortable: our countries had a relatively low level of debt and a much better ability to react.

WHAT CAN WE DO?

We must now face the obvious question, and here I shall argue for an equally obvious theory: firstly, out of moral conviction, second on account of my personal beliefs, and third, because I am an official of the United Nations, which believes absolutely in dialogue. This position may seem overly idealistic in a world where not everyone is in favour of dialogue and where, on the contrary, there seem to be forces working in favour of chaos, which would mean a gloomy future for humanity. Unfortunately, if the current systems persist we may not be far from chaos, and perhaps some irrational forces may be thinking that this is the only option at present. For this reason, common sense and the vision of great political leaders must prevail against what could become a real holocaust, if a true international dialogue is not established.

I believe, then, that dialogue is absolutely essential and, furthermore, that it is possible, because for the first time we have conditions that will allow the various sectors involved in the matters being discussed to seat themselves at a single table, bringing to it a range of interests which can be reconciled through negotiation.

What the developed countries want today is an orderly evolution of the world economy and international prices: in other words, they are interested in the possibility of restructuring the world economy on a joint basis. What the OPEC countries want is that the world should respect their right to defend the value of their natural resources, so that they can gain the technological resources required to develop their economies and can guarantee their supply of food. The non-oil-exporting developing countries, for their part, want to acquire the elements necessary to survive the current crisis and to be able to promote the development which we all desire. All of these interests could be reconciled in a well-organized dialogue.

In order to make this dialogue possible, however, I believe that the international community must first accept certain *principles* and second, certain *attitudes*, which are primarily political.

Some of these principles, which I see as basic and upon which any international dialogue must be founded (a dialogue which must take place within the framework of the United Nations), are the following.

Firstly, we must recognize that there are no alternatives to a global dialogue. Here we must weigh the specialized interests of the industrialized countries, which wish only to discuss the question of energy, against those of the developing countries which contend and rightly so, that the dialogue should be global. I believe that at this point further discussion becomes academic: there really is no way to avoid a global dialogue, since if we sit down at a table to discuss only energy problems, we cannot complete the discussion without also considering world inflation, the functioning of money markets and the prospects for economic growth. In other words, the dialoge will immediately take on global dimensions.

The second principle is that during the transitional period, the countries which can make the greatest contribution towards the orderly development of the process are those which currently consume the greatest energy resources: the developed countries. It is useless for the developing world to save on electric light bulbs if the United States, which continues to consume one-third of the world's energy, fails to reply with clear and resolute conservationist actions. In other words, a decisive contribution to an energy conservation strategy can only be made by the industrialized countries, and above all the United States. I think that if we agree on this matter, the international dialogue will have a much better chance of success.

Third, as we have said, we must accept the fact that the cost of fuel will continue to rise, since this is the only way to ensure that the world will awaken from the unreal, irresponsible dream in which it has slumbered for the past thirty years, during which it based its entire development process on the provision of an inordinately cheap source of energy.

The fourth principle is that there can be no dialogue unless certain global responsibilities which are incumbent upon humanity as a whole are accepted. The first responsibility involves the world balance-of-payments position. It is senseless to insist that only the OPEC countries, in the case of the Third World, can solve this problem, when it is clear that in reality it can only be solved through the commitment of the entire international community. The subject of investments is likewise a global one and represents a challenge which, in my view, could be much more important than the problem of the balance-of payments positions. The world must accept that energy investment implies a responsibility for the entire international community. It is debatable, to say the very least, whether Algeria or Venezuela should invest their petroleum surpluses in the development of new sources of hydrocarbons when this petroleum will be consumed by Europe or the United States. In the final analysis, this investment is the joint responsibility of the major consumers. This is a new idea in the international community, but we must continue to develop it. On the other hand, if the developing countries can increase their energy investments while simultaneously sustaining their development, the demand on world energy markets will decrease, thus facilitating orderly market development and decreasing the pressure on scarce resources. This will be in the interests of the industrialized countries, which are responsible for 90% of the world demand for hydrocarbons.

Furthermore, the investments which will be required in the petroleum sector are so large that unless the principle of world responsibility for them is accepted, the petroleum-producing countries and the developing countries will have to contribute beyond their means, for the effort will compete strongly with their global investment needs. This is a fundamental matter for Latin America, and I will return to it later.

The third global responsibility involves technology, and here we face one of the greatest challenges. According to the statements made during the recent Vienna conference, the international community must accept that technological progress is, by definition, the common heritage of mankind. The technological efforts being made at present must be expanded and transferred, especially to the developing countries.

I believe that the responsibility for managing the international money system is also global, and that the world is facing an extremely serious problem, to which the OPEC countries must react with financial discipline in the management of surpluses if the system is to continue to support world economic development. This is probably the most crucial problem for the international community at present. The possibility of an international financial crisis implies collective responsibility on the part of all the countries of the world, and they must make an effort to consider the problem seriously within the framework of the International Monetary Fund and the United Nations, which must play an important role in the future management of this process. It would be highly inadvisable for this to be left to the vicissitudes of struggles among financial groups or the special interests which are behind them.

Finally, there is a fifth principle, the recognition of the need to develop "South-South" co-operation, which I have intentionally left until last because here we find that international public opinion is somewhat at a loss to know what to think. Let us not deceive ourselves: the problems of the Third World will not be solved solely through South-South co-operation; the developing countries cannot solve their problems alone. Nevertheless, this co-operation front is a fundamental aspect of the Third World's self-defence and assertion of its own identity, and the developing countries must remain united to sustain any negotiating strategy with the industrialized nations. However, we must not assume that the solution of the energy problems affecting the Third World can be left to this type of co-operation alone.

All of the above calls for the establishment of negotiating procedures or machinery. And I must note with satisfaction here that, in principle, this mechanism has already been drawn up in the General Assembly. The solution of current North-South problems depends to a large extent on the rounds of global negotiations which are being completed within that body.

I said a moment ago that in order for the dialogue to take place, certain political attitudes must be developed. The international dialogue is truly a political process and can only be developed by defining our political attitudes. We face an international crisis of major proportions, and only political decisions equal to the crisis will allow us to solve it. We must keep in mind that these decisions will have to be adopted in a climate of generalized mistrust caused by economic uncertainty, political differences and the very novelty of the problems with which the world is faced. And it is disturbing that at present there is no clear sense of progress towards a political commitment on which to base the dialogue and build a new system of international co-operation.

MEASURES AT THE NATIONAL LEVEL

I wish now to refer briefly to what must be done at the national level, with special regard to the Latin American countries. This is a subject on which CEPAL must work quickly. We must consider the elements that will make up the development strategy for the 1980s, and define the actions to be taken on the internal front.

Firstly, we must recognize the differences between Latin American countries, because there is no doubt that between Mexico and Brazil on the one hand and Uruguay and Costa Rica on the other there are striking disparities. Accordingly, the countries face very different situations and problems. But there are also common denominators, and I wish to point out three or four of those which I feel are important. The need to take action to adjust to the increased price of energy, international inflation and the protectionism of the industrialized countries are examples of these common needs, whose cost might increase dangerously as a consequence of the stagnation of the central economies.

A second common element is the need to face up to the serious problems of the balance of payments, an area where, as I have already pointed out, the international community must assume its share of responsibility, but where solutions must also be sought both on the national and the regional level.

A third important element is the need for countries to adopt stringent conservation policies —on the basis of some promising experiments which have been carried out in the industrial sector, in transport, urban development and rural organization— and, if necessary, to institute the rationing of energy consumption.

Fourthly, there is the need to diversify energy sources according to the situation and capability of each country. Thus, for example, Nicaragua must continue to develop geothermal energy and Uruguay, hydroelectric energy, while Brazil should emphasize green energy. In short, each country should try to find its own energy balance on the basis of its natural resources.

A fifth and extremely important consideration is that of investments. Whatever the capabilities of each country in this field, huge investments will be required to develop them. Energy objectives can therefore be expected to compete with other economic development objectives from the point of view of the assignment of the resources available for investment. Indeed, the demand for investment will be formidable, and will pose a serious challenge to development programming in the coming years.

This leads us to give a warning that the development of the energy sector may involve intense competition with the social and economic development requirements of our countries in the next years. Nor should we forget that energy investments have long lead times before they bear fruit. It is therefore highly probable that the solution of the energy problems will generate and sustain regressive trends affecting the social structure which will be much stronger in the upcoming decade than during the 1970s.

But we must not become discouraged about the impact that such a group of measures could have, especially if we recall the as yet unutilized energy potential in Latin America. For example, this region has one of the largest potentials in the world for the production of hydroelectric energy: 30% greater than that of the Soviet Union, double that of the United States and Canada combined, and four times that of Europe. The importance of this fact can be seen when we consider that at present only 15% of the potential just mentioned is being exploited.

MEASURES AT THE REGIONAL LEVEL

We must now consider what measures could be adopted in Latin America as a whole —an extremely delicate subject concerning which I wish merely to sketch out some thoughts.

This region of the world which has tried out all posible co-operation efforts, could well set itself novel goals in this field. In this connexion, it is very encouraging to note that the Latin American Energy Organization (OLADE) is acquiring its own momentum, as shown by its recent meeting in Costa Rica, where the Latin American countries united to consider this subject at the highest level. There is no doubt that OLADE will be called upon to play an extremely important role in the next decade. It is equally encouraging to see that Venezuela has offered to represent the interests of Latin America within OPEC in order to achieve better co-operation from that organization: this is an extremely important political development.

But we must also move towards new frontiers. I believe that the search for new forms of regional co-operation in this field should be greatly intensified in the next few years. Both the Latin American Economic System (SELA) and CEPAL must carry out extremely important functions in this connexion. Why should not Latin America consider developing an energy co-operation programme that would allow us to achieve security of supply in the event of world upheavals or conflicts? Why should not we envisage a programme of technological co-operation with the participation of UNDP, a body which is making extremely important contributions to that field? Why should not we consider achieving greater co-operation in the field of investments, which must become a fundamental element in the development of the energy sector, by deliberately using the energy investments that must be made to stimulate the internal development of countries: a policy in which the Inter-American Development Bank (IDB) could play an important role? Why should we not search for better co-operation with regard to markets, using the advantages of geographical proximity and commercial complementarity and formulating appropriate agreements and machinery? I believe that these are extremely important subjects regarding which an optimistic attitude must be maintained in an area of the world like our own which has tried all possible forms of co-operation. At the same time, however, they are subjects which pose an important political challenge.

In sum, I believe that we are entering a period that will be characterized by an awakening responsibility regarding these matters. Humanity, and especially the industrialized countries, is leaving behind a long period of blindness and irresponsibility concerning the subject. It will be difficult for history to explain how man could have lived through this period without becoming aware that the great industrial centres were expanding through the extraction of energy resources, especially from the Third World, at inordinately low prices and with imminent prospects of their exhaustion. It will be difficult to explain why a gradual process of adjusting prices was not undertaken earlier, and why serious policies for long-term substitution were not applied. I believe that this awakening responsibility on the part of all the countries in the world as regards energy must be accompanied by an effort to clarify the ideas for the man in the street: a task in which the United Nations must play an important role, since public opinion on this subject has been greatly distorted for many decades.

This awakening responsibility on the part of the international community will present new challenges to planning; it will be necessary to reduce current uncertainties. The decisions which may be adopted in the next few years will affect the future of humanity for two or three decades. The Latin American countries possess all the elements required to understand the importance of planning in this field: let us not forget that Latin America learned to plan because of energy. Nevertheless, our countries will require support to perfect this process, and here the CEPAL system must make a major contribution. The socialist experience in the energy field must also be reviewed and examined, for in many respects the socialist countries are much better prepared to face the energy challenge than is the capitalist world.

Simultaneously, however, the current crisis will create new opportunities for stimulating our economies; the industrialized world is already fully aware of this and believes that the energy transition will mean a "Schumpeterian" period, marked by impressive development of its productive forces. Unfortunately, this view is mainly confined to the countries of the North. To what extent can the investments required for the development of energy resources be used to stimulate the growth of the developing countries? And, simultaneously, to what extent must this growth be based on styles and policies that differ from those of the past if the problems posed by the energy crisis are to be reduced to manageable dimensions?

As I have already stated, the priority given to energy development could also have socially regressive consequences, because it will inevitably involve a far-reaching reorientation of investments. In order to reconcile energy objectives with social development goals, we must carefully weigh the energy options which arise in the light of their impact on employment, where appropriate technologies must be adopted, agricultural development and food production, and other elements that will strongly affect the social development of our countries.

What does seem obvious is that energy factors must weigh much more heavily in the planning process than they have in the past. I fully agree with what was said to me by a Minister in the Indian Government: "We who studied at Oxford and Cambridge came to India, and before making an economic decision we thought of its impact on the balance of payments. Today, however, before making an economic decision we think of its impact on the energy balance". This applies equally to Latin America, where we must begin to see things in the same light.

I am convinced that the weight of energy factors and other factors which are taking on growing importance in the world today will determine the changes to be made in the next decades, and many of those changes will originate in the North. I am aware that these changes will generate strong resistance, and that those who currently benefit from the advantages of the current style will be ready to make superhuman efforts to maintain it, or to transfer its negative consequences to other social sectors. Nevertheless, I also believe that it will be very difficult to stifle the anxieties of the vast majority of mankind, which currently is so gravely affected by the consequences of this style. For this reason, I am convinced that it will inevitably be changed. This is an essentially political task, wherein it is necessary more than ever to appeal for a degree of social voluntarism. The market has shown clearly that it is incapable of effecting lasting solutions. For that reason, these solutions are not yet in sight. CEPAL must be aware of these problems, and I hope that the contribution it can make to solving them will transform it into a kind of critical conscience of Latin American development.

Meeting on a new Latin America in a changing world economy

INTRODUCTION

The essays reproduced below were presented at a small, informal and high-level conference on the theme of "A New Latin America in a Changing World Economy" held at the Belmont Conference Center near Washington D.C. on 25-26 June 1979.

The purpose of the conference —organized jointly by the Economic Commission for Latin America (CEPAL) and the Latin American Program of the Woodrow Wilson International Center for Scholars— was to facilitate a full and frank exchange of views among key scholars and officials interested, from a variety of different perspectives, in Latin America's evolving international economic and political roles. All participants were invited in their personal capacities, and not in representation of their respective organizations.

The discussion was informal and free of official statements, in order to stimulate an open and constructive dialogue. The focus of the discussion was provided by a series of short papers on specific issues; namely, exports of manufactures, exports of primary products, international monetary reform, capital flows and debt, transnational corporations and technological transfers, and the distributional impact of international economic reforms. Each of the corresponding papers is printed below in this issue of the *Review*.

A key concern of all the papers and of the ensuing dialogue was to identify, in the most specific terms possible, areas of actual or prospective mutual interests between the countries of Latin America and the more industrialized countries, including but not limited to the United States. A separate though related objective was to help sketch out those kinds of policies, both within Latin America and *vis-à-vis* the industrialized countries, which might serve to reinforce those shared interests.

An underlying purpose of the conference was to determine to what extent the future role of Latin America in the world economy depends on changes in the external environment, including in particular those affected by policies in the industrialized countries. However, although the main focus of the discussion was on external forces and relations, consideration was also given to certain key internal trends and policies. A report on the conference, prepared by the rapporteur in his own name, synthesizes and analyses the central elements of the conference dialogue and outlines some of the more organic relationships linking those various elements.

The conference was chaired by Mr. Enrique Iglesias (Executive Secretary of CEPAL) and by Dr. Abraham F. Lowenthal (of the Wilson Center). The rapporteur was Professor Colin Bradford (Assistant Director, Concilium on International and Area Studies, Yale University). The conference was organized jointly by Professor Lowenthal and Mr. David H. Pollock (Director, CEPAL Washington Office). Grateful acknowledgement is made to Mr. Marco Pollner, Mrs. Ana Ormerod and Mrs. Patricia Pilvin of the CEPAL Washington Office, Miss Sallie Mitchell of the Woodrow Wilson Center, and the staff at the Belmont Center, for all they did to make this meeting so successful. Special thanks are due to the World Bank and the US Agency for International Development for their financial contributions which made the meeting possible.

The Woodrow Wilson Center and CEPAL are very pleased to have had this opportunity to co-operate so closely in such a fruitful exchange of views.

Abraham F. Lowenthal
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David H. Pollock
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The Export of Manufactures

*Pedro I. Mendive**

Introduction

The development of the manufacturing sector has an important role to play in Latin America in relation to a long list of economic variables, all of which aim at changing the economic characteristics of the region in aspects such as the diversification of production, structure of employment and production, growth of income and the average wage, and attenuation of the fluctuations in prices and export earnings, as will be seen in the following pages. Hence all measures tending to develop and consolidate this sector, whether through import substitution or exports of manufactures, merit special attention in the economic policy of the Latin American countries and the developing countries in general.

This study comprises four parts: (i) the first shows the important effect of exports of manufactures by the developing world on those and other related economic variables; (ii) the second considers the supply conditions —relative availability of factors, technological level and goals— and their international comparative advantages in certain sectors, export promotion policies and production incentives, etc.; (iii) from an analytical point of view, a study is made of the conditions of access to the industrialized countries' markets (demand), considering the existing protectionism, generalized systems of preferences (GSP) and the multilateral trade negotiations (Tokyo Round) which have just ended, together with an evaluation and quantification of their results as far as conditions of access to the developed countries' markets are concerned; and (iv) the lines of action to adopt in accordance with the results of the analysis under points (i) to (iii) above.

I

Importance of exports of manufactures for the Latin American economy

Simultaneous and parallel policies of exports of manufactures versus the production of manufactured goods to substitute for imports, i.e., production for domestic consumption, tend to be regarded as conflicting or at least incompatible. It is further argued along the same lines that one dollar of export receipts is exactly the same as a dollar not spent abroad on imports. In actual fact, according to this sector's evolution in the developing countries, the majority began with import substitution and advanced subsequently along the road to exports of manufactures. The difference between the policies followed in the various countries lies in the fact that some countries, after substituting imports of the "easier" goods —produced with high labour intensity, little capital, simple technology and a wide supply of cheap inputs— immediately went on to the export stage, while other countries continued with import substitution covering more complex goods —produced with higher capital intensity and advanced technology. This difference in industrialization policies often depended on the compressible margin offered by the respective import structures: when the wide substitutable margin of some countries had been covered, they went on to exports, while

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those with a small easily substitutable margin continued to substitute more complex goods for imports. In the first case, the relative abandonment of any further progress in import substitution seems to have been due to the taking of a decision concerning the option raised by the availability or otherwise of basic inputs, the attitude being that although their purchase abroad might subject the supply of these inputs to the fluctuations of the international market and to the purchasing power of the country concerned, domestic production of such inputs would have made them more expensive, with adverse repercussions on the cost of the finished goods. In contrast, the second case seems to have been guided by the decision to reach more advanced levels of technology and to economize on relatively scarce external purchasing power.

This brings to mind a number of differences between exports and import substitution which may be summed up as follows: (i) exports require a comparative or competitive advantage (better resource allocation and bigger scales of production, and often promotional measures as well); (ii) the substitution of imports by domestic production of more difficult procurement requires, at least initially, a variable degree of protection; (iii) exports, however, also require a higher level of entrepreneurial and manpower training, more suitable techniques and a different and more complex infrastructure.

Turning once again to exports of manufactures, it will be seen that they produce amplified positive effects on the sector in two different ways: through inter-industry relations —input-output— which disseminate them throughout the manufacturing sector itself and to other sectors of the economy, and through the increase in demand represented by the addition of external demand to domestic demand.

If exports are initially confined to labour-intensive goods, there is a saving in the use of capital —a relatively scarce factor in the developing economies which will thus be free for expanding the sector or for use in other sectors of the economy.

As the manufactured goods exported become more complex, however, requirements in terms of capital and the use of advanced technologies become greater, all of which increasingly reduces the absorption of manpower and tends towards the production of capital-intensive goods. This represents an apparent dilemma. If the introduction of improved production techniques and the consequent use of capital in the primary sectors —agriculture and mining— save labour and the same situation arises in the complex industry, the conclusion would seem to be contrary to the economic and social interests of the developing countries. It should be remembered that the relative supply of factors in these countries is characterized by plentiful manpower and a shortage of capital.

This criterion should, however, be modified in the light of other factors such as the expansion —through new branches of productive industry— and growth of the whole sector (including of course that of capital-intensive industries), to which should be added the employment promoted or induced in other independent but related activities, such as marketing, financing, export and other services and in particular, the rise in personal income determined by this process, which should lead to considerable growth of tertiary sector activities which do not represent disguised unemployment but are of a really productive nature. This process is characteristic of sustained development and is the employment structure displayed —not only at the present time— by the industrialized countries.

In other words, a general rise in wages (in real terms) takes place in the sector and in the economy in general, and this process may even induce or promote a less regressive distribution of domestic income, and even of world income on the basis of exports which, though still competitive, have a larger content of *increasing wage rates vis-à-vis* those prevailing in the developed countries. At the start of the process there would probably be —as there were in Japan— two parallel labour markets, one with depressed wages —for labour-intensive industries using simple technology— and another with high wages for the great dynamic industries. As the process advances, however, the wage rates would gradually converge at increasingly high levels.

It is now necessary to take into account the fact that the prices of manufactured goods are subject in the world economy, and particularly in international trade, to a certain generally upward stable trend in keeping with the course of world inflation: a situation which does not occur over the long term in commodity trade, characterized as the latter is by big fluctuations. The assumed development of the manufacturing sector and exports of manufactures by developing countries would thus have the virtue of reducing the fluctuations in world commodity prices and, therefore, in earnings from total exports.

Within the context of these general aspects and considerations with respect to the advisability of exporting (and therefore producing) manufactured goods, there remains to be considered the correlation that may exist between the growth of such exports and the growth of the gross product. It may be noted that there are two different positions in this respect.

The first denies the validity of such a correlation, holding that manufactures —whether or not exported— are included among the data on the gross product considered in this correlation, thus invalidating the results from the start.

The second position, based on empirical observations on the evolution of exports of manufactures by various developing countries which considerably expanded their manufacturing sector and exports, concludes that such a correlation is clearly and conceptually valid.

If the general formula for the gross product is:

$$\text{GNP} = C + I + X - M$$

where C = consumption,
I = investment,
X = exports and
M = imports,

there is no reason why any growth which occurs in X owing to an increase in exports of manufactures (or of any other kind of goods) should affect C and I directly, and it would affect M only to a minor extent on account of imports of certain inputs and capital goods, so it is not difficult to conclude arithmetically that the gross product must inevitably increase.[1]

II

Supply conditions

As noted earlier, the relative availability of factors in the Latin American countries, and in all developing countries in general, is characterized by a relatively greater supply of labour than of capital. At the same time, their present production structure reveals a predominance of primary commodities, whether of agricultural, livestock or mining origin. This means that, still in relative terms, wages and many inputs are cheap and capital is expensive. Accordingly, in the secondary sectors (manufacturing and others) goods produced with the use of the more abundant factor are in an excellent competitive position, in both the domestic and the international economy. It should be noted that this is so, notwithstanding the fact that the *physical* productivity of manpower in the industrialized economies is greater than in the developing countries, because such greater physical productivity fails to compensate for the low wages paid in the developing countries.

The proportion accounted for by raw materials in the final price of manufactures where Latin America has a clear competitive advantage is also lower in the region. This is due to two circumstances. On the one hand, the inputs in these exported products have a high nationally-produced content, and on the other, these nationally-produced inputs also

[1]The growth of the GNP will give rise to an increase in imports through the well-known mechanism of the external trade multiplier (k), but this is merely a consequence of the increase occurring first in the GNP owing to the growth of exports.

have a high labour content, the cost of which is between 20% and 30% of the total price of the raw material used. Likewise, the low wage costs included in these inputs are not neutralized by the greater physical productivity of labour in the developed countries.

A study carried out by the author of this document[2] shows that for the same goods exported by the United States, Argentina, Brazil and Chile, the number of times the unit of wages produces value added is a good deal lower in the United States. Thus while in Argentina one unit of wages produces 3.77 units of value added, in the United States it produces only 2.18. Compared with Brazil, these figures are 3.33 and 2.02, and in the comparison with Chile the contrast is between 3.9 and 2 units of value added.

Furthermore, technology today —subject to certain conditions and limits— is within the reach of every country, thus providing optimum conditions for the production and export of such goods.

As regards the more complex manufactures produced with more advanced and sophisticated technology, some favourable factors still persist, but the competitiveness gap tends to narrow. Frequently this narrowing of the competitive margin is due to the fact that the development of such lines of production requires, in addition to considerable scales of production, certain special basic and intermediate inputs which can be obtained in Latin America and other developing countries only at a not very favourable cost. Thus, in order to overcome this obstacle or stumbling-block, two opposing policies may be followed, leading to different results. One policy is to produce these inputs locally, which means a varying degree of protectionism and domestic production subsidies that obviously make the cost of the input produced in the country higher than the similar imported input without the protection obstacle (i.e., unless the subsidy cancels out the difference in costs). If this is the case, the well-known action of the formula of the effective rate of protection for production factors will mean that such a policy, in the absence of special internal defences, will act as a tax on the location of the activity producing the final good in the economy of the developing country concerned. The defence measures against this implicit tax will lead to drastic changes in certain internal variables, whose nature and effects are easy to foresee.

The other policy —aimed at overcoming the obstacle represented by the high cost of the input concerned— lies in importing such inputs under very low customs tariffs, while levying high customs tariffs on the final goods produced from them. The result will be that the effective rate of protection for domestic factors of production of the final good will be much higher than the nominal rate and will act as a subsidy for the location of such activity in the developing country. If there is no possibility of this domestic production being carried out in the future in an economic manner, an inefficient production enclave would be created which would lead to higher prices for the final goods produced there. On the other hand, if such production could eventually be carried out economically, the final goods produced with such inputs would be competitive both domestically (with respect to other activities) and on the world market.

The export of manufactures, as may be inferred from these observations, constitutes something in the nature of the last link in the chain which starts with production for import substitution. For the full development of this process it has become imperative for the developing countries to adopt policies such as —to mention only a few— incentives for the production of final goods, special treatment for certain inputs, the establishment of credit, insurance and other instruments: in short, everything that makes up a complete and well-structured export promotion policy.

If the various measures composing these policies are classified by subject or area of competence, two clearly defined groups of measures or instruments may be established: incentives for the production of export goods, and incentives for export activity itself.

[2]Pedro I. Mendive, document on the identification of non-tariff barriers for the Tokyo Round negotiations presented at the seminar on the Multilateral Trade Negotiations held in Guatemala in October 1976 under the auspices of SIECA and the CEPAL/UNCTAD/UNDP Interregional Project.

In the first group, special mention may be made of the following instruments:

— elimination or reduction of import tariffs on inputs and capital goods;

— elimination of taxes on production financing;

— elimination or reduction of taxes on energy used in the production of export goods;

— extension of credit in respect of income tax on the export part of production;

— use of the "draw-back" system for capital goods and inputs;

— financing and reduction of the interest rates applicable to export production;

— differential treatment for the transport of export goods;

— direct subsidies for the production of export items.

In the second group of measures, i.e., those aimed at promoting export activity, the following may be mentioned:

— total or partial refunds or exemptions in respect of domestic taxes on exported products;

— export credit financing;

— export credit insurance;

— refund or reimbursement of foreign exchange, operating like a differential exchange rate;

— special export programmes;

— direct export subsidies.

It is not necessary to analyse these measures since, besides the fact that the machinery for their implementation is well known, their economic effects on the domestic economy and exports are also common knowledge. It is, however, important to offer some comments on the developed countries' opposition to their implementation by the developing countries.

A number of non-tariff measures have gradually been included in the long-established protectionist structure with the aim of impeding the access of developing countries' goods to the developed countries' markets. Two of these measures which are covered by articles VI, XII and XIX of GATT have particular relevance to this rejection, however. Although these two measures —safeguard clauses and countervailing duties— are regulated in those articles, the truth is that —besides being more numerous than before— their current implementation by the developed countries does not conform to the provisions of those articles, either in procedure or as regards their justification. In the case of safeguard clauses, no proof is provided of the serious damage referred to in article XIX, while in the case of countervailing duties, not only are these imposed arbitrarily and without such proof, but the threat of imposing them is used to discourage existing and planned exports of goods to those markets.

The present situation of the world economy differs substantially from that existing during most of the past century and the first decade of the present one, in that at that time the basic characteristics of the international division of labour were in force and restrictions on trade practically consisted only of tariff barriers. This was merely the result of the fact that the world economy was composed, on the one hand, of a few developed countries requiring raw materials and consumer markets, which not only produced a wide range of manufactured goods but, in their capacity of exporters of capital, facilitated the exploitation of the natural resources they needed from the other group of countries, which were far more numerous and were barely in the incipient stages of development. Of course, while the small group of industrialized countries achieved rapid development on the basis of diversified production through progress in manufacturing, the other more numerous group was developing on the basis of the exploitation of a few primary commodities. The balance-of-payments capital account of these countries —fed by increasing external investment— permitted not only the development of these resources but also payment for the necessary goods they imported from the more developed countries, as well as the remittance of returns on such investment. This international division of labour was partly based —rightly or wrongly— on a certain comparative advantage which some countries possessed in the production of certain goods in relation to other countries, but for some years past, a radical change has been taking place in the pattern of international comparative advantages. Formerly, only one or two countries were little by little attaining a higher level of development based on progress in manufacturing, not only supplying the domestic market but also gradually gaining external markets too. In an expanding world economy, where many developing countries were in need of those types of products, this did not lead in practice to any disturbance in the world economy and trade.

In the last few years, however, this process has spread at a rapid and increasing rate to a large number of developing countries which have suddenly appeared on the world scene as exporters of a wide range of manufactured goods, produced advantageously on the basis of high labour-intensity, manpower being their most abundant factor.

This latter fact, coupled with the false argument concerning the alleged starvation wages which, according to the developed countries, are paid in the developing economies, is used to justify the adoption of protectionist measures, when the real grounds are the policies aimed at promoting exports of manufactures adopted by the developing countries.[3]

In reality, when the competitive lines of production achieved by the developing countries run into barriers like those described above and the whole protectionist system which will be referred to later, the only way to surmount this obstacle to trade created by the developed world is to adopt subsidies and other incentives for the production and export of such goods. This is very far from being an unacceptable attitude, since all that the developing countries are trying to achieve in this way is to neutralize the unfair treatment meted out to their products by the developed countries. There is also the principle of infant industries, which is an argument or policy already applied in the past by the developed countries themselves, notably the United States.

Mention may now be made of another difficulty in addition to those alluded to above, which in its own way prevents the goods of certain complex capital-intensive industries from increasing their competitiveness on the external market. This is the existence of transnational corporations in certain manufacturing sectors using advanced technologies which, however, are often outmoded in the centres and are transferred in the form of plant which is technically obsolete in the country of origin.

A first difficulty lies in the fact that these industries use inputs produced by the parent companies, which are usually imported at higher than market prices. Another difficulty arises out of the imposition of bans on competing with the parent company, either because of the geographical distribution of the market established by the centres or for other easily imaginable reasons.

These sectors are therefore restricted to the domestic market of the developing countries in which they are established, or at best to exporting to the developing markets of neighbouring countries.

Furthermore, the trade links established between imports and exports of inputs and final goods usually obscure the real prices, profits, taxes, etc., thus hindering the harmonious development of a series of activities relating to the sector and preventing normal tax collection.

Even so, Latin America is exporting considerable quantities of goods to the world market, as may be seen from table 1.

Table 1

EXPORTS OF MANUFACTURES (EXCLUDING OIL AND NON-FERROUS METALS) BY SOME LATIN AMERICAN COUNTRIES

Country	Exports (millions of US$)	Per capita exports (US$)
Mexico	2 105	34
Brazil	1 916	18
Chile	110	11
Argentina	550	21
Peru	27	2
Uruguay	118	38
El Salvador	79	19
Ecuador	48	7
Colombia	180	7

Source: UNCTAD.

[3]The wages and interest paid in developing economies derive from the marginal productivity of labour and capital, which is determined (in the Marshallian sense) by the relative supply of those factors of production. Thus in Latin America wages are low and capital is expensive, which is the precise opposite of what occurs in the developed world.

III

Conditions of access in the developed world

While a long series of manufactures from developing already have a definitive competitive advantage in international circles, e.g., textiles and clothing, footwear, leather articles and leatherwear, processed foods, some chemicals, and some electronic parts, components and products, a whole list of other goods produced by light industries, and even some produced by heavier industries, justify the policies applied by these countries to promote the development of industry and the export of their products.

In a supply situation with these characteristics, however, manufactures do not have the same advantages as regards the conditions of access offered by the markets of the developed countries. Indeed, such access is meagre, and recent trends unfortunately confirm that it is becoming increasingly precarious, in other words, markets are increasingly hermetic.

First of all, the tariffs of the developed countries have an average weighted rate of less that 10%. This is due to two main facts which explain why it is deceptive to limit oneself to this one simple average in analysing the tariff system. Nearly 40% of their imports enter these countries duty-free, a situation which was brought about during the various rounds of negotiations within GATT. These duty-free imports, however, are in their immense majority imports of products which it is in the interest of the developed countries to trade on an international scale, but which are of little interest to the developing countries. Moreover, there are extraordinarily large deviations from this rate which affect products of export interest to the developing countries.

The structure of the tariff systems of the developed countries shows definite scaling of tariffs as a line of production advances in its degree or stage of processing. This means that the factors of production of the developed countries have an effective rate of protection which is in many cases over two or three times higher than that afforded by the nominal rate.

In an earlier work by the author[4] these effective rates were determined for the United States, the European Economic Community and Japan as regards the following groups of products: processed foods, textiles and clothing, light industries, and industries of greater complexity, including products of particular interest to Latin America. Table 2 gives an idea of the size of the effective average weighted rates. There are many individual examples, such as butter in the Community (1,322.7%), refined cottonseed oil in the United States (465.9%) or cigarettes and cigars in Japan (405%), which show the incredible spread of these effective rates compared with the weighted average rate.

Table 2

EFFECTIVE RATE OF PROTECTION
(*Percentages*)

Group of products	USA	Japan	EEC
Processed foods	28	68	63
Textiles and clothing	43	45	60
Light industries	24	26	15
Complex industries	16	22	22

These high effective rates of protection warrant some comments. The first is that they act as a subsidy for locating the activities producing final goods in the protecting country. A second comment is that in the developed countries these rates cover up production activities which are clearly inefficient both in comparison with similar activities abroad and with other local economic activities. They are protected from the former by tariff scaling,

[4]Pedro I. Mendive, "Protectionism and development", *CEPAL Review*, No. 6, second half of 1978.

while as for the latter, the remuneration of the factors of production employed in the activity protected may be said to tend to be equal to that of the factors employed in the efficient industries. The cost-structure inflation which may be observed nowadays in the developed world is partly the result of the effective rate of protection of inefficient industries and other non-tariff barriers which protect such industries from foreign competition and which will be analysed below.

Thus, in addition to this tariff structure, and even more important, are the non-tariff barriers. As well as the recent increase in the variety of types of these barriers, there has been tremendous growth in the number applied. This is due to the fact already mentioned that trade in many products of importance to the developed countries themselves is conducted duty-free or on the basis of low rates. As these are generally consolidated in GATT the developed countries are not free to change them. In cases like the present, with unemployment sweeping the developed countries, resort has been had to the false solution of renewed protectionism through non-tariff barriers or measures.

All this superstructure which has now been created around protectionism has come to be known as "new protectionism", but it is actually nothing more than the introduction of new forms and modes of protectionism into an earlier structure. Among these new forms mention may be made of the "voluntary" restrictions, the regular marketing agreements, the restrictions imposed by means of multilateral agreements which become operational once bilateral agreements are reached under them (e.g., the multifibre agreements), trigger prices in the United States and minimum prices in the Community —both currently applied to the iron and steel sector— and the American Selling Price System in the United States. All of these tend euphemistically to be called organized free trade or, more correctly, conditioned free trade. If what was said at the beginning about the arbitrary application of safeguards and countervailing duties is added to this, it will give an idea of the instruments which restrict access to the markets of the industrialized countries.

Table 3 gives a quantitative picture of these barriers for the United States, the European Economic Community and Japan, in respect of a sample of products which in 1976 had a commercial value of 8,196, 8,961 and 3,117 million dollars respectively.

Table 3

NON-TARIFF BARRIERS IDENTIFIED FOR PRODUCTS OF EXPORTS INTEREST TO LATIN AMERICA IN 1976[a]

Type of restriction	Number of items or positions		
	USA	Japan	EEC
Total number of items analysed	165	126	172
Total number of positions with barriers	76	43	156
Quantitative restrictions	65	33	117
Sanitary restrictions	10	7	17
Variable duties and components	–	–	18
Other restrictions	1	3	4

Source: Pedro I. Mendive, *op. cit.*

[a]Not including measures which, although authorized by GATT, are at present applied without being subject to its rules (such as safeguards and countervailing duties).

In view of the precarious conditions of access which the developed economies offer to exports by the developing countries, the latter have placed great expectations, first in the operation of the generalized systems of preferences maintained by the developed countries outside the principles of non-discrimination and global reciprocity laid down in article I of GATT —an exception arising out of a waiver granted under the terms of article XXV, paragraph 5 of the General Agreement— and secondly, in the multilateral trade negotiations (Tokyo Round) which were held in Geneva for almost six years.

The generalized systems of preferences do not seem to have resulted in any appreciable opening-up of markets, owing to the uncertainty over the permanent or non-permanent status of the products included in them, the safeguards they contain, their maximum limits, the complication, difficulty and cost of the proof of origin formalities, and the precariousness due to the short period of validity of these systems (10 years), even when there is some certainty that their expiry dates will be extended. At all events, relatively little use has been made of these systems in practice, and they have not contituted any form of escape from the protectionism described in the foregoing pages, one reason being the very nature of the products they cover.[5]

Thus, for example, in the multilateral negotiations referred to above the United States not only made no offer under the generalized system of preferences but in 1979 eliminated instead a series of products which no longer fulfilled the conditions of the competitive need clause and which, according to estimates, accounted for some US$ 60 million in 1978. The European Economic Community (9 countries) made 33 offers, but these only lowered the average weighted rate from 18.7% before the offer to 18.6% after it, and they only referred to chapters 01-24 of the Customs Cooperation Council Nomenclature, no offers being made in respect of manufactures (chapters 25-99). Finally, Japan made only 4 offers, which likewise reduced the average rate by a very small amount.

The multilateral trade negotiations, for their part, have given very meagre results according to the preliminary data published.[6]

As regards tariffs, the reductions agreed upon by the United States, the EEC and Japan in the most-favoured-nation weighted average rates for industrial products of −4.5, −3.0 and −3.2 units respectively, at import demand price elasticities of −2.2, −1.3 and −1.9 and at the 1976 value of imports from Latin America would have brought about a growth in such exports of US$ 328 million for that year. As can easily be seen, this is only a minimal increase if it is compared with the US$ 6 billion worth of imports subject to duties out of a sample of more than US$ 10 billion.

This apparent growth in trade, moreover, does not take account of the network of non-tariff barriers now hindering international trade. When considering these barriers the quantitative restrictions can be said to have been practically excluded from the negotiations, and only five codes of conduct[7] were negotiated to make such trade more efficacious in fields where it is restricted by health and plant-health barriers, valuations, State purchases, licences and subsidies and countervailing duties. In reality, a summary analysis of these codes leads to the conclusion that they will merely legalize the practices already applied by the developed countries, thus giving apparent respectability to the rules of the game which such practices involve.

In addition, according to estimates made by the author, more than three-quarters of the increase in trade which would have been experienced in 1976 if all the barriers in question had been eliminated would have been due to the disappearance of non-tariff barriers, and only a quarter to the reduction to 5% of all the tariffs above that figure, which is considered not to be protectionist but only fiscal. In absolute terms, the removal of non-tariff barriers in 1976 would have promoted an increase in Latin America's exports of manufactures (chapters 25-99) to those countries of around US$ 1,400 million, while the elimination of all tariffs over 5% would have led to an increase in Latin American exports of only US$ 420 million. It should be noted that these figures include certain manufactures —processed foods— which appear in chapters 01-24 of the CCC Nomenclature.

If, therefore, the generalized systems of preferences, the tariff negotiations and those on non-tariff barriers do not lead to an opening-up of the markets, then the main obstacle to the

[5]According to UNCTAD, the utilization of these systems by the countries has been between 15% and 75%. In the particular case of Latin America the actual degree of utilization is generally nearer the lower figure.

[6]Although the MTN have now been declared closed, their final results have not yet been published.

[7]The safeguards code is still being negotiated.

export of manufactures by the developing countries takes the form of the demand for manufactures (conditions of access to the markets) and not the supply of such goods.

Once again, the conclusion that can be drawn from this is that it is perfectly legitimate for the developing countries to make use of export subsidies.

IV

Lines of action

It is clear from the foregoing pages where the main obstacle to exports of Latin American manufactures to the world market lies. It is also clearly established that the two institutional choices before the countries of the region —and all developing countries— for the removal of this obstacle were never more than empty hopes. The solution to the problem must therefore be sought along other lines. Various types of partial solutions are analysed below, with a view to measuring their effectiveness or alternatively their disadvantages or lack of effect.

The first measure usually proposed is that the developing countries should continue with import substitution, firstly as a means of retaliation against the developed countries and secondly as a way of avoiding the accumulation of larger balance-of-payments deficits. This measure may prove relatively effective, for rather a limited period, in those countries which are at the commencement of their manufacturing development and still have a broad margin of easily substituted imports. But in more advanced developing countries where these circumstances do not apply, the process may be contrary to their economic and social interests. As already noted, in addition to creating a markedly inefficient industrial structure, it may lead to the creation of its own pitfalls for exports of manufactures by other sectors of industry.

A second measure would be to increase trade in manufactures among the countries of the developing world. There can be no doubt that this trade, which has been growing continually —at least for some countries— may alleviate the problem to some extent. For the moment, however, it is limited to certain manufactures and almost completely excludes those produced by the heavy industries, such as capital goods, transport equipment, etc., which therefore continue to be supplied by the developed countries, creating trade imbalance not only in terms of the value of the trade but also as regards the structure of reciprocal demand between developed and developing countries.

A third line of action would consist of negotiating, both inside and outside GATT, to secure the elimination of tariff and non-tariff barriers. This argument meets with a major difficulty, however, in the difference between the bargaining power of the large countries *vis-à-vis* the small countries, taken individually. It may therefore be doubted whether, even if these negotiations prosper, they can achieve significant results for the developing countries. This was clearly demonstrated in the negotiations which have just ended in Geneva.

Another line of action lies in taking advantage of the kinds of products least protected by the developed countries. In addition to confining the developing countries to a limited range of goods in developing their industry and exports, however, this solution gives rise to great uncertainty as to whether even this relatively reduced protection can be maintained in the future. We saw in earlier pages all the superstructure of barriers which the developed countries started to put up against the exports of the developing countries when the latter began to flood their markets with competitive goods produced with definite comparative advantages.

There remains the possibility of modifying trade flows by promoting and increasing trade with those developed countries with which extensive trade links have not yet been established. Here there would be room for an attempt at some kind of bargaining which could secure more liberal mutual trade.

As may be observed, all the measures which have been mentioned offer very little guarantee of being the most appropriate. The author believes that the solution lies in increasing the bargaining power of the developing countries, answering protectionism with restrictions on access to the vital materials which the developing countries possess, using the enormous import market constituted by the sum of the individual markets to counter the restrictions or obstacles created by the barriers of the developed countries, and even applying within this collective framework effective measures of retaliation[8] to counter the effects of the spread of new or old protectionist measures, etc.[9]

All this calls for the mounting of an efficient and rapid system of information and action among the developing countries, making use, in Latin America at least, of the assistance which can be provided by the Latin American groups in Brussels, Geneva, New York, and in CECON in Washington. Along with these groups of government representatives, mention may be made of the international organizations with competence in the interregional and the various regional contexts, which can provide the necessary elements of analysis to serve as a basis for measures and decisions by the developing countries and to be used as elements for negotiation.

In reality, a system can be envisaged with three operative mechanisms. The first of these would be an information and consultation mechanism, in which only the Latin American countries would participate. The second mechanism would be made up of both developed and developing countries: it would settle differences that might arise in the information, and consultation stage, and its decisions could be either legally or merely morally binding.[10] Finally, the third mechanism would form a kind of supervisory body which would watch over the implementation of the agreements reached in the dispute-solving mechanism.

[8]This is a measure proposed by important Latin American personages who attended a seminar on protectionism, held in Buenos Aires from 31 October to 3 November 1978, which was organized by CEPAL and UNDP under the auspices of the Government of Argentina. See the report of this meeting in document E/CEPAL/1057.

[9]Many of these measures are illegal within GATT, since they were not accepted by the organization when the country joined GATT or do not arise out of a waiver (see Article XXV).

[10]Perhaps the best thing would be to lay down or agree on "equivalent compensation measures" which would be taken whenever there was any transgression of the established rules: i.e., whenever there was any attempt to bring back protectionism.

Exports of non-fuel primary products

*Jere R. Behrman**

Introduction

The major macroeconomic goals of the Latin American countries relate to: (1) growth, (2) distribution, (3) short-run stability regarding employment, inflation and the balance-of-payments position, and (4) the international situation. Latin American analysts and policy-makers have long been preoccupied about the impact on the attainment of these goals of fluctuations and trends in international non-fuel primary commodity markets. It is not surprising, therefore, that Latin Americans have given considerable (although not unanimous) support to the call for the revision of conditions in international non-fuel primary markets that is the foremost demand of the developing countries in their quest for a "New International Economic Order".[1]

Although non-fuel primary products have accounted for a steadily declining share of total Latin American exports during the post-war era, they still represent a major source of foreign exchange for the region. In the first half of this decade, for example, they accounted for over 40% of total regional merchandise exports and over half of the individual country merchandise exports for three-quarters of the 24 countries that are included in table 1 (in descending order of dependence on such commodities for export revenues, these 18 countries are: Jamaica, Chile, Cuba, Honduras, Dominican Republic, Costa Rica, Guyana, Haiti, Peru, Guatemala, Colombia, Nicaragua, Uruguay, Brazil, Panama, El Salvador, Bolivia and Ecuador). Thus, both for the region as a whole and for many of the individual countries, non-fuel primary exports will continue to be important sources of foreign exchange during the 1980s whatever changes occur in the world economy.

The framework for recent and ongoing exploration of changes in the international non-fuel primary commodity markets was established by the proposal and resolution adopted at UNCTAD IV (Nairobi, 1976).[2] The original proposal focuses on 10 core commodities, five of which are important from the point of view of Latin America in the sense that they account for at least 1% of total regional merchandise export value (coffee, sugar, copper, cotton and cocoa), and one of which (tin) provides half of the merchandise export value of Bolivia. Together these six core commodities accounted for 24% of Latin American merchandise export earnings in the first half of the 1970s. Eight other commodities also were mentioned, four of which (beef, iron ore, bananas, bauxite) each accounted for at least 1% of the region's merchandise export earnings, while the eight commodities together

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[1]For recent analyses of the New International Economic Order see the references to this subject in: Bhagwati, Jagdish, N., ed., *The New International Economic Order: The North-South Debate*, Cambridge, Mass.: The MIT Press, 1977; Cline, William R., ed., *Proposals for a New International Economic Order: An Economic Analysis of Effects on Rich and Poor Countries*, Washington, Praeger and Overseas Development Council, 1979; Erb, Guy F. and Bart S. Fisher, "U.S. Commodity Policy: What Response to Third World Initiatives?", *Law and Policy in International Business*, Washington D.C., 9:2, pp. 479-513, 1977; Fishlow, Albert, *et al.*, *Rich and Poor Nations in the World Economy*, New York: McGraw-Hill Book Company, 1978; Grubel, Herbert G., "The Case Against the New International Economic Order", *Weltwirtschaftliches Archiv*, Tübingen 54:4, pp. 284-307, 1977; Kreinin, Mordechai E., and J. M. Finger, "A New International Economic Order: A Critical Survey of its Issues", *Journal of World Trade Law*, Twickenham, England, September/October 1976, and Vastine, Robert J., "United States International Commodity Policy" *Law and Policy in International Business*, 9:2, pp. 401-77, 1977.

[2]United Nations Conference on Trade and Development (UNCTAD), "An Integrated Commodity Programme", Geneva, 1976 and "Resolution Adopted by the Conference: Integrated Programme for Commodities", Geneva, TD/RES/93, (IV), 1976.

Table 1

PERCENTAGE CONTRIBUTION OF MAIN NON-FUEL PRIMARY EXPORTS TO LATIN AMERICAN MERCHANDISE EXPORTS, 1970-1975[a]

Country	UNCTAD													Other regionally significant[c]			Other nationally sig.[d]		Total main commodity exports	Instability indices[e]		
	Core							Others[b]														
	Coffee	Sugar	Cooper	Cotton	Cocoa	Tin	Subtotal	Beef and prepared meat	Iron ore	Bananas	Bauxite	Wood	Subtotal	Soybeans[b]	Maize	Fish meat	Shellfish	Lumber[b]		Prices	Quantities	Earnings
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)
Argentina							0	24				4	28						28	19	27	28
Barbados		35					35						0				2		37	24	16	22
Bolivia	2[f]	2[f]	3[f]			50	57						0						57	24	34	16
Brazil	24	7[f]		5	2		38	3[f]	6				9	10	1	1	1	2	61	16	9	16
Chile			73				73		5				5			2		1	81	16	17	24
Colombia	52[f]	3[f]		4[f]			59	2[f]		2[f]			4				1		64	13	7	15
Costa Rica	27	5[f]			2[f]		34	9[f]		27[f]			34				1		69	7	9	9
Cuba[g]		75					75						0						75	...	...	...
Dominican Republic	8	52			5		65	2[f]			4		6						71	17	13	28
Ecuador	11	4[f]			8		23			28			28				2		53	10	13	14
El Salvador	38	6[f]		12			56	1[f]					1				2		59	10	7	19
Guatemala	31	8		11			50	6[f]		6			11				1	1	65	12	9	15
Guyana		35									30						3		68	18	16	12
Haiti	39	8			4[f]		51	2[f]			13		15						66	18	13	17
Honduras	16	1[f]		1[f]			18	7[f]		34			41				1	13	73	10	17	15
Jamaica		13			1[f]		14			3	68[f]		71						85	25	11	17
Mexico	5	6	1[f]	7			19	2[f]					2		4				25	11	11	17
Nicaragua	14	6		26			46	12		1[f]			13						64	8	10	11
Panama	1[f]	9					10	1[f]		39			40			1	3	2	61	10	11	14
Paraguay	2[f]	1[f]		7			10	28					28	9			10		38	24	47	27
Peru	4	8	23	5			40		6				6			20			66	12	7	11
Trinidad and Tobago		5					5						0						5	25	13	28
Uruguay							0	36				27	63						63	18	25	25
Venezuela									4										4	18	14	21
Latin America	8	7	5	2	1	1	24	4[f]	3[f]	2[f]	2[f]	1[f]	12	2	2	1	1	1	43			

[a]From Behrman, *International Commodity Agreements:...*, *op. cit.*, except in the case of items for which notes c, d and f are relevant, which are from Lord, *op. cit.*

[b]In the original UNCTAD proposal soybeans and lumber were not included, but they are included with the other commodities in later documents.

[c]"Regionally significant" means commodities that accounted for at least 1% of Latin American merchandise exports in 1970-1974 (the period on which these columns are based).

[d]"Nationally significant" means commodities that accounted for at least 10% of some Latin American country's merchandise export value for 1970-1974 (the period on which these columns are based).

[e]Defined as 100 times the variance from the trend for 1960-1976 relative to the arithmetic mean, where the dependent variable was first transformed by dividing the geometric mean of its series to make comparable linear and semi-log functions. A Paasche index is used for prices and a Laspeyres index is used for quantities. Based on coffee, sugar, copper, cotton, cocoa, beef, iron ore, bananas, bauxite, and soybeans. Source is Lord, *op. cit.*

[f]1970-1974.

[g]No data are given for Cuba in Lord, *op. cit.*

accounted for 10% of total Latin American merchandise export value. The emphasis in the proposal and resolution is on price stabilization for the core commodities through international buffer stock agreements, although there are also a number of phrases that suggest the possibility of increasing the secular trend of prices.

The UNCTAD proposal is called an integrated feature in it is the establishment of a Common Fund, primarily to provide financing for the core commodity agreements and secondarily to conduct "second window" lending operations for commodities not amenable to stockpiling, for product diversification, etc. The Common Fund would also pool and reduce risks, have more bargaining power in international capital markets than would a set of individual capital markets for the same commodities, and require smaller total financing than the aggregate of a set of individual funds because of differences of phasing of cycles across commodity markets. The original proposed magnitude of the Common Fund was US$ 6 billion.

Negotiations over the details of the Common Fund have continued for several years. The "Group of 77" developing countries sought a Fund with paid-up capital from direct assessments of about US$ 2 billion, to be supplemented by borrowing approximately US$ 4 billion on capital markets, and they advocated that about one-quarter of the total would be used for "second window" operations. The "Group B" or industrial countries, in contrast, advocated financing by deposits from the individual international commodity agreements instead of direct assessments, and opposed "second window" operations.

A breakthrough occurred at the March 1979 UNCTAD negotiating session with the resolution of the two major controversial issues: (1) as regards the basic capital structure, agreement was reached that US$ 400 million would be raised by direct assessment (about two-thirds of which would be from Group B countries) and that other financing (amounting to one-third of the agreements' prospective financial requirements) would come from contributions by the producing and consuming country governments in each individual international commodity agreement; (2) as regards the second window, it was agreed to establish such operations with funding of US$ 370 million, but without any transfers allowed from the first window (the United States maintained its opposition to participating in the second window, but no longer opposed the voluntary participation of other Group B countries). More than a hundred countries agreed in the plenary of the session to a document that resolved these issues and referred further negotiations and the drafting of the articles of the Common Fund to an Interim Committee. Although some difficult issues remain (e.g., the distribution of voting rights), Common Fund negotiations may well be successfully concluded within a year or so. Subsequently, ratification by national legislatures will be required.

Consideration of the UNCTAD Integrated Commodity Programme has dominated recent discussions of future changes in international non-fuel primary commodity markets. Moreover, after the March 1979 UNCTAD negotiating session there appears to be a significant probability that some variant of the UNCTAD programme will be implemented. Therefore the rest of this paper focuses on the implications of the UNCTAD proposal for Latin America. Section I explores the primary question of "first window" price stabilization of the core commodities, section II more briefly considers the implications of attempting to alter the secular price trends, and section III summarizes the results.

I

Non-fuel primary commodity price stabilization

The UNCTAD Programme emphasized the stabilization of prices of the core commodities through international buffer stock operations. In order of the commodities' importance in export earnings for Latin America, the average annual absolute value percentage deviations from the trends of these prices over the period 1963-1972 were 17 for coffee, 33 for sugar, 22 for copper, 8 for cotton, 23 for cocoa and 8 for tin.[3] For all but cotton and tin these fluctuations were relatively large. The specific implications of these price fluctuations for each country, of course, depend on the exact composition of its exports. The price instability indices in column 20 of table 1 suggest that among Latin American countries in recent decades Jamaica, Peru, Paraguay, Barbados and Bolivia have experienced particularly large fluctuations in the prices of their commodity exports included in the UNCTAD programme. Such large variations in prices may make private or public planning much more difficult. They may also contribute to fluctuations in earnings if they are not offset by changes in volume of production. Because of differential variations in such volume, however, the Latin American countries with the greatest instability in export earnings from these same commodities differ somewhat from the above list, their order being Argentina, Dominican Republic, Trinidad and Tobago, Paraguay, Uruguay, Chile, Barbados, and Venezuela (column 22 of table 1). For many purposes the effect of such fluctuations in earnings may be more important than that of price fluctuations, although it is the latter towards which the UNCTAD programme is directed (this topic will be dealt with again below).

A number of questions arise about the UNCTAD programme. What are the magnitudes that are involved in its operation? What are the implications for developing countries in general and for Latin America in particular? What are the implications for the developed economies? How does this programme compare with alternative policies?

These questions will be explored in this section primarily through the use of simulations of international buffer stock activities with simple econometric models of the relevant international markets. These models capture the time pattern of simultaneous and lagged responses in supply, current demand and private inventory demand relations for each of the relevant commodity markets, and the parameters used in them are those most consistent with observed behavioural and technological responses.[4] Before turning to the insights gained from these simulations, however, it is useful to indicate some reasons why the simple *a priori* theorizing and simple correlations that are often used for such analysis may be inadequate.

1. *Limitations of a priori and correlation analysis of commodity markets.*

Much of the analysis of international commodity markets is based on simple supply and

[3] Behrman, Jere R., *International Commodity Agreements: An Evaluation of the UNCTAD Integrated Commodity Programme.* Washington: Overseas Development Council, 1977.

[4] For further details concerning these models and their use for commodity market simulations, see Behrman, *International Commodity Agreements: ... op. cit.;* Behrman, "The UNCTAD Integrated Commodity Program: An Evaluation", in F.G. Adams and S. Klein, eds., *Stabilizing World Commodity Markets: Analysis, Practice and Policy,* Lexington, Mass.: Heath-Lexington Publishing Company, 1978; Jere R. Behrman, and Pranee Tinakorn, "Evaluating Integrated Schemes for Commodity Market Stabilization" in F. Gerard Adams and Jere R. Behrman, eds., *Econometric Modeling of World Commodity Policy,* Lexington, Mass.: Heath-Lexington Publishing Company, 1978, and "The UNCTAD Integrated Program: Earnings Stabilization Through Buffer Stocks for Latin America's Commodities", in W. Labys, M. Ishaq Nadiri, and José Núñez del Arco, eds., *Commodity Markets and Latin American Development: A Modeling Approach,* Cambridge: Ballinger Publishing Company and NBER, 1979.

demand models or bivariate correlations. However, such analysis may be quite misleading in respects that frequently do not seem to be recognized. For this reason, simulations of macroeconometric models will be used in the analysis below.

One problem with many of the analyses is that the results are sensitive to the assumed forms of the supply and demand functions. For example, Johnson[5] argues that "elementary economics" demonstrates the incompetence of UNCTAD economists, since they did not recognize the trade-off between prices and earnings stabilization, yet Johnson's own analysis of this trade-off depends upon his particular assumptions of linear price-elasticity curves and additive shifts, without any empirical testing. With alternative assumptions —some of which seem theoretically and empirically at least as warranted as his— very different results are obtained![6]

Another example is provided by Lord's[7] recent empirical analysis of the supply versus demand causes of fluctuations in Latin American commodity exports. By looking at the sign of the correlation between retrended quantities and prices, he claims to identify whether the underlying shifts were primarily in supply (negative correlations) or in demand (positive correlations).[8] But Porter[9] proves that such a test is valid only if the supply and demand price elasticities are equal,[10] and it seems very unlikely that such elasticities are anywhere near equal for most of the country-commodity combinations that Lord considers. The market shares of Latin American countries for the six UNCTAD core commodities of interest to them are generally relatively small, the only values higher than 10% being for Bolivia (tin), Brazil (coffee and cocoa), Chile (copper) and Colombia (coffee). Thus, the demand price elasticities facing the individual countries are very high, often approaching infinity, but Lord's analysis is appropriate only if the country supply elasticities are equally high: an assumption that does not seem to be based on empirical facts. Therefore, once again his conclusions seem to be quite suspect because they are not based on relevant assumptions regarding the underlying structure (in this case the elasticities) of the markets.[11]

Yet another problem affecting much of the simple theoretical and empirical analysis is that all adjustments are assumed to be instantaneous, so that fairly long-run price equilibria are reached immediately. Both Johnson and Lord are among the multitude of analysts who make this simplifying assumption. In the real world, however, there are considerable lags because of the time required for adjustment of production, consumption and investment processes and for the creation of expectations, and such lags may substantially alter the outcomes compared with those implied by analyses that ignore such factors, as the textbook "explosive cobweb" model demonstrates.

The models used for the simulations reported below differ from the Johnson-Lord type of analysis in that decisions regarding a number of critical questions (e.g., magnitude of elasticities, additive versus multiplicative

[5]Harry G. Johnson, "Commodities: Less Developed Countries' Demands and Developed Countries' Response", in Bhagwati, *op. cit.*

[6]See Berhman, *International Commodity Agreements:..., op. cit.*

[7]Montague, J. Lord, "The UNCTAD Integrated Program: Export Stabilization and Economic Growth in Latin America", in Labys, Nadiri and Núñez, *op. cit.*

[8]There is a long tradition of making some inferences by this method dating back at least to United Nations, *Instability in Export Markets of Under-Developed Countries*, ST/ECA/15, 1952. Another, more recent, example is Ezriel M. Brook, Enzo R. Grilli and Jean Wallbroeck, "Commodity Price Stabilization and the Developing World", Washington: IBRD, Bank Staff Working Paper No. 262, 1977.

[9]Richard Porter, "On Placing the Blame for Primary Product Instability", *International Economic Review*, Philadelphia, Pa., 11:1, pp. 175-178, 1970.

[10]To see that elasticities must matter, consider the case in which one of the two curves is stabile and infinitely elastic (thereby fixing the equilibrium price) and the other curve has less than infinite elasticity and shifts considerably. Even though by assumption the instability arises from the movements in the latter curve, the Lord method will give a zero correlation between pairs and quantities and atribute the instability equally to shifts in both curves.

[11]If demand elasticities are bigger than the supply elasticities, as is probably generally the case for the country-commodity combinations that Lord considers, then this method is biased towards incorrectly attributing the relative responsibility for shifts to the supply side. See Porter, *op. cit.*, for an explicit demonstration of this bias.

shifts, pattern of lags) were made in order to ensure the highest consistency possible with the historical data from these markets. It is true that the use of these models still involves a number of important assumptions,[12] but they provide a much better basis for this analysis than the frequently encountered studies involving much stronger critical assumptions, of the types noted above.

2. *Magnitudes involved in buffer stock operations.*

The UNCTAD Integrated Commodity Programme has been simulated over a thirteen-year period under the assumption that the buffer stock operators have sufficient financial and commodity reserves to keep price fluctuations within 15% of the secular trends that actually prevailed in the 1950-1975 period (see discussion at start of section II below). The simulation was conducted over a relatively long period so that the ongoing behaviour of the agreement can be considered under a variety of external conditions regarding world economic activity, etc.

Table 2 summarizes the simulated activity of the buffer stocks and the impact of this activity on producers' revenues over the thirteen-year period.[13] For each of the six commodities of interest to Latin America it gives the number of buffer stock purchases and sales; the longest continuous period of buffer stock activity without buying and without selling; the present discounted value of buffer stock activity with and without inclusion of the value of final stocks; the mean percentage changes due to the buffer stock price stabilization programme in prices, quantities supplied and producers' revenues; the present discounted value of additional producers' revenues due to the institution of the Integrated Commodity Programme; and an index of the extent of revenue stabilization which occurs because of the Programme.[14]

The simulations indicate that for three of the six core commodities of interest to the region the buffer stock must begin with initial stocks in order always to be able to defend the price ceiling. If there were not such initial stocks for sugar, copper and tin, the buffer stock authorities would not always be able to defend the ceilings in the initial years because to do so would require greater quantities of commodities than they would have purchased at an earlier time in efforts to defend the floors.

After establishing their initial position, in the subsequent thirteen years of simulated buffer stock operation the buffer stocks intervene in the market 42 out of 78 possible times, or slightly more than half of the years, on average, for each commodity (columns 1 and 2 of table 2). Such activity is somewhat more frequent for sugar and somewhat less frequent for tin than for the other four commodities. Despite this frequency of intervention in the market, there would be long periods when the buffer stocks would not intervene on one side of the market. Columns 3 and 4 of table 2 show the longest continuous period in years of buffer stock activity without buying or without selling, respectively. The longest period without buying ranges from three years for cocoa to thirteen years for cotton and tin, with an average of 9.7 years, while the longest period without selling ranges from two years for sugar to ten years for tin, with an average of 5.3 years. These long periods without intervening on one side of the market suggest that it might be quite difficult to be sure that the target prices around which the buffer stocks are attempting to stabilize are related to long-run equilibrium values. These long periods also imply that if international commodity agree-

[12]See Behrman, *International Commodity Agreements:..., op. cit.*, and "The UNCTAD Integrated Commodity program...", *op. cit.*, and Behrman and Tinakorn, "Evaluating Integrated Schemes...", *op. cit.*, for further discussion of this question.

[13]For much more detailed discussion of these results see Behrman, *International Commodity Agreements:..., op. cit.*, and "The UNCTAD Integrated Commodity Program...", *op. cit.*, and Behrman and Tinakorn, "Evaluating Integrated Schemes...", *op. cit.*, and "The UNCTAD Integrated Program...", *op. cit.*

[14]This index is the ratio of the standard deviation of real revenues with the price stabilization programme to the standard deviation of real revenues without the stabilization programme. A value of less than 1 thus indicates that revenues are more stable with the programme than without it.

Table 2

SUMMARY OF BASIC INTERNATIONAL BUFFER STOCK COMMODITY PROGRAMME SIMULATIONS FOR SIX UNCTAD CORE COMMODITIES OF IMPORTANCE TO LATIN AMERICA, OVER 13 YEARS

UNCTAD core commodities of interest to Latin America	Number of buffer stock interventions		Longest continuous period (in years) of buffer stock activity		Value of buffer stock activity[b]		Mean percentage changes[c] due to price stabilization in:			Value of additional producer revenue[b,c]	Revenue stabilization index[d]
	Purchases[a]	Sales	Without buying	Without selling	Excluding final stock	Including final stock	Price	Quantity supplied	Producers revenues		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Coffee	2	5	9	4	−494	−413	1.5	1.0	2.4	1 734	0.71
Cocoa	6	1	3	6	−667	−70	4.2	2.9	6.7	334	0.24
Sugar	11	1	12	2	−13 877	−6 309	23.1	2.2	23.6	10 609	0.22
Cotton	9	0	13	4	−3 735	−643	3.7	2.4	6.1	8 241	0.51
Copper	3	5	8	6	−508	382	0.8	−0.2	0.6[e]	−188[e]	0.94
Tin	1	1	13	10	30	30	−0.2	−0.0	−0.2	−21	1.00
Average[f]	5.3	2.2	9.7	5.3	−19 251[f]	−7 023[f]	5.5	1.4	6.5	20 709[f]	0.60

[a]Including initial purchases in the case of sugar, copper and tin.
[b]These values are present discounted values using a 5% real discount rate and are in millions of constant 1975 dollars.
[c]The comparisons are with identical simulations, except that no buffer stock activity is assumed.
[d]This is the ratio of the standard deviation in real revenues with price stabilization to that without price stabilization.
[e]The present discounted value is negative even though the mean percentage change in producers' revenues is positive, because of negative values early in the simulation period.
[f]Total for columns 5, 6 and 10.

ments are in effect only for the five-year period suggested by the Havana Charter, in many cases activity might be quite concentrated on one side of the market. Such considerations suggest that it might be desirable to have buffer stock agreements with longer lives than has generally been proposed.

Another interesting aspect of the simulated buffer stock interventions is that purchases are more than twice as frequent as are sales for the six commodities combined. The prevalence of purchases for cocoa, sugar and cotton much more than offsets the weight of sales for coffee and copper (columns 1 and 2 of table 2), and this overall asymmetry between purchases and sales occurs despite the fact that the buffer stocks are stabilizing around the long-run secular trends that actually occurred. The frequency of intervention on one side or the other of the market is not a very good indication of whether or not the target secular price trend is above or below the long-run equilibrium path, except possibly in extreme cases or with a very large number of years of operation.

Another important point about the simulated operation of these buffer stocks is that the magnitude of financing becomes fairly large after several years, even though there are significant advantages from pooling finances across these six core commodities. For example, the sum of purchases minus sales indicates that, on the average, a total of about US$ 1 billion per year would be expended. For half of the commodities, moreover, the maximum financing needs would occur in the first five years of operation. Therefore, in about six years the buffer stocks would exhaust the US$ 6 billion fund originally mentioned in the UNCTAD proposal, even if only these six of the ten core commodities were included and even if no second window operations were conducted. This occurs despite the gain of about 21% obtained by pooling across commodities so that sales of one commodity offset purchases of other commodities.[15] The large access to financing required despite such pooling may make it necessary —at least politically— to establish such a programme initially on a shorter-term basis than the considerations in the previous paragraph would indicate are desirable. However, one important caveat should be made here. The model for sugar seems much less satisfactory than those for the other commodities,[16] and sugar plays a very big role in these estimates. If sugar is excluded the average required access to funding drops 70% to less than US$ 350 million per year, with a 43% gain from pooling. This level of financing would be possible for a number of years with funding of the order of magnitude proposed by UNCTAD, even if allowance is made for the four core commodities not of particular interest to Latin America and for some second window operations.

What are the net cost of this buffer stock activity after adjustments for storage, transactions, deterioration, interest, and buying-selling differentials? The answer depends largely on the value placed on the final stocks and on whether or not the simulations for sugar are reliable. For all six core commodities the present discounted value of operating the UNCTAD programme for 13 years is —7.0 billion 1975 dollars if final stocks are valued at actual prices prevailing the year after the simulations, and —19.3 billion 1975 dollars if final stocks are valued at zero (columns 5 and 6 of table 2). The most realistic estimate presumably is somewhere between these two numbers, since if all of the stocks were sold after the last year of the simulation, prices would fall considerably, but not to zero. If sugar is excluded the two analogous values are —0.7 and −5.4 billion 1975 dollars. The range is still negative and may imply fairly large costs, but is of the order of magnitude that has been discussed in the UNCTAD negotiations (and the upper limit of this range increases only to −0.9

[15] This calculation of the gains from pooling depends upon the assumption that capital markets are not perfect and that individual countries participating in the international commodity agreements could not do such pooling on their own. See Behrman, Jere R. and Pranee Tinakorn, "The Simulated Potential Gains of Pooling International Buffer Stock Financing Across the UNCTAD Core Commodities", Philadelphia: University of Pennsylvania, Report for the U.S. Treasury, 1977, for further discussion of these issues.

[16] See Behrman and Tinakorn. "Evaluating Integrated Schemes..", *op. cit.*

billion 1975 dollars if the other four core commodities are added).

Where do such considerations about the simulated operation of the UNCTAD Integrated Commodity Programme leave us? They suggest some reservations. There would be start-up problems in about half of the agreements in that the price ceilings could not be defended due to inadequate prior purchases, and such events would strain the patience of consuming participants. It would be difficult to know whether or not the target price paths were close to the long-run equilibrium paths from the frequency or pattern of market interventions by the buffer stocks. Even if the target price paths were identical with the long-run equilibrium price paths, moreover, considerable finances might be involved. If the target price paths exceed the equilibrium price paths by much, furthermore, the required financing could become enormous (see section 3 below). At the cost of reducing the price stability around the long-run trends, however, the target price paths could be adjusted in line with buffer stock accumulations to ensure that financial requirements did not explode.[17]

On the other hand, the simulations suggest that price stabilization for the core commodities of interest to Latin America (or for all the core commodities) is feasible over a number of years with total financing not too much greater than the amounts mentioned in the negotiations. If the estimates for sugar are misleading because of inadequacies in the underlying model, if sugar were excluded, or if a flexible target price path reduced the financial requirements for sugar, the order of magnitude of the financing required would be within the limits discussed at the negotiating sessions.

But these comments refer only to the feasibility and direct costs of operating the UNCTAD Integrated Commodity Programme. The benefits and costs from the point of view of the developing and developed countries must now be considered.

[17]See Behrman and Tinakorn, "Evaluating Integrated Schemes...", *op. cit.* The simulations there suggest that the use of variable target price paths (or variable price bands) adjusted for actual stock accumulations can substantially reduce the financial costs.

3. *Implications of the UNCTAD Programme for developing countries in general and for those in Latin America in particular*

The six core commodities of interest to Latin America are produced and exported primarily by developing countries. At the start of this decade such countries accounted for virtually all of the world production and exports of coffee and cocoa, almost a third of production and over two-thirds of exports of sugar, about 40% of production and 54% of exports of copper, about a third of production and almost two-thirds of exports of cotton, and about three-quarters of production and a slightly higher proportion of exports of tin. The developing countries as a group import and consume a significant, although much smaller, proportion of these goods. Thus, at the start of the decade they accounted for 12 to 20% of world imports of sugar, cotton and tin, although only 4 to 6% of world imports of coffee, cocoa, and copper. The producer-exporter role is stressed here because that is the more important one in the aggregate, but the reader should keep in mind that for a few developing countries the consumer-importer role is significant, particularly for sugar, cotton and tin.

Of course for developing country producers and consumers (as well as for both groups elsewhere) there are some potential gains from the price stabilization itself to the extent that risks are diminished or costs related to price fluctuations in production or in use are adjusted. Such gains have the interesting feature of being shared across the market. For example, if they exist on the production side, price stabilization is likely to lead to increased supplies from which users will benefit, while if they exist on the users' side, price stabilization is likely to lead to increased demand from which suppliers will benefit. Unfortunately, empirical estimates of the magnitude of such gains are not available, but they should not be ignored, since some analysts argue that they may be substantial.

Now let us consider the impact on producers' revenues of the operation of the buffer stock programmes. It is useful to break down revenue between the quantities supplied and the price received.

As regards the quantity supplied, the simulations indicate initial periods of no response for cocoa, coffee and copper. These initial periods of four or five years of no supply response reflect the relatively long lead times required to bring newly-planted trees or expanded mine capacity into operation. Subsequently, however, fairly large supply responses are induced, at least for the agricultural products, with increases of over 11% for cocoa and sugar, over 6% for cotton, and over 3% for coffee. Changes of these magnitudes imply that it may be quite misleading to consider the impact of international commodity agreements within a framework which assumes no supply responses. In fact, in some respects the existence of supply responses with long lags may make stabilization more difficult. For example, the simulation for cocoa indicates a fairly large supply increase eight to ten years after the beginning of the programme in response to the much higher price received for cocoa because of the simulated buffer stock programme in the third and fourth year, *not* in response to the simulated current market conditions.

Except in the case of tin, the simulated buffer stock programme has much larger percentage effects on prices than on quantities supplied.[18] For the other five core commodities of interest, in almost every year the price is affected either upwards or downwards. The price is changed in many years in which no buffer stock activity occurs because of the dynamic impact of past buffer stock purchases or sales. Under the particular assumptions of these simulations, the average price increase is 23.1% for sugar (see column 9 of table 2).[19] For cocoa and cotton the average annual increases are respectively 4.2% and 3.7%. For coffee the increase is 1.5%, while for the two minerals it is less than 1% in absolute value. It is interesting to note, however, that in every case except tin the price stabilization programme leads in some years to prices higher than would otherwise exist, while in other years it leads to prices lower than those which would prevail without it.

Altered dynamic price paths induce changes both in supply, as noted above, and in demand, and the combination of the impact on prices and on quantities results in changes in producers' revenues. In some cases, the movements in prices and quantities reinforce each other, while in other cases they are opposing. The total effects are fairly significant revenue gains for agricultural commodities and much smaller revenue losses for the two minerals (columns 9 and 10 of table 2). For sugar the estimated annual average revenue gain is 23.6%, which implies a present discounted value of additional producers' revenues of over US$ 10 billion. For the other three agricultural commodities the average annual percentage revenue gains range from 2.4 for coffee to 6.7 for cocoa. The total 6.1% average annual revenue gain for cotton, however, implies a present discounted value of total producers' revenue gains of the order of US$ 8 billion over the simulation period. Across all six commodities, the total simulated present discounted value of additional producers' revenues is somewhat over US$ 20 billion. This gain is fairly substantial, with most of it accruing to sugar and cotton producers and, to a lesser extent, to coffee producers.

On the other hand, there are simulated small losses for the two mineral products. Of course, these results are conditional on the particular assumptions underlying these simulations, and they might change with different assumptions, but it well might be the case that under any set of assumptions for a particular time period there would be some losers among the producers (such as the minerals in this case) as well as some gainers. This possibility may make it quite difficult to hold together an integrated arrangement.

These comments refer to what happens to the *level* of revenues. But some critics of the UNCTAD programme have claimed that under reasonable assumptions increases in revenues will be accompanied by decreases in their

[18] Tin may be an exception because the International Tin Agreement and United States Government tin stockpile activities apparently kept prices fairly stabile during the sample period. See Smith, Gordon W. and George R. Schink, "The International Tin Agreement: A reassessment", *The Economic Journal*, New York, No. 86, pp. 715-28, 1976.

[19] But it should be remembered that there is some question about the sugar model.

stability. For example, Johnson[20] makes this argument. However, as indicated above, the question of whether or not there is a trade-off between the level and the stability of revenues cannot be settled *a priori*. It depends upon the elasticities of the underlying curves and the natures of shifts in those curves, and is thus basically an empirical issue. The results in the last column of table 2 indicate that only for copper is there evidence of a trade-off between the stability and the level of revenues. In thecase of copper, the price stabilization programme stabilizes revenues slightly, but with the result of a somewhat lower present discounted value. For the four agricultural commodities, revenues are increased fairly substantially, while revenue instabilities are reduced significantly. For tin there is a slight reduction in revenues with almost no change in stability. At least for the agricultural commodities, then, Johnson's strong warning about the trade-off between the level and stability of revenues does not seem warranted.

[20]Johnson, *op. cit.*

Up to this point, the simulated impact of the UNCTAD Integrated Commodity Programme on the revenues of all producers has been discussed. Now, let us turn to its effect on the Latin American producers. Table 3 gives the present discounted values of real revenue changes which would accrue to each of the major Latin American producing countries in respect of each of the six UNCTAD core commodities, the total present discounted additional value for each major Latin American producing country, and the ratio of that total value to the average export value over the period 1970-1975.

Table 3

PRESENTE DISCOUNTED VALUES OF GAINS ACCRUING TO LATIN AMERICAN PRODUCERS FROM SIMULATED UNCTAD COMMODITY PROGRAMMES OVER THE PERIOD 1963-1975[a]

Countries	Present discounted values (PDV) of additional revenues to producers (millions of 1975 dollars)							Ratio of PDV of additional producer revenues to average annual export value in 1970-1975 (percentage)
	Coffee	Cocoa	Sugar	Cotton	Copper	Tin	Total	
Argentina				82			82	3
Bolivia						−3	−3	−1
Brazil	312	40	743	412			1 507	28
Chile					−23		−23	−2
Colombia	243	3		82			328	29
Costa Rica	52						52	16
Cuba			849				849	55
Dominican Republic		7	424				431	97
Ecuador		13					13	2
El Salvador	87						87	28
Guatemala	69						69	17
Jamaica			106				106	22
Mexico	69	3	424	247	−2		741	33
Peru			212	82	−8		286	26
Venezuela		3					3	0
Total	832	70	2 758	907	−32	−3	4 532	16

[a]Calculated by distributing the simulated present discounted values of additional revenues to producers in column 10 of table 2 by each Latin American country's share in world production. For the last column the total export values are from United Nations figures (1976), with the OECD deflator used to convert into millions of 1975 dollars.

The present discounted values of gains to producers in an individual country depend upon the total present discounted value of additional producer revenues (column 10 of table 2) and the country's share in world supply. These simulated gains are gross gains that do not include any contributions to the financing of the buffer stock operations (columns 4 and 5 of table 2). If the producing countries contributed half of the net cost of buffer stock operations the aggregate producer net gains would be from 17 to 46% lower, depending on the evaluation of final buffer stocks held at the end of 1975. In order not to become too complex because of alternative schemes for distributing the net costs of buffer stock operations among producers and consumers and the question of how to value the final stocks, the present analysis is focussed on gross producer gains without subtracting their contributions to the buffer stock operations. The present discounted value of gains net of contributions to the costs of buffer stock operations would of course be lower than this, with the amount of the reduction depending on the exact assumptions about the funding arrangements and the evaluation of final stocks.

The largest simulated gainers in absolute terms are the sugar and cotton producers (because of the large simulated overall gains for those producers in table 2) and the coffee producers (because of the moderate overall simulated gain in table 2 and the large Latin American share in world production). The gains for the other three commodities are much smaller, and they are actually negative for the two minerals.

In absolute terms, then, the big simulated gainers among Latin American countries include Brazil (1,507 million 1965 dollars), Cuba (849 million), Mexico (741 million), the Dominican Republic (431 million), Colombia (328 million), Peru (286 million) and Jamaica (106 million). Smaller gainers include Argentina and the Central American countries. Bolivia and Chile are small losers. The total present discounted value of these revenue gains to Latin American producers is about 4.5 billion 1975 dollars.

To put these amounts in perspective, it is useful to consider them as percentages of the average annual value of exports in 1970-1975 (the last column in table 3). In these terms, they range from —2% to +97%. The big relative gainers are the Dominican Republic, with almost a year's export value (97%), and Cuba, with over a half a year (55%). Mexico, Colombia, Brazil, El Salvador, Peru and Jamaica all gain from one-fifth to one-third of a year's export value. For Latin America as a whole the estimate is a gain of about one-sixth (16%) of an average year's export value.

Are such gains for Latin America small or large? The answer depends upon the point of comparison. A total of 4.5 billion 1975 dollars is not so small as to be irrelevant. On the other hand, to obtain it requires operation of the buffer stock programme for a fairly long period of time. It is small, moreover, in comparison to the transfers of roughly US$ 65 billion per year brought about by the OPEC petroleum price increases, and furthermore, some of the poorer Latin American countries (e.g., Bolivia and Paraguay) would not benefit from such a programme.

Finally, let us return to the macroeconomic goals of the Latin American economies that are listed in the first paragraph of this paper. What are the implications of the simulations for the attainment of these goals? To consider this question it is useful to separate the impact of increased levels of earnings from that due to the reduction of fluctuations.

The impact of increasing the levels of earnings is almost certainly positive in regard to many of the macroeconomic goals. Moreover, in economies in which foreign exchange availability is an important constraint or in which unutilized capacity exists, the indirect effects transmitted through government expenditure, the money supply, import availabilities and the signalling functions of the commodity-producing sector may be much more important than the direct effects. The author is also engaged in an extensive project to evaluate the interactions between world commodity markets and goal attainment in developing countries, with case examples including coffee and copper in Brazil, Central America and Chile,[21] and the tentative results of this project suggest that

[21] Some preliminary results are given in F. G. Adams,

the impact of increased primary commodity export earnings, as magnified by the indirect channels noted above, may be quite considerable:

(1) The growth impact is likely to be positive in the commodity-producing sector and in the economy as a whole due to relaxation of the foreign exchange constraint, increased savings and investment, and fuller capacity utilization.

(2) The distributional effects may be regressive because the direct beneficiaries (e.g., the owners of factors used in the sector of commodity production) and those who benefit from the wage signalling effect (e.g., those in organized or government sectors) are likely to be in the middle or upper parts of the income distribution scale. The impact of induced inflation on distribution is likely to reinforce this tendency. Offsetting considerations are the progressive impact of increased employment (or employment in the modern sector) and of some induced increased government expenditures on human capital, housing, and welfare. Whether the regressive or progressive tendencies dominate depends upon the exact structure existing in a particular country and the weight put on various parts of the income distribution scale, but the often substantial overall employment effects may make the net impact progressive in many cases.

(3) The short-run stability effects may be quite substantial because of the magnification through the indirect channels and the considerable time period required for adjustments to long-run equilibria. As noted above, overall employment and capacity utilization increases are likely to be large. Although additional imports will be induced with part of the extra foreign exchange, not all of it will be so used, so the balance of current international payments generally improves. Given the passive nature of most monetary systems in Latin America, the raised level of foreign exchange reserves, further augmented by reduced government deficits (due to increased tax revenues from the commodity sector and the rest of the economy) will cause an expansion in the money supply. Only part of the larger money supply will be absorbed by greater economic activity, so prices will also rise.

(4) The international position of the economy will almost certainly be improved by the additional foreign exchange and the lessening of the foreign exchange constraint. In many cases positive capital inflows may be induced by expectations of ongoing greater economic activity. The only offsetting consideration might be greater dependence on the international system if this situation could not be reversed easily, but at least in principle policies could be directed towards keeping such risks minimal.

The impact of increased export earnings from primary commodities on goal attainment in Latin American economies is therefore relatively straightforward, fairly considerable, and likely to be mostly positive. The effects of reduced fluctuations in primary commodity prices or in related export earnings, however, are much more ambiguous, and the large but unsatisfactory literature on this subject finds conflicting results.[22] The ongoing study on integrated commodity and developing country models to which reference was made above provides the best tool available to date to explore such effects.[23] These models incorporate lagged responses, permanent versus transitory responses, and non-linearities (but, as noted above, not direct responses to variances) that might result in principle from different degrees of fluctuations. The experiments conducted to date, however, underline the lack of empirical support for the widely suggested

Jere R. Behrman and R. Roldan. "Measuring the Impact of Primary Commodity Fluctuations on Economic Development: Coffee and Brazil", *American Economic Review*, Nashville, Tenn., pp. 164-169, May 1979. The final results will be forthcoming in a series of books written or edited by Adams and myself.

[22]Lord and Manger review this literature and note that most of it depends upon extraordinary assumptions about the similarity of adjustment structures and the degree of exchange rate disequilibrium across the countries. See Lord, *op. cit.*, and Manger, John, "A Review of the Literature on Causes, Effects and Other Aspects of Export Instability", Philadelphia: WEFA (mimeo), 1979.

[23]Earlier macro studies have focussed on only one country or have used questionable model specifications (e.g., demand-determined Keynesian models without supply factors.)

hypothetical effects of fluctuations in international markets on goal attainment in Latin American economies. Depending on the structure of the individual economies, reduction of such variations may or may not aid in the pursuit of each of the four macroeconomic goals that are discussed above. The study in question, however, indicates that the total impact generally is not large.

4. *Implications of the UNCTAD Programme for developed countries*

The developed countries as a group are primarily importers and consumers of the six core commodities of interest to Latin America. At the start of this decade they accounted for the following percentages of world imports: coffee (90), copper (87), tin (81), cocoa (78), sugar (65) and cotton (51). They enter into the production and exporting side to a smaller extent, but still accounted for over 40% of world copper production and exports, over 20% of world sugar and cotton production and exports, and 16% of world tin exports.[24] The followings paragraphs, however, are focussed on the impact of the Programme on the developed countries in their primary role as importers and consumers of the UNCTAD core commodities. To the extent that they play a secondary role as producers and exporters, of course, the effects are similar to those emphasized above for the developing countries.

Once again, stabilization of the individual commodity prices may in itself have a positive effect on consumers and producers for the same reasons discussed above for the developing countries. Likewise, such effects are likely to be transferred across markets to the other participants, although the empirical magnitudes are not known.

The mayor direct costs of obtaining more stabile prices and other possible benefits noted below are the generally higher prices for the relevant commodities (column 7 of table 2) and the developed countries' share of running the UNCTAD Integrated Commodity Programme. Most of the additional producers' revenues noted above come from the developed countries through these channels. Another possible cost is the development of a new entity in international primary commodity markets that may have significant market power and that probably will be less responsive to the developed countries' interests than to those of the developing countries.

In addition to the possible direct benefits due to stabilization of particular primary commodity prices, there are at least two further major possible indirect macroeconomic benefits for the developed economies:

First, the more stabile export earnings of the developing economies are largely transformed into more stabile effective import demands, thus leading to more stabile demand for exports from the developed world, with consequent anticyclical benefits.

Second, the gains from the reduction of inflationary pressures may be significant. Imported inflationary shocks from rising commodity prices (as in the 1972-1974 commodity boom) may provoke macroeconomic policies that depress economic activity in the developed countries. Because of non-competitive pricing by industrial firms using commodity inputs directly or using their prices as a signal and because of macro policy-making, output losses attributable to rising commodity prices might not be offset by equivalent gains due to falling commodity prices. Thus commodity price stabilization may lead to a real macroeconomic gain for developed countries. It has been calculated by the author that the gain in this respect (in terms of prevented unemployment and product loss) brought about by the UNCTAD programme operating for a decade could be of the order of a present discounted value of US$ 15 billion for the United States alone.[25]

In an increasingly interdependent world, of course, both of these effects would have some secondary benefits for producers by stabilizing demands that they face and the prices that they must pay for imports from the

[24]See Behrman, Jere R., *International Commodity Agreements:..., op. cit.*

[25]See Berhman, Jere R., *International Commodity Agreements:..., op. cit.*

developed countries. The more important aspect of these benefits from the point of view of the developing countries, however, is that they may make co-operation in the UNCTAD programme desirable from the point of view of the developed countries.

5. *Alternatives to the UNCTAD programme*

Two international policy alternatives to such buffer stock agreements have received considerable attention: the formation of producers' cartels by the developing countries, and expanded compensatory finance for shortfalls in export revenues of the IMF or STABEX type.

The OPEC experience raised in many people's minds the possibility of the developing country producers of other commodities forming similar cartels of their own to stabilize and probably to increase commodity prices. In addition to OPEC there have been a number of such efforts that have been successful for a while in raising primary commodity prices.

However, an examination of the characteristic associated with the products involved in OPEC and other successful efforts leads to the conclusion that developing country efforts to cartelize the UNCTAD core commodity markets are unlikely to be successful. The producer countries have too little market power, or production is diversified among too many countries with too diferent cost structures, or there are too great substitution possibilities. Only with the institutional and financial aid of the developed countries is there likely to be much possibility of a reorganization of these markets along the lines desired by the producers.

Compensatory finance facilities for shortfalls in the developing countries' export proceeds have recently expanded considerably. They present some advantages over international commodity agreements: they refer to all export earnings, not only those from selected products; they do not interfere as directly with market signals, although elsewhere I question whether international commodity markets work as well as is often suggested by those who are concerned about tampering with the markets;[26] and they explicitly favour low-income countries, as may be desirable for global income distribution reasons, rather than the countries that produce specific commodities.

They also have some relative disadvantages, however: they do not permit the reaping of any micro gains by producers and consumers from the stabilization of primary product prices; they do not generate the potential macroeconomic gains from the reduction of inflationary pressures that are discussed above, and the existing facilities of this type, moreover, are centered in institutions that are characterized by some as being too conservative and too oriented towards the interests of the developed countries. Finally, from the point of view of most of Latin America, their orientation towards favouring low-income countries makes them less relevant (although in principle this could be changed).

The developed countries have emphasized the advantages of compensatory financing and have greatly favoured its expansion rather than the establishment of international buffer stocks, while the developing countries have viewed it as a supplementary measure rather than a substitute for the UNCTAD programme. Probably underlying both views, in addition to the pros and cons outlined here, are questions relating to changing the secular trends of prices for non-fuel primary products.

[26]See Behrman, Jere R., *International Commodity Agreements:..., op. cit.*

II

Changing non-fuel primary commodity price trends

Over the 1950-1975 period the secular trends in the deflated prices of the six UNCTAD core commodities of interest to Latin America were −3.5% per year for coffe, −2.4% for cocoa, −3.8% for cotton, and insignificantly different from zero for sugar, copper, and tin.[27] Prior to UNCTAD IV there was considerable advocacy by the developing countries of "indexation" (i.e., tying commodity price movements to changes in the prices of the goods imported by the developing countries). Opposition to indexation from the developed countries, however, was very strong. Consequently, in the UNCTAD IV proposal and resolution no mention is made of indexation *per se*, although a number of references hint at such an effort. Since the possibility of changes in the secular price trends probably underlies both the strong advocacy of some developing countries and the opposition of some developed countries in regard to the UNCTAD programme, a brief consideration of the implications of indexation (as one special case of so altering the price trends) may be useful here.

In Behrman and Tinakorn[28] the effects of indexation of all ten UNCTAD core commodities to the 1963 price levels for a 13-year period are explored. The results suggest that such an option is not likely to be politically feasible for all ten core commodities, nor for the six of interest to Latin America. Buffer stock interventions are required in every year, and for most commodities usually only on one side of the market, while the present discounted value of the buffer stock activities involved would be large: US$ 142 billion for all ten core commodities, US$ 70 billion if sugar is excluded, US$ 93 billion for the core commodities of interest to Latin America, and US$ 21 billion for the core commodities of interest to Latin America, excluding sugar.[29] The amount of financial backing required would be of a similar order of magnitude. Therefore scepticism seems warranted about the feasibility of getting consuming countries to agree to or to allow changing the secular trends for long by anything like as much as would be required for indexation. Since the market characteristics do not seem to allow for successful indexation by the developing country producers alone, it may be concluded that indexation probably is not feasible.

UNCTAD-type buffer stock agreements probably could alter the price trends in an upward direction by a lesser amount for a while, and to do so might result in significant gains for the developing producing nations. However, it would also lessen the anti-inflationary benefit and increase the cost to the consuming developed nations, so that their cooperation, which seems essential for effective international organization of these markets, would probably be withdrawn if they perceived that there was a significant effort to alter the underlying secular price trends.

[27] *Ibid.*

[28] Berhman, Jere R. and Tinakorn, Pranee, "Indexation of International Commodity Prices Through International Buffer Stock Operations", *Journal of Policy Modeling*, 1, pp. 113-134, 1979.

[29] The implications of excluding sugar are indicated because of the doubts about the underlying model that are mentioned above and that are discussed in Behrman and Tinakorn, "Evaluating Integrated Schemes...", *op. cit.*

III

Conclusions

UNCTAD-type international non-fuel primary commodity price stabilization agreements are not an easy solution. They require the co-operation of countries with some competing interests, and the possibility that they may alter the secular price movements is difficult to monitor. Under any particular circumstances some developing country producers may lose due to their operation, and the global benefits may not be particularly progressive.

Even so, such arrangements do present some possibilities for real gains by some Latin American producers and by the United States and other developed economies. Alternative strategies to alter these markets would not confer all of the same benefits (although they might have other additional advantages). Therefore some efforts to explore the possible joint advantages of UNCTAD–like programmes seem warranted.

A new Latin America in a new international capital market

*Albert Fishlow**

Introduction

The timeliness of another look at the development prospects and policy options for Latin America can hardly be disputed. Another shock from a significant increase in the price of petroleum is adding to the burdens of a world economy already mired in stagflation. The recent UNCTAD meeting has not produced a common programme for accelerating and spreading economic development: on the contrary, divisions among and between the industrialized and developing nations have widened. Even the conclusion of the Tokyo Round has failed to evoke enthusiasm among the Group of 77.

For all the failure to seize upon its possibilities, however, economic interdependence remains more than rhetoric, and for no part of the developing world is this truer than Latin America. The countries of the region substantially increased their integration into the world economy at the end of the 1960s and the beginning of the 1970s. Growth rates of their trade were superior to those of the gross domestic product, which were themselves accelerating. Terms of trade were favourable. Capital flows increased dramatically.

Since 1973, as the industrialized countries have performed less well, with corresponding reduction in the growth of trade, the regional statistics have mirrored the global adjustment problem. For all the success —in large measure unexpected— that the private banks have had in recycling the surpluses of the OPEC countries, the transfer of the extra petroleum revenue has not gone smoothly. This was true even as the OPEC surplus diminished from US$ 40 billion to some US$ 10 billion in 1978, and before the substantial increase now in prospect again.

Statistics for Latin America as a whole, of course, conceal the significant differences that have emerged between the oil-exporting and non-oil-exporting countries of the region. Of the latter, sixteen experienced lower growth in the period 1974-1978 than in the prior 1970-1974 period, and only three smaller countries (Honduras, Paraguay and Uruguay) registered an improved performance. In contrast, the oil exporters showed tangible gains, and even Ecuador —the only country not to gain markedly relative to the earlier period— nonetheless grew at one of the highest rates of the region, 6.8%.

The regional growth rate, heavily dominated by the non-oil-exporters, is in itself an obvious source of concern, sinking from a postwar high of 7.5% in 1970-1974 to 4.0% in 1974-1978. The current average is lower than that of the stagnant early 1960s, which provoked such concern. Slowing and uneven growth has been accompanied by generalized inflationary pressures. Excluding the extreme experiences of Argentina and Chile, consumer prices have climbed at more than 30% a year recently, compared to less than half this rate in 1970-1973. In short, even if we include the gains of its oil producers the Latin American economy has not fared well in the unsettled post-1973 circumstances, and this conclusion applies all the more when comparison is made with the performance of other developing countries.

What makes the Latin American experience of special concern is that this post-1973 decline in growth and resurgence of inflation have taken place despite record capital flows exceeding those to other areas. During the period 1974-1978 the non-oil-exporting countries of the region increased their indebtedness by some US$ 60 billion. As an order of magni-

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tude, this capital inflow should be compared with a *total* cost of petroleum imports of less that US$ 30 billion and an *incremental* cost of petroleum imports of about US$ 20 billion. To put it another way, and more comprehensively, the capital flow was sufficient to sustain the same 9.6% rate of increase of the purchasing power of exports experienced in the extraordinary 1970-1973 period. Thus it substantially compensated for both diminished volume and terms-of-trade effects.

It is difficult to sustain, therefore, that Latin America has suffered from inadequate access to foreign capital markets. Despite the substantial access it has enjoyed, however, the consequences have not been entirely satisfactory. While it is correct to argue that the payments deficits of Latin America, and of the developing countries generally, have provided a necessary counterpart to the OPEC surpluses, one should not exaggerate the efficiency of the transfer process.

In looking ahead to the renewed imbalance in global finances that is imminent, it is important to appreciate both the limitations and the possibilities inherent in the strategy of debt-finance adjustment which some countries in Latin America have opted for. The sections below address this fundamental issue from different perspectives. Section I considers the characteristics of recent capital inflow, sources as well as uses. Section II examines the capital requirements for continuing economic expansion in the region, as well as the means for meeting them, and attention is also given to some of the suggestions that have been made regarding ways to confront future capital needs more adequately. Section III considers the domestic side of integration into international capital markets and notes that reliance upon external capital inflows is not neutral in its consequences for internal policies.

I

The pattern of debt accumulation

The dimensions of the capital inflow into Latin America are tolerably clear from recent research on the subject. The disbursed debt of the non-oil-exporting countries now exceeds US$ 100 billion —roughly two-thirds official and one-third provided without government guarantee. Brazil and Mexico together account for some 70% of the regional total. The Brazilian debt stands at around US$ 40 billion, and the Mexican close to US$ 30 billion. Argentina, with a debt of US$ 10 billion, and Colombia, Chile and Peru, each in the range from US$ 5-US$ 8 billion, trail far behind.

That debt has increased more than eight times from its 1965 level, and more rapidly than for the developing countries as a whole. Debt has become the principal form of capital inflow into the region, and direct investment, which a decade ago provided almost as much resources, now accounts for little more than 10% of the capital inflow. Multinational enterprises have increasingly financed their requirements through bank indebtedness abroad rather than by resort to internal credits or to equity.

Accompanying the shift to debt finance has been a much greater role for private rather than public sources of credit. Commercial banks in particular have become the principal creditors. They have now become responsible for more than 40% of the officially guaranteed debt, compared to less than 10% little more than a decade ago, and with the rise in the importance of non-guaranteed debt, supplied almost exclusively as bank credit, their participation must stand at close to 70% of the total outstanding debt. Estimates for 1978 suggest a partial retreat from the proportions of the 1974-1977 period, partly for that very reason.

These capital inflows over that last decade cannot usefully be viewed as forming a single process of debt accumulation, but seem rather to correspond to three distint sets of circumstances. The first period, approximately from 1970 to 1973, is one of the initiation of access to the rapidly growing Eurocurrency market. Supply, in the form of bank discovery of the profitability of application of resources in the middle-income countries, vied with demand. Increasing investment coefficients meant increasing need for imports of capital goods, and consequently for foreign exchange. At the beginning, despite buoyant exports and favourable prices, import requirements exceeded import capacity —hence the attractiveness of finance available for reasonable periods and at low interest rates owing to an excess of investible funds. In 1972 and 1973, however, the extraordinary rise in the prices of commodity exports increased the value of exports by more than 60%, thus providing a much larger supply of foreign exchange, and the continuing inflow of loans was substantially applied to the accumulation of reserves rather than to offsetting the current account deficit.

I have labelled this early period prior to 1974 one of debt-led growth, in order to emphasize the positive relationship between the flow of external capital and the acceleration in real growth of the product. In the early 1970s such supplementation of foreign exchange made it feasible to adopt high growth strategies without fear of foreign exchange constraints.

The years 1974 and 1975, in contrast, are those of debt-financed accomodation to the oil price increase. As a result of the increased demand for loans, interest rates rose perceptibly and maturities shortened. The purchasing power of exports fell sharply in both years owing to increasing prices of petroleum and other imports, while the volume of exports stagnated. Import capacity was sustained by resorting to the external market to finance unprecedentedly high deficits on current account. So substantial were the needs that there was even some modest depletion of reserves. The net effect was virtually uninterrupted growth in 1974, but perceptible reduction in 1975. Nonetheless, the performance in those two years, taken together, did not compare unfavourably with longer-term trends, and in both years the investment coefficient continued to rise.

The almost US$ 30 billion in current account deficits of the Latin American non-oil-exporting countries was largely offset from the surpluses accumulated by the OPEC countries. These balances found their way for the most part to the Eurocurrency market, where they were intermediated by the banks. Non all developing countries were equally fortunate, however. The lowest-income countries, whose growth rates had failed to respond favourably in the earlier period, did not have access to the new resources, and their unhappy alternative consisted of still slower rates of expansion and reliance upon public capital made available for the most needy.

Other countries, notably Korea and Taiwan, responded by accepting an immediate reduction in growth, and undertook diversion of production to the export market. This, of course, is the means by which the real income loss due to the adverse change in the terms of trade is palliated by translating it into reduced domestic absorption. While possible for some countries, it is not a solution for all simultaneously unless total world income were to fall significantly.

The large economies of Latin America opted for a third course —one of using the capital market to sustain domestic expenditure. They did so in part because private commercial banks effectively recycled the new petrodollars by making borrowing attractive. Latin American countries already in debt had an easier time obtaining more. But such differential access is not the only reason. Clearly there were important political advantages in seeking to sustain higher rates of growth that had recently given such striking advantages, and in avoiding economic recession or worse. This combination of circumstances led Latin America to emerge as an even larger participant in the capital market after 1974, and the two largest developing-country debtors to commercial banks became Brazil and Mexico.

A third period, after 1975, should also be distinguished. It has been marked by substantiallly reduced current account deficits compared with the 1974-1975 levels, the 1978 level in real terms —deflating for both inflation and real product growth— being less than half the 1975 peak. In addition, the composition of the deficit has changed, and whereas it was made up almost entirely of net payments of profits and interest in 1977 and 1978, in 1975 these formed only a third of it. The last three years have therefore seen a delayed adjustment to the altered external conditions prevalent since 1974: a rise in the rate of growth of exports, virtual constancy in import volume, a reduction in the rate of growth to less than 5%, and a lower investment coefficient.

Yet this last period has also seen an actual expansion of foreign borrowing rather than a reduction. Massive increases of reserves explain this apparent contradiction. The non-oil-exporting countries are responsible for an accumulation of more US$ 17 billion in reserves in the last three years, and almost half of the increment in debt has been used for this purpose. Much of the rest, in turn, has gone to compensate for the outflow of service payments on prior direct investment and indebtedness. Far from financing a necessary supply of imports essential to continued growth, real external resource transfer has sharply declined. Foreign borrowing satisfies domestic credit requirements rather than foreign exchange needs, and large international reserves create domestic monetary policy problems as well as complicating management of the debt. These reserves have become offsetting deposits feeding back into the Eurocurrency market, earning lower rates of interest, and of limited convertibility to material imports because of creditor apprehension.

For many of the countries of Latin America, therefore, the debt cycle threatens to come full circle in little more than a decade —from a process of debt-led growth to one of potentially debt-constrained growth. Foreign capital inflow, while staving off some of the worst consequences of the new world economic situation since 1974, has not been a panacea.

II

Capital requirements

This record accumulation of debt in Latin American and other developing countries has not gone unnoticed. Initial concern by some in 1974 and 1975 lest the entire world financial structure crash on account of generalized incapacity to repay has quite correctly abated, and more optimistic forecasts, showing how the record current account deficits of 1974 and 1975 would moderate and involving adjustments for inflation and product growth to assess more accurately the extent of indebtedness, have proved better founded.

Yet it is too soon to dismiss the debt problem entirely. It is clear from the experience of recent years in Latin America —even before the present petroleum shortage— that the inflow of increasingly private capital has not been performing its intended function. Potential savings both in the direct form of OPEC surpluses, and indirectly in the form of lesser investment in the industrialized countries, have not been translated into capital formation and sustained economic growth. Resources have not been allocated to those whose return was highest, but rather to those whose needs were less. That is, of course, one of the ironies of commercial-bank evaluation of creditworthiness: those who accumulate reserves are the best customers.

Underlying this failure of the market to produce more positive results is the reliance on a short-term, private profit motive criterion. Commercial banks could hardly be asked to function otherwise, since they have no pretensions of serving as development banks, and neither could the recipients. Each country, facing an uncertain supply of credit, could hardly risk larger current account deficits, given the short maturity of its large outstanding liabilities. It is not surprising, then, that Latin American growth rates and investment coefficients should decline and that the building up of reserves should be a favoured application of borrowing—and a key to continued access.

Furthermore, the optimistic assessments

tend to look backward rather than forward. Whether the calculations on which they are based involve deflating the debt by rising export prices, or extrapolating diminishing current account deficits, they fundamentally err in failing to tackle the question of the future means of meeting foreign exchange needs.

While export prices may rise, so do import prices. The real problem for non-oil-exporting countries since 1974 has been the combination of inflation and adverse terms-of-trade movements. Moreover, global inflation also means higher and immediately adjustable interest costs on debt of shorter average term. While we have seen that current account deficits for Latin America have indeed declined, we have also noted the lesser real transfer of resources consequent upon the rising incidence of interest and profit payments.

Once one projects forward to ascertain the capital inflows that will be needed, the essential characteristics of the Latin American debt problem become clearer. Firstly, the debt over next decade is likely to increase by a significant multiple, and more rapidly than gross national product. Gross inflows will have to rise even more in order to cope with amortization. Secondly, the ratio of service payments to exports is likely to increase further in the near future from its current average of more than 40% before stabilizing. Thirdly, the gain to debtor countries from inflation should not be exaggerated. Such a gain does exist, because price increases magnify the dollar merchandise surplus that can be used for amortization and service payments denominated at historical cost, but as the maturity of the debt shortens, and as interest rates reflect inflation —as they must with increased reliance upon commercial bank loans— this advantage is curtailed. More significant than inflation *per se* are the terms of trade, because they have a greater effect upon the size of the commercial balance. In crude terms, on the basis of a variety of actual projections using parameters appropriate to the Latin American experience, a one percentage point improvement in the terms of trade is equivalent to three percentage points of generalized inflation.

Fourthly, capacity to cope with the size of the debt and its servicing requirements depends critically upon real export growth rates that exceed the growth of the domestic product, that is to say, it depends upon an increase in the importance of the external market. Import substitution can help in increasing the commercial balance, but cannot be relied upon to the extent it was formerly. At the low ratio of imports to income that the larger countries now have, there is a limit beyond which the import elasticity cannot be pushed. Moreover, as one approaches that limit and relies upon import reduction to equilibrate capital needs, there is no further flexibility for economic policy: a decline in foreign exchange for any reason automatically becomes a serious economic constraint, whereas at higher levels of exports and imports there is more room for restricting less essential imports. Furthermore, an export-promotion policy reaps the gains of a much larger market and, if correctly pursued, stimulates increased productivity in response to the rigours of international competition, whereas an import-substitution policy runs the risks of excess protectionism and inefficiency.

Fifthly, the growing export surplus required to slow reliance on external capital inflow calls for a corresponding reduction in domestic expenditures. National savings must rise as a counterpart to the resources transferred from abroad earlier. One can postpone, but not avoid, the real income consequences of the higher petroleum prices, and the question of how to allocate that cost internally, as surpluses are transferred externally, is not a trivial matter.

Finally, and most important, a more causal projection structure makes it clear that the real cost of repayment of the debt under adverse trend and financial conditions is lowered economic growth. Foreign exchange must be allocated to service past inflows of capital rather than to purchase imported inputs essential to sustained capital accumulation. At low rates of continuing capital inflow and of exports there is a trade-off between adjustment in the current account deficit and economic performance. The debt problem is far from exclusively a creditor's problem, and it becomes an impossible one if creditors simultaneously choose to close off both capital and merchandise markets.

raise legitimate doubts in this direction— they are not a necessary concomitant of rising exports. It would be unfortunate, as more democratic tendencies stir in a number of countries, for nationalist, inward-looking development to become synonymous with an economic policy more responsive to popular needs. The reality is that import substitution, domestic austerity fairly distributed, and continuing capital inflow must all be coupled with aggressive efforts to increase exports.

The great bulk of these exports, moreover, will have to be directed to the market outside Latin America rather than within. Just as the shortages of foreign exchange in the late 1950s stimulated the creation of the Latin American Free Trade Association, so again there are suggestions that an expanded regional market may contribute to the solution. A recent CEPAL publication, for example, took the view that Latin America will now undoubtedly have to place more emphasis on intra-regional trade. Without denying the growth of intra-regional trade in recent years and its more than proportional significance in the field of manufactures, however, it seems to me unlikely that the formal integration process will much accelerate in the next several years unless two conditions are met: reversal of the diminishing regional political identity which has characterized Latin America in the last decade; and much slower growth of trade opportunities outside the region. A Latin American Common Market is more likely to have its origins in circumstances external to the region than to arise spontaneously from within. Even then, the capacity to bridge the significant differences between oil exporters and oil importers, large economies and small, advanced and lower-income countries, etc., seems to me doubtful. Intra-regional exports may contribute to the solution, but only to a limited extent.

Apart from assuring a continuing allocation of resources to exports, domestic policies must seek better to accommodate the external and internal capital markets. During the period of rapid debt accumulation, the restructuring of internal capital markets has been given secondary priority, since external credit has substituted for the need to capture domestic savings. The distribution of such credit is, of course, non-neutral. It favours larger enterprises relative to smaller; governmental relative to private; industry relative to agriculture; multinational firms relative to national. Government policies often seek to offset such biases, but at the cost of compartmentalizing the internal capital market still further. Those sectors receiving subsidies suffer from a shortage of real investment as loans are applied elsewhere.

This impact of capital inflow upon domestic financial institutions must be a matter of greater concern. There is no simple equalization of internal and external interest rates, as a simple theoretical model suggests. Moreover, as is well known, external savings are not a pure supplement to national savings, but to a considerable degree displace and substitute for them. Failure to take these structural consequences into account biases an otherwise rational calculus in favour of a larger resort to debt than may be necessary. In recent years, when foreign exchange requirements have been less pressing and debt has had such a large counterpart in reserves, these financial effects loom larger.

This accumulation of reserves has led to wider appreciation of the limits imposed upon domestic monetary and fiscal policy by integration into international capital markets. It is a measure of the excessive reliance upon debt that efforts have been made to sterilize the monetary increases resulting from even greater reserves. Far from the capital flows being an equilibrating mechanism, they threaten the effective management of the domestic economy. External credit must be neutralized by government sales of securities. It is not an easy operation —and one that more often than not has led to larger increases in the money supply than were desired or planned. This avenue of imported and magnified inflation has been an important component in the price rises of the largest regional debtor, Brazil. In undertaking such sales of securities with monetary correction it should be noted, moreover, that government nominal expenditures are given a significant upward impulse.

Apart from these effects on monetary and fiscal policy, there is a further constraint upon of long-term funds by offering protection against inflation; encouraging commercial banks to intermediate some of their resources through public institutions, perhaps initially through some swap arrangement; creation of new public institutions directed to particular investment objectives in which there is a common global interest: agriculture, substitute sources of energy, natural resources.

These proposals share a common feature. They presume that the problem for Latin America is not a need for concessional resources but for more certain and longer-term funds on which social returns are high enough to offset interest costs. They also presume that exclusively regional arrangements —whether a short-term safety net or longer-term guarantee schemes— are not likely to be as efficacious as more universal arrangements that satisfy special Latin American needs.

Finally, they focus on measures directly relating to capital flows. This is not to ignore that the debt problem is in the last analysis a trade problem. Quite to the contrary. Without high growth of exports, these measures required in the capital markets would be quite inadequate. Unless the means are provided to sell exports in a volume sufficient to meet foreign exchange obligations, the alternatives are either lower Latin American (and world) growth or massive and more certain capital transfers. The former is unacceptable; the latter, unlikely. That is why the subject of capital flows is inextricably linked to that of real flows.

III

Domestic implications and policies

International capital flows must also be related back to the domestic economy. Three interfaces require brief comment in this respect. One is the ability to sustain the growth of exports needed to satisfy foreign exchange requirements. The second is the interaction between internal and international capital markets. The third is the interrelationship between debt management and domestic monetary and fiscal policies.

The progressive reintegration of many of the principal countries of Latin America into the world market at the end of the 1960s and beginning of the 1970s is well documented, as is the rising share of manufactures in total exports. Both the favourable growth of the world economy and domestic policies reducing biases against the external market contributed to this. In some cases, both significant subsidies and more favourable exchange rates were offered; that was clearly true in Brazil, for example, although the subsidies were to a large extent only compensatory for the combination of tariffs and exchange-rate overvaluation.

Such policies of frank export promotion may have been easier to sustain than the combination of import substitution and growing exports now advocated. They were easier because they were accompanied by high rates of growth of imports, and hence rapid expansion of domestic absorption. They were easier because integration into a buoyant world economy yielded tangible benefits in the shape of more rapid growth of the product. They were easier because they did not involve, as in recent years, heightened tariffs and quantitative restrictions against imports, with simultaneous complaints about protectionism in the industrialized countries.

Latin American commitment to the external market runs against deep sentiments to the contrary. An export orientation is feared as anti-industrialization, anti-national enterprise, and anti-more equitable income distribution. All of these concerns have their roots in historical experience. Yet it would be a sad mistake to extrapolate the past to the future. While particular policies to exploit the external market may have such features —and the proposals in Brazil to reorient the agricultural sector

I have emphasized these qualitative conclusions here rather than present a specific set of estimated capital requirements, because these considerations seem to me the more relevant context against which to evaluate different policy proposals. Particular values will change with altered circumstances. The additional cost of oil this year, for example, as well as higher interest rates, will alone add more than US$ 4 billion to the current account deficit registered last year, reversing its trend reduction.

These developments make all the more desirable a concerted effort to tackle the inadequacies of a capital flow monitored almost exclusively by the private market. Corrective measures should fall into two broad categories: conversion of a much larger proportion of current debt into long-term borrowing, and more effective means of coping with short-term shortfalls of foreign exchange. The aim of both these measures is to permit external resources to be used to better advantage, thereby stimulating growth not only within Latin America but also for the industrialized countries.

Bank borrowing through the Eurocurrency market, as we have seen, has in recent years failed to fulfill this objective. Foreign resources have been applied to reserve accumulation rather than investment, and growth rates have fallen below trend levels. The problem is not inadequacy of capital, but rather the availability of too much of the wrong kind.

Many specific proposals have been put forward since 1974 to address these needs, the great majority without success. As long as the Eurocurrency market increases by 25% a year, and as long as the larger Latin American countries enjoy favourable access to it, it is difficult to generate any sense of urgency. The Witteveen Facility of the IMF is one of the few concrete steps taken; it makes available an additional US$ 10 billion to compensate for short-term shortfalls, and we shall probably see greater use made of it after this round of oil price increases.

To supplement this facility, however, some means of more orderly debt restructuring remains necessary. Borrowing to meet immediate foreign exchange needs may avert bankruptcy, but it remains inadequate to finance the longer-term productive adjustments required. Experience suggest that it is precisely those countries already heavily overburdened with debt that repeatedly require emergency assistance. It would be better policy to facilitate a really fresh start than to engage in unrealistic roll-overs that merely stretch out very high service payments over a longer interval. Commercial banks are reluctant to write off foreign loans, although one presumes that the high risk premiums charged provide a financial reserve for doing so. They had no similar compunction with real estate investment trusts —despite larger losses— because a legal code of bankruptcy made settlement desirable. I continue to believe that international lending would benefit from a similar escape clause. Clear applications in Latin America would have been Chile and Peru.

Such a provision would not grant a license for irresponsible conduct by borrowing countries. They would have to pay the cost of failing to meet their obligations through less future access to the capital market, and moreover they could not default without establishing their need for such relief to the satisfaction of, say, the IMF. There would be a chilling effect on the willingness of commercial banks to lend directly for the short term, and some impact on interest costs. That would not be all bad, even when one is quite correctly concerned about the adequacy of capital flows. Reliance on short-term borrowing probably should be discouraged —particularly if its results are as mixed as those of recent years.

Furthermore, such a measure would correctly shift attention to the more fundamental need to make external resources available for productive longer-term investment. Such a need will be met only by increasing the pool of funds available for borrowing at extended maturities. One means of doing so is to enhance the role of the public development banks relative to the private commercial banks. Recent increases in the capital base of the World Bank and of the Inter-American Bank, and co-participations, clearly contribute to this end. More dramatic measures may be necessary, however, including explicit solicitation the capacity to utilize exchange rate devaluation in a heavily indebted economy. The impact upon external liabilities does not have an even incidence upon sectors or firms. To offset it is to negate the attempt at reducing domestic expenditure, while to permit the financial consequences may be to invite serious displacements in production. One may therefore be forced into a situation of using selective measures to offset overvaluation rather than altering the exchange rate itself.

The essential point is that reliance upon external capital inflows is not an unmixed blessing. Effective management of the debt involves more than a computer print-out of projected amortization and interest payments. It involves the internal allocation of resources, the relationship with internal capital markets, and the synchronization of policy instruments. These tasks are complicated by uncertain conditions of supply determined externally.

Conclusions

Latin America's rising participation in the international capital market in the last decade reflects on the whole its gathering economic strength. Higher levels of income, apparent political stability, a facility to increase and diversify exports, and attractive future prospects are responsible for the differential access to the Eurocurrency market enjoyed by the principal countries of the region. That access has enabled many of those countries to protect themselves against the worst consequences of a much more sluggish and uncertain world economy since 1974.

Integration into international capital markets has not worked equally well for all, however, nor has it worked perfectly for any country. Peru remains saddled with a debt that exceeds its capacity to pay. Mexico's underdeveloped fiscal capacity has been compensated —through good fortune— by the timely discovery and exploitation of petroleum and natural gas. Brazil has embarked upon a stop-go policy in recent years reminiscent of its neighbours to the south. Some smaller countries have not been able to borrow readily or on favourable terms.

Capital inflows thus have not been a panacea, and they threaten to become a problem if they prematurely turn to outflows of real resources. If they are to recover their recent high growth rates, the countries of the region must be able to count on adequate continuing finance. Whether the private market, and the increasing concentration of commercial bank debt, can satisfy that need is doubtful. Uncertain and short-term borrowing does not translate efficiently into the long-term process of capital accumulation and sustained growth that is desirable. Stabilization packages that meet symptomatic excesses of domestic absorption by imposing unrealistically short adjustment periods do not address structural deficiencies.

Many specific proposals have been advanced to deal with one or another of these problems. Few have been seriously considered, because there is little sense of urgency. So long as modest product growth is sustained, debt obligations are met, and continuing capital is available, it will be difficult to arouse keen interest in suggested reforms to improve intermediation. Innovation in international financial markets seems to be dominated by private initiative rather than public policy. The danger is not that the financial markets will suddenly collapse, or that Latin American debtors will all find themselves unable to pay, but that the *status quo* will continue, with adequate, and indeed perhaps excessive availability of credit of the wrong kind.

The countries of Latin America are not entirely dependent upon the initiatives of others in responding to this real, if undramatic, threat. They can reduce their borrowing and rely more substantially upon national savings; they can engage more vigorously in a style of development directed to the internal market; they can insulate themselves to a greater extent against world economic circumstances. Such a strategy is not costless, either for Latin

America or the industrialized countries, for it involves a rejection of the mutual advantages inherent in a rational transfer of resources to more productive applications.

Yet that outcome may well occur, because policies are slow to evolve. Few trends have been foreseen with such monotonous regularity as the altered importance, needs, and role of the middle-income countries of Latin America. Up to now, we have successfully muddled through. But can we confidently rely on such an accommodation in the future?

Latin America and the international monetary system: Some comments and suggestions

*Carlos Massad**

I

The functioning of the system

In this paper, I intend to emphasize aspects of the present system of international economic relations in the monetary and financial area that create difficulties for an adequate insertion of Latin America in the world economy. I do not propose to make a comprehensive study of all transfers of resources between developed and developing countries.

My comments will be arranged under three main headings: the workings of the present international monetary system; the effect of the present system on Latin American countries and less developed countries in general, and changes in the system that could help to minimize the present difficulties.

Generalized floating of currencies became unavoidable as the Bretton Woods system proved incapable of providing enough adjustment incentives for reserve currency countries, essentially the United States and the countries with surpluses. In fact, IMF "discipline" could only apply to non-reserve-currency deficit countries. Reserve currency deficit countries could finance their deficits with their own currency, while countries with surpluses did not need to request IMF assistance.

The lack of international incentives to adjust created a situation where convertibility in terms of gold could not be maintained, and the Bretton Woods system collapsed. As a matter of fact, the lack of adjustment incentives, together with some domestic banking regulations, gave rise to an explosive growth of private financial markets as financial intermediation between surplus and deficit countries became more and more in demand. Between 1973 and 1978 the net size of the Eurocurrencies market grew at a rate of about 19% per year.

Those changes are not only important quality-wise, however: they also represent a complete qualitative transformation of the system.

1. *The role of the monetary authorities and of the private sector*

The first important qualitative change is that wich took place in the market intervention role and reserve holdings of the monetary authorities versus those of the private sector. In a fixed exchange rate system, the authorities have to maintain exchange rates through intervention in the market, for which purpose they must hold foreign exchange, gold and SDR reserves. In a floating system, such a role is transferred totally or partially to the private sector, and it is the latter which has an incentive to accumulate "reserves" in order to "intervene" in foreign exchange markets.

This fact implies a higher sensitivity, or elasticity, of the composition of reserves to economic incentives. Usually, central banks are less sensitive to changes in expectations

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This paper is a revised version of the statement delivered by the author before the Independent Commission on International Development Issues on 5 May 1979 at Annecy, France.

than private holders of foreign exchange. The latter tend to adjust the composition of their holdings rapidly when relative interest rates or exchange rates are expected to vary. Hence, the more important the role of private holders in foreign exchange markets, the faster will be the reaction to changes in expectations. The expectation of devaluation of a reserve currency —or a currency important in international trade— brings about an immediate change in the composition of assets and liabilities of the private sector and this helps to produce the expected devaluation. In a sense, it could be said that under the present system, since central banks cannot resist the pressure of private speculators, generalized expectations will never be wrong.

Another consequence of the increased importance of the private sector in intervention is a relative reduction in the demand for SDRs. In fact, SDRs cannot be held by the private sector, but insofar as the relative importance of private "reserve" currency holdings increases, the demand for SDRs will decrease relative to that for currrencies. All this has important implications for the system as a whole (the implications for LDCs will be developed later).

(a) Exchange rate changes tend to "overshoot the mark", so that the magnitudes of such changes tend to be relatively large. It has been observed that prices tend to react faster than quantities to exchange rate changes in industrial countries. Thus, when a particular currency suffers a devalution, the export prices of the devaluing country tend to fall and import prices to rise soon after devaluation, but export and import volumes react more slowly, so that, for a time, a devaluation increases the imbalance it was suppossed to correct. Private holders of the currency will see their devaluation expectations reinforced, and the exchange rate will reflect such strengthened expectations with further devaluation. Then, after some time, the effect of devaluation will show itself in the balance of payments, in the form of a relative reduction of imports as compared to exports, and the opposite process will be generated. As this process is better understood and the pattern of events repeats itself, the private sector may "learn" to speculate better and the destabilizing effect of expectations formed in the way described above should tend to dissappear. The length of the learning period is, however, unknown.

(b) The degree of stringency of monetary policy becomes more difficult to evaluate. Let us take, for example, a German-based company that holds US dollars in its assets. If such a company expects a reduction in the value of the dollar relative to the German mark, it will try to sell its dollars for marks, while if the Bundesbank wants to give at least partial support to the dollar to avoid an excessive strengthening of the mark, it will buy the dollars in exchange for marks. The figures in Germany will show an increase in the money supply, whereas all that has happened is a change in the composition of assets of the German-based company. There is no reason for this action to change the desired spending pattern of the company, so that the increase in the money supply in Germany will have no direct inflationary effect. Of course, the real world is not this simple, but I hope that this example serves to illustrate the essence of my argument.

(c) Exchange rates become more volatile through changes in transactions on capital account (capital flows). If private capital and money markets are well developed, with reserves diversified in terms of currencies, changes in expectations will affect the market rapidly and fully: desired changes in the composition of assets and liabilities of economic agents will be reflected in market actions which will result in changes in exchange rates. The money markets for developed countries' currencies are sufficiently deep to allow the operation of a futures market where interested parties can buy "coverage" for exchange risks. With or without coverage, however, changes in domestic interest rates or other factors affecting the desired composition of assets and liabilities will tend to produce sizable capital movements, unless interest rate policy is closely associated with expected exchange rates. Such association is very difficult to achieve in practice, so exchange rates must be expected to vary sharply in short periods of time.

Furthermore, changes produced through the capital account may tend to reinforce those in the current account. An unfavourable current account will produce devaluation expectations. At the same time, the expected cost of borrowing abroad or the expected benefit of external investment will increase (due to the expected devaluation), producing as a consequence an imbalance in the capital account with the same sign as that in the current account. Since, as pointed out above, the adjustments in the current account come about only slowly, one must expect relatively sharp movements in exchange rates on this account, on at least a movement in a particular direction for some time and then a reversal, in a cycle which will take two or three years to develop fully.

(d) Sharp changes in exchange rates help to stimulate protectionist tendencies in world trade. As some currencies appreciate, the issuing countries will face some loss of competitiveness, while deficit countries, whose currencies depreciate, tend to yield more easily to protectionist lobbyists on balance-of-payments grounds. Thus, global resistance to protectionism is substantially weakened, and if at the same time, for this and other reasons, the world economy is expanding slowly, the stage is set for the proliferation of direct controls, regulations and increased tariffs on trade.

2. *The international transmission of economic disturbances*

With fixed exchange rates, it was expected that inflation rates in the world would tend towards equality, since it was argued that any discrepancy would bring about imbalances in foreign payments that would force adjustment. As exchange rates were not completely fixed, however, some discrepancy in inflation rates was allowed for, over and above that coming from different rates of change in productivity. Between 1960 and 1970 the average yearly rate of inflation for 9 industrial countries[1] was 3.5%, with a standard deviation of 1.5 and a coefficient of variability of 0.43. Floating, it was argued, would allow for more freedom in domestic monetary policy, since variation in exchange rates would insulate countries from external shocks. On these grounds, rates of inflation should have diverged after 1973 more than they did before, and particularly before 1970.

However, empirical evidence does not lend support to this expectation. For the same 9 countries considered, yearly inflation between 1974 and 1977 averaged 11.3%, with a standard deviation of 4.8 and a coefficient of variability of 0.42: i.e., practically indentical to that prevailing in the 1960s, while for the period 1970-1973—a transitional period— the average rate of inflation was 6.5%, with a standard deviation of 1.7 and a coefficient of variability of 0.26. It therefore looks as though floating rates have not helped very much to insulate countries from external disturbances. An alternative hypothesis, which I have put forward elsewhere, could be formulated to explain this behaviour. For our purposes, it is sufficient to point out that floating has not insulated countries from external shocks. Floating is no substitute for responsible domestic policies.

3. *Creation of international liquidity*

The present system has considerably obscured the concept of international liquidity itself. When the authorities accumulated most of their external reserves the concept was clear-cut. But as soon as the private sector assumed, partly or wholly, the responsibility for intervening in the market, the concept of international liquidity became vague and ill-defined. Should it be only official reserves which were considered? Or should one take account of private holdings in some way? These questions are not academic, for the difference between official holdings and "total" holdings of foreign exchange —and gold and SDRs— is enormous (the second is at least twice the first).

In a floating system, it is legitime to consider private holdings of foreign exchange as "international liquidity", since there should be a demand in the private sector for such holdings, and if the demand is not satisfied, the private sector will look for ways to satisfy it, even creating new liquidity instruments. In a world where the foreign exchange operations of banks in industrial countries and offshore

[1] Belgium, Canada, France, Germany, Italy, Japan, Netherlands, United Kingdom and United States.

centres are usually not subjected to the same types of controls as their domestic currency operations, the supply of international liquidity becomes demand-determined. And insofar as the foreign exchange holdings of the private sector are a good substitute for domestic (or national) money, changes in the supply of the first will affect the demand for the second. Through this process, national central banks lose control over the relevant monetary aggregates. This is not because they cannot control the supply of domestic money in the short run, but because the demand for such money changes, with the result that control or regulation not only of the rate of growth of international liquidity, but also of liquidity in general, becomes much less effective. Of course, if the supply of liquidity in the form of foreign exchange becomes essentially demand-determined, the relative importance of SDRs is bound to suffer.

II

The effects on Latin American and other developing countries

As the system, or lack of it, works at present, one must expect relatively sharp and recurrent variations in the exchange rates of the principal currencies. Most Latin American countries, as well as other less developed countries (LDCs), peg their own currencies to one or another of the principal currencies, or to a basket of them. Pegging is necessary because most LDCs do not have financial or money markets deep enough to do otherwise, the Central Bank being the only entity capable of absorbing short-run excess supply or demand for the domestic currency. But pegging means that the domestic currency moves together with the currency or currencies to which it is pegged, and the fluctuations of those currencies are geared to the adjustment needs of the issuing countries, not of the pegging country. Hence, floating imposes a cost on LDCs in terms of destabilizing influences on their economies. Floating also tends to discourage the allocation of additional resources to the production of tradeable goods, since an uncertainty element is introduced in all calculations regarding activities connected with foreign trade. In most cases, the LDCs exporters cannot even buy coverage, because there is no futures market for their own currencies.

There are more deep-seated problems than this, however. Thus, if floating does not insulate countries from external shocks, it does not solve the adjustment problem in the short or medium run either, and may even complicate it. As everyone knows, if there is a group of countries running a protracted surplus on current account, there must be another group running a deficit, and floating will not correct the situation. Floating could perhaps equilibrate the balance of payments as a whole, in the long run, but it might never produce equilibrium in the balance-of-payments current account. As we have already seen, the short-run effect of floating on the current account of the balance of payments and on the balance of payments as a whole may actually be destabilizing.

As a matter of fact, equilibrium on the current account is not an ideal situation. Non-oil-exporting developing countries are net capital importers, so that the desired position of their current account is one of deficit, to be financed with a surplus on the capital account. In the case of Latin America, the average deficit on the current account of the non-oil-exporting countries for the period 1974-1978 is five times larger than for the period 1966-1970. The capital surplus should be high enough to cover the deficit on the current account and the necessary increase in reserve holdings. But a surplus on the capital account is only a more respectable way to refer to a net increase in foreign debt, since unrequited transfers are negligible and direct foreign investment is not on the increase and is concentrated in a few countries. At all events, new net indebtedness accounts for at least 80% of the surplus on the capital account of the non-oil-exporting Latin American countries.

Table 1

EXTERNAL FINANCING OF LATIN AMERICAN NON-OIL-EXPORTING COUNTRIES
(Billions of dollars)

	1966-1970	1974	1975	1976	1977	1978[d]
Deficit on current account[a]	−2.0	−13.1	−16.1	−11.5	−8.0	−9.5
Increase in reserves[b]	0.4	−0.7	2.2	4.9	3.9	8.5
Use of external financing (uses)	2.4	12.4	13.9	16.4	11.9	18.0
Net external financing (sources)	2.5	12.6	14.4	16.2	10.5	16.0
Direct investment	0.7	1.6	2.3	2.2	(2.3)	3.0
Donations	0.1	0.1	0.1	0.2	0.2	
Net loans[c]	1.7	10.9	12.0	13.8	(8.0)	13.0
Loans from official sources	0.9	1.9	1.9	(2.0)	(2.2)	3.0
Multilateral	0.4	0.9	0.8	(0.9)	(1.0)	
Bilateral	0.5	1.1	1.0	(1.1)	(1.2)	
Borrowing from private sources	0.8	9.0	10.1	11.8	(5.8)	10.0
Supplier credits	0.4	0.2	0.1	0.6	(0.6)	1.5
Commercial banks	0.3	8.2	8.2	7.5	4.7	5.5
Bonds	—	0.1	0.2	0.5	(1.0)	2.0
Others and unallocated	0.1	0.6	0.6	2.2	−0.5	1.0

Sources: International Monetary Fund, *Balance of Payments Yearbook*; Bank for International Settlements: supplements for July and December 1978 and Yearbook; CEPAL estimates.
[a]Excluding official donations.
[b]Positive figure indicates an increase in reserves.
[c]Includes long, medium and short-term non-compensatory and compensatory loans.
[d]All figures for 1978 are provisional.

Table 2

ESTIMATED OVERALL INDEBTEDNESS OF LATIN AMERICAN NON-OIL-EXPORTING COUNTRIES
(Billions of dollars)

Years	Officially-guaranteed debt	Non-guaranteed debt to banks	Overall indebtedness[a]
1974	31.51	19.76	51.72
1975	38.05	24.50	63.48
1976	48.74	30.65	81.28
1977	59.00	32.00	91.00
1978[b]	68.00	37.00	106.00

[a]Includes debt to IMF.
[b]Figures for 1978 are provisional.

Despite the levels already reached by such debt (over 100 billion dollars for the non-oil-exporting countries of Latin America by the end of 1978) it must go on increasing for many years if the development process is to continue and if world resources are to be more efficiently allocated. The additional short-run instability in the balance of payments which is a by-product of floating, however, does not facilitate official decisions in industrial countries about long-term development finance, while private financial markets expand rapidly. Thus, the terms of the new financing are substantially worse than those of the past, both in terms of interest rates and of amortizations schedules. "Debt burden" becomes a problem for further borrowing, a problem which is more a consequence of the present system than of "misbehaviour", even though the latter is not always absent. Moreover, as debt terms deteriorate, borrowing countries need to increase their reserve holdings, both in order to present a better "image" and in order to be ready to offset possible outflows. So, as the terms deteriorate, the necessary rate of accumulation of reserves tends to grow, and so does the necessary net borrowing per year.

An obvious way out of this problem for LDCs would be to expand exports. If exports grew at a rapid rate, both the "debt burden" and the current account deficit could be reduced. However, as pointed out above, in the present circumstances the developed countries tend to yield more easily to protecionist pressures, so that this way out does not seem to be feasible. In fact, a recent article in *IMF Survey* reaches the conclusions that protectionism has increased significantly in the recent past, and the trend does not show signs of abating.[2] Regrettably, this trend has emerged precisely when a good number of LDCs, at least in Latin America, are following an outward-oriented strategy.

This strategy, to be succesful, requires two prerequisites: foreign markets and foreign finance. The former are being increasedly protected from outside competition. The latter is available, but on terms that are compatible only with a rapid growth of LDC exports.

III

What can be done to solve, or at least alleviate, the present difficulties in the monetary and financial system?

At least some of the roots of the difficulties pointed out above can be traced to problems of the adjustment process and of liquidity creation. If the adjustment process worked smoothly, and international liquidity grew at a reasonably stable rate, excessive fluctuating of exchange rates would be flattened out and there woud be less of a weakening of the will to resist protectionist measures.

One could argue that the adjustment process is working smoothly when the choice between fixed or floating exchange rates becomes irrelevant. In other words, if the domestic policies of the main industrial countries were strictly co-ordinated, there would be no need to vary their exchange rates *vis-à-vis* each other in the short run, and there would therefore be no need for floating. I hope it is obvious by now how great an interest LDCs have in more stable exchange rates and a smoother adjustment process.

But of course close co-ordination of domestic policies is an ideal which is very difficult to reach. Different countries have different institutions, different interest groups and different social and political forces. For example, some countries can export their unemployed and so can accept more restrictive economic policies than others.

However difficult it is, I believe one should continue trying to secure closer co-ordination of economic policies among industrial countries. Naturally, such co-ordination should take global needs into account, so as to facilitate the necessary current account deficit of the LDCs ant its adequate financing. In this way, a smoother process of real resource transfers would be achieved. In order to ensure the consideration of global needs, LDCs should be represented in some way in discussions on policy co-ordination among industrial countries.

Reports that take a global look at the world economy play an important role here. For example, the excellent IMF periodic reports on the world economic outlook should be given wider circulation. The Interim Committee of

[2]"Retreat from liberal trade becomes clearer as more restrictive practices take effect", *IMF Survey*, April 9, 1979.

the Board of Governors of the Fund should perhaps devote at least one full meeting a year to evaluating and discussing the world economic situation. But policy co-ordination touches some very sensitive points in many countries, and for this reason it requires some degree of regular involvement of governments at the highest political level.

At the same time, however, improving the adjustment process is in the interests of all countries, developing and developed alike.

All the effort expended in attaining the goal of policy co-ordination is well spent. However, one cannot expect such efforts to be fully effective alone, so some action should be taken in especially difficult areas even before co-ordination is improved:

(a) Asset settlement of international obligations should be established, in order to create an incentive for reserve currency countries to adjust.

If asset settlement were the norm, countries could not settle their international obligations by simply increasing their liabilities abroad. Hence, if a reserve currency country were in deficit, it would pay for it with assets, like any other country. The adjustment incentive would appear as those assets were depleted.

(b) An account aimed at the substitution of SDRs for reserve currencies should be set up in the IMF. Its role would be to minimize pressure on exchange rates due to desired changes in foreign exchange portfolios of monetary authorities. The countries issuing the currency accumulated in the account would recover it in an agreed period, in exchange for SDRs. In fact, this would be a form of short-term debt consolidation for some industrial countries. As these countries recover their currencies from the account, the SDRs accumulated there could be used for long-term lending to LDCs. One might call this operation the "substitution link".

(c) Countries with net reserves higher than, say, 4 months' imports and with reserves growing faster than a given rate per year would pay a tax on their reserves. One way to apply this concept, for example, would be not to allocate SDRs to such countries in a future allocation, the SDRs not allocated to them being assigned to LDCs in proportion to their quotas in the IMF. In this way, an incentive for surplus countries to adjust would be established. One might call this the "adjustment link".

(d) A debt refinancing facility should be established, perhaps as a joint undertaking of the World Bank and the IMF. This facility would operate under a system similar to that of the Oil Facility of the IMF. LDCs would have voluntary access to it on the basis of a pre-established set of indicators, but the amount and conditions of refinancing would be studied case by case. A refinancing facility would be a natural LDC counterpart to a substitution account for reserve currency countries.

(e) A forum should be established where monetary, trade and development matters, which are so closely linked, are regularly jointly discussed, with main tendencies being highlighted and policy measures suggested. Such a forum could assess the global contribution of each industrial country to development, taking into account their contribution both through trade and through aid and other financial flows. The ideal could be to create some form of international economic court that could pass judgement, particularly on restrictive trade practices, and establish compensation for the economic damage caused. Countries could then evaluate whether or not it was in their own interests to apply protectionist measures and to pay compensation for them. This concept of "compensated protectionism" could be further evolved as a way to allow countries some freedom in this respect, but with compensatory payments to countries damaged in the process. The multipolarity of the present world lends some realism to this proposal.

Of course, most of these ideas are neither new or realistic. However, the problem of development will be with us for a sufficiently long time to permit some unrealistic approaches at present. I believe that, as time passes, it will be increasingly clear that development is not a problem of developing countries alone, but of the world as a whole. This is my justification for considering not only problems of the Latin American countries, or of all developing countries, but also problems of the world economy to which the latter are so closely linked.

The Latin American countries and the New International Economic Order

*Pedro Malan**

Introduction

As is well known by now, the so-called North-South agenda is made up of a whole array of political and economic issues: the presently changing patterns of trade, old and new trade restrictions, the implications of foreign investment, the volume and burden of foreign debt, the yet to be designed future international monetary system, the controversial commodity price stabilization schemes, the frightening poverty of the Fourth World, and so on. It is obvious that these issues will remain on the agenda —political and economic— for many years to come. This is not the time to present yet another survey of the present state of frustration with respect to the progress achieved so far in several of the topics listed above. The question to which we would like to address ourselves in this paper is the following one: does *Latin America* as a region have a common stake in these ongoing discussions?[1] If so, in which ones? If the region is not a meaningful economic region and interests diverge sharply between different countries —or groups of countries— then do they have an identity of interest with other countries (developing or developed) outside the region? In other words, is there anything specific to Latin America as a region, or to Latin American countries *qua* Latin American countries, in terms of either the international resource-transfer mechanisms or the international distribution of political power, both presently under sharp criticism in all international forums?

In order to discuss these questions, this paper is organized as follows: section I attempts to place the issue of the relationship of Latin America with the New International Economic Order in what we feel is a much-needed wider global context. This is done by presenting in a rather summary fashion the major dominant viewpoints of both North and South concerning the so-called North-South conflict.[2] Section II deals with Latin America proper. Its purpose is to sort out what are the specifically *Latin American* interests —if any— in the ongoing discussions, concentrating on three major areas of interest (and conflict): (a) the changing patterns of trade and protection; (b) the implications of foreign direct investment, and (c) capital flows, external debt and the future international monetary system.

I

The *political* process of identification of what Professor Hirschman considered to be the most pressing problems[3] to be tackled by public policy is both a global one (taking place at international forums such as the United Nations, UNCTAD, CIEC meetings and all conferences where so-called North-South

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[1]For a positive answer see Francisco Orrego Vicuña, "Las alternativas de América Latina como clase media de las naciones", *Estudios Internacionales*, Buenos Aires, Vol X, No. 40, October/December 1977, pp. 89-110.

[2]This section draws heavily on a previous work of the author. See P. Malan, *Brazilian International Economic Relations: An Agenda for Research*, mimeo, 1977. Written originally in English, this paper was published in Portuguese in *Dados*, No. 17, 1978 and in Spanish in *Estudios Internacionales*, Vol. XI, No. 41, January-March 1978, pp. 62-70.

[3]A. O. Hirschman, "Policymaking and Policy Analysis in Latin America - A Return Journey", *Policy Sciences*, Amsterdam, No. 6, 1975, especially pp. 388-394.

conflict issues are under discussion) and a domestic one (in which the agenda of relevant problems and alternative solutions to them is a natural object of controversy, mediated by and reflected within the State). In this section, we attempt to discuss the relevant issues involved in the framing of an eventual New International Economic Order from two points of view. The first is the viewpoint of the central countries, i.e., the meaning to them of the re-organization of the world economy and their dominant views, likely answers, and major options on the so-called North-South conflict. The second viewpoint is the effect of the political and economic decisions (or lack of decisions) of the advanced countries on the peripheral (Southern) countries, and the latter's response to them. The following paragraphs deal with the viewpoints of the Northern economies. They are not very reassuring, due to the present fragmentation of power. But this, as we are going to argue later, is a mixed blessing.

The Northern economies have successfully followed a policy of benign neglect with regard to the developing countries' criticisms of the old international economic order as working to their disadvantage. The early writings of the Economic Commission for Latin America, the Bandung Conference in 1955, even the creation of UNCTAD in 1964 (and its role since then) were seen as a display of ineffective political mumblings completed with a dash of bad economics and wrapped in sheer rhetorical jargon. The collapse of the Bretton Woods arrangement in 1971-1972, followed soon after by the successful assertion of market power by the OPEC in 1973-1974, and the adoption, exactly five years ago, of a "Charter of Economic Rights and Duties of States" by the United Nations General Assembly (with its call for a "New International Economic Order") dramatically changed the picture and prompted the advanced countries to agree to start serious talks.

The outcome of these talks is as yet unpredictable. The failure of the eighteen-month CIEC meeting in Paris in 1976 was not a final result, and the whole panoply of economic issues that make up the North-South agenda again came under discussion at UNCTAD V in May 1979. Much depends on the Northern countries' response to the as yet somewhat unarticulated specific demands of the LDCs. The issues and criticisms raised so far, however, will not vanish into thin air —they are likely to remain on the agenda, both economic and political, for the whole of the 1980s. Few would disagree that we are living now through a period of economic and institutional crisis such as the world had not experienced since the 1930s— nearly half a century ago.

What has been shocking to the Northern economies' representatives in international discussions —surprising as it may seem— is what they consider an undersirable and excessive *politicization* of the issues at stake.[4] Scholars with some sense of history, however, distinguish between two levels of analysis: "a process level dealing with short-term behaviour within a constant set of institutions, fundamental assumptions and expectations; and a structure level, having to do with long-term political and economic determinants of the systematic incentives and constraints within which actors operate ... It is when accepted structures with their associated rules of the game are called into question that controversy, and therefore politicization, are likely to increase most rapidly ... questions of who will exercise political control and how, become dominant".[5] Indeed, frustrating though it may seem so far, the debate on the New International Economic Order has sharply focussed the attention of the world on the need to reexamine the implicit politics and existing (and missing) rules of the game. It is not something that one could expect to see solved in a few years, especially when there is no agreement on an agenda for action even within the supposedly threatened Northern countries.

[4]See, for example, N. Leff, "The New Economic Order - Bad Economics, Worse Politics", *Foreign Policy*, Farmingdale, N.Y., Fall issue, November 24, 1976. For a more balanced account, see the first published volume of the Council on Foreign Relations' 1980's Project; F. Hirsch, M. Doyle and E. L. Morse, "Alternatives to Monetary Disorder", Mc Graw-Hill, 1977.

[5]C. F. Bergsten, R. O. Keohane and J. S. Nye, "International Economics and International Politics: a Framework for Analysis" in C. F. Bergsten and L. B. Krause (eds.), *World Politics and International Economics*, The Brookings Institution, Washington, 1975, pp. 5-6.

Indeed, the response of the Northern countries to Southern pressures will probably develop according to the (non-mutually-exclusive) patterns of: (a) *resistance* (whenever the challenge from the LDCs can easily be turned back); (b) *co-optation* of some of the bigger and higher-income LDCs[6] and (c) *compromise* (whenever some concessions must be made to preserve the Northern economies' control of the basic decisions). However, much more important than to guess prospective response from the North is to assess the dominant attitudes prevailing in these societies, especially in the United States, which, despite its declining importance (as compared with the immediate post-war period), is still the key country influencing the future outcome of the North-South conflict.

There seem to be four dominant attitudes in the North on issues related to this conflict. The first one is what Roger Hansen called the "Southern Unity Won't Last" attitude.[7] It was clearly the policy outcome which the major industrial countries (especially the United States) were hoping to bring about, and is still very influential. Its first major setback was the inability to set non-oil developing countries against the oil exporters shortly after OPEC's first dramatic price rise, while the second was the refusal by OPEC and all the other LDCs to restrict the Paris Conference to a discussion of energy problems alone. This attitude is still very much alive, however, and cannot be ruled out. What do Brazil, Upper Volta, Sri Lanka and Iraq have in common? Perhaps only a shared sense of deprivation *vis-à-vis* the OECD countries. But as R. Hansen rightly reminded us, this "unnatural alliance" should not be underestimated "especially when faced by intransigent Northern solidarity ... and if no other card is played at the bargaining table".[8] The events of the last five years do suggest that Northern responses will have to move progressively away from resistance and towards co-optation and compromise formulae.

The search for compromise formulae within the framework of multilateral diplomacy in an international community in which power is more diffuse than ever before is the basis for the second major Northern attitude on the North-South conflict: the multilateral approach searching for collective consent. As Professor Dahrendorf has put it: "The number of actors is large, the degree of their cohesion is small, the definition of the situation is imprecise. ... While a cynical view of international organizations and conferences is spreading ... this method of dealing with international conflict is in fact becoming more and more important ... there will be more conferences".[9] Not because one can be sure that some 150 nations would ever reach agreed solutions to global issues, but simply because there is no alternative. Constructive leadership, however, is unfortunately in short supply, except perhaps in one very controversial area.

This area is that of the third Northern (as a matter of fact essentially United States) attitude on the North-South issue: the equity perspective. As is well known, it is very much linked to the present United States strategy of attempting to reassert leadership in world economic affairs, after Vietnam and Watergate, by infusing American foreign policy with a greater sense of justice and moral purpose. The equity perspective, however, covers many different and often contradictory concerns. In Northern parlance the concern is with equity considerations *within* developing countries themselves or, as a variant, with human rights issues. In "Southern" parlance the equity issue is related to what is perceived as an unfair *inter-country* pattern of income distribution resulting from the present international "order". The North-

[6]Witness the expansion of the "Group of Ten" to the "Group of Twenty" in the IMF, the suggestion that Brazil and Iran be invited to join the OECD, and so forth (this suggestion was put forward by C. F. Bergsten in J. Bhagwati (ed.), "The New International Economic Order", MIT Press, 1977.

[7]See R. Hansen, "Major U.S. Options on North-South Relations: A Letter to President Carter" in *The United States and World Development - Agenda 1977* by J. Sewell and the staff of the Overseas Development Council, Praeger, 1977, p. 25. The next few paragraphs draw heavily on this rather interesting "action" memorandum.

[8]R. Hansen, *op. cit.*, p. 29.

[9]Rolf Dahrendorf, "International Power: A European Perspective", Foreign Affairs, New York, August 1977, p. 81.

ern liberal's response to LDC claims for a New International Economic Order which emphasizes the equity issue is to point out that these claims, if ever accepted, may have little, if any, effect on the distribution of income, wealth or opportunities *within* LDCs —and that this should be their major concern.[10] Since most developing countries' ruling groups consider this issue a non-negotiable one and a purely internal affair, a stalemate is likely to occur, unless the Northern concern comes to be seen as an irreversible trend (which it has not yet) *and* a mutually satisfactory definition of "acceptable" inequality and "minimum" human rights is reached in the North-South discussions. In the attempt to avoid this hard nut to crack, a fourth Northern perspective has recently been put forward.

This fourth perspective is concerned not with income differentials and their evolution, but with absolute poverty; it is the *basic human needs* perspective concerned with a terrible fate of around one billion people —close to 25% of the world's population— who live in miserable deprivation. In principle, everyone is against sheer misery. However, the concern raises the same sort of problems as the previous perspective: the so-called "domestic élite" problem. As Hansen has noted: "No program to eliminate absolute poverty can be constructed and implemented without the necessary degree of commitment of a countrv's governing élite groups and political system. No amount of foreign resources can overcome domestic resistance or indifference to the achievement of this goal".[11]

In short, summing up this rather brief sketch of dominant Northern perspectives, two of them (the "Southern Unity Won't Last" and the "Global Multilateral Approach") may lead to Northern policy options which are essentially a continuation of the present policies with *ad hoc* marginal changes to accomodate demands which cannot be —as in the past— effectively resisted. The other two attitudes ("Equity" and "Basic Needs") attempt to partially shift the blame for the present unsatisfactory (in view of the LDCs) workings of the international economic order essentially on to the developing countries' *own* internal policies or political systems. The setting may well evolve into a sort of "dialogue of the deaf" if some basic agreement about the agenda and about some long-run perspectives both in the North and in the South is not reached in time. The next few paragraphs deal with the likely effect of these Northern perspectives —and Northern structural trends— on the peripheral economies, with special reference to Latin America. In our view, any discussion about international economic relations must start with a grasp of world structural changes and of present Northern attitudes. After all, even if initiatives come from the South it is the Northern response to them which will shape the future arrangements.

The so-called "Southern" attitudes on the issues involved in the framing of the New International Economic Order are dominated by the desire to obtain control of additional real resources so as to speed the development process in the LDCs. Such real resource transfers may involve "current account financing" (through price changes, through aid or through default on external debt) or "capital account financing" (through borrowing or through running down reserves). *All* LDCs, whether commercial or aid-dependent,[12] would rather have current account financing of the required real resource transfers, especially through price changes,[13] since this does

[10]For an elaboration of this influential (at least within the United States) argument by an economist now at the forefront of American foreign económic policy, see R. Cooper, "A New International Economic Order for Mutual Gain", *Foreign Policy*, No. 26, Spring 1977.

[11]R. Hansen, *op. cit.*, p. 34.

[12]"Commercial" developing countries are those which have regular access to commercial bank lending. Most of the non-OPEC LDCs, as is well known, depend mainly on foreign aid, being unable to attract much bank lending. Nine "commercial" countries (Brazil, Mexico, South Korea, Taiwan, Philippines, Argentina, Peru, Colombia and Israel) accounted for more than 80% of LDC *bank* debt outstanding by the end of 1976. See David O. Beim, "Rescuing the LDCs", *Foreign Affairs*, July 1977, pp. 718-719.

[13]Not only in the prices of LDC commodity exports. Continuing world inflation reduces the real burden of the debt, but obviously this is not an adequate solution to the problem, since the expectation of inflation will raise interest rates and hence the cost of servicing the debt.

not —as capital account financing does— involve reverse transfers in the future. In this discussion, commercial and aid-dependent countries are likely to form a common front, rightly insisting upon the fact that the advanced countries cannot continue to be internationalist in finance and investment while being increasingly protectionist in trade.

Where a common front is not likely to be formed is on issues related to capital account financing through borrowing in international capital markets. Here, a sharp division is likely to emerge (as it has already in Manila, Nairobi and at the CIEC meetings in Paris) between commercial and non-commercial countries. The first are deeply aware of the need to assure continuing availability of external finance (besides rapid growth in world trade), due to the drain of rising service payments on foreign exchange, so they are likely to refuse any "radical" proposal to default or delay or reschedule payments and will ask rather for new loans.[14] In the case of most higher-income LDCs the problem is not the imminence of default or rescheduling but the distribution of *the burden of internal adjustment.*

In my view, perhaps one of the two most relevant and promising areas of investigation in any agenda on international economic relations of a given country or region is the question of the implications of continuing outward-looking development strategies in terms of domestic income distribution *and* of the nature of the associated *political* régimes. Much more remains to be done in these areas, especially in terms of comparative analysis. There is now a growing appreciation of the fact that analysis should be focussed on the character and the social base of the State (and State policies) in less developed societies. Therefore, curious as it may seem, any agenda on international economic relations must include an analysis of the question of the State in Southern and Northern countries.

The other relevant and promising area of investigation has already been touched upon earlier: it is related to the asymmetrical outlooks and contradictory interests *within* the less developed world. These asymmetries and contradictions should not be underestimated. Indeed, as we have seen, the "North" counts on them. After all, no more than 10 semi-industrialized LDCs account for nearly 85% of the total (bank) external debt, and 10 semi-industrialized countries account for nearly 80% of the total LDCs' exports of manufactures. All the discussions and difficulties about intra-LDC trade as an alternative to mounting Northern protectionism are marred by the fact that in each region of the LDC world two or three countries are likely to be the major beneficiaries of regional trade agreements.[15] As pioneered by Hirschman more than thirty years ago, studies on the relationship between national power and the structure of foreign trade are likely to re-emerge as fascinating and much needed topics in the North-South agenda.

Of course, *any* agenda of this sort must include a careful consideration of transnational corporations, especially now that it is becoming clear that most developing countries will increasingly move in the direction of greater vigilance over their foreign trade and financial links —even as they seek to expand those links. Harder bargaining between transnational corporations and the State (or State enterprises) in each major LDC is certain to occur. In my view, however, rather than *general* studies of transnationals and their effects and/or *general* studies of possible State response to them, what we do need is a much deeper understanding of the invisible markets internalized in most transnational corporations, of which the visible ones are often only the tip of the iceberg. After all, as Díaz-Alejandro noted, the conservative case for "free markets" has always depended upon mini-

[14] As David Beim rightly asserted, the difference between rescheduling of a debt and a new loan "is nearly metaphysical. The economics are the same —money is repaid later rather than now. It is the psychology which differs— a rescheduling is a confrontation, an admission of failure, and emotional catharsis, while a new loan is business as usual", D.O. Beim, "Rescuing the LDCs", *Foreign Affairs,* July 1977, p. 723.

[15] See Sir A. Lewis, "Aspects of Tropical Trade", Wicksell Lectures, Almqvist, Wicksell, Stockholm, 1969, for an elaboration of these points.

mizing knowledge of how markets actually operate. Studies of the operation of imperfect markets should be an important item in the agenda, since the LDC case for reshaping the world economic order depends ultimately upon the alleged existence of imperfect international markets working to their disadvantage.

II

It has become a commonplace to observe that Latin America was a guiding intellectual force for the Third World during the 1950s and 1960s. It is true that most of the ideas about the unequal relationships between rich and poor countries emanated from the region, especially through the United Nations Economic Commission for Latin America, and it is well known that the creation of UNCTAD owes a great deal to Latin American efforts to show that the international economic order of the time was working against the Third World's basic interests. Today, however, Latin American influence has waned somewhat. After all, the Group of 77 of the early sixties is now made up of 119 legally sovereign countries. The issues of the day are either global issues (requiring multilateral action); selective issues (of non-regional character), or plain bilateral concerns. There is no more room for the exercise of leadership by one regional bloc: the world has become too much integrated for that. There is no more room for a distinctive Latin American view of the so-called North-South conflict, the controversial issue of the day. After all, what is Latin America?

Latin America, broady defined (i.e., including Cuba and the Caribbean area), contains twenty-five legally sovereign countries enjoying United Nations and World Bank membership. The region's total population is presently about 325 million, growing at an average of more than 2.6% a year, while its combined GNP for 1978 in current dollars was about US$ 400 billion. Obviously the old clichés about structural heterogeneity, asymmetrical degrees of development and national potentialities apply just as much to the region as they do to the so-called Third World as a whole. Levels of per capita income range from US$ 200 (Haiti) to US$ 3,300 (Bahamas), although the majority (15) of these 25 legally sovereign countries fall into the US$ 600-1,000 range of per capita income. Above the level of US$ 1,140 there are only five countries: Argentina, Trinidad and Tobago, Venezuela, Barbados and Bahamas, while below the US$ 600 level are El Salvador, Guyana, Honduras, Bolivia and Haiti. According to the World Bank's recent classification, excluding the countries with population less than one million (Guyana, Barbados and Bahamas), centrally-planned Cuba and extremely poor Haiti, all the other 20 Latin American countries fall into the "Middle Income Countries" category, which includes 58 out of the present 153 members of the United Nations and the World Bank.[16]

The need for a typological classification of the structurally heterogeneous Latin American countries has been put forward forcefully, especially by H. Jaguaribe. His essential concern is with the question of "national viability" of the countries of the region, and he attempts to distinguish these countries according to relative levels of societal development and degrees of national viability ("relative individual viability", "collective viability" and "non-viability"). According to his scheme only three countries of the region (namely Argentina, Brazil and Mexico) could pretend to reach the first type of viability; eight countries (all in South America) could hope for collective viability, and the rest fall into the non-viability category. Interesting as this may be for strategic studies of a geopolitical nature, or polemical as it may seem in terms of its analytical meaning, however, this is not exactly the sort of typology with which we

[16] For the relevant data see *World Development Report*, Washington, 1978.

shall concern ourselves in this paper, for reasons that will be clear as we proceed.

It is perfectly true that Brazil, Mexico and Argentina together account for 70% of Latin America's combined GNP and for two-thirds of intra-regional trade. Brazil and Mexico alone account for more than half of its population, GNP, external debt and foreign trade. It is also true that the combined population of 13 countries with a population of less than 5 million each was, in mid-1976, around 30 million —less than half the population of Mexico and less than one-third that of Brazil. It is obvious that countries differ not only in resources but also with respect to perceived needs and policy issues: Mexico will seek from the international financial system services rather different in quantity and quality from those sought by Ecuador. Even with respect to policy, Brazilian attitudes toward greater exchange flexibility or the extent of control over foreign investment can be expected to differ sharply from those of Guatemala. The remaining paragraphs of this section represent an attempt to deal with these differences in resources and perceptions with regard to trade, investment, financial flows and the future international monetary system.

1. *Changing trade patterns and the resurgence of protectionism*

The share of non-OECD countries in world exports declined during the 1950s and 1960s from 34% in 1950 to less than 20% in 1969. Latin America's share declined from 10% to 5% over the same period. The proportion of manufactures in world trade rose from below 40% in the thirties to 45% in 1953, 54% in 1970 and 67% in 1969:[17] a phenomenon very closely related to international investments of the transnational corporations and very like Linder's well-known hypothesis about the influence of patterns of demand and income levels on the shaping of trade among developing countries. For most observers, this outcome was the natural result of the great post-war liberalization project which experienced its golden age from 1959 (European return to convertibility) to 1971 (*de facto* collapse of the Bretton Woods arrangement). The "success" of the project was gauged by the rapid expansion of international trade (partly due to the progressive dismantling of the generalized protectionism of the inter-war period), by the growing internationalization of capital (partly mediated by the transnational corporations) and by the resurgence of international (private) financial markets which had collapsed with the 1929 crash and the Depression years.

However, as noted by more than one observer: "at the time when the OECD countries were rapidly dismantling their trade barriers against each other, they were equally feverishly creating new barriers to keep out light manufactures from the tropics ".[18] Indeed, a recent study of the World Bank does show that over the last twenty-five years developing countries have emerged as major markets for the manufactured exports of the industrialized countries. These exports increased by 7% a year in the 1950s and the increase accelerated to 8.5% a year in real terms between 1960 and 1975.[19] Trade with developing countries accounted for only 29% of the increase in the industrialized countries *exports* of manufactures. Much more important, however, is the fact that trade with developing countries accounted for only 9% of the industrialized countries' *imports* of manufactures, thereby confirming Sir Arthur Lewis's assertions above. Trade *among* industrialized countries and trade *within* Western Europe accounted for nearly 80% of the increase in the industrialized countries' *imports* of manufactures over the 1960-1975 period.[20]

There are no indications that these figures will be dramatically altered over the foreseeable future. On the contrary, what we have been observing is a sort of progressive retreat

[17] For basic data, see the relevant issues of GATT, *International Trade.*

[18] A.W. Lewis, "Aspects of Tropical Trade: 1883-1965", Wicksell Lectures, *op. cit.*, p. 40.

[19] The developing countries' exports have increased more slowly than those of the industrialized countries over the last twenty years (5.9% per year as against 7.5% per year on average).

[20] *World Development Report*, 1978, *op. cit.*, p. 9.

by the North from liberal trade in the face of the increased competition of imports from newly industrializing countries. It should be noted, moreover, that manufactured exports are highly concentrated in the developing world. About 45% of them come from four countries: Korea, Taiwan, Spain and Hong Kong, and as the World Bank notes, the addition to this list of Yugoslavia, Brazil, India, Mexico, Israel, Portugal, Singapore and Greece raises the proportion to around 80%, although it is true that exports of manufactures from countries such as Malaysia, Colombia, Turkey and Thailand have increased substantially. But what are the prospects for the 1980s and what is the role of the Latin American countries? After all, as noted by Lewis, in each region of the globe we observe today the existence of two or three semi-industrialized countries which tend to be the natural beneficiaries of a possible "new order" which assures LDCs access to new markets, intra-regional or not. As Díaz-Alejandro put it: "several of the LDCs which have spearheaded the drive for a NIEO, and the public and private agents behind that drive, may best be conceptualized as new oligopolists trying to break into world markets dominated by old oligopolists. The new oligopolists want to exercise a greater share of market power ... and to participate in 'organizing' trade in (these) world markets".[21]

In a recent paper, Chenery and Keesing[22] have attempted to clarify the comparative advantage of country groups by classifying LDC trade and production patterns into four groups: (a) countries that specialized relatively early in exports of manufactures and have followed generally outward-looking policies; (b) large semi-industrial countries with relatively low export/GNP ratios that have achieved success in industrialization based on the domestic market and have also moved to promote exports of manufactures; (c) countries now emerging from primary specialization which are changing their policies in an attempt to diversify their exports and accelerate development; (d) large poor countries with significant exports of manufactures. What is the significance of such a classification for the Latin American countries?

The first group contains only East Asian (Hong Kong, Singapore, Thailand, Korea) and Mediterranean countries, all characterized by limited natural resources. Their exports have usually (or initially) been labour-intensive and technologically stable products such as textiles, clothing, footwear, assembled electronic components, toys, etc. However, as Chenery and Keesing noted "... over 90% of LDC clothing exports and almost all the electronic products come from locations where imported inputs are given virtual free-trade treatment by one means or another".[23] Obviously, this is not a path open today to semi-industrialized countries which have experienced a long period of import substitution. But more importantly, as Arthur Lewis reminded us a decade ago: "... the real problems of continued success are more probably related to the structure of export organizations and to the financing of foreign trade. Food and raw materials are sold on international commodity exchanges but manufactures have to be sold by sellers and buyers seeking each other out ... price and quality are not all that is required for success ...".[24] Chenery and Keesing seem to confirm that assertion: "LDCs limited capabilities in marketing and related aspects of design appear to restrict capacity to export even labour-intensive goods".[25] The Latin American countries' potential seems to depend crucially upon the transnational corporations' interest in exporting manufactures *from* the host countries, a point we will tackle in the next section.

The second group in the Chenery-Keesing classification (large semi-industrialized countries) is well-known in Latin America, where

[21] C. Díaz-Alejandro, "International Markets for LDCs - The Old and the New", *American Economic Review*, Nashville, Tenn., Vol. 68, No. 2, May 1978, p. 268.

[22] H.B. Chenery and D.B. Keesing, "The Changing Composition of Developing Country Exports", Background Paper No. 5 to World Development Report 1978, September 1978, *op. cit.*, pp. 21-23.

[23] Chenery and Keesing, *op. cit.*, p. 24.

[24] A. W. Lewis, *op. cit.*, p. 44.

[25] Chenery and Keesing, *op. cit.*, p. 26.

market size has allowed Brazil, Argentina and Mexico, for instance, to build up (behind protective barriers) a substantial industrial structure which allowed, later on, some degree of success in their development of some exports based on economies of scales. In Latin America the three largest countries account for around 70% of intra-regional trade and (excluding oil-rich Venezuela) for around 60% of the region's total exports. However, success depends to an even greater degree than in consumer goods on design and the organization of marketing and technical services, which again pushes to the forefront of the discussion the role of the transnational corporations in Latin America.

The third group is made up of countries emerging from primary specialization. Their apparent success is basically due to the extremely favourable international conditions prevailing in the sixties, especially from 1967 to 1973, when world trade grew at nearly 19% a year in current dollar terms. Their prospects are not so bright under the conditions likely to prevail in the 1980s, however, as we shall see shortly. In Latin America, Colombia's expansion of exports of manufactures and Chile's recent attempts to liberalize its economy are the only examples of this category of "emergence from primary specialization" towards diversification (in the case of Chile diversification of both exports and imports). The fourth group (large poor countries) is not relevant to Latin America, since it is made up of countries such as India and Pakistan and the only possible Latin American examples (Brazil and Mexico) are not that poor. Interesting as it may seem, however, this classification does not go to the crucial issue at stake: the prospects for outward-looking strategies under *present* world conditions, and the prospects for the future. Part of the discussion in this connexion will take place in the section dealing with the present "non-system" and the future international monetary system. For the purposes of the present section, it is sufficient to note a crucial structural factor associated with the internationalization of capital and the international diffusion of technical knowledge. Both, as noted by R. Cooper "... reduce the costs, in terms of output foregone, of shifting resources from the production of one good to another —that is, these changes make the conventional production possibilities frontier flatter ... [although] ... it is true that this means that trade becomes less profitable in the sense that the difference between the cost of producing for export and the cost of producing the import-competing goods at home has dimished".[26] It is obvious that the volume of trade (relative to income) need not fall if, for instance, innovations are more frequent in the export industries and/or demand patterns converge internationally more rapidly than the structures of production costs —both trends which have been observed up to the present. There are no signs, however, that these past events are likely to be repeated in the future. The rate of growth of world trade, for example, is not likely to remain at more than 7% a year as in the past twenty-five years.

This last observation —if correct— affects the Latin American countries in a rather special way. After all, the share of intra-regional exports in total Latin American exports is around 16%. More than 70% of the region's exports are directed towards the "Northern" developed countries. Outward-looking policies depend essentially upon the state of expectations regarding world trade prospects. The resurgence of protectionism and the revised (downward) estimates of real income growth in the North do represent a serious cause of concern. The present mood, in Latin America at least, is well summarized in the following statement by Carlos Díaz-Alejandro: "... international links may be useful to help countries achieve some development targets under some conditions and specific historical circumstances, but it is fatal to regard openness as a good thing *per se* and to let external links and foreign demand become the engine of growth".[27] With the possible exception of Chile and of those small countries which really do not have much choice, most Latin American coun-

[26] R. N. Cooper "Growth and Trade: Some Hypotheses about Long-Term Trends", *The Journal of Economic History*, Wilmington, Del., December 1964, pp. 625-626.

[27] C. Díaz-Alejandro, *Delinking North and South: Unshackled or Unhinged?*, preliminary draft, 1977.

tries will follow —or have been following— this advice in practice, if not in rhetorical terms. Trade, *per se*, is not seen any more as a *deus ex machina*, as it used to be in the euphoric late sixties-early seventies, although Latin America can be expected to form a common front against the Northern countries' limitation of access to their markets and reluctance to restructure their economies by phasing out industries which are not internationally competitive any more. But it is not only the Latin American countries which call for these reforms, and even within Latin America the issue is much more pressing for some countries than for others. Those for which it is most pressing could more easily find allies outside the region.

2. *The question of foreign investment and technology*

The way in which the process of internationalization of capital may conceivably proceed in the future is a crucial element behind any discussion of the so-called New International Economic Order. The preceding paragraphs dealt with the implications for trade of the changing international division of labour associated with the world-wide diffusion of capital and technology. In this section, we would like to address ourselves to the question of foreign investment proper in the framework of the North-South conflict. Perhaps more than any other this is an area which economics and politics are closely intertwined and old slogans about imperialism and manichaeistic attitudes towards transnational corporations still exert a great deal of influence.

The perceptions dominant in the North usually emphasize what is perceived as a sort of schizophrenic attitude of Southern countries with regard to foreign direct investment. On the one hand, the South seems to need, demand, and often compete for more foreign investment, perhaps influenced by the so-called success stories of capital accumulation *cum* industrial diversification observed after the war (but especially in the sixties) in countries such as Brazil, Mexico, Taiwan, South Korea, Hong Kong and other "newly industrializing countries", all of which relied upon a significant contribution of foreign capital. On the other hand, the North sees the South (or the major part of it) as refusing to abide by internationally defined rules and procedures (especially with respect to expropriation) and neglecting the creation of a proper "investment climate" through the reduction of political risks as perceived by would-be private investors.

The magnitude of the resources underlying this discussion are rather significant: taking the United States alone, the direct investment position at the end of 1977 (net book value) was US$ 149 billion, but only US$ 34 billion of this was located in the developing countries, 80% of it in Latin America (nearly US$ 28 billion).[28] The importance of Latin America has been declining, however. Over the 1975-1977 period, the flow of United States capital directed to the developing countries remained around 20-25% of the total (the same proportion as in the case of the existing investments), but less than half of this was directed towards Latin America.[29] It is important to note that United States foreign direct investment, both in terms of existing investments and new flows, is highly concentrated in the developed world (US$ 108 out of US$ 149 billion). Foreign direct investment in the United States at the end of 1977 was estimated at US$ 34 billion, with eight developed countries accounting for more than 85% of the total.[30] Thus, foreign direct investment is also an "intra-North" affair, but apparently not a cause of concern for the countries involved. Why, then, is the issue so hotly debated within the South and in North-South relations?

In point of fact, this "paradox" puzzles only the more naive observers,[31] for whom

[28] United States Department of Commerce, *Survey of Current Business*, August 1978, pp. 16-17.

[29] Capital expenditure by majority-owned foreign affiliates of United States companies in 1975, 1976 and 1977 was respectively 26.8, 26.0 and 29.1 billion dollars, of which the developing countries received respectively 6.4, 5.4 and 6.0 billion. Latin America received 3.1, 2.9 and 2.9, respectively. See *Survey of Current Business*, *op. cit.*, September 1977, pp. 26-28.

[30] *Survey of Current Business*, August 1978, *op. cit.*, p. 39.

[31] See, for example, P. Juhl, "Prospects for Foreign Direct Investment in Developing Countries" in H. Giersch

increasing the mobility of capital through worldwide expansion of private investment would not only allow for a more efficient allocation of resources at the international level but might even shift outward a hypothetical Southern production possibility frontier, thereby increasing the South's total well-being (if measured, as usual, by the current flow of goods and services). In addition, the argument goes, by helping to relieve the foreign exchange constraint faced by most Southern countries, foreign investment could play a crucial role in reducing the depressing and widening gap between (most of) the poor countries and the rich nations.

Underlying this view is the strong presumption that the private (internationally-minded) sector of the developed world is always bullish, opportunity-perceiving, ready to assume risks in far-away exotic countries, guided by marked signals and profit expectations (obviously affected by guarantees and incentives given by the potential hosts). However, as Professor Vernon warned us: "The evidence is persuasive that the investment process is a relatively rational phenomenon —rational in the sense that it is consistent with an effort to maximize profit and minimize risk. The environment in which these activities take place, however, is one in which oligopoly is the normal state, scale factors are very large, and uncertainties of various sorts dominate the calculation".[32]

Indeed, since the work of Penrose, Hymer, Rowthorn, Vernon, Knickerbocker, Caves and others, the understanding of these flows is based mainly on the theory of the growth of the (big) firm, and especially on the reaction of firms in oligopolistic market structures to the actual or perceived threat to their respective market shares. In other words, when we talk about foreign direct investment today, we do not mean decisions to locate small repair shops or grocery stores in Karachi or Tegucigalpa, but huge sums of indivisible expenditures aimed at gaining or retaining control of specific resources and/or promising markets. To quote Vernon again: "Foreign investments in oligopolistic industries are often made in order to counter a threat to the stability of the oligopoly structure itself, that is, in order to protect and prolong an existing oligopoly rent".[33]

This last (crucial) observation means that, in practice, foreign direct investment affects developing countries in a rather asymmetrical way. For a poor "Southern" —or Latin American— country for instance, agreeing to relinquish some national autonomy with respect to the definition of the pattern of foreign investment is no guarantee whatsoever that foreign investment will flow to the country in the magnitude and type desired. The so-called market economy simply does not function that way. The flow of foreign investment will probably be directed to relatively richer or resource-rich Southern countries, as it has been doing for decades, irrespective of multinational agreements designed to insure foreign investors against political risks.

Latin American countries display a long tradition of political and economic concern with foreign investment (especially United States direct investment). There are sound historical reasons for this, but perhaps they are no more profound than the historical reasons of countries which have been made legally sovereign over the last two decades or so. Even within Latin America, however, agreement on subregional common attitudes towards foreign investment is hard to come by, as witness the Chilean opposition to the Andean Group's proposed policies and controls over foreign investment and the transfer of technology. Negotiations over a code to cover this transfer from rich countries (i.e., companies) to poor countries have been progressing: of the 160 or so points in the code nearly 120 have been agreed upon so far. What is left is of course the hardest part. But countries such as Brazil have been deriving benefits from multilateral negotiations coupled with pragmatic bilateral and/or specific negotiations for such transfer.

(ed.), *Reshaping the World Economic Order*, Tübingen, J.C.B. Mahor (Paul Siebeck), 1977.

[32]Raymond Vernon, "A Program of Research on Foreign Direct Investment", in C. Bergsten (ed.), *The Future of the International Economic Order: An Agenda for Research*, Lexington, Mass., 1973, p. 96.

[33]*Ibid.*, p. 100.

Obviously, the bargaining power of Brazil (due to its market size) is much bigger than that of the smaller countries in the region, and a common regional attitude towards foreign investment and technology would be hard to achieve, but one could well predict that the general trend will be towards an increase in selective controls over the pattern of foreign investment even when the desire is to increase its global volume.

One direction in which one could well expect progressive intervention (or stimuli) is in the promotion of exports by transnational corporations. After all, ongoing research in Latin America is confirming the relationship between foreign capital, external indebtedness and high propensities to import which are not matched by a comparable flow of industrial exports. It should be noted that for Latin America foreign capital investment (United States origin) in *manufacturing* represents 37% of the total while for the developed countries the proportion of United States capital in manufacturing is nearly 50%. In Latin America, however, the rate of return on activities other than manufacturing has been around 50% higher than the rate of return in manufacturing over the last few years, while in developed countries the rates of return are nearly equal.[34] Therefore, the countries which can potentially attract foreign direct investment through fiscal incentives, subsidies and guarantees may well wonder if they are not a bit ill-advised to attempt to reproduce (especially after the oil crisis) the pattern of (private) consumption-biased capital accumulation to which foreign direct investment seems to be most suited. Latin America should serve —to other "Southern" countries— as a fascinating set of case studies on the benefits and costs of foreign investment and technological dependence.

3. *Financial flows, external debt and the future international monetary system*

As is becoming increasingly well-known by now, the world crisis of the early 1970s was not due simply to the quadrupling of oil prices decided by OPEC late in 1973. The crisis was a "systemic" crisis with both real and financial underlying factors, the oil price rise being merely the most apparent and dramatic consequence —as well as a contributing factor.[35] This is not the place to survey this fascinating course of events. It suffices to note that three classes of problems have dominated the discussion in the aftermath of OPEC's decision: (a) the costs and consequences of the adjustment to the abrupt change in relative prices and to the tax levied by OPEC on oil-importing countries, which led to the uncomfortable combination of inflation and recession; (b) the sudden discovery of the vulnerability of even major capitalist countries to sudden interruptions in oil supply —and the ensuing controversy about alternative sources of energy for the long term; (c) the difficulties involved in the recycling of the surpluses rapidly accumulating in the external accounts of oil-exporting countries.

The first two problems are still very much with us and likely to remain so for many years to come. With respect to the last problem, we now know that the initial worries have proved exaggerated as regards its two significant dimensions: the projections of future OPEC surpluses and the alleged inability of the *private* financial system to recycle them with the appropriate speed. In retrospect, the accumulated actual surplus of OPEC over the five years from 1974 to 1978 was around US$ 180 billion in current dollars, or only about half the initial estimates of both OECD and the World Bank. Its decline in real terms has been extremely marked, since the increase in wholesale prices in the United States, for example, was around 50% over the last five years. On the other hand, the recycling was effected by the private financial system in a way that surprised most observers —although at a cost that one would have to analyse in terms

[34] *Survey of Current Business*, August 1978, *op. cit.*, pp. 16-22.

[35] See Professor Triffin's writings since the late fifties about the inherent contradictions of the Bretton Woods system, the collapse of which he predicted ten years before it happened. For the underlying real factors see N. Kaldor, "Inflation and Recession in the World Economy", *Economic Journal*, New York, December 1976.

of its implications for the future. Indeed, oil-importing developing countries had to face both higher oil prices (among other higher import prices) *and* the effects on their export receipts of the simultaneous (1974-1975) recession in the North.

Growing foreign indebtedness was the inevitable result. As noted by Fishlow, "LDC debt after 1974 was therefore a necessary concomitant to sustain global economic activity. In the absence of willing debtors and with all countries striving for exports to pay for oil, the consequences easily would have rivaled those of the Great Depression".[36] In point of fact, the external debt of oil-importing LDCs, which had augmented from less than US$ 40 billion in 1967 to nearly US$ 100 billion in 1973, reached some US$ 280-290 billion by 1978. It is obvious that a growing foreign debt of this magnitude poses a serious problem to the world economy (since it is ultimately a global *trade* problem) and not only to specific borrowers. It should be noted, moreover, that the recycling as realized by the private banking system dramatically accentuated the asymmetries *within* the South. Some ten or twelve of the most "comercial" countries are responsible today for nearly 85% of total LDC external debt to the international banking system. Brazil and Mexico alone are reported to account for nearly 50% of the total. Peru has faced the political consequences of having foreign debt run out of control, as did Zaire. The constraints of foreign debt servicing —and the burden of internal adjustment— are a serious concern in many Southern countries.

Globally speaking, some optimistic observers have concluded that the adjustment to the "oil crisis" is over, in the sense that the OPEC surplus is not a worry anymore (German and Japanese surpluses were indeed higher than OPEC's in 1978), and that the recycling was done with the proper speed. We hope to show, however, that there are no grounds for such optimism. To begin with, the present international monetary system is still what J. Williamson called a "non-system" in which the traditional problems of *confidence* (in a stable reserve currency), of *adjustment* to asymmetries in balance-of-payments positions among major trading countries, and of control of the expansion of international *liquidity* remain unsolved. With respect to the first problem, there is no longer a single risk-free asset in the system. The dollar played this role in the past, but a fluctuating dollar cannot serve any more as a satisfactory international monetary standard. Fluctuations really have been too big: a 12% swing (such as the one experienced by the dollar in 1978) *vis-à-vis* the average of other rates seems unduly high. These swings have a peculiar effect on prices: they push prices up in depreciating countries but they do not pull prices down in the appreciating countries, so they exercise a net inflationary effect which in due course may affect the terms of trade against developing countries.

The *adjustment* problem is yet to be solved too. Textbook writers would say that floating rates are designed to deal with it. What we have, however, is not a textbook case of perfect floating rates, but a system of managed or dirty floating which has the effect of transmitting inflation internationally and might transmit recession internationally if the Northern countries give top priority to their domestic problems and decide not to gear their monetary policies to the aim of stabilizing exchange rates. The international transmission mechanisms of both inflation and recession under dirty floating are phenomena in search of a theory, but they should be a cause of concern, for the rate of growth of world trade could very well be reduced by too much variability in exchange rates due to large potential movements of short-term capital of the size and mobility which characterize the present situation. This brings us to the control of international liquidity, still to be accomplished at the world level. Indeed, probably the villain of the piece —in its monetary version— is the volume of perfectly mobile liquid funds available at short notice in the so-called Eurocurrency market, estimated at more than US$ 450 billion. These funds allowed some free rides after 1974 and are behind the excessive foreign capital inflows experienced by a number of Southern countries, many of them in Latin America.

[36] A. Fishlow, "Debt Remains a Problem", *Foreign Policy*, Spring 1977, p. 136.

Latin America has in a sense a common stake —and in our view a role to play— in the discussion about the (yet to be designed) international monetary system, not only with respect to the confidence problem but especially with respect to the adjustment problem (through exchange rates) and to the control of the system of international credit creation. For several Latin American countries diversification of trade has advanced sufficiently far to render untenable the view that for all practical purposes the optimum currency area for a developing country is that between it and its dominant trading partner. While in the late forties and early fifties around one-half of total Latin American exports went to the United States, by the late seventies this proportion had declined to around 30%. Fluctuations among key currencies introduce a serious source of uncertainty about the terms of trade, the cost of servicing the foreign debt, the composition of reserves and the balance of payments proper. Latin America as a region —and each country within the region— does have (or should have) an interest in multilateral co-ordination at the world level, and as we all know, in order to have an effective voice in such negotiations the smaller and peripheral countries will have to group together in order to defend their common interests jointly.

This joint defence of common interests might be easier to advocate than to realize, however. The world encompasses today more than 150 legally sovereign countries, inescapably interdependent, but in a rather special way. Indeed, as Triffin noted recently, "a minimum of realism will force each country to focus its negotiating capabilities on co-ordinating its intervention policies with those of the handful of partner countries most important in their foreign transactions and most ready to accept and implement co-ordination commitments".[37] The emerging European Monetary System is a case in point —and one to which Latin America should have been paying much more attention. Thus, while Latin American countries absorb only 16% of Latin America's total exports, European Community countries absorb more than half of the participating countries' merchandise exports. Obviously, this proportion is much higher still for other transactions and therefore for their current account receipts and expenditures in general. Moreover, as Triffin notes, the exchange rates of many other European, Middle East and African countries are likely to gravitate also around the proposed European Currency Unit. Triffin estimates that the "emerging European exchange area will probably account for 2/3 to 3/4 of the member countries' external transactions".[38]

These events will certainly have an impact on Latin America, which, although as a region it does not gravitate so much around the dollar as it did in the past and will never gravitate around the European currency area, has not had a very successful experience of integration and is too heterogeneous to have a common *regional* stance in world negotiations. On matters of substance, Venezuela will more likely close ranks with OPEC than with its neighbours; Brazil with the more advanced semi-industrial new oligopolists than with the poorer countries of the region, and so forth. One *real* common front is the desire to obtain a net flow of real resources from the "North", financed preferably by a rise in Latin American export prices rather than through (capital account) borrowing. The critical attitude to Northern protectionism could also be considered another common front. Neither are specifically Latin American, however. Latin American countries must rally specific support outside the region for specific concerns. A possible New International Economic Order will not depend in any meaningful sense upon Latin American regional interests or Latin American leadership as a region with coherent common interests. This is not to say that the countries of the region do not have a role to play in international forums. However, much depends on their ability to see —and act— beyond the region, for today's apparently specific issues are really global issues of an

[37] R. Triffin, "The Emerging European Monetary System", *mimeo,* March 1979, p. 3.

[38] R. Triffin, *ibid.,* p. 5.

inescapably interdependent world into which even centrally planned economies are increasingly integrated. Paradoxically enough, the Latin American countries' influence in the framing of an eventual New International Economic Order will be greater, the sooner those countries recognize the global nature of their concerns —and act accordingly.

Technological development in Latin America and the Caribbean

*Jorge A. Sábato**

Introduction

The scope and limitations of this document are as follows:

(i) It refers to technology in its broadest sense, that is, as the organized body of *all* knowledge used in the production, distribution (by trade or any other means) and use of goods and services. Accordingly, it encompasses not only the scientific and technical knowledge generated by research and development (R&D), but also that which results from empiricism, tradition, manual skills, intuition, imitation, adaptation and so on.

(ii) Secondly, it recognizes that this broad scope means that technology is an essential component of economic, educational, cultural and political systems, and as a result has an influence throughout society. However, the document *restricts* itself to analysing technology as a component of economic and social development and it therefore presents an analysis of the interface between the structure of production and technology without dealing with the interfaces between science and technology, culture and technology or education and technology, except to the extent necessary for better understanding of the central theme.

(iii) Another important limitation of this document is that the analysis covers most, but not all, of the structure of production. It includes manufacturing, with its subsectors of consumer durables, intermediate goods and capital goods, as well as the basic infrastructure of energy, transport, communications and so on and the so-called "high-technology" industries (electronics, computers and data processing, nuclear power and the aeronautical industry), but it excludes agriculture, forestry, fisheries, and the finance and insurance sectors, which are outside the author's province. It is possible that much of what is asserted for the other sectors is valid for these sectors, but this will have to be evaluated by competent experts.

In preparing this document the author has endeavoured to bear constantly in mind that:

(a) Latin America and the Caribbean (hereinafter referred to as LAC) is *not* a unit, but a collection of nations which are at very different stages of development and which have governments of different kinds, are carrying out development plans with different aims based on very different economic policies, are implementing subregional and bilateral agreements of various types, possess substantial areas of competition, and so on.

(b) The United States, though it has maintained a sort of special relationship with LAC, has political, economic, cultural, scientific and military interests which extend far beyond the context of LAC and its institutions, while at the same time it is the political, administrative, technical and financial headquarters of most of the transnational corporations operating in LAC.

As a result, the policies, strategies and actions recommended in this document are not those which might be valid for a more homogeneous group, but those most capable of being undertaken in such a heterogeneous framework, through existing or similar bodies.

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I

Technology in LAC: a balance-sheet

It is necessary to draw up a balance-sheet of the situation in order to ascertain what has been done and where matters now stand. To begin with, it is important to mention that, in the two decades following the end of the Second World War, an intensive effort was made in Latin America to establish a scientific and technical infrastructure and create public awareness of the importance of science and the urgent need to develop this subject in our countries: a campaign which was crowned with success in the establishment of faculties of science in many Latin American universities, research institutes and centres, and national councils for scientific and technical research. However, technology was not very important in this effort, because it was assumed that once the capacity to produce science was acquired, it would flow in a continuos manner and become quite smoothly integrated within the structure of production, which was anxiously awaiting it. It is only in the past decade that attention has focussed on problems such as: When, why and how is demand for science created in specific circumstances? What are the relations between science and technology? Is technology merely "applied science"? How do the flows of supply and demand for technology move through the various socioeconomic circuits? Who benefits from the results of scientific and technological research? How and why are the structure of production and the scientific and technical infrastructure not properly interconnected? What relations are there between technology and foreign investment? What is technological dependence? —and so on and so forth. These and other similar questions have been studied with thoroughness and originality, leading to significant progress both in the *academic* field —in other words the field of studies and research on the group of problems involved in science, technology, development and dependence— and in the *political* field, which covers the action taken to use science and technology to attain specific objetives of economic and social development, as summarized below:

Recognition of the existence of structural obstacles to scientific and technical progress. Study of these obstacles made it possible to draw a distinction between explicit and implicit scientific policy; to understand the causes of the usual attitudes of the governing élites to science and technology (hostility, lukewarm support or indifference); to explain apparent contradictions, such as the relative advance of certain branches of science (such as biology) and the backwardness of others (such as geology); to discover the impact of the import-substituting model of development on the assimilation of technology; to create awareness of the existence of a new international division of labour, centred on the production and consumption of technology; and so on. The practical result was the explicit formulation of science and technology policies and the establishment of appropriate bodies (ministries and the like) to implement them. Outstanding examples are Decisions 84 and 85 of the Andean Pact, the Science and Technology Plan prepared by CONACYT in Mexico (1976), the organization of the CNP (Conselho Nacional de Pesquisas) in Brazil, etc.

Recognition of the importance of technology as a carrier of values, so that importing technology means importing not only an organized body of knowledge, but also the production relations which gave rise to it, the sociocultural characteristics of the market for which it was originally devised, and so forth. Technology transmits the value system for which it was designed, just as if it bore a "genetic code" within its structure. This means that the scope of technological dependence goes far beyond merely economic considerations.

Comprehensive study of trade in technology on the basis of recognition that technology is a valuable commodity in the system of production, and that most movements of technology occur through trade and not through free transfers. This study was also accompanied by an examination of the technology market, highlighting its imperfections, criticizing its worst distortions and unfair practices, penetrating into the sanctified area of industrial property and discovering the importance of "unpackaging" in the importation of technology. The result has been the introduction of measures to analyse and control the flow of imported technology (for example, the establishment of registers of technology), to govern relations with foreign investment (Decision 24 of the Andean Pact), to revise legislation on industrial property (as in Brazil and Mexico), etc.

Verification that most imports of technology have occurred through direct foreign investment, with recognition of the growing role of the transnational corporations in producing and marketing technology, the growing importance of movements of technology between the head offices of such corporations and their subsidiaries, and recognition that the concept of industrial property has broadned to include property which is not legally protected and is known as quasi-property (know-how, engineering services, trade names, place in the market and so on), which accounts for an increasing volume of commercial technological operations.

Recognition that the process of industrialization is leading to a growing "technologization" of LAC, measured in terms of the larger number of persons from various levels of society who have acquired scientific abilities or technical skills, giving rise to an important qualitative change in the structure of employment. The local output of technology is small compared with the flow of imported technology, but some encouraging successes have been recorded (PEMEX in Mexico, agricultural machinery in Argentina, machine tools in Brazil, and so on), as well as progress in "unpackaging" technology (Atucha nuclear power station in Argentina; the Brazilian iron and steel plan; petrochemicals in the Andean Pact, and so on) and growing activity in the field of adaptation of imported technology to local conditions, which means that the flow of internal innovatory activity is by no means non-existent. The first cases of substantial exports of packaged and unpackaged technology are being recorded, and measures are being introduced to support and encourage them (preferential credits, tax relief, favourable exchange rates). Exports of capital and technology within the region, especially from the three largest countries, are beginning to acquire importance. Brazil, for example, exported unpackaged technology worth US$ 135 million in 1975, against a total of only US$ 3 million in 1967.

Critical analyses of multilateral and bilateral co-operation and assitance in the field of science and technology, and of the bodies and executing agencies involved. These have led to corresponding stimulation of a new strategy for co-operation and negotiation at the regional level (OAS and SELA), the subregional level (Andean Pact) and the international level (United Nations agencies), and adoption of a new attitude to the United States (declaration by the CACTAL conference, position in UNIDO and UNCTAD and so forth).

Increases in local consultancy and engineering capacity, in some cases to international levels of quality and quantity, thus making it possible to extend such services, in open competition, outside national frontiers and even outside LAC.

Significant increases in scientific and technical exchanges among the countries of the region and with the rest of the world.

So far, we have indicated the most significant advances. In order to complete the balance-sheet it is now necessary to mention the areas where there has been no progress, and possibly even retrogression. Perhaps the most important of all these areas is the limited impact, in the field of technology, of the science and technology development plans implemented in various countries, and the failure to link the structure of production and the scientific and technological infrastructure. In contrast to science which can develop in the isolated environment of a university, academy, institute or laboratory, technology operates in a much larger area of society, that of the units of the structure of production, with a wide range of active participants. In particular, entrepreneurs and managers in the industrial sector and farmers in the agricultural sector are of fundamental importance in introducing technology in their activities. These activities, however, have been and remain totally isolated from the policies, strategies, plans, agencies and actions related to technological development, which, as a result, have remained as if floating in a socioeconomic void, without real links with reality. In short, technology has so far been handled more as an item of data than as an operational variable to which the tools of economic policy must be applied if it is truly wished to achieve some impact on reality.

The importation of technology, whether by subsidiaries of the transnational corporations, private national enterprises or by State enterprises, is effected first and foremost in the light of the micro-economic interests of such enterprises, regardless of the ecological, socioeconomic and cultural consequences. There is implicit or explicit acceptance that certain assumptions are firm truths: (a) that technology from the central countries is the only, the best, and the most suitable technology; (b) that technology is neutral, in other words, value-free; (c) that any "modern" technology will, by definition, be of the greatest use for development; (d) that this technology is sufficiently well tested, and that its introduction therefore poses no risks. It is forgotten that such technologies are designed in the light of the availability of factors and resources in the country where they were created; that for that very reason they are capital-intensive and energy-intensive; that they are aimed fundamentally at meeting the needs of sectors of the population of those countries which, because of their incomes, stand far above the mass sectors of the importing country, so that a technology which, in a central country, meets the needs of a large number of consumers can, in a peripheral country, be of use only for the élites, etc.

Local production of technology has not been properly promoted: it has not been given the protection essential to permit competition with imported technology, nor has it been possible to introduce efficient means for its production.

Studies on technology in the fields of food, housing and health fall below those carried out for the industrial sector in terms of quality and quantity, so that they have received little attention, while the importation of technology for use in the production of goods and services for the privileged sectors has continued to increase.

There is still no sound theory on the role which the State should play as a producer and as an owner of units (industries, banks, business, insurance, and so on) which are major consumers of technology and which frequently behave *vis-à-vis* science and technology as regressively as the private sector, or even more so, thus giving the lie to the belief that nationalizing a unit of production or bringing it into the hands of the State is sufficient to put an end to its technological dependence.

The brain drain has continued, and in a number of countries has increased, basically because of political persecution and ideological discrimination.

Demand for local technology remains weak, since under the prevailing rationale of the structure of production it continues to be more convenient to import technology than to produce it or purchase it locally.

Regional and subregional co-operation, which are essential for achieving the "critical mass" and thus jointly tackling the multitude of problems which need to be solved, are making slow progress, and in particular the ability to fulfil the formal undertakings entered into is very inadequate. No machinery has been established for trade co-operation in the field of technology.

Technological dependence and technological dualism have been denounced vigorously, but not thoroughly studied, and there is still no proper strategy to overcome them.

No country of the area, with the possible exception of Brazil, has yet passed from a *defensive* strategy, consisting of such actions as strengthening the infrastructure, operating registers of technology, and so on, to an *attacking* strategy, with emphasis on the production of technology and on aggressive negotiations with the external suppliers of technology. It is urgently necessary to recognize that the defensive strategy has a structural and operational upper limit, and that this limit can only be passed by going over to an attacking strategy.

The scientific and technical infrastructure is not linked either with the structure of production or with its own "owner", the State, thus showing that institutional obstacles of a socio-political and cultural nature can be as important as strictly economic obstacles.

Local efforts at scientific and technological development continue to be weak, and only Brazil has planned a significant change, through its Second Plan for Scientific and Technological Development, which provided for investments of the order of US$ 2,700 million for the three years 1975 to 1977. This situation is all the more serious since economic, material and human resources continue to be used very inefficiently. Skilled personnel still do not receive proper social and political recognition.

In these efforts there is a clear absence of projections and decisions regarding the relation between technology and the quality of life in the broadest sense. If this situation is not rapidly corrected, the consequences will be serious.

II
Objectives and strategies

A possible common objective

The above outline of the present situation defines the frame of reference within which it will be necessary to specify objectives and strategies for the better use of technology in the socioeconomic development of LAC. Three conclusions should be emphasized:

(a) There is now clear awareness that the problems are highly complex: much more so than was naively thought in previous decades. As Máximo Halty clearly put it:
"The first step towards solving a problem is to know that the problem exists. This step has been taken. Simplistic solutions have gradually been put aside: the problem is not solved merely by training skilled technical staff and increasing research funds. Neither is the evaluation and control of the importation of technology, with all its strategic importance, a complete solution on its own and in itself. The two are necessary but not sufficient conditions...".

(b) The LAC countries are basically consumers of technology but poor producers. As a result, they are spectators and not actors: passive recipients of what others do in the light of their own needs and interests, and they thus inexorably tend to adopt the general outlook of the suppliers, against which mere rhetorical protest is of no use. This leads to one of two equally harmful positions: to the worst kind of technolatry —slavish copying or imitation— or to furious denunciations of technology, which are completely sterile if no viable alternatives are proposed.

(c) International co-operation has taken place particularly in respect of the science/technology interface, and the greatest efforts have been applied to creating and strengthening the scientific and technical infrastructure (training of staff, exchange of scientific and technical personnel, equipping of laboratories and pilot plants, establishment of institutions, technical service centres, etc.), and carrying out academic and field research on the many aspects of the problems of science, technology and development. The programmes applied to the interface between technology and the structure of production have been few in number, and so far very limited in scope and resources.

There is no doubt, in these circumstances, that the next stage should focus on objectives which are directly related to technology as an operational variable *in* and *for* the system of production, and should proceed on the basis of overall ***attacking*** strategies which are consistent with the objectives and strategies of socioeconomic development. A fundamental preliminary question immediately arises: in view of the large number of nations which make up the continent, each with its own interests and its own conception of economic and social development, will it be feasible to define objectives and strategies which are useful for all in such a way as to make firmly based and continuing *co-operation* possible and desirable? We are not referring, of course, to co-operation to strengthen the scientific and technical infrastructure, which can and should continue, since a firm basis exists for it, but to the area of socioeconomic development, because co-operation in the exchange of scholarship-holders and teachers, the organization of courses and seminars, the equipping of libraries and laboratories, and so on, is one matter, while tackling problems so bound up with power and interests as the regulation of imports of technology, reform of industrial property laws, and the evaluation of technology in relation to income distribution, for example, is very different. What is convenient and desirable for country A may not be so for country B: thus, A may pursue socioeconomic development through extreme liberalization *vis-à-vis* foreign investment and technology, while B, in contrast, may pursue the same goal by restricting and controlling such investment; country C may hope to improve its non-traditional exports through the massive assimilation of imported technology, while D may give priority to meeting the basic needs of its rural population (food, health and housing), sharply reducing imports of technology for use in the production of luxury items and applying its greatest efforts to the development of indigenous technology, and so forth.

This is a consequence of the very nature of technology and its full participation in the process of production, which means that everything related to it is necessarily linked to conflicts of interests between classes, groups, countries, and so on. Any decision on technology *benefits* some and *harms* others, just as occurs with other variables of socioeconomic progress, such as wages, rents, interest, etc. In itself, there is nothing bad about this, since it is a natural consequence of the prevailing rules of the society; what is really important is *to be aware* that the situation is thus, and this is often forgotten or ignored, perhaps because technology is often confused with science. In scientific matters conflicts are usually academic, while in the field of technology they are political. "The capacity of technology to transform the nature and orientation of development is such that whoever controls technology controls development. Thus this is a fundamentally political issue" (Dag Hammarskjöld Foundation).

The argument of this document is that it is possible to define at least one objective which, since it is shared by each of the countries, makes co-operation among all of them possible and desirable; this objective is that each sovereign nation should, by definition, attempt to achieve an *autonomous* capacity to handle technology, so as to be able to direct it and use it in the way most convenient and appropriate to its interests and objectives. However opposed the interests of nations A and B, or C and D, each and every one of them needs to *know how to handle* technology, just as it needs to know how to handle taxes, currency, income distribution and external trade.

Only insofar as a nation acquires this capacity for handling technology will it be able to achieve the desired objective of converting technology into a special tool for its own development, an operational variable *in* the system of production, subject to its own decisions and not to those of others. In this complicated game there is a crucial dilemma: either one manages technology, or one ends up by being managed by it. Whatever each nation does with the technology once it has learned to manage it will be exclusively a matter for its own policy, and its decisions in this regard will be taken in the light of its own plans and programmes, its specific characteristics and its degree of interdependence with other nations.

Why does the pursuit of this objective make co-operation between nations desirable? In the first place, because such co-operation is an essential element in achieving a local capacity to produce technology, the effort to secure which will, because of its magnitude in terms of human and material resources, necessarily demand all the co-operation which can possibly be obtained. Moreover, such joint action also offers the participating countries greater latitude and makes it possible to achieve reasonable scales of operation. Secondly, because concerted action will help to develop the capacity to identify and formulate specific technological requests, a capacity which is notably absent at the moment. Finally, because it will make it possible to negotiate with the United States and other nations which provide technology to the region from a position of greater strength.

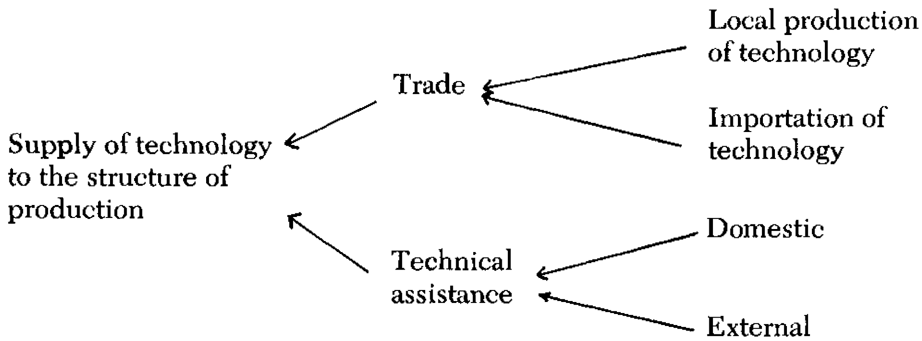
Considered as a political and social process, knowing how to manage technology also means knowing how to define it in the terms which are most convenient and appropriate to the objectives proposed, knowing how to produce it using one's own resources, knowing how to select it from the existing local or foreign stock, and finally knowing how to use it in the existing socioeconomic circumstances. Two areas must be distinguished in all this:

Area I, that of the structure of production of goods and services, where technology behaves as a commodity and the problem consists in the smooth and reliable *supply*, in quality and quantity, of the technology needed for the area's proper operation, in keeping with the inherent rationale of this structure of production and using the machinery and channels which normally operate within it;

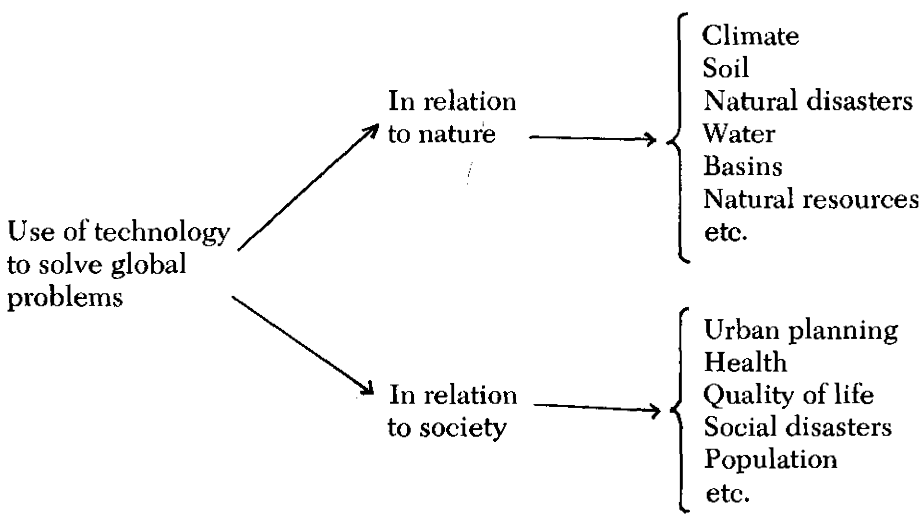
Area II, that of the "global problems", where managing technology means knowing how to use it effectively to solve problems which, by their very nature, extend beyond the framework of the structure of production, such as weather control, the development of hydrographical basins, forest or desert management, the occurrence and control of natural disasters, urban planning, control of the environment, health protection, and so on.

In both areas the management of technology comprises various stages, as summarized in the following diagram:

AREA I



AREA II



It is clear that the rules are different in the two areas, as are the principal participants. In area I the economic system rules, and the principal protagonists are the entrepreneurs (private and public, national and foreign, industrial, commercial and agricultural), because they are directly responsible for producing the goods and services and therefore for taking the final decisions regarding the technology to be used. The State participates in its dual function as regulator and controller of the structure of production, and as owner of productive enterprises. In area II, on the other hand, it is fundamentally the system of penalties and rewards that governs the behaviour of the State as the entity responsible for managing the territory of the country and its resources, the health and protection of its inhabitants, the provision of urban infrastructure, defence against natural and social disasters, and so on.

In both areas I and II *local production* of technology is an essential element for achieving the desired autonomous capacity, not least because it will permit better management of the importation of technology and of technical assistance, for a sound local productive capacity substantially strengthens a country's bargaining position.

While for thousands of years man produced technology in a spontaneous, unsystematic and almost amateurish way (i.e., in the manner of the craftsmen of those days), in recent decades this mode of production has sharply changed, and has been converted into a specific, organized, differentiated and continuous activity with its own identity, its own legitimacy and its own economic characteristics. Just as everyday goods are produced in establishments broadly referred to as factories, the same occurs with technology, with the difference that the technology factories or firms are given such names as "research and development laboratories", "R&D departments", and so on. In area I in the developed countries the technology factories and firms are the largest and most efficient units producing technology, and represent one of the fundamental components of the power of the transnational corporations.

The situation is different in area I of the LAC countries, however, where the production of technology fundamentally remains at the craftsman level; while such production is important and therefore should be suitably encouraged, it is far from enough to enable these countries to become efficient producers of technology.

The technology used to tackle the global problems of area II usually —although not always— originates from specialized applied research institutes along the lines of those dealing with lake studies, integrated basin studies, seismology and soil dynamics, urban planning, infant nutrition, and so on. The vast majority are State, para-State or university institutions, and the results of their work are distributed much more by means of technical assistance than by means of trade. These institutes provide services which are very important for the community and undoubtedly provide a basis for the knowledge and control of natural resources, the natural and human environment, natural and social disasters, and so on. In all the LAC countries there are institutions of this type, and in many cases they have achieved significant successes: indeed, some of them have acquired international prestige.

Only in the last few years have the principal aspects of the importation of technology into LAC begun to be understood, thanks to the establishment of National Registers of Technology.

Since this procedure has been introduced not only in various countries in LAC, but in many others in the Third World, the importation of technology is becoming more open, and this will in due course make it possible to bring into effect appropriate regulating legislation, like that which exists for the importation of other commodities. It will then be possible to control imports of technology in terms of *cost*, *use* (reducing or eliminating provisions restricting its use) and *content*. Among the most important consequences of this process are the negotiations at present under way within UNCTAD to formulate a Code of Conduct for the Transfer of Technology.

In order to ensure that the supply of technology in area I is properly managed, the LAC countries should concern themselves first and foremost with *promoting the local produc-*

tion of technology and *controlling its importation.* These two processes should be carried out simultaneously, since one is supported by the other, because imports cannot be replaced if there is no local replacement, and it is not possible to produce locally without a certain degree of protectionism against external production.

The promotion of production requires action both in the field of demand and in the field of supply. The promotion of demand for local technology can only be successful if the prevailing rationale of the structure of production is adapted to this end, which means using fiscal, economic and financial incentives to increase the consumption of local technology and introducing penalties of the same types for the unnecessary use of imported technology. A certain degree of *technological protectionism* will necessarily have to be established, not by means of "ad valorem" tariffs, but through preferences of a qualitative type, since in general technology is purchased on the basis of its "quality" and the trust inspired but its supplier, rather than its price. One possible mechanism for qualitative technological protectionism would be the giving of preference to local consulting and engineering firms in feasibility studies and design work on investment projects in the public sector, as in the Argentine legislation on "national contracts": the purchase of locally produced capital goods, the engagement of skilled personnel of local origin, and so on.

In order to improve supply, it will be necessary to strengthen the scientific and technological infrastructure and encourage the establisment and operation of enterprises producing technology, consultant services, engineering and design services, and auxiliary technical services. This encouragement should also make use of the machinery and procedures which are accepted and used in the structure of production: bank credit, reduction of taxes, other fiscal benefits, etc. The quasi-artisanal production which takes place within enterprises in the structure of production should also be suitably encouraged, for example by permitting tax deductions in respect of expenditure on the production of technology, with "soft" credits for the development of prototypes and the establishment and operation of pilot plants, and so forth.

The encouragement of production should be complemented with vigorous *promotion of exports of technology,* which have already been successfully started in various LAC countries and which are likely to experience explosive growth in the next few decades, especially towards the Third World, where countries which are still at an earlier stage of development find that technologies from LAC are more suitable than those from the central countries. In particular, the export of technological services is of the greatest importance, since it prepares the ground for the subsequent export of technological items, capital goods, etc.

As regards the *control of imports of technology,* the principal aim here is not to reduce the volume but to improve the quality and importance of what is imported, to bring it into line with local needs and resources, and to improve the terms on which the imports occur. In fact imports of technology are not only not going to decline, but are very likely to increase, insofar as the development of LAC becomes more thoroughgoing and extensive; what is needed is to avoid superfluous imports, replacing them by imports which are really essential and are negotiated on the basis of fair and non-restrictive conditions.

It is clear from the above that policies to promote the production of technology and control its importation must be mutually consistent, so as to ensure a smooth flow of technology which is suited to the structure of production.

Choice of technology

In recent years there has been increasing awareness of the need that all technology, before being supplied and used, must be selected from among various alternatives so as to ensure that the most appropriate technology has been chosen. This process of elimination should be applied not only to imported technologies, but also to those produced locally, since these are in many cases copies and adaptations of foreign technologies and as a result transmit the value system carried by their "genetic code", also sometimes called their "ideological content".

Of course, each country will make this selection on the basis of its own criteria and for its own purposes, but co-operation among various countries will be very useful in defining more precisely the questions of: (a) Why to select; (b) What to select; and (c) How to select.

Some limitations

At this point in the document it is necessary to realize that technology, even when selected with the greatest care and supplied to areas I and II with maximum efficiency, is *not* a "magic wand" which solves everything, a "cure" for all the evils of underdevelopment, a "key" to open all the doors to happiness. It is a *necessary*, but not sufficient, condition to enable the LAC countries to pass beyond their present stage of development and succeed in reducing poverty, backwardness, malnutrition, disease and so on; to that end technology should be used in accordance with appropriate overall policies and with plans and programmes for socioeconomic development which are designed to solve these problems. Technology is sometimes expected to eliminate or reduce unemployment, protect ecosystems, uphold cultural independence, and the like, at the same time as it is being used in a context which ignores such objectives or —worse still— implicitly defends what it rhetorically purports to be combating. These are complex demands which cannot be satisfied merely by using appropriate technologies, although it is true that this can help, sometimes to a significant extent. There is a danger of proposing solutions which are unattainable, or which are not solutions at all but merely desires expressed with attractive rhetoric but little profundity. Thus, for example, the demand is often heard in LAC that modern capital-intensive and energy-intensive technologies should no be introduced into rural areas, but that the traditional technologies, appropriately improved and adapted, should be maintained. This position, which has a certain validity and enjoys a degree of recognition in mainland China, India, Indonesia, and so on, would seem to be difficult to apply in our continent. In the first place LAC is no longer rural, although it has rural sectors which have very rapidly been "opened up to the world", with the help of geographical mobility (in contrast to Asia, there are no *large* isolated plateaux). Moreover, it has a single language which unifies and promotes integration, widespread urban life patterns, growing penetration by industrial goods, a touching 19th century faith in Progress, and great admiration and respect for Technology with its magic products (radio, the cinema, TV, the telephone, antibiotics, electricity, agricultural machinery, and so on).

Finally, this position is difficult to uphold because the greater productivity of modern technologies makes their introduction almost inevitable. This does not mean that these technologies are the only possible ones, or that they must necessarily be capital-intensive and energy-intensive, for other solutions, better suited to the availability of local resources and factors, might be imagined and possibly developed, but this will only be possible by means of an intensive research and development effort and not simply through a sort of romantic "return to Nature". If modern technology is not appropriate and convenient, the only acceptable response is to produce even more up-to-the-minute technology, which *is* appropriate and convenient.

Furthermore, some criticisms of modern technologies, both for the agricultural and for the manufacturing sector, unfairly forget that the only way of breaking away from the old international division of labour has involved the use of technologies which, because of the increased productivity they brought to the economy, have enabled some underdeveloped countries to begin to produce industrial goods on acceptable terms. Without the help of those technologies, these countries would probably have continued to be mere producers of raw materials.

In short, this complex subject requires much more research before the present stage can be passed.

Some important obstacles

In order to attain the desired objective it will be necessary to overcome a group of obstacles of varying importance, including:

(a) The groups of interests which benefit from technological dependence and will not remain indifferent to a vigorous programme aiming at technological independence.

(b) The weakness of the State, which must play a leading role, and its meagre capacity to implement and ensure the implementation of decisions of a technological nature.

(c) The intellectual alienation of those groups in the ruling class which hold that nothing can change because "we are not capable", and others which hold that nothing can change because "they won't let us".

(d) The existing rationale, according to which it is better business to import technology than to produce it locally.

(e) Cultural dependence, holding that "any foreign technology is better... because it is foreign".

(f) The prevailing system of values, which gives action to provide for superfluous consumption by the élites priority over providing for essential consumption by the majority of the population.

(g) The slavish imitation practised by the periphery, whereby even the worst products and processes from the centre are copied.

(h) Local financial machinery, which fails to provide risk capital for the production of technology, will provide backing for any "prestigious" imports of technology.

(j) The poor links between the principal participants in the process: State officials, entrepreneurs and managers, scientists and technologists.

III

Possible strategies

Two fundamental strategies are proposed: a strategy of *co-operation*, to help to make technological autonomy in LAC *viable*, and a strategy of *negotiation*, to help to make equitable interdependence between LAC and the United States on a basis of solidarity *possible*.

The *strategy of co-operation* should aim at the same general ends in both areas I and II: *to support* the national plans and programmes for technological development, *to carry out* a coherent set of actions to strengthen national efforts and expand their scope of operation, and *to co-operate* with the programmes of other subregional, regional and international bodies. However, the development of such a strategy cannot be the same in areas I and II: it will take place in each of them in conformity with their particular characteristics. Equally, it will not take place with the same intensity throughout the whole wide range of possibilities, but must select some *priority directions* where efforts will be particularly concentrated so as to use the scarce resources available with maximum efficiency.

Bearing in mind the particular characteristics of area I, it is proposed that the co-operation should focus on the two following lines:

(a) *Promotion of production of technology*, through action aimed at greatly strengthening the capacity to produce technology and promoting the creation of bilateral, multilateral and subregional capabilities which, at an appropriate time, could come to be articulated in a genuine regional technological capability.

The promotion of production should include both industrial and quasi-artisanal production, as well as the protection of them from foreign technology. The extension of production and protectionism to the whole region might be achieved through such appropriate instruments as the operation of Latin American technology enterprises, agreements for technological complementarity, regional preferences, etc.

(b) *Promotion of trade in technology* among the LAC countries, so as to increase the present meagre flow significantly, control the importation of foreign technology by seeking a reduction in the redundant imports which occur when various countries import the same technology, and develop adequate economic room to permit autonomous technological development.

Trade promotion should encompass both technology embodied in goods and in human knowledge and technology which is not embodied in technological goods and services, and as a result should cover capital goods, the emigration and immigration of skilled personnel, consulting services, design and engineering services, and so on. The instruments used should naturally be compatible with those used in trade within Latin America in general.

Just as in area I the strategy of co-operation proposed highlights the production of and trade in technology, for area II it is proposed that the co-operation should develop on the basis of *"joint projects* for production and technical assistance". It has already been noted that, because of the very nature of the global problems of area II, technical assistance is more important than trade; thus, for example, if country A has developed a given technology for flood control, while country B needs it for application on its own territory, it is very unusual for the technology to pass from A to B by means of trade: it is most likely to be transferred under an *agreement* between A and B, which might possibly include some payment, but not in terms of an actual *price* for the technology.

An important aspect of the global problems is that, by their nature, although one of them may be specific to one country or a sub-group of countries (for example, the protein deficit), there will certainly be another which is specific to another sub-group (for example, the ecosystem of desert zones) and so on and so forth, so that the set of problems as a whole will in fact be of equal interest to all the countries and, as a result, co-operation will prove to be of genuine mutual interest. There are also problems of regional —and even worldwide— scope, such as general weather control, earthquake prediction and control, exploitation of the seabed, mass hunger and poverty, the exhaustion of natural resources, waste management (industrial, mineral, nuclear and so on), urban marginality, world population growth, and so on, which will be impossible to study and solve without co-operation by all, which is therefore an ineluctable *imperative.*

The principal characteristics of the "joint projects" would be as follows:

(a) They would be defined and organized around problems to be solved, and not around disciplines. For example, there might be a joint project for the development and use of tropical forests, but not a silviculture project; for the replacement of animal protein in mass diets, but not a protein chemistry project; for the ecological control of marginal problems, but not an ecology project; for the use of non-bauxitic ores for aluminium productions, but not a mineralogy project, and so on.

(b) Thus defined, the projects will necessarily be multidisciplinary, and although some will be linked more to the "hard" sciences such as physics and chemistry and others to the "soft" sciences such as sociology and anthropology, the solution of the problems will require knowledge from various sources and disciplines. Moreover, although applied research will be one of their fundamental tools, the projects will not make use of "applied science", but of "technology", because their final objective is not to *inquire into* the problems, but to propose *solutions*, and for that purpose they will be able to use knowledge of any origin and nature, provided that it is *useful* for that purpose.

(c) The projects will aim to develop technological solutions which are feasible, viable, appropriate and convenient, on the basis of definitions and criteria explicitly set out in the programmes themselves.

(d) The joint projects will encompass all the stages, ranging from prefeasibility and feasibility studies to the production of technology —which will contain an appropriate mix of local and foreign technology— and its application and full use by society. The countries participating in each project will endeavour to participate fully in *all* these stages, so as to transform the static transfer from the owner to the recipient into a dynamic transfer in which all the participants give and receive.

(e) The *joint action* will mean that the countries which wish to embark on a specific project aimed at solving a problem of common interest will define the nature and structure of the project, the terms of their participation and the adaptation and use of the technological solution achieved and other technologies which it may have been possible to generate in the process.

(f) The projects will be implemented by suitable institutions such as research institutes, technology enterprises, university laboratories, research centres and so on, which will co-ordinate the organization, administration, control and implementation of each project.

(g) It will be essential, for each project, to ensure that it is related as closely as possible to the circumstances which it is supposed to improve; otherwise there will be a risk of producing solutions which might be satisfactory to their authors but impossible to apply. For this reason, the various interest groups linked with the problem which is to be solved should be properly represented in the management of the project. Thus, for example, in an endeavour to solve the problem of improving the everyday diet of the mass of the people through the addition of proteins to bread, the body responsible for managing the joint project should contain representatives not only of the scientists and technologists participating in the project, but also of the bakers who may possibly produce and market the new type of bread, the manufacturers of bread-making equipment, the producers of the raw materials used in producing bread, and so on.

(h) The final form of applying the solution reached will depend on the specific circumstances of each project. Although in general this will be done by means of technical assistance, there will undoubtedly be cases where it is most desirable to do so by means of trade. Thus, for example, in the case of flood control, the technological solution found will no doubt be transferred in the form of technical assistance; but in the case of the new type of bread, it is likely that marketing of the solution through the specific channels of the sector (for example, the manufacturers of bread-making equipment) will be not only the most rapid and efficient way of achieving the goal sought (to improve the diet of the masses), but perhaps the *only* feasibly way, despite the difficulties inherent in it.

(i) In the global projects which are regional or worldwide in scope, where because of their magnitude and complexity scientific, technical and economic leadership will in fact be in the hands of the developed countries, LAC will nevertheless demand genuine co-operation and, as a result, full participation in decision-taking and in the benefits.

The strategy of *negotiation* in the field of technology between LAC and the United States must naturally be part of the strategy of *general* negotiation between the two sides which is carried out in various forums. In the specific case of technological negotiations, the central concern should be to ensure that the United States *recognizes* that it is in its own political interest that the LAC countries should pass beyond their present stage of technological dependence, and that it should *undertake* to *co-operate* actively to ensure that this occurs in the shortest possible time and at the lowest possible cost.

The technological negotiations should encompass at least the following subjects:

(a) Regulation of trade in technology between LAC and the United States, under a "Code of Conduct for the Transfer of Technology", identical or similar to that currently being drawn up within the United Nations;

(b) Regulation of the behaviour of the United States-based transnational corporations, as far as technology is concerned, by means of provisions identical or similar to those which will appear in the United Nations "Code of Conduct for Transnational Corporations" which is being prepared;

(c) Regulation of the behaviour of the United States consulting and engineering firms which sell services in LAC in order to prevent restrictive practices or trade abuses arising from their power;

(d) Sustained support for the development of a local capacity to produce technology, and particularly for the establishment and operation of technology enterprises;

(e) Support for the LAC countries in their negotiations with the World Bank, IDB and other international financial institutions with a view to eliminating the conditions which "tie" their credits to the supply of foreign technology, stimulating full use of local technological goods and services (especially in consulting and engineering) and allocating "risk capital" for the establishment and operation of local technology enterprises;

(f) Active co-operation in "joint projects" among LAC countries and support to ensure that they achieve full participation in "joint projects" at the global level;

(g) Development of technological transactions with medium-sized and small industry in the United States, and increased use of the programmes of the Small Business Administration.

The *negotiation strategy* aims to ensure not only that a harmful confrontation with the United States is transformed into active co-operation, but also that the LAC countries engage in an active learning process on some central problems connected with the interface between the structure of production and technology and become aware of their principal shortcomings in this field. The United States knows how to manage technology as an operational variable and has an "implementation system" for decisions in this field, which functions in response to explicit orders from the political authorities. This is precisely an area where LAC falls seriously short, all the more so because there is not even full awareness of its necessity and importance. The negotiations will bring this out very clearly, while at the same time clarifying relationships and mechanisms which are still hidden behind an ideological tangle of absolute pseudo-truths. For this reason the negotiations must constitute a continuous and ongoing process.

The major unresolved issues in the negotiations on the UNCTAD code of conduct for the transfer of technology

*Miguel S. Wionczek**

I

Ten years after the appearance on the international agenda of the issue of technology transfer, a consensus seems to be emerging among the parties concerned —both technology suppliers and technology importers— that:

(a) technological know-how, including its development and transfer, is one of the key factors in the economic growth and social development of all countries;

(b) the technology transfer process involves a complex blend of capital, know-how, and trained personnel, and

(c) the successful selection, adaptation, utilization and innovation of technology requires a certain level of technological capability within a given country.

This sort of agreement in principle on the centre points of the issue of less developed country (LDC) participation in world technological advancement points to considerable progress towards understanding by the advanced countries of the reasons for the LDCs' long-standing insistence on the need to regulate international technology trade. Unfortunately, however, the deadlock reached at the United Nations Conference on a Code of Conduct for the Transfer of Technology, which adjourned in Geneva after three meetings last February without having been able to reach final agreement regarding such a Code, indicated once again that a consensus on broad principles is a necessary but *not* a sufficient condition for agreeing on international policy measures and their implementation. Moreover, the general economic stagnation and the growing competition for international markets among the major industrial powers has been reviving lately the opposition in some advanced countries against the liberalization of technology flows to the LDCs and the establishment of international "rules of the game" for technology transactions.[1]

II

In view of the present adverse conditions it may be useful to restate once again the LDC case for a multinational code of conduct for the transfer of technology. Not only was the initiative in that respect taken by the LDCs, but over five years have now been spent in international meetings on clarifying misunderstandings around that issue, considered to be of great importance for a new international economic order.

Because they have been dependent historically to a decisive degree on imports of technical know-how, the LDCs saw ahead of the rest of the world the need to establish a set of mutually acceptable rules for worldwide technology trade and to link international technological transactions with their own development needs. The LDCs were innovators in that field precisely because, as technology importers, they realize better than others the

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[1]For more details see M. S. Wionczek, "Science and Technology for Development", *The Bulletin of the Atomic Scientists* (Chicago), Vol. 35, No. 4, April 1979, pp. 45-48.

complexity of technology transfer, the economic disadvantages of traditional technology packages incorporated unilaterally into foreign private investment projects, and the crucial importance of domestic technological capability for the success of technology imports. They realize furthermore that this domestic capability neither comes automatically with commercial technology transfers nor can be imported lock, stock and barrel.

If one remembers that the LDCs acted as the initiators of the present worldwide debate on the subject of technology transfer and its regulation, then their arguments as regards the particular form of such regulation cannot be disposed of lightly as stemming either from ignorance or radical delusions.

All initial proposals for the regulation of international technology trade, made by a large group of the more advanced LDCs at UNCTAD and elsewhere in the 1970-1975 period, have met with strong opposition on a number of grounds from the major Western technology-exporting countries. The LDCs were told on innumerable occasions during that period that technology, being an undefined and very complicated object of international transactions, did not lend itself to international regulation; that technology, being mostly private property, could not be subject to such regulation; and, finally, that any attempt to regulate international technology trade would have negative effects on technology flows.[2] The LDCs were warned that such regulation would scare technology sellers from entering into contracts with relatively small, uncertain, and underdeveloped markets in countries supposedly only too eager to impose technology restrictions for the restrictions' sake.

By now, we all know that these general objections against the regulation of technology transfer do not stand up to any serious criticism. If technology and technology transfer could not be defined and identified, we would scarcely have seen the emergence of an international patent system more than 100 years ago, a system aptly called a private system of technology trade control by an outstanding United States expert on international law, Prof. C. Fatouros of the University of Georgia.[3] If transactions involving private property could not be subject to international regulation, there would be no room for such multilateral arrangements as GATT. If the absence of regulation were a precondition for the international exchange of goods and services, there would have been no such thing as East-West trade, which apparently is advantageous to all the parties involved.

III

The quasi-metaphysical discussions about the feasibility and possibility of regulating international technology trade gave place to a more practical and pragmatic debate only in May 1975 at UNCTAD in Geneva, when the LDCs presented the Western industrial countries and the European socialist bloc with a detailed draft of the possible contents of an international Code of Conduct on technology transfer. This first draft outline of international regulatory measures in the field of technology trade, prepared by experts from some 40 LDCs, injected real life into the intergovernmental political and technical discussions on technological advancement, technology transfer and industrial property systems.

The objective of the draft outline of a Code prepared by the LDCs in 1976 was not to impose its contents unconditionally upon technology producers and exporters, but only to prove that international regulation of technology trade was both possible and feasible and that

[2]This last argument, based upon partial and biased evidence, continues to be propagated under the guise of "scientific surveys" by commercial firms selling advice to large international business firms. For details see, for example, Business International, S.A., *Transfer of Technology — A Survey of Corporate Reactions to a Proposed Code*, Geneva, April 1978.

[3]See the background papers for the International Conference on Technology Transfer Control Systems (Phase II), Seattle, 6-7 April 1979.

it was urgent to start meaningful negotiations on the subject. This objective was achieved. In answer to the LDCs draft the Western industrial countries presented counter-proposals covering all major subject areas included in the LDC proposals. It is common knowledge that the outline Code offered by the Western countries borrowed heavily in many substantive points from the LDCs draft.

Moreover, in late 1976 the European socialist countries, which are heavy importers of technology, decided to join actively in the exercise by offering their own sektchy outline of a Code. The subsequent socialist drafts, submitted in 1977-1978, covered all major Code issues in technical language comparable to that used in the LDC and Western proposals. Finally, China joined the UNCTAD negotiations in February 1978, supporting in general terms the LDC position.

North-South technological co-operation, technology transfer and the Code of Conduct were perhaps the only subject on which UNCTAD IV (Nairobi, May 1976) was able to reach a substantial degree of agreement by consensus. This Conference recommended that:

1. The drafting of a single set of proposals for an international Code of Conduct for technology transfer should be accelerated with a view to its completion by the end of 1977;

2. The experts drafting the tentative composite text of the proposed Code should be free to formulate draft provisions ranging from mandatory to optional, without prejudice to the final decision on the legal character of the Code of Conduct, and

3. After the drafting of the proposed Code was completed, the United Nations should convene in 1978 an international negotiating conference for the purpose of drafting the final document as well as "taking all other decisions necessary for its adoption".

IV

Subsequently, six UNCTAD expert meetings at governmental level were held and an UNCTAD Conference on the Code of Conduct opened in the fall of 1978. By the time the third session of the Conference adjourned in February 1979, considerable progress had been made toward a single text of a possible convention on what the LDCs call a code of conduct and the Western industrial countries a "voluntary code", that would apply universally to all technology transactions, including those involving the different "national" segments of transnational corporations.

There are three major North-South disagreements still pending, however, related to (1) the legal form of the final international arrangement, (2) its implementation machinery, and (3) the scope of restrictive practices in international technology transactions to be considered undesirable —in the language of the North, or to be banned— in that of the LDC technology importers.

Let us take the first two points together, since they are closely linked. It is quite possible that the magnitude of the disagreement in respect of the legal form of the Code has been exaggerated by both the LDCs and the Western industrial countries, because from the beginning both sides have divorced the issue of the legal form from that of the substantive content of the Code. The decisions adopted by UNCTAD IV to leave the legal aspects of the Code in abeyance for the time being represents general albeit somewhat belated recognition of the intimate relationship between the legal form and the content of the future international arrangement. Such recognition may pave the way for some sort of mutually acceptable solution of the legal issue at a hopefully final resumed session of the United Nations Conference on the Code in the fall of 1979. A compromise clearly depends upon agreement on the machinery for implementing the Code of Conduct: a subject to which not enough attention has been given at the earlier stages of the UNCTAD negotiations by both the LDCs and the Western industrial countries.

According to the latest information from

UNCTAD, some sort of compromise solution is in the making on this second important point, independently —it would appear— of the final decision on the Code's legal form. An intergovernmental body is to be established within UNCTAD for the purpose of (1) providing a forum for discussion and exchange of views between States on matters related to the Code, in particular its application and the experience gained from its operation; (2) undertaking studies and research for the purpose of furthering the objectives of the Code; (3) inviting and considering relevant studies, documentation and reports from within the United Nations system; (4) studying, collecting and disseminating information on matters relating to the Code; (5) providing a forum for consultations between States, and (6) organizing meetings concerning the application of the provisions of the Code.

Even though the terms of reference of such an intergovernmental body might state explicitly —as the Western industrial countries insist— that it could not act as a tribunal or reach conclusions on the conduct of individual governments or parties, the fact that consideration is given also to periodical reviews of the application of the Code and its possible revision suggests strongly that, contrary to some interpretations, the potential role of the Code goes beyond that of just providing a favourable framework for the exercise by the States of their policy— and decision-making powers in the field of technology transfer. The future of the Code depends on its international implementation and not only on its legitimizing function in respect of national regulation.

At least to this writer, the question of implementation is much more important than the legal issue for several very simple reasons. If one accepts that (1) a law by itself does not govern social relations unless it is supported by the power of potential sanctions, and (2) in the present technology transfer set-up importers of technology (except in the case of the advanced countries of the West and of the East) have much less bargaining (and any other) power than technology producers and holders, then in the absence of sanctions not even a cast iron legally binding convention could help. Moreover, national legislation cannot secure the desired objectives either in the absence of some sort of bargaining parity.

Thus, the issue of the legal form of the Code is subsidiary to that of its implementation machinery. The insistence by the LDCs on a legally binding code instead of mere guidelines is tantamount to an admission by the weaker parties that they are very weak indeed, so that they would like to see their weakness diminished by any means available, including the "sanctification" of the international regulating instrument.

It is the implementation of the Code which can make it into an international agreement worth more than paper on which it is going to be written. Technology owners and sellers are well aware of the importance of that issue, and they hoped for the best of two possible worlds: voluntary guidelines with the implementation mechanism reduced to an informal forum for "observation" of the technology transfer practices. As one of the participants in the UNCTAD negotiations, representing a major Western power, stated publicly at an international academic conference on technology transfer controls, held at the Wharton School of the University of Philadelphia last February, the industrially advanced countries continue to consider unacceptable any "quasi-judiciary" international evaluation of such practices.

The present writer expects a change in that position within the framework of a trade-off between the issue of implementation machinery and the legal form of the agreement on technology transfer regulation. Only through such a trade-off can the negotiations result in some degree of international equalization of technology transfer terms and conditions, rather than just a framework for national regulatory action. Of course, no automatic power can be built into the Code at the present stage. Moreover, the Code may fall apart through cut-throat competition for technology transfer among the recipient countries, through the drift away from the industrial property system into secrecy by technology holders, or through other even less expected developments. After more than five years of negotiations, however, the LDCs can at least feel that an end will be put to exploitation without the participation of all the parties involved as far as most (albeit not all) international technology transactions are concerned. Whether the stage of "participation without exploitation" will ever be reached depends largely on the LDCs.

V

These considerations lead us to the third unresolved issue —that of the level of restrictive practices to be defined as undesirable and contrary to the interests of the LDC importers of technology.

The fact that restrictive business practices have increasingly become an important policy issue for governments and international agencies is the result of two clearly contradictory trends: firstly, government policies (especially in major industrial countries) have, by encouraging and permitting the concentration of economic power at the national and international levels, inevitably facilitated the growth of power over the market and provided ample opportunities for the increased and effective use of restrictive business practices by private enterprises, and secondly, concurrently with the expanded use of such practices, particularly by transnational enterprises, it has become widely recognized that they affect the interests not only of the home countries of large enterprises but of other countries as well.

While the subject of restrictive business practices is at present being dealt with in many places simultaneously, both inside and outside the United Nations, it is probable that the treatment it has received in the course of the UNCTAD negotiations on an international Code of Conduct on technology transfer offers better operative possibilities than in other forums, because nowhere outside the UNCTAD draft Code has an effort been made to specify and exemplify all the major restrictive practices currently in use in technology trade. At the same time, however, the progress achieved in that respect by the UNCTAD Code negotiators should not obscure by any means the size of the disagreement still existing between the developing world and the Western industrial countries.

At the United Nations Conference on a Code of Conduct, agreement was reached by February 1979 on the provisions relating to exclusive dealing, exclusive sales or representation agreements, and payments and other obligations after the expiration of industrial property rights. Moreover, agreement has also been reached with respect to the criteria to be applied as regards including the notion of restraint of trade and adverse effects on the international flow of technology, particularly when restrictive practices hinder the economic and technological development of acquiring countries. Behind the unwillingness of the industrial countries to include in the list of restrictive practices *six* items that appear in the draft code elaborated by the Group of 77, however (limitations on volume and scope of production, use of quality controls, obligation to use trade marks, requirements to provide equity or participate in management, unlimited or unduly long duration of arrangements, and limitations upon use of technology already imported), lies a series of major disagreements between the two main negotiating groups.

According to an UNCTAD secretariat document, presented to UNCTAD V in Manila, which gives a review of major issues under negotiation in the field of the transfer of technology and the industrial property system, the following difficulties in respect of the chapter on restrictive practices in the draft Code still persist:

(a) While fourteen restrictive business practices are agreed by all parties, including all the industrial countries, to be anti-competitive in nature, the Group of 77 insists on the inclusion of the above six additional practices, independently of whether they are anti-competitive or not, because they are regarded as being, for one reason or another, unfair to the acquiring party or as adversely affecting economic and technological development in the wider sense. Such is particularly the case as regards the obligation to use trade marks, which not only strengthens the monopoly patent but it directly responsible for creating outward-directed consumer preferences.

(b) The question of the coverage and scope of the practices is far from settled. The industrial countries would like to refer in the title of the chapter dealing with them just to "restrictive business practices", while the Group of 77 explicitly suggests their regulation by proposing the general title "The regulation of practices and arrangements involving the transfer of technology".

(c) The industrial countries continue to insist that it is necessary not only to enumerate restrictive practices but to determine whether their effect is actually harmful in practice. Consequently, they want to introduce in this, as in other fields covered by the Code, the notion of the "rule of reason" or "public interest". The Group of 77, however, objects to the inclusion of such a concept in the definition of the practices, on the grounds that the application of the "rule of reason" gives rise to a real danger of arbitrary interpretation of restrictive practices by the parties responsible for originating such practices, be they private parties or their governments.

(d) Finally, on the grounds of "unequal partnership", the Group of 77 defends the right of the competent authorities of the technology-acquiring country to disregard, in exceptional circumstances, the restrictive practices proscribed by the Code, provided that on balance and on development grounds there will be no adverse effect on its national economy. Industrial countries do not accept such an exception clause in the Code.

In brief, while the shape of the treatment which the issue of restrictive business practices will receive in the UNCTAD Code is slowly emerging, the process of international negotiation has been protracted and difficult. Indeed, perhaps it would never have reached such a detailed level in the absence of the expertise available within the Group of 77 as the consequence of the recent introduction in many LDCs of restrictive business practices legislation. Such new legislation has arisen mostly from the double concern, first, about the structure of economic power in itself, resulting from historical developments and economic dependence on the advanced industrial economies, and, second, about the ability of mostly foreign enterprises with dominant power to use it to the detriment of the broadly defined national interest, through overpricing goods and technology and controlling the manufacture and distribution of products. It is no accident that these concerns found their reflection in the most detailed ever presentation of 40 restrictive practices in the early draft Code, elaborated by the Group of 77.

The reduction of this original list to 20 practices between 1975 and 1978 should not be understood as an admission by the Group of 77 of the irrelevance of half the actual practices detected by its experts. On the contrary, for the sake of arriving at a mutually agreeable consensus the "missing" twenty were incorporated in the shorter basic list or transferred in new legal language to other parts of the draft Code.

Just as in the case of national legislation on restrictive business practices, it would be unrealistic and naïve to assume that any sort of international regulation of such practices, including that which may emerge from the UNCTAD Code on the transfer of technology once it is adopted, can by itself take care of the concentration of economic power and its encroachment on the development process in LDCs. It must be stressed that international regulation of restrictive business practices will fail unless the individual countries (1) set up their own development strategies, (2) design and implement policies aimed at increasing their domestic economic and technological capability and (3) introduce national legislation against restrictive business practices —defined more broadly than is the case in the similar legislation in force in the industrial countries or their groupings such as the European Economic Community.[4]

[4]UNCTAD, *Control of Restrictive Business Practices in the European Economic Community*, Report by the UNCTAD Secretariat, TD/B/608, Geneva, 1977.

VI

These three major unresolved issues are closely related to the North-South divergence of views on the role of private interests in the international technology transfer process. The present official position of the Western industrial countries is based on the belief that private investment and investment-related activities, such as licensing and service and management contracts, among others, represent the most effective method for the international transfer of technology. This assumption gives rise to their advocacy of a liberal investment policy with a minimum of government intervention at both ends of the technology transfer process, i.e., in the selling and buying countries, accompanied by insistence on the maintenance of what has traditionally been called a sound and predictable investment climate.

These beliefs are not shared by most LDCs, even including those countries that follow quite liberal policies *vis-à-vis* foreign investment. The LDCs do not deny that a very large part of the presently available technology is privately owned, and they accept the right of its owners to reasonable retribution, but most of them take the view that excessive emphasis on the role of private investment as the bearer of technological progress either originates from the intention to defend particular interests of technology exporters or reflects confusion as regards the basic issue of technological development and technology transfer to the LDCs. According to the LDCs, technological progress and technology trade cannot be considered at the international level merely as a set of private transactions.

While most people in the industrial West equate technology transfer with the diffusion of privately-held know-how, the LDCs believe that real technology transfer takes place only when the know-how is incorporated into the stock of available knowledge in such a way that the receiving society can use it for varied purposes. One of these purposes —perhaps the most important for the LDCs— is that of building up their own more or less autonomous technological capacity so as to permit them to decide about the importation of the know-how, its adaptation to local conditions and its uses for broad societal objectives.

If local technological capability is not understood only the very limited sense of the capability of the private industrial sector, and if technology transfer is understood not as the diffusion of private know-how within individual firms but as a social process, then it is difficult to defend the position that a single channel, such as foreign private investment —more and more equated these days with transnational corporations— represents the only, the best and the most expeditious transfer mechanism. There is ample evidence, both in the developed and the developing countries, that the spill-over of the know-how diffused within an enterprise, large or small, is very limited because of the proprietary character of such know-how and the owner's legitimate interest in keeping it to himself for competitive reasons. If this is so, such transfers are not sufficient for a developing country, even if regulated. Other transfers through other mechanisms are clearly needed to amplify the range of the scientific and technical knowledge available to society as a whole, including that available to the State and the educational system.

A variety of transfer mechanisms is also needed, in the context of underdevelopment, for another important purpose: in the LDCs the technological capability of the State and of the higher education system are needed to assure social uses of private knowledge. This problem does not arise in the advanced countries because they count upon the scientific and technological equilibrium among the major segments of society which has been established gradually over the last 100 years. The situation is very different in the underdeveloped world, however, which is backward because, among other reasons, it does not have at its disposal the necessary minimum overall scientific and technical capability. That capability must be build up by the domestic effort, with the support of imports of know-how (i.e., technology transfers) —support which is hardly automatic and should be subject to both international and national regulations.

VII

There are two very important political factors that work in favour of the elaboration and international acceptance of some sort of Code of Conduct, hopefully by 1980. At the present moment, technology transfer regulation is the only concrete point on the large agenda of North-South economic issues on which both the LDCs and the West have been able to proceed from the stage of general debate and mutual recriminations to that of working together on technical and operational proposals. Since clearly nobody wants to go back to violent political confrontations, the common interest in pursuing negotiations on international technology transfer regulation —if only to prove that a dialogue between the developed and developing countries is possible— may prevail over those circles in the major industrial countries, and particularly in the United States, who —taking a narrower short-term view— would have nothing against making out of these UNCTAD negotiations another United Nations Conference on the Law of the Sea.

The second important factor militating in favour of a compromise solution on the subject of the Code is that in its prolonged absense there would be an increased risk of some LDCs starting to devise unilaterally restrictive national regulatory systems that might negatively affect international technology exports. Under such conditions many people in the industrial technology-exporting West feel that reasonable international technology trade regulation might be better —much better as a matter of fact— than a maze of restrictive national schemes. If adopted without undue delay, such international regulation may offer basic standards in many LDCs for similar domestic schemes that would take into equitable consideration the interests of all the parties concerned.

A question that seems to linger still in many minds in the Western industrial countries is —what is the need for international action if the problems of international technology trade could be taken care by national regulation? In the light of the evidence available the answer seems quite simple. The issues involved are too big, too important and too complicated to be treated exclusively at the national level at a time when the North is talking about interdependence and the South is stressing the need for a new international economic order. Technology, its development and its transfer are a worldwide problem and must be considered as such. Not only is a set of mutually acceptable rules urgently needed for the only remaining part of world trade not subject to any multilateral agreement, but the whole exercise also has a tremendous educational value for the developed, developing and socialist countries. It is helping all of them not only to design the general rules for technology transactions but also to define the preconditions for socially useful technology transfers and to clarify the crucial issue of the contribution of technology to development.

International economic reform and income distribution

*William R. Cline**

I

The distribution of world income

A major goal of the New International Economic Order (NIEO) is to achieve a more egalitarian world-wide distribution of income. The best evidence available suggests that the size distribution of world income (in principle, with the family as the unit) is as shown in table 1, which is based on purchasing-parity exchange rates estimated by Kravis and associates, and on national income distribution data compiled by the World Bank. The first estimate (Kravis *et al*) assumes complete equality within countries, while the second (Cline) incorporates information on income distribution within the countries (the data refer to 68 developed and developing countries, excluding the socialist bloc).

Clearly, the world distribution is highly unequal. Indeed, the world economy is slightly more unequal in distribution than the most unequal of national economies (such as Brazil and Colombia). Moreover, the relative (and of course absolute) per capita income gaps between countries have been rising over the past several decades.[1]

It is clear from table 1, however, that much of the world's inequality stems from unequal distribution within countries. As shown by the first column (which abstracts from within-country inequality), the share of the world's poorest 40% in world income would be twice as high if incomes were equal within countries.

Table 1

ESTIMATES OF THE SIZE DISTRIBUTION OF WORLD INCOME, 1972
(Percentage of total income)

	Kravis, Heston, Summers	Cline
Lowest 40% of recipients	8.4	4.1
Next 50%	58.0	45.6
Top 10%	33.6	50.2
Gini coefficient	n.a.	0.67

Sources: I. Kravis, A. Heston and R. Summers, "Real GDP Per Capita for More than One Hundred Countries", *The Economic Journal,* 88 (350), June 1978, pp. 125-142, and William R. Cline, "Commodity Prices and the World Distribution of Income", mimeographed, 1979.

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[1] See Simon Kuznets, "The Gap: Concepts, Measurement and Trends", in G. Ranis, *The Gap Between Rich and Poor Nations,* Macmillan, 1972.

II

Development strategy and distribution

By now it should be clear to all that unequal income distribution *within* a developing country is neither a prerequisite nor an inevitable consequence of growth. Although the Kuznets inverse-U curve (relating income concentration to per capita income level) has been confirmed as a statistical pattern,[2] it has much lower explanatory power (unless enhanced by other, policy-endogenous variables) than does the "patterns of industrial growth" concept (relating industrial patterns to per capita income). The contrasting examples of Taiwan and Korea on the one hand and Brazil and Mexico on the other are vivid evidence that rapid growth may occur under conditions of equal or unequal income distribution.

Political conditions and development strategy set the course of income distribution. The single most important factor distinguishing the Taiwan-Korea model from the Brazil-Mexico model has probably been the difference in initial asset distribution, primarily because of the presence of thorough-going land reform in the first case and its absense in the second. This difference in initial conditions (determined by differing political conditions) has been exacerbated by contrasting development strategies: labour-intensive (with manufactured exports) versus capital-intensive, respectively.

Transnational corporations. What about the role of foreign forces in determining internal income distribution? About the only argument that the inequality of the less developed countries (LDCs) may be blamed on outsiders rests on the idea that the transnational corporations (TNCs) apply only capital-intensive technology. While there is some evidence that TNCs use more capital-intensive technology than domestic firms,[3] it does not follow that foreign investment makes domestic income more concentrated. Indeed, it should raise labour's share in the economy (by increasing capital availability and lowering the local return on capital), and only under improbable assumptions (preemption of local investment by foreign, so that total capital stock does not rise, plus a more skewed structure of employee payments than by domestic firms) is the TNC likely to worsen domestic income distribution.

Basic Human Needs. While LDC inequality is basically homegrown, external forces currently seek to reduce it. Thus, donor countries and international agencies have adopted an emphasis on income distribution in their lending programmes, and programmes for Basic Human Needs (BHN) are in fashion. The change in style is welcome, after decades of donor emphasis on growth alone, but the politics are delicate. Developing countries fear that BHN is a device for intervening in their domestic affairs, while as for the donors, some of the underlying motives are open to suspicion, since BHN (as well as "human rights") can be used as a slogan by those who oppose aid altogether. The economics of BHN are also uncertain, given the difficulty of distinguishing between mere maintenance of consumption and "investment" in human beings, but on balance the swing towards BHN is very likely appropriate in the light of economic criteria if reasonable equity weights and discount rates are applied. There is a need for flexibility in implementation: where an entire country is poor and distribution is relatively even, focus on growth alone will probably be more socially efficient than limitation of aid to the types of projects typically found on a BHN checklist.

[2] Montek Ahluwalia, "Income Distribution and Development: Some Stylized Facts", *American Economic Review*, Nashville, Tenn., May 1976.

[3] See Samuel A. Morley and Gordon W. Smith, "Limited Search and the Technology Choices of Multinational Firms in Brazil", *Quarterly Journal of Economics*, New York, 1977, pp. 263-287.

Within the NIEO context, an income distribution (or BHN) focus of donor programmes is essential, because resource transfers are so limited that they must be concentrated on the poorest if they are to have much impact on world equity. Moreover, more funds are likely to be mobilized if donor legislatures believe they are going for equity-oriented programmes ("don't tax the poor at home to help the rich abroad"). For these reasons it is important to dislodge the "sovereignty" issue from the unfortunate predominance it has held in the United Nations and other forums.

Latin America, poverty and concessional aid. One of the most difficult aspects of North-South relations is the issue of whether concessional aid flows should go to Latin America to finance projects that help to correct income inequality (development of low-income regions, for example). The hard reality is that concessional resources are so scarce, and most of the African and Asian population is so much poorer than that of Latin America, that there is little justification for concessional aid to most countries of the latter region. Market-related loans from the World Bank and the Inter-American Development Bank (IDB) already carry an element of concessionality (their maturities are longer and interest rates lower than are available in the private capital market), and they are the appropriate vehicles for middle-income recipients. As a matter of donor policy, however, it is important that even these flows be for equity-oriented programmes, if the North is to have an influence in improving equity in the South.

III

NIEO reforms and the distribution of income among countries

What would be the potential impact of NIEO reforms on the world distribution of income?

Commodities

(a) *Price increases.* Commodity policy has been the most prominent element on the LDC list of NIEO demands. To take an extreme version first, what would happen to the world distribution of income if somehow the LDCs were able to increase radically the prices of their raw material exports, repeating the OPEC experience? Although that scenario is highly improbable because of demand elasticities, supplier fragmentation, and the importance of industrial country suppliers, the question has considerable interest in the abstract. "Unequal exchange" theorists such as Emmanuel[4] hold that the route to greater international equity is through improved terms of trade for LDCs, and there is little doubt that much of the initial LDC enthusiasm for a Common Fund for Commodities stemmed from the hope that it could be used as a device to generalize the OPEC result to other commodities.

A recent study by the present author[5] simulates the impact on world income distribution of the quadrupling of prices for several LDC commodity exports (sugar, coffee, cocoa, tea, natural rubber, cotton, jute, iron ore, bauxite, petroleum, copper, and tin), using 1972 as a base year and assuming totally price-inelastic demand. The results are not encouraging for "commodity power" as the road to global equality, since these price increases raise the share of the world's poorest 40% from 4.15% of world income to 4.28%, assuming no changes in intra-country distribution. If the equalizing assumption is made that for each country net gains accrue to the poorest 40%

[4] A. Emmanuel, *Unequal Exchange: A study of the Imperialism of Trade* (New York: *Monthly Review Press*, 1972).

[5] William R. Cline, "Commodity Prices and the World Distribution of Income", (Washington, D.C., mimeographed, 1979).

and net losses are at the expense of the richest 20%, then the quadrupling of commodity prices raises the world income share of the poorest 40% from 4.15% (the Gini coefficients are 0.673, 0.669, and 0.658 for the base year and the two respective simulations).

The ineffectiveness of even extreme commodity price increases for equalizing world income reflects the fact that (a) production is dispersed among rich and poor countries, and (b) trade in commodities accounts for only a small fraction of world income. More generally, the simulation results suggest that "world equity" is not a sound basis for supporting higher commodity prices.

(b) *Price stabilization.* Commodity price stabilization holds more promise as a NIEO reform, since it could add to world income by providing for smoother adjustment in both industrial and developing countries. Behrman[6] has estimated that over the decade 1963-1972, the presence of buffer stocks limiting price fluctuations to 15% around the trend levels would have added a total of US$ 15 billion to United States income by facilitating policies of fuller employment through the avoidance of inflationary shocks from commodity import prices. His study also estimates the static welfare gains to LDCs from commodity price stabilization, although the unestimated dynamic welfare gains associated with more stable domestic macroeconomic conditions (in LDCs), as well as gains from the stimulus to commodity investment caused by the reduction in uncertainty, are probably far larger.

Commodity price stabilization would benefit both rich and poor countries and would therefore increase world income, but it probably would not redistribute it to any significant degree. In March 1979 the industrial and developing countries agreed in principle on a Common Fund for commodity price stabilization. Whether the Fund will adopt binding decisions, and whether its presence will lead to more commodity agreements, remains to be seen. Nevertheless, the prospective Common Fund represents an important tangible result (or near-result) of the tortuous North-South negotiations of the last five years.

Concessional aid. An important potential instrument for redistributing world income is concessional assistance. Out of a world income of approximately US$ 5 trillion, the world's poorest 40% receive about 4% or US$ 200 billion. In 1977, the OECD countries provided US$ 15 billion in concessional aid (OPEC provided another US$ 5.7 billion), or 0.31% of their GNP. If the OECD countries met the United Nations target of 0.7% of GNP, and if the additional US$ 19 billion in aid were channelled wholly to the world's poorest 40%, the latter would obtain approximately a 10% increase in their income (it should be noted that this increment in the income of the poor would be about the same size as that obtained under the highly implausible quadrupling of commodity prices with gains focused on the poor and losses on the rich).

Political realities do not favour a massive rise in concessional aid, however. With slow growth, high inflation and unemployment in industrial countries, legislatures are more inclined to cut down budgets.

Trade reform. The recently completed Tokyo Round of trade negotiations represents an important achievement for the developing countries, since world tariffs facing their products will fall by about 25%. Rather than emphasizing that this cut is lower than the overall average (about 33%), LDC policy-makers should recognize that this result of the negotiations represents a considerable "free ride" (for which they made few concessions themselves). Other parts of the negotiations are less favourable, however: a new deal between the United States administration and the textile industry could cut the growth of LDC quotas from 6% to 2% per year in many items, because of the need to mollify the industry in the face of lower tariffs on imports from Japan and Europe, and the new codes on safeguards and countervailing duties also have potentially injurious implications for the LDCs ("selective safeguards" might be used as a club to force voluntary quotas, while obligatory phasing out of export subsidies may be inconsistent with efficient shadow pricing of foreign exchange).

[6]Jere R. Behrman, *International Commodity Arrangements: An Evaluation of the UNCTAD Integrated Commodity Programme* (Washington, D.C, Overseas Development Council, 1977).

The need for trade reform goes far beyond the liberalization accomplished in the Tokyo Round. The régime of textile quotas is not the only restrictive aspect of North-South trade. Safeguard protection of shoes and television sets and various forms of restrictions on steel, shipbuilding and electronics plague the trading system. Reform would call for elimination of those restrictions, but in practice the LDCs will be fortunate if even a standstill on protection is achieved.

Protection makes the world distribution of income more unequal by limiting the process of factor price equalization through trade. It may keep distribution more equal in industrial countries by boosting the demand for labour; Balassa[7] shows that the labour content per billion dollars of industrial country imports from LDCs is higher than that per billion dollars of exports to LDCs. But even in industrial countries there are offsetting factors: protection against LDCs limits the supply of low-cost imports, probably affecting low-income consumers the most,[8] while for LDCs, foreign protection (and their own for that matter) concentrates income distribution by skewing demand for production away from labour-intensive goods towards capital-intensive goods. Among LDCs, freer trade worldwide may ironically be income-concentrating in the short run, because it is the middle-income countries (not the low income ones) that will capture most of the increase in markets.

As for tariff preferences, the trade reform long advocated by UNCTAD, the consensus is that they have added little to LDC exports because of the ceilings and exclusions which accompany them, and that moreover the political context makes any significant future liberalization of preferences highly unlikely.

In sum, then the "reform" of trade achieved in practice will be simply the maintenance of at least the current degree of openness in world markets. By minimizing the chance of trade wars, the new non-tariff-barrier codes and the tariff negotiations of the Tokyo Round should help achieve this "reform".

Debt relief. At the end of 1976 the external public debt of the developing countries amounted to US$ 160 billion.[9] In the initial stages of the NIEO discussions, some Third World spokesmen advocated generalized debt relief as a means of increasing international equity. It is widely accepted by now, however, that generalized debt relief would be counterproductive for middle-income countries, because it would jeopardize their credit ratings and dry up capital inflows. At the same time, public concern about the danger of a rash of debt defaults, with a consequent collapse in industrial country financial centres, has gradually subsided, as it has become evident that after adjustment for inflation and in view of higher export earnings, the LDC debt problem is not much worse today than in the early 1970s (before the massive borrowings of 1974-1975).

Two issues remain. The first is the danger of debt servicing problems (such as those which have recently arisen in Zaire, Peru and Turkey). The second is the possibility of debt cancellation for poorer countries, as a means of aid. International negotiations have achieved a modest breakthrough on "retroactive terms adjustment" for poor LDCs, and less successful attempts have been made at defining "features" of debt profiles warranting rescheduling by middle-income countries. For world income distribution, the cancellation of debts owed by poor countries to donor governments represents a somewhat promising instrument. Approximately US$ 2.4 billion annually could be transferred to poor countries in this way if donors did not make corresponding cuts in new aid. (The agreements so far fall far short of this potential, because they are limited to a minor list of "least developed" countries.) In general, the potential for world income equalization through debt relief is comparable to that of a modest rise in global aid flows. Refinancing facilities for middle-income countries in trouble under specific "features" would have little impact on world income distribution, because new

[7]Bela Balassa, "The Changing International Division of Labor in Manufactured Goods" (Washington, D.C., mimeographed, 1979).

[8]William R. Cline, ***Imports and Consumer Prices:* A *Survey Analysis*** (Washington, D.C., American Retail Federation, 1978).

[9]World Bank, *Annual Report 1978.*

loans would most likely be at market-related interest rates, the supply of concessional funds being limited.

Some analysts emphasize the danger that high LDC indebtedness will spell stagnation over the next few years, as LDCs (usually middle-income) reduce growth in order to keep debt manageable.[10] However, slower future growth represents the price paid for faster growth during the world recession in 1974 and 1975. From 1973 to 1975, when OECD growth fell from 5.9% to −0.9%, non-oil-LDC growth fell only from 7.3% to 4.1%. The decline might have been much greater without heavy borrowing to finance current account deficits.[11] With a high time discount rate, higher earlier growth was probably a correct strategy, but it should come as no surprise that the implication was lower subsequent growth. Until growth at the centre reaccelerates, the production possibility frontier of the LDCs will remain on a lower time path than before, and attempts to achieve more rapid growth (or maintain earlier rapid growth rates) will cause worsening external imbalance. The problem will only be resolved by reacceleration at the centre, or failing that, a turn a new strategy of growth that is less dependent on external factors (if such an alternative exists).

The international monetary system. A decade ago there was considerable hope that monetary reform could be meshed with aid to developing countries (the SDR/aid "link"). Triffin and others[12] have accused the present exchange-reserve system of being discriminatory against LDCs because their currencies are not used as reserve currencies and they do not enjoy seigniorage. In principle, therefore, monetary reform might help to equalize the distribution of income among countries.

The prospects for significant aid flows through the linkage of SDRs to development assistance are poor. Relatively small amounts of SDRs are likely to be created over the next few years. If a "link" were created, it would have to be focused solely on the poorest countries in order to be most effective for redistributive purposes, yet LDC politics (as shown by the LDC proposals in the Committee of Twenty) would probably lead to allocation based on IMF quotas, which favour middle-income LDCs.

As for the premise that the reserve centres benefit from the current system, the extreme reluctance of Germany and Japan to allow others to hold their currencies as reserves suggests that by the time all factors (including payment of interest) are taken into account, the reserve centre's real seigniorage is negative.

Flexibility versus fixity of exchange rates among industrial countries is another monetary reform issue affecting LDCs. There is growing recognition among LDCs that fixed exchange rates among industrial countries are not feasible and can lead to greater restrictions on trade and capital flows than a régime of flexible rates. Here there are few implications for world income distribution, however: whichever system is better for the industrial economies will almost certainly also be better for LDC's because of derived benefits from faster growth at the centre.

Technology transfer. Although hypothetically lower-cost transfer of technology would work towards redistribution of income from the North to the South, extreme "reforms" such as the undermining of patent rights within the industrial countries would dry up the flow of new inventions and reduce total real income. There is, however, considerable scope for increased LDC bargaining in the "bilateral monopoly" situation of TNCs versus LDCs. Andean Pact restrictions on royalty payments, and requirements of local content and ownership, are examples, and some analysts contend that it is now generally the LDCs that have obtained the upper hand in bargaining (partly because of the "obsolescing bargain" whereby host bargaining power increases once the investment in sunk).[13]

[10] Albert Fishlow, "Debt Remains a Problem", *Foreign Policy*, 30 (Spring 1978).

[11] J. Holsen and J. Waelbroeck, "The Less Developed Countries and the International Monetary Mechanism", *American Economic Review*, May 1976.

[12] In Jan Tinbergen *et al*, *RIO: Reshaping the International Order. A Report to the Club of Rome* (New York, E.P. Dutton, 1976).

[13] See C. Fred Bergsten, Thomas Horst, and Theodore H. Moran, *American Multinationals and American*

IV

NIEO proposals: Summary

A recent Overseas Development Council study[14] contains quantitative estimates of the economic benefits and costs of several NIEO proposals. Table 2 summarizes these estimates. Achievement of the 0.7% of GNP aid target is the reform that would go the farthest towards reducing international inequality. Not only would this reform generate a larger net flow of benefits to LDCs, but also (a) the benefits would be focused on the poorest LDCs and (b) the cost would be borne by the industrial countries. Debt cancellation would be similar in effect but more modest in scope.

Commodity price stabilization, grain reserves, and trade liberalization represent a second kind of reform, that benefits both industrial countries and LDCs (mainly middle-income LDCs). These reforms would have a considerable effect on world economic growth (especially considering that the table's estimates are understated for commodity stabilization benefits to LDCs), although they would probably leave world income distribution unchanged.

A third category of reform is the new automatic aid mechanism, ranging from the SDR aid link and IMF gold sales to ocean resource revenues. Because of the acceptance of the 200 mile economic limit, most of the potential aid from ocean resources has already been given away. One of the more intriguing proposals for automatic aid is the restitution of tariffs collected to exporting LDCs, which would generate an estimated US$ 7 billion annually. Although these funds would go mainly to middle-income LDCs, they would contribute to world equity.

Reviewing the whole range of reforms listed in table 2, however, and considering the political implausibility of many of them, it is clear that the programme of NIEO reforms cannot be expected to make a major impact in equalizing the world distribution of income. Even under the extremely optimistic assumption of implementation of the whole set of NIEO reforms, the net benefit to LDCs would be only about US$ 30 billion annually, and even if most of this benefit were focused on the world's poorest 40%, the resulting increase in their real income would be only about 10%.

Accelerated development within the LDCs holds much more potential for world equity than does a programme of redistribution through NIEO reforms. For the world's poorest 40%, an acceleration of 1% per annum in LDC growth rates would give the same result after one decade as if the entire agenda of politically difficult NIEO reforms were implemented. The growth-based gains would be more permanent, because they would not rely on transfers from rich countries, and if internal LDC income redistribution policies were followed as well, the time span would be shorter than a decade, while the potential benefits for the poor could far exceed anything possible from international redistribution under even highly optimistic political assumptions.

In summary, NIEO reforms can increase world efficiency (commodity price stabilization, trade reform) and secure a modest improvement in world equity (aid target, debt relief, automatic aid mechanisms). However, the scope for world income equalization through NIEO reforms is small, especially if one is not optimistic about large increases in aid flows. Accordingly, the key to an improved world distribution of income lies in accelerated LDC growth and income redistribution within them.

International economic management

Although not on the NIEO agenda, prudent management of the international economy is

Interests (Washington, D.C., The Brookings Institution, 1978).

[14]William R. Cline, *Policy Alternatives for a New International Economic Order* (New York, Praeger Publishers, 1979).

Table 2

ESTIMATES OF ECONOMIC BENEFITS AND COSTS RESULTING FROM ALTERNATIVE POLICIES

Potential policy	Annual benefits to developing countries[a]		Annual benefits or costs to industrial countries[a] (billions of US$)	Comments and qualifications
	Amount (billions of US$)	Country income level		
Commodity price stabilization (Common Fund)	0.6 or more	middle	4.6 benefit	Assumes price stabilization, not price raising. Developing country benefit figure is for static gains. Omits benefits from increased certainty in planning and from stimulus to investment. Figure for industrial countries refers to macroeconomic stabilization benefits.
Grain reserves	0.04 or more	food importers	0.09 or more benefit	Estimates for both developing and industrial countries are understated by exclusion of benefits from increased certainty and macroeconomic stabilization. (Industrial country figure includes centrally planned economies.)
Debt refinancing facilities	n.a.	middle	n.a. n.a.	Benefits would include increased certainty in financial markets and smoother adjustment to payments problems in developing countries. Quantification difficult.
Cancellation of debts of poor developing countries	2.4 or less	low	2.4 or less cost	Transfer to developing countries depends on extent to which aid through debt relief would be offset by reductions in direct aid. Such reductions would lower both benefits to developing countries and cost to donors.
Trade liberalization 60% cut in:				Figures for developing countries refer to increase in annual exports: economic benefits would be lower, given resource costs of producing exports. Figures for industrial countries refer to liberalization of imports from all sources; figures for tariffs refer to both static and dynamic benefits; figures for agricultural non-tariff barriers and textiles refer to static benefits only. 1974 data base.
tariffs	2.2	middle	8.5 benefit	
agricultural non-tariff barriers	0.4	middle	2.0 benefit	
textile protection	1.6	middle	0.9	

Table 2 (cont. 1)

Potential policy	Annual benefits to developing countries[a]		Annual benefits or costs to industrial countries[a] (billions of US$)	Comments and qualifications
	Amount (billions of US$)	Country income level		
Aid target				The 0.5% target is more realistic than the 0.7% target, but either of them would require major revival of political will in support of aid. Real benefits to developing countries somewhat below nominal figures because of non-grant aid and aid tying. Real costs to donors below nominal figures to extent that unemployed resources exist that would not be mobilized by increased domestic spending programmes in the absence of increased aid expenditures. Long-run donor costs also may be much lower because of stimulus to world economic growth, and thus growth of donor countries, through effects such as increased supply of raw materials from developing countries and improved developing country markets for donor exports.
0.7% of GNP	15.3 or less	low	0-15.3 cost	
0.5% of GNP	7 or less	low	0-7 cost	
Automatic aid mechanisms SDR "link"	0 to 4	uncertain	0-4 cost	Measure has little prospect in the near term (see chapter 5 of Cline, *Policy Alternatives..., op. cit.*). If applied, a large share of benefits would accrue to middle-income developing countries under a formula based on IMF quotas, although distribution could be altered to favour low-income countries. Cost to industrial countries based on premise that net use of SDRs represents a claim on existing resources, not on the creation of new world resources.
Ocean resources	5 or less	uncertain	5 or less cost	See chapter 5.
Tariff repayment	7	middle	7 cost	Estimate of current tariff collections by industrial countries on imports from the developing countries. Repayments would accrue to developing country exporters, mainly middle-income countries.
Tax on brain drain	0.5	all	0-0.5	See chapter 5.
Sale of IMF gold	1	low	1 cost	See chapter 5.

Table 2 (conclusion)

Potential policy	Annual benefits to developing countries[a]		Annual benefits or costs to industrial countries[a] (billions of US$)	Comments and qualifications
	Amount (billions of US$)	Country income level		
Liberalized migration	very large	all	large internal redistribution	Measure highly unliked politically. Would benefit both developing countries and industrial countries in aggregate, but would cause redistribution of income from workers to owners of capital in industrial countries.
Increased competition in product markets	n.a.	all	n.a.	Orders of magnitude unclear. The usual presumption is that developing countries would benefit and transnational firms from industrial countries would suffer from reduced monopoly power in international trade, but even this direction of change is uncertain.

Source: William R. Cline, *Policy Alternatives..., op. cit.*
[a] 1976 base.

ultimately the most likely source of success or failure in reducing world poverty. Since 1974, growth at the centre has been low, and growth rates on the periphery have been faltering as a result; similarly, the high inflation at the centre has resulted in "imported inflation" at the periphery. The energy shocks to the world economy have resurfaced in 1979 after receding temporarily, and traditional macroeconomic policies at the centre have failed to resolve the problem of stagflation.

The international economic outlook for the medium term is not bright: it is very far from the buoyant environment of most of the post-war period. In this context, the question of whether the industrial countries can break out of their stagflation impasse and resume high growth rates will probably have a much more profound influence on the economic prospects for the poor in LDCs than will the specific outcome of the NIEO negotiations. Similarly, the inventiveness of the LDCs' policy response to the more hostile international economic environment will play a crucial role regarding the prospects of the world's poor.

Interpretative Summary

*Colin I. Bradford, Jr**

I

The New Latin America*

Latin America stands at the treshold of the 1980s as the most highly industrialized region in the Third World. Because of concern in industrial countries over the increasing competitive capacity of some developing countries in the production and export of manufactures, Latin America's essential thrust is often perceived by those *outside* the region as based on its new industrial capability. Thirty-five years of deliberately encouraged industrialization have brought Latin America to a point where it can be viewed as a newly industrializing region on the verge of participating in a major way in world trade in manufactures. Import substitution industrialization, fostered by internal protectionist policies for twenty-five years, led in the 1970s to singnificant expansion in manufactured exports and to freer trade policies. Export-led growth policies met with considerable success in the late 1960s and early 1970s. Hence, one view of the "new" Latin America sees its world role essentially as that of an industrial region, similar to several emerging Asian countries, whose principal relationship with the industrial countries in the 1980s will be based on manufactured exports. The Conference discussion questioned this view of Latin America's essential thrust and the central role of industrial exports in its international economic relations in the 1980s.

Another significant dimension of Latin America's current profile is the degree to which it has become integrated into the world economy not only through its trade patterns but also through expanded investment, capital flows and international debt. Increased diversification of the region's economic structure has led to a new kind of relationship with the world economy. Countries in Latin America have moved from dependence on a few primary products or agricultural commodities to a more macroeconomic interdependence that is more complex and interlaced with the world economic system. The combination of increased industrialization, the rise of the multinational corporation as a major presence in the region and the recycling of the OPEC surplus to Latin America in the form of increased debt have brought this region to a degree of integration into the world economy which is higher than in the past and also higher than that of other developing regions. This new macroeconomic interdependence poses problems as well as potentialities, but it is an important feature of the Latin America of today. This aspect of the new Latin America shows what a stake this region has in the fate of the world economy, the economic recovery of the industrial countries, and world economic reforms.

These two dimensions of Latin America's new world profile —industrialization and integration into the world economy— emphasize its distinctness from other Third World regions. They lead to still another set of questions regarding its relations with other regions of the South, its participation in the North-South dialogue, and the importance to Latin America of the New International Economic Order (NIEO) and of the international institutional system.

These issues and questions, as well as others, received considerable attention at the Conference and are discussed in the following sections.

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*I would like to thank Joseph Grunwald, Norberto González, Nathaniel Leff, Abraham Lowenthal, Carlos Massad, David Pollock and Luciano Tomassini for helpful comments on an earlier draft and Pedro Malan for spirited conservation at the initial drafting stage. However, I naturally assume sole responsibility for this article.

II

Latin America and the world economy

The long-run historical trend of Latin American industrialization and increasing integration with the world economy since the Second World War, along with the more recent changes in the world economy in the wake of the initial oil "shock" in 1973, have now combined to create unprecedented external pressures on the region's future and have elevated the importance of its relationship to the world economy to the top of the Latin American economic agenda. Whereas there is deep concern for internal development and economic conditions, there is an increasingly widely held perception that the global economic environment and its future evolution are now critical to Latin America's short-run economic management. The balance of payments of individual countries and for the region as a whole are already crucial to immediate survival, in contrast to the emphasis in earlier decades on the external accounts as critical to savings and development in the long run. Financing current imports, servicing foreign debt, and sustaining economic growth in the short run are urgent economic policy priorities which tend to supersede longer-run perspectives.

Given the importance of Latin America's external relations, there must be a global analysis of the different international economic elements which define the external context. International finance, export of manufactures, commodity trade, monetary issues and the flow of technology are interrelated in their impact on the region. It is difficult, if not impossible, to treat these different elements in isolation due to the immediacy of the external constraints which impose the overriding criteria of the balance of payments in the aggregate as the ultimate benchmark. The circumstances of each country vary significantly, and the manner in which each will ultimately cope with the current international pressure will depend on the particular confluence of internal and external variables. Nevertheless, the fundamental nature of the international economic problem facing Latin America can best be seen by considering the region as a whole in a global context.

For Latin America, as well as for the world, energy is the most significant single "swing" variable, both in an internal and an external sense. Every non-oil-producing country in the region is examining alternative energy sources and re-examining economic policies in the light of the ever-rising price of oil. Brazil, because of its size and because it imports 80% of its oil, is perhaps the most dramatic example of the problem faced by the region as whole. Hence, it can be expected that Latin America will want to focus on energy issues in future international economic discussions.

Because of Latin America's high degree of integration into the world economy and because of the linkage of the various elements of the international economy to each other and the immediacy of their impact, the region has a vital stake in the economic recovery of the more industrialized countries. The economic growth of the OECD countries has a major effect on the rate of growth of world trade, which in turn makes a substantial difference in the potential rate of growth of Latin America. However, because this region and the rest of the Third World are important importers of OECD products, their growth has an equally important impact on the prospects for recovery of the industrialized countries. Hence, there is a strong sense of mutuality of interest, and both industrialized and developing countries have a stake in the economic recovery of each other. The hope is that this mutuality of interest can be translated into action and enhanced international co-operation that can be held up as proof of benefit to those who insist that "what's in it for us" should be the criterion for judging international policies.

The immediacy of Latin America's external economic situation is defined by the confluence of recent patterns and developments in international finance, world trade and the international monetary system.

A. *International Finance and Debt*

The high degree of Latin American indebtedness to the rest of the world is one of the key constraints in the current situation. It is useful to see the current circumstances against a background of three periods over the last decade.[1] The first period, from 1970 to 1973, is one in which Latin America had increased access to international capital markets due to its high growth and export prospects. The debts thus contracted in turn helped finance growth and the accumulation of reserves, further strenghthening the region's economic position. This period can be seen, then, as one of debt-led growth.

After the initial rise in oil prices in late 1973, Latin America was able to continue to finance moderately high economic growth during 1974 and 1975 through increased international debt, which led to extremely high current account deficits. The increased debt was used in this period to finance accommodation to the oil price rise rather than suffer restraints on imports and growth in the short run. These were essentially postponed until the subsequent stage in the process from 1976 to the present, when current account balances decreased relative to the earlier period but growth rates also declined, imports levelled off and investment fell. Foreign borrowing continued and was partly used for the further accumulation of reserves to provide the creditworthiness to sustain more borrowing. Hence, "for many of the countries of Latin America, the debt cycle threatens to come full circle in little more than a decade —from a process of debt-led growth to one of potentially debt-constrained growth" (Fishlow).

This process occurred in the region as a reflection of shifts in the world economic situation. In the first three years after the initial oil price rise (1974-1976), the developing countries in general and Latin America in particular ran current account deficits to offset the massive surplus on current account accumulated by the OPEC countries, while the industrial countries, especially Germany and Japan, continued to run current account surpluses. In the following two years (1977-1978), the United States ran current account deficits as inflation and depreciation of the dollar had their impact on its external accounts, and the United States deficit joined with that of the developing countries in helping to offset the continuing OPEC surplus, as international concern grew regarding the debt burden of the poorer countries.

Now, as the United States position begins to improve and the price of oil continues to increase, the question becomes: what countries are going to be able to run deficits on current account to offset the OPEC surplus, and how are these going to be financed? This global management question is a pressing issue for Latin America. This region's oil and capital goods import needs continue to grow even as a higher proportion of export proceeds are needed to service the already high external debt. If Latin America is perceived to reach what might be construed as a debt limit, severe restraints would be placed on the region's immediate growth and longer-run development prospects. Hence, it has a vital stake in the successful management of global debt financing and in the securing of growing export markets to continue to finance the debt during the next stage of the global adjustment process.

The pattern of international financial adjustment in the 1970s and the kinds of economic policies adopted in Latin America in recent years have left the region with huge debts and these must be serviced in the 1980s at the same time that the real internal adjustment to higher real energy costs must be made not only in terms of higher internal energy prices but also of large investments in new sources of energy. The cost of this internal adjustment, which has been postponed by the availability of foreign credit (in some instances pushed on developing countries by foreign creditors), will almost certainly entail higher inflation, lower internal growth, or both.

[1] Albert Fishlow, "A New Latin America in a New International Capital Market", *herein*.

The debt issue is not a problem which can be viewed in isolation. In this instance, it also becomes an investment issue. Savings in Latin America must increase even as consumption patterns realign themselves to higher internal energy costs, and these increased savings must go into new investment rather than being allowed to be used to pay off the external debt. Added investment is needed in order to assure future growth and to achieve less dependence on external sources of energy.

Without adequate financing of Latin America's high debt service payments, it will not be possible to increase investment for longer-run economic growth because the short-run financing needs are so great. Exports to the industrial countries are the most important means of assuring adequate debt financing capacity, and the region therefore has a fundamental stake in the growth of world trade and the openness of industrial markets for its exports. Looking beyond trade, there is a need to increase the availability of longer-term financing in order to attenuate high debt payments and to finance longer-run investment projects. Both longer maturities for lending by private banks at commercial rates and more development financing by the international financial institutions, such as the World Bank and the Inter-American Development Bank, at near commercial interest rates with long maturities, are required to meet the needs of the 1980s.

Increased international debt financing seems an absolutely critical need as Latin America looks to the future. Further import substitution could be part of a strategy for coping with external pressures, but it could not be the sole basis of such a strategy as there are limits to the reduction of imports. Curiously, the accumulation of reserves in earlier years has a perverse effect now, because to draw down on reserves to finance current imports under balance-of-payments pressure would be seen as a sign of weakness and restrain the flow of additional credit. Hence, the flow of new long-term resources becomes critical even though international reserves in Latin America are currently at high levels. It is equally important, however, that debt should not continue to be used to postpone internal adjustment. Rather it should be used to keep the economy going and investment increasing while internal income and consumption patterns change.

Ultimately, though, the debt problem becomes a trade problem. Without increased export growth, foreign exchange will not be generated to pay off the past external debt or attract new financing. World trade prospects and policies will not only have a heavy impact on how Latin America manages its external debt but will also have a critical effect upon its overall economic outlook.

B. *Trade*

Protectionism in the industrialized countries is now a matter of urgent concern to the Third World. With the OECD economies also suffering from the external pressures of the oil crisis, there is a generalized feeling that latent, and sometimes manifest, protectionism is on the rise. Now that Latin American and other developing nations have gained sufficient industrial capacity to export manufactures on a significant scale, the focus of concern is on the trade barriers most affecting manufactured exports. Non-tariff barriers are seen as the most important limitation now affecting exports of manufactures from the developing world.[2]

Although protectionism in Europe and the United States is a reality and often takes specific forms which can be highly harmful to LDC trade prospects, there is reason to suggest that perhaps too much emphasis is being given to Latin America's role as an exporter of industrial goods. There are distinct differences between the Latin American economies and the newly industrializing countries (NICs) of Asia in their degree of industrialization and the role of manufactures in their exports. Thus, for example, in 1975, 97% of Hong Kong's exports were manufactures, as were 82% of those of Korea, whereas for Brazil and Mexico the percentages were 27 and 52% respectively.[3] The export of manufactures to industrial markets is clearly of great importance to Latin

[2]Pedro I. Mendive, "The Export of Manufactures", *herein.*

[3]World Bank, *World Development Report 1978,* tables

America, but the region's export trade is more diversified than this, and its agricultural, mineral and raw material exports together are proportionately more import to it than manufactured exports. The idea that past industrialization should necessarily culminate in a growth strategy led by the export of manufactures had some currency ten year ago, but this is not now seen as a full picture of Latin America's future. Hence, the region's current concern over protectionism in the developed world is not limited to non-tariff barriers and other restrictions on trade in industrial goods, but is focussed also on import quotas, tariffs and more general economic policies affecting world trade.

The greatest restraint on the growth of world trade is the global economic slowdown caused by increasing inflation and continuing oil price rises. Slower economic growth in the OECD countries and a lower growth in world trade have more restrictive effects on exports from the developing world than the direct actions of protectionism which may spring from the same source. Because of the size of the more advanced economies, small changes in rates of growth in their imports generate much larger export growth rates in the smaller economies of the developing world. One potential avenue for more fully exploiting this difference in size would be to shift the country allocation of import quotas gradually from developed to developing country exporters. Since developing countries are relatively smaller in GNP, a small percentage shift in import quotas by the larger developed countries would translate into significant percentage increases in LDC exports.

There is more that the developing world can do to improve its own trade prospects. Increased trade among developing countries, along with enhanced integration and regional import substitution, has some potential, and greater exploitation of the principle of reciprocity could be achieved by making trade concessions and seeking further liberalization from OECD countries in return, although the Conference felt that these actions were second-best solutions compared with a more liberalized global trading environment.

If protectionism increases and the Third World feels that it has exhausted its own policy possibilities and patience, retaliation by developing nations might well become a distinct option. These countries can restrict foreign investment opportunities, access to their raw materials, and export penetration into their internal markets. This would be political action with definite economic costs for the retaliating countries. Retaliation against protectionist actions is already contemplated within the multilateral framework of the GATT, which helps both to regulate and to legitimate retaliation actions. While multilateral agreements are useful mechanisms for channelling such actions, however, the best restraint against retaliation is avoidance of the need for protectionist measures.

Increased consultation among Third World countries producing the same commodities would be helpful in developing countervailing power in cases of protectinist actions by industrial countries, and might be particularly helpful in shoes and textiles. Resistance to protectionism cannot best be achieved by Latin America alone but should also include actions in conjunction with other developing countries. Until now, there has been a lack of consultation and an absence of common strategies among developing countries with similar interests.

The prevailing mood in Latin America in the face of rising protectionism in the industrial world seems to be one of resignation. It was felt that very little could be done in the face of this trend, since the scope of action of GATT, for example, is constrained by its juridical base and its mandate. What is needed is a broader framework which does not isolate trade but treats it within a global context, linked to finance and monetary matters. Given the intimate linkage between these different elements, the debt problem also is a monetary problem.

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6 and 7. Also, trade among industrial countries in manufactures is very much greater than the total exports of such goods from LDCs. See Pedro Malan, "The Latin American Countries and the New International Economic Order", *herein.*

C. *The monetary system*

The difficulties and disjunctures in the international monetary system antedate the energy crisis. The end of the Bretton Woods phase in international monetary management came in 1971 when the dollar ceased to be pegged to gold. Since that time, the international monetary system has operated on an *ad hoc* basis, with floating, semi-floating, and pegged exchange rates replacing the generally uniform fixed exchange rate system of the Bretton Woods era. The oil crisis is taking place within a less regulated international monetary system and has made the system still less subject to overall management. In fact, it can be said that "the present international monetary system is a 'non-system' in which the traditional problems of confidence in a stable reserve currency, of adjustment to asymmetries in the balance-of-payments positions among major trading countries, and of control of the expansion of international liquidity remain unresolved".[4]

In the current circumstances, Carlos Massad concludes that floating and pegged exchange rates have not solved the adjustment problem nor have they insulated countries from external shocks. Pegging simply transmits inflationary shocks from the issuing country to the pegging country. Floating can help achieve equilibrium in the balance of payments as a whole but not in the current account. Massad concludes tartly, "floating is no substitute for responsible domestic policies".[5]

Reasonable rates of liquidity creation and greater co-ordination of domestic policies among the industrial countries would dampen fluctuations in exchange rates and facilitate the adjustment process instead of exacerbating and extending the inflationary process. However, such policy co-ordination is difficult to achieve.

Under the current scheme, reserve currency countries do not have incentives to adjust whereas non-reserve currency countries have IMF incentives to do so. Massad proposes that reserve currency countries should undertake to settle their international obligations through asset settlement. In this way, they would have to pay international obligations through the transfer of assets rather than by increasing their liabilities abroad. As these assets are run down, incentives to undertake adjustment policies would come into play.

Secondly, an SDR substitution account could be created in the IMF in which industrial countries would make reserve currency deposits in exchange for SDRs as a means of short-term debt consolidation on the part of monetary authorities in issuing countries. The SDRs that would result from this exchange could be used for long-term lending to developing countries, thus making this account a "substitution link".[6]

Thirdly, a debt refinancing facility could be established as a joint enterprise of the World Bank and the IMF. This would be available to developing countries on a voluntary basis and operate in a manner similar to the IMF Oil Facility.

These proposals would help facilitate the international adjustment process and the workings of the international monetary system, and in so doing, they might ease protectionist pressures in industrial countries, thereby making it possible for developing countries to incur additional indebtedness in order to aid their development. The goal of Latin America is not to achieve equilibrium in its current accounts but to finance the deficits on current account through surpluses in the capital account by increased foreign borrowing. Hence, Latin American debt must continue to grow, and for it to grow there must be adequate international liquidity and sufficient international finance on a longer-term basis. Without these, trade growth will decline, lowering world economic growth rates as a result.

Hence, the world economy finds itself at this moment in a closed circle with no exit. Debt, trade, the monetary system and development are all inextricably linked to each other, and since every element in the system is under extreme pressure, they interact to form the present crisis in the world economy, in which

[4] Malan, *op. cit.*

[5] Carlos Massad, "Latin America and the International Monetary System: Some Comments and Suggestions", *herein.*

[6] Massad, *op. cit.*

Latin America now has such an important stake. All this heightens Latin America's fundamental concern over the fate of the world economy, the recovery of the industrial countries, and the international dimensions of its own problems.

III

The New International Economic Order

While increased growth in the industrial countries and more dynamism in the existing international economic system have now gained a new urgency and immediacy for the developing countries, there is also a need to reform the world economic system in ways specifically designed to improve living standards in the Third World.

Much effort has been expended in recent years in formulating and trying to implement proposals for international economic reform which would lessen the gap between rich and poor nations. The demand for a New International Economic Order (NIEO) in which developing countries would benefit more equitably from the workings of the world economy led to discussions in various forums on specific proposals. At the beginning, the NIEO proposals and the North-South dialogue it generated held out great promise for a more equitable world order, and progress has indeed been made in several areas, while the dialogue itself has provided a means of exploring the feasibility of a variety of options.

Nevertheless, as one prominent Latin American stated at the outset of the present Conference. "The world has been losing faith and enthusiasm for the New International Economic Order". He went on to say that at the Manila meeting of UNCTAD earlier this year, there was "stagnation in the course of negotiations, confrontation in rhetoric, fatigue, and a sense of indifference and irrelevance in the work", all of which seemed to him "very serious in relation to the crisis the world is facing to accommodate expectations and build a new world order for humanity".

An important focus of this Conference has been on the specific proposals of the NIEO, to better understand where the North-South dialogue stands. Thus, William Cline examined each of the major NIEO reforms to assess their potential impact on the world distribution of income.[7] This provided an overall assessment of the NIEO based on an evaluation of the specific elements.

Cline calculated the impact on the share of world income received by the world's poorest countries that would be caused by a quadrupling of prices for a dozen LDC commodity exports. The results showed only minor changes in the world distribution of income, partly because world trade in commodities is only a small proportion of world income and partly because the production of commodities is spread among both rich and poor countries, so that the benefits of price increases did not accrue solely to the latter. Similarly, although commodity stabilization is important for other reasons, it is not expected to have a major effect on the world distribution of income.

Increased concessional assistance would be the most direct and significant form of redistribution, but the likelihood of the OECD countries approaching the United Nations target of 0.7% of GNP is very small. Debt relief and an SDR link would be equally direct, though they would result in smaller real transfers of resources than reaching the 0.7% GNP target. Again, however, the political feasibility of putting through these reforms is low. Similarly, Cline found that while there would be benefits to LDCs, no major redistribution of world income would result from the recently

[7] William R. Cline, "International Economic Reform and Income Distribution", *herein*.

completed Tokyo Round of trade negotiations and from technology transfer schemes.

He concluded, "it is clear that the programme of NIEO reforms cannot be expected to make a major impact in equalizing the world distribution of income... Accelerated development within the LDCs holds much more potential for world equity than does a programme of redistribution through NIEO reforms. For the world's poorest 40%, an acceleration of 1% per annum in LDC growth rates would give the same result after one decade as if the entire agenda of politically difficult NIEO reforms were implemented... In this context, the question of whether the industrial countries can break out of their stagflation impasse and resume high growth rates will probably have a much more profound influence on the prospects for the poor in LDCs than will the specific, outcome of the NIEO negotiations".[8]

These analytical results are particularly useful when comparing different NIEO proposals with one another. However, the criterion of reducing the income gap between rich nations and poor is not as significant as that of reducing poverty within developing countries. The NIEO reforms are important in supporting efforts to reduce poverty, though the domestic economic policies of LDCs are the primary determinants. Furthermore, action on the NIEO reforms also has important effects on the international economic climate and on the perceived sense of fairness of the international system that go beyond the quantitative magnitudes involved. The indirect effects of marginal improvements in trade and financial conditions should not be belittled. A good example of an NIEO reform which has these several beneficial effects is the Common Fund.

A. *The common fund*

As a result of the decisions taken on several issues at the March 1979 UNCTAD meeting, the Common Fund will become a reality, with US$ 400 million being generated for "first window" buffer stock operations and US$ 370 million being put up for the "second window" supply expansion and diversification investments, both with the objective of stabilizing commodity prices.

In order to ascertain gross producer gains from participation in UNCTAD Commodity Programmes for six commodities (coffee, sugar, copper, cotton, cocoa, and tin),[9] Jere Behrman calculated the benefits to Latin America over a 13-year period (1963 to 1975). He found that the gains over this period for Latin America could have been about 16% of an average year's export value. This is not only significant as regards the foreign exchange constraint on the region's economic growth, but is also of importance in stabilizing its demand for exports from industrial countries.

Hence, there would be sufficient gains to both Latin America and to industrial countries to justify the costs of participating in the agreements under the Common Fund. But commodity agreements are not a panacea for the region's problems. They must be seen rather as just one programme among the myriad of elements in the international system, valuable though they are in benefitting Latin America and the developing world as a whole while making a general contribution to stability in the world economy. There may be some disappointment in the size and scope of the Common Fund agreement as compared to the initial discussions, but this should be weighed against the fact that agreement has been reached after long and difficult negotiations. The Common Fund is the result of international co-operation, which must always contain elements of compromise if agreement is to be reached. The institutional machinery needed to administer the Common Fund could be more responsive to developing country problems, and this could provide an additional benefit. All in all, this Fund is an important step by the international community to relate trade and development together.

There is a need to ensure that investment in the expansion of the supply of commodities,

[8]Cline, *op. cit.*

[9]Jere R. Behrman, "A New Latin America in a Changing World Economy: Exports of Non-Fuel Primary Products", *herein.*

which may take place largely in an unplanned fashion through the private sector, does not clash with efforts at price stabilization under the Common Fund. Thus, there may be a need to monitor supply and to foster more investment where it is needed. The concern over the political risk in large foreign investments needs to be taken into account as well.

Basically, the Common Fund should work along with other programmes with similar objectives, such as the Compensatory Financing Facility of the IMF, rather than serve as a substitute for them or be displaced by them. The US$ 400 million initial assessment, while small in relation to the total problem, is the first rather than the last tranche, and can hence be increased with time.

B. *Technology*

Another area in North-South relations which has been characterized by both progress and limitations has been that of the international regulation of the transfer of technology. Technology is one of the few components of international trade that is not regulated by any multilateral agreement, and yet technological know-how is decisive in determining market shares and growth rates in the world economy today.

Progress has been made over the last decade in gaining a consensus as regards the conceptual understanding of the key role played by technology in development, the complexity of the transfer process, and the importance of the capacity within the developing countries to successfully utilize technology.[10] Nevertheless, it has not been possible to reach agreement on a Code of Conduct for the Transfer of Technology. Disagreement over the legal character of the proposed Code, its implementation machinery, and the practices of technological transfer to be reformed still remain to be resolved.

Despite this, progress has been made in the last ten years in understanding the nature of science and technology issues and the process of technological transfer. Whereas it used to be assumed that science and technology, once in existence, would be automatically absorbed into the economic structure, it is now well understood that deliberate efforts have to be made to assure that gains in productivity are drawn from scientific and technological advance.

The most important objective is to generate the autonomous capacity within Latin American nations to manage technology.[11] This requires not only national competence in science and technology but also a broader understanding in the academic community of the overall process of relating science and technology to national development. There has to be a clear perception of national needs and national interests, and all this must be more closely integrated into action in the political realm in the form of development policy. Furthermore, there is a need to generate domestic demand for locally supplied appropriate technology.

The generation of national capacity to deal with science and technology becomes all the more important against a background in which technological gaps within a country may be as large as or larger than technological gaps between countries. It would be exaggerating the potential benefits of the international transfer of technology to claim that such transfers can solve Latin America's development problems. Nevertheless, progress in the transfer of technology, whether in the form of case-by-case arrangements affecting specific countries or in the form of a Code of Conduct for the world as a whole, represents a forward step that the international community should support.

[10]Miguel S. Wionczek, "The Major Unresolved Issues in the Negotiations on the UNCTAD Code of Conduct for the Transfer of Technology", *herein*.

[11]Jorge A. Sábato, "Technical Development in Latin America and the Caribbean", *herein*.

IV

Latin America in the international institutional order

From the foregoing discussion, it seems clear that Latin America has a vital stake in the world economy and in the international institutional system at a variety of levels, and that the international order at these various levels would benefit from an active Latin American role.

Latin America's vital stake in the overall evolution of the world economy in the short term —recovery in the industrialized countries, higher growth in world trade, an orderly evolution of the financial system to accommodate increased debt, a global approach to energy problems— points up the need for a global mechanism to co-ordinate trade, finance and development. The "globality" of the problems and issues themselves and their linkage to one another call for an international forum where these problems can be discussed and dealt with in a more integral fashion. The developing countries are sufficiently involved in these issues to make their inclusion in such a mechanism essential.

While there have been forces at work which have tended to make Latin America's interest somewhat *sui generis* within the developing world, this region has an interest in working within the Group of 77 to retain coherence within the South and in supporting further progress on the North-South dialogue. Latin America has a leadership role to play within the South, and the fact that the North-South discussions and the institutional system that sustains them have come to a stalemate calls for greater efforts to rally the increasingly differentiated South together around a set of common international interests. As Enrique Iglesias put it in his concluding remarks, "the New International Economic Order is not just an aggregation of individual interests but something more". Latin America has a stake in the progress of the international community and in asserting its identity of interest with the rest of the developing world. There is a mutuality of interests within the South that is at least as great as that between North and South. On the other hand, Latin America needs to give greater attention to a strategy for the region within the Group of 77. The South has suffered from lack of organization and strategy in international discussions. Hence, there is a need for more intensive South-South discussions in coming years to clarify common interests and generate coherent strategies.

To play a stronger leadership role within the South, Latin America will have to avoid a crisis of identity as the region becomes more differentiated, ranging from mini-States on the one hand to newly industrializing countries on the other. It is important to Latin America's world role to retain unity and identity in the region, and special efforts will be required to integrate the smaller economies of the Caribbean into the regional economy and discussions.

There are dangers that rich and poor countries will give too much attention to pressing short-run problems and lose a longer-run perspective. The North is preoccupied with the problem of stagflation, while the South is worried about the immediate balance-of-payments outlook, yet there are deeper problems of structure which may be overlooked and hamper the resolution of the short-run problems themselves. Access to markets and the adequate availability and terms of international finance are critical to world economic recovery and to external equilibrium. Latin America's concern for long-run investment and development will have to be asserted in international discussions in order to ensure that sufficient priority is given to this issue.

In addition, there is a tendency in the North to assume that recovery in the industrial countries and reforms in the world economic system that will stimulate such recovery will automatically redound to the benefit of the Third World, so that these results alone will be sufficient. On the other hand, there is a tendency in the South to think that the North should reform the structure of the world economy so that it will benefit the South. Both perspectives are limited by the bounds of self-interest, and neither formulation is sufficient. The North-South dialogue is necessary as a means of seeking global reforms which give global benefits, and adequate institutional machinery is needed in order to stimulate discussions and negotiations so that the common interests of the world community can be perceived and enhanced.

There will be a continuing need to emphasize the efforts required to reduce poverty within the Third World. World recovery creates conditions conducive to the improvement of the living standards of the world's poor, but without specific action directed at reducing poverty at both the national and international levels, poverty will worsen. Proposals that might improve the distribution of income between nations will not necessarily improve the distribution of income within poor countries. There is a tendency for the North to feel that support for development should be conditioned upon internal distribution measures within the South and a tendency in the South to see the North as having an obligation to provide assistance. Neither view is sufficient to articulate the stakes both have in the global community and the responsibilities of each within it. In global discussions, Latin America will have to be particularly assertive in emphasizing concern for the poor within the region, since the world's poorest people are more often perceived as being in Africa and Asia.

Finally, the political problems of bringing divergent perspectives and diverse nations together to discuss and decide on international measures to improve the world economic system are exacerbated by the institutional obsolescence which hinders international dialogue. The institutional machinery is not responding sufficiently to global needs. There is frustration and fatigue, and it seems that reform of the international institutional system must be an integral part of future efforts to achieve reform in the international economic order.

Hence, the 1980s pose a myriad of simultaneous challenges for Latin America and the world at large. A renewed international effort will be required globally, within the South and within Latin America, if the current crisis in the world economy and the prevailing stalemate in the international institutional order are to be overcome and if progress is to be made in long-run development and the improvement of the human condition.

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CEPAL REVIEW
April of 1980

The monetary and real effects of the financial opening up of national economies to the exterior

The case of Chile 1975-1978*

*Roberto Zahler***

The object of this article is to describe and analyse certain aspects of Chilean short-term macroeconomic policy which have not been sufficiently investigated, placing special emphasis on the financial measures applied from the end of 1973, and more specifically from the first quarter of 1975, when the so-called Economic Recovery Programme began.

The introduction to this paper is followed by a description of the initial situation with which the new macroeconomic policy had to deal. The second part analyses the problems facing the stabilization programme, as well as its characteristics and its achievements, recognizing from the outset that price stabilization was the priority objective of short-term macroeconomic policy in the period under study. In particular, a discussion is made of the links between the stabilization policy, on the one hand, and the external opening up, the evolution of demand for money, and movements in the exchange rate and in the interest rate, on the other.

The third part analyses the implications of an external opening up occurring at a different rate and in a different manner in the real sector as compared with the financial sector of the economy, and studies the relations between exchange, monetary and credit policies in a process of this type, as well as some of the effects it had on investment, employment, resource allocation and the process of concentration of wealth. Finally, the fourth part offers a summary of this study and its main conclusions, perhaps the most important and controversial of which is that the macroeconomic policy applied was not neutral *vis-à-vis* the sectors and groups which had to bear the cost of the stabilization policy and the redistributive effects arising from the way in which the external financial opening up was brought into effect.

*An earlier version of this paper (E/CEPAL/PROY.4/R.1) was presented at the Sixteenth Meeting of Technicians of Central Banks of the American Continent, which was held in San José, Costa Rica, from 25 to 30 November 1979.

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Introduction*

Several countries in the Southern Cone of Latin America have in recent years experienced fairly similar economic and social circumstances, involving political and institutional breaks with the past of varying degrees of abruptness, partly as a result of a very complex economic situation marked by inadequate economic growth, a high rate of inflation, balance-of-payments difficulties, extensive price controls, the existence of large black markets and a drop in output.

In each case the new authorities attributed this situation to the development strategy based on industrialization through import substitution, and to the effect of the numerous 'distortions' which affected the price system.

In these circumstances, in the light of this interpretation and in the context of a new political order, economic policies seeking 'normalization' were introduced with the aim of laying the foundations of a different style of development, guided by a strategy very different from that followed over the past thirty years.

The new strategy emphasizes opening up to the exterior, the free functioning of markets and the stimulation of private initiative; it assigns a 'subsidiary' role to the State, and places emphasis on reducing the government deficit and public expenditure, controlling the means of payment, and ensuring price stability.

The principal features of the short-term economic policy have been an endeavour to reduce the existing macroeconomic imbalances and the allocation of priority —in view of the initial situation— to control inflation and improvement of the balance of payments, as well as external creditworthiness.

The above describes more or less what happened in Argentina, starting in March 1976, in Chile, starting in September 1973 and in Uruguay, starting in September 1974.

*The author wishes to express appreciation for the comments made by Félix Bacigalupo, Tomás Baliño, Andrés Bianchi, Robert Devlin, Gunther Held, Ricardo Ffrench-Davis, Carlos Massad and Andrés Sanfuentes, as well as those made at an internal CEPAL seminar. Thanks are also due for assistance provided by Eugenio Alviz and Tatjana Montes. Responsibility for any errors which still remain is of course my own.

However, there were also some substantial differences, arising partly from the initial situation from which the experiments evolved, and from certain structural characteristics specific to each of these countries. Particular mention may be made in this respect of political and institutional features; those related to the type of export market; the degree to which productive activity was in private or State hands; the speed and completeness with which the economies were opened up to external forces (as regards both real and financial aspects); the predominance of certain economic policy objectives over others (for example, full employment versus price stability); and the approach used and degree of independence and consistency achieved by the technical teams in handling economic affairs.

To a degree, this study falls within a context established by two relatively new global phenomena, one in the international economic field and the other in the application of economic policies by some developing countries.

On the one hand there is the growth in international liquidity and the increasing importance of the international private banks in the recent period, as a result of which private financial credits have been growing in importance in comparison with official external financing, and are beginning to replace direct foreign investment as the main mechanism whereby capital is exchanged between the industrialized countries and the countries at an intermediate stage of development. The emergence of these new characteristics on the international financial scene makes it necessary to highlight, in relation to the past, the specifically economic determinants of supply and demand for external financial resources.

From the viewpoint of the development strategy and economic policy applied by various Latin American countries, especially in the Southern Cone, there is a definite tendency towards external economic opening up. As far as the opening up of trade is concerned, this has attracted a good deal of attention in professional and academic circles. However, there is a lack of studies on the external *financial* opening up proper, and also on its implications for the efficiency of monetary and credit policies and its repercussions on the evolution of domestic prices, the external debt, employment, investment and redistribution of wealth arising from differences in timing or in speed between commercial opening up and financial opening up.

In view of the fact that these events are very recent, that information is relatively scarce and that a comparative analysis of the three cases goes beyond the planned scope of the present study, and also because of the author's greater knowledge of the Chilean case, Chile has been selected as the subject of this study.

I

The initial situation

Between 1971 and 1973 an attempt was made to modify profoundly the distribution of income and wealth in the country. In the long term this implied an alteration of the structure of production, of the mode of operation of the economy and, more broadly, of the type of relations predominating in Chilean society up to that time. As far as economic aspects were concerned, this involved an intensification of the process of agrarian reform and the establishment of an area of social ownership in the spheres of production, finance and marketing.

The economic programme drawn up at that time did not pay due attention to the management of financial variables, but concentrated on an attemp to control the concrete aspects of the process of production and distribution. Because of this, the short-term macroeconomic policy produced such results, at least in some respects, that towards the end of 1973 Chile was facing an economic situation characterized by numerous severe imbalances, both in the fiscal and monetary sectors and in the balance of payments.

The creation of the area of social ownership and the prices policy applied in it, together with the increasing gap between government expenditure and tax revenues, led to a marked increase in the fiscal deficit. While in the decade 1960-1969 the deficit represented on average 14.6% of expenditure in the sector and 3.3% of gross domestic product expenditure, the corresponding values in the period 1970-1973 were 35.5% and 12.5%. In 1973, the fiscal deficit was equivalent to 55.1% of fiscal expenditure and 23.6% of gross domestic product expenditure (see table 1). In real terms the fiscal deficit in 1973 was seven times as large as in the decade 1960-1969, while fiscal expenditure as a proportion of gross domestic product expenditure stood at double its recent historical share.

Table 1

CHILE: FISCAL DEFICIT, 1960-1978
(Per cent)

As a proportion of	1960-1969	1970-1973	1973	1974	1975	1976	1977	1978
Fiscal expenditure	14.6	35.5	35.1	32.6	11.6	10.0	8.1	4.2
Gross domestic product expenditure	3.3	12.5	23.6	10.3	3.1	2.7	2.3	1.2

Source: Ministry of Finance, Budget Department, *Exposición sobre el estado de la hacienda pública*, Santiago, Chile, January 1979.

Developments in the monetary sector also showed signs of severe imbalances. Whereas in 1960-1969 the average growth rate of private money (M_1) was 37% a year, this figure rose fivefold in 1970-1973, and in 1973 growth in M_1 was 419%. There is no doubt that, in the face of this growth rate in the means of payment, 'monetary' causes were important in explaining the inflationary process which the country was experiencing; inflation reached levels unprecedent in the economic history of Chile. In the period 1970-1973, annual average growth in the Consumer Price Index was 117%,[1] and it reached a rate equivalent to 355% in September 1973, revealing a very serious state of affairs not only because of the very high rates of inflation, but also because inflation did not appear to be under control. In the period 1960-1969, in contrast, the average annual rate of inflation was 25% (see table 2).

Table 2

CHILE: MONEY AND PRICES, 1966-1973
(Percentage change)[a]

	Inflation[b]	Currency issue[c]	Money[d]
1966-1970	26	48	41
1971	41	133	113
1972	205	174	152
1973	599	462	363

Sources: Central Bank, *Boletín mensual*, various issues, and "Series Monetarias", July 1979. University of Chile, Department of Economics, "Indice de Precios al Consumidor", 1970-1976.

[a]December to December.
[b]Consumer Price Index: 1966-1970 — National Statistical Institute (INE), 1971-1973 — University of Chile, Department of Economics.
[c]Adjusted issue (figures of the Central Bank Of Chile).*
[d]Private sector money (figures of the Central Bank of Chile).
*This is the recorded issue by the private and banking sector, adjusted for various non-monetary items in the Central Bank Balance. See University of Chile, Department of Economics, *Estadísticas monetarias de Chile 1940-1975*, Publication No. 70, Santiago, June 1979, pp. 37-42.

[1]Calculated on the basis of the Price Index prepared by the Department of Economics of the University of Chile.

The country's external position, the level of international reserves and capacity to secure external loans had also sharply worsened.[2] As can be seen from table 3, both the trade balance and the current account balance deteriorated in 1970-1973 compared with the average for the 1960s. By the end of 1973 the level of net international reserves was negative to the extent of US$ 231 million, compared with a positive balance of US$ 409 million in December 1970.

Of course, the situation described above was at least partly due to, and was aggravated by, the mode of operation of the foreign exchange, financial and monetary markets, and even the market for real goods and services.

The functioning of the foreign exchange market was characterized by the existence of multiple undervalued exchange rates, prior import deposits, para-tariff restrictions, import bans and other quantitative limitations.

The financial sector, for its part, operated with interest rates held at excessively low levels, high and differential reserve ratios,

[2]It would seem necessary to make a distinction between the actual and potential difficulty of *obtaining* external loans and the ability to disburse them. In fact, as the figures indicate, external financing was *used* fairly easily.

Table 3

CHILE: BALANCE OF PAYMENTS

	1960-1969	1970-1973	1973	1974	1975	1976	1977	1978
	(millions of US dollars)							
Exports of goods	704	1 056	1 304	2 146	1 554	2 109	2 177	2 480
Imports of goods	686	1 170	1 447	2 016	1 708	1 655	2 244	2 917
Trade balance[a]	18	−114	−143	130	−154	454	−67	−437
Current account balance	−135	−236	−288	−211	−491	148	−399	−730
Balance of non-compensatory capital	148	203	242	228	299	235	346	1 351
Balance of payments	25	−132	−112	−45	−275	455	−7	671
Net international reserves (average for the period on the basis of end-of-year figures)	−15	42	−231	−277	−551	−96	−103	515
	(percentage of gross domestic product expenditure)							
Exports of goods	18.2	17.4	19.2	25.6	19.5	24.3	21.8	21.7
Exports of goods (excluding copper) and services	7.8	6.5	5.5	8.0	11.5	13.4	15.0	16.2
Imports of goods	17.7	19.3	21.4	24.0	21.4	19.1	22.4	25.5
Trade balance[a]	0.5	−1.9	−2.1	1.6	−1.9	5.2	−0.7	−3.8
Current account balance	−3.5	−3.9	−4.2	−2.5	−6.2	1.7	−4.0	−6.4
Balance of non-compensatory capital	3.8	3.3	3.6	2.7	3.7	2.7	3.6	11.8
Balance of payments	0.6	−2.2	−1.7	−0.5	−3.4	5.2	−0.1	5.9
Net international reserves (average for the period on the basis of end-of-year figures)	−0.4	0.7	−3.4	−3.3	−6.9	−1.1	−1.0	4.5

Sources: Central Bank of Chile, *Boletín mensual*, December 1976 and May 1979. Ministry of Finance, Budget Department, *Exposición sobre el estado de la hacienda pública*, January 1979.

[a]Defined as exports of goods less imports of goods.

qualitative and selective control of bank credit, and so on. Moreover, the Central Bank offered no resistance to the demands of the government sector and State-owned enterprises, and thus helped to accentuate inflationary pressures.

To this should be added the profusion of price controls in the market for real goods and services, with the resulting effects on the allocation of resources and the general efficiency of the economic system, and on the emergence of parallel (black) markets.

Although the unemployment rate stood below its historical levels (to a large extent because of the rise in employment in the public sector and the area of public ownership), the share of gross domestic fixed capital investment in the gross domestic product expenditure in the period 1971-1973 was 20% lower than in the 1960s. Furthermore, after a growth of 7.7% in gross domestic product expenditure in 1971, it fell to 0.1% in 1972 and 3.6% in 1973.

In view of the circumstances described above, the new authorities set themselves the short-term aim of re-establishing macroeconomic equilibrium, particularly in the financial field.

As a longer-term strategy, the new régime has endeavoured to build up an economy based on the use of the free price system as a mechanism for resource allocation,[3] the progressive reduction of the State's role in the economy and the attribution of a 'subsidiary' role to the State, which must act in such a way as to cause the least possible distortion in the operation of the markets.

Repeated stress has been laid on the need to control inflation and to open up the economy to the exterior. Measures to combat inflation have principally been justified on the grounds of their impact on the transparency and stability of the price system, and accordingly on the allocation of resources. The need to open up the economy has been explained in terms of the size of the international market and the effect of such a step on the competitiveness and efficiency of the Chilean economy.

Consequently, the policies which most merit analysis here —though they were not necessarily applied at the same time, despite the fact that their introduction became fairly systematic[4] from the beginning of 1975 onwards— were the following:

(a) Efforts to control the inflation process by reducing the growth rate of the means of payment and currency issue;

(b) Reduction in the size of the State apparatus, government expenditure and the fiscal deficit, and transfer by the State to the private sector of all those activities (including, of course, productive activities) which the authorities felt that the private sector could carry out efficiently;

(c) Opening up the country to the exterior, especially as regards trade in goods and non-financial services, by simplifying and reducing rules applying to external trade, progressively lowering and standardizing tariffs and, where possible, eliminating all allocation criterion other than the price of foreign exchange;

(d) Unification and forward planning of the nominal exchange rate on the basis of two criteria: the differential between the Chilean and the United States inflation rates, and the evolution of the international reserves of the monetary system;

(e) Liberalization and development of the domestic financial sector, with the criteria of profitability of assets and liabilities of the financial system, and competition between its institutions and intermediaries, becoming the guides for decision-making and action by economic agents. Interest rates would be allowed to move freely, and legal reserve requirements would be reduced and standardized in accordance with general economic policy;

[3]The most notable exceptions have been the labour and foreign exchange markets, where prices have been determined by mechanisms other than the free play of the market. Furthermore, the prices of a small number of goods have been controlled, though apparently at levels very close to those prevailing in the market.

[4]It is not intended to assert that the economic policy has been applied in a manner displaying external and internal coherence and consistency. Nevertheless, despite various changes in emphasis and of priorities both as regards objectives and the means used (for example, inflation and external equilibrium, exchange rate policy, and so on), a basic long-term philosophy has predominated and has generally set the framework for the design of economic policy.

(f) A partial opening up to movements of international capital, principally controlled through the establishment of minimum repayment periods and restrictions on the capacity of the national banking system to borrow and to issue guarantees.

II

The counter-inflation strategy within the macroeconomic policy

The counter-inflation strategy was principally based on the effort to control the rate of growth of the monetary base and money (defined as M_1). This approach was based on the view of the new economic authorities that the magnitude of the Chilean inflationary process by the end of 1973 stemmed from monetary causes which could fundamentally be attributed to the deficit incurred by the public sector and the enterprises in the area of social ownership.

This prompted a sharp restriction of credit from the monetary system to the government sector, which in 1975-1978 became responsible (as regards its budgetary situation in current terms) for a 'disissue' of currency, absorbing in that period 15% of the total issue of the Central Bank (see table 4).

This is consistent with the official medium-term and long-term views on the size and self-financing of the State sector and the need for a sharp reduction in the fiscal sector deficit (see table 1). In these circumstances, the public sector cut back its deficit by reducing expenditure,[5] increasing tax revenues,[6] raising the tariffs of public enterprises and services and, though to a lesser extent, seeking to finance deficits by borrowing domestically from the private sector.

Another important source of finance for the State was the sale of some of its assets; by December 1978 the Corporación de Fomento de la Producción had obtained the equivalent of US$ 585 million in this way. Naturally, this source of income tends to vanish when the process of selling State assets has been completed.

Table 4

CHILE: VARIATIONS IN ADJUSTED CURRENCY ISSUE, 1974-1978

	Adjusted issue	Exchange operations[a]	Domestic credit	Treasury and bond operations
		Absolute values (millions of pesos)		
1974	692	−41	−14	746
1975	3 138	2 336	997	−193
1976	11 027	9 536	3 285	−1 794
1977	14 318	7 453	7 025	−160
1978	16 578	16 747	4 223	−4 392
		Percentage breakdown		
1974	100.0	−6.0	−2.1	107.8
1975	100.0	74.4	31.8	−6.2
1976	100.0	86.5	29.8	−16.3
1977	100.0	52.1	49.1	−1.2
1978	100.0	101.1	25.5	−26.5

Sources: Central Bank of Chile, *Series monetarias*, July 1979; University of Chile, Department of Economics, *Estadísticas monetarias de Chile, 1940-1975.*

[a]Including operations with the private sector and with the Treasury.

Nevertheless, it should be noted that despite the appreciable effort of the public sector to accommodate itself to the requirements of the new economic policy, growth in the monetary base up to the end of 1977 remained extra-

[5]This was accompanied by changes in the breakdown of the expenditure.

[6]Principally through the introduction of a value added tax and strict measures against tax evasion.

ordinarily high for what was termed a 'monetarist' stabilization strategy. Only in 1977 did annual growth in the monetary base fall below the levels recorded in 1971-1973, and even then it remained excessively high, both in absolute terms and in comparison with the periods prior to 1970 (see table 5).

Table 5

CHILE: MONEY AND PRICES, 1966-1978

	Adjusted issue (Percentage change from December to December)	Private sector money	Consumer price index	Velocity of circulation[a] (number of times per year)
1966	60.3	38.9	17.0	12
1967	21.1	25.1	21.9	12
1968	46.0	38.3	27.9	13
1969	41.8	35.2	29.3	13
1970	70.3	66.2	34.9	12
1971	132.7	113.4	41.0[b]	8
1972	173.7	151.8	205.0[b]	8
1973	461.6	363.0	599.0[b]	10
1974	222.5	231.2	375.9	20
1975	312.9	257.2	340.7	24
1976	266.3	189.3	174.3	25
1977	94.4	113.5	63.5	20
1978	56.2	65.0	30.3	17

Sources: Central Bank of Chile, *Series Monetarias, op. cit.; Exposición sobre el estado de la hacienda pública, op. cit.;* INE and Department of Economics, University of Chile.

[a]Defined as the gross domestic product expenditure divided by M_1. These figures correspond to observed values, which are not necessarily the equilibrium values.

[b]*Source:* Department of Economics, University of Chile. For the remainder of the period, the source is INE.

Moreover, in spite of the efforts of the monetary authorities to control the means of payment, it took about five years[7] to reduce inflation to levels close to, though higher than, historical levels.[8]

In terms of the analytical framework in which the economic policy operated, this would seem to be due principally to the relative lack of sound instruments for monetary control,[9] above all because of the embryonic nature of the long-term capital market, which prevented proper open-market operations. This was aggravated by the evolution of the velocity of circulation of money,[10] basically as a result of the creation of very good substitutes for money and the persistence, for a considerable period of time, of high inflationary expectations.[11]

1. *The counter-inflation policy and opening up to the exterior*

Since the difficulty in controlling currency issue lay principally in the exceptional inflow of foreign currency, which accounted for 80% of the cumulative change in the money base between 1975 and 1978, it would appear essential to analyse more thoroughly the repercussions of this change on a group of variables of key importance for the operation, balance and vigour of the economy.

In the first place, it is worth recalling the well known fact that, if the exchange rate is fixed (in the sense that the Central Bank undertakes to buy and sell foreign exchange at a given, though not necessarily constant, price), then as an economy is opened up to external forces (either through the current account, the capital account, or both), domestic issue and money become increasingly endogenous[12] *vis-à-vis* the functioning of the economy. In this

[7]This happened at the end of 1978, though in 1979 inflation revived.

[8]Nevertheless, it should be remembered that international inflation in the last five years has been much greater than that of the 1960s, so that in that regard the greater control recently observed over the pace of Chilean inflation is significant.

[9]A phenomenon which occurs more clearly the more open the economy is to external forces.

[10]This refers to money as defined traditionally (M_1), the growth rate of which was, for most of the period under consideration, regarded as an indicator and guide of monetary policy.

[11]Furthermore, the fact that the economy had been 'indexed', as well as other elements associated with cost pressures, helped to prevent the inflation rate from falling more rapidly.

[12]In the sense that they cannot be controlled by the monetary authority and that in contrast, demand for the means of payment (which depends on the behaviour of individuals, enterprises and banks both at home and abroad) "creates its own supply", basically through movements in the current and capital accounts of the balance of payments.

way the efforts of the authorities to control the nominal supply of money tend to be fruitless, and their field of action is limited to domestic credit.

As is well known, the Chilean production sector was subjected in a rapid and escalating manner to external competition, as a result of the progressive reductions in tariffs (see table 6)[13] and the introduction of a single real exchange rate which, despite these reductions, did not rise appreciably (see table 7).

Table 6

CHILE: NOMINAL TARIFFS, 1973-1979
(Percentage of CIF values)

Date of adjustment		Average tariff	Maximum tariff[a]
1973:	at 31 December	94	Over 500
1974:	1 March	90	200
	27 March	80	160
	5 June	67	140
1975:	16 January	52	120
	13 August	44	90
1976:	9 February	38	70
	7 June	33	60
	22 December	27	60
1977:	8 January	24	50
	30 April	22	50
	29 August	20	35
	December	16	25
1978:	March	15	20
	June	14	20
	December	12	15
1979:	June	10	10

Source: Central Bank of Chile.
[a]There are a small number of exceptions to the maximum tariffs, the most important of which relates to motor cars.

Although protection for some sectors which were previously subject to negative effective protection was increased, the average tariff was lowered and standardized, and quantitative restrictions of all kinds were minimized almost to the point of elimination.

As a consequence of this opening up to foreign trade, attempts to control money supply tend, though not immediately, to be cancelled out by movements in the current account[14] or the capital account of the balance of payments. In other words, changes in the level of international reserves result from imbalances in the monetary sector.

The evolution of the capital account of the balance of payments, and in particular that of net inflows of foreign loans to the domestic private sector, especially since the end of 1977, have played a preponderant role in this regard.

Although the external financial liberalization took place more slowly than the liberalization of the real sector of the economy, it came to form the main mechanism through which liquidity in the economy was increased. Part III below contains a more thorough discussion of the special stimulus given to private borrowing abroad. Here we shall briefly analyse the important role played by such borrowing in slowing the decline in the growth of currency issue and thus causing the main burden of the stabilization programme to fall with excessive force on the public sector.

In order to understand the role played by international movements of capital, it is necessary to remember that during the first half of 1975, determination of the interest rate in the domestic financial system was left to market forces. At the same time, steps were taken to ensure a sharp reduction in the previous control —both quantitative and qualitative— on bank credit, by stimulating competition within the financial system.[15] However, because of the desire to control growth of the means of

[13]The lower tariff protection was partially offset by a rise in transport costs during the period.

[14]However, it should be mentioned that, according to the authorities, the commercial opening up had a twofold justification. As far as long-term development strategy was concerned, it would force domestic producers to face up to international competition, while in relation to the counter-inflation policy, although it would restrict the instruments for monetary control over domestic credit, it would, for a given exchange policy, impose a ceiling on the domestic prices of internationally tradable goods and services.

[15]This paper does not analyse the situation within the financial sector as regards the greater or lesser competitiveness, rules of the game, or equality of opportunity as between institutions and intermediaries, both domestic and foreign. In this regard see F. Berger, "La protección efectiva negativa a la industria monetaria y la política financiera externa de Chile", *Cuadernos de Economía*, No. 42 (August 1977), pp. 197-234.

Table 7

CHILE: EVOLUTION OF THE EXCHANGE RATE AND PRICES
Indexes (Average for 1974 = 100)

Period	(1) Index of the nominal exchange rate	(2) Index of wholesale prices of domestic products	(3) Index of wholesale prices in the United States	(4) [(1)(2)](3) Index of the real exchange rate[a]
1974 (average)	*100*	*100*	*100*	*100*
First quarter	52	46	92	104
Second quarter	77	73	96	101
Third quarter	108	115	103	97
Fourth quarter	167	169	106	105
1975 (average)	*595*	*590*	*108*	*109*
First quarter	280	261	106	114
Second quarter	490	452	107	116
Third quarter	700	697	109	109
Fourth quarter	907	946	111	106
1976 (average)	*1 580*	*1 920*	*114*	*94*
First quarter	1 212	1 224	112	111
Second quarter	1 517	1 720	113	100
Third quarter	1 640	2 266	115	83
Fourth quarter	1 950	2 474	116	91
1977 (average)	*2 607*	*3 514*	*121*	*90*
First quarter	2 230	2 900	118	91
Second quarter	2 353	3 392	121	84
Third quarter	2 695	3 744	121	87
Fourth quarter	3 128	4 020	122	95
1978 (average)	*3 828*	*5 097*	*130*	*98*
First quarter	3 520	4 352	126	102
Second quarter	3 778	4 868	130	101
Third quarter	3 953	5 358	131	97
Fourth quarter	4 060	5 810	134	94

Sources: Central Bank of Chile; National Institute of Statistics (INE).
[a]This column probably underestimates the actual real exchange rate, if one takes into account the diversification of Chilean foreign trade and the devaluation of the dollar against other industrial countries currencies. No calculations of the effective exchange rate are published in Chile.

payment, high reserve ratios on deposits were maintained for a substantial period, and this helped to create a marked difference between interest rates for borrowers and for lenders.

As may be seen from table 8, from the second quarter of 1975 onwards extremely high real interest rates for borrowers existed side by side with rates to depositors which, while positive (especially from the second half of 1976 onwards), were much lower than the lending rates. The principal explanation for this, as already noted, lies partly in the high reserve ratios and also in the cost of operations by intermediaries and the profits obtained by the financial system during the period under consideration.[16]

[16]Another variable which would explain the high spread between rates to borrowers and rates to lenders would seem to be inflation, as a result of the fact that, as depositors received a positive real rate, part of the inflation tax would be paid by by borrowers, by paying high interest rates on loans. See R. McKinnon, "La intermediación financiera y el control monetario en Chile", *Cuadernos de Economía*, No. 43 (December 1977), pp. 31-32.

Table 8

CHILE: REAL 30-DAY BANK INTEREST RATES ON PESO DEPOSITS[a]

(Percentages)

	1975			1976			1977			1978		
	Charged	Paid	Margin	Charged	Paid	Margin	Charged	Paid	Margin	Charged	Paid	Margin
January	−3.8	−4.0	0.2	3.7	−0.4	4.1	6.2	1.9	4.3	5.4	4.2	1.2
February	−5.9	−5.5	−0.4	3.9	0.1	3.8	5.4	1.0	4.4	3.6	2.2	1.4
March	−9.6	−8.0	−1.6	1.0	−3.2	4.2	3.8	0.1	3.7	1.5	0.1	1.4
April	−9.3	−6.8	−2.5	2.6	−1.3	3.9	3.9	0.9	3.0	1.8	0.7	1.1
May	2.6	−1.3	3.9	4.8	2.3	2.5	3.8	1.4	2.4	3.6	2.4	1.2
June	1.0	−3.3	4.3	1.6	−0.6	2.2	3.5	1.4	2.1	2.8	1.3	1.5
July	10.9	5.4	5.5	2.7	−0.9	3.6	2.4	0.6	1.8	1.9	0.7	1.2
August	9.4	3.7	5.7	6.0	2.6	3.4	2.8	1.0	1.8	1.8	1.0	0.8
September	8.7	0.3	8.4	3.7	0.3	3.4	2.4	1.0	1.4	2.1	1.3	0.8
October	3.3	−0.4	3.7	4.8	1.3	3.5	2.6	1.3	1.3	3.6	2.7	0.9
November	3.5	−0.2	3.7	8.4	4.6	3.8	5.2	3.8	1.4	4.0	2.9	1.1
December	6.9	2.7	4.2	7.7	3.8	3.9	4.2	2.9	1.3	4.0	3.1	0.9
Annual[b]	15.9	−17.8		64.2	10.8		57.2	18.7		42.6	25.0	

Source: Central Bank of Chile.

[a]Defined as $i_R = \dfrac{i_N - p}{1 + p}$, where i_N is the nominal monthly bank rate and p is the montly inflation rate as indicated by the change in the Consumer Price Index.

[b]Annual real rate, calculated by compounding the real monthly rate over the year.

Table 9

CHILE: 30-DAY BANK INTEREST RATES ON US DOLLAR DEPOSITS[a]
(Percentages)

	1975			1976			1977			1978		
	Charged	Paid	Margin	Charged	Paid	Margin	Charged	Paid	Margin	Charged	Paid	Margin
January	−6.88	−7.16	0.28	2.88	−1.16	4.04	6.61	2.28	4.33	4.42	3.19	1.23
February	−7.03	−6.35	−0.68	4.19	0.27	3.92	5.21	0.83	4.38	3.28	1.92	1.36
March	−11.60	−10.07	−1.53	7.58	3.26	4.32	14.54	10.48	4.06	1.82	0.43	1.39
April	−13.67	−11.31	−2.36	7.32	3.21	4.11	6.53	3.47	3.06	1.86	0.82	1.04
May	4.06	0.12	3.94	5.48	2.91	2.57	3.89	1.40	2.49	3.40	2.26	1.14
June	6.86	2.27	4.59	5.84	3.53	2.31	2.46	0.36	2.10	3.09	1.63	1.46
July	3.97	−1.18	5.15	18.17	13.96	4.21	2.70	0.85	1.85	2.91	1.71	1.20
August	9.47	3.86	5.61	6.19	2.68	3.51	1.41	−0.28	1.69	3.27	2.39	0.88
September	11.39	2.76	8.63	5.21	1.73	3.48	−2.29	−3.62	1.33	4.06	3.27	0.79
October	1.96	−1.68	3.64	5.61	2.12	3.49	3.23	1.97	1.26	4.67	3.76	0.91
November	2.37	−1.29	3.66	5.80	2.13	3.67	3.52	2.20	1.32	4.53	3.49	1.04
December	3.26	−0.80	4.06	7.22	3.33	3.89	−0.11	−1.33	1.22	4.74	3.85	0.89
Annual[b]	0.39	−27.90		118.53	44.36		58.38	19.57		51.10	32.73	

Source: Central Bank of Chile.

[a]Defined as $i_D = \frac{i_N - \dot{t}}{1 + \dot{t}}$, where i_N is the nominal monthly bank rate and $\dot{t}$ is the monthly percentage change in the nominal exchange rate.

[b]Annual rate, expressed in US dollars, calculated by compounding the monthly rate (expressed in US dollars) over the year.

Table 9 provides data on actual domestic interest rates[17] expressed in (nominal) dollars, in other words the pertinent rates which are comparable with international interest rates. Here it can be seen that, with the exception of 1975, when the rate of devaluation of the peso was almost identical to the nominal bank interest rate to borrowers, real rates in the remainder of the period were extraordinarily high.

The differential between the interest rates prevailing in Chile and those in the main international financial centres (which on various occasions have recorded negative rates in real dollars), together with the excess supply of international liquidity in the industrialized countries, the improvement in the international reserve position of the Chilean monetary system and Chile's creditworthiness, go a long way towards explaining the inflow of foreign exchange to the country during this period.[18]

Mention must also be made of the stimulus given to demand for external liabilities on the part of residents, because of the types of controls affecting international capital movements, which, for persons who had access to external finance, led to substantial monopolistic or quasi-monopolistic profits (see Part III).[19]

As may be seen from table 10, in the four years between 1975 and 1978 net flows of private capital made up 74% of exchange operations and 58% of the cumulative issue during that period.

It should be noted that, while the inflow of external credit, through its influence on the domestic capital market, helps to reduce the interest rate, this requires that there should be no simultaneous attempt to reduce the rate of increase in the means of payment. If mechanisms are applied to reduce the build-up of domestic credit, a situation arises where a substantial part of the effort made by the public sector is nullified by growth in money arising from the balance-of-payments situation.

It should be mentioned that repayment of the official external debt helped to create this situation, since an 'active' net inflow of foreign exchange was needed to make the payments, even though it is not possible to discount the use of international reserves, at least in part, for that purpose.[20] Nevertheless, the foreign exchange required did not have to be generated by the private sector. The Chilean public sector might also have helped to refinance the debt by means of new foreign borrowing, although this was not the option followed, so that the foreign exchange needed to service the external debt had to be obtained through the trade balance or the *private* capital account.

Table 10

CHILE: NET FLOW OF PRIVATE EXTERNAL CAPITAL AND CURRENCY ISSUE

	(1) Currency issue	(2) Exchange operations	(3) Net inflow[a] of private capital	(3):(2) (Percentage)	(3):(1) (Percentage)
	(Annual flows in millions of US$ dollars)				
1975	639	476	236	50	37
1976	844	731	254	35	30
1977	665	346	267	77	40
1978	523	529	783	148	150
1975-1978	2 671	2 082	1 540	74	58

Sources: Central Bank of Chile, ***Boletín mensual*** and ***Series monetarias***.

[a]Gross inflows less amortization and interest payments.

[17]As in table 8, these rates correspond to observed values (as distinct from expected values) of nominal interest rates, of the change in the level of prices and of the evolution in the nominal exchange rate.

[18]This assertion relates to the monetary impact of the inflow of external financial capital obtained by the domestic private sector.

[19]This should not be interpreted to mean that the supply of external credit is perfectly horizontal, at the same level, for all potential users of such finance, but rather that the imperfections which characterize this market were exacerbated by inadequate State controls.

[20]Naturally, the monetary 'impact' of payments on the foreign debt is not unconnected with the way in which the public sector generates the required resources. In particular, cases where the fiscal deficit is reduced should be distinguished from cases of government borrowing from the Central Bank.

To the above should be added the objective of increasing the country's international reserves (which, however, probably grew faster than was desired); this necessarily imposed a very active role on exchange operations within the scheme of monetary emissions, leading to delays in reducing the growth of the means of payment.

2. *The counter-inflation policy and demand for money*

One of the aspects of the economic policy which attracts most attention is the excessively passive attitude of the economic authorities both to managing demand for money and to influencing the community's inflationary expectations.[21] It is well known that the liquidity ratio is determined by the public in general, but the cost of keeping money can nevertheless be affected by the behaviour of the Central Bank. In this regard, the moment chosen to free interest rates,[22] which, in view of the prevailing circumstances, could be counted on to rise to extraordinarily high levels, does not appear to have been in keeping with the counter-inflation policy, both because of its implications for the velocity of circulation (see table 5) of already existing money[23] and because of the impact on demand for international finance.

There can be no doubt that the freeing of the interest rate, in an intensely inflationary context, together with a relatively slow devaluation, stimulated the economic agents to keep their financial assets (in the form of *quasi-money*) in pesos and their liabilities in dollars.[24] Naturally, these two phenomena were inconsistent with a counter-inflation strategy which involved an *attempt* to reduce the rate of growth in (nominal) money, especially as no decisive action was taken on the determinants of the (real) demand for money.

Accordingly, the timing of the sales of State assets and the freeing of the interest rate does not appear very appropriate in the light of the effort made as regards fiscal discipline, which, *inter alia*, contributed to a sharp drop in investment and an extraordinarily large increase in unemployment.

One interesting aspect was only tackled in part; this was the effort to increase demand for money by reducing the reserve requirement on bank deposits and/or by the payment by the Central Bank of adequate interest on the legal reserves maintained by the banking system.[25]

As is well known, the reserve requirement on deposits is equivalent, from the viewpoint of the banks, to a tax on the use of a 'factor of production'. Reducing the reserve requirement amounts to lowering the tax rate, while paying interest on the reserve, in the final analysis, reduces the magnitude of this tax.

Accordingly, by increasing the capacity for making loans or, alternatively, making it more profitable for banks to seek deposits, it may be hoped that measures such as those indicated will further stimulate competition among banks for deposits, which tend to become more attractive assets for individuals and enterprises, thus increasing the quantity

[21] The exceptions —perhaps somewhat belated— appear to have been two revaluations of the peso (July 1976 and March 1977), the establishment of a daily depreciation schedule for the peso starting in February 1978, and the endeavour to 'guide' interest rates in the capital market, which was of very brief duration.

[22] This coincided with a time of extremely high inflation, severe restrictions on public expenditure, and the sale to the private sector of an appreciable number of enterprises with large State shareholdings.

[23] This is due to the fact that the type of financial assets which were becoming most profitable, and which were not previously available to economic agents, did not include those that comprise money as traditionally defined, although this definition was used as a guide and indicator of the expansionary or restrictive nature of monetary policy.

[24] It should also be mentioned that the domestic financial system was liberalized only partially, and this, according to some analysts, was a principal cause of the high spread between interest rates to borrowers and to lenders. See McKinnon, *op. cit.*, pp. 22-57, and "Represión financiera y el problema de la liberalización dentro de los países menos desarrollados", *Cuadernos de Economía*, No. 47 (April 1979), pp. 3-22.

[25] In practice, this latter mechanism operated by reducing the reserve requirement for the following month by an amount equivalent to the interest payable on the reserve maintained during the previous month. Thus the 'payment' of interest did not cause increases in currency issue, as its effect was manifested in the behaviour of the bank multiplier.

of them sought.[26] Of course, this increase should be compared with the rise in currency issue and the probable increase in the value of the bank multiplier arising both from the reduction in the reserve requirement and from an expected decline in the currency/deposit ratio.

Another point which merits emphasis in connexion with a counter-inflation policy based on an effort to reduce the growth rate of the nominal money supply is the need to pay attention to the evolution of the flow demand for money. The more traditional type of monetary analysis takes account only of money as a stock, and it is in this sense that both the supply of money and demand for it are usually studied. A more relevant concept for evaluating the short-term implications of monetary imbalances, however, refers to the flow of supply and demand for money, and the latter corresponds to demand for money over a given period of time.

Either as a consequence of imbalances between the real stock of money sought and the existing stock, or of economic growth, of expectations of a reduction in the cost of holding money, of the probable lower yield from assets used as substitutes for money, of demand for nominal money to replenish the real stock sought, or of a combination of these factors, a given demand will exist for nominal money flow.

If the monetary authority does not meet it, there will be an excess supply of goods and a fall in the rate of economic activity, though even so inflationary pressures will not abate for some time. This would be a possible 'monetary' explanation of the phenomenon of 'stagflation'. According to some authors, the mechanism described above could have provided a fundamental explanation for the Chilean situation in 1975.[27]

Because of the magnitude of the tax represented by inflation[28] at that time, and because the monetary authority insisted on controlling the growth of M_1, there was an excess demand for nominal money flow. This imbalance was reflected in excess supply in the goods market, so that the macroeconomic adjustment occurred fundamentally in the form of a profound economic recession, thus reducing demand for real monetary balances.[29]

The above points to the need to ensure that a counter-inflation programme which is aimed at moderating growth in M_1 should also take into account the evolution of demand for money, especially when the real liquidity of the economy is excessively low.[30] This latter aspect is of great importance since, at least in the Chilean case, there is some evidence that when the cost of holding money becomes excessively high, real demand for money stock becomes very inelastic *vis-à-vis* the inflation rate,[31] whereas this does not, of course, happen with the flow demand for money.

[26] It should be noted that, from the viewpoint of the financial institutions, the payment of interest at market rates on legal reserves is equivalent to a reduction in the reserves, so that the large spread between interest rates to borrowers and to lenders would tend to diminish. If this spread is defined as *m* and is expressed, like the other variables, per unit of deposit, then $m = i_a - i_p = g + c + e_a i_a - e_l i_l$, where i_a = rate of interest to borrowers; e_l = legal reserve requirement; e_a = actual reserve ratio; i_l = rate of interest applicable to the legal reserve; c = administration and intermediation costs; i_p = interest rate to lenders; g = profit. Changes in i_l and e_l of such a magnitude as to modify the spread *m* by a given amount do not necessarily have the same impact on the value of the bank multiplier or, consequently, on money.

[27] See L. Sjastaad and H. Cortés, "El enfoque monetario de la balanza de pagos y las tasas de interés real en Chile", in University of Chile, Department of Economics, Faculty of Economic and Management Sciences, Santiago, *Estudios de Economía*, No. 11, first half of 1978, p. 13.

[28] See R. Zahler and E. Budinich, "Financiamiento gubernamental, emisión e impuesto inflación", *Estudios de Economía*, No. 8 (second half of 1976), p. 138.

[29] The attempt to regulate one or other of the determinants of demand for money meant a delay in domestic financial liberalization. As far as the official economic strategy was concerned, the financial reform was apparently of such priority that it was decided to sacrifice the performance of other markets and economic sectors in order not to hold up the evolution and development of the capital market.

[30] In the Chilean case, real demand for money stock dropped sharply until mid-1976, from which date the liquidity coefficient began to rise. For the implementation of monetary policy in the short-term it is very important to be able to determine the evolution of demand for money stock (real) and demand for money flows (nominal), since at different moments in time stock and flow disequilibria of different intensities may coexist, or there may be equilibrium with respect to stock and disequilibria with respect to flows, and vice versa.

[31] When the rate of inflation (actual and expected) is very high, economic agents tend to replace real monetary

3. *Counter-inflation policy, the exchange rate and the rate of interest*

As is well known, in a small, open economy with a non-floating exchange rate there is very close relationship between exchange, monetary and credit policies. The Chilean case fits this description in many respects.

A matter continuously under discussion is what the 'equilibrium' exchange rate should be, and what exchange rate policy would be most appropriate. If it is accepted that the monetary authority should fix the exchange rate instead of letting it float, what criterion should guide forward planning of the exchange rate? A great deal has been written on this matter, and it will undoubtedly continue to be a subject of debate between economists for a long time to come. A recent meeting jointly organized by CEPAL and the Central Bank of Uruguay contributed some interesting ideas (of great importance for the countries of Latin America) to this old discussion.[32] The paragraphs below contain a few additional reflections prompted by Chilean experience in the last five years.

It would seem that forward planning of the exchange rate in Chile was guided by at least two criteria: differences between international and domestic inflation rates, and the level of the country's international reserves.[33] Furthermore, it was sometimes used to help guide expectations of inflation and, through its influence on exports and imports, to secure a desired deficit on the current account of the balance of payments.

This was undoubtedly a case of an attempt to use an instrument to reach various objectives which are not necessarily compatible. In particular, it was not clear whether the exchange rate was a mechanism to be used to control the commercial opening up, or whether its evolution had to be planned in the light of the evolution of the exchange market. For example, during periods of very slow devaluation, and even revaluation, the inflow of short-term capital rose, apparently stimulated by expectations concerning the ratio between the future rate of devaluation and the evolution of the domestic interest rate. In this way, if the exchange rate is used merely as an instrument of monetary control, without combining it with proper planning as regards the relative yields of the different liabilities in the financial system, this may, at least for a time, produce effects very different from those expected.[34] This latter factor is of particular importance because of the close relationship between exchange rate management and interest rate management.

When the exchange rate is indexed, while the interest rate is free and rises to the very high levels it reached in the Chilean case, there is no doubt that this provides an enormous stimulus for the inflow of financial capital. Indeed, attempts to regulate or control this inflow will be fruitless if the interest rate differential between the domestic economy and outside, after discounting expectations of a devaluation (which may include exchange rate risk in parallel markets) is sufficiently attractive.

This, it would appear, was what happened in the Chilean economy. If ***total international reserves*** are taken as a guide in determining the exchange rate, a situation arises where, as a consequence of the initially restrictive monetary policy, the domestic interest rate rises; as

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balances within their portfolios of assets by other financial and physical assets which offer a higher yield than money. Nevertheless, until money is replaced by other goods as a means of exchange for carrying out transactions, there is a 'minimum' level of real money which, because of its liquidity, is essential for effecting payments in the economy. Thus, over and above a certain (high) rate of inflation, real demand for money stock becomes very inelastic. However, since nominal demand for money flow depends directly on the rate of inflation, among other things, it becomes necessary in a counter-inflation programme to reconcile the evolution of supply and demand for money flows, by taking the appropriate policy measures. See in this regard footnote 30 and Zahler and Budinich, *op. cit.*, p. 142.

[32] *Seminario sobre política cambiaria*, Central Bank of Uruguay and CEPAL, Montevideo, August 1978.

[33] See A. Bardón, "Algunas experiencias de la política cambiaria en Chile (1973-1978)", in *Seminario sobre política cambiaria, op. cit.*, and McKinnon, *op. cit.*

[34] For more details see C. Massad, "La paradoja de septiembre", *Estudios de Economía*, No. 5 (first half of 1975), pp. 51-56.

a result, the inflow of external capital is stimulated and the exchange rate is depressed (in relative terms).[35]

This means that the current account deficit and the consequent external borrowing are greater than they would have been if the evolution of the exchange rate had been planned using another criterion, with more rapid devaluations.

In this way the country is placed in a situation where the economic recovery can be slowed down by the continuing restrictions on government expenditure (which ceases to be the 'cause' of inflation, but whose inactivity is an important factor in the slowness of the recovery), together with lower net external demand than would have existed if a different combination of monetary, fiscal and exchange policies had been applied.

In this regard, it is noteworthy that the real exchange rate in Chile, despite the lowering of tariffs and the worsening of the terms of trade which occurred in the period 1975-1978,[36] was on average 2.3% *below* its average value in 1974.[37] In addition, it was very unstable as regards its role in allocating resources for export activities and import substitution, as the currency had been devalued in 1975 and 1978 and revalued in 1976 and 1977.[38] This would indicate that the reduction in tariffs was one of the factors accounting for the marked growth in the country's exports and imports in the recent period, principally through the reduction in the cost of imported raw materials, inputs and capital goods.[39]

The sharp deterioration in the current account balance in 1977 and 1978, and the preliminary projections for 1979, indicate that a more rapid devaluation would be desirable,[40] to generate foreign exchange by means of a smaller current account deficit. In this way greater protection would be granted to the domestic market and, subject to success in modifying expectations of devaluation, the inflow of international capital would be moderated, while there would be still greater stimulation of non-traditional exports, whose real growth rate, *in relation to the tariff reductions*, must tend to decline because of the fact that, once the planned level and structure of tariffs has been reached, the *additional* stimuli to activities which make intensive use of imported goods cease.

In addition, the rate of external borrowing, which in 1978 and 1979 grew much faster than the average for the period, would be reduced. In this regard it has recently been asserted that, in the case of the Chilean economy, foreign borrowing is not of great importance, since most of the loans are contracted by the private sector, thus ensuring the profitability of externally financed projects. In this way, it is argued, servicing of the external debt would be ensured automatically through the efficiency associated with the uses to which it would be put.

However, it would appear necessary to point out that the above argument is excessively simplistic. Because of the considerable recent build-up of external debt, the exchange rate has been held down, making its long-term adjustment more difficult. However, the real cost of servicing the external debt in the future requires not only the generation of domestic saving, but also its conversion into foreign exchange. Accordingly, if important changes occur in the terms of trade, in international liquidity or in domestic economic or institutional circumstances, so that the country does not enjoy the present abundance of foreign exchange, it might be necessary to modify the parity, with corresponding implications for the

[35] If the capital account is freed more rapidly, this latter effect will be magnified.

[36] In the period 1975-1978, the average level of the terms-of-trade index was 77, compared with 85 in 1960-1964, 119 in 1965-1969 and 121 in 1970-1974.

[37] See table 7. Of course, the problem of properly defining what is the 'equilibrium' real exchange rate remains

[38] Nevertheless, it would seem to have been perceived as fairly stable compared with the evolution of the exchange rate between 1971 and 1973.

[39] Naturally, the sharp devaluation in 1974 and 1975, the initial drop in domestic aggregate demand and the unused export capacity existing at the end of 1973 played a fundamental role in the rise in exports, and especially of non-traditional exports.

[40] Naturally, in view of the openness of the economy, a measure of this nature would have an inflationary impact derived from the increase in the Chilean peso prices of internationally tradable goods and services.

real value of the external debt expressed in terms of domestic resources, and for the social efficiency of the externally financed projects.

As already noted, prior commitments as regards payment of the official external debt imposed strong pressures on the monetary sector. However, it is not clear what procedure for the generation of foreign exchange would be most appropriate —a surplus on the non-compensatory capital account or a smaller deficit on the current account. Perhaps during the period of highest inflation stimulation of. the exchange rate might have offered some disadvantages.

Nevertheless, a rate of devaluation persistently lower than the differential between domestic and international nominal interest rates stimulates the flow of international capital to the country, and when this inflow does not finance a current account deficit, but is principally used to build up international reserves, it does not contribute to raising total saving. In fact, for a given level of growth of the quantity of money, external credit actually competes with domestic credit; in contrast, if the inflow of international capital takes the form of a larger current account deficit, external saving is increased.

The combination of devaluation (revaluation) and domestic interest rates are not independent of the inflow of foreign exchange and the creation of base money. Nor are they independent of the degree of substitution and/or complementarity between domestic and foreign saving. It would seem from Chilean experience that the exchange rate is not an appropriate instrument to control the monetary base, especially when it is used in isolation.[41] Insistence on forward planning of the exchange rate using this criterion has important effects on other economic policy objectives, particularly foreign borrowing, complementarity between domestic and external saving, and the allocation of resources between domestic and tradable goods, all of which must be properly evaluated in terms of the objective of stabilizing the level of prices.

III

Opening up to the exterior in the financial field[42]

One aspect of Chilean economic policy which is out of keeping with the general approach which has guided the economic programme in the last five years relates to the opening up of the Chilean economy to international financial capital. It is interesting to note that recent developments in Argentina and Uruguay have been much more liberal in this regard, but at the same time rather more cautious and 'gradualist' as regards the commercial opening up.

Despite the common impression that Chile borrowed a great deal between 1975 and 1978,[43] the empirical evidence indicates that this view should be carefully evaluated. In *nominal* terms, between the end of 1974 and the end of 1978 the country contracted loans totalling US$ 2,137 million, increasing its gross

[41] However, the more open the economy is to external influences, the greater the importance acquired by the evolution of the exchange rate as a *direct* determinant of domestic inflation (not through its influence on the monetary base), together with international inflation and the characteristics of markets for goods and services which are not internationally tradable.

[42] The analysis which follows refers to financial credit rather than to direct external investment, because of the separate determinants of each, the low level of direct investment compared with loans (between 1975 and 1978 external investment accounted for 20% of the net flow of non-compensatory capital, since *private* loans accounted for more than 100% of that flow), and the closer relationship between private loans and the financial aspects of macroeconomic policy.

[43] This may have been due to the fact that during this period external borrowing was in fact strongly *stimulated* by the relatively slow devaluation and the objective of sharply increasing the country's international reserve position and permitting a substantial rise in interest rates to borrowers.

reserves by US$ 1,062 million, giving nominal net borrowing of US$ 1,075 million. This is equivalent to cumulative growth of 25.4% over the net debit balance at the end of 1974, in other words, an annual average rate of nominal net borrowing of below 6% (see table 11). However, it should be mentioned that the net borrowing figures underestimate the 'actual' nominal debt to some extent, since it is necessary to maintain a high level of reserves in order to retain access to external financing.

Table 11

CHILE: EXTERNAL DEBT, 1973-1978
(Millions of US dollars)

Year	(1) External debt	(2) Gross reserves	(1)-(2) Net debt
1973	4 048	401	3 647
1974	4 774	535	4 239
1975	5 263	427	4 836
1976	5 195	816	4 379
1977	5 434	871	4 563
1978	6 911	1 597	5 314

Source: Central Bank of Chile, *Deuda Externa de Chile 1978.*
Note: The external debt figures refer to sums actually disbursed outstanding at the end of each year. They include traditional debt and other external liabilities comprising the International Monetary Fund, suppliers' credits and financial credits to the private sector, as well as short-term lines of credit to commercial banks, the Banco del Estado and the Central Bank.

'Real' net borrowing is usually estimated by deflating the nominal value of the external debt by an index of the unit value of the country's imports. During the four years 1975-1978, if this procedure is used, Chile's real gross external debt fell at an average rate of 0.4%, and the real net debt fell at an annual average rate of 3.9% (see table 12).

However, as has been asserted in a recent study,[44] the methodology set out above suffers

Table 12

CHILE: EXTERNAL DEBT, 1975-1978
(Percentage change)

Year	Gross debt			Net debt		
	a	b	c	a	b	c
1975	10.2	−8.3	82.4	14.1	−5.1	88.7
1976	−1.3	−3.2	−8.0	−9.4	11.2	−15.6
1977	4.6	−5.7	16.4	4.2	−6.1	16.0
1978	27.2	17.8	34.0	16.5	7.8	22.7
1975-1978[d]	9.7	−0.4	27.2	5.8	−3.9	22.7

Sources: Table 11.
CEPAL: *Economic Survey of Latin America, 1978.*
[a]Growth rate of the nominal external debt.
[b]Growth rate of the nominal external debt deflated by the index of import prices.
[c]Growth rate of the nominal external debt deflated by the terms-of-trade index.
[d]Average annual growth rate during the period.

from serious limitations, and it seems more appropriate, in measuring the effective debt burden, to deflate it by an index of the terms of trade. This calculation, in the Chilean case, leads to the conclusion that the average annual growth rates of the gross and net debt during the period 1975-1978 reached 27.2% and 22.7% respectively. In other words, real growth in the external debt thus defined, in the last four years, was three times the growth of the nominal external debt.

Furthermore, provisional figures indicate that in 1979, as in 1978, external borrowing showed a sharply increasing trend.

Despite the above, it would have seemed reasonable to expect a much greater inflow of external credits in view of the very high domestic interest rates, the low interest rates on international markets, the abundance of international liquidity and the evolution of the exchange rate in Chile.[45]

[44]See Carlos Massad and Roberto Zahler, "Inflación mundial y deuda externa: El caso del deflactor impropio", in *Dos estudios sobre endeudamiento externo,* Cuadernos de la CEPAL No. 19, Santiago, Chile (English version entitled "World inflation and foreign debt: the case of the improper deflator", CEPAL internal document No. 79-4-978).

[45]It should be remembered that the domestic interest rate in dollars was 60% a year on average between 1975 and 1978.

In order to understand the smaller relative inflow of financial capital to the Chilean economy from an economic viewpoint, three main aspects should be borne in mind.

Firstly, it is necessary to point out that in the first years of application of the new economic policy, the attitude of the international financial community to Chile was very cautious, so that until well into 1977 there were probably substantial limitations on external borrowing on the supply side.

A second consideration is that, while the public sector increased its debt very slowly, the same did not happen with the private sector. As can be seen from table 15 below, in the four years under review the public sector increased its external debt by 17%, while the rise in the private sector debt was 228%. This has important implications in the field of redistribution, as will be indiated below.

A third factor which helps to explain the phenomenon is the set of obstacles and restrictions imposed by the monetary authorities on such external capital as might be appropriated by the domestic financial system.[46]

The most important limitations on the inflow of external credits[47] include those relating to minimum periods for repatriation, and those which restrict bank borrowing in foreign currency in terms of the sums involved (which are tied to the banks' capital and reserves), the speed with which they can be increased (because of restrictions on the flow of borrowing), and the capacity to grant guarantees.[48]

There are also two further aspects of this subject which merit thorough analysis: one relating to the monetary approach to the balance of payments, and the other to the implications for resource allocation and wealth distribution of the type of restrictions imposed on external borrowing. However, the lack of sufficient disaggregated, up-to-date information makes it necessary to conduct the discussion in broad terms, in the form of questions, merely laying down a few general recommendations which, in our view, may be inferred from the Chilean experience.

1. *Financial opening up to the exterior and the monetary approach to the balance of payments*

As already indicated, the economic strategy relating to external financing does not fall squarely within the general lines of economic policy.

It would appear that the economic authorities considered, at least until the middle of 1979, that the so-called monetary approach to the balance of payments has greater validity in the long than in the short term. If dynamic aspects of movements in the balance-of-payments accounts, patterns of adjustment in variables, etc., are ignored, the process of opening up to the international capital market and complete integration into it (together with the liberalization of the domestic capital market, including reforms of reserve requirements, and so on) would, according to the monetary theory of the balance of payments, generate a large inflow of external credit and a very rapid tendency for the domestic interest rate and international rates (adjusted for a certain risk) to become equal. This would furnish a substantial stimulus to investment, especially in construction (one of the most depressed economic sectors in the last five years), and promote a rise in economic activity.

The principal drawb a ks of such a measure are connected with the adjustment process, and particularly its possible repercussions on inflation (depending on the degree of commercial opening up and the exchange rate policy adopted, through monetization of the accumulation of reserves), the external borrowing position and the probable drop in the rate of devaluation, with the consequent adverse

[46]See note 15 and D. Tapia, "Apertura al mercado financiero internacional", in *Institucionalidad económica e integración financiera con el exterior* (Santiago, Chile, Instituto de Estudios Bancarios Guillermo Subercaseaux, 1979), pp. 107-130.

[47]There were substantial modifications and simplifications in this regard during 1979.

[48]These limitations are those imposed on demand for loans. It must not be forgotten that, even with total openness, there are also important imperfections, such as market fragmentation, differential guarantees, imperfect information, risk evaluations and quantitative rationing by banks in addition to rationing by price, positive-slope supply of external credit, and so on.

effects on economic activity and employment (particularly in the sectors producing tradable goods).[49]

The main argument cited by the economic authorities against a complete liberalization of the external financial market refers to the potential impact of a massive inflow of external capital on the money supply, and consequently on the stabilization effort.[50] In fact, it is necessary to assess the elasticity of demand for finance *vis-à-vis* the interest rate, identify the monetary repercussions of the measure (including the larger deficit on the current account of the balance of payments) and compare them with the expected evolution of demand for money.

There are very few empirical studies in Chile concerning the behaviour of the market for loanable funds. However, recent experience suggests that a very substantial capital inflow would be required in order to lower the interest rate.[51] If this occurred, it would generate an excess supply of money flows, with equilibrium being achieved in three basic ways.

The first way is adjustment through an increase in *output and/or prices,* principally of goods which are not internationally tradable, with the resulting repercussions on economic activity and/or the general level of prices.

The second adjustment variable would act through the domestic financial market, by means of a rise in *demand for money* (appropriately defined) arising from the possible reduction in the cost of holding liquid balances, and from the rise in the volume of transactions.

Finally, the third means of adjustment is a change in the current account balance of the balance of payments. Naturally, the more open the economy to the exterior, and the greater the trade links with international markets for real goods and services, the more important this variable is. Consequently, it is very likely that a more rapid opening up to external finance would only temporarily generate greater inflationary pressures and a certain improvement in output of non-tradable goods and services. The main result would be a larger trade gap, with a consequent rise in external indebtedness and a fall in levels of activity and employment in the sector producing internationally tradable goods.

However, this last conclusion is closely linked to the exchange rate policy adopted during the external financial liberalization. If the movement of the exchange rate is guided by the evolution of the current account and the external debt, with the currency being devalued more rapidly or more slowly as the current account deficit or the level of external debt increases or declines, there will be a rise in the level of prices, increasing nominal demand for money. The build-up of international reserves, accompanied in this case by the attempt to reduce the growth rate of money, means that external financing replaces domestic credit, without necessarily helping to generate a greater volume of domestic saving. If, on the other hand, the exchange rate policy is guided by the *balance-of-payments* position, a growing accumulation of international reserves would lead to a slower devaluation (or a revaluation), with an increase in the current account deficit and the external debt. In this way, external financing constitutes foreign savings, which, *assuming* a certain level of domestic savings, helps to ensure that the expenditure of the economy exceeds the level of the product.[52]

[49]Obviously, there are other arguments in favour of not allowing a complete opening up to external capital, such as the political arguments which recognize the implications of a situation where a substantial proportion of domestic capital is in foreign hands, as well as others related to the imperfections of the capital markets, information costs, market fragmentation and, above all as regards direct investment, arguments related to the mode of operation of the transnational corporations.

[50]See Tapia, *op. cit.*

[51]This assertion refers to the implications which an inflow of credit would have for external debt, rather than to high interest-elasticity of demand for external finance. The domestic interst rate depends not only on external finance, but also on domestic saving. Domestic saving dropped sharply during the period under consideration. The short term domestic interest rate expressed in dollars in the middle of 1979 was still very high, despite a substantial inflow of capital. In 1975-1978 the inflow of *private* capital (net of amdrtization and interst payments) was equivalent to 4% of gross domestic product expenditure, rising to 7% in 1978.

[52]Obviously, domestic saving is not independent of external saving: the relationship between them should be specified in each particular case.

It should be noted that increasing external borrowing leads to a 'negative' externality because of the criteria used by creditors in evaluating risks and solvency, so that the social marginal cost (for the country) of external borrowing is greater than the private marginal cost. This is an argument in favour of imposing a tax on the raising of external finance, even when there is complete external financial openness.

On the basis of the interest rate differential, the exchange rate policy followed and recognition of the delayed action of economic policy, it seems clear that more rapid external financial opening up would, in the Chilean case, have led to greater net external borrowing, a fall in the level of activity in the sector producing tradable goods and a rise in domestic liquidity (or a combination of the three effects), thus justifying the authorities' concern to control the degree of external financial openness.[53]

However it cannot be denied that more thorough-going domestic financial liberalization and a stronger devaluation of the peso would have substantially reduced the influence of private capital from abroad, probably stimulating domestic saving and lessening the impact of exchange operations —through the capital account of the balance of payments— on currency issue and the counter-inflation strategy.

Since a decision was taken to move faster towards openness in the trade field than in the financial field,[54] it would seem to be of interest to study this phenomenon, and particularly the way in which external finance was restricted, and its implications for the Chilean economy. These points are analysed below.

2. *Some 'real' consequences of the control of external finance*

One of the most interesting subjects of analysis in the Chilean economic experience is the way in which the external financial opening up was controlled. This is because normally in order to ensure consistency with the remaining measures adopted, it would have seemed natural to expect a total opening up to international capital markets, or alternatively, from considerations of short term macroeconomic equilibrium,[55] the rationing of external credit by price, which was the mechanism governing most of the remaining economic decisions.

However, the procedure adopted[56] involved establishing *de facto* quantitative restrictions on external borrowing,[57] especially in the case of the domestic financial system, which enjoys greatest ease of access to the international capital market. As already noted, the capital and reserves of the financial enterprises limited both their external borrowing and their capacity to issue guarantees, and there was in addition a general limitation on all economic agents as regards the periods of time for which external funds could be borrowed.

The above becomes even more important if it is remembered that, in addition to imposing this type of limitation on external borrowing, the interest rate in the capital market was freed, trade was rapidly opened up, the major part of the process of selling off State enterprises to the private sector took place, and strict discipline was imposed on the State sector and on public enterprises.

These measures led to a sharp rise to extraordinarily high levels in the real rate of

[53] It should also be pointed out that any fall in the domestic interest rate would have produced a stimulus (though probably a small one) to investment, and accordingly to economic growth and employment.

[54] In our view, while it was necessary to regulate the flow of external capital to the country (a phenomenon which would have occurred more easily with a more gradul commercial opening up), the mechanisms used were far from being the most effective and equitable ones.

[55] It is important to note that in very few other areas of the economy was as much concern shown for the short term and the adjustment process.

[56] In June 1979, the restrictions on the contracting of external loans by banks and finance companies were modified.

[57] It is reasonable to argue that, because of the specific characteristics of flows of international financial capital, their volatility, creditors' attitudes and risk assessment, and so on, it is necessary to establish some form of quantitative regulation of the inflow of external credit. However, there are different ways of ensuring this regulation, with different effects in terms of efficiency and redistribution.

interst to borrowers in the financial system,[58] And to a very profound change in the level and structure of aggregate demand and consumption and in the relative prices of goods and factors. The consequences of this situation are to some extent reflected in the investment and unemployment situation in Chile during the period (see table 13). Excessive demand for finance also arose, partly because of the sale of State-owned enterprises, and was aggravated by demand generated on the domestic capital market by public enterprises, which found that contributions from the government, and credits from the Central Bank, were restricted.

Table 13

CHILE: UNEMPLOYMENT AND INVESTMENT
(*Percentages*)

Period	Unemployment rate in Greater Santiago[a]	Rate of investment[b]
1960-1970	6.0	15.3
1971	5.5	14.1
1972	3.8	11.9
1973	4.6	12.0
1974	9.6	13.0
1975	16.2	10.7
1976	16.8	9.7
1977	13.2	10.7
1978	14.3	11.3

Sources: University of Chile, Department of Economics: *Comentarios sobre la situación económica*, 1978, 1979; and *Ocupación y desocupación en el Gran Santiago*, various issues.

[a]Simple average of the rates for March, June, September and December.

[b]Gross domestic fixed capital investment as a proportion of gross domestic product expenditure.

Accordingly, two important consequences arising from the phenomenon under discussion are those relating to the evolution of investment and to the allocation of resources.

There is no doubt that the high rates of interest on loans provide an explanation, even though a partial one, of the depressed level of private investment in the period; to this should be added the drop in public sector investment.[59] In addition, the enterprises which had access to external credit were characterized by their large size and their use of relatively capital-intensive technology, so that there was no guarantee that their investment would necessarily generate high levels of employment or be the most efficient from a social viewpoint.

In this regard it is interesting to observe how in these years, despite some liberalization of the domestic financial market, some of the features of the way the financial system was traditionally managed persisted. Thus, the dual nature of the industrial structure and the distribution of income has tended to be retained, so that a handful of companies receive substantial amounts of credit on preferential terms which they invest in over-capitalized enterprises that are only partially used. In this way this sector generates large incomes, while most of the smaller, fairly labour-intensive enterprises subsist with extraordinarily high financial costs.

It may also be held that, as in the past, such a restricted financial system grants clear advantages to those enterprises which have direct or indirect access to preferential credit (in this case credit from abroad), and to those which can make use of their undistributed profits, either from within the enterprise or from other enterprises belonging to the same economic group. In Chile, a substantial group of enterprises combine all these advantages, and are accordingly improving their competitive position, though this does not necessarily correspond to an increase in their productive efficiency.

It may be deduced from the above paragraphs that the *mechanisms* used to control the flow of external loans to Chile did not promote an adequate level of investment, nor the efficient allocation of it, but instead probably made

[58]The rate to lenders, though it has increasingly been positive, has not been very high because of the wide spread between the rates to lenders and to borrowers.

[59]Public sector investment, which in 1974 represented 12% of gross domestic product expenditure, made up only 6.4% in 1977.

possible a substantial change in the distribution and concentration of wealth.

Because of the form of the attempts made to regulate the flow of external borrowing, conditions were created which enabled enterprises with access to international credit to obtain substantial profits. In other words, because of the way in which the 'import quota' of financial capital was distributed, a profit was generated from the difference between the international and the domestic price of such capital.[60]

There is even evidence that some enterprises engaged in import activities fundamentally because of the attraction of the external credit associated with importing. It has also been alleged that the deficit on the current account of the balance of payments is overestimated because of the incentive for underinvoicing exports and over-invoicing imports, with the difference entered in the form of external credit.

Preliminary, very conservative estimates indicate that the transfer obtained in this way by private enterprises enjoying access to external credit during the period 1976-1978 totalled at least US$ 540 million, rising to over US$ 650 million by mid-1979[61] (see table 14).

[60]It should nevertheless be stressed that, independently of the degree of external financial openness, many imperfections remain in the domestic and international capital markets.

[61]At the end of 1978, the sales value of the State-owned enterprises sold to the private sector during the period stood at US$ 585 million.

Table 14

CHILE: FINANCIAL PROFITS OF PRIVATE ENTERPRISES ENJOYING ACCESS TO EXTERNAL CREDIT

Year	Interest rate			Alternative (1)		Alternative (2)		Alternative (3)	
				Article 14[b]		Non-compensatory capital[c]		Stock of external debt[d]	
	LIBOR	Chile	Differential[a]	Private sector	Profit	Private sector	Profit	Private sector	Profit
	(annual percentage in US dollars)					(millions of US$ dollars)			
1976	6.12	118.53	1.0629	227	121	319	170	641	681
1977	6.42	58.38	0.4554	287	169	381	207	772	351
1978	9.35	51.10	0.3240	750	251	932	326	980	318
1979 (first half)	11.21	42.10	0.1968	500	113	(466)	133	1 569	155
					654		*836*		*1 505*

Sources: Central Bank of Chile, *Boletín mensual*, May 1979; *Deuda Externa de Chile*, June 1979.

[a]Calculated as the difference between the interest rate on bank loans in Chile, expressed in dollars, and double the LIBOR rate.

[b]Alternative (1) was calculated on the following assumptions: (a) the only sums entered are credits disbursed to the private sector under article 14; (b) they remain in the country for two years; and (c) the amount available per year is equal to half the annual flow. This calculation is undervalued both by reason of the coverage of article 14 (article 15, which corresponds to credit for the private sector, was not included), and by reason of the period spent in Chile, since these credits remain in the country for more than two years; and because no account is taken of the stock of debt under article 14 existing at the end of 1975.

[c]Alternative (2) is based on balance-of-payments data and refers to the movements (net of amortization payments) of non-compensatory capital for private use. In this case the assumptions of alternative (1) were repeated for long term and medium-term capital movements, while only one year of stay in Chile was assumed for 50% of the total short-term credits. For 1979 a movement equal to that of 1978, for all debt periods, was estimated.

[d]Alternative (3) is based on the assumption that the total stock owned by the private sector to foreign sources at the end of the previous year remains in the market for only one year. Neither traditional private debt nor short-term debt is included.

In addition to the above, it should be mentioned that while the private sector was securing its financing to an increasing extent from abroad, the public sector was doing so at a much slower rate. Between the end of 1974 and the end of 1978, private debt increased by US$ 1,449 million, to more than 30% of the country's total stock of debt, compared with less than 14% at the end of 1974. The public sector, on the other hand, which increased its accumulated debt by US$ 688 million, dropped its share from 87% at the end of 1974 to slightly under 70% at the end of 1978.

An examination of debt servicing shows that the net flow of external resources to the public sector in the four years under consideration was *negative* (−US$ 468 million), while the flow to the private sector was US$ 948 million. If, instead of external debt, balance-of-payments figures are used, the situation is even more favourable to the private sector. Moreover, the proportion of borrowing by the public sector during the period 1975-1978 under article 14 of Decree-law 471 (the main provision under which external credits entered the country) was less than 8%, while more than 90% represented borrowing by the private sector.

Table 15

CHILE: EXTERNAL DEBT[a] BY SECTORS, 1973-1978
(Millions of US dollars)

	Public debt		Private debt		
	Millions of US dollars	Percentage	Million of US dollars	Percentage	Total debt
December 1973	3 260.2	80.6	787.8	19.5	4 048
December 1974	4 138.2	86.7	635.8	13.4	4 774
December 1975	4 444.6	84.5	818.4	15.6	5 263
December 1976	4 163.8	80.2	1 031.2	19.9	5 195
December 1977	4 067.4	74.9	1 366.6	25.2	5 434
December 1978	4 826.0	69.8	2 085.0	30.2	6 911

Source: Institucionalidad económica e integración financiera con el exterior, op. cit.
[a]The external debt figures refer to sums actually disbursed outstanding at the end of each year. They include traditional debt and other external liabilities comprising the International Monetary Fund, suppliers' credits and financial credits to the private sector, as well as short-term lines of credit to commercial banks, the Banco del Estado and the Central Bank.

It is clear from the above not only that there was probably inefficient allocation with tendencies towards concentration within the domestic private sector, but also that the public sector, including naturally public sector enterprises, found itself in financial conditions which were very disadvantageous compared with those private enterprises which enjoyed access to external credit on the above-mentioned conditions.[62]

Criteria of efficiency and equity dictate that, if it is wished to ration external credit, this should be done through a tax (supplemented as appropriate by other mechanisms) to be collected by the government.[63] Although it is true

[62]It may be held that the private sector borrowed abroad as a way of financing payment of the tax represented by inflation, which was very high during this period. However, this tax fell principally on those economic agents for whom it was most difficult to replace cash or sight deposits by other assets, and on borrowers in the domestic market for short-term capital. It is clear that these categories do not include the major private enterprises with access to international finance, to which they resorted precisely in order to 'evade' the inflation tax.

[63]The measures adopted by the Central Bank in the second quarter of 1979, designed to establish obligatory

Table 16

CHILE: GROSS AND NET FLOW OF EXTERNAL CREDIT[a] BY SECTORS
(Millions of US dollars at current prices)

	1975			1976			1977			1978		
	Gross flow	Debt service	Net flow	Gross flow	Debt service	Net flow	Gross flow	Debt service	Net flow	Gross flow	Debt service	Net flow
Public sector	768	778	−10	545	868	−323	580	1 042	−462	1 529	1 202	+327
Private sector	110	54	56	238	224	14	526	199	327	824	273	551
Total	*878*	832	*46*	783	*1 092*	*−309*	*1 106*	*1 241*	−135	2 353	*1 475*	+878

Source: Central Bank of Chile.
[a]The external debt figures refer to sums actually disbursed outstanding at the end of each year. They include traditional debt and other external liabilities comprising the International Monetary Fund, suppliers' credits and financial credits to the private sector, as well as short-term lines of credit to commercial banks, the Banco del Estado and the Central Bank.

that the domestic and international capital market is far from perfect, such a measure would drastically reduce the serious drawbacks associated with certain aspects of the way in which the quantitative restrictions on the import of capital were applied.[64]

IV

Summary and final comments

This paper began with a short outline of the macroeconomic situation with which economic policy in Chile since the end of 1973 has had to deal.

There followed an analysis of the foundations of the stabilization strategy which was based on an attempt to reduce the growth rate of nominal money, as traditionally defined.

It was felt that this policy tended to be inconsistent with the progressive opening up of the Chilean economy to the exterior, because of the increasingly endogenous nature of the money supply. Difficulties in controlling base money were exacerbated by the extremely rapid (though partial) liberalization of the domestic capital market, especially in the context of an extraordinary level of international liquidity.

As a result, the stabilization programme appears to have been conceived within the frame of reference of a closed economy, since as the country's economic relations become internationalized, the restrictions on domestic credit, and particularly credit to the public sector, were modified to a greater or lesser extent because of the inflow of foreign exchange. This inflow was also stimulated by the evolution of the domestic interest rate and the

reserve ratios for the inflow of certain types of external credit, are similar to this tax. However, by that time the principal redistributive effect had already been consolidated.

[64]Nevertheless, as pointed out earlier in the text, if the supply of external credit becomes very unstable, it may be necessary to resort to some form of direct control, regulated by the economic authorities.

exchange rate policy followed in 1975-1978.

Consequently, it is considered that an excessive burden fell on the Chilean public sector, with the consequent adverse effects on the level of investment, employment and social expenditure.

Limiting the analysis to a non-floating exchange rate, it was argued that exchange rate policy should not be used as an instrument for controlling the money supply (although it is in fact an important direct determinant of the evolution of domestic prices in an open economy), and it was pointed out that an attempt was made to use and plan an instrument —the exchange rate— on the basis of considerations which were not necessarily mutually consistent, such as the level of international reserves, external debt, expectations of inflation and the differential between domestic and international inflation rates. It is, furthermore, clear that the application of a succession of different exchange rate policy objectives and/or guidelines can lead to excessive instability in the real exchange rate.

The advantages and drawbacks of using the evolution of the current account, or that of the balance of payments, as the most appropriate criterion for exchange rate policy were examined, and it was concluded that, if the aim is that external financing should be channelled so as to ensure the greatest external savings, it seems more desirable that the exchange rate should follow the level of international reserves. If, on the other hand, it is not wished to increase external borrowing, and if appropriate credit measures designed to reduce the inflow of foreign exchange through the capital account are not adopted, external financing will principally be a substitute for domestic credit.

It was therefore concluded that the timing of the external opening up, the domestic financial liberalization and the sale of enterprises to the private sector was inappropriate in view of the effort made by the public sector within the framework of the monetary policy. A more gradual opening up of trade, and measures aimed at directly or indirectly (through credit policy) holding back the flow of capital from and to the private sector, might have permitted a form of monetary planning which placed fewer restrictions on government activity and that of public enterprises.

As regards demand for money, emphasis was laid on the excessively passive role adopted by the economic authorities, the consequences of which were aggravated by the circumstances prevailing when the development of the capital market was promoted. All this helped to delay the reduction of inflation, and helps to explain a substantial part of the process of 'stagflation' suffered by the Chilean economy during part of the period under consideration.

Accordingly, it was suggested that during stabilization processes based on restrictive monetary policies, more emphasis should be placed on the effort to control inflationary expectations and/or on the behaviour and evolution of money substitutes.

This was followed by an analysis of the implications of a process of opening up to the exterior which occurred at a rate and with characteristics which were different in the real sector from those in the financial sector of the economy.

An attempt was made to demonstrate the close relationship between exchange, monetary and fiscal and credit policies in a process of this type. In particular, stress was laid on the need to pay greater attention to the composition of the balance of payments, in addition to its level; and mention was made of the dual role of the exchange rate, both as regards the trade balance and through the effects of expectations concerning its future evolution on international capital movements.

An analysis was then made of the justification —based on counter-inflationary arguments and considerations relating to external borrowing— given for the decision to carry out the external financial opening up in a relatively slow manner. It was indicated that, while such arguments are not without validity, they would carry greater weight if the commercial opening up had also been carried out more gradually; at all events, the magnitude of the inflow of external capital, and the way in which it was restricted, are highly disputable.

A faster planned devaluation, together with a form of domestic credit management designed to reduce the spread between interest rates to borrowers and to lenders, and an effort to quantify and take appropriate action on the demand for nominal money flow, might have led to a monetary situation such that, without generating inflationary pressures, public sector expenditure and investment would have been spared such drastic reductions.

The mechanisms used to control the flow of capital do not appear to have been those best suited to promoting greater investment or employment or the optimum allocation of resources.

An estimate was made of the total transfers obtained by the domestic private sector which had access to external credit, and stress was laid on their important redistributive consequences, both within the private sector and *vis-à-vis* the public sector.

The analysis leads to the conclusion that the macroeconomic policy applied was not neutral with regard to the sectors and groups which had to bear not only the cost arising from the stabilization policy, but also the redistributive effects associated with the particular form in which the external financial opening up occurred.

It seems clear that, on the basis of criteria of efficiency and equity, a government tax equivalent to a tariff on the import of external credit is a more appropriate mechanism for controlling external financial opening up than the introduction of quantitative restrictions. Such restrictions might become more important if it is felt that the supply of international liquidity available to a country is very eratic or unstable. Indeed, this latter consideration, together with the speed of adjustment of capital movements compared with that of goods, suggests that the external financial opening up offers greater difficulties for the management of macroeconomic policy than the commercial opening up.

Finally, if it is decided to reform the external sector of the economy, the commercial and the financial opening up must be analysed, assessed and implemented in a co-ordinated manner.

CEPAL REVIEW
April of 1980

Towards a theory of change

*Raúl Prebisch**

With the present article the author rounds off the series he began with "A critique of peripheral capitalism" (published in *Review* No. 1), and continued with "Socio-economic structure and crisis of peripheral capitalism" (No. 6) and "The neoclassical theories of economic liberalism" (No. 7). While in all the preceding articles his main concern was to offer a critical interpretation of the functioning of peripheral capitalism and to show the inability of neoclassical theory to comprehend it in depth, in this one he seeks to trace the lines along which that system should be changed.

After recalling the basic features of his critique of how capitalism works in the periphery (chapter I), he sketches the criteria by which the process of change should be guided and which, *in toto*, constitute a synthesis of central values of socialism and liberalism (chapter II). He then goes on to pose certain inevitable questions as to the political conditions of change, through which he reaffirms the value of democracy as the ideal foundation for a harmonious society (chapter III). The next chapters (IV and V) are devoted to completing the presentation of his ideas via the analysis of problems of change linked to technique, demand, the structure of production, the specific features of peripheral capitalism, etc. In the final chapters he slightly shifts his angle of approach in order to deal, on the one hand, with the role of centre-periphery relations in change (chapter VI); and on the other hand, with the present crisis in the centres and its repercussions on the periphery (chapter VII); ending with a few reflections on ethics, rationality and foresight (chapter VIII).

His central ideas will give rise to controversy, not only because of their provenance, but also because they pivot upon the vexed questions of appropriation and social use of the surplus. But the writer is convinced that the present crisis will not be overcome with superficial measures; if it is to be surmounted and a developed, democratic and equitable society is to be built up, the process of change will have to strike at the very roots of the system.

*Director of the *Review*.

Part One

I

The dynamics of peripheral capitalism

I think it desirable to begin this new article —the last lap in the difficult task I have set myself— with a summary of the interpretation of peripheral capitalism set forth in earlier papers. I invariably refer to Latin American capitalism as a whole, disregarding certain inter-country differences which, important though they are, do not invalidate the essential significance of that interpretation.

In this summary I have sought to answer some well-aimed criticisms directed at the first draft of the present article, as well as at those which have preceded it.[1] I believe I have thus cleared the way for discussion of the outlines of a theory of change.

1. *The fruits of technical progress and the flaws in the system*

Peripheral capitalism is exclusive and conflictive: two major flaws which are aggravated by the centripetal character of capitalism in the developed countries, the inconsistency of its relations with the periphery and the effects of its hegemony.

The internal origin of these defects is to be found in the mode of appropriation and distribution of the fruits of the increasing productivity that results from the penetration of the technology of the centres into the heterogeneous social structure of the periphery, widely different from that of the centres themselves.

[1] Some of these criticisms and comments are published at the end of the present article, while the remainder will appear in the next number of this *Review*. I have found them helpful and enlightening, and should like to express my gratitude to their authors. Furthermore, as always, Aníbal Pinto has given me the benefit of his keenly perspicacious opinions. And Adolfo Gurrieri has lent his patient and intelligent collaboration by discussing the development of my ideas with me and making highly positive suggestions.

This process is dominated by the interplay of power relations.

The lion's share of the fruits in question is retained in the shape of a surplus in the upper strata of the social structure, thanks to the power accruing to them from the concentration of the means of production in their hands.

This unequal distribution of income in favour of the upper strata incites them to premature imitation of the consumption patterns of the centres, which, moreover, are by no means criticism. The privileged-consumer society which grows up in this way signifies a considerable waste of capital accumulation potential, with which is combined the siphoning-off of income by the centres —especially through the transnational corporations—, thanks to their technical and economic superiority and their hegemonic power.

The consequent insufficiency of capital accumulation, in respect of both physical goods and education of human beings, and the explosive growth of the population, explain in essence why the system cannot intensively absorb the lower strata of the social structure. This constitutes the exclusive tendency of the system.

With the increasingly pervasive penetration of technique, structural changes supervene which are manifested in the formation of the middle strata, both in the sphere of the market and in that of the State.

2. *Twofold pressure on the surplus*

In the sphere of the market, with the advance of the democratization process, the main body of the labour force acquires trade-union and political power, which enables it to secure a share in the surplus, either directly or through the social services provided by the State.

The State in its turn contends for a share in the surplus with a view to absorbing a steadily increasing proportion of the labour force, chiefly from the traditional middle classes, which, like the other workers just mentioned, acquire trade-union and political power. Thanks to this last, the employment of labour to expand State services, including the social services, is generally marked by a good deal of spurious absorption of manpower that is not really needed. The State taps part of the surplus in order to cope with this situation and to cover the purchase of goods and services in the market, in the fulfilment of its functions.

As a result of this twofold pressure on the surplus from the sphere of the market and from that of the State, imitation of the consumption patterns of the centres is gradually extended to the middle strata, although much less intensively than in the case of the upper strata.

Thus, income distribution basically results from a changing interplay of power relations, as alterations take place in the social structure with the march of technical progress.

3. *The dynamic mechanism of the system*

Thanks to the surplus and to the capital accumulation permitted by the system largely to meet the consumer requirements of the upper strata, these latter control the dynamic mechanism of the system. The system operates regularly as long as the surplus continues to be enlarged by successive productivity increments, despite the twofold pressure for shares in it.

These pressures are governed by no regulatory norm whatever, so that if they become intense, they compress the surplus to such an extent that in the end accumulation suffers, and so does the evolution of the privileged-consumer society. It is then that the conflictive phenomena of the system supervenes. Enterprises react by raising prices in order to re-establish the dynamic of the surplus, and this is followed by a counter-reaction on the part of the labour force, provided it has sufficient power, with the consequent wage increases. Thus an inflationary spiral is triggered off: a new type of social inflation which is superimposed upon and aggravates the effects of other factors.

This is how the crisis of the system begins in the later stages of development, when the play of power relations gains great momentum with the unrestricted advance of the democratization process.

The tendency to this type of crisis does not arise, of course, in countries where the social structure is unfavourable to democratization or where the changes in this structure make for a democracy in form rather than in substance.

4. *The structural surplus*

The first thing to recall is the structural significance of the surplus. If the fruits of technical progress are concentrated in the upper strata, this is because most of the workers whom capital accumulation makes it possible to employ do not succeed in pushing up their wages correlatively with their increasing productivity. The explanation lies in the regressive competition of the labour which stays in lower-productivity layers of technology, or is unemployed. All that happens is that a part of the fruits of technique is transferred to the limited proportion of the labour force which, mainly by virtue of its social power, has been able to acquire the ever-greater skills demanded by the new techniques.

The surplus does not peter out as a result of inter-enterprise competition, but is retained, circulates and increases because of the expansion of demand which, given the nature of the production process and its monetary requirements, precedes the appearance of the final products. This anticipatory expansion of demand prevents prices from falling as productivity rises.

The social inequality inherent in peripheral capitalism has its roots in the mode of appropriation of the surplus, without which the system could not function, since the privileged-consumer society —its outstanding manifestation— has, as we have seen, a peculiar dynamic of its own. Its ceaseless imitation of the patterns of consumption of the centres and the corresponding capital accumulation can be achieved only by virtue of the growth of the surplus.

If the twofold participation in the surplus referred to above has positive effects in certain phases of development, it ultimately comes up against the resitance of the privileged-consumer society, which jibs at conceding shares in the surplus beyond a certain limit; and this is the starting-point of the crisis.

The dynamic in question does not admit of superficial rectifications. Rather do the serious problems it poses call for another and substantially different dynamic. They call for the transformation of the system.

What can explain why the twofold participation in the surplus cannot be carried beyond this critical limit? Why should it not be possible for the income of the labour force to grow at the expense of privileged consumption? The reply is categorical. It cannot do so without detriment to the dynamics of the system; and this is precisely what happens.

The fact is that if the sharing-out of the surplus proceeds beyond the critical limit, not only is privileged consumption compressed but also the capital accumulation largely earmarked for its satisfaction. And there is no mechanism in the system to offset the diminution of this latter. The twofold participation of the labour force in the market sphere and of the State is not accompanied by an accumulation process to replace that of the privileged strata. At best, any such accumulation would be consumptive, not reproductive. Accordingly, accumulation is adversely affected, and so is the growth of the surplus deriving therefrom.

Nothing is farther from the intentions of the upper income strata than to change the system. Their reaction is quite different: they will do all they can to revive the growth of the surplus, thus launching the inflationary spiral, which gains considerable impetus if and when the lower strata join in the struggle for participation.

5. *Trade-union and State responsibility*

When the crisis of the system enters upon and pursues its course, emphasis is usually placed on the responsibility of the trade unions. But very important too, and sometimes paramount, is the responsibility of the State, when it increases its share in the surplus without due regard to economic viability. The reason for this lies not only in the political pressure exerted by the labour force to obtain social advantages, but also in the State's own dynamic, which leads it continually to expand its services and its absorption of personnel (military expenditure included.)

Fiscal orthodoxy gradually becomes ineffectual as these forms of State participation are intensified. In reality, even if the hypertrophic growth of expenditure is covered by taxation, as the critical limit of the system is approached, and still more so if this limit has already been passed, the taxes in question become largely inflationary when in one way or another they affect the labour force and this latter has enough power to recoup itself by means of pay increases.

Ideas applicable to outdated situations still persist. In the early phases of development trade-union power is non-existent or very slight; and the labour force is incapable of defending itself against the tax burden it is called upon to bear. In such conditions, the dominant political power of the upper strata enables them largely to evade their own tax responsibilities as a way of safeguarding the surplus.

Taxes are not inflationary in this case. And if inflation then occurs, it is because they are not being brought into service to cover excess expenditure. In these circumstances the rules of the game are very clear-cut: to increase taxation in so far as expenditure cannot be restricted. This is the golden age of fiscal and also monetary orthodoxy.

6. *The use of force*

Private appropriation of the surplus is arbitrary. So is the struggle to share in it. The greater the power enjoyed, the bigger the share obtained; and this arbitrariness is aggravated as the inflationary spiral pursues its course. The intent to re-establish the dynamics of the surplus by raising prices proves a mirage, inasmuch as the counter-reaction of the labour force immediately ensues. Accordingly, accumulation and the formation of new surpluses —that is, the very stuff of redistribution— is adversely affected. And when these effects are produced they weaken the system's capacity to absorb the increase in the labour force and the manpower vegetating in the lower layers of technology.

The political power of the upper strata, which seemed to be declining with the march of democratization, once again bursts on to the scene, and the next step is the use of force, which makes it possible to break down the trade-union and political power of the disadvantaged strata, so that the dynamics of the surplus may be successfully re-established.

Let me recall what I have already said in another paper[2] with respect to the productivity increment resulting from the lavish exploitation of certain non-renewable natural resources. In this case the surplus can continue to increase, and nothing untoward will occur, despite the intensity of the twofold pressure for shares in it. The crisis of the system is acordingly deferred, but not indefinitely.

It is important to stress that when the power of the upper strata is predominant in the social structure, the trade-union and political power of the labour force is inadequate or non-existent, and the State keeps its expenditure within moderate limits, development crisis are of a different kind.

In the more advanced stages of development, if the holders of military power are not necessarily under the dominion of the economic and political power of the upper strata, one is tempted to ask why they intervene to serve the privileged-consumer society. Here undoubtedly a complex set of factors comes into play. But the fundamental explanation lies, in my opinion, in the fact that given the nature of the system no other criteria for getting it back into working order are available. For, as has already been remarked, its dynamic mechanism, namely, the capacity for capital accumulation, without which no impetus could be given to development, is in the hands of the upper strata. So there is nothing for it but to let them carry on, even if, apart from the political cost, the social cost is enormous.

The income of the labour force has to be squeezed not only to feed accumulation, but also so that the exorbitant State expenditure referred to can be covered, in so far as corrective measures are not viable, by non-inflationary means. Herein lies the aberration of the system.

It will not be superfluous to reiterate here what I have already emphasized in earlier articles. The system heads for a crisis when,

[2]"Biosfera y Desarrollo", a report presented at the Seminar on Development Styles and Environment, CEPAL/UNEP, Santiago, Chile, November 1979.

under the impulse of the democratization process, the power of the labour force is strengthened, while at the same time the functions of the State are expanded: in other words, when the twofold pressure for participation in the surplus becomes increasingly severe.

7. *Economists in face of the outcome of the crisis of the system*

There is something poignant about the situation of those economists with a sense of social justice who share the responsibility for a policy of this kind with the new political protagonists entering the scene in consequence of the use of force. They have to resign themselves to adopting the obsolete rules of monetary and fiscal orthodoxy, since they have no others within their reach.

I say economists with a social sense, for there are also some who in the full tide of neoclassical euphoria have become convinced of the need to sacrifice the labour force because it has not been capable of respecting market laws. The free play of these laws must be re-established by suppressing the power of the labour force outright; and this not without a certain satisfaction in wielding the rod! Only in addition the power of the upper strata to appropriate and increase the surplus is likewise re-established.

I should be sorry to make no mention here of yet other economists who hold prudently aloof from so disconcerting a scenario. Some cherish the hope that the institutional recovery which one day will come about may give them a chance to recommend redistributive measures consistent with their ideologies, or, perhaps, a monetary and fiscal policy free from the bonds of dogma; whereby they lay themselves open to the vicissitudes of a new political cycle and to a new frustration.

Others, again, are awaiting their opportunity to transform the system. Only the transformation they advocate is not the one I am proposing to set forth here.

8. *In default of a new option*

The use of force supervenes because there appears to be only one alternative to the option advocated by the neoclassical economists, namely, that of transferring the ownership and management of the means of production to the State: an alternative which is based, in the last analysis, on a political régime radically different from democratic liberalism. In both cases recourse is had to authoritarianism. In the one, to a conjunctural authoritarianism which sanctifies the social inequity of the system; and in the other, to a structural authoritarianism stemming from a concept of social equity.

There does not seem to be another option, combining this concept of social equity with vigorous development, popular participation and the advance and consolidation of the democratization process.

9. *The neoclassical option*

The use of force makes it possible to follow certain neoclassical principles, although suitably trimmed to accommodate dominant interests, and not always skillfully applied.

Moreover, under the aegis of these principles measures are taken that differ widely according to the countries concerned and the aptitude of those who adopt them, whether they concern internal development or relations with the centres. The results also vary a great deal, with respect both to the rate of development and to relations with the centres. But over this diversity a common denominator prevails: the aggravation of social inequality.

Neoclassical reasoning, of course, is based on the regulatory action of personal interest under a system of free competition. It will be useful to recall the argument in question. Driven by the powerfull motive of personal interest, in their economic activity the owners of the means of production select the techniques and capital investments that offer the highest productivity and the biggest profits. But the interplay of competition reduces profits until they are wiped out, and all that is left is the entrepreneurs' remuneration for their work as such. The conclusion is patent. The whole community benefits if the forces of the system are granted free play.

In our preceding articles we have tried to show that this is not so; for, far from the system's tending towards the elimination of profits, they increase, and are perpetually retained by the owners of the means of production in the shape of a surplus, thus giving impetus to the privileged-consumer society. This structural phenomenon of the surplus has been overlooked by the neoclassical economists. And for this reason above all, their arguments are hopelessly divorced from the realities of the periphery.

Similarly, the facts uncompromisingly belie the notion of a spontaneous trend towards full and efficient utilization of productive resources. These economists fail to note the squandering of accumulation potential; nor do they observe the waste of manpower, especially in the lower strata of the social structure. Faced with the immense harm done to the biosphere under the full operation of market laws, they impute it to exogeneous factors which have no bearing whatever on the virtue of their principles.

Where is that 'invisible hand' which was to assign those productive resources wisely, and equitably disseminate the fruits of development?

10. *Economic liberalism and political liberalism*

Over and over again we have endeavoured to show that this is not how peripheral capitalism works. It promotes concentration of economic power and distributional inequity. And the concentration of economic power brings in its train that of the political power of the advantaged strata.

It is true that in the course of the democratization process the sharing capacity that the labour force gradually acquires tends to counterpoise the power of the privileged strata, as well as that of the State. But the evolution of the crisis finally culminates in the use of force. Thus democratic liberalism breaks down, while the ideas of economic liberalism flourish —an adulterated liberalism which, far from bringing with it the dissemination of the fruits of development, flagrantly consolidates social inequity.

Obviously the Latin American region of the periphery has not yet succeeded in establishing democratic liberalism on a firm footing; we are all too familiar with its vicissitudes, its promising forward strides and its painful setbacks. But the past cannot account for everything. New and complex elements make their appearance as changes take place in the social structure through the agency of technique. The use of force acquires a significance different from that attaching to it in other days: it involves the aforesaid absolute divorce between democratic liberalism and economic liberalism.

What is the essential concept of democratic liberalism? To prevent the arbitrary concentration of political power at the expense of the liberties and rights of the individual and of his social and political participation. Economic liberalism, in its turn, means distributing the fruits of development to the whole community and thus disseminating economic power, in full consonance with the political objectives of democratic liberalism. Both sprang from a common philosophical source; nevertheless, in peripheral capitalism they become mutually contradictory. The use of force enables economic liberalism to be re-established —in accordance with the neoclassical option— at the cost of the relentless sacrifice of political liberalism. And both forms of liberalism come to grief under that other option which consists in transferring the management of the economy to the State.

II

Outlines of change

1. *A synthesis of socialism and liberalism*

In embarking upon this outline sketch, I must make my goal perfectly clear. I am seeking a synthesis between socialism and liberalism or, if preferred, a version of socialism based on the freedom of the individual and on new patterns of social coexistence.

Socialism, inasmuch as the State will have to shoulder one responsibility of fundamental importance, among others: the responsibility of democratically deciding how social use is to be made of the surplus in order to accumulate the fruits of technical progress much more intensively and distribute them equitably.

And liberalism, in so far as the discharge of this responsibility must be compatible with the exercise of economic freedom, both because of what it means in itself and because it is essential to political freedom and to the human rights inherent therein.

This synthesis of socialism and liberalism is the new option which I am proposing to explore in these pages.

In doing so I wish to state expressly that I am not drawing my inspiration from certain currents of European social democracy —especially important in the Federal Republic of Germany— in which enlightened Latin Americans think a solution for our problem is to be found.

It is true that some European countries have attained the utopian ideal of widespread dissemination of the fruits of development. The problem is no longer that of accumulation —which, after a lengthy process, they have largely resolved— but one of continuing to forge ahead and progressively arrive at new patterns of management and social participation.

In the periphery we need to resolve the problems of accumulation and distribution at one and the same time. And we cannot, like the countries referred to, invoke the so-called social market economy, because the social structure underlying the market in the Latin American region of the periphery is fundamentally different from that of the countries which have attained a high degree of development.

At the other extreme of European socialism lies Marxism-Leninism. In the Soviet Union an enormous and deliberate effort has been made in respect of accumulation and equitable distribution. The demands of the doctrine in question, the historical conditions in which this great social experiment was launched, and the unfavourable constellation of international forces amid which it has had to pursue its course, have there combined with ideological considerations to build up a régime in which State ownership and management of the means of production has consequences that are incompatible with the aspirations of democratic liberalism and its inherent values. For me this is of definitive significance. I am averse to this system —great as is my respect for what has been achieved— on political grounds as well as on others of an economic nature.

I shall dwell later on the weighty reasons I have for thinking on these lines. Here I must utter a value judgement which nothing could induce me to renounce. It is not enough for a system to permit of social equity and vigorous development; it must also be compatible with the prevalence of certain principles which have gradually crystallized in the uneven course of democratic liberalism. They are a legacy which we have inherited from Western civilization, whose full significance is never better felt and understood than when those principles are violated and eclipsed.

Let us therefore shake off an intellectual dependence which clouds our view of our own problems. This calls for explicit statement of our objectives, and, above all, for clear-cut emphasis on the values by which they are inspired.

The social objective is obvious. The distributional disparities of a structural character in peripheral capitalism are extremely serious, and must be corrected through the social use of the surplus. This is the objective of equity, which could not be lastingly attained without a higher rate of capital accumulation, in respect not only of physical goods but also of education of human beings.

This last is of great importance, since apart from the structural inequalities there are others of a functional nature which derive from the differences in individual capacity to meet the increasingly complex requirements of technique. The acquisition of the necessary skills is strongly influenced by the social power inherent in the position of the individual in the structure of society. At the same time, the correction of structural disparities would be incomplete indeed unless, by virtue of an intensive educational effort, the great differences in social power were progressively smoothed away. On no other basis could functional inequalities be justified.

Income distribution must be dynamic if it is to be lasting; accordingly, it necessitates vigorous development. Although in the centres it has become the fashion to consider the possibility of calling a halt to the dynamic impetus, in the periphery we are still a very long way from attaining such conditions as would make it possible to enter upon a phase of this kind. Decidedly, the growth rate of the product must be speeded up; its composition, however, must not be the same, but needs altering to meet the requirements of social equity. And also the demands of the biosphere.

This endeavour to step up growth poses a dilemma whose vital significance cannot be bypassed. We have referred to it in passing. Will it be necessary to transfer the ownership and management of the means of production to the State in order to secure the social use of the surplus? and can this be done without detriment to personal freedom?

An integral and inseparable part of personal freedom is economic freedom. Here we come upon a value judgement whose scope must be defined. When in the exercise of this economic freedom the urge to consume acquires exaggerated proportions it must inevitably end by eroding other human values. Would this trend have to be repressed? Would that be the work of the omnipotent and omniscient State? The solution must spring from those essential rights of the individual and from his membership of the social community. Persuasion, not coercion. But persuasion of a very different order from that exerted by the formidable interests which are the motive power behind the consumer society.

Persuasion and creative participation, from the classroom to the mass communication media.

Why not use those media to formulate and propagate human values which conspicuous consumption is smothering? Why should not new motivation emerge to stay economic interest from penetrating deeper than is essential for the economic efficiency of the system?

The human values in question are of transcendent importance. It is not our province to enlarge upon them now. In the vastness of Latin America there will be others better qualified to speak of them. But the transformation of the system will have to create the right conditions for these values to spring up and bear fruit. And also for the rescue of certain ethical principles which are foundering in the tides of market forces.

They are principles essential to social cohesion, without which the new system would run the risk of disintegrative instability. And those principles could not be imposed by State coercion.

2. *Social use of the surplus*

It has already been shown in the appropriate context that the private use of the surplus lacks collective rationality and is ultimately the source of major flaws in the system. Its rationality pertains essentially to the limited scenario of the privileged-consumer society.

Consequently, the State must determine how the surplus will have to be used in order to attain the economic and social objectives of change. To fulfil these objectives the rate of capital accumulation must be speeded up as intensively as possible in order that the increment in the labour force may be employed in conditions of increasing productivity, together with the manpower in the lower layers of technology and that part of the active population, mainly in the middle strata, which the system spuriously absorbs, largely because of the insufficiency of capital accumulation.

The social use of the surplus will make it possible to imbue the new system with a dynamic fundamentally different from that characterizing peripheral capitalism.

I shall now proceed to explain in what the social use of the surplus consists, presenting my ideas somewhat schematically, since I shall confine myself to expounding them in broad outline in order to facilitate critical analysis. Consequently, I am not proposing to go into aspects which, albeit important, would distract attention from what I consider to be of paramount significance. In any event, I hope to have the opportunity of dealing with them in some other study.

The social use of the surplus is a way of meeting the need for the State to establish an impersonal and collective accumulation and distribution discipline, compatible with the exercise of economic freedom within the play of market forces.

Under this accumulation discipline, all enterprises would be expected to increase the amount of the surplus devoted to accumulation, at the expense of consumption on the part of the owners of the means of production.

Furthermore, accumulation would also have to be increased at the expense of consumption by those who carry executive responsibilities and by personnel of enterprises who, thanks to their skills, spontaneously obtain a share of the surplus in the higher strata and the upper fringe of the middle strata.

While all enterprises would have to step up their capital accumulation, redistributive responsibilities would be incumbent only upon those in which most of the surplus derives from their concentration of a large proportion of the means of production. Medium-sized and small enterprises would therefore be responsible for accumulation alone.

Part of the surplus in the large enterprises would be distributed not only to their own labour force but also to the manpower working in all enterprises as a whole. Thus the distributional disparities of a structural character would gradually be corrected. And thus too the private and social consumption of the labour force could be increased, at the expense of the consumption of the privileged strata.

The distribution struggle which at present distorts the operation of the system would then have been replaced by a discipline based on consideration of social equity that were compatible with the economic efficiency of the new system.

All that would remain would be functional pay differentials. As their capacity, experience and skills increased, individuals would climb above the rest to higher rungs on the ladder of responsibilities and remunerations. This indispensable social mobility calls for appropriate training patterns so as gradually to do away with the differences in social power.

In addition to this method of encouraging individual productivity, others are conceivable in relation to the entire personnel of each enterprise and to the growth of its surplus.

3. *Ownership and accumulation of capital*

The time has now come to speak of the ownership of the capital which mounts up as the surplus accumulates. It should first be recalled that the major evils of the system do not derive from ownership in itself, but from private appropriation of the surplus and the concentration it brings in its train. There are three possible approaches susceptible of combination in different ways:

- distribution of the new capital among the labour force;
- accumulation mainly in the hands of those owning the means of production;
- accumulation by the State.

The first approach implies assigning the labour force an increasing share in the responsibility for accumulation. This growing capital accumulation on the part of the labour force would gradually pave the way for its management of the large enterprises, which would thus become self-managed enterprises if and when it held a majority of the shares.

The second method, relating to compulsory accumulation by the present owners of the means of production themselves, would give them greater interest in the operation of the enterprises than in the preceding case, but would also strengthen concentration of capital in the upper strata. With the disappearance of the owners, however, the capital accumulated could be partly redistributed to the labour force, and in this way the redistribution of successive surpluses would be initiated. These too would become self-managed enterprises, although the process would take longer than in the former instance. In all this pragmatic consideration are of great importance.

Let us now look at the third system of accumulation, whereby the new capital would belong to the State. Not all enterprises would be socialized, but only the large ones. This would counteract the trend towards private concentration, and although the political power thus accruing to the men at the top would be considerable, it would not be unassailable, as in the case of total socialization. This is a point to which I shall revert in the appropriate context.

Moreover, this partial socialization, unlike general socialization, would be compatible with genuine political plurality. Party strife, however, might have very serious effects on the life of enterprises. There is no need to imagine these effects; suffice it to observe what is actually happening —with a few exceptions— in our countries. Directors of State enterprises are not generally chosen on the basis of efficiency criteria but in the light of political interests. And this fact, in addition to the spurious absorption of personnel, is prejudicial to the surplus, which sometimes may even be wiped out or converted into losses.

Obviously these adverse effects could be mitigated, if not warded off altogether, were it to be decided that the personnel of State enterprises should participate in their management. The régime would thus incorporate certain elements proper to the self-managed enterprise.

Attention must now be turned to another important facet of capital accumulation when it is undertaken by the labour force. Whatever resources deriving from the surplus were devoted to this purpose would mostly be retained in the same enterprises from which they originated, in order to cover the expansion of these or the formation of new enterprises; with the remainder, the State would also promote the creation of new enterprises or would support the expansion or improvement of some already existing, especially those of small and medium size.

It should be reiterated that the distribution of capital to the labour force would not be effected enterprise by enterprise, in accordance with the accumulation corresponding to each one, but among all enterprises as a whole, and in conformity with impersonal norms.

In addition to this participation in capital, a recommendable incentive to efficient operation would be to distribute to the personnel of each enterprise a proportion of any surplus in excess of certain limits.

4. *Distribution complications*

The social use of the surplus is only the starting-point for thorny distribution problems. To understand the nature of these difficulties it is necessary to bear in mind the heterogeneous composition of the labour force and the power relations which it generates, in contradistinction to what is usually assumed in some lines of reasoning inspired by the mistaken notion of social duality.

For the purposes of our exposition a schematic distinction may usefully be drawn between the following structural groups, in accordance with the analysis presented in earlier articles:[3]

— the labour force which, largely thanks to its social power and also by virtue of its experience, possesses the more and more demanding skills called for by the penetration of technique. It is found mainly in the upper strata and also at the higher levels of the middle strata, and spontaneously obtains a share of the increase in the surplus without the necessity of trade-union power, although it habitually resorts to certain combinations in order to boost its income, sometimes exceptionally fast;

— the wide range of economically active population in the middle strata which, despite

[3]It is not my intention at the moment to offer a detailed analysis of the structure and the wide diversity of interests which come into play within it. I have confined myself to mentioning the social groups which are of great importance in power relations and therefore in the distribution struggle.

the possession of skills —easily acquired, however, and inferior to those mentioned in the preceding sub-paragraph— needs trade-union and political power in order to share in the surplus under the existing system.

This labour force from the middle strata is active both in the sphere of the market and in that of the State. And the interests of the two spheres are sometimes coincident and at others divergent, according to differences in trade-union and political power;

— the labour force in the lower strata, with little or no redistributive power; and

— the increment in the labour force.

It is not superfluous to recall that an increase in the rate of capital accumulation is necessary above all in order to absorb at rising levels of productivity the manpower from the lower strata and the personnel, chiefly from the middle strata, spuriously absorbed in State employment, as well as the increment in the labour force. Upon this the social efficiency of the new system essentially depends.

This increased accumulation, however, poses very serious problems. We have already pointed out that the surplus must be redistributed to the labour force and that part of it would take the form of new capital.

Obviously, there would be no reason to include in the redistribution process either the higher strata of the labour force or the upper middle strata which at present spontaneously obtain a share in the fruits of increasing productivity. What is more, the responsibility for accumulation, which is incumbent upon them too, should be borne at the expense of their own consumption.

In contrast, the accumulation effected by the rest of the middle strata, as they reaped the benefit of the distribution of the surplus, would be achieved without reducing their former level of consumption, which would be more likely to improve in a measure compatible with accumulation requirements.

These accumulation requirements should not be extended to the lower strata: among them considerations of immediate consumption could be allowed to prevail over the need to accumulate capital. It is easy to understand how this can be justified. Dynamic income distribution is a process which takes a fairly long time, so that some response would have to be made to the immediate pressure of the private and social consumption of these lower strata.

Hence it is obvious that the transformation of the system might be largely frustrated if consumption pressures made it impossible to meet the demands of collective rationality, in relation both to the growth of capital and to its social composition.

5. *Incentives*

Moreover, this frustration might go so far as seriously to jeopardize the dynamics of the new system if the pressure of consumption reached the point of impairing the system's economic efficiency. Considerations of social efficiency cannot be overstressed to the detriment of economic efficiency. This brings us to the incentives already mentioned. The penetration of technique demands of the labour force an increasing range of skills, from the highest to the humblest. Incentives are needed —and opportunities too— to acquire such skills and make full use of them in economic activity.

With respect to incentives, an unfortunate confusion generally exists, which needs clearing up. An increase in productivity is the result of a combination of two elements, namely: the technical innovations which take concrete shape in capital goods, so to speak; and the skills called for by technical progress. Participation in the fruits of this increasing productivity by the possessors of such skills —including entrepreneurial qualifications— constitutes an incentive indispensable to the dynamics of any system, although in peripheral capitalism it is usually carried to excess.

The surplus is a different matter: i.e., that part of the fruits of productivity which is not spontaneously transferred to the labour force because of the heterogeneity of the social structure. Its appropriation by the owners of the means of production might be supposed to constitute an indispensable incentive to stepping up capital accumulation and thus obtaining new productivity increments.

If the surplus were used essentially in this way, there might be a measure of pragmatic justification for its private appropriation. But that does not happen, owing to a countervailing incentive: the incentive to consumption in imitation of the life styles of the centres.

Recourse must therefore be had to the social use of the surplus in order to resolve the accumulation problem. But how can that part of the fruits of productivity which corresponds to the entrepreneurial activity of the owners of the means of production be distinguished from the part corresponding to the surplus proper?

The neoclassical economists had managed to clear up this question with great conceptual finesse: at the system's point of equilibrium profits are wiped out, and all that remains is the remuneration of the entrepreneurs; so the surplus disappears.

But this is not the case, since profits, far from vanishing, go to form and swell the global surplus. Consequently, the problem has only an empirical solution. It is true that in enterprises there would appear to be a clear distinction between earnings and profits. But the earnings concerned, especially in the higher strata and the upper middle strata, are influenced by the surplus, and it would only be possible to separate these two elements empirically.

In brief, the dynamics of the new system requires, on the one hand, incentives to productivity, and on the other, accumulation as an inescapable condition for redistribution of the surplus to the labour force.

Nor must it be forgotten, from another point of view, that in the skills made necessary by the penetration of technique there is generally a substantial content of social power. The solution does not lie in underrating (or politically attacking) their possessors, but in progressively eliminating that social power, by offering to all, and especially to those who are vegetating in the lower layers of productivity, adequate opportunities for training and social mobility.

It is worth while to lay yet further stress on so significant an aspect of the question. Income redistribution will gradually smooth out social disparities of a structural character, but functional disparities will continue to make their appearance. The problem consists in getting rid of the residual element of privilege contained in these latter, rather than arbitrarily smothering incentives.

I hope all this is plain and simple. But in any event, it must be recognized that redistribution which is at once equitable and dynamic is a difficult matter, owing to the interplay of immediate interests. And I say immediate, because there is an unquestionable convergence of long-term interests. This convergence could be reached only after a more or less lengthy period of transition: but it is precisely this transition period which is of interest to study. We cannot fall back on the neoclassical —and also the Keynesian— economists' hackneyed resource of passing from one point of equilibrium of the system to another without noticing the changes which take place between the two positions.

6. *The State and power relations*

In discussing the operation of the present system we remarked that its dynamic mechanism was in the hands of the upper strata, where most of the means of production are concentrated. Under a new system the control of this mechanism will be transferred to the State, by virtue of its fundamental responsibility for the social use of the surplus. We likewise said that in order to discharge this responsibility the State does not need to assume the ownership of the means of production, but is merely required to determine how the surplus is to be used in order to attain the objectives of change. But what State? How is the State to override the play of power relations if, apart from its own dynamics, it functions largely in consequence of those relations?

As long as power relations make it possible to maintain the dynamic potential of the surplus —based on social inequity— it is almost inconceivable that those who primarily appropriate the surplus will be disposed to give it up on the basis of a democratic consensus. But with the advent of the crisis of the system, its economic distortion and social disintegration, the democratic power of the middle and lower strata might be able to prevail over the power of the upper strata and transfer control of the dynamic mechanism of the system to the

State. This is an option which might also offer itself to those who use force to avert disruption: in that case it would be used to change the system rather than to maintain it. And if things were otherwise, the option would still be open when circumstances made it possible to return to institutional normality. This normality, however, would be exposed to the risk of a new crisis unless it were based on the transformation of the system and of the State itself.

For the purposes of this transformation, new rules of the game are needed to guide the action of those responsible for implementing democratic decisions on the social use of the surplus. They too are politicians, and motivated by their immediate political interests. Their power cannot be discretional: it must be exercised subject to rules of the game that are consistent with the economic and political objectives of change.[4]

7. *Planning the use of the surplus and institutional mechanisms*

The new and complex functions thus assumed by the State will entail significant changes in its institutional mechanisms. Supreme intervention will be called for, aimed at achieving what cannot feasibly be brought about through the operation of the market, and differing widely from the countless ways in which the State at present intervenes, in many cases because it has not had at its disposal the institutional machinery to determine how the surplus should be used.

In order to meet the requirements of a collective rationality that the system lacks at present, the State will have to determine how the surplus is to be shared out among accumulation, consumption and State services. The incompatibility between these various purposes becomes increasingly marked, of course, in the more advanced phases of the system and leads to its crisis.

Accordingly, these different ends must be reconciled. But what are the criteria in the light of which the State will have to act? To what extent will it have to aim at raising the rate of accumulation?

I do not hesitate to assert that upon this last the success of the process of change mainly depends, since the rate of accumulation is an essential factor in dynamic income distribution. To that end, the absorption of the lower strata, of the labour force from the middle strata which has been spuriously integrated into the system, and of the population increment must be speeded up.

What are the dimensions of this task of labour absorption? How far will the rate of accumulation have to be raised in order to attain this objective by a given deadline?

These are questions that are very hard to answer, for the greater the effort made to increase the rate of accumulation the fewer the resources that can be earmarked for the early improvement of the private and social consumption of the disadvantaged labour force. The same problem arises —and looms very large— in connexion with the amount of the surplus that the State will have to appropriate in order to expand its services.

The social use of the surplus entails constricting the consumption of the privileged strata to serve the above-mentioned ends; for this purpose a substantial part of the surplus and of the income of the strata in question would have to be tapped. A very tricky problem, this, since accumulation and distribution requirements must be weighed against the incentive needed by those at present carrying directorial and executive responsibilities in enterprises, and those who will have to take their place as progress is made towards the social enterprise. This relates particularly to the distinction between surplus and entrepreneurial remunerations, which, as we have already said, will have to be determined by

[4] Here the old rules of monetary operation are pertinent. They meant that considerable power was given to the monetary authority, but in line with norms institutionally established by the political organ of the system. And those who were invested with executive responsibility in the political organ also had to keep their influence over the monetary authority within bounds. This regulatory system generally worked efficiently as long as the power of the upper strata made it possible to handle the dynamic mechanism of the system without major upheavals. But this is no longer the case when the middle and lower strata acquire considerable power to share in the surplus. The rules of the game then turn out to be inoperative or, worse still, counterproductive.

pragmatic considerations in default of accurate criteria.

Lastly, once the new rate of accumulation has been fixed, how is responsibility to be shared out between the upper strata and the rest of the social structure as the surplus is redistributed?

The merest glance at the aspects of the question that have just been presented, not to mention others that for the sake of brevity have not been dealt with, suffices to take in the complex tasks which the State will be called upon to perform. These tasks will have to be carried out at two closely related levels: the technical level and the political level. At the technical level, the different aspects of the social use of the surplus will have to be analysed in quantitative terms, and various alternatives will have to be put forward as to ways of using it so as to serve the objectives of change: a task whose results must be transmitted to the political level, where the pertinent decisions will have to be adopted.

I am stressing this last point, because, while the tasks to be undertaken at the technical level are of great importance, we must not be seduced by the allurements of authoritarian technocracy. The fundamental decisions are political, not technical. In order to adopt them, however, it is impossible to dispense with the contribution of technical expertise; nor can those on whom political responsibilities are incumbent override the independence of those carrying technical responsibilities in so far as the preparation of their analyses and the presentation of their alternative proposals are concerned.

From the combination of tasks on the two levels should emerge the plan for the social use of the surplus. Thus planning will acquire a meaning that at present it lacks, since the private appropriation of the surplus inexorably leads to disturbances which preclude the exertion of deliberate and rational influence on the factors of development.

It is enough to propound this idea here without prematurely entering into details. All that need be added is that planning for the surplus will have to be extended over a number of years in order to achieve a reasonable degree of stability in the fulfilment of its objectives. Stability, not rigidity, since, apart from any contingencies which may make it inevitable to modify the implementation of the plan, it would not be possible to freeze the emergent power relations of the different social groups, in which the changes that are taking place in the social structure find expression.

Nor will we go very deeply in this preliminary outline into discussion of the institutional mechanisms to which the State will have to resort in order to discharge its responsibilities respecting the social use of the surplus. Suffice it to mention here the mechanisms relating to the above-mentioned planning tasks, to the participation of different social groups on a consultative basis, to the adoption of the pertinent political decisions, and to the supervision of plan implementation. It should also be recalled, in the light of CEPAL texts, that however great the extent to which the problem of accumulation and distribution may have been resolved, planning is necessary to enable the State to take farsighted determinations with respect to certain highly important changes in the structure of production which elude the operation of market forces.

From another standpoint, the State will have to establish norms for the social use of the surplus, both as regards accumulation and with respect to the share in it obtained by the labour force as redistribution takes place. These norms must be linked to the tax régime and the changes which would have to be introduced into it in order to ensure the compatibility of different objectives.

As already pointed out, a substantial share of capital accumulation would correspond to the same enterprises in which it was generated, and a part of it to other enterprises or to new ones. Here the State will fulfil promotion functions of great dynamic significance, for which it will need, of course, a mechanism to channel financial and technical resources and encourage technological research.

Much could be said on these and other subjects, but to do so would mean overstepping the bounds of the preliminary outline of change to which this article must be confined. However, in recognition of the criticisms which have been expressed in connexion with the structure of production, there will be room in due course for discussion of indispensable measures to correct certain distortions in accumulation and consumption, whether by altering the price system or in other impersonal ways.

In addition, a wide field for discussion is opened up on which I must abstain from entering, both to avoid exceeding the scope of my exposition, and because it concerns matters outside my province. I refer particularly to the constitutional régime for the surplus, that is, to the basic principles which should govern its social use and the necessary institutional mechanisms, the legal provisions relating to these latter, and the political handling of the plan and its possible modifications. It would also be neeessary to establish the legal régime and the responsiblity of the State respecting those enterprises in which part of the surplus would have to be accumulated.

These reflections on the State lead to a conclusion which needs emphasizing. Changes in power relations, in the structure of political power, are an indispensable but by no means a sufficient condition for the transformation of the system. It is necessary to know the object and the manner of that transformation; in short, a theory of change is required.

Nor, in turn, will it be enough to construct such a theory, if no change takes place in the structure of political power.

The democratic option in question can be glimpsed, although it has not yet been formulated; we must zealously search for it. I hope it will be a synthesis of socialism and liberalism — a liberalism springing from its original philophical fountainhead.

8. *Enterprises in the process of change*

We shall not explore this issue either, but it does seem desirable to mention the changes that would have to take place in enterprises as a result of the social use of the surplus. In the light of what has already been said in the context of accumulation and of what we shall go on to say, the enterprises that would exist could be divided into the following categories:

—small enterprises in which accumulation and management would remain in the hand of their owners;

—medium-sized enterprises in which part of the accumulation would begin gradually to be effected for the benefit of the labour force as a whole, while their management would still be the responsibility of the owners;

—large enterprises, including any resulting from the growth of those of medium size. In this case progressive accumulation in the hands of the labour force would clear the way for self-management;

—enterprises whose capital would belong to the State;

—foreign enterprises.

It is worth while to dwell briefly on the implications of this entrepreneurial plurality.

There is no reason for surprise at the special treatment of small and medium-sized enterprises, in view of what has been said of the significance of ownership of the means of production. What is of fundamental importance is to prevent their concentration, since that gives rise to the concentration of the surplus and, in turn, to a new process of concentration of capital. This objective will be attained through the social dissemination of capital throughout the labour force in all enterprises as a whole.

On the other hand, from the standpoint of the dynamics of the system and the incentives required to keep it going, the capital of these small and medium-sized enterprises ought as far as possible to be accumulated in the hands of their owners. It must be recalled, however, that after a certain point the surplus in such enterprises would begin to be distributed to the labour force.

The importance of accumulation on the part of the personnel of enterprises goes far beyond a redistributive operation. The dissemination of the new capital would gradually place a larger proportion of the ownership of the means of production in the hands of the personnel. A time would thus come when the latter would acquire a majority of shares that would allow it to assume the management of the enterprises, converting them into self-managed enterprises, independent both of those in whose hands capital used to be concentrated, and of the State.

This is a point of vital importance. Self-management is the concern of large enterprises whose technical and economic complexity demands a strong sense of responsibility in the choice of those who are to form their boards of directors, which, in their turn, will have to appoint the holders of executive posts. Different ways of making the selection are conceivable. One of them, perhaps the most advisable, would be to form three estates carrying equal weight: that of the high-ranking personnel (directors and technical experts); that of middle-rank employees and skilled workers; and that of lower-rank employees and unskilled workers. The representatives of these three estates would form the board of directors of each self-managed enterprise, on which the State would also be represented when it had contributed resources for the enterprise's expansion or rehabilitation.

These representatives, together with those of the present owners, would participate in proportion to their share in the capital, whose social composition would gradually change as described above.

The motives justifying State ownership of enterprises are common knowledge. They relate, above all, to those activities whose very nature precludes their competing in the market; to cases in which the dimensions and technical complexities of the activity make State promotion important; and to the purpose of counteracting the penetration of foreign enterprises in decisional fields which are the exclusive province of the country itself.

But we also know that the results achieved by public enterprises are not always positive. Hence the desirability of giving their personnel a share in their management, in combination with representatives of the State. Moreover, there would be no reason to debar the labour force from acquiring shares in the capital of such enterprises.

Foreign enterprises pose a special problem with regard to accumulation. For, in contrast to what happens in the case of a country's own enterprises, part of the surplus is used outside the national jurisdiction. This fact and other considerations make it advisable to establish a special régime. Among such considerations it must be borne in mind that the changes in demand brought about by the social use of the surplus will enforce certain adjustments in the operation of these enterprises which will favour their transfer to national ownership.

In all this the State will have to act in the light of a strictly selective criterion, both as regards the establishment of new enterprises and with respect to the takeover of ownership by the country's own nationals, once the technical and economic capacity for running the enterprises under a self-management system had been built up.

9. *Distortions in the social use of the surplus*

Whatever the extent to which the new system is based on a significant change in the structure of political power, it will not mean that the effects of the structural heterogeneity of the labour force will have been overcome. A long time will have to go by before relative social homogeneity is attained.

In the meantime, the new system will not be immune from dangerous pressures which could weaken the régime of social discipline in respect of accumulation and distribution, with very serious political consequences.

Under the new institutional régime, no social group would be able to improve its share in the surplus by its own decision alone. I am not of course referring to differences corresponding to individual contributions to the production process, that is, to differences of a functional nature, but to those whose origin is structural. The share in question could only be altered in accordance with the organic procedure established, subject of course to any modifications which it might become necessary to introduce. For an improvement in one social group's relative participation in the surplus would be detrimental to that of the other groups, unless it were secured at the expense of accumulation; the same might be said of the share in the surplus directly or indirectly appropriated by the State.

Note the fundamental difference from the existing system, in which these various pressures are exerted without regard to their subsequent incidence and, if they go beyond a certain point, their inflationary effects.

Such would be the rationality of the new system and its elemental need for planning.

But planning, despite its rationality, will not suffice in itself to contain disruptive pressures. How can the various immediate interests be reconciled with one another and their compatibility with accumulation requirements likewise be ensured?

I am far from cherishing a mechanistic illusion. The wisest and most farseeing constitutional provisions are always exposed to risks of distortion and violation. But there are ways of re-establishing their regular operation, perhaps with certain reforms recommended by experience; and the same might be said of the institutional régime for the surplus. The power of certain social groups might overstep its bounds and secure political decisions which would have perturbing effects on the new system; or the system might suffer the consequences of populist irresponsibility. But in accordance with new rules of the game the exact social incidence of such aberrations would be ascertained, and there would also be known means of bringing the institutional régime for the surplus back into working order; another great difference from the present system, in which there are no rules of the game that can hold the inflationary spiral in check.

However, not very much imagination is needed to discern the consequences of persistent irregularities in the course of which the groups with most political power would end by undermining the very foundations of the new system. Thus events might provoke the use of force, either to impose the aforesaid rules of the game, or to bring about by authoritarian means a return to peripheral capitalism, or to enforce structural authoritarianism by establishing an omnipotent State through the transfer of the ownership and management of the means of production.

I say this in all frankness because I do not suppose myself to have found an impregnable solution. I am very well aware of the great obstacles that will have to be surmounted. This is not a matter of formulas which, once adopted, will produce their beneficial effects by themselves. Strong convinction will be needed, both to arrive at a new system and to overcome the formidable obstacles which will present themselves in the course of its operation.

But is there any other way? A way which will enable vigorous development and equitable distribution to be combined with individual freedom? If there were, if this discussion pointed to it, I should not hesitate to follow it, retracing all the toilsome road I have travelled up to now.

10. *The social use of the surplus and the degree of development*

From all that I have said so far it might be thought that my arguments relate only to the countries at a more advanced stage of development, in which the democratization process is becoming incompatible with the system of accumulation and distribution.

But this is not so. In reality, I have placed the emphasis on such cases, not only because of the importance attaching to them, but in order to reveal the prospect that lies ahead of the other less developed countries, if they do not profit in time by the experience of those that have advanced farther.

It is true that very marked differences exist. In countries where industrialization is incipient the proportion of the labour force working in agriculture and in other low-productivity activities is very high; so too, usually, is the rate of population growth. Consequently, the problem of absorption presents itself on a relatively very large scale. How can it be faced if the surplus in the nascent industrial sector is tiny?

There is nothing for it but to resort to the real or potential surplus from agriculture and other sources of primary production. True, this is also necessary in countries with a higher degree of development; but there surpluses also exist in industry and in other technically advanced activities.

In the less developed countries in question, the two land tenure situations mentioned in chapter IV are to be found: estates that are technically well-run and others that are not. In the case of the former the surplus must be tapped with a view to its social use; whereas in that of the latter the surplus has first to be created, by enforcing in one way or another their more efficient exploitation. In both cases part of the surplus appropriated must be used not only in agriculture but also to give impetus to an indispensable industrialization process.

The same might be said of non-renewable natural resources, where usually a disproportionate amount of the surplus is transferred to the centres.

These are problems by no means easy to resolve, but a solution will have to be found if a country is to develop vigorously on a basis of distributional equity.

In any event, the experience of the more developed countries shows that if in such circumstances no attempt is made deliberately to influence accumulation and distribution, a course will have been followed that inevitably culminates in the exclusive and conflictive phenomena with which we are so deeply concerned.

Sooner or later the democratization process will begin to gain momentum, or to recover if a collapse should have occurred. And whether the movement is spontaneous or violent, it is essential to beware in time of the risk that is run if the process is primarily oriented towards immediate forms of distribution and dynamic requirements of decisive importance are disregarded.

And thus we come back to the same fundamental problem that is common to all, whatever the stage of development reached: the problem of accumulation, especially of reproductive capital, so that dynamic income distribution can be placed on a firm footing.

If the movements inspired by concern for social equity do not face up to this problem, democratization is risking self-destruction.

Differences in degrees of development mainly affect those who will undertake accumulation and the aims they are to pursue. Of course, where industrialization is incipient, accumulation will have to be effected in small and medium-sized enterprises in the hands of their owners. It is these enterprises that in the course of time will evolve in the direction of more advanced technical methods and larger scales of production. Through the social use of the surplus it would be possible to give technical and financial support to the initiative shown by entrepreneurs; unquestionably a very important role for the promoter State.[5]

III

The political art of change

1. *Changes in the structure of political power*

Obviously, the transformation of the system —whether the point at issue is the socialization of the surplus or that of the means of production— cannot come about without fundamental changes in the composition of political power.

It is true that these changes occur as the social structure gradually alters. Political movements set afoot by the increasing power of the middle strata, with the eventual addition of that of the lower strata, gradually strengthen the capacity of these social groups to obtain a share of the surplus. But they are essentially distributional movements, which never have and probably never could have got to the bottom of the problem. In reality, the belief has prevailed that in this way the inequity of the system would gradually be corrected and the risk of radical solutions would thus be warded off.

It can now be seen more clearly that distributive democracy tends to bring destruction upon itself by provoking the use of force.

To put it plainly, the option of socializing the means of production has been confronted

[5]This is not the place to enter upon a discussion of the possible applications of the capital accumulated, but what it does seem worth while to stress is the potential significance of State intervention in foreign trade. Here again the experience of the past can teach a useful lesson.

with no other option capable of securing a majority consensus and thus averting the use of force. I do not count, of course, the neoclassical option, which is based on flagrant suppression of the democratic process.

The use of force cannot be indefinitely kept up. As experience shows, force wears itself out with the passage of time, new leaders assume the responsibility of exercising it and popular aspirations to political freedom and equitable distribution grow and multiply. And unless channels for the re-establishment of institutionalism are opened up, the system is increasingly exposed to violent confrontations.

At all events, I cannot discuss political strategy without exceeding the aim pursued in these pages, and, perhaps, because it is not within my competence to do so. Furthermore, strategy must take into account the conditions really prevailing, in respect of both internal development and relations with the centres. The difficult task I have set myself is different: what is to be done when, whatever the strategy adopted, a composition of political power favourable to the transformation of the system has been achieved?

A change in the political structure is an essential but not a sufficient condition. And I have endeavoured to answer this question by exploring a new option which might combine, as I have said elsewhere, vigorous development, social equity, and participative democracy accompanied by respect for the essential rights inherent in it.

In the course of this exploration my particular intention has been to study the phenomena that occur at the more advanced stages of peripheral development. I consider that sooner or later they are bound to appear in other countries, in view of their special conditions. But in the meanwhile political crises in these less developed countries are of a different nature.

Not only import substitution is a necessity, but also the encouragement of exports. Asymmetry in industrialization will have to be avoided. It is true that this largely depends upon the attitude of the centres, which, as we are all well aware, have not been characterized by their openness, if I may be allowed to reverse the usual application of the term. In view of this fact, it is all the more essential to press with renewed energy along the promising path of reciprocal trade.

They are countries in which the way has not yet been cleared for democratization, either because of the opposition put up by the dominant power of the upper strata in whose hands a large proportion of the land and capital is concentrated, or because the process is slowed down or halted by the various forms of co-option or manipulation which characterize a democracy in appearance, where external forms prevail over genuine substance.

Can the inhibition or adulteration of the process be indefinitely kept up? Can the system withstand increasing aspirations towards democracy and social equity? Supposing the reply were in the negative, and an important change in the power structure of the countries concerned were to supervene: What should be done? How could the illusions of a merely redistributive democracy be avoided, so as to prevent a repetition of the same process as in the more developed countries? The answer cannot be the same as in their case, although neither is it fundamentally different, as will be seen in due course.

Let us now return to the countries where democratization has made some progress. Notwithstanding the ideological differences which characterize political pluralism under a democratic régime, there are generally areas of agreement as to forms of direct and immediate redistribution and as to the expansion of State services, in which the paramount need for accumulation is disregarded. Nevertheless, accumulation, as we have repeatedly stressed, is the only way of securing dynamic income redistribution, and, therefore, a lasting improvement in the lot of the disadvantaged strata.

2. *The political solution of the crisis*

When the crisis of the system becomes acute, however, an irreconcilable rift is opened between those who still adhere firmly to a genuinely democratic ideology and those who profess other ideologies with a substantially different political significance. These discrepancies are too well known to justify a digression into hairsplitting discussion of the use of words, although they end by becoming an insurmountable obstacle to a political solution of the crisis backed by a majority consensus.

Important as this obstacle is, it is not the only one. Political movements that maintain the inescapable need for an omnipotent State, based on a single disciplined party, which can dissolve the power of the private owners of the means of production and take over the management of these, have at their disposal a well-knit doctrine of change which they propose to put into practice; but the same is not true of those other movements of a democratic character. Among them there is frequent talk of a society which is neither capitalist nor socialist, and although these movements are inspired by the idea of distributional justice, they usually abstain from making a determined attack on the very source of the major defects of the system, i.e., private appropriation of the surplus.

All this is profoundly serious and disconcerting. It is not surprising that in these circumstances an attempt is made to blame the politicians for not finding ways and means of resolving the crisis of the system. The responsibility, however, is one which those of us who hold forth about development must share, and in the highest degree, since we have been incapable of contributing to the search for a new option.

We have offered no such new option, either to democratic movements inspired by the ideal of social equity, or to those who resort to force in a not always successful endeavour to put the system back into regular working order. We can hardly be surprised when these latter, swept along by circumstances, and also by certain doctrinal preferences, succumb to the lure of simplicity as held out by the formulas of economic liberalism. And since the trade-union and political power of the labour force has violated market laws, with the ensuing disruption and social disintegration of the system, it must be suppressed in order to contain the inflation which is responsible for these evils!

Herein lies our fundamental problem. It is essential to offer a new option to democratic movements in order to forestall this grave eventuality in time: whether democratization is resolutely pushing ahead where it has been unable to develop, or whether it is being revived where it had been suppressed.

In such cases there would no longer be the option of an economic liberalism which can be maintained only by the use of force. And the lack of a new option could lead to serious capitulations on the part of those who, motivated by deep-rooted aspirations to social equity, might allow themselves to be seduced by the illusion that transfer of the ownership and management of the means of production to the State is the best way of fulfilling these aspirations without sacrificing democratic plurality.

Very striking, moreover, is the social ferment seething in the Church. And it is easy to understand the tribulations of theologians and believers who, deeply distressed by the spectacle of tremendous social inequality, seem to be prepared to compromise up to a point with ideologies of change whose underlying philosophy would appear irreconcilable with the spiritual power of the Church. They do not need to do this. I hope they will consider the ideas which are set forth in the present article. While writing it, I have been profoundly impressed by this recent declaration on the part of John Paul II: All private property carries a social mortgage.[6] Is this mortgage perhaps the social use of the surplus?

Furthermore, why should not this new prospect be put before the military authorities too? We have repeatedly referred to the use of force with a view to introducing economic liberalism without changing the bases of the system. However far it may be true that those responsible are not necessarily concerned about the political cost, which some consider transient and inevitable, if not acceptable, it is common knowledge that in the end many of

[6]See his opening address at the Latin American Episcopal Conference, 28 January 1979. The Pope also explicitly states the evangelical mission of the Church in face of social inequity in the following terms: it must preach, educate individuals and communities, form public opinion, guide those who are responsible for their peoples. It will thus be working for the benefit of society, in which this Christian and evangelical principle will ultimately bear fruit in the shape of a more just and equitable distribution of goods, not only within each nation, but also in the international world in general, preventing the stronger countries from using their power to the detriment of the weaker.

Those who shoulder the responsibility for public life in States and nations must understand that internal peace and international peace will only be ensured if a social and economic system is in force that is based on justice.

them are disconcerted by the social consequences of an adulterated economic liberalism — consequences which are protracted if not aggravated with the passage of time.

Is is not surprising, therefore, that after a phase of euphoria —fostered by some external evidence of admiration— there should be growing dismay at the serious social implications of this type of development, apart from its huge political cost.

Thus events act as a spur to increasing aspirations towards a return to normality, with certain institutional adjustments. But it is necessary to get to the bottom of the problem. Normality of course entails restoring the redistributive power of the labour force. How, then, is the development of a new political cycle to be avoided? How would it be possible to hold in check the conflictive tendencies deriving from a new inflationary spiral, or from the intensification of one that had not been successfully extirpated? How can the exclusive tendencies of the system be counteracted, which, far from being attenuated, are usually aggravated under a régime of force?

Schooled by their frustrating experience, the armed forces might perhaps be interested in considering other options, such as that set forth here; with a view, however, not to imposing them, but to understanding the significance of any democratic movements proposing to put them into effect.

In default of the other options referred to, no one can affirm that the course of events may not incline the armed forces too to overcome certain doctrinal objections —hitherto apparently very powerful— to the option of socializing the means of production.

3. *Political significance of socialization*

The new option described in the foregoing pages is based on the social use of the surplus. The mere mention of this idea turns one's thoughts in the direction of the socialization of the means of production, since it is from them that the surplus derives. This would seem to be a condition logically imposed by the transformation of the system.

But I think otherwise; and these are my reasons. The socialization of the means of production and their management by the State has very serious political consequences, quite as important, in my opinion, as its economic effects, or even more so. Socialization is indissolubly linked to a political régime which is substantially at variance with the values that have guided and continue to guide Latin America's strivings after a representative and participative democracy in which basic human rights are fully respected.

I am conveniently placed to speak bluntly about the consequences to which I refer, inasmuch as I am very far from having defended peripheral capitalism in my earlier work. I have criticized it not only from the economic but also from the social and political standpoints. Accordingly, when I oppose the socialization of the means of production, I must not be taken to do so for the sake of exalting the virtues of that capitalism, much less to condone its social inequity.

Be this as it may, both the socialization of the means of production and the process of change that I am advocating impugn private appropriation of the surplus. The social use of the surplus is the starting-point common to both, but the roads to be followed subsequently are very different.

To place the management of all the means of production in the hands of the State bestows unassailable power on the men at the top, however they may have got there. That is where the lines of command start. And the way of life of the labour force, or rather of the whole population, their income, their promotion, the reward of merit, depend in the last analysis upon summit decisions. And in all this account is taken not only of personal capacity but also of militant loyalty to the system.

Ideological unity is an essential element in this loyalty and in the stability of the system. And the ideology in question is not one that is fed by the free and spontaneous expression of thought, but one which emanates from those who carry the responsibility of power and feel the need to strengthen it by diverse means. Accordingly, there is no room for fundamental dissidence which may jeopardize ideological unity, party discipline and the cohesion of the system: a cohesion which might be impaired if the exercise of freedom of expression were to overstep certain bounds, or if artistic and literary creation and intellectual activity were to deviate from the channels mapped out from above. This is the cohesion inherent in and imposed by the system, which allows of no other manifestation of authority.

It is understandable, therefore, that the spiritual authority of the Church should be deemed incompatible with the omnipotence and omniscience of the State.

This requirement of cohesion in doctrine and praxis is binding even upon those at the summit. For if any of them disagree over weighty questions, they incur the disapproval of the rest, which is a very serious matter, for those who lose status in these internal disputes have not the alternative of expending their efforts in the sphere of private activity, which simply does not exist. Thus the indefinite protraction of the leaders' term of office, however long it may be, becomes an important factor of enforced unity. Stability of the system and gerontocracy!

In addition, the hierarchical links in the chain of decision and vigilance make it possible to nip in the bud the slightest sign of substantial nonconformity. The system has its own internal logic, and exceptional firmness of mind is needed to refuse to comply with its adamantine requirements.

4. *The vitiation of the market*

Furthermore, State ownership and management of the means of production is inseparable from a radical change in the nature of the market, since what is to be produced and consumed depends ultimately upon a central authority. Thus the market loses its political significance, which transcends its economic importance. I am not going to idealize peripheral capitalism in this respect either; nevertheless, to whatever extent the course of development may bring in its train an increasing concentration of economic power, the margin of individual freedom is still quite wide. Otherwise the trade-union and political power of the labour force could not have grown up with the advance of democratization. The only thing is that when that power interferes with the dynamics of the surplus, the use of force permits its suppression.

As I maintained in my earlier articles, the major defects of the system lie neither in the market itself nor in the economic freedom on which it is based. They arise out of the social structure and the power relations which pervert the social efficiency of the system through the arbitrariness of distribution and the insufficiency of capital accumulation.

It is true that under a strongly authoritarian system the concept of the economic freedom of enterprises and individuals —an essential factor in economic efficiency— is not ruled out. But if this freedom were to become genuine, the dominant nucleus would lose an element of cohesion indispensable to the stability of the system and to its own continuance in power.

What is more, if economic liberty exists and entrepeneurs are free to use their own initiative, and if these entrepreneurs emerge from within the enterprises themselves and not from among those in whose hands political power is concentrated, how could they be prevented from aspiring to freedom of expression and participation in political decisions? How far would it then be possible to separate political freedom from economic freedom? Would not the logic of the system call for repression of the political liberty of those who, having acquired economic freedom, expressed discrepancies with that system or with the way in which it works? Could economic freedom be insulated from these effects?

5. *Political pluralism and socialization*

Let us now pause a moment to interpolate a word on doctrine. In the scientific theory of Marx —which must be distinguished from militant Marxism— doctrine is an integral part of the superstructure, which is decisively conditioned by the basic structure of the system. Changes in the structure, as the forces of production develop, promote changes likewise in the superstructure. There are no idelogies of permanent value.

I wonder, therefore, whether the changes that have been taking place in the structure have not something to do with the new currents of ideology which are springing up in other latitudes, and to which a circumstantial and temporary value is sometimes attributed, rather than a lasting significance. At all events they should be considered within a broader doctrinal context.

In these new currents political pluralism is explicitly accepted, in contradistinction to the hiterto dominant concept of the dictatorship of the proletariat, however it may be defined. Pluralism is a *sine qua non* of democratic liberalism. An I do not understand how the latter can be reconciled with an omnipotent State which concentrates in its hands the ownership and management of all the means of production. If democratic change is really the aim pursued, the new currents of thought must not shirk frank discussion of this problem.

6. *Some initial political risks in the process of change*

What I am undertaking in these pages is persuasive action. I want to bring it home to my readers that there is an option for change compatible with democracy and requiring thorough exploration. Should the findings of this exploration be positive, that would be only the first step towards inspiring and promoting broad political movements which could result in a majority consensus.

Subsequent events, however, might vitiate certain basic elements in the process of change to such a point as to jeopardize the existence of the new system.

Among these elements I should like to mention the collaboration of the present owners of large enterprises who are efficiently performing the task of directing them. In our countries this entrepreneurial work on the part of the owners is still important. They must be given not only the opportunity to go on with it but also adequate incentives to do so, although it is true that they will no longer have the surplus at their disposal, since control of that dynamic mechanism of accumulation will be handed over to the State. But the owners would continue to earn interest on the capital accumulated in the same way as any part of the labour force that accumulated new capital. They would also receive the remuneration due to them for their entrepreneurial activities, and other incentives linked to the global productivity of the enterprises.

If, in spite of this, stubborn opposition to the new order of things was still put up, those who carried political responsibility in the new system might be induced to transfer all the means of production to the State. Thus, instead of a gradual change in the composition of the capital of large enterprises until their management passed into the hands of the labour force, there would have been a sudden switch-over to State ownership and management.

It is readily understandable that serious distortions would be entailed by such a modification of some of the basic elements in the new system. It would not be only the large enterprises that were affected. We have already explained that medium-sized enterprises would increase their capital accumulation in the hands of their present owners. But as their dimensions approached those of the large enterprises, they would run the risk that, precisely because they had accumulated more capital, they would be exposed to the transfer of their capital and management to the State. This would weaken the impulse to growth, of so much importance in the new system.

The effects of this kind would be equally serious, or even more so, if no attention were paid to the necessity of granting special incentives to the executives, technical staff and other members of the personnel of large enterprises. Their collaboration is of the greatest importance in itself; and much more so in default of that of the owners. If they were dispensed with out of excess of political zeal, it would take time to fill the gap. And then incentives would have to be offered similar to those which had previously been withheld.

Taking an unflinchingly realistic view, I must recognize that the great initial difficulties —not only internal, but also international— attendant upon the process of change might lead those responsible for it to a measure of authoritarianism: a conjunctural authoritarianism, perhaps, but in any event profoundly regrettable. Strong conviction would be needed to prevent it from becoming structural authoritarianism. Undoubtedly, in the face of obdurate opposition, the transfer of the ownership and management of the means of production to the State would be a formidable instrument of supreme authority of a structural character. And the way would have been barred, perhaps for an unconscionable length of time, to democratic progress.

IV

Technique, demand and structure of production

1. *Consequences of unequal distribution*

In my critical analysis of peripheral capitalism it was largely to the unequal distribution of the fruits of technical progress that I attributed the major flaws in the system. The aim of the social use of the surplus is to correct these flaws, as has been shown in the foregoing pages.

There are two main ways in which unequal distribution influences the structure of production. On the one hand, it casts demand into a mould which is wasteful of physical capital and labour; and, on the other hand, it promotes a certain selection of techniques, and therefore certain patterns of accumulation, which also represent a waste of productive resources. To the best of my belief, the system of accumulation and distribution that I am advocating will enable these deficiencies in the structure of production to be largely set right.

But that would not be enough, for the penetration of the technique of the centres into a peripheral social structure very different from theirs brings with it certain unfavourable effects on the efficient use of capital, which could not be counteracted under the aegis of the new régime, but would necessitate deliberate State intervention in the structure of production.

I have been rightly criticized for having shelved these adverse consequences, as well as others deriving from the erroneous choice of techniques, in my anxiety to stress the paramount influence of the system of accumulation and distribution which characterizes peripheral capitalism.

In reality, I have had no difficulty in taking into account the phenomena to which these criticisms refer, since I have discussed them in former articles in this *Review* and in other earlier publications. Accordingly, in the present chapter I should like to present a succinct and coherent version of those interpretations and to underline their significance.

I note that in all this there may be something more than a mere matter of theoretical emphasis, since I should not be surprised if the influence of these phenomena affecting the structure of production were to encourage a certain trend in favour of the State's taking it into its own hands, via the socialization of the means of production. In my view, from the standpoint of the social use of the surplus the socialization and management of these means by the State is not acceptable, for basically political reasons which I have already set forth in the appropriate context, apart from its economic consequences. For it would undoubtedly mean endowing the State with a power so considerable as to be incompatible with the conservation of essential freedoms.

If this is so, it would hardly be possible to resort to socialization, not in this case to resolve the problem of accumulation and distribution, but to remedy deficiencies that might persist in a new system, despite the social use of the surplus. I maintain that the State has other means of correcting them at its disposal.

2. *Reproductive and consumptive techniques*

In order to understand the changes that take place in the structure of production in the course of development the meaning of the duality of technique must be recalled: on the one hand there are the techniques which aim at increasing productivity; and, on the other, those mainly geared to the diversification of goods and services.

I have applied the term 'reproductive' to the capital required for the first group of techniques, inasmuch as the productivity increment obtained by their means enables capital accumulation to be increased, with further productivity increments as a result, and so on in succession, in a process which has multiplier effects on employment.

The diversification techniques also necessitate capital, not, however, to boost productivity but to obtain more efficient goods and services, of better quality, or designed to satisfy aspirations after different life styles and conspicuous consumption, as well as social prestige and ostentation of wealth.

These diversification techniques cannot develop without the reproductive techniques. It is the productivity increment and the corresponding increase in income brought about by these latter that spur the progress of the diversification techniques, so that the growing demand generated by the income in question may be stimulated and tapped.

It would indeed be pointless to go on lavishly producing the same goods and services beyond certan limits, by virtue of the improvement in productivity. On the contrary, diversification allows the income increment to be expended on a ceaseless display of new and better goods in ever-increasing quantities.

Accordingly, the progress of diversification techniques is the logical consequence of their close combination with reproductive techniques in one and the same production process. Thus the proportion of diversification techniques in the composition of capital tends to rise.

Because the fruits of productivity are so unequally distributed, the use of diversification techniques develops more intensively than it otherwise would. Thus the proportion of consumptive capital increases to an exaggerated extent, at the expense of reproductive capital. And this is of considerable importance in peripheral capitalism.

This social waste of capital is one of the major factors in the exclusive tendency of peripheral capitalism. There are cases in which productivity has increased remarkably by virtue of the introduction of new layers of technology, but the fruits of this productivity increment, owing to their unequal distribution, are largely earmarked to satisfy the diversified consumption of the privileged strata, to the detriment of the social integration of the lower strata.

3. *The consumer society and accumulation*

One of the criticisms that have been addressed to my account draws attention precisely to cases in which the privileged-consumer society has developed to a notable extent and nevertheless a high coefficient of capital accumulation has been achieved. Accordingly, there is not an insufficiency of capital, we are told.

The insufficiency is to be seen, however, in reproductive capital. This state of affairs is aggravated when the suppression of the trade-union and political power of the labour force allows real wages to be squeezed for the benefit of higher social strata. These strata can then still further increase their diversified consumption and their accumulation of consumptive capital.

Let us recall in passing what we have said in earlier articles. A considerable part of this accumulation of consumptive capital corresponds to conspicuous investments in costly housing on the part of the upper strata, as well as to certain State investments which are immune from considerations of economic viability.

It is not enough, therefore, to observe that the rate of accumulation has risen; it is also necessary to ascertain what is being accumulated.

Here I have another remark to make before leaving this aspect of the question. If the object of development is not only economic efficiency but also social efficiency, consumptive accumulation should be kept in a proper relationship to reproductive accumulation. But unequal income distribution pushes demand in the direction of diversified goods and services which necessitate increasing consumptive accumulation. This means using capital in short supply, notwithstanding the fact that there is capital accumulated and consequently capacity available for the production of similar goods, although with less advanced techniques and a lower degree of diversification. This deviation of demand leads to waste of the capital invested in these lower-quality goods, and to an increase in consumptive capital investment, while reproductive capital is socially insufficient.

Clearly, however, in the course of the development process these inferior techniques will ultimately pave the way for more advanced diversification techniques, as has generally happened in the case of capitalist development in the centres. But this process is prematurely anticipated in peripheral capitalism.

Some pertinent considerations still remain to be added with respect to demand and the structure of production.

It is an all-too-familiar fact that the mass communication media, so closely linked to the privileged-consumer society, resort to every available form of collective suggestion in order to spread consumption of diversified goods. And thus they persistently seek to penetrate downwards into the social structure, propagating at its lower levels the attractive image of certain goods which the upper strata are dropping as they adopt the new patterns in which imitation of the centres constantly finds expression. Needless to say, the abuse of credit perpetrated in these collective suggestion campaigns generally plays a very active role.

The transnational corporations, of course, carry a great deal of responsibility in the promotion of imitative consumption. But I incline to believe that even without them the privileged-consumer society would have developed, owing, above all, to distributional inequality, as we have seen so often. The vigour of our imitative genious must not be underrated!

Unquestionably, if the privileged-consumer society lost importance, the mass communication media and the transnational corporations would witness a marked restriction of their field of action. But some exaggerated forms of diversification might possibly survive which would adversely affect reproductive accumulation.

Accordingly, the State would have to intervene deliberately by resorting to taxation, that is, by raising the prices of the goods in which this tendency to certain consumer extravagancies chiefly makes itself manifest.

But let there be no misunderstanding. It is true that I frankly encourage State intervention for accumulation purposes or in questions of health and the necessary defence of the biosphere. Just as taxes and subsidies are justifiable when they are used to influence the structure of production in respect of foreign trade, that is, where the market is not efficacious.

Apart from this, however, I consider it essential to guarantee the freedom of the individual to pursue his own preferences as regards consumption, as likewise in the vast range of human activities, so long as he does not encroach upon the freedom of others. How, then, can one justify the State's overruling such preferences and making the individual's decisions for him? What reason would there be for it to take the structure of production into its own hands in order to fulfil this authoritarian intention? Or for it to apply a wide range of taxes so as to invalidate those preferences?

4. *Accumulation alternatives*

Let us now look at another aspect of the penetration of technique into the social structure. Income distribution also influences the choice of technical alternatives and, through that mechanism, the structure of production, favouring combinations of capital and labour which are at variance with the absorption of manpower.

It is a well-known fact that the techniques which have their origin in the centres signify a flat contradiction: they economize in labour which is plentiful and require intensive use of capital which is in short supply. Here in CEPAL, I believe, we were among the first to analyse this anomaly, as early as the beginning of the 1950s.[7]

This erroneus choice of techniques, with the corresponding waste of capital, is mainly attributable to a distortion of relative prices. I have maintained elsewhere that interest on capital and wage levels are not consistent with

[7] See *Theoretical and practical problems of economic growth* (E/CN.12/221), Santiago, Chile, mimeographed text, May 1951. (Published in Spanish in the series of texts commemorating the Twentyfifth Anniversary of CEPAL, Santiago, Chile, 1973.)

the assumptions of neoclassical theories and their conception of equilibrium. At bottom, we are up against the phenomenon of the surplus which those theories overlook. Thanks to the surplus, enterprises have to resort to the market for only a part of their accumulation requirements, so that the rate of interest is lower than it would be otherwise. Furthermore, wage levels are not what the market spontaneously determines, but are considerably influenced by the struggle of the labour force to obtain a share in the surplus, both through their political and through their trade-union power.

In reality, during the period of almost thirty years that has elapsed since we drew attention to these phenomena, the technological alternatives in question would not seem to have been put forward, save in a very partial and limited fashion.

In the meantime, there has been a great deal of talk about how price levels can be reached that more satisfactorily reflect reality. Something has been said of taxes on capital goods or subsidies for the employment of labour as a more appropriate response to the available supply of these factors of production. Ideas of this kind, and others, have not prospered, I suspect because insufficient progress has been made in respect of technological alternatives in which the centres have no immediate interest.

There is another form of waste of capital that is encouraged by the distortion of relative prices. In countries like ours, where capital is in short supply, it is a striking fact that factories generally work on the basis of a single shift, when they could arrange two or three. The blame must not be laid on price distortions alone, however, but also on other obstacles standing in the way of this more efficient use of capital. As in such cases it would be difficult, if not impossible, to resort to support prices, various measures have been discussed by which the advantageous use of capital might be promoted.

Lastly, other criticisms urge that as new layers of technology are introduced which are of higher productivity than those that preceded them, the fall in prices leads to the liquidation of the enterprises affected, with the consequent loss of capital. This is an argument which is fairly often put forward. But how far is the phenomenon peculiar to peripheral capitalism?

I am inclined to think that the general problem is of another sort, since, as we have already shown, prices do not fall as productivity rises. I do not believe price competition is frequent in cases like these. In the dynamics of development new investments are directed towards taking advantage of the growth and diversification of demand, rather than towards forcing enterprises with higher costs out of the market. Thus the investors can reap the profits for themselves instead of scattering them through a fall in prices. The way to capture the market is not by this means, but by supplying new and better goods.

However, I leave open the possibility that evidence to the contrary may appear. In any event, I wonder whether in that case it would be necessary to resort to the price system or other appropriate modes of intervention, or to fall back on State management of the means of production.

Even on this last assumption, however, it would be a moot question whether the intervention would have to be effected through instructions from the top or whether recourse would also be had to the price system and the play of market forces, in order to moderate the increasing bureaucratization which is arousing so much concern everywhere, the socialist countries being no exception to the rule.

5. *The price system*

I should now like to venture upon a brief digression. As soon as mention is made of the possibility of using the price system for purposes such as those referred to above, the risk is incurred that this may be held to smack of neoclassicism. No such thing.

In reality, neoclassical theories have completely annexed the price system as if it were the exclusive province of their lucubrations. It certainly is the quintessence of their arguments as to the system's tendency towards equilibrium, if it is not upset by artificial interventions. But the price system existed throughout long centuries of precapitalism. There can be no other explanation either for the Emperor

Diocletian's famous edict, or for the admonitions of the Thomists in the Middle Ages. It happens, however, that the neoclassicists have dogmatically enthroned it as the supreme regulator of the economy.

In order that the price system may perform this regulatory role, the neoclassicists do of course accept certain interventions, with a view to correcting the so-called imperfections of the market. To this end they resort to taxes whereby those imperfections can be rectified, as in the case of those misguided selections of technique to which we referred in the appropriate context.

This path, however, could take one too far, as, for instance, when the price system is advocated as a means of protecting the environment. Can it possibly be said that the serious deterioration which the environment has been suffering is due to market imperfections? Would it not be more accurate to speak of the harmful consequences of the unrestricted play of market laws?

There are also some neoclassical economists who recognize that market laws do not resolve the serious problems of income distribution in the centres. If they were to take a more careful look at the periphery, they would see that here market laws do not resolve the vitally important problem of capital accumulation either. If this is the case, what becomes of the role of supreme regulator of the economy that is assigned to these laws?

Neoclassical theory disregards the social structure and its changes, as well as the power relations which accompany these, and their considerable significance in connexion with income distribution. How could it be expected, therefore, to impugn the privileged-consumer society?

V

The specificity of peripheral capitalism

1. *Imitative capitalism*

The question might now be asked, why a theory of change? Would it not be possible to reproduce in the periphery the capitalist development of the centres?

A few decades ago there may have been some justification for this persistent illusion. There is none now. It is fading —the illusion that we could develop in the image and likeness of those countries where welfare has spread to the masses (although not altogether) and democratization (although not without defects) has vigorously forged ahead.

What differentiates our imitative capitalism from the innovative capitalism of the developed countries? We have tried to explain this in our articles. And now, before dealing with relations with the centres, it seems desirable to underscore the specific features of capitalism in our countries, which are really of great importance.

It should be recalled that we have characterized peripheral development as a process of irradiation and propagation from the centres of techniques, consumption patterns and other cultural manifestations, ideas, ideologies, and institutions. All this in a fundamentally different social structure. Therein lie the contradictions from which the great internal defects of peripheral capitalism arise.

This imitative process is carried on under the time-honoured aegis of the hegemony of the great developed countries, principally the United States, and is set in motion by a capitalism whose centripetal character was and still is of outstanding significance, inasmuch as it is the origin of the marked contradictions which also manifest themselves in centre-periphery relations and which aggravate the major defects of peripheral development.

The next chapter will be devoted to this latter subject, while here we shall briefly review the specific features referred to above, recalling what has been said elsewhere.

The specificity that characterizes the peripheral social structure relates mainly to technique and consumption, the degree of development and the democratization process, land tenure, the formation of the surplus, and population growth.

2. *Technique and consumption*

Owing to the great heterogeneity of the social structure, the fruits of the penetration of technique are appropriated mainly by the privileged strata. I do not deny, of course, that the same thing happened during the historical evolution of capitalism in the centres. The difference lies in that, owing to this form of distribution, consumption patterns are adopted in the periphery which developed gradually in the centres, as capital accumulation allowed technique to penetrate more and more deeply into the social structure. In the periphery, in contrast, we are imitating these consumption patterns when accumulation is not sufficient to fulfill its labour-absorbing function; and this situation is aggravated inasmuch as the centres siphon off income by virtue of their technical and economic supremacy and the weight of their hegemony. This point must be clearly understood. The specificity lies not so much in the imitation of the consumption of the centres, which, strictly speaking, is a worldwide phenomenon, but in the dimensions which this phenomenon is acquiring in the periphery, thanks to the flagrant inequality of income distribution. To put it another way, the specific feature is the privileged character of the imitation.

This becomes more marked because the technical progress of the centres is not favourable to technical alternatives that are better suited to peripheral conditions, whence results one of the most serious contradictions of imitative development: a situation that makes it all the more necessary to exploit to the utmost the potential of the surplus.

3. *Degree of development and democratization*

Furthermore, the democratization process made its breakthrough in the centres when considerable capital accumulation had already been achieved. Whereas peripheral democratization is evolving before capital accumulation can meet the dynamic requirements of development; moreover, its bias is essentially distributional, and also conflictive.

It should be noted that I am not deploring a premature democratization process, but stressing the serious consequences of our having devoted attention to immediate questions of distribution while bypassing the indispensable requisite of capital accumulation.

An additional factor is the tendency to disproportionate expansion of State services, which is also largely due to the various forms of distributional pressure and spurious absorption of labour. But it must not be forgotten that this is generally combined with the heavy pressure exerted by military expenditure; it is not surprising; therefore, that State expenditure represents a proportion of the product that in the developed countries it took a long time to attain.

4. *Land tenure*

From another standpoint, it is beyond question that the prevailing system of land tenure has been and still is a stubborn obstacle to development, as CEPAL has so often pointed out. In the industrial centres this obstacle was removed at an early stage, with favourable social and technical consequences. But this is not the case in the periphery, where industrialization is superimposed on a land tenure régime which acts as a brake on the penetration of technique and productivity, to the detriment of development. This is another specific feature of peripheral development which we will go on to examine.

In the context of the structure of production, reference was made to the diversification of demand. This relates above all to industrial goods and skilled services; but not to agriculture, where diversification is very limited. Demand, then, increasingly veers towards the aforesaid goods and services, prejudicially to agriculture. And employment tends to shift to the diversified activities. Thus the share of agriculture in the structure of production and in employment declines. This trend towards the displacement of labour sharpens as productivity rises.

But this is not all. .Regressive income distribution and insufficient capital accumulation, by which the lower strata chiefly suffer, account for the fact that demand for food products is relatively weak, despite the manifest underconsumption.

This often leads to frustration of the favourable effects that might attend increased productivity; there is not enough demand to absorb the larger volume of goods. And the consequent trend towards a deterioration in the internal terms of trade discourages the expansion of production.

Here, then, one of the most flagrant contradictions of the system is to be seen. Unequal distribution displaces the growth of demand towards increasingly diversified goods, at the expense of those that are less diversified or in which diversification is slight or non-existent, such as agricultural commodities.

If the accumulation potential of the surplus were thoroughly exploited, demand and the structure of production would assume a different guise, to the benefit of the less privileged social strata.

However, it is not all a question of demand. The land tenure system which characterizes the structure of production, needless to say, is of paramount importance where concentration prevails in the form of latifundia. As generally happens in Latin America, the inordinately large land rent ensured by the very extent of the property owned makes many landowners indifferent to the possibilities opened up by technical progress, especially in respect of yields. For the same reason they are more attracted by mechanization, since they do not need to devote as much time to the land as the application of biological techniques requires.

It is true that in recent decades the use of these techniques has been spreading, with noteworthy effects on productivity. But the large landowner who is reluctant to adopt them sees that nevertheless the value of his property is rising by virtue of its greater potential capacity. This is a very important feature which also characterizes urban land: the appreciation of land value through the work of others, apart from population growth.

A moment's thought should be given to the contrast with physical capital that this represents, in order to understand the position of agriculture more clearly. The owner of physical capital who fails to avail himself of technical progress does not see the value of his possessions rise; quite the contrary, since in the end he is jostled out of the market by entrepreneurs who are more alert to the advances of technique.

It would seem, as has just been noted, that perceptible progress has been made in Latin America in respect of agricultural productivity. But as one of the major failings is progressively eliminated another comes to the fore. Undoubtedly, with the diffusion of technical progress in agriculture the surplus is increasing; and this is a good thing. But unfortunately the excessive amount earmarked for the privileged-consumer society and for transfer abroad has negative effects on capital accumulation.

Moreover, the agricultural surplus is crystalized —if I may be permitted to use the term— in the value of the land. And this aggravates the concentration of wealth.

Thus agriculture displays very special characteristics. If technical progress is not introduced the surplus is less than might be obtained. And if it is introduced and the surplus increases and is used for the purposes of conspicuous consumption, accumulation potential is wasted. In both cases the effects on absorption of labour and income distribution are frankly unfavourable.

These effects are more serious still when mechanization is introduced and the opportunities of accumulation represented by the resulting increase in the surplus are thrown away. Even though mechanization may meet strict criteria of economic efficiency, this neglect of accumulation possibilities precludes the employment of the displaced labour force and the contribution that might have been made to the absorption of labour whose productivity was low, by virtue of the multiplier power of reproductive capital. Consequently, to the waste of accumulation potential is added a waste of human potential, whether it is left redundant in the rural areas, or goes to swell the ranks of the poor in the cities.

This remark is also of concern to those who adduce the argument that mechanization cannot be introduced in small farms in support of large estates. But where are the people thrown out of work to go? A blind eye is turned to the other side of economic efficiency. Moreover, it should be taken into account that in small and medium-sized farms yields per unit of land are usually higher than in latifundia, especially if the technical action of the State is effective. This is a socially efficient way of keeping labour in the rural areas until the acceleration of development —the transformation of the system— makes it possible to resolve this serious problem in depth.

5. *The euthanasia of the surplus*

Let us now turn our attention once again to the surplus, upon which our theoretical explanations have pivoted. Its appropriation is certainly not a phenomenon peculiar to the periphery, but is common to all capitalism; here too, however, the specificity of the periphery is evidenced. It is worth while to pause for a moment at this point, since the matter is of considerable import.

We have basically accounted for the structural phenomenon in question by the regressive competition of the labour force which remains in lower-productivity layers of technology, when newer and higher-productivity layers of technology are superimposed upon these.

The consequences of this phenomenon merit careful thought. Thanks to the capital accumulation which the surplus permits, in the centres technique has penetrated in depth, and by absorbing lower-productivity labour from the lower strata, has spontaneously relieved the system of some of the regressive competition which prevents the labour force from improving its wages correlatively with the rise in productivity.

Thus the surplus would tend to diminish and finally disappear as the heterogeneity of technique gradually became less marked. In this way a degree of development is conceivable in which the whole of the labour force would be employed in higher layers of technology, using the most advanced techniques available at any given moment. By then the surplus would have been wiped out because the system would have been deprived of a major source of productivity increments, apart from the growing pressure exerted on it by the intensive expansion of State services.

Nevertheless, another important source would still remain: the successive innovations from which increases in productivity would derive.

As the system approached homogeneity, euthanasia of the surplus would ensue, and the neoclassical economists would be able to rejoice in the illusion that the ideal phase had been attained in which competition between entrepreneurs would rapidly do away with the fruits of those successive productivity increments, through wage increases. Moreover, they would be able to point out what favourable effects had been produced by the unrestricted play of market forces, with no need for trade-union and political power. But the illusion might be very fleeting, since the euthanasia of the surplus would pose a serious accumulation problem. There is indeed, nothing in the system which could spontaneously lead the labour force to compensate with its own capital accumulation for what could no longer be done by the upper strata.

This digression affords us a better understanding of the structural and essentially dynamic nature of the surplus. In short, it is a question of a historical category in the development of capitalism.

The periphery, of course, has a long way to go before it reaches this situation, owing both to its great structural heterogeneity and to the waste of accumulation potential. This wastage makes it exceedingly difficult to absorb the lower strata and those middle strata of the labour force that find a niche in the system by spurious means. Here is yet another element in the specificity of the periphery.

And as we have explained elsewhere, in the periphery the twofold pressure on the surplus exerted by the State and the labour force tends to bring the system, much sooner than to a distant phenomenon of euthanasia, to a critical phase; for when this double pressure damages the dynamic mechanism of the system to the detriment of capital accumulation and the privileged consumption of the upper strata, the system reacts with a rise in prices, which inevitably leads to an inflationary spiral.

And the spiral, of course, is not accompanied by a new régime of accumulation. I do not say that the centres are exempt from this trend, but there it generally occurs in different conditions.

6. *Specificity of population growth*

When the technical advances which protect and prolong human life bring down the rate of mortality in the centres, the changes in their social structure, and the psychosocial consequences which these changes bring in their train, are also favourable to a fall in the birth rate. Whereas the rapid penetration of the same techniques into the periphery takes place within a social structure where high birth rates tend to prevail. Hence the population explosion of the last four decades.

This is another specific feature of the periphery. It sometimes severely aggravates the problem of insufficient capital accumulation, as regards both the absorption of labour and the investment that needs to be made before the new labour force reaches the age of productive activity.

7. *Poverty and the structure of production*

What was said above of agriculture helps to explain the problem of poverty in a general context of development: another specifically peripheral characteristic. For poverty looms large, alike in rural areas and among the social groups that have shifted to the towns.

In face of this poverty problem, we are witnessing a certain amount of ferment in connexion with one of those catchwords that are so seductive. It has been given currency, this time —perhaps mistakenly, in my view— not in the empty rhetoric to which we economists of the underdeveloped world are of course prone, but by some of the northern countries. Thence we are now being exhorted with apostolic zeal to combat poverty and satisfy the 'basic needs' of the population. The poverty persisting in the developed world has been somewhat belatedly discovered, and we are being shown that this execrable social scourge exists in our countries too!

No heed is paid, of course, to CEPAL, and I really do not know which is preferable: that it should go unheeded or that it should be credited with what it has never said or proposed, as is frequently done. Its studies are unknown in the centres, or are known at second or third hand, through spokesmen who are not always well-intentioned and are often contemptuous of our ways of thinking. CEPAL has long been drawing attention to the persistence of poverty and the inescapable need to raise the rate of capital accumulation in order to employ the lower strata at higher levels of productivity and income.[8] In other words, it has advocated dynamic income distribution, as we have explained elsewhere.

What happens, however, is that those who are proposing to eradicate poverty generally put forward their formula without explicitly stating how it is to be applied. Is there to be a simple and direct redistribution? Could the problem of social equity be resolved without affecting the system? It is understandable that this may be feasible in countries where over a long period of time a great deal of capital has been accumulated, while poverty, in contrast, exists on a relatively small scale. But in the peripheral countries, where conditions in this respect are strikingly different, it is unwarrantable to shirk the necessity of raising the rate of accumulation as rapidly as possible. And we have already seen that beyond a certain limit this is not compatible with the dynamics of the privileged-consumer society.

If, on the contrary, the proposal is that distribution should be dynamic, if the need for a transformation of the system is recognized, it will be necessary to say so and to say so outright. And this does not appear to be the case.

Be this as it may, the ingenuity of the promoters of this formula is devoted mainly to discussing what needs must be met in order to eliminate poverty. And clearly their enthusiasm has already gone so far along this generous path as to compile a long list of basic needs of the human race, not only those inherent in poverty.

I recognize, however, that there are some

[8] See *Towards a dynamic development policy for Latin America* (E/CN.12/680/Rev.1), United Nations publication, Sales No. 64.II.G.4. (Published in Spanish in 1963.)

who do get a little closer to the tangible facts and acknowledge the need for changes in the structure of production. But beyond this they do not go, perhaps imagining that these changes will come about in one way or another, especially if responsibility for the structure of production is assumed by the State.

I apologize, however, for not presenting here an eloquent chapter on basic needs. Presumably I too could bring some ingenuity to the task; but I prefer to expend mine, perhaps because I cannot afford to waste it, on criticizing the system and suggesting how it might be changed.

Moreover, I maintain that individual needs should not be regimented, because regimentation inevitably means authoritarian enforcement. I have voiced elsewhere my concern in this connexion. And now, more than ever, my overmastering preoccupation is with the essential concept of the freedom of the individual, bounded only by the rule of not encroaching on the freedom of others; but in the context of a new system.

I sometimes think —if I may be excused a touch of misgiving— that some of those who offer such formulas to the periphery from the centres do so in order to evade the problems of the new international economic order. Why listen to all this disturbing rhetoric, instead of mounting a direct attack on poverty? Would it not be easier to hand over a few funds for the purpose?

It would be unfair, however, to maintain that everyone thinks on these lines. There are some who sincerely believe in this solution for the problem of poverty; while others, without harbouring illusions, consider that only by this means, using the image of the undernutrition, disease and ignorance that are rife in the periphery, will it be possible to awaken the slumbering ethical conscience of the centres.

Let it be assumed for a moment that by virtue of some such benevolent magic poverty could be eradicated without the need to accumulate more capital in order to absorb the lower strata at rising levels of productivity. At best, the exclusive tendencies of the system would have been precariously corrected, but not its conflictive tendencies. Rather might these latter be aggravated.

True, there are fortunate countries which have another kind of magic in their hands: abundant financial resources deriving from their non-renewable natural wealth. If instead of being squandered in the privileged-consumer society these resources were devoted as far as possible to capital accumulation, the problem of poverty could be effectively combated. And a higher proportion of the surplus might be earmarked for the satisfaction of immediate consumer pressures. But experience attests that opulence, as well as shortage of resources, is perturbing to the rationality of development.

The distinction —of such importance— between the exclusive and conflictive tendencies of the system should always be borne in mind. For the crisis of the system is generated not so much by the pressure of the lower strata with little or no redistributive power, but by the middle strata that have progressively increased their capacity to obtain a share in the surplus. Clearly, if the lower strata too acquire redistributive power, the inflationary spiral is intensified, with all the ensuing effects.

Accordingly, there are two evils to be attacked: two evils that are closely interlinked and cannot be arbitrarily separated. Yet some devote their entire attention to poverty and others to the inflationary spiral; it all depends upon the prism through which they look. And all alike refrain in general from penetrating to the deep-lying roots of the evils in question. I suspect that if they did so, they could not escape the incontrovertible conclusion that the system must be changed.

8. *Specificity and the process of change*

In the light of what we have just briefly set forth, pursuing the lines followed in our earlier studies, there is every justification for this anxiety to explore new paths in peripheral development.

We have made a decided break with neoclassical teachings; nor do we find the key to our process of change in Marxist theory. For the former, the problem of accumulation resolves itself of its own accord through the unrestricted play of market forces. And for Marx, accumulation was a spontaneous and systematic result of capitalist development. The periphery had no place on his intellectual horizon.

Deliberate accumulation on the part of the State was, however, a dominant concern in the praxis of the socialism of Lenin and Mao: a socialism essentially based on the socialization and State management of the means of production. In this there was a measure of authenticity, correspondent with the intention of arriving at a socialism adapted to the objective conditions of a reality different from that postulated by the Marxist critique of capitalism; but on political bases very unlike any we should wish to accept in this part of the world.

There is also an inescapable need for authenticity in the periphery's process of change; that is precisely why we have stressed the specificity of the existing form of capitalism.

At all events, we must once again be wary of another imitative illusion. There is much to be learnt from the experience of others, of which advantage can be taken to reach a synthesis between socialism and liberalism. Such a synthesis would be the periphery's response to the specificity of its process of change.

PART TWO

VI

Centre-Periphery relations in the process of change

Significance of the present chapter

The dream of developing in the image and likeness of the centres that beguiled the imitative capitalism of the periphery has never come true; this has already been shown in our preceding articles. Neither have the great social disparities been gradually smoothed out —on the contrary, they have become more profound— nor has democratization made any progress: yet another hope frustrated.

What is more, the capitalism which it was sought to imitate is passing through a serious crisis which, because of its structural character, is much more complex and harder to cure than the great depression of the 1930s. Its repercussions on the periphery have already begun to make themselves felt. In our relations with the centres there has been a resurgence of pertinacious problems to which CEPAL has given priority from the time of its earliest writings.

These problems seemed to have vanished into thin air during the long-drawn-out boom years which preceded the present crisis in the centres. They were years of exceptional development in the centres themselves and also in the periphery, where, as we have so often pointed out, the prosperity of the privileged-consumer society was impressive.

The centres, and in particular the chief dynamic centre of capitalism, associated themselves more and more closely with this type of development based on flagrant social inequity. They resolutely played their cards in its favour. But as often happens in boom periods, attention was diverted from the basic problems, namely, the great contradictions in centre-periphery relations.

This situation can no longer subsist in face of the crisis in the centres. It is clearly out of our power to shed much light on the nature of this crisis, but we should like to point out certain factors that play a part in it so that its repercussions on the periphery may be better understood. First, however, the basic problems in relations with the centres will be briefly reviewed.

Capitalism in the developed world has been and still is centripetal. The concept of its power of expansion throughout the world scenario is a myth. However great the initiative and drive of its entrepreneurs may have been, it did not spontaneously carry industrial development to the periphery in the days of outward-directed growth. Industrialization was started deliberately by the periphery itself; it was a necessary result of the crisis in the centres. And this inescapable requisite of the periphery's development is being met with a time-lag so great as to give rise to a number of problems deriving from the disparity between the structure of production of the periphery and that of the centres. These problems primarily concern:

— the innate tendency towards external disequilibrium which acts as brake on the development of the periphery;

— the economic fragmentation of the periphery; and

— the considerable differences in economic and technological power which characterize the phenomena of peripheral dependence under the time-honoured hegemony of the centres.

The crisis in the centres is also the crisis of a development ideology which, from the chief dynamic centre of capitalism, has spread to the periphery, and in particular to Latin America. This chapter would be quite incomplete if we did not end it with a few remarks which, besides being relevant, are timely in face of regrettable deviations and backward steps in development policy and relations with the centres.

The centripetal character of capitalism

1. *Deliberate industrialization and CEPAL's ideas*

My assertion as to the centripetal character of advanced capitalism will not fail to cause surprise, since this, like other development phenomena, eludes the grasp of conventional theories. It is fundamentally imputable to the centres' retention of the fruits of their technical progress. These fruits, as well we know, do not spread to the rest of the world through a fall in prices as productivity improves. For better or for worse, capitalist development would have been entirely different if this retention had not taken place.

Whatever may have been the internal distribution of the fruits of technical progress, the demand generated by the growth of income in the dynamics of development operates in the centres themselves, except for that fraction which is diverted to the purchase of primary commodities from the periphery. Moreover, the periphery's corresponding export earnings are also converted into demand for industrial goods from the centres.

These industrial goods are being constantly diversified by virtue of technical progress and the investment connected with it. There is no incentive to place this investment in the periphery rather than in the centres themselves, where the process of diversification is stimulated by the expansion of demand.

Thus, the longer the time that goes by, the greater become the differences between the structures of production in the centres and in the periphery, with important effects on development.

We were saying earlier that peripheral industrialization was not the spontaneous result of capitalist expansion in the centres: initially, the periphery was compelled to resort to industrialization in order to produce technically simple goods which could not be imported owing to the crises by which the centres were affected (two world wars and the Great Depression between them).

Until then, in reality, it did not suit the immediate interest either of the centres or of the dominant groups in the periphery for the latter to embark on domestic production of goods that it imported at prices lower than would have been the cost of producing them at home.

In those times of crisis which imposed import substitution it was impossible to think seriously of exporting manufactures; but as the industrialization process gradually gained momentum, the need for doing so became clearly apparent. Perhaps we in CEPAL were the first to stress this necessity.[9]

2. *The centres' reluctance to accept exports from the periphery*

CEPAL has more than once recognized the periphery's responsibility for having concentrated all its effort on import substitution, without paying sufficient attention to exports of manufactures. But at the same time stress was laid on the responsibility of the centres, and it was asserted that to have placed production for export on an equal footing with import-substituting production for the home market would have not been enough. In the large centres, measures would have had to be adopted to facilitate imports of certain industrial goods from the developing countries, thereby giving these countries a greater capacity to import precisely those products for which cost differentials are bigger. In this way, an appropriate division of labour would have developed in the industrial field, widely different from the traditional pattern of trading primary commodities against manufactured goods.

Yet neither did the centres encourage exports of manufactures from the periphery, nor did the periphery itself determine to launch a policy definitely favourable to such exports until the exceptional rate of development attained by the centres, in the course of the 1960s, showed the possibility of doing so.

The advanced countries' prosperity had repercussions not only on the periphery's external sales of primary commodities, but also, and above all, on its exports of manufactures. In some cases, the latter developed at high speed and import substitution policy was not merely weakened, but actually repudiated.

During those years the centripetal tendency of capitalism was in some degree obscured, but it did not disappear. The periphery's strenuous export effort has not reached the centres to the extent called for by increasing import requirements and debt servicing.

The periphery has had barely a marginal share in the centres' voluminous and growing flow of industrial trade, which a clear-cut liberalization policy encouraged. Its new industrial exports to the centres, largely handled by the transnational corporations, either involve mainly goods in which innovations are no longer such, having been left behind by technical progress, or else are confined to parts of up-to-date goods in whose case the transnationals take advantage of the prevailing low wages, with no intention, however, of introducing advanced forms of integrated industrialization.

It is understandable that the transnational corporations, spontaneously incited by their own interests, as has been remarked elsewhere, should prefer to invest in the centres themselves, where the aforesaid ceaseless innovations have their origin, and where increasingly diversified demand is concentrated.

But the periphery could send to the centres technically less advanced goods in respect of which it is acquiring competitive capacity and has shown its ability to export them through the

[9] Thus, in a study published in 1961, attention was drawn to the "excessive channelling of industry towards the domestic market", as 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 export and even of traditional export commodities within certain relatively narrow limits." See CEPAL, *Economic development planning and international co-operation* (E/CN.12/582/Rev.1), United Nations publication, Sales No. 61.II.G.6, pp. 14 *et. seq.* (Published in Spanish in the series commemorating the Twentyfifth Anniversary of CEPAL, Santiago, Chile, 1973.)

In another study it is added that "protection has, of course, been essential in the Latin American countries. But it has not been applied with moderation, nor has there generally been a policy laid down rationally and with the foresight which is essential for the alleviation, if not the prevention, of balance-of-payments crises". And it is subsequently remarked that "the closed industrialization fostered by excessive protectionism, as well as the unduly high customs tariffs applied to some staple agricultural commodities, have created a cost structure which makes it extremely difficult for Latin America to export manufactured goods to the rest of the world". See *Towards a dynamic development policy for Latin America, op. cit.*, pp. 71 and 72.

endeavours of its own enterprises. But liberalization policy has not been extended to these goods; quite the contrary.

All this bears on the present stage of peripheral development. But it by no means signifies that given a new industrialization policy the periphery could not tackle production and export of goods of increasing technical complexity. Such is the dynamics of development.[10]

Hence there is a blatant paradox in centre-periphery relations. In the Kennedy Round, as in the Tokyo Round, decisions have been adopted to liberalize trade in those products in which the periphery lacks comparative advantages for the time being owing to the technical and economic superiority of the centres, which is manifested chiefly through the transnational corporations. And the goods that escape liberalization —defended by various forms of protectionism— are the manufactures (and primary commodities too) in respect of which the periphery does enjoy comparative advantages, or easily could do so through its own enterprises' efforts.[11] And new manifestations of inveterate protectionism are emerging in the industrial centres.

Nothing of any importance has been done in the centres, then, during their spells of prosperity, to encourage imports from the periphery. It is common knowledge that the system of preferences established after long years of negotiation has proved of little significance because of the serious limitations it involves.

To all this must be added the adverse effects of the crisis through which the centres are now passing. The growth rate of peripheral exports has fallen, and although their volume is still relatively large, it is far from enough to allow the rate of development to rise again, if we are to avoid an exacerbation of the exclusive and conflictive tendencies of the system, which would have very serious social and political consequences. These are knotty problems to resolve, in view, moreover, of the need to boost exports still further in order to cover the higher cost of petroleum without indefinite recourse to borrowing from abroad.

3. *The disparity in structures of production*

To obtain a complete grasp of the nature of these problems it is worth while to examine them from the standpoint of the structure of production.

It has been explained elsewhere that development brings with it changes in the composition of demand, thanks to the increase in productivity and per capita income; to meet these changes, the structure of production also has to be modified. And here two vitally important options present themselves: to develop the structure of production in such a way as to satisfy part of the expansion of demand through trading exports against imports, or to gear it to producing at home instead of importing.

Clearly, the choice of the option that is more expedient from the economic viewpoint depends above all upon the attitude of the centres, apart from the periphery's own trade policy decisions.

The attitude of the centres was of course negative in the times of crisis that fostered the industrialization of the periphery. It has already been shown, and can bear repeating, that the periphery was inevitably obliged to resort to import-substituting domestic production. And it is a fact fully attested in the CEPAL studies that as a result the Latin American countries were able to keep up a rate of

[10] This is the thesis that Héctor Sosa develops in a study in course of preparation for the *CEPAL Review*.

[11] A recent appraisal of the Tokyo Round ends with the assertion that the results of the tariff reductions have been very meagre, whether they are measured by the fall in customs revenue that these reductions would bring about or by the increase that they would have caused in the developed countries' imports from Latin America if they had been in force since 1976. Similarly, the centres still maintain a tariff scaling which lays a heavier burden on final goods than on raw materials —particularly ores, hides and skins and textile fibres— as well as a vast and tangled network of non-tariff barriers. Lastly, while the six Codes of Conduct and the reform of the General Agreement itself clarify the rules of international trade, at bottom all they do is to confer institutional sanction on the practices already applied by the developed countries. See Pedro Mendive, "Evaluación de los resultados alcanzados en las negociaciones comerciales multilaterales (Ronda Tokio) hasta el 30 de octubre de 1979", CEPAL, mimeographed text, January 1980; and, by the same author "Protectionism and development: New Obstacles of the centres to international trade", in *CEPAL Review*, N.° 6, Santiago, Chile, second half of 1978.

development which exceeded the growth rate of their exports to the industrial centres. The higher cost of import substitution was more than offset by the much bigger increment in the product. This was the economic justification of import substitution, which, as we observed before, could have been of greater importance if a more rational policy had been pursued.

I do not say it is just the same situation that is now confronting the periphery in consequence of the rate of development of the centres —so much lower now than in the days of buoyancy— and the stronger emphasis on protectionism. The periphery has learnt to export, and some of these exports do go to the centres. But, as we have already noted, their volume is a long way below what is required, especially if development is speeded up.

There has been a significant change in the structure of production, but it is far from enough. And in so far as the centres refuse to accept more imports from the periphery, the latter will also have to gear its structure of production to satisfying by means of import substitution the requirements that cannot be met through trade.

The inference is obvious: in this crisis, as in others of more distant date, the centres have forced and still are forcing the periphery to resort to import substitution.

The difference between this crisis and those of the past lies in the fact that it is now possible to combine the import substitution drive with the effort needed in order to continue expanding exports of manufactures.

The way in which the two types of effort are combined depends primarily upon the attitude of the centres with respect to these industrial exports from the periphery. If the endeavour to increase them were to encounter serious obstacles, either because of the centripetal tendency of developed-world capitalism or because of the other unfavourable factors mentioned above, the only solution open to the periphery would be to give its structure of production a more decided slant towards import substitution, in order not to restrict its own rate of development, or to develop more rapidly than would otherwise be possible. It is difficult to say whether the transnational corporations might in the event help to counteract the centripetal tendency by exporting advanced goods to the centres; they have not hitherto done so on any impressive scale, albeit they have played an important role in respect of exports to peripheral countries. And they might do much more still in this direction if import substitution were undertaken at the regional level, a point to which we shall revert in due course.

This situation, together with the siphoning-off of peripheral income, explains how it is that while at first the transnational corporations help to correct external disequilibrium through import substitution, later on they are more apt to aggravate it in relations with the centres when the amount transferred abroad in the shape of their profits and other payments exceeds their new capital contributions, while at the same time the possibilities of further substitution are gradually being exhausted.

Nor are these the only ways in which income is siphoned off; there are others deriving from the technical and economic superiority of the centres and the weight of their political power.

The disparities in the structure of production of course have their origin in the time-lag in peripheral development due to the centripetal tendency of capitalism in the advanced countries. Two important points need stressing in this connexion.

The first relates to the income-elasticity of the centres' demand for primary imports from the periphery. This elasticity is relatively low, but for a few exceptions. And the periphery's effort, in the days of outward-directed growth, to expand its exports beyond the limit set by the development of the centres was —as it still is— exposed to the risk of a deterioration in the terms of trade.

To this congenital weakness in primary exports is added their great external vulnerability, since cyclical movements in the centres are transmitted to such exports more intensively than in the centres themselves.

The low income-elasticity referred to also affects the centres' own primary production. And this has led them either deliberately to restrict production, as in the United States, or to restrict imports, as in the European Economic Community. Since these possibilities are not open to the periphery, the tendency towards a deterioration of the terms of trade has caused production to be slowed up, almost always spontaneously, at the expense of the greater surplus that might have been obtained if a larger proportion of the fruits of technical progress could have been retained in the periphery.

That is why, in the days of outward-directed development, and in so far as the centres did not welcome industrial exports from the periphery, import-substituting production was the only road open for development. There was no other way of counteracting the trend towards external disequilibrium generated by the great difference between the above-mentioned relatively low income-elasticity of the centres' demand for primary exports from the periphery, and the relatively high income-elasticity of demand in the periphery for the constantly-diversified industrial exports from the centres.

This is a transitory phase of development; but it is a transition that takes a long time. Conceivably, changes in its structure of production may enable the periphery to approach progressively nearer to external equilibrium of a structural character. This depends, in the last analysis, upon a favourable attitude on the part of the centres and upon import substitution at the Latin America level, as well as on trade with other peripheral countries.

There is certainly no lack of economists in the centres who, even setting aside these structural phenomena in centre-periphery relations, point out the advantages of importing less advanced goods against exports of more advanced goods characterized by a high level of productivity per worker. But these rational considerations do not suffice for the adoption of policy decisions to modify the structure of production both in the centres and in the periphery. What is more, during those years of booming development in the advanced countries, any unemployment that might have occurred in industries adversely affected by competition from the periphery could have been compensated by employment in those other industries and activities which were growing at an exceptional rate. It was thought preferable, however, to employ labour from less developed countries, a move which subsequently turned out to have some sort of rationality too, although the form it took was not very humane: dismissal and repatriation of these workers when the rate of development dropped.

4. *Comparative advantages*

In the light of these observations, fresh consideration should be given to certain theses which, like that of comparative advantages and trade reciprocity, are often put forward afresh without reference to the great disparities between the centres and the periphery in respect of the structure of production.

In face of the phenomena of centripetal capitalism and its reluctance to liberalize trade in those industrial goods where the periphery has the comparative advantages in question, the only course open to the latter is that of import substitution. But this substitution must satisfy considerations of economic efficiency. How could their recommendations be followed up? Needless to say, import-substituting domestic production, particularly during a certain initial phase, represents a higher cost than imports would, which is a comparative disadvantage. Accordingly, considerations of economic efficiency suggest that the objects of substitution should be those goods in which the comparative disadvantage is least. That is, the direct disadvantage, for, as was pointed out in the relevant context, this disadvantage is more than offset by the increase in the product.

The situation in this respect differs widely from one country to another; there are some relatively small countries which could, for example, develop certain agricultural export lines without detriment to their terms of trade, especially in the case of commodities for which, on account of their special attributes, there is a steady demand in the centres. Some industrial goods, too, have this particularity.

Similar cases may also arise in larger countries, but there is no reason to suppose that this is a general rule, and that such exports could support a growth rate high enough to do away with the flaws in the prevailing type of development.

5. *Trade reciprocity*

While the centres do not acknowledge the comparative advantages of the periphery, they harbour some theorists who are returning to the attack on import substitution, with the old thesis of trade reciprocity as their weapon. According to this thesis, any liberalization of imports from the periphery should be accompanied by similar liberalization of the latter's imports from the centres. The tendency to external disequilibrium in peripheral development attributable to the disparity in elasticities is still disregarded. And worst of all, these ideas, which might be supposed to have been discredited by the elucidation of development phenomena, are once again dominant in certain sectors in our own countries.[12]

In view of these ideas of CEPAL, which have lost no jot of their validity, it is surprising that in Latin America tariffs should actually have been lowered and industries exposed to ruinous competition from abroad, in the hope that the centres may decide to practice reciprocity by liberalizing imports from the periphery. I greatly fear that this is a hope which will be indefinitely deferred!

All this is only too well known in CEPAL. And if I recall it now, it is to bring back into touch with reality some of our economists who live in an aseptic world in which they hatch their learned lucubrations. For instance, they talk about the internationalization of production and external openness. Excellent, but let the centres be the first to begin! Long years of struggle, mainly in UNCTAD, have not succeeded in altering their restrictive attitude. Do those economists perhaps suppose it possible to move the centres to compassion with the spectacle of industries that are closing down because of external openess?

That there are certain industries which must either step up their productivity or disappear, is not open to question; they are industries which in view of their considerable comparative disadvantage ought never to have been established. But it would be a grave mistake to demolish them before increased accumulation of reproductive capital and a rise in the rate of development have made it possible to reabsorb the labour thrown out of employment. This is a problem of proper timing. Advances must first be achieved in the structure of production, either towards exporting or towards import substitution, with due regard to comparative advantages or disadvantages; and then the abuses of protectionism must be thoroughly set to rights. We must not destroy until we can build better.

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[12]It seems appropriate, therefore, to recall what we said in 1963:

"The peripheral countries are in a position diametrically opposed to that of the major centres with respect to trade reciprocity. The great industrial centres export manufactured goods for which demand increases sharply as income rises in the peripheral countries, whereas these latter export primary commodities for which the upward trend of demand is more gradual as income rises in the major centres.

"Thus the great centres have no need to engage in import substitution from this point of view, since the trade disequilibrium with the peripheral countries tends to be positive in their case; in other words, exports are in excess. On the other hand, the trend towards a negative imbalance in the peripheral countries compels them to resort to substitution within the present pattern of trade in order to avoid a deficit in their balance of payments.

"Moreover, if the major centres, for other reasons which may or may not be justified, embark on substitution with respect to imports from the peripheral countries, they aggravate this disparity in international demand. On the other hand, import substitution by the peripheral countries with respect to items from the major centres tends to reduce the disparity and thus to make development possible.

"This basic inequality calls for a revision of the concept of reciprocity accepted until now, for if the great centres reduce or abolish their customs tariffs, the peripheral countries can increase their exports to them. And if this happens, the imports of the peripheral countries will also increase, in view of the buoyancy of demand for the goods concerned...

"To require a developing country to grant equivalent tariff concessions would hamper its industrialization, to the obvious detriment of its economic development."

It was next explained that the idea of implicit reciprocity did not imply that nothing should be done about correcting abuses of protectionism. Quite the contrary... "the customs tariffs in force for the rest of the world must gradually be lowered, both in the light of economic expediency and to ensure that industry is constantly encouraged by external competition to narrow the gap in productivity *vis-à-vis* the major centres.

"A reform of this kind obviously cannot be carried out where an increasing bottleneck exists. Relief must come rather from the external sector, in the shape of a speeding-up in the tempo of the export trade. In other words, a rational customs tariff must be part of an international plan to expand trade on new bases. Tariff reform cannot be a prelude to such a policy, but must stem from it." It should be borne in mind that this was written before UNCTAD came into being.

See *Towards a dynamic development policy for Latin America, op. cit.*, pp. 73-75.

6. *Economic fragmentation of the periphery*

In the centres the change in structure of production has been brisk and continuous. But no country has attempted intensive production of everything required to meet the endless variations in demand: on the contrary, there has been a division of labour between the diverse advanced countries accompanied by a remarkable growth of trade, under the stimulus of incessant technological innovations. This has been the dynamic significance of the two liberalization rounds which were mentioned above.

Yet the establishment of rational forms of division of labour among the peripheral countries has been beyond their capacity. In so far as it has not been possible for them to export enough to the centres, each country has developed its industrial production without troubling about trade with the rest. For that reason it is essential that import substitution should be tackled at the Latin American level.

Ever since it published its first studies —in the early 1950s, and prior to the establishment of the European Common Market—, CEPAL has drawn attention to the trend towards exhaustion of the easier forms of import substitution and the necessity of moving on to technically more complex production calling for markets much broader than the watertight compartments of the individual country markets.

Hence originated the idea of a Latin American Common Market, based both on the progressive reduction of tariffs and other restrictions, and on industrial specialization agreements concerted by the governments.

The common market idea was oposed at first by the centres, and in particular by the United States. Influenced by their immedite interests, they did not realize the dynamic significance of this Latin American undertaking.

In the end they accepted it, but they objected to specialization agreements, on the grounds that these deprived the transnational corporations of their freedom to decide what best suited their interests.

I am inclined to think that this was an adverse factor, but what did most to discourage progress towards the common market was the trade boom brought about by the exceptional rate of development of the centres. I am referring not only to the periphery's trade with the centres, but also to trade among the various peripheral countries, which was powerfully stimulated by the repercussions of the development process aforesaid.

Now the same import substitution problem is once again rearing its head in the Latin American scenario. I do not suppose for a moment that recourse should be had to the original formulas; too much water has flowed under the bridges! We must profit by the lessons of experience and arrive at formulas which, *inter alia,* may ensure the equitable distribution of advantages alike for the more developed countries of the region and for the less developed and those at an intermediate stage.

The economic fragmentation of our countries must be brought to an end. This is another of the manifestations of the time-lag in their development caused by the centripetal nature of capitalism; each of the peripheral countries made its contribution to the supply of primary commodities separately from the rest. And when industrialization supervened as a result of the crisis in the centres, we were not capable of breaking down the old centre-periphery pattern by means of a rational division of labour.

This pattern still largely governs inter-Latin American relations. To change it becomes essential now that the myth of the unlimited expansion of capitalism has again been dispelled. Moreover, even if the centres were to pursue a more favourable policy towards peripheral imports, we could hardly pour into their markets all the exports required to satisfy the dynamic exigencies of development and the transformation of the system.

7. *Hegemony and dependence*

The time-lag with which the periphery embarked upon its integrated development —based on industrialization— is strikingly reflected in the economic and technical superiority of the centres, particularly the chief dynamic centre of capitalism. And that superiority has economic and political effects between which a distinction should be drawn, although the two are closely related and evolve under the hegemony of the centres.

This hegemony affects the peripheral countries in different ways and degrees, as the centres exert themselves to promote and defend their economic, political and strategic interests. And in its direct exercise the centres have powerful instruments to use: financial, economic and technological co-operation, as well as military aid.

The transnational corporations, apart from pursuing their own objectives, are usually effective agents of this hegemony. The centres promote their penetration into different branches of domestic activity in the periphery; and the transnationals, in their turn, support in one way or another the hegemonic interests of the centres. Where their own interests are concerned, the transnational corporations wield a twofold influence. They exercise it both in the centres and in the periphery; on the mass communications media, on the political movements which support the system and on the governments. And in the centres there is, in addition, a whole constellation of interests which have an impact on the periphery and its governments.

All this goes to form the notorious relations of dependence, in degrees of intensity that differ according to the countries' ability to defend their autonomy. Dependence makes a peripheral country do what otherwise it would not, and refrain from doing what otherwise it would. And its bargaining capacity is limited.

Dependence is never more strikingly apparent than when a peripheral country acts in a manner counter to the centres' hegemonic interests, especially that of the leading centre. All the aforesaid constellation of interests is then mobilized against it, and it is penalized by measures of one sort or another which in the past —and not so very long ago at that— have culminated in military operations.

There are some economists and sociologists who extend the concept of dependence to all centre-periphery relations. There would be no harm in this if they were to analyse clearly the different implications of the centripetal nature of capitalism, as we have tried to do in the preceding pages. Often, however, this does not happen; which is why I have exerted myself here to shed further light on its consequences, at the risk of repeating what has been said in other studies.

Furthermore, some have gone so far as to maintain that dependence, however it may be interpreted, is responsible for underdevelopment. Translated into our idiom, this means that the poverty of the broad masses excluded from development must have been generated by the action of the centres.

Nothing is gained in the field of theory, or in that of praxis either, by assertions of this sort; which by no means implies that they are not efficacious in political indoctrination.

A distinction must be drawn between the existence of poverty and its persistence. When the technique of the centres began to penetrate into the periphery's export activities, much of the population was living in poverty, and this poverty has gradually diminished with the spread of technique to activities in other fields. But the fruits of that technique, instead of being fully capitalized, have served to promote the privileged-consumer society and the siphoning-off of income by the centres, thus giving rise to the exclusive tendency of the system, the explanation of which need not be repeated here. Hence the persistence of poverty, aggravated by rapid population growth.

The centres and the existing relations of dependence do not create poverty, but because of the centripetal nature of capitalism they do help to make it last. It might be said that this happens precisely because the myth of the worldwide expansion of capitalism has never become a reality. If it had, very serious harm would undoubtedly have been done to the autonomy of the periphery, shaky though this may be as things are.

Again, the periphery has not lacked believers in the possibility that the transnational corporations might turn the myth into fact. But of course this has not happened, owing, once again, to the centripetal tendencies of capitalism. As we have said before, at the international level there are no factors that spontaneously lead to the counteraction of these trends. The transnationals have a different outlook, and they could not be expected to change their attitude on their own accord in order to help the periphery to carry technique deeper into its social structure.

But is the periphery itself doing this? Is it making thorough use of the capital accumulation potential deriving from its technical progress in order to absorb at rising levels of productivity the lower strata that are vegetating in a state of penury? The interests of the fortunate members of the privileged-consumer society stand in the way.

The inference is conclusive: the mere interplay of private interests, however legitimate they may be, could never change the limited dynamics of the privileged-consumer society or the centripetal character of capitalism. These are, at bottom, largely structural problems which call for major political decisions both in the centres and in the periphery.

But the centres are passing through a crisis which makes it much more difficult for them to adopt such decisions; and the same thing is happening in the periphery. In the next section we shall attempt to single out the main elements in this crisis.

VII

The crisis of capitalism in its leading dynamic centre and its repercussions on the periphery

1. *A preliminary survey*

The present crisis of capitalism is very complex, and harder to resolve than the great depression of the 1930s.

It is, in my opinion, a crisis which the very vigour of capitalism has brought about. Capitalism has overreached itself; if has overflowed its own banks, and has not yet discovered how to channel development back into its regular course.

I have endeavoured to understand these phenomena, which, apart from their enormous importance for the centres, have severe repercussions on the periphery. I am looking at them from the periphery, at a distance, and my interpretation is open to errors which, I hope, will be no worse than those often perpetrated by some who, speaking from the centres, pronounce incautious judgements on the periphery.

Prior to the difficulties of recent times, there was an exceptional rise in productivity and the global product in the United States, whose repercussions made themselves internationally felt. This fact, however, incorporated an element of falsity, since the productivity in question had been mainly achieved by virtue of techniques which depredated non-renewable natural resources and which, in addition, caused a serious deterioration of the environment. The natural capital of the biosphere was being gradually swallowed up.

Growing requirements in respect of consumption, investment and State expenditure accompanied this increase in the product, while its allocation was not guided by any criterion of compatibility. Moreover, largely because of the inflation stemming from state expenditure, these requirements came to outstrip the growth of the product, and have been covered at the expense of the product of the rest of the world, in exchange for currencies which have internationally propagated inflation; and to all this have been added the effects of the upswing in the cost of petroleum.

The rectification of this element of falsity in the dynamics of development will call for large-scale investment which, despite its positive ecological and social significance, will not bring with it new increases in productivity. Thus average productivity will decline.

This downward trend will combine with that already occurring both because of the organic evolution of the system and because of certain investments which, by reason of their nature and volume, were also depressing productivity.

The system is faced with an incontrovertible reality. The illusion of a prosperity achieved at the expense of the biosphere has vanished; and so has the illusion of the limitless power of the dollar.

That the system has immense vitality is beyond question. But a transition period would be needed, at present of indeterminate length, to introduce major adjustments in it with a view to remedying its distortions.

Both technique and capital accumulation will need to be reoriented. But to generate capital when productivity is falling poses a new and difficult problem for capitalist development: a problem which becomes more serious still if inflation is to be eliminated.

There will be no escaping a reduction of the rate of consumption, in a country accustomed to its constant expansion. But it would seem that as yet no clear awareness exists of what the hard facts will enforce.

Nor is this all. Over and over again I wonder whether the current accumulation and distribution mechanisms are adequate for the solution of those problems. All the more, inasmuch as the evolution of the system was already showing symptoms of disturbance.

We will now enlarge upon the ideas which have just been so briefly set forth.[13]

2. *Exceptional productivity at the expense of the biosphere*

It is now possible to obtain a clearer insight than before into the capitalist development of the centres. The exceptional impetus of the last few decades, up to recent times, was the effect not only of impressive technical progress, but also of the irrational exploitation of natural resources, especially energy, which, in turn, markedly influenced the orientation of techniques; whence the above-mentioned element of falsity, with its dramatic implications for the world.

In all this a role of decisive importance has been played by the hegemonic power of the centres, especially the United States, in the periphery of the world economy. The petroleum-exporting countries were not strong enough to make a stand against the centres' hegemony, although they had long been clearly aware that the non-renewable resource in question was being squandered; but any attempt on their part to restrain this insensate exploitation would have come up against tough opposition.

The exporter countries could concertedly restrict the expansion of production only in a international conjuncture which enabled them to acquire power themselves and so face up to the power of the centres.

A little thought will show the irrationality in the use of petroleum resulting from the application of new techniques and the profit incentive of the oil firms was propagated throughout the whole system. The low cost of petroleum considerably influenced technological research, channelling it towards extremely abusive forms of utilization of this non-renewable good, as well as of other natural resources; all this being fostered by the unequal distribution of the fruits of the increasing productivity of technique, given the nature of the social structure and the changes in it.

But this is not the whole story. It is only in recent times that technological research has concerned itself at all with the harm inflicted by technique on the environment. Such is the ambivalence of technique: its immense contribution to human welfare by virtue of the continuous increase in productivity, and, at the same time, its serious effects on the biosphere.

Philosophists and humanists have been devoting themselves for some time past to the psychosocial implications of technology, but economists have generally been unwilling to take its ambivalence into account in their interpretation of development phenomena. They have regarded it as an exogenous element like the political, social and cultural aspects of reality. In their concern for a peculiar doctrinal asepsis, they have withstood the incorporation of these elements, and of their mutual interrelationships, into the dynamics of development.

[13] In the following pages I have made use of part of the paper on "Biosfera y desarrollo", *op. cit.*

3. *Requirements incompatible with the growth of the product*

We were saying that in the chief dynamic centre of capitalism the product, notwithstanding its exceptional rate of growth, had not been sufficient to meet requirements which were competing with one another for an increasing share in it. These requirements derived from the growing volume of domestic and foreign investment, from the boom in private consumption and from the considerable expansion of State services, including social services and military expenditure.

This increase in State expenditure was to a great extent inflationary. The State, for understandable political reasons, was reluctant to step up taxation, preferring to resort to monetary expansion in order to cover the fiscal deficit. Even if it had done so, however, the consequences would have still been largely inflationary. If the additional tax burden had fallen, in one way or another, on the labour force, it would have tried to recoup itself by wage increases at the expense of the economic surplus, and that would have entailed a rise in prices. Enterprises would have defended themselves similarly if taxes had been levied directly on the surplus, to the detriment of capital accumulation.

In any event, the inflationary financing of the deficit caused prices to rise; and the subsequent wage adjustments considerably intensified the inflationary spiral which had already been developing to a moderate extent. And to all this has now been added the fresh impetus given to inflation by the energy crisis and the protection of the environment.

These various pressures have been eased, however, thanks to the fact that part of the inflationary expansion of demand due to the fiscal deficit could be satisfied by increasing imports: that is, at the expense of the gross product of the rest of the world. The dimensions of this situation, aggravated as it has been by the growing volume of petroleum imports and the considerable rise in their value, have been appreciably affected by the regressive income distribution which has accompanied inflation. There has been a boom in imports of those goods which are in greatest demand among the social groups favoured by inflation, principally to the detriment of the consumption of those social groups which have less redistributive and defensive power.

This growth of imports in excess of exports and other external resources has been the most important factor in the United States' chronic balance-of-payments deficit. To this must be added the transnational corporations' investments abroad, in so far as they have not been covered by the enterprises' own external profits.

To put this in another way, the expansion of state expenditure has not been covered at the expense of consumption —except for the consumption of the disadvantaged social groups— but has been superimposed upon it and on private investment. And the consequent excess of demand in relation to the domestic product has spilled otwards, and has been met with imports.

4. *Organic decline in productivity*

To understand the decline in productivity which takes place in the advanced stages of capitalist development, the two ways in which it is manifested must be taken into account: the technological innovations which are continually incorporated into the system, on the one hand; and, on the other, the improvement in productivity which occurs as a result of the displacement of labour from lower-productivity occupations to others where productivity is higher.

As capital accumulation in the shape of physical goods and education of human beings increases, the proportion of the labour force employed at lower levels of productivity progressively decreases. In other words, there is a trend towards homogenization of technique and productivity, with significant effects on income.

The operation of this tendency will bring down the average productivity of the system unless the rate of productivity of the new capital accumulation necessitated by the innovations is stepped up. This improvement would be needed to offset the effect of the homogenization of technique.

But there is something much more important. As has been explained elsewhere, the productivity increment stemming from the accumulation of reproductive capital encourages the ceaseless diversification of goods and services via the accumulation of consumptive capital. The techniques concerned, while they do not increase productivity, improve the efficiency of the goods and their capacity to satisfy new requirements or considerations of social status and conspicuous consumption.

These techniques, like the corresponding accumulation, are closely combined, of course, with those that improve productivity, but as this happens the proportion of consumptive capital gradually increases, prejudicially to reproductive capital. This is a logical consequence of the organic evolution of the system: there would be no sense in increasing productivity if it meant continually adding to the available supply of the same goods and services, since obviously this reduces the rate of productivity.

Consequently, the rate of average productivity decreases both because of the effects of the homogenization of technique on the displacement of labour, and because a steadily increasing proportion of the labour force is thus displaced and is diverted, along with the corresponding capital accumulation, into satisfying the more and more decided bent of demand towards the diversification of goods and services in which efficiency is heightened rather than productivity.

It is sometimes said that the fall in average productivity is due to the progressive increase in the proportion of skilled services in relation to goods; this is true, but it does not suffice to account for the phenomenon. For, as has just been shown, there is also an increase in the proportion of goods which are diversified and in which techniques improves efficiency rather than productivity.

It was stated above that diversification is a consequence of the growing productivity of the system; but considerable influence is also exercised by the distribution of the fruits of productivity. Thus, the social strata favoured by distribution tend to increase their demand for diversified goods and services much more intensively than the disadvantaged strata, whose demand is concentrated on goods where diversification is slight. This state of affairs is aggravated by the regressive effects of inflation, and sharpens the downward trend in the average productivity of the system.

Lastly, to all this must be added a very important factor: capital accumulation for the purpose of producing weapons of war. Obviously, this type of accumulation also contributes to the decline of average productivity, although it must no be forgotten that innovations in armaments technology have greatly influenced other innovations in the system.

If we have dwelt on this subject, although somewhat schematically, the reason lies in its great importance for understanding the incidence of the decline in productivity on the economic surplus, which represents the dynamic mechanism of the system; and also for grasping the complexity of the major adjustments which the crisis of the system necessitates, especially in the leading centre of capitalism.

5. *The surplus and the decline in productivity*

In the discussion of peripheral capitalism we have attributed paramount importance to the structural phenomenon of the surplus, which has also made its appearance in the historical development of capitalism in the centres. But in these latter, the trend towards homogenization noted above gradually reduces the surplus formed by successive productivity increments. The steeper this trend, and the greater the concomitant decrease in the proportion of the labour force occupied at lower levels of technique, the stronger becomes the workers' spontaneous ability to obtain better pay.

But at the same time the labour force has been developing its trade-union and political power, so that its pressure on the surplus steadily increases. Similarly, direct or indirect pressure on the surplus is also exerted by the intensive development of State services. Thus the surplus is subject to the effects of two opposite movements: on the one hand, new productivity increments, and, on the other, the twofold pressure of the State and the labour force. There is nothing in the system to regulate this double pressure.

This being the case, a stage is reached in the evolution of the system at which the twofold pressure in question prevents the surplus —especially that pertaining to the upper strata in the social structure— from playing its dynamic role. For the combined pressure of the State and the labour force is detrimental to the capital accumulation and the consumption of the strata referred to, notwithstanding further increases in productivity. Sooner or later the enterprises where these strata prevail raise their prices, in order to reanimate the growth of the surplus or, alternatively, of their profits, if in this skeleton outline of a complex phenomenon I may be allowed to identify profits with the surplus.

When the labour force acquires a great deal of trade-union and political power, as has happened in the centres, the rise in prices is followed by wage increases. This is the meaning of the inflationary spiral.

I am inclined to think that the spiral which was developing in the United States before the fiscal deficit became very large was the consequence of the phenomena described. In the foregoing argument we have preferred to sacrifice rigour to simplicity.

6. *The requirements of the crisis and the accumulation and distribution régime*

Everything suggests that in the leading centre, as in the others, the growth rate of productivity and the product will sink appreciably lower than in those years when it was exceptionally high. Accordingly, there will be a period of transition, after the major adjustments required in the system, as to the duration of which it would be unsafe to hazard an opinion. It may be, however, that important technological innovations, or full utilization of recent ones, may push up productivity again without those elements of falsity that we indicated at the outset.

But the progressive elimination of these elements of falsity calls for heavy investment. A new type of accumulation in respect of energy and protection of the environment will then proportionally increase in relation to reproductive accumulation. While this is a form of accumulation of enormous importance, it will not immediately raise the productivity of the system; on the contrary, it will accentuate the downward trend of the rate of average productivity and of the growth rate of the global product.

Let us consider the incidence of these facts. The fall in the growth rate of the product will inevitably enforce a correlative decline in the rate of consumption, for if instead of this the rate of accumulation were reduced the product would decrease more rapidly still.

This adverse effect on consumption would pose a difficult social and political problem. Which social groups would be affected by these adjustments? What mechanisms has the system to put them into effect?

First and foremost, it should be borne in mind that investment relating to the biosphere represents a higher cost per unit of product, which the enterprises will transfer to prices. Petroleum prices have soared in immediate response to the increased cost of imports, and a similar upward trend will be progressively reflected in an appreciable rise in the cost of new sources of energy. Accordingly, given the power of the labour force, wage increases will ensue, with the consequent endeavour on the part of enterprises to protect their surplus by raising prices yet again. Will there be any way of avoiding this?

Clearly, if the labour force had only incipient trade-union power, or none at all, there would be no reason for this further rise in prices to supervene, with the consequent initiation or increase in the momentum of the inflationary spiral. The spiral is, in reality, the result of a confrontation of powers. Monetary policy can prevent it only if the unfavourable effects on employment produced by a restriction of the money supply weaken the trade-union and political power of the labour force and the play of market forces brings down wages. I do not think that this is the case in the United States, where the said trade-union and political power, despite unemployment, strives to offset the rise in prices with wage increases. What is more, wages will follow an upward trend, if the incidence of petroleum is combined with the operation of other factors that force up prices, among them the inflationary effects of subsidies to the unemployed and of other State expenditure. This is the new phenomenon of stagflation, an unmistakable symptom of the changes that have occurred in power relations.

The problem could be temporarily resolved if the labour force were to refrain from compensating for the rise in prices with wage increases. That would be the aim of those who advocate some kind of social pact. But consider what this means. This sacrifice of income, with the consequent constraints on consumption, would be endured in order to enable the privileged social strata to continue stepping up their own accumulation. Could this conceivably be a lasting solution?

Clearly, if the labour force were to offset these unfavourable effects by its own accumulation, the accumulation process would continue; the same might be said if the State were to fulfil this compensatory role. But obviously that is not how the system functions.

From these explanations a conclusion of the greatest importance can be drawn, and should be emphasized. The machinery for appropriation and retention of the surplus constituted a rational response to the dynamic requirements of the system in a social structure in which the economic, social and political power of the upper strata was virtually unchallenged. But it is no longer rational when, as a result of the changes in the social structure, the trade-union and political power of the labour force develops and gains strength, and State services are considerably expanded.

Moreover, this machinery does not seem designed to enable enterprises to absorb the aforesaid higher production costs by cramping their surplus, for therein lies the dynamic mechanism of the system, as we have said elsewhere. Unquestionably a very sensitive mechanism, and also of great importance because of the political power of those who have it in their control, and who mainly belong to the upper strata.

I have no possible means of quantifying the dimensions of this complex problem. Perhaps they are not disproportionate in relation to the high level of personal consumption in the United States; but this is only one factor in the problem, since the consumer society, which has spread throughout the whole of the social structure, although with wide disparities, has gained remarkable momentum. But this impetus will be impossible to keep up, at any rate during a very difficult transition period.

Difficult, not only because of the internal factors that come into play; for the euphoria generated by the consumer society in question and the large scale of State expenditure have been attained not merely thanks to the exceptional increase in productivity —which has been followed by a marked decline— but at the expense of the product of the rest of the world, as we have already pointed out. This is linked to another of the great illusions which is now being dispelled: the might of the dollar. The time has come to deal with this question.

7. *Reflections on the might of the dollar*

The crisis in the leading dynamic centre of capitalism is also a crisis in the financial ascendancy of the United States, finding dramatic expression in the depreciation of the dollar, the use of which as an international currency has signified a great advantage and an enormous responsibility for the United States.

The great advantage is that of seigniorage, i.e., the benefit resulting from the creation of its own currency in response to the development of world trade. This implicitly involved responsibility for regulating the issuance of that currency in the light of internationally meaningful as well as internal considerations.

This responsibility was fairly effectively discharged prior to the inflation caused mainly by the fiscal deficit. But in the end the deficit has disrupted the whole international monetary system, and on top of this have come the effects of the rise in petroleum prices. And seigniorage has turned into that gigantic transfer to the United States of part of the increase in the world product to which reference was made in earlier pages of this same chapter.

The serious implications of the use of the dollar as an international currency had long been perceived. An eminent Yale professor, Robert Triffin, drew attention to them with admirable persistence.[14]

[14]See "The international role of the dollar", *Foreign Affairs*, Vol. 57, No. 2, Winter 1978-1979, an article in

In the United States the illusion of the almighty dollar held sway. Perhaps it was partly on account of this illusion that recourse was had to internal monetary expansion to cover the colossal expenditure on the war in Vietnam which was superimposed on the heavy social expenditure of President Johnson's "Great Society". The notorious unpopularity of the war made it difficult to resort to borrowing or taxation to finance it. In fact, what was the point of doing so, if instead of casting the whole burden of its cost on domestic consumption, the issuance of dollars made it possible to appropriate part of the product of the rest of the world at no expense?

Outside the United States, then, there was an overwhelming flood of dollars. Great international liquidity was what it was called at the time: a euphemism which certainly does nothing to mitigate the serious consequences of this state of affairs.

But matters did not stop there, since the dollars thus floating multiplied their inflationary effects in the Eurodollar market. Dollar deposits in favour of countries with a surplus were used to issue loans to other countries, so that to their original deposits new ones were added, with the result that the inflationary pressure was exacerbated.

These operations seem similar to those that occur within a country as the result of an increase in the money supply issued by the Central Bank. There is a great difference, however, for whereas the latter has the means of regulating the multiplier effects of this initial issue of money, no such regulatory mechanism exists in the Eurodollar market.

Thus matters have reached the pitch of a veritable monetary aberration, which, besides producing the effects referred to above, vitiates internal monetary policy.

It must be admitted, however, that not everything has been negative in the Eurodollar market; Eurodollars have played a useful role in helping to cope with the external disequilibria resulting from the sudden upswing in petroleum prices. As the International Monetary Fund was not prepared to meet requirements of such unwonted size, the countries affected obtained financing from the Eurodollar market. Thus they were able to avoid restricting imports of other goods essential for the maintenance of their economic activity.

Recourse was also had to this market's facilities by the socialist countries of Eastern Europe, in which military expenditure absorbs a considerable proportion of the global product. In the Soviet Union, for instance, this proportion is estimated at between 12 and 13%, that is, about twice the corresponding percentage in the United States. Obviously such figures are incompatible with the very widespread aspiration to increase the population's consumption and the necessary investment. Accordingly, these countries have resorted to the Eurodollar market.

It is certainly paradoxical that the inflation largely brought about by the military expenditure of the United States has helped to ease, in some measure, the financing of the same type of expenditure in the socialist sphere.

At all events, the United States has continued to launch dollars into the world in order to deal with the aggravation of its external deficit resulting from the rise in petroleum prices. This preference is readily explicable, since if it had resorted to the Eurodollar market it would have had to pay interest on its loans, like the other debtor countries. In any event, this further issue of money and its multiplier effects have increased inflationary pressure at the world level.

There can be no doubt that this monetary expansion was essential to avert serious world contraction, but neither is it open to question that the funds thus created could have been withdrawn from circulation, not in the form of deposits as in the Eurodollar market, but by investing them in international securities which would have averted the multiplier effects of the original expansion. However, the International Monetary Fund was not prepared for operations of this kind either.

Obviously, such operations would be stopgaps, maintained only until the deficit countries could expand their exports sufficiently to cover the increase in the cost of their petroleum imports.

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which Professor Triffin, in face of the international monetary chaos, expresses his regret at the evidence that his timely and severe warnings went unheeded.

From another standpoint, the United States has urged the need for countries with a surplus to increase their imports from it in order to assist in the correction of its deficit. For this to happen, the countries in question would have had to expand their credit on the basis of their augmented monetary reserves, and this would have accentuated the effects of the inflation of external origin. It is understandable, therefore, that the pursuit of a cautious monetary policy should have been thought preferable. Otherwise, the countries with a surplus would have returned to the United States dollars that had previously left it. But just as the exodus of these dollars alleviated the internal inflationary pressure by spreading it outwards, their conversion into demand for imports would have intensified it. Whereby a very old truth is confirmed: the only way to cure the effects of inflation caused by a fiscal deficit is to prevent it!

It has just been remarked that the countries with a surplus had opted for a restrictive monetary policy. In its endeavour to curb inflation the United States has had to follow suit. In both cases the growth of the product that could otherwise have been achieved is being sacrificed. This is the counterproductive dynamic effect of having covered the fiscal deficit by inflationary means: the aggravation of its incidence on a product which is shrinking!

In any event, there can be no doubt that the increasing severity of inflation in the United States not only steadily amplified the internal inflationary spiral but externally touched off the petroleum spiral. The original increase in petroleum prices was of course influenced by the inflation that had already been developing. The price rise intensified this inflation and the deterioration in the international value of the dollar. Thus oil prices were eroded again, and so was the value of the considerable dollar holdings of the petroleum exporters. And this, of course, led the latter to raise prices yet again. It can thus be seem that just as the capacity of the labour force to recoup itself from the adverse effects of inflation pushes up the internal spiral, so the power recently gained by the oil-exporting countries enables them too to recoup themselves and so give impetus to the international spiral.

8. *Incidence of the crisis on the periphery*

The non-petroleum-exporting peripheral countries are severely affected by the rise in oil prices as well as by the inflationary increase in the prices of their imports from the centres.

It would be difficult for them to recoup themselves for this deterioration in their terms of trade by raising the prices of their exports, subject as these are to a relatively low income-elasticity of demand at the international level.

Accordingly, the periphery will have to step up its effort in the field of exports of manufactures, where it has acquired well-attested ability. But it would be idle to hope that this would suffice to counteract the resurgence of the trend towards external disequilibrium, now aggravated by the fall in the growth rate of the centres and the recrudescence of protectionism on their part.

In face of this situation, import substitution has once again become inevitable, as it was during other crises in the centres, especially in the Great Depression. It is not a question of doctrinal preferences, but a necessity imposed by the international circumstances.

For obvious reasons of economic viability, import substitution should not continue in those watertight compartments which CEPAL has been impugning since its earliest days. Now more than ever is it essential to conduct the process rationally at the Latin American level and on a basis of formulas for trade with other developing countries.

But all this takes time, and in the meanwhile the external imbalance will still have to be faced. Clearly, continued recourse to borrowing in the Eurocurrency market is not the best solution; but there is no other, as long as the petroleum-exporting countries fail to adopt compensatory measures in favour of the countries hardest hit by the high oil prices —a step that has long been canvassed. In reality, the proportion of petroleum consumed by these countries is not very large, albeit that would not excuse them, if compensatory arrangements were to be introduced, from adopting stringent energy-saving measures.

The adverse implications of all this for the periphery cannot be exaggerated. Its rate of development has declined, although less than it would have done without borrowing. The days of prosperity when the annual growth rate averaged more than 7% have come to an end.

It must be remembered, however, that even this rate was insufficient from the dynamic standpoint. A recent CEPAL analysis[15] maintains that in order to absorb the increment in the labour force a rate of 7.5% would be necessary. So the tendency to exclude from development the broad masses relegated to the lower strata of the social structure would still persist; and the conflictive tendencies of the system would be exacerbated.

What is the significance of these phenomena? Truly grave, which makes the social use of the surplus a yet more imperative need. But there is no room for illusion as to the possibility of so radical a change, since the tasks of doctrinal persuasion and political preparation are bound to take a fairly long time. However, in any event, it would seem inevitable to restrict privileged consumption, not only in order to increase capital accumulation, but also to lighten the incidence of external price increases on the broad masses of the population. This objective could hardly be attained by intensifying inflation!

It must be borne in mind, however, that as long as the trend towards external disequilibrium is not counteracted the effort to increase capital accumulation might be at least partially frustrated. It is not enough to accumulate more; there must also be a possibility of using the resources concerned for imports of capital goods which, at least for the time being, could not be obtained through peripheral trade.

In the light of these considerations, the need for financial resources from abroad for accumulation purposes is obvious. No very meaningful co-operation can be expected of the centres during the transition period which will be required to overcome the crisis. On the other hand, Eurocurrency loans cannot indefinitely take the place of financing from the international credit institutions. Such institutions, particularly if certain reforms in them are introduced, might constitute an appropriate mechanism for channelling large volumes of financial resources accruing from petroleum which are at present used in the Eurocurrency market or revert to the centres.

Little progress has been made in channelling these resources into the periphery, either via the credit institutions or directly through investment placed by the petroleum-exporting countries themselves.[16] This would be the best way of ensuring that funds would revert to the centres, in the form of payment for imports of capital goods effected by the periphery with the resources in question: a three-cornered reversion.

In this connexion, additions may be expected to certain proposals for setting up multinational enterprises among Latin American countries, petroleum-exporting countries and other developing countries; these multinationals might play a very important role in collective import substitution, especially in respect of capital goods and intermediate goods of some technical complexity. This would open up the possibility of advantageous participation on the part of the centres, in accordance with appropriate rules of the game.

9. *The process of change in the periphery and relations with the centres*

From all that has been said it is clear that even if the forces of democracy were to succeed in transforming the system in the periphery, they would be powerless to change on their own account the nature of relations with the centres. It is not enough to demonstrate the incongruity of these relations and their adverse effects on the periphery. Perhaps in the end the disas-

[15]"Latin America and the New International Development Strategy: goals and objectives" (E/CEPAL/L.210), Santiago, Chile, mimeographed text, 1979.

[16]At the time of writing, news is being cabled of important decisions which the petroleum-exporting countries would seem to be prepared to adopt.

ters overtaking the biosphere may convince the centres that the exercise of their hegemonic power and the free play of economic forces at the international level are intensifying the exclusive and conflictive tendencies of development in the periphery, with very serious political consequences; but the periphery lacks the power to do so. Power it certainly has to disrupt, but not to transform!

Only a long-term view could lead the centres to face up to their world responsibilities; they might play a supremely important role in the process of change. Accomplishing it is the business of the periphery: accomplishing it and deciding how to do so. But the centres for their part could make a notable contribution to the success of the transformation and also —plain speaking is called for here— to its political significance.

But what interest could the centres have in performing this role? They have played their cards in favour of the privileged society, almost invariably prompted by their short-term interests. Now they see evidence that the basis of this type of development is social inequity. And perhaps they may also be bringing themselves to believe that in the advanced stages of development the privileged-consumer society can only be maintained by the real or potential exercise of force.

Social equity, genuine democracy and unequivocal respect for human rights are values that have struck deep root in the centres, after many historical vicissitudes. It is understandable therefore that signs of anxiety and disconcertment should be shown when those great human values are trifled with in the periphery. But this does not prevent the transnationals from displaying their skill in accommodating themselves to such political apostasies, if not actually exalting the merits of a complete eclipse of democracy!

VIII

Ethics, rationality and foresight

1. *Human welfare: privilege and utopia*

For the first time in life on this earth the prodigious development of technique offers us immense potentialities for human welfare —and human dignity too—, which are not unattended by pernicious effects. We are on the brink of the materialization of a utopia; yet these potentialities are being wrecked by the ambivalence noted earlier and by the privilege inherent in the social structure of the periphery, as well as in its patterns of linkage with the centres.

It is the privilege that has existed from time immemorial: throughout the long history of the human race, the fortunate life of the few has always been based on the wearisome toil and the social subjection of the many, barely alleviated by a rudimentary technique, evolving in the past at a snail's pace.

In reality, given those conditions, no substantial results could be expected in respect of income redistribution; nor, of course, a dynamic redistribution. Poverty seemed unassailable. And one may wonder whether western civilization would have flourished as it did without inequality. Did not Plato and Aristoteles, and so many others, defend slavery? Without inequality, could the splendour of art and literature, of philosophy and science, ever have flashed out so vividly, in brilliant though fleeting episodes of human talent?

Be this as it may, the significance of privilege has radically altered, since it now represents a formidable obstacle to the materialization of that utopia of human welfare; a stumbling-block in the way of access for all to the conquests of culture; a bar to the exaltation of the abundant creative talent which is going to waste because of the social relegation of the disadvantaged.

2. *The ethics of development*

This is the privilege of the surplus. To whom does the surplus pertain? There is no scientific reply to this question, for the answer is ethical. By virtue of its origin and nature, the surplus belongs to the whole community and should serve the collective interest.

Without a measure of ethical consensus political movements in the direction of change will never acquire lasting vigour. But neither could they attain their objectives without rationality —a rationality ultimately imposed by the evolution and ambivalence of technique.

Two centuries of belief in the regulatory virtues of market laws have also helped to smother the ethics of development. It is forgotten that Adam Smith was a professor of ethics before he wrote his monumental work; and indeed, in all his arguments there is an underlying ethic, as there is in the neoclassical doctrine which has followed after him. All this has come to nothing.

3. *Joint responsibility*

In its efforts to bring about a change in its relations with them, the periphery generally invokes the moral responsibility of the centres. But ethics is indivisible. And we are far from having recognized our own moral responsibility in face of the social unrest of peripheral development. Nothing solid can be achieved without a joint acceptance of responsibilities.

Let us speak frankly: under the impulse of their hegemonic power, the centres cultivate their own immediate economic, political and diplomatic interests, but they are basically lacking in ability to take the long-term view, in farsighted concern for the future, in self-restraint in the exercise of their power.[17]

Want of foresight with respect to energy resources has had dramatic consequences. Will this crisis teach people to think ahead in the exploitation and use of other natural resources?

Will the centres have learnt to set limits to their hegemonic power? Have they fully realized that this is essential if their own interests are not to be doomed to suffer?

It is the reckless exercise of that power and an inconceivable lack of foresight that have led to international monetary chaos.

Similar attitudes have also prevailed in relations with the periphery. Will there be nothing for it but to await a succession of crises before these attitudes undergo any change? Do the centres hope to weather the social storm that is brewing in the periphery?

All these vast and anxious questions, of profound world significance, are causing leaders perplexity and disquiet. And the ability to steer a course amid the tide of events seems to have been lost: that gifted leadership which has always been called for in the major vicissitudes of history.

What is to be done? Those who have the theoretical responsibility for shedding light on the path and discussing solutions can find no answer.[18]

The periphery's responsibility is likewise immense. I do not believe, however, that we are as yet prepared to carry out a major task of transformation, whence the ultimate significance of the present article. If it succeeds in giving rise to discussion in depth, if it leads to more searching examination of what the facts mean, and to consideration of how we ought to act on them in order to attain the major objectives of development, it will have served the purpose for which it is intended.

Needless to say, this is not our business

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[17] Nothing important, nothing really constructive has been done since the developing countries began, two decades ago, to take a firm stand *vis-à-vis* the developed countries. The latter, with a few shining exceptions, have been at one in adopting negative attitudes.

It is understandable, therefore, that in the course of my international experience I have been increasingly dominated by grave concern: concern at witnessing how events are running adrift.

[18] See a letter from K. Galbraith to the *New York Times* of 7 May 1979.

alone. The effort at enlightenment and persuasion must also be extended to those in the centres who are earnerstly seeking a response to the problems of the world of today: a world very different from that of yesterday, by reason both of the great possibilities it offers and of the great risks it presents. Possibilities and risks alike we must confront without delay, undaunted by the image of the past. For upon us too a clear moral responsibility is laid by participation in this great human adventure of development; in the realm of thought at least, if we can no longer play our part on the scene of action.

Some CEPAL Publications

Economic Survey of Latin America, 1978, E/CEPAL/G.1103, Mimeographed edition, Santiago, Chile, 1979, pages*.

The *Economic Survey* is an annual report whose main objective is to summarize the economic trends of the year in question. The 1978 *Survey* begins with an introduction in which three fundamental aspects of this evolution are analysed —economic growth, the external sector and inflation— and goes on in Part II to study developments in each of the 27 countries of the region.

As regards the above-mentioned aspects, the *Survey* concludes that, generally speaking, there were no major changes compared with 1977. During 1978, although there was a partial recovery from the consequences of the long and intensive recession of the industrialized countries and the exceptional increase in the price of petroleum, the Latin American economy continued to be affected by the sequels of these phenomena. Thus, although the rate of growth of economic activity was higher than during the period 1975-1977, it was noticeably lower than in the first five years of the decade; the average rate of inflation was more than double the rate which was usual before the increase in the price of oil; and the deficit on current account, which had decreased in 1976 and stabilized in 1977, shot up in 1978 to an unprecedented level nearly four times the average for the period 1970-1973.

The aim of the third and last part is to present a special study on the significance for Latin America of the internationalization of the world economy and the problems and opportunities posed by this for the continent. Chapter one reviews the significance and historical background of this phenomenon, its main features in the postwar period and the principal changes it has brought in the centre-periphery system. Chapter two focusses on Latin America, distinguishing between groups of similar countries. A description of the evolution of external links since the 1950s is followed by a discussion of the reasons for, variety of, and dangers presented by the policies of opening up to the exterior. Finally, an outline is given of the options and possibilities for achieving new forms of insertion in the world economy, based on inward-directed industrial development and on industrialization directed towards the regional and world markets.

América Latina: Las Evaluaciones Regionales de la Estrategia Internacional del Desarrollo en los Años Setenta (Latin America: The Regional Appraisals of the International Development Strategy in the 1970s), Series "Cuadernos de la CEPAL", No. 30, Santiago, Chile, 1979, 237 pages.

The United Nations General Assembly proclaimed the 1970s as the Second Development Decade and adopted an International Strategy to serve as a guide for the activities of governments. Approximately every two years, an appraisal was made of the progress achieved, and in the case of Latin America this was done at the biennial sessions of CEPAL. Thus, the first appraisal was made at Quito (Ecuador) in 1973, the second at Chaguaramas (Trinidad and Tobago) in 1975, the third at Guatemala City in 1977, and the fourth at La Paz (Bolivia) in 1979.

This Cuaderno brings together the texts of these four appraisals and presents them as a whole. The first two had already appeared in Cuaderno No. 2 —now out of print— and the third in No. 17.

Educación, Imágenes y Estilos de Desarrollo, (Education, Images and Styles of Development) by Germán W. Rama, Series "Cuadernos de la CEPAL", No. 31, Santiago, Chile, 1979, 72 pages.

This Cuaderno begins with a critique of the ideas of educational development, showing how the notions on which the analysis of education and its relations with society have most frequently been based were conditioned by ideological settings which were presented as if they were neutral and governed by technical criteria independent of the alternative and contrary options arising out of the dissension and conflict among the social groups. In particular, it analyses the developmentalist theories which, in situating education in the perspective of an organization specializing in the training of human resources depending on the existing or projected needs of the economic system, conceive of its role as reinforcing the functions of conserving existing social structures.

The author maintains that each type of development corresponds to the power relation between social classes and groups, the situation and possibilities of the economy, and the societal image or future horizon which the dominant group or alliance of groups aspires to through a specific style of development.

On the basis of this hypothesis the study places the most clearly defined Latin American educational styles in order from the conceptual point of view and postulates that in all cases education is more advanced than income distribution and participation in power, to the point that opposing trends are even to be seen between education and the other dominant dimensions of the social system. These contradictions make education a vital element in the control of social tensions, since at certain stages its expansion reduces pressures towards obtaining a share in income and power, while at others the mass of the educated may become a potential source of pressure which, when integrated with other factors of social crisis, makes it necessary to carry out social changes or apparent changes or else to exacerbate political coercion and control.

Within this analytical framework, the author distinguishes five styles of educational development, each characterized by a predominant main function, which, by linking together the economic, political and social dimensions, condition the relations between education and social groups and at the same time settle the main lines and content of the educational system.

*Printed editions in Spanish and English of all the issues of the *Economic Survey* appear at a later date.

América Latina en el umbral de los 80 (Latin America on the threshold of the 1980s), E/CEPAL/G.1106, Santiago, Chile, 1979, 206 pages.

The first mimeographed version of this study was presented at the eighteenth session of CEPAL (April 1979) under the title "The economic and social development and extenal economic relations of Latin America" (E/CEPAL/1061 and Add.1) and was summarized in CEPAL *Review* No. 8 (August 1979).

The object of these reports (four of which were prepared in the course of the 1970s) is to evaluate the economic and social situation of the region; the time of preparation of the report summarized here, with the end of the decade approaching and the United Nations activities to define the guidelines for the preparation of a new International Development Strategy for the next decade being intensified at the technical and political levels, is a particularly appropriate and interesting moment for reviewing and evaluating the nature and scope of the economic and social development prevailing in Latin America, and particularly the different aspects and problems of the region's external economic relations. This assumes particular importance since CEPAL is required to contribute its ideas and proposals to the discussions which has already started, in order that the new Strategy may be successful in giving expression to an efficient international action programme for furthering the development of the peripheral countries and incorporating subjects and objectives which may be of special interest for Latin America.

Políticas de promoción de exportaciones (Export promotion policies), E/CEPAL/1046, Santiago, Chile, 1979 and 1980, Vols. VII, VIII, IX, X and XI, of 173, 68, 72, 64 and ... pages respectively.

The printing of the last volumes on the seminar on export promotion policies organized by CEPAL, UNDP and the World Bank in Santiago, Chile at the end of 1976 was completed early in 1980. The aim of all the studies presented was to answer, from different theoretical stadpoints and national situations, some key questions arising out of experience in this field both in the region and outside it.

Should import substitution and the export of manufactures be considered as mutually exclusive alternatives or as complementary elements in a development policy for Latin American countries during the next decade or two? Is specialization compatible with the achievement of a diversified export structure? What criteria should govern the selection of the goods on which Latin America's export effort should be concentrated? (A more detailed analysis of the general objective of the studies may be found on pages 231-232 of *CEPAL Review*, No. 5, first half of 1978.)

The complete list is as follow:

Vol. I Summaries and comments on all the documents.

Vol. II (1) "Las exportaciones manufactureras de América Latina: experiencias y problemas", (Latin American exports of manufactures: experiences and problems), by Angel Monti.
(2) "Exports in the new international scenario: the case of Latin America", by Barend A. de Vries.

Vol. III (1) "Export incentives and export performance in developing countries: a comparative analysis, by Bela Balassa.
(2) "Políticas de promoción de las exportaciones en los países en desarrollo" (Export promotion policies in developing countries), by Ricardo Ffrench-Davis and José Piñera.

Vol. IV "Las exportaciones manufactureras argentinas" (Argentina's exports of manufactures), by Angel Monti.

Vol. V "La política de desarrollo de las exportaciones de manufacturas en Brazil" (Brazil's development policy for export of manufactures), by Héctor A. García.

Vol. VI "La política colombiana de promoción de exportaciones", (Colombian export promotion policy), by Ricardo Ffrench-Davis and José Piñera.

Vol. VII "La exportación de manufacturas en México y la política de promoción" (Mexico: export of manufactures and promotion policy), by the CEPAL Mexico Office.

Vol. VIII "Korea's experience with export-led industrial development", by Larry E. Westphal.

Vol. IX "Indian exports", by Martin Wolf.

Vol. X (1) "Export promotion policies in Israel", by Michael Michaely.
(2) "Yugoslavia: Commodity exports and export policies", by Vinod Dubey.

Vol. XI Methodologies for the selection of export priorities.

Structures and Dynamics of Development in Latin America and the Caribbean and Their Implications for Education, ED-79/MINEDLAC/REF.1, CEPAL, 1979, mimeographed edition, 72 pages.

This document was presented by CEPAL at the Regional Conference of Ministers of Education and those Responsible for Economic Planning of Member States of Latin America and the Caribbean, organized by UNESCO with the co-operation of CEPAL and OAS and held in Mexico City from 4-13 December 1979. It deals with the state and trends of economic and social development in Latin America and is largely based on the special studies and reports prepared by the CEPAL secretariat for the appraisal of the International Development Strategy (IDS), as well as on that appraisal itself, the draft of which was prepared by the Committee of High-Level Government Experts (CEGAN, Quito, 12-16 March 1979) and adopted as the fourth regional appraisal by the Commission at its eighteenth session (La Paz, Bolivia, 18-26 April 1979) under the title of the *La Paz Appraisal*.

Indicadores sobre la situación de la infancia en América Latina y el Caribe" (Social indicators on the situation of children in Latin America and the Caribbean), CEPAL/UNICEF, Santiago, Chile, 1979, 279 pages.

The object of this volume is to present a series of indicators and statistics on the situation of children in Latin America and the Caribbean.

The choice of statistics and indicators and the form of breaking down these data are designed to provide useful information for formulating policies, strategies and programmes aimed at improving the situation of children in the region. The publication therefore has three characteristics which distinguish it from other statistical studies on the topic.

Firstly, a distinction is drawn between early childhood, school-age children and young people, taking account of the significant differences in the problems characterizing them. Each of these groups is the subject of a chapter, although the major part of the statistical study is devoted to the first two groups.

Secondly, in the chapters on early childhood and school-age children, a central area of topics is defined in each case, chosen for its capacity of synthesizing the basic problems of these age groups. The study goes on to select indicators which give information on the most significant aspects of each central area of topics for which there is a practical possibility of obtaining data on their behaviour in relatively homogeneous subgroups of the population studied.

On the basis of these criteria, survival capacity is selected as the central area of problems in early childhood, and the death rate as the general indicator. In the case of school-age children, participation in the education system constitutes the central topic, and indicators are prepared on the coverage of the educational system and particularly its capaticy for retaining pupils.

Thirdly, the indicators selected are broken down internally into relatively homogeneous subgroups. This makes it possible to identify sectors of the population studied which have differential life probabilities in the case of early childhood, and differential probabilities of access to and continuity in the educational system, in the case of the school-age population. This endeavour to break down and specifically describe the situation of different sectors in each age group with regard to a problem central to that group constitutes an appropriate method of guiding action towards the sectors most affected.

Nicaragua: Repercusiones económicas de los acontecimientos políticos recientes (Nicaragua: The economic repercussions of the recent political events), E/CEPAL/G.1091, mimeographed edition, Santiago, Chile, 1979, 156 pages.

This is not the first time that the CEPAL secretariat has presented a report on an exceptional event in a Central American country. This particular occurrence, however, is different from past events, especially because of the heavy loss of human life and material damage involved. The systematic drain of foreign currency sufferend by the economy of Nicaragua in recent years, the virtual paralyzation of production activities, the considerable damage —still not completely repaired— of the 1972 earthquake, and the natural disintegration of public administration caused by the sharp change of government last July, foretold for Nicaragua an adverse economic situation unprecedented in the recent history of any Central American country. A patent illustration of this is the fact that the per capita income in 1979 will hardly reach the level registered in 1962.

This report, intended to facilitate the mobilization of the international technical and financial co-operation required by the situation of Nicaragua, is divided into three sections and a summary. The first section makes some reference to the recent past to facilitate the interpretation of the events which have taken place and give an idea of the social cost that they have entailed for the people of Nicaragua.

The second section describes very briefly the list of priorities adopted by the new Government of National Reconstruction and the first steps it has taken to implement its programme. This section also identifies priority areas of national activity which might receive financial and technical support from the international community. Lastly, the third section is basically directed at the latter community and indicates some external co-operation requirements within the framework of priorities which the Nicaraguan Government proposes to establish.

República Dominicana: Repercusiones de los huracanes David y Federico sobre la economía y las condiciones sociales (Dominican Republic: Repercussions of hurricanes David and Frederick on the economy and social conditions), E/CEPAL/G.1098/Rev.1, mimeographed edition, Santiago, Chile, 1977, 91 pages.

Natural disasters occur in Latin America with relative frequency and substantially affect the economic and social development of the countries, causing damage which it is difficult to avoid or mitigate. Examples are the earthquake which occurred in Managua in 1972, hurricane Fifi which devastated Honduras in 1974, and the Guatemala earthquake of 1976.

On this occasion the Caribbean subregion was successively affected by hurricanes David and Frederick which sowed death and destruction in the Dominican Republic, Dominica, Puerto Rico and, to a lesser extent, Cuba, Haiti and other neighbouring islands. This document, which restricts itself to analysing the situation in the Dominican Republic, consists of four chapters. The first, intended to provide a general frame of reference, describes the evolution of the Dominican economy in recent years. The second is devoted to quantifying the loss of human lives, infrastructure, stocks and production, but should only be taken as a rough indication of the magnitude of the cost of replacing such losses. The third chapter analyses the possible implications of the disaster for the economy in 1979 and 1980, while the last chapter offers some guidelines on the financial co-operation and technical assistance that the international community could give the country in order to facilitate a rapid and effective recovery.

Integración de la mujer en el desarrollo de América Latina. Directorio (The integration of women into the development of Latin America. A Directory), CEPAL-CLADES, E/CEPAL/G.1102, Santiago, Chile, 1979, 246 pages.

The Programme on the Integration of Women into the Economic and Social Development of Latin America which is being implemented by CEPAL has set itself the task of improving the information and documentation on which action is being taken and projections made in the countries of the region as regards the situation of women and their incorporation into development. Responsibility for achieving this objective has been assumed by the Latin American Centre for Economic and Social Documentation (CLADES), a unit of CEPAL concerned with the problems of development in the field of information.

Starting from the idea that it was necessary to collect as much information as possible on the subject and present it in a systematized form so as to co-ordinate and rationalize the human and financial efforts and resources which exist at the national and international levels, the first research work resulted in a publication on projects which have been or are being implemented by the agencies of the United Nations in co-operation with the region. (*Inventario de Proyectos sobre Integración de la Mujer en el Desarrollo en América latina*, Santiago, Chile, March 1979.)

In order to continue with this task and complete the information submitted, this Directory was conceived of as an instrument for consultation and reference to provide information on the efforts being made by the institutions in the countries of the Latin American region.