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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.

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Basic needs or comprehensive development

Should UNDP have a
development strategy?

*Sidney Dell**

In recent years widespread interest has been shown in the development strategy which focuses on the satisfaction of basic needs. However, the sympathy that its content of social justice arouses should be no bar to critical analysis whereby attention can be drawn to the operational and strategic difficulties it entails.

This is the object of the present article. The author begins by presenting the practical problems that a basic needs strategy would encounter if an attempt were made to turn it into an efficient planning instrument, and shows that it has considerable shortcomings in conceptual respects as well as from the standpoints of measurement and of implementation. Nevertheless, the strategic problems which are subsequently analysed present even greater difficulties. Among these problems three of the most important are discussed: the relation between economic growth and satisfaction of basic needs; the choice between present and future consumption; and, lastly, the development pattern which this strategy proposes. In connexion with this last topic, which may be regarded as the core of the article, the author recalls well-known dichotomies such as industrial development or rural development, use of capital-intensive or of labour-intensive technologies, and so on. In conclusion he suggests that the international agencies should proceed with caution and humility in tackling the complex problem of basic needs.

*Staff member, United Nations Centre on Transnational Corporations.

Introduction

1. *What is a basic needs strategy?*¹

Strong political, intellectual and moral forces have been mobilized in favour of a basic needs strategy of development, and the strategy was given powerful endorsement by the World Employment Conference and by the General Assembly of the United Nations in 1976. The present essay seeks to question not at all the goal of more equitable development policies but the general framework within which such policies have been presented for the consideration of the international community. It also indicates some of the pitfalls awaiting international development agencies if they limit themselves to a particular development strategy—the basic needs strategy or any other—as a guide for their operations.

One of the difficulties in getting to grips with this elusive subject is that the idea of a basic needs strategy means different things to different people. For some it is a basically humanitarian issue, a categorical imperative that transcends all other considerations. To others it represents a fundamental reordering of development priorities, often assigning a leading role to rural development. Some

¹ This is a revised and extended version of an address given by the author on 10 December 1976 to the Thirteenth Policy Forum of the United Nations Development Programme (UNDP). The views expressed are those of the author, and do not necessarily represent the views of the UN or UNDP. The author gratefully acknowledges valuable comments received from Shahen Abrahamian, Michael Dell, Gerald Helleiner, Paul Streeten and Laurence Whitehead; he has benefited particularly from reading certain unpublished papers by Paul Streeten. The author alone is responsible for any errors or shortcomings that remain.

members of the latter school completely reject the development path traced by the industrially advanced countries of today, while others take a less radical position. A curious feature of the strategy is that it finds supporters in all parts of the political spectrum from left to right, and in all schools of economic thought, from dirigiste to laissez-faire, and from neo-classical to neo-marxist. In the discussion that follows, mention will be made of several of the above schools, and it is inevitable that points made in relation to one school may be less applicable, or even quite inapplicable, to another.

Perhaps the best-known exposition of a basic needs strategy is that contained in a report submitted in March 1976 by the Director-General of the ILO to the World Employment Conference. It was proposed to the Conference in the report in question that "development planning should include, as an explicit goal, the satisfaction of an absolute level of basic needs".² In this context, basic needs are considered to include two elements:

"First, they include certain minimum requirements of a family for private consumption: adequate food, shelter and clothing, as well as certain household equipment and furniture. Second, they include essential services provided by and for the community at large, such as safe drinking-water, sanitation, public transport and health, educational and cultural facilities".³

² *Employment, Growth and Basic Needs: A One-World Problem*, International Labour Office, Geneva, 1976, p. 31.

³ This is the definition of basic needs adopted by the World Employment Confer-

ence, which is virtually the same as that proposed by the ILO staff (*Ibid.*, p. 32).

These goals should be achieved, in the view of the ILO staff, within one generation, or by the year 2000. To that end there was a need for measures aimed at changing the pattern of growth and of the use of productive resources by the various income groups – including, in a number of cases, "an initial redistribution of resources, in particular land".⁴ Additional elements would be the provision of adequate employment opportunities for the unemployed and underemployed, the introduction of the "right kind of technology" and "quite high levels of investment, without which there would be neither growth nor meaningful redistribution".⁵

The literature on poverty-oriented development contrasts these approaches with those of the past. It is suggested that past strategies sought maximum growth at any price and that questions of social equity were ignored. These strategies were, it is believed, based on the assumption that the benefits of high rates of growth would somehow "trickle down" to the low-income groups. It was also assumed, according to the critics, that the gross national product (GNP) was a satisfactory measure of development and that if real GNP grew at an adequate rate, this in itself implied that development was proceeding satisfactorily. All this, said the critics, was quite wrong. The growth process had often bypassed the poorer members of the community: the latter would benefit from growth only if distributional goals were made a deliberate and explicit element of policy. It was said to be

ence, which is virtually the same as that proposed by the ILO staff (*Ibid.*, p. 32).

⁴ *Ibid.*, p. 43.

⁵ *Ibid.*

necessary to dethrone "King GNP" and enthrone "basic needs" in its place.

Certainly, there are countries where it was considered essential to establish the growth process on a secure and self-sustaining basis before proceeding to any redistribution of income. In Brazil, for example, the argument was advanced that the release of resources for investment in growth required the enforcement of strict austerity, and that any effort to improve present welfare through a 'premature' redistribution of income, or through wage 'prodigality', was incompatible with the maximization of future welfare.⁶

2. *The International Development Strategy*

But it would be a mistake to suppose that growth-at-any-price, or the trickle-down approach, was either explicit or implicit in the United Nations International Development Strategy.

The Strategy adopted by the General Assembly for the 1970s has the following major statement in the preamble:

"Governments designate the 1970s as the Second United Nations Development Decade and pledge themselves, individually and collectively, to pursue policies designed to create a more just and rational world economic and social order in which equality of opportunities should be as much a prerogative of nations as of individuals within a nation."⁷

⁶ See Mario Henrique Simonsen, *Brasil 2000*, Rio de Janeiro, 1969, p. 285. Mr. Somonsen later became Minister of Finance of Brazil.

⁷ General Assembly resolution 2626 (XXV).

In defining the content of the above declaration so far as "individuals within a nation" are concerned, the Strategy places in the forefront of national objectives, along with the promotion of higher growth rates, a more equitable distribution of income and wealth. Moreover, "qualitative and structural changes in the society must go hand in hand with rapid economic growth, and existing disparities—regional, sectoral and social—should be substantially reduced". To this end, the Strategy calls for measures to reduce unemployment and underemployment; to improve the quality of education; to raise general levels of health and sanitation; to improve levels of nutrition, placing special emphasis on the needs of vulnerable groups; to expand and improve housing facilities, especially for low-income groups; to foster the well-being of children and the participation of youth; and to integrate women fully in the development effort.⁸

The General Assembly Strategy was drafted with the assistance of the Committee for Development Planning at sessions held in 1969-1970, under the chairmanship of Professor Jan Tinbergen. The report of the sixth session included the following assertion: "It cannot be over-emphasized that what development implies for the developing countries is not simple increase in productive capacity but major transformation in their social and economic

⁸ *Ibid.*, paragraphs 12 and 18. Paragraph 71 calls for particular efforts "to expand low-cost housing through both public and private programmes and on a self-help basis, including through co-operatives, utilizing as much as possible local raw materials and labour-intensive techniques". Paragraph 68 calls for national targets for the provision of potable water.

structures.”⁹ It was therefore necessary to eliminate the dualism between the traditional economy and the modern sector. A separate section of the report was devoted to methods of improving income distribution and providing for the needs of the people in the fields of employment, education, health and housing. “The glaring inequalities in the distribution of income and wealth prevailing in the developing countries will have to be eliminated... It is a fallacy that more rapid growth and reduction of inequalities of income and wealth are necessarily competing elements.”¹⁰ National measures to this end should include “activation of broad masses of the population and assurances of satisfaction of their primary needs and aspirations”.¹¹ As for “King GNP”, Tinbergen and his colleagues had this to say: “Although the rate of growth of gross product per head is by no means an adequate indicator of economic and social progress—since it does not reflect such major conditions of development as income redistribution or structural change—it is the one aggregate indicator which comes closest to providing some quantitative impression of the underlying change.”¹²

3. *The real issues*

The real issues between the basic needs

⁹ United Nations Committee for Development Planning, Report of the sixth session (5-15 January 1970), document E/4776, paragraph 14. The other members of the Committee were Gamani Corea, Nazih Deif, A.N. Efimov, Paul Kaya, J.A. Lacarte, J.H. Mensah, Saburo Okita, Josef Pajestka, M.L. Qureshi, K.N. Raj, Jean Ripert, Germánico Salgado, Jakov Sirotkovic, Zdenek Vergner.

¹⁰ *Ibid.*, paragraphs 28-29.

¹¹ *Ibid.*, paragraph 41.

¹² *Ibid.*, paragraph 16.

strategists and those who favour comprehensive development policies lie not in the goal of social equity, which is common ground between them, but in the means for achieving that goal.

There are three main issues. The first relates to the need for higher or accelerated rates of growth: some of the basic needs strategists agree in attaching importance to such objectives, but others seem not to do so. A second issue, closely related to the first, is whether the pre-empting of resources for the attainment of a minimum absolute level of consumption in the nearest possible future would entail a lower rate of growth than would otherwise be possible as well as socially acceptable, and hence would imply a lower level of provision for the basic needs of future generations. Are there not societies that, if they could control their own destinies, would certainly seek the reduction of inequality, but would also prefer to tighten their belts a little more now in the interests of more adequate provision for the future?

The third issue arises out of the opinion held by many of the basic needs strategists, as noted earlier, that the road to development adopted by the present high-income countries is inappropriate for the developing countries of today; and that the current maldistribution of income is due largely to the development of modern industrial sectors, employing capital-intensive techniques, accompanied by neglect of rural areas. Some of those who take this view play down large-scale industrial growth and focus their attention on rural development. Others recognize the need for rapid industrial progress, but consider that it needs to be reoriented in a labour-intensive direction.

I

Operational difficulties

1. *Basic needs: the meaning of absolutism*

Before embarking on an examination of these issues, it is important to note some of the difficulties in the use of 'basic needs' as an operational tool for planning. There are difficulties of concept, of measurement, and of implementation.

As to the concept, the Director-General of the ILO suggested to the World Employment Conference that there are certain minimum levels of personal consumption and access to social services that should be adopted "as minimum targets for raising the living standards of the very poor for the entire international community"¹³ It is, however, difficult to envisage how such universally applicable targets would be defined. Differences in climate alone result in different minimum requirements for calorie intake and clothing. Would not additional differences arise owing, if not to intercountry differences in levels of income, then at least to differences in social and cultural traditions and circumstances? In fact, the World Employment Conference rejected the idea of a worldwide standard and invited each country to set its own standard.

But how is such a minimum standard to be established, even for a single country? No doubt the idea of a minimum standard of nutrition is acceptable — although even here one runs into difficulties, as we shall see. But as

soon as one includes such items as shelter and clothing, and even household equipment and furniture, as the World Employment Conference did, the line to be drawn between basic and non-basic needs is bound to be arbitrary. If 'absolute' norms are set for such non-food items, does this mean that attainment of the norms must constitute a prior claim on resources, to be pre-empted for that purpose regardless of all other needs, however pressing?

Equally arbitrary is the setting of absolute standards for the essential services that appear on the ILO list of basic needs. In the case of educational and cultural facilities, for example, it would be odd to define standards in the abstract without taking into account the alternative goods or services that would have to be forgone — even by the poorest 20 per cent of the population — in order to attain them.

Even if certain norms for basic needs had been generally agreed upon in a particular country, the question would still arise as to how rapidly the minimum standards should be achieved. Should all resources be allocated for the quickest possible attainment of the chosen goals, or would it be permissible to use resources for other valid development programmes? As regards nutrition, for example, should all food exports be discontinued irrespective of the degree of essentiality of the counterpart imports? And should the entire proceeds of non-food exports be used for the purchase of food — up to the point at which every man, woman and child was adequately fed? If not, what degree of

¹³ *Op. cit.*, p. 7.

provision for the food needs of the poor could be regarded as 'adequate' in the immediate future, and how soon should the norms be attained?

There are other conceptual difficulties in interpreting the 'absolutism' of basic needs. Does it mean that no-one should be allowed a level of consumption in excess of basic needs until every member of the community has reached that level? If not, what degree of 'excess consumption' should be permitted, and where does one draw the line between tolerable and intolerable degrees of inequality? If 'excess consumption' can be allowed, is it also acceptable to provide for 'excess investment' in the sense of investment not required to meet basic needs? If so, how much 'excess investment' is tolerable? And in what respect is a basic needs strategy that permits excess consumption and investment preferable to a comprehensive strategy that seeks to deploy available resources for the attainment of all socially acceptable ends, including basic needs?

A further difficulty arises for the many countries at the lower end of the resource and income scale. How are they to determine the particular package or combination of basic needs, the satisfaction of which should constitute their overall minimum target? What are the relative priorities to be assigned to such items as public health and sanitation, potable water supplies, public transport, housing, and household equipment? What should be the tradeoffs between these items at the margin, and what resources should be invested in each?

Answers to these extremely difficult questions of judgement are not made any easier by the assertion that absolute standards must prevail. The use of the

term 'absolute' has no meaning without a time dimension, and once it is acknowledged that the fixing of the time dimension involves decisions on overall development requirements and not merely on basic needs, it will be apparent that a basic needs strategy must form part of a comprehensive development strategy. As such, basic needs are no longer absolute but relative, and there is no valid difference between the Development Decade strategies and basic needs strategies except possibly in emphasis.

2. *Setting the standards*

Problems of measurement of basic needs, though not fundamental, are far from trivial for what is intended as an operational approach to planning. One might think that at least in the case of food consumption, quantitative targets would be readily available. Surely there is some minimum intake of food below which people can be said to be under-nourished, and it should clearly be a primary and overriding objective to ensure that even the poorest of the poor do not suffer from malnutrition.

On closer examination, however, it appears that the setting of absolute standards even for food consumption poses unexpected problems. According to a report published in February 1977 by the staff of the Select Committee on Nutrition and Human Needs of the United States Senate, "there is only limited knowledge of human requirements for most nutrients". An appendix to the report prepared by the Nutrition Institute of the United States Department of Agriculture describes the state of knowledge even on total human energy requirements as "fragmentary" except for school-age and adolescent

children and for young adults.¹⁴ If the gaps in knowledge of nutritional requirements are so great in the United States, in developing countries such knowledge may be even more inadequate, since requirements in one country are not applicable elsewhere because of differences in climate and other factors.

It turns out, moreover, that the record of institutions responsible for reaching conclusions in this field has been one of continual, and generally downward, revision. The changes in assessments made have, in fact, been surprisingly large, suggesting that the scientific basis of the assessments is still quite shaky. As Thomas T. Poleman has pointed out, "the energy allowances for the United States 'reference man'—in his twenties, moderately active, weighing 70 kilogrammes—now stand at 2,700 calories daily, 500 calories less than in the 1953 recommendation": in other words, there has been a 15-per-cent reduction in the twenty-one years up to 1974. Poleman goes on to note that in 1974 FAO estimated that perhaps a quarter of the population of the developing world (excluding China) were inadequately fed, while the corresponding estimate in 1963 had been at least 60 per cent. Poleman shows further that "depending on your assumptions you can prove beyond a statistical doubt that 43 per cent of Ceylonese suffer protein-calorie malnutrition or none do".¹⁵

¹⁴ *Dietary Goals for the United States*, Report prepared by the staff of the Select Committee on Nutrition and Human Needs, United States Senate, Washington D.C., United States Government Printing Office, February 1977, p. 20 and Appendix C.

¹⁵ Thomas T. Poleman, "World Food: Myth and Reality", *World Development*, vol. 5, No 5-7, May-July 1977, pp. 385-386. It also

This does not, of course, mean that the problem of malnutrition is not extremely grave and worrying. What the foregoing discussion does, however, show is that the scientific, statistical and analytical foundations for a basic needs strategy are extraordinarily weak even in the sector where they should presumably be strongest—namely, that of food consumption—, while in other sectors they are non-existent. Let us imagine that the basic needs strategists had won their battle against the GNP-at-any-cost school (*sic*) in 1963 instead of thirteen years later in 1976. The planners in developing countries in 1963 would have been told to pre-empt the resources required to eliminate malnutrition among 60 per cent of the population, whereas the true dimensions of malnutrition must have been very much smaller.¹⁶ No doubt this would have been beneficial to the extent that malnutrition, where it existed, might have been reduced more quickly, and that elsewhere food consumption might have advanced beyond minimum levels. But the more important point in the present context is that choices would

appears that there may have been widespread underestimation of calorie intake in the developing world owing to inadequate sampling of food items consumed. For example, a study on Kerala has shown that this factor has been responsible for a 30-per-cent underestimation of food consumption in that state. See United Nations, *Poverty, Unemployment and Development Policy: A Case Study of Selected Issues with reference to Kerala*, United Nations publication, Sales No.: E. 75.IV.11, pp. 1, 22-24, 34-35.

¹⁶ This would be true even after making a generous allowance for the increase in *per capita* consumption from 1963 to 1974, when the proportion of malnutrition was estimated at one quarter.

have been made and strategies devised on the basis of data that were quite wrong, and wrong by a very large margin.

3. *Implementing a basic needs strategy*

The problem of ensuring that basic needs are met even among the poorest members of the community is complex, especially since the requisite systems and channels of distribution would have to be provided or created. What would be the respective roles of governments and the private sector? Distribution of foodstuffs might be undertaken directly by government entities, and provision for educational, health and housing requirements might also be a government responsibility. But in most if not all countries governments are not likely to be involved in the distribution of other essential goods and services, such as household furniture and equipment, and clothing. To this extent income supplements or subsidies might have to be provided to those lacking employment and to those for whom employment does not provide sufficient monetary

income. Some countries might prefer to use income supplements or subsidies to cover food needs also.

Of course the fact that a minimum ration of goods and services is distributed, or that income supplements or subsidies are provided, does not mean that the recipients will necessarily enjoy the corresponding benefits. If they are extremely poor and, as is often the case in such circumstances, heavily in debt, they may sell part or all of the income in kind in order to service their debts, and use money income for the same purpose.

Thus the basic needs of the poorest will be satisfied only if broader conditions are conducive to that end, and this in turn implies fundamental social and structural change, and a rate of growth of the economy sufficient for progressive absorption of the unemployed and underemployed into remunerative employment. In other words, it emerges here also that the satisfaction of basic needs can be secured only in the context of a broader process of comprehensive change and development, and that efforts to give an 'absolute' priority to basic needs are unlikely to be productive.

II

Strategic problems

1. *Growth and development*

Thus far, reasons have been given for doubting whether the satisfaction of 'basic needs' for consumption of particular goods and services can be regarded as

an overriding priority even in a society with egalitarian development objectives. We may now revert to the three issues raised earlier with respect to a basic needs strategy, beginning with the problem of growth and development.

It is often difficult to determine what exactly the stand of the basic needs strategists on this problem is. They deplore 'growth-at-any-price', as any sensible person would, but their own overall prescription for growth is usually obscure. This obscurity is a matter of concern in itself, since no strategy for overcoming poverty is worthy of the name if it does not indicate the means whereby the requisite rate of growth is to be attained. It is striking that the ILO report's summary of the six "main ingredients of the proposed new approach to development" does not even mention either growth or industry.¹⁷

The Director-General's introduction to the report suggests that measures to implement a basic needs strategy "need not imply a slower growth of output. They place greater emphasis on patterns of growth leading to a more equitable distribution of the gains from growth, and they may well lead to increasing growth rates as well".¹⁸

The report itself, on the other hand, argues that "a rapid rate of economic growth is an essential part of a basic needs strategy".¹⁹ On the basis of certain econometric exercises, the conclusion is reached that "All these calculations, tentative though they may be, strongly suggest that in many countries minimum incomes and standards of living for the poor cannot be achieved, even by the year 2000, without some acceleration of present average rates of growth, accompanied by a number of measures aiming at changing the pattern of growth and use of

productive resources by the various income groups".²⁰ According to the report, moreover, the ILO is "forced reluctantly to conclude, from this model, that the growth target of the Second Development Decade [6 per cent per annum] is not consistent with the proposed objective of fulfilling basic needs within one generation".²¹

The "reluctance" of the ILO to reach the above conclusion is noteworthy. The context suggests that it would have been preferable if basic needs could have been satisfied through income redistribution, but in the light of available evidence the ILO judges that "the extent of redistribution that would be required would be such that social changes of this magnitude are unlikely to occur". The alternative, therefore, is to step up growth rates so that basic needs can be satisfied out of the additional resources thereby generated.

But even if basic needs *could* be met entirely through redistribution of income, would not higher growth rates be desirable as well, so as to shorten the transition period and attain the targets by, say, 1990 instead of by 2000? Can it not be that the Development Decade strategists knew what they were about in pressing for higher growth rates, even from the standpoint of effecting the redistribution of income required under the preamble and paragraph 18 of the Strategy? They pointed to the widespread experience that at low rates of growth, a large part of the increasing labour force fails to find productive employment, and obstacles to economic and social mobility persist. Thus the absorption of underemployed labour,

¹⁷ *Employment, Growth and Basic Needs*, op. cit., p. 68.

¹⁸ *Ibid.*, p. 8.

¹⁹ *Ibid.*, pp. 32-33.

²⁰ *Ibid.*, p. 43.

²¹ *Ibid.*, p. 43. In other words the 6-per-cent growth target is *insufficient*.

the redistribution of income and the acceleration of growth are interdependent goals.²²

Already in 1970, when the Second Development Decade had barely begun, Raúl Prebisch was pointing out that the targets of the Decade were much too low to make any impact on the growing problem of unemployment and underemployment or on the maldistribution of income. Prebisch considered in the case of Latin America that a growth rate of 8 per cent would need to be attained by the end of the 1970s if the region was to proceed along a viable development path and if the benefits of development were to be widely shared.²³

2. *The choice between present and future consumption*

Reference has already been made to the problems involved in determining the rate at which any particular level of basic consumption should be approached.

Of course, the lower the level of consumption of basic essentials in any country, the more difficult will the people find it to release resources for investment. But if the basic needs

²² These points had been made as far back as 1963 by Raúl Prebisch at the outset of his study *Towards a Dynamic Development Policy for Latin America*, United Nations publication, Sales No.: 64.II.G.4. As he saw it, the concentration of income and wealth in Latin America was inimical to development, and major structural changes were therefore required to eliminate poverty, along with measures to accelerate growth.

²³ Raúl Prebisch, *Change and Development: Latin America's Great Task*, Report submitted to the Inter-American Development Bank, Washington D.C. (mimeographed text), July 1970, chapter IV, *passim*.

strategy were to be pressed to the point at which the attainment of minimum levels of nutrition, health, sanitation and education—to say nothing of household equipment and furniture—had to take priority over all other goals, some of the poorest societies might be condemned to an indefinite period of stagnation at the subsistence level, since virtually all resources might have to be pre-empted for consumption, little or nothing being set aside for investment in future growth and development. Even at the lowest levels of *per capita* income, countries in which social morale and sense of unity and purpose are high will deliberately forgo even essential items of consumption, including food, if they feel that by so doing they can improve the prospects for their children. No international agency has a right to tell such countries that there are absolute and overriding “basic needs” to which they must assign priority. They are entitled to define their development needs in terms relevant to their own goals and their own time horizons.

Does the above imply acceptance of the view, cited earlier, that inequality of income distribution must be accepted in the short and medium run as part of the price to be paid for a high rate of growth and effective redistribution of income in the long run? Not at all. On the contrary, the greater the degree of austerity required in the interests of setting aside resources for the future, the more important is it to ensure that the burden is divided fairly, and in some reasonable relationship to the capacity to bear it. The argument that inequality is indispensable in achieving an adequate level of savings because the rich save a larger proportion of their incomes than the poor is unconvincing. Societies with a strong sense of common purpose are

quite capable of imposing the most stringent limits on consumption, on an egalitarian basis, as has been shown in time of war. Inequality, on the other hand, can be highly divisive and whatever may be gained in terms of savings ratios may be more than lost through lower labour productivity and even social strife. In many developing countries, moreover, the richer classes scarcely offer a model of thrift, but tend rather to squander large proportions of their incomes on luxury consumption.

Thus the fact that a country prefers to postpone the attainment of basic needs targets in order to permit a more rapid rate of growth and structural transformation does not in the least imply that it thereby gives up ideas of social equity.

Perhaps the basic needs doctrine can be adjusted to take all these broader considerations into account, so that, as suggested earlier, the goals are defined in the wider context of comprehensive development strategies for the society as a whole. Whether we speak of the equitable distribution of the benefits of total growth (as per the Development Decade resolution) or of the attainment of adequate levels of consumption in the context of overall development needs (as per the basic needs strategy suitably amended) is a matter of small moment. It is to be hoped that a reconciliation of approaches and strategies can be achieved in some such terms as these.

3. *The pattern of development*

The third and most complex of the issues raised by the basic needs school is that of the pattern of development. Is the inequitable distribution of the benefits from growth in many countries

due to their having followed the example set by the industrially advanced countries, concentrating on the development of a modern sector, to the detriment of rural areas, where the majority of the population is to be found?

According to the Twenty-fourth Pugwash Symposium, "a development strategy imitative of highly industrialized countries does not appear to be possible, necessary or even desirable for the majority of the developing countries"²⁴ According to the report "it is unlikely to be possible because the quantum of natural resources—both renewable and non-renewable—as well as of the resources of capital, technology and markets to which the developing world would need to have access in order to traverse successfully such an imitative road, is infinitely greater than the prevailing international political and economic order, dominated as it is by the demands (not needs) of the highly industrialized countries, will make available".²⁵ It is not quite clear what is meant by the words "will make available", but what the above passage seems to be saying is that, in the first place, the natural resources of the world are insufficient to make it possible for developing countries to consume the

²⁴ Report of the Twenty-fourth Pugwash Symposium, Dar-es-Salaam, 2-6 June 1975, as published in *World Development*, vol. 5 No 3, March 1977, p. 257. The participants in the Symposium were R. Andriambolona, O. Bassir, W.K. Chagula, Bernard T. Feld, L.K.H. Goma, M. Goldsmith, K.N. Hirji, M.M. Semakula Kiwanuka, I.M. Kaduma, I. Mann, P. Mwombela, D. Nkunika, M.S. Ntamila, C.H.G. Oldham, S.J. Patel, A. Parthasarathi, J.F. Rweyemamu, F. Sagasti, A.R. Sidky, I. Sachs. The report was prepared by the Rapporteur of the Symposium, A. Parthasarathi.

²⁵ *Ibid.*

same volume of material goods *per capita* as is currently consumed in the industrial countries. The insufficiency may be due simply to such factors as the exhaustion of available supplies of minerals; or perhaps the wording of the statement is to be understood as implying that those in control of the limited supplies available will not release them to meet the needs of the poor countries. Either way the thesis would appear to come close to saying that the developing countries had better content themselves with the natural resources, capital and technology that are left over after the demands of the industrial countries have been satisfied.

If the foregoing interpretation is correct, the Pugwash Symposium was in effect giving a neo-Malthusian twist to the basic needs strategy. For the implication appears to be that in order to avoid the pressure of population on resources, the developing countries should adopt a development strategy that satisfies basic needs without seeking the high levels of material consumption characteristic of the industrial world. It is not possible to discuss the neo-Malthusian theories in the present context, but they have been thoroughly refuted — most recently by Professor Wassily Leontief's study for the United Nations entitled *The Future of the World Economy*.²⁶ Leontief's study shows that resource constraints would not prevent the income gap between developed and developing countries from being reduced by half by the end of the present century, and eliminated by the middle of the next.

²⁶ Wassily Leontief, *The Future of the World Economy*, Oxford University Press, 1977.

A low level of material consumption *per capita* may or may not be desirable for other reasons, but the case for it certainly cannot be based on a presumption that supplies of food or natural resources would be inadequate. It is even less credible that shortages of capital or technology would impose such limitations on consumption.

Even if a development strategy imitative of the industrial countries were feasible, it would not, according to the Pugwash group, be desirable. This is "because of the acute concern in the highly industrialized countries themselves that the kind of natural resource-, energy- and technology-intensive development strategy which they had adopted is not leading to genuine development — it is leading instead to growing personal and group alienation, to disruption of the human and social environment in a variety of ways ranging from organized crime to acute pollution and urban claustrophobia, and, more recently, monetary and economic crises".²⁷

It is, of course, quite true that the industrial societies of today are plagued by enormous problems and tensions, but whether this is the result of modern technology is something that has to be demonstrated, not taken for granted. It is at least arguable that any effort to put the clock back by suppressing modern technology would compound the problems and tensions of the world instead of easing them. There are remedies for pollution and crime that do not involve throwing the baby out with the bath water.

²⁷ *Op. cit.*, p. 257.

III

Development alternatives

1. *Rural and urban development*

It is not necessary to accept the back-to-nature implications of the Pugwash reasoning in order to agree with the basic needs strategists in their emphasis on the importance of rural development. Much of the hard-core poverty in developing countries is concentrated among the peasantry in rural areas, and greater attention to their needs is imperative not only in itself but as a means of raising their productivity. Moreover, the inadequate absorption of labour by urban industry makes it necessary to create additional employment opportunities in rural areas not only on the land but in rural industry, rural public works and rural services.

Thus far no controversy arises. Sometimes, however, the basic needs strategists seem to be suggesting that rural development can supply a wholly new approach that can replace the traditional strategy of industrialization. While urban industry led the development process in the past, the leading sector of the future will, it seems, be the rural sector, a viable and comprehensive economy in its own right.

Thus Ponna Wignaraja writes of "the village becoming the focal point of development". It is there that the creative energies of the people can best be mobilized to bring about "a social transformation of enormous magnitude" indispensable for satisfying their needs. "The capital fetishism of the past must give way to the fullest utilization of labour power and creativity" as well as

of local resources and appropriate technology.²⁸

But neither Wignaraja nor other writers in this field have indicated how exactly the village is to lead the development process, and, in particular, what is to happen to the agricultural workers released by rising labour productivity on the land.

The problem is a formidable one. In the least developed countries, it takes as much as eighty to ninety per cent of the economically active population, or even more, to supply the barest food subsistence requirements of the community. On the other hand, at the levels of agricultural productivity obtaining in the United States, the food needs of the entire population can be supplied by approximately 3 per cent of the labour force. Long-term development planning must therefore provide for the ultimate absorption of at least eighty per cent of the working populations of the lowest-income countries into non-agricultural employment. Does the new approach to development imply that the rural sector of the future will generate alternative employment for all or most of the people released from agriculture? In a world rushing headlong towards urban chaos, it is easy to see the attractions of such an idea, and the scope for studies of its feasibility. But it would be a mistake to act as if the feasibility of such an

²⁸ Ponna Wignaraja, "From the Village to the Global Order", *Development Dialogue*, 1, Dag Hammarskjöld Foundation, Uppsala, 1977 pp. 35-49.

approach, in political, economic and social terms, had already been demonstrated.

In China, rural industry at present occupies approximately 3 per cent of the working population, while another 2 per cent are engaged in a network of extension services covering agriculture, public health and industry. Rural industry is certainly not regarded as an alternative to medium- and large-scale enterprises, but only as a complementary element in the industrialization process.²⁹ Thus, if rural development were to be the spearhead of the development strategy of the future, it would have to be conceived on a scale far beyond anything currently contemplated in China.

There are, of course, powerful reasons for the concentration of industries and associated services in urban centres that embrace a great deal more than the economies of large-scale operations. As Nicholas Kaldor has pointed out, the advantages of geographic concentration lie in the opportunities for greater specialization among enterprises and the consequent subdivision of industrial processes; in the availability of labour with the whole range of specialized skills; in the accessibility of engineering and marketing know-how; and so forth.³⁰

²⁹ Jon Sigurdson, "Rural Industrialization in China", *World Development*, vol. 3, nos. 7 and 8, July-August 1975, pp. 527-538.

³⁰ Nicholas Kaldor, "The role of modern technology in raising the economic standards of the less developed countries", in Wayne L. Hodges and Matthero A. Kelly (ed.), *Technological Change and Human Development. An International Conference*, New York State School of Industrial and Labor Relations, Cornell University, Ithaca, N.Y., 1970, pp. 15-29.

Unless something occurred to remove or offset the advantages of geographic concentration, it seems doubtful whether the rural sector would, in the foreseeable future, be capable of taking over from urban industry the leadership of the development process. The fact that most of the population is to be found in the countryside does not mean today, any more than it meant in eighteenth-century Britain or nineteenth-century Germany and the United States, that the primary stimulus to development will come from the rural sector. This is not to say that the urban concentrations of the past and present provide a satisfactory model for the future. An immense effort of imaginative planning will be required to overcome the defects of contemporary urban society. But there is no evidence that there will be any less need in the next twenty years than there has been since the Industrial Revolution for the concentration of interdependent manufacturing and service facilities in towns, although it may prove desirable to place limits on the growth of any single urban centre.³¹

Great as is the preoccupation of the basic needs strategists with rural development, one of the key issues in this regard is often overlooked. Most of the concern

³¹ One of the most disruptive features of urban life —traffic congestion— would not be difficult to remedy if the political will to do so existed. Such is the power of the automobile industry that road transport (particularly the personally-owned automobile) does not have to bear anything approaching the social costs of the congestion and pollution that it causes. Rectification of this anomalous situation by drastic restrictions or heavy taxation on personal use of automobiles in central cities, combined with adequate provision of public transport, would greatly increase the viability and amenity of urban living.

is, quite rightly, addressed to improving the economic prospects of the small family farm through a variety of convergent measures. The fruits of rising productivity on the small farm are, however, likely to be consumed by the occupants themselves, so that relatively little contribution may be made to the marketable surplus of production over consumption. There is abundant evidence that the growth of employment-generating activities outside agriculture has been constrained far more by the size of the food surplus available for sale to the non-agricultural sector, than by any other single factor. On the one hand, efforts to expand non-agricultural employment faster than the marketable surplus of food have foundered on the inflationary spiral that resulted. On the other hand, the size of the agricultural surplus, which determines the purchasing power of the farm sector for industrial products, has helped to limit the growth of industrial employment. Although no programme for rural development can therefore be complete without a prescription for increasing the marketable supply of food, an adequate treatment of the subject can rarely be found.³²

Some members of the basic needs school show a certain reticence about structural change in the rural sector. Respects are paid to the need for agrarian reform, but, as the ILO report puts it, "agrarian reform is practicable only if political forces with more strength than those of the landlords can

be mobilized".³³ An alternative view might be that the entire fabric of rural development programmes featuring so prominently in the basic needs strategy would be of doubtful value in a considerable number of countries in the absence of land reform.

2. *The role of industry and the modern sector*

Among those who think about these matters in the industrial countries it has come to be held distinctly unfashionable—or worse—³⁴ to entertain the view that industrial transformation is the key to the development of low-income countries. Yet there is nothing very new or shocking about the idea, which still commands general support in the developing world. It is over two hundred years since Adam Smith pointed to the increasing returns generated by manufacturing activities and explained them in terms of the division of labour, or specialization, which itself depended on the extent of the market.

Paul Streeten has shown that "to rise above poverty, industrialization is necessary, for industrialization means the application of power to production and transport. Output and consumption per head can rise towards the desired modern levels only with the help of mechanical aids. In this sense, development, including rural development, is industrialization". And he goes on to point out that there is no evidence of an inevitable conflict between high rates of

³² The ILO's report to the World Employment Conference confines itself to saying that any transitional shortages of basic goods can be met by changing the composition of imports or increasing their volume, by food aid, or by a temporary rationing system (*op. cit.*, pp. 67-68). The problem is, however, of a much more than transitional character.

³³ *Op. cit.*, p. 67.

³⁴ Michael Lipton refers to "the dark neo-Stalinist night in which almost all 'development experts' have lurched around since 1945, muttering half-coherent praises of instant industrialization". See *World Development*, vol. 5, no. 3, March 1977, p. 267.

industrial growth and the achievement of other development objectives such as rural development and the equitable distribution of income; if anything, as he says, there is evidence to the contrary. In many, though not in all cases, the achievement of social objectives has been consistent with high rates of industrial growth and, indeed, has depended on them.³⁵

Despite the disappointing rate of absorption of labour by industry in developing countries in recent years, there cannot be any doubt that faster growth means a more rapid rate of increase in employment. Employment does not rise as quickly as industrial output because of increases in productivity, which are due to economies of scale, technological progress, and the process of 'learning by doing'. However, analyses of growth rates of output, employment and productivity by Verdoorn, Kaldor and others have led to the conclusion that each percentage addition to the growth of industrial output requires, in general orders of magnitude, a 0.5-per-cent increase in man/hours of employment and a 0.5-per-cent increase in productivity.³⁶

Basic needs strategists are as reticent about the role of the modern sector in poverty-oriented development as they are about the growth requirements of the economy in general. It is, however, usually left to be inferred that since modern industry has not been able to absorb as much of the labour force as had been hoped or expected, it has little

or no role to play in a basic needs strategy and that a fundamental shift towards a labour-intensive pattern of industry is indispensable for the future. Such a shift would, it is thought, be facilitated if a concept of the international division of labour were adopted whereby industrially advanced countries specialized in capital-intensive and developing countries in labour-intensive industries, and exchanged their output to mutual advantage.

The comments of Charles Paolillo, staff consultant to the United States House of Representatives Committee on International Relations, who attended the World Employment Conference, are of particular interest in this context. He suggests that "many countries may well want to take steps towards a basic needs strategy while at the same time expanding the modern sector, increasing the use of advanced technology, and strengthening the heavy industrial base". He goes on to say that their reasons for acting in this way "may include politics, prestige, psychology, security and self-reliance".³⁷

Paolillo appears to be implying that "expanding the modern sector" would not normally be regarded as part of a basic needs strategy. Indeed, such an idea would have to be justified, in his view, on one or more of several grounds, among which he places politics and prestige in the forefront, and none of which includes rational economic calculation (except perhaps to the extent that this is involved in self-reliance). From this angle of vision, then, modern

³⁵ Paul Streeten, "Industrialization in a Unified Development Strategy", *World Development*, vol 3, no. 1, January 1975, pp. 1-2.

³⁶ Nicholas Kaldor, *Strategic Factors in Economic Development*, Cornell University, 1967, p. 17.

³⁷ See *A Basic Human Needs Strategy of Development: Staff Report on the World Employment Conference*, Washington D.C., U.S. Government Printing Office, September 1976, p. 11.

industrial installations in developing countries can be explained only in non-economic terms.

3. *The labour-intensive strategy*

Yet there are strong reasons for doubting whether the pattern of industrial specialization in developing countries can be determined even in the short run by the simple criterion of the amount of labour employed per unit of capital. It is often taken for granted that labour-intensive techniques are capital-saving, but in many instances they certainly are not. In fact the capital cost of labour-intensive techniques is often quite high. For example, the ILO Employment Mission to Colombia was informed that the capital-output ratio in the traditional sector of Colombian industry averaged about twice as high as in the modern sector. Some insight into possible reasons for this kind of unexpected result is provided by studies of cotton textile production in India. These have shown that cottage industry employs substantially more capital per unit of output than factory production, principally because the much longer time required for manual operations involves the tying-up of far greater amounts of working capital per unit of output.

Thus capital-intensive techniques are not necessarily associated with higher capital costs per unit of output than those of labour-intensive techniques: on the contrary, there is reason to believe that over a wide range of industry capital-output ratios are actually lower for capital-intensive than for labour-intensive techniques.

In general, labour-intensive techniques are clearly advantageous to developing countries only if they permit the same volume of output to be

produced at no greater capital cost. The available evidence suggests that in many core industrial processes techniques requiring a large volume of investment per worker generate a far higher level of output, as well as of output per worker, while capital outlays per unit of output are no greater than for less capital-intensive techniques.

The principal qualification to be made in respect of this conclusion is that in some cases the choice of a capital-intensive technique may be precluded by the fact that the domestic market is too small to permit the advantages of the technique to be realized. At the same time there may be difficulties in breaking into export markets.

There are a number of ancillary activities, notably construction and materials handling, as well as services, in which the use of labour-intensive methods may yield economies in the use of capital per unit of output. However, the successful application of labour-intensive methods in large-scale road and dam construction has been found to depend on a high degree of managerial efficiency in the deployment of labour as well as on tight labour discipline. Failing this, capital-intensive methods may be preferable even here.

The point is often made that capital-intensive techniques have in effect been subsidized in developing countries through low interest rates and the remission of duties on imported equipment embodying advanced technology, coupled with high levels of protection on the finished products manufactured with such equipment. Examples can be cited in which the value added by heavily protected modern industry in certain developing countries was actually negative at world market prices: motor-vehicle production in some

of the Latin American countries is a case in point.

It is doubtful whether subsidization of such magnitude, especially of luxury consumer durables, can be justified. Equally, however, it would be inadvisable to introduce distortions of precisely the opposite character, namely, those that would result from indiscriminate incentives or subsidies to labour-intensive technologies. There are instances in which the subsidization of capital-intensive as well as of labour-intensive techniques can be justified: both may find their place in a purposeful development strategy so long as decisions are based on rational calculation rather than on general doctrine.

Notwithstanding the above considerations, it appears to be implied in some of the employment-maximizing strategies that labour-intensive techniques should be adopted even though they do not yield a higher aggregate output, and even though total capital requirements may be greater. This, however, is a self-defeating strategy under almost any conditions. It amounts to saddling industry with the additional costs of a public works programme. This inevitably makes it more difficult to gain export markets and may even necessitate high levels of protection against cheaper imports from abroad. In such cases it would obviously be preferable to adopt capital-intensive techniques in the industries concerned, and use the savings in capital cost to help in financing employment-creating public works programmes of value to the community.

4. *'Appropriate' technology*

It is nevertheless true that most of the technology employed in developing countries was originally designed for use

in the quite different conditions of industrial countries, and has usually undergone only minimal adaptation to the requirements of a new environment. Much greater efforts are therefore needed, as the basic needs strategists emphasize, to design or adapt technologies that would be more 'appropriate' to the conditions prevailing in developing countries.

Whether a programme to promote 'appropriate' technology would bring about a significant change in the strategic options available to developing countries is far from clear. In the first place the mobilization of an adequate scale of R and D for this purpose will take more time than is generally realized, and the production of usable prototypes may take even longer. Moreover, account will have to be taken of the fact that differences in factor prices and in other relevant conditions among developing countries are greater than average differences between developing and developed countries. Consequently there is no technology that is equally 'appropriate' for all developing countries, and adaptations will themselves have to be graduated accordingly. Secondly, it will be necessary to accommodate the effects of changes in factor price ratios over the lifetime of durable equipment: for example, at a rate of growth of seven per cent per annum real wages double in ten years. Thus the problems involved in elaborating 'appropriate' technology over a significant range of industry are immensely complex, and for many of the most important industrial processes solutions cannot even be envisaged at this stage, let alone anticipated. Meanwhile life must go on, and choices will have to be made from the options available at present.

The application of up-to-date scien-

tific and engineering know-how could undoubtedly help to improve the performance of traditional techniques. Whether the improvement could ever be sufficient to outweigh the productive advantages of capital-intensive techniques in a major part of industry is open to doubt. In many and perhaps most cases, traditional techniques do not lend themselves to development beyond a certain point, because of such factors as their inability to accommodate high rates of power utilization. It would have been useless, for example, to try and harness a steam engine to a stage-coach. In fact, no matter how much scientific and technological ingenuity had been invested in trying to bring pre-railways methods of transport up to date, it is scarcely conceivable that any system competitive with the railway could have been invented at the time, under any configuration of factor price ratios.

All this in no way diminishes the need for an effort of adaptation, and indeed of innovation, to be begun, and on a massive scale. In fact, this is a case where the minimum critical mass of resources required is exceedingly large. This is not only because of the immense variety and complexity of industrial technology, and the enormous differences among developing countries, and hence in the degree of adaptation required in particular cases, but because small amounts of R and D devoted to 'appropriate' technology are likely to produce their results too slowly for these ever to be put into practice, since the dynamics of technological progress will have rendered them obsolete before they are applied. One can only hope that the strong support of the industrial countries for a basic needs strategy of development will be accompanied by a recog-

nition of the need for this kind of massive effort.

Even if adequate resources were allocated, and a successful R and D effort were mounted, there can be no presumption that the new and 'appropriate' technologies would be more labour-intensive—at any rate in the core processes of the principal branches of industry—than the technologies now imported without adaptation. Their 'appropriateness' may lie rather in the capacity to achieve maximum cost-effectiveness at a lower level of output than existing technologies require.

The issue of 'appropriateness' must, however, be seen in terms of the products themselves, as well as in terms of the technologies required to produce them. As Frances Stewart puts it: "When techniques designed for use in rich countries are transferred to much poorer countries, the products produced by those techniques are transferred too. The two—the techniques and the products—are inseparable aspects of the technology. Thus products designed for consumption in much richer societies are transferred to economies where, on average, incomes are much lower".³⁸ In the case of durable consumer goods a further adverse consequence may ensue: the creation and maintenance of an adequate market may require—over and above the kind of socially uneconomic protection referred to earlier—a high degree of inequality in the distribution of income.

There are, of course, various ways of preventing the diversion of resources into luxury consumption, including the creation of strong disincentives to

³⁸ Frances Stewart, *Technology and Underdevelopment*, London, Macmillan, 1977, p. 78.

domestic manufacture, the levying of high duties on imports, and the redistribution of income through taxation and public expenditure. It is, in fact, a surprising feature of the basic needs approach that far less attention is usually devoted to direct and practical measures of income redistribution than to a reorientation of development strategy that may well turn out to be as nebulous as it is ambitious, and which can in any event hardly be relied on to yield the desired result. We have already noted that the treatment of land reform is likewise often more tentative than one might have expected from a school that is profoundly concerned about rural poverty. In both these instances there appears to be an implicit hope or expectation that a basic needs strategy, by encouraging poverty-oriented development projects, might be able to sidestep the issue of direct redistribution of land and income. Perhaps the political and social strains of such a strategy would be less severe than those of a programme of land reform and tax reform; but the costs in terms of slowing down the rate of modernization of the economy may be high, while the benefits may prove quite elusive.

5. The international division of labour

The idea of an international division of labour between developed and developing countries based on labour and capital intensities is not viable for at least two reasons. In the first place, just as it does not necessarily follow that labour-surplus countries should adopt labour-intensive technologies across the board, so also there are no grounds for presuming that the comparative ad-

vantage of such countries in world trade lies exclusively in the export of labour-intensive products.

Any such principle for the international division of labour is in any case ruled out because the developed countries are not less opposed to it than the developing countries are. Imports of labour-intensive products hit the most vulnerable industries of the developed countries — industries that often employ the poorest workers and members of minority groups. While a few developing countries have been able to establish strong positions in world textile markets, further export growth is under severe and discriminatory constraints, and there is no possibility at all that developing countries generally could look to textile markets as potential sources of substantial expansion in export earnings. The first international agreement on restricting textile imports from developing countries was adopted in 1962 as a temporary measure to be applied "during the next few years". The restrictions have, however, been renewed periodically ever since, and the rate of expansion of imports has been curtailed to the point at which there appears to be an intention to avoid the need for adjustment by preventing any significant further encroachment on domestic markets. Similar considerations apply to other restrictions on trade in manufactures with developing countries, whether imposed by importing countries, or by exporting countries under duress.

Thus the idea we have been considering is not only poor economics. It is also quite impracticable in a world of growing protectionism, in which it is the labour-intensive industries that are the weakest in the developed countries.

6. *The Chinese example*

The point that never emerges either from the ILO report or from other versions of the basic needs strategy is that there is no necessary incompatibility between rapid development of the modern sector and promotion of new employment opportunities by more traditional methods in other sectors. If the Chinese model, which the basic needs strategists frequently quote with approval, proves anything, it surely proves that.

Chinese experience is often cited in support of the labour-intensive, small-project approach to industry combined with the concentration of major resources and intensive efforts upon rural development. But the parallel drawn is often founded on a misunderstanding of

that experience. The Chinese strategy is to walk on two legs, not on one, which is not a bad idea if the pedestrian is to remain upright. China encourages the simultaneous development of industry and agriculture, making use of the most modern capital-intensive technologies as well as of traditional methods of labour-intensive production. Provision is made for a minimum level of consumption accessible to all, while at the same time heavy industry is the key industrial activity that is given the highest priority in the allocation of resources.³⁹ Thus the Chinese model is based on a strategy of comprehensive development quite different from what is usually understood as the basic needs approach, even though China clearly does have a definite policy on providing for a minimum level of living for all.

IV

Basic needs and international aid

1. *Should UNDP have a development strategy?*

The preceding discussion brings us to the second main issue of this paper — namely, should the aid donors in general, and UNDP in particular, use their resources to further a poverty-oriented or basic needs strategy of development?

Except in the Netherlands and the

Scandinavian countries, the constituency for aid programmes in the developed countries is at the best of times relatively weak. Evidence that the distribution of income is becoming less rather than more equitable in some of the developing countries has been grist to the mill of the opponents of aid, who make the persuasive point that it is irrational to transfer income from poor tax-payers in developed countries to the well-to-do of the developing world.⁴⁰

³⁹ See Suzanne Paine, "Balanced Development: Maoist Conception and Chinese Practice", *World Development*, vol. 4, no. 4, April 1976.

⁴⁰ The latter proposition is, of course, valid even where the distribution of income in recipient countries improves.

Thus acceptance by the developing countries of a commitment to a poverty-oriented development strategy has come to be regarded in the industrial countries as indispensable if aid programmes are to be sustained. In fact the case for such a strategy emerged in the developed countries long before the World Employment Conference. Charles Paolillo notes that "The basic needs strategy bears a striking resemblance to the 'participation' strategy of development that underlies the 'new directions' in development assistance which the United States Agency for International Development (AID) has been pursuing over the past several years, in accordance with legislation put forth initially by the House International Relations Committee and enacted into law in 1973 and 1975".⁴¹ Similarly, in a Blue Book issued in October 1975, the United Kingdom Government stated that "...we and other aid donors are now adapting our aid policies to give more help to the poorest countries and the poorest people within these countries".⁴²

Why, then, are developing countries reluctant to enter into a compact whereby development assistance would be linked to programmes in aid of the poor? In the first place, they resent what they regard as an unwarranted assumption by the developed countries that it is only they who are concerned about the poor, and that the developing countries have to be offered the bait of foreign aid to induce them to show equal concern. The United Kingdom Blue

Book recognizes that these are "highly sensitive matters at the heart of the political process in all countries both developed and developing", and that efforts to exert pressure in this field might well be resisted even by countries otherwise favourably inclined towards poverty-oriented development.⁴³ The Chairman of the OECD's Development Assistance Committee writes that "experience with the African Club du Sahel indicates that no nation in this century would be likely to accept a minimal standard of life as an objective of policy for more than a temporary emergency period".⁴⁴ What is more serious is that attempts to reach agreement on minimal poverty lines are certain to be deeply resented by developing-country leaders and peoples as unduly technocratic and paternalistic on the part of the affluent North. Moreover, the developed countries carry little conviction in this field at a time when unemployment and deprivation among their own disadvantaged and minority groups have risen to levels not seen since the Great Depression.

It is not as though the campaign for poverty-oriented programmes of development is accompanied by offers of a substantially larger volume of aid in support of such programmes. On the contrary, there is deep concern among developing countries that narrowing the scope of the international community's development objectives so as to concentrate upon poverty in a restricted sense of that term may be intended to provide a rationale for eroding the trade and aid commitments of the industrial countries. According to the World Bank, official development assistance declined

⁴¹ *A Basic Human Needs Strategy of Development, op cit.*, p. 1.

⁴² United Kingdom Ministry of Overseas Development, *The Changing Emphasis in British Aid Policies: More Help for the Poorest*, H.M. Stationery Office, Cmnd. 6270, October 1975, p. 2.

⁴³ *Ibid.*, chapter III, paragraphs 3-4.

⁴⁴ *The OECD Observer*, November 1977, p. 20.

as a percentage of the total GNP of developed countries from 0.52 in 1960 to about 0.33 in the mid-1970s, and there is no prospect in the near future of a really significant move towards the General Assembly's target of 0.7 per cent of GNP.⁴⁵ At the same time the trade objectives of the United Nations International Development Strategy seem farther than ever from realization as the commodity problem remains unresolved, and, as noted earlier, the new protectionism of the industrial countries is particularly severe in its treatment of manufactured imports from developing countries. There is consequently a profound uneasiness among developing countries lest the poverty slogan and the basic needs approach are being used to undermine the International Development Strategy and to divert attention from the failure to meet the international obligations it sets forth.

In addition, the developing countries consider that concentration of aid efforts on the poorest 40 per cent of the populations of the poorest countries ignores the fact that in most countries the majority of the remaining 60 per cent are, by any reasonable standards of basic needs, themselves extremely poor and deprived. It is, on this view, a dubious procedure to separate out the poorest 40 per cent in, say Tanzania when four-fifths, of the population are probably living at levels below the 100 dollars per capita line.⁴⁶

⁴⁵ Robert McNamara, *Address to the Board of Governors*, World Bank, September 26, 1977, Annex III.

⁴⁶ According to Hollis Chenery *et. al. Redistribution with Growth*, Oxford University Press, 1974, table I.2, 72.9 per cent of the population of Tanzania was living below the poverty line of a *per capita* income of 75 dollars (at 1971 prices) in 1969. The

It is not necessarily in the poorest countries that the greatest inequities in income distribution are to be found. Even if it were regarded as desirable and efficacious to use aid programmes to exert leverage on the developing countries in favour of the poor which is itself open to question for the reason given in the United Kingdom Blue Book, that leverage should presumably be directed towards the countries where inequities are greatest, rather than towards countries where the overwhelming majority are so poor that poverty-oriented development is virtually the same thing as development for all. But it is obvious that aid cannot be used as a means of pressure upon a country that receives no aid, and it is the countries that have been excluded from programmes of concessional assistance because of their relatively high incomes that could do the most for their poorest citizens.

Thus there is more than a possibility that the pressure will be applied most strongly at precisely the point where it is least needed, and will not be felt at all in the cases where resources are indeed available for making significant progress towards the eradication of poverty, if the will were there.

2. *The transfer of development strategies: the basic needs approach*

Earlier we saw that while there is unquestionably a need for more equitable distribution of the gains from development, the strategy devised by the

corresponding percentages for some other countries were as follows: Dahomey, 90.1; Chad, 77.5; Burma, 71.0; Madagascar, 69.9; India, 66.9; Sri Lanka, 63.5; Sierra Leone, 61.5; Niger, 59.9.

basic needs school to achieve this goal is at best highly controversial and at worst likely to slow down the process of development and with it any real hope for improving the living standards of the poor.

But even if the above analysis were too pessimistic, and even if it could be shown that rural development and small-scale labour-intensive industry held the key to development with social justice, it still would not follow that the international agencies have any comparative advantage in planning, designing and implementing projects in these particular fields. The simplistic assumption is often made that the best way for the international community to improve the lot of the rural and urban poor is to go to them directly, and involve them in internationally-supported projects, multilateral or bilateral. Such projects frequently neglect the most basic preconditions for success.

3. Rural development

In her important book on *The Design of Rural Development*, Uma Lele stresses the crucial importance of appropriate policies and commitment of resources by governments, without which rural development programmes cannot succeed.

In the field of broad policy, for example, if the system of land tenure precludes participation of the lowest income groups in rural development programmes, land reform may be an indispensable prerequisite for the success of such programmes. Likewise the pricing policies of the government or of marketing boards may have to be

adjusted to permit low-income groups to benefit from increases in productivity.⁴⁷

Popular participation in and support for rural development programmes are also essential, and the general ineffectiveness of past attempts to secure such support is noteworthy. As Uma Lele points out, most programmes have "suffered from poor knowledge of the sociocultural and institutional environment in which they were to be implemented" combined with "extreme scarcity of trained local manpower".⁴⁸ These considerations prompt the conclusion that 'without a very major commitment of resources by national governments to rural development and, equally important, to suitable training of the manpower necessary for expansion of these services, intensity'⁴⁹ of most of these programs cannot be replicated on a large enough scale to reach a mass of the rural population in the foreseeable future'.⁵⁰

It can hardly be said that in the entire spectrum of development support that international agencies are capable of providing, rural development is the sector where their comparative advantage is greatest. Even if it were true that rural development should have the highest claim on the total resources available for development (which is itself far from certain), it still would not follow that it should also rank first in claims on *external* resources, which, it should be remembered, represent only a

⁴⁷ Uma Lele, *The Design of Rural Development*, published for the World Bank by the Johns Hopkins University Press, Baltimore, 1975, p. 176.

⁴⁸ *Ibid.*

⁴⁹ "Intensity" is roughly measured by the ratio of extension workers to farmers.

⁵⁰ *Ibid.*, p. 69.

small proportion of the total – less than ten per cent on average.

It stands to reason that no outsiders, however well-meaning, can be expected to have the intimate knowledge of the sociocultural and institutional environment that Uma Lele points to as crucial in any such programme. Indeed, in the overwhelming majority of cases, the outsider will not even have the minimum understanding of the local language that is indispensable if close contact with the people is to be achieved and maintained.

Consider two countries, A and B, with similar *per capita* income levels and similar sectors of extreme poverty. Let us suppose that A has a laissez-faire government that does not believe in direct domestic aid for the poor but prefers to rely on market forces to put things right. B, on the other hand, has an active programme of employment generation for both rural and urban poor; and a system of taxes and subsidies that effectively narrows the internal *per capita* income differentials, and puts a floor under the real income of the poorest.

UNDP proposes, and country A accepts, a programme of integrated rural development. Efforts are made to raise the productivity of the small producer. Gradually it is noticed, however, that the fruits of the productivity increase are not retained by the producers but are passed on by them, involuntarily, to the industrial population in the form of lower food prices. The suggestion is made by the UNDP team leader that the government should consider supporting producer prices, but the government replies that Nobel prizewinner Milton Friedman is against such interference with the market.

Country B's officials do not want an externally financed rural development

programme at all; they feel that they understand the rural development problems of their country better than any external agency, and do not need any external inputs in solving them. UNDP's comparative advantage, they feel, lies in helping them to obtain and master advanced technology. They have some mineral resources already being exploited, and would like UNDP to help in establishing facilities for semi-manufacture. The programme will not generate much employment and it certainly will not go directly to the poorest sectors. But, says the government, it *will* accelerate the rate of growth of the economy as a whole, and the benefits will be redistributed by the government so that the poor obtain a more than proportional share.

Which of these two programmes is more effective as a means of dealing with poverty? Views may differ, but certainly the second approach is not obviously inferior to the first.

It is no doubt considerations of this kind that prompted the United Kingdom Government to take an extremely cautious approach to poverty-oriented development in its Blue Book cited above. The Blue Book suggests that a poverty-focused aid policy "has to proceed by means of detailed programmes related carefully to the circumstances and wishes of each country, and not by way of general guidelines to be applied regardless in all countries". It argues against direct methods whereby the donor would "specify in advance the economic or social sectors, types of projects, geographical areas, or particular beneficiary groups within a country to which it wishes to confine, or preclude the use of, its aid".⁵¹

⁵¹ *Op. cit.*, chapter III, paragraph 4.

Programmes of poverty-oriented development have nevertheless gone ahead with the best of intentions, and the expected difficulties have materialized. In a certain Asian country, for example, a large-scale development project encountered severe problems resulting at least in part from the lack of familiarity of the international agency concerned with the cultural and political cross-currents among the host of small communities that were involved. More surprising, the agency did not foresee the consequences of upgrading provision for water supply, sewage and other improvements in isolation from more comprehensive development measures (that would, of course, have required a large multiple of the already substantial resources made available for the project). As the improvements raised the value of land and housing in the area concerned, the impoverished occupants felt compelled to sell out to richer people and move to slums on the outskirts of the country's capital city.

Again, at a recent intergovernmental meeting to discuss the basic needs strategy, a representative of one of the poorest African countries described how a certain international agency had created "a State within a State" in his

country. The motives underlying the project in question were no doubt of the highest and best; the agency was determined that the experiment should succeed, that a significant impact should be made on the poor of the area concerned, and that nothing should be allowed to interfere with the progress made. But in order to achieve this result the agency felt compelled to assert a degree of control over the project, and a degree of protection from outside influences, that isolated it from the rest of the country. Moreover, conditions were created in the project area that made it quite impossible for the country in question to repeat the experiment elsewhere. Thus a purely artificial entity had been established with no spread effects to the economy as a whole, and posing a serious problem for the government once the international agency concerned leaves the scene.

External support for a basic needs approach does not have to consist of basic needs projects. International agencies have acquired a high degree of competence in a number of areas, and it is in those areas that their efforts can be most productive, whatever the overall development strategy of the country concerned.

Conclusions

The basic needs school has made a contribution to the development dialogue by emphasizing the importance of equitable distribution of the benefits of development. But it claims too much. There is no such thing, thus far, as a basic needs strategy that clearly defines the direction to be taken by the economy as a whole.

While apparently radical in intent, the basic needs approach is in fact to a considerable extent backward-looking. This is particularly evident in the absence of unambiguous provision for the structural changes that are indispensable in releasing the potential for development, and in the playing-down of the role of modern industry and modern

technology. Even in the rural sector, proposals for structural change seem hesitant and half-hearted.

It does not follow that because a country has egalitarian development goals, it will necessarily wish to give overriding priority to the attainment of certain absolute targets for consumption. It may prefer to hold down present and short-term consumption in order to permit a more rapid rate of growth and structural transformation. The success of such a strategy may well depend on the fairness with which the associated burden of deprivation is distributed within the society as a whole.

Just as experience has shown that the success of efforts to limit the growth of population depends on placing such efforts squarely within the context of general economic and social development, so also will programmes to assist the poor succeed only if established as part of a broader development strategy. The goals of growth and equity are not only compatible but interdependent, and their achievement certainly does not call for weakening or slowing down the growth of the modern sector, or for one-sided reliance on labour-intensive technologies.

Finally, however important it may be for countries to make more deliberate provision for the needs of their poorest

citizens, it does not follow that international agencies have any special competence or expertise to offer in dealing with poverty problems through projects addressed directly to the poor. On the contrary, lack of familiarity with the complex political, economic, social and cultural problems of assisting the rural and urban poor should prompt the agencies to offer their resources and services in the areas where they know from past experience that they can perform well. They do, however, have a responsibility to advise governments on the goals that the latter have freely accepted in international forums, and on the means of achieving those goals within the framework of each nationally-determined strategy.

But the agencies should not aspire to be leaders in development theory or the principal authorities on the development process; and they have no mandate to impose particular development strategies on member countries. Development is a long-term task requiring from the international agencies steadiness and persistence, as well as a certain humility and restraint; a sense of proportion respecting their own capacities and the importance of what they do; and the strict avoidance of both complacency and evangelism, together with the ups and downs of development fashion.

Between reality and utopia

The dialectics of the social sciences in Latin America

*Jorge Graciarena**

If the social sciences are conditioned by the real circumstances in the midst of which they emerge, and their recent manifestations occur in Latin America, these can only be properly explained within the frame of reference of the changes which have taken place in the region. Specifically, certain key points must be raised in the context of the technocratic order that has come to dominate the fundamental institutions: what conceptions are currently predominant in the social sciences and why, what counter-ideas are brought forward to oppose them, and what is the probable evolution of each.

Consequently, the central aim of the present essay is to describe the development of a 'technocratic conception' of social science in the ground prepared by the aforesaid technocratic order, and to reveal its basic features. Outstanding among the latter are its instrumental and pragmatic function, subordinate to the technocratic order, its emphasis on the production of social techniques and its predilection for a fragmentary and sectoral outlook. And over against this it asserts the need to consolidate a 'critical conception' establishing social knowledge on the basis of a systematic critique of itself and of hard fact: a conception that assumes its ethical responsibilities and considers the freedom of the mind an indispensable requisite for its work, since otherwise there is no possibility of attaining either truth or objectivity.

*Director, Social Development Division of CEPAL.

I

The development of the social sciences in Latin America has primarily been a dialectical counterpoint between ideas and real processes in which the former have adapted to the latter—and vice versa—to produce syntheses, never conclusive and very often different and contradictory, but always rooted in an unceasing concern for the course of history, for current perplexities and likewise for the anxious anticipation of things to come. Any attempt to attribute a direction to the scientific work of the social sciences must inevitably recognize the existence of a recurring movement which has alternately brought them closer to and drawn them away—although never entirely separated them—from real social situations and critical events; so that these have been incorporated into the field of reflection and intellectual discussion in many ways and from a great variety of angles. The problems, fundamental conflicts and potentialities of the real social world have been present, in one way or another, in the subject-matter of the social sciences of recent decades. The real history, changes and critical problems of Latin American societies have *pari passu* conditioned the intellectual history of their social sciences, although with a natural lag and perhaps some accidental breaks. The aspirations and hopes of each moment in history have weighed no less heavily. Thus reality and utopia have become interwoven elements in the specificity of the Latin American social sciences.

None of this is new or original, of course. The conditioning of the social sciences by history has been demonstrated repeatedly, especially in connexion with some of their specialized

disciplines. Nor has there been any shortage of broader studies stressing the importance of social problems in wider areas of cogitation in the social sciences over relatively long periods in the present century.¹

The adaptation of the social sciences to historical fact has not been merely a mechanical process of reaction, as might have been the case if they had developed by blindly following the course laid down by the direction of prevailing social events. This is not what has happened. On the contrary, in the dialectical play between thought and reality social ideas have had a by no means negligible influence on the development of Latin American societies. In the last analysis, they, and more specifically their ideological projections, gave rise to the objectives and strategies which in one way or another have helped to shape the historical development of the region.

It is perhaps in order to recall here that social reality does not exist *per se*, but rather manifests itself through one of its various possible interpretations. Without falling into the idealistic subjectivism that denies the objective existence of reality and reduces it to the mere content of consciousness, which implies

an inadmissible reductionist monism, it must nevertheless be pointed out that ultimately reality is reflected in the consciousness of individuals (social actors and/or agents), mingling with their ideas and interests in specific clusters which constitute the bases and guidelines of their social behaviour. Strictly speaking, ideologies are precisely a type of concrete ideas which fuse a combination of social needs, socially-conditioned judgements about reality and goals for action. Hence their importance in the process of development and social change and of course in specific historical situations.

It may therefore tentatively be said that the Latin American social sciences have in one way or another followed a path which converges with the historical course of social reality. Their greater or lesser distance from it has in no way represented a profound change in their connexion with social reality, still less a break in it. This has been due not merely to the deliberate efforts of some of their practitioners —an element of some importance— but also simply to the very nature of things, which presupposes a dialectical interconditioning of ideas and social reality. This reciprocal relationship is in a sense the core of the reflections which follow.

¹ A study which conclusively shows these correlations is A.E. Solari, R. Franco and J. Jutkowitz, *Teoría acción social y desarrollo en América Latina*, Mexico City, Siglo XXI, 1976. See also J. Graciarena and R. Franco, *Social Formations and Power Structures in Latin América* (at press in the Current Sociology Series of the International Association of Sociology), which analyses the trends in socio-political change and then the reflection of

that change in social thought, particularly in the fields of Latin American sociology and political science. Some of the arguments in this study had appeared previously in J. Graciarena, *Formación de Postgrado en Ciencias Sociales en América Latina*, Buenos Aires, Paidós, 1974, *passim*, and in "Las ciencias sociales, la crítica intelectual y el Estado tecnocrático", *Revista Mexicana de Sociología*, vol. 37, Nº 1, January/March 1975.

II

Before proceeding to other questions, it is perhaps worth recalling some specific aspects of the formation of social knowledge, particularly in relation to the creation of the social sciences, which over the years modelled themselves on the experimental natural sciences. Originally, any more or less systematic thinking about society contained elements of magic and transcendental projections, and thus became a kind of social theology, a mixture of God and the world, the desirable and the observed, knowledge and values, whose particular nuances depended on the social position, experience, idiosyncrasies and feelings of its proponents. Religious prophecy is perhaps the fullest expression of these elements.

At a later stage, under the influence of empirical rationalism and secularization, social thought tended to become more worldly, turning into social philosophy and subsequently social science. During this process social knowledge gradually abandoned its transcendental sources and references, although without thereby losing its teleological projections or its normative character.

This transition, which gained irresistible impetus in the eighteenth century and was largely completed in the nineteenth, brought two major problems to the fore. The first related to the possibility of isolating and separating the objective elements—or the scientific elements, according to the canons of positivism—from the subjective and doctrinal elements with which they had hitherto been deliberately fused, and, despite the process of secularization, still were combined, since the study of society in the nineteenth century continued to blend

judgements about reality, ideological projections of past and present and utopian forecasts of the future. Hence the close links established with the social movements and political struggles of the time, particularly obvious in respect of both liberal and marxist thinking.

The second problem concerned the new bases for the validity of social knowledge. According to the positivist model, these would essentially be the factual verification of theoretical propositions, and their rationality and practical efficacy. In either case what was called in question was not only the nature of earlier knowledge, but also the criteria of its truth, as well as its sources of legitimation, based on revelation and tradition in the more distant past, or more recently on reason and various types of social practice and experience. Positivist logic flatly rejected both possibilities, sticking to facts as the sole reliable source of knowledge.

Later developments are well-known, and there is no need here for more than brief mention of a few points of particular interest. The boom in the natural sciences soon made them the paradigms of scientific knowledge, and their methodological patterns rapidly became the blueprint repeatedly prescribed for the progress of the social sciences. Since the earlier tradition of speculative social thought, sometimes transcendental, at other times rationalist, was never abandoned even in the social sciences, their development has followed a course which swings between the pole of militant commitment and deliberate ideologization, on the one hand, and, on the other, hermetic isolation and thematic asepsis aimed at preventing scientific

knowledge from being contaminated by the controversies and conflicts of the moment. Despite all the intellectual efforts made in the latter direction, the results have fallen short of expectations. It has been demonstrated over and over again that in the formation of social knowledge the confusion between ideals and social reality is perennial.² This has been the case precisely because this interconnexion is deeply embedded in the very heart of social knowledge.

The study of the past suggests that the moments of greatest intellectual creativeness in the social sciences occurred precisely when their connexion with social change and historical crises was lucidly and consciously accepted. One has only to think of the obvious connexion which exists between various important historical events and the genesis of some of the social sciences.

It is perhaps worth recalling first of all that science, as organized knowledge, was the product of bourgeois society and of a type of rationalism which developed only in the urban environment. Thus empirical science was a result of the

² The sociology of science and of knowledge has repeatedly shown that this connexion exists. The literature on the subject is too extensive for references to be really needful, but I cannot resist the temptation of mentioning a brilliant critique in this tradition on the structural functionalism of Talcott Parsons: A. Gouldner, *The Coming Crisis of Western Sociology*, New York, Avon, 1971. Still more important is the critical work of the Frankfurt School, on which Gouldner drew extensively. In this connexion, see M. Jay, *The Dialectical Imagination. A History of the Frankfurt School and The Institute of Social Research 1923-1950*, Boston, Little Brown & Co., 1973. A number of the problems discussed here owe much to the work of one of its founders: see M. Horkheimer, *Crítica de la razón instrumental*, Buenos Aires, Editorial Sur, 1969.

social practice of urban life. In the case of the social sciences it is worth while to mention the obvious link between the appearance of industrial capitalism in the eighteenth century, and political economy; between the formation of the European national societies based on the Nation-State, and political science; and finally, for the sake of brevity, the relationship between the nineteenth-century crises in the consolidation of bourgeois society and the formation of an urban industrial proletariat, and sociology. One of the most famous proponents of the historicity of the social sciences, Karl Mannheim, defined sociology as the science of crises, stressing that it not only was born of them but waxed with the stimuli and challenges they offered.

This has also been true of the other social sciences, whose development has been strengthened and whose potentialities have been increased whenever they have had to respond to social demands to weather moments of crisis, in the form of generalized conflicts and deadlocks which cannot be resolved by ordinary means. In such circumstances there have often been real "scientific revolutions" which have reshaped social knowledge from the bottom up. One example is what happened as a result of the capitalist economic crisis of the 1930s to liberal economics, which was completely overhauled by the 'keynesian revolution'.

The historical conditioning of the social sciences is assumed as a starting-point in this paper and is on the whole judged to be positive. It is assumed that this connexion exerts a beneficial influence which enriches both social knowledge and thinking on the one hand, and social ideologies and values on the other.

The fact that the connexion between the study of society and social reality is deemed to be beneficial does not mean that the former is invariably a good thing when it reflects the latter in some way, because knowledge can sometimes be alienating and repressive. At other times, however, access to it may open the gates to new social forces, thus generating

greater possibilities of substantial rationality among groups that are too deprived and downtrodden to feel anything but apathy towards a political and social life of which they are not an organic part. Both possibilities depend less on knowledge itself than on the frames of reference conditioning it. We shall return to this point later.

III

When stressing the fundamental connexion implied by the social conditioning of knowledge of society, it should not be forgotten that on many occasions and for the most diverse reasons there has been a persistent effort to free the social sciences from this dependence, either by converting them into "pure" sciences, which are mathematically formalized, abstract and unpolluted, in line with the scientific model of theoretical and experimental physics, or by ridding them of the infiltrated values and the human conditioning which have crept in at different stages through various chinks in the scientific process.

The ideal of a neutral science is imperishable and has sometimes been invoked from social positions and intellectual standpoints which were simultaneously deeply committed to the continuity of the prevailing hegemony. In such circumstances, this position was obviously contradictory, since the claim to a neutral science could not hide its ideological nature, placed at the service of maintaining the *status quo*. When this was the case, its truth became politically inapplicable purely because of the support it received from an authoritarian power which endorsed it.

However, it is not only the weight of political factors that has influenced this view of social science. A by no means minor role has also been played by the totalitarian pretensions of some of its variants or schools to become the Social Science *par excellence*, thus excluding as non-scientific all the other variants which do not recognize it as their paradigm, or which do not start from the same premises and accept the approaches and problems, as well as the methodological rules, advocated by neopositivist epistemology.

The efforts of this kind have been continuous and remain unflagging. In fact, the need to isolate knowledge by apparently freeing it from its social conditioning reaches giant proportions in the technocratic societies.³ The reason for this is that in such societies knowledge, which is their main source of social legitimation, must necessarily appear to be independent of technocratic power. The admission of the existence of a symbiosis between knowledge and technocratic power would deal a death-blow

³ An explanation will be given later of what is meant here by a technocratic social order.

to the latter's attempts to legitimate itself by means of the incontrovertible truth which knowledge provides and which it is striving to realize.

The paradigm of a value-free social science has always been strong and even, at some stages in Latin American development, dominant; and when predominant it imposed forms which were reflected in its scientific subject-matter and practice. This movement, although vigorous, was unable to dissociate itself completely from the social problems of its time, and failed to endure for more than a few years, much less than in the English-speaking world from which it came.

It would be pointless to attempt to explain the nature of this particular moment in the social sciences, *inter alia*, partly because there is no shortage of explanations of every kind, and partly too for brevity's sake, because it would be out of place here. Suffice it to say, elaborating on what has already been remarked, that the predominance of the empirical social sciences, self-styled as scientific in the strict sense of the word, which sought to differentiate themselves from the other forms of knowledge precisely inasmuch as they resorted to empirical proof and formal demonstration as their truth criterion, is linked with an optimistic phase in Latin America's development. Circumstances at the time appeared to be favourable in several ways: steady, self-sustained economic growth that ensured a flow of products and services, the more equitable distribution of which would pave the way for higher levels of social well-being and increasingly democratic forms of political life. All that was called for, therefore, was to study reality in order to eliminate the obstacles and resistances which hindered growth from becoming true

social development and consolidating the bases of consensus and well-being needed to achieve a more harmonious and just society.

This utopia was certainly attractive to many, among other reasons because they wanted change and development without useless conflict. It looked then as though peaceful progress towards a fairer society could be made through consensus and rational methods. Stern reality, however, was at work undermining the main pillars of the utopia. For example, to put it briefly, growth and development were not converging or even parallel processes; planned change did not remove the obstacles and resistances to social development, but instead frequently strengthened them by increasing social inequality through the concentration of resources and income in very small sectors of the population; balanced development and harmonious social change turned out to be useful myths, whose effectiveness depended in any case on the indiscriminate use of repressive and alienating measures necessary to contain or divert the reactions of the various social groups and sectors that were passed over and exploited.

Conflict reappeared as a resource, perhaps the only one open to some desperate social groups which by this means alone could try to satisfy their social demands and needs. As a result the possibility of a general consensus vanished, as did that of 'institutionalizing change' by resolving conflicts on the basis of peaceful settlements and reconciliation of interests. The clash between 'dangerous classes' and 'threatened classes' once again cast a menacing shadow over Latin American development.

For scientific neutralism to be possible a number of external requirements

and conditions must be met. We have already mentioned them in passing, but let us recall them briefly: an advanced and well-consolidated degree of autonomous institutionalization of the social sciences; the formation of a professional community with its own means of communication; a tradition of respect for independent academic work; an attitude of permissive indifference and limited demands on the part of the hegemonic order *vis-à-vis* the social sciences; and finally a predominantly conservative disposition, sometimes disguised by the apparent neutrality of its practitioners' aloof attitude towards the most pressing social problems. Their greatest open display of concern usually consists in observing the rules of the game and not overstepping the bounds of tolerance accepted by the authorities. The last condition is perhaps more important when reinforced by a professed indifference towards the immediate, practical effects and the political impact of the social sciences. This means that they are considered useless for conjunctural purposes and that social techniques derived from them are not desired or deliberately-pursued effects, but merely chance by-products of the study of society. Consequently, it is believed that the social sciences lack the necessary capacity to point the way to coherent and viable social action, and furthermore that it is not desirable that they should have it. Unquestionably, neutralism seems to insist on denying them this possibility, i.e., that of being knowledge that serves as a guide, and, for that very reason, a source of social values and ideologies.

This isolation —the ivory tower that many long for— is only possible, and then but to a limited extent, when social tensions are contained or repressed and

the power struggle is not open and does not go beyond circumscribed and well-defined social environments and power circles whose members move discreetly, carefully preventing their quarrels from rising to the surface. A situation of this kind can only result from the predominance of a generalized tacit consensus of apparent indifference towards the struggle for the control of the government machinery and the orientation of its policies. It sometimes stems —most frequently in fact— from a different kind of political apathy, namely, the apathy caused by the repression which crushes conflictual tensions either *a posteriori* or —when their public expression is stifled or collectively sublimated into other forms of alienated social expression— *in statu nascendi*.

In one way or another, autonomous social participation is externally repressed or psychologically inhibited. This narrows the margin of possibilities of raising the fundamental questions of society through rigorous intellectual criticism. But such an assertion does not mean that criticism disappears in repressive circumstances. One of two things may happen: either intellectual criticism —on a lesser scale, it is true, than in more stimulating conditions— dives into the national underground movement and expresses itself primarily abroad, thus attempting to reach a wider political public; or it withdraws to obscure levels of the subconscious mind and ceases to voice itself publicly, resorting instead to indirect and symbolic forms of expression such as literature, the theatre, the cinema and others. It may also happen that the 'thinking groups' which are organically embedded in the 'Establishment' devote themselves to the preparation of methodologies and to more abstract or specialized problems

than the critique of society. This is a form of escape with less repressive consequences, but it nevertheless remains conservative.

Whether the fluctuating connexion between the social sciences and the course of history can be considered positive or negative is a question which depends on the position taken with regard to different epistemological alternatives and to ideological preferences and personal values, since, as is well known, a wide variety of contradictory ideas exist on the subject. For many, however, what appears to be beyond question today is the fact of the historical conditioning of the social sciences. The positivist attempts to project them

beyond the bounds of social events and historical trends have sought to universalize them, either by raising their abstractness and generality to such a level that their concrete significance has practically disappeared, or else when their objects of knowledge have become so specialized and minimized that one cannot see the wood for the trees. In other words, autonomy of the social sciences with regard to the march of events has been achieved only when at the same time their possibilities of social relevance, i.e., their capacity to account for the direction of movement and change in particular societies at specific historical junctures, have been reduced to a minimum.

IV

The recent past in Latin America has shown that the broadest possible margins of intellectual liberty have existed when the hegemonic order has managed to become stable, without challenges to threaten it from abroad or internal fissures to militate against its continuity. When the consolidation of power has been followed by the conviction that nothing can undermine it or jeopardize its future, the levels of intellectual permissiveness and tolerance have generally been greatest, at least in the tradition of the Western societies. Indeed, academic liberty has simply been the obverse of almost uncontested power.⁴ But in Latin

America such moments have been short, if not almost ephemeral.

The questioning of the social sciences in Latin America reaches its lowest point when the trend towards specialization is strongest and also when the highest hopes are placed in the existence of an autonomous drive towards economic and social development. This set of conditions largely corresponds to the post-war world, which aroused utopian illusions that prevailed in the region until the late 1950s.

The pragmatic, neopositivist view of the social sciences was introduced at that time as part of a cultural and ideological package which was widely welcomed. The package contained developmentalism as

⁴ The capitalist bourgeoisie of Victorian England could afford the luxury of welcoming the exiled Marx and offering him the facilities of the library of the British Museum to help him write the most important critique of bourgeois capitalist society ever known, at a

time when that society was successfully and almost effortlessly building the greatest empire in history.

an up-to-date version of the philosophy of progress, modernization centred essentially on efficiency, rationalism and specialized knowledge, and the doctrine of nation-building as a process which, guided and stimulated by development, would inevitably culminate after a certain time in a democratic, Western-style Welfare State.

This came at a moment when there was great faith in the future, in the harmonization of interests and in ideological pluralism, all of which pointed to the possibility of progress towards open horizons from a present which was considered to pose no problems that development could not solve. Self-sustained, harmonious growth would rapidly shake off the deadweight of a traditional past, while at the same time ensuring the attainment of higher welfare levels in the

near —and happy— future. It was confidently believed that with practical reason planning the changes and growth of the economy and society, and harmonizing possibilities and needs, economic crises and internal and external structural imbalances could be overcome, making it possible to realize at long last the ideal of a society governed by omniscient, benevolent sages, who, with the help of scientific knowledge and technical measures, would be able to create a veritable golden age. With some nostalgia and a good deal of contrition it must be confessed that what appeared then to be undeniable truths, now, only a few years later, are wholly called in question. Little remains standing of this Panglossian vision so dear to an entire generation of Latin American social scientists.

V

The concept of crisis as used in the present paper covers a broad spectrum which presupposes the existence of a moment in history when the weight of social contradictions is so overwhelming that it disrupts the functioning of society and alters its structural foundations. The crisis thus tends to become a break in at least two senses. In the first place, something comes to an end, and something else begins. Hence a crisis is a moment of flexion between two differentiable historical periods, of social indecision characterized by a kind of deadlock in which the system is unable to resolve the conflicts stemming from its contradictions. Secondly, a crisis is accompanied by a state of dissociation which involves the loss of the notion of entirety, whether of an institution, a

social class, a nation-State or an international order. The social indecision this implies entails a fragmentation of reality springing primarily from the aforesaid dissociative nature of crises, due above all to the generation and accentuation of more and more conflictual confrontations, which are exacerbated by the loss of identification with the meaningful unit in question. Overcoming the crisis necessarily implies some degree of re-composition of the whole.

Transposing all this to the field of the social sciences, it may be assumed that the disciplinary diaspora constitutes an essential moment in a crisis of disaggregation which is advancing alongside specialization and methodologism. The return to fundamental subjects and to a concern for relevance may also be in-

volved in the crisis, but in a different way, which shows signs of a positive reaction. Those who are moving towards a way out can do so only in so far as they are aware of its existence; once aware of it, they place themselves above and beyond the crisis itself, i.e., in a position which brings with it some form of solution.

In more concrete terms, the present crisis is characterized by: (a) a progressive and irreversible breakdown in the social and political orders of industrial civilization; (b) a greater confusion and ambiguity of objectives and values; (c) a considerable weakening of moral respon-

sibility and of spontaneous consensus, with the consequent increase in dissension, apathy, alienation and conscious social repression; (d) the predominance and spread of decadent, sensualist life styles, of which consumerism is one of the most tangible expressions; (e) widespread questioning of the future possibility of indefinite economic growth; (f) and finally, dwindling confidence in the prevailing societal models and the absence of viable alternatives with which to replace them. What is at stake is the survival not of particular social orders but of nothing less than industrial civilization and the Faustian drive which animates it.

VI

As may easily be supposed, discussion of the relationship of the social sciences with the reality of history has always been controversial and has never reached a satisfactory or effective settlement of the question. As such, it is of no particular interest to us here. It is important to note, however, that this relationship has not been univocal or constant. On the contrary, upon close inspection a kind of swing of the pendulum may be seen, moving closer to or further from reality with the relative predominance of one epistemological position after another, according to structural trends and the existing combination of circumstances. The utopian and ideological content of the social sciences has swung in a similar way, in accordance with the historical conjuncture and the tensions of social change.

Let us now look at this question a little more closely, and distinguish two possible situations. When the social situa-

tion shows such signs of crisis as cause bewilderment and confusion, an appeal to the social sciences constitutes a direct connexion with the crisis itself. In such a case there is a growing call for an integral social science —if not for the total absorption of the more limited branches of social knowledge by a kind of supra-disciplinary Olympus— to which is attributed an assumed capacity for grasping all the more meaningful connexions of the process judged as critical.

From this intellectual grasp of the situation, some hope to find ways of saving the *status quo*, while its critics wish to obtain revolutionary solutions for ending it. In either case, such calls are made at times when discord and confrontation prevail. These are generally times of open conflict, although the dissension can sometimes be buried for a while when heavy repression prevents it from reaching the surface. Technocratic repression seeks to deny the existence of

these conflictual options and prevent their discussion.

The opposite occurs in periods when progress appears to be self-sustaining, when intellectuals are neither assumed nor asked to be able to change the 'logic of history' or planners to interfere in the delicate balances achieved by the 'invisible hand' in the dynamics of the market. It is in such situations that specialization and fragmentary knowledge flourish, gaining easy recognition at a time of relative apathy about the importance of

knowledge in a broader sense. Intellectual work becomes more academic and introverted. Knowledge becomes 'privatized', confining itself to an esoteric dialogue centred on the world of the professional community of social scientists, who thus become the main audience and consumers of scientific production. In such a case the academic-professional community devoted to its 'own' needs and occupations stands aloof, remote from the tensions and struggles of the political arena.

VII

Some points remain to be made in order to specify more precisely the sources and nature of the present currents in the Latin American social sciences. They essentially concern two problems which occupy a central position in the internal debates and the dialectics of their development. At the risk of oversimplification, we shall present these problems as polarizations, sometimes antinomical. Briefly, the first consists in the contrary ideals of integration—and perhaps unity—of the social sciences, on the one hand, and of disciplinary specialization on the other. The second, which was mentioned earlier, is equally persistent and important, since it is represented by the ideological and scientific tensions which stem from a permanent opposition between objective explanation and normative predication; in other words, between knowledge and doctrine. Finally, it should not be forgotten that the interplay of these opposing elements has varied according to an internal dynamics which is not unrelated to change in social reality. The two have together determined the degree

and kind of synthesis achieved by the social sciences at every specific point in time.

Let us look briefly at the discussion about the never-relinquished historical ideal of a unified social science in contrast to the actual trend towards a disciplinary diaspora or dispersion. Although it may appear to be—and to some extent is—paradoxical, the two ideals have coexisted since the very beginnings of the social sciences without its ever having been possible to reach either a satisfactory synthesis of social knowledge or else a total segregation of its disciplines. The coexistence of the two currents has been relatively peaceful, but nevertheless the contradiction implicit in the simultaneous assertion of both possibilities has not disappeared.

That the potential unity of the social sciences continues to exert a powerful attraction is proved by the fact that every now and then the concept is reborn, like the Phoenix from its ashes, when demands are renewed for a synthetic knowledge capable of grasping the complexities of social life as a compre-

hensive and intelligible whole. This concern has spread to the United Nations Organization itself, whose declaration on the Second Decade of the International Development Strategy advocates the adoption of a 'unified approach' for 'integrated development', in a desire to deal with the social development process in its entirety, after the repeated failure of disciplinary and sectoral approaches to create strategies and policies leading to fairer and more equitable development styles.⁵

On the other hand, and as a matter more of fact than of principle, new social disciplines have continued to proliferate, and once created and baptized they rapidly delimit their object of knowledge, isolating it from the hegemonic pretensions of its peers. This gives rise to languages which are open only to initiates, private methodologies which are increasingly sophisticated and hermetic, and institutionalized divisions both on the teaching side (professorial chairs, departments, schools, faculties) and in research (centres, institutes), all of which serves to strengthen each discipline's claim to the monopoly of its intellectual territory.

For a better understanding of the general meaning of the movement towards specialization as a partial process in the formation of a technocratic order, it is perhaps important to bear in mind from the start the multiform nature of

the concept of a discipline. Few words are used arbitrarily. All those which belong to the same conceptual family share a core of meaning in common. In this case, an intellectual discipline has at least two complementary meanings. In the first place, it is a field of knowledge formed as an offshoot of a basic social science, covering an intellectual territory with more or less definite boundaries and following a body of methodological rules which its members claim to be specific to it and autonomous. In other words, it is an organized, limited and specialized field of knowledge, a branch of social knowledge with an object of its own which tends to become independent and thus to break away from its overall frame of specific reference, as well as from the body of objects of knowledge from which it sprang.

In the other sense mentioned, which is by no means unrelated to the above, a discipline may be considered to be a body of knowledge with an inherent logic and order to which one must submit in order to gain access to it. Literally, discipline is subjection to an external order which a person may (but need not necessarily) internalize by accepting and espousing it. This is the more specific meaning of the idea of discipline in university education, where knowledge of any kind is organized into disciplines, the basic principle of classification of knowledge in the academic world. In other words, the reality and validity of the disciplines is postulated *a priori* and almost as something to be accepted as a matter of principle, so that it is more proper to discuss their content than their nature.

The discipline as specialized knowledge has become the prevailing model of knowledge in the technocratic order. This has occurred less because it has

⁵ For a recent discussion of these problems in the Latin American context, see the following articles: A. Pinto, "Styles of development in Latin America"; M. Wolfe, "Approaches to development: who is approaching what?"; and J. Graciarena, "Power and development styles", all three in the *CEPAL Review*, Santiago, Chile, United Nations publication, Sales No: E.76.II.G.2, first half of 1976.

been imposed in authoritarian fashion than because it is based on a division of scientific labour stemming from the idea that general truth is neither attainable nor perhaps even desirable, and that the only legitimate and exoteric truth is what results from the fragmentation imposed by the very existence of the disciplines.

Fragmentary knowledge is partial in two senses. In the first place, *de facto* it never builds up to reconstitute the whole of which it is part; the very proliferation of disciplines starts from the negation of this possibility. Secondly, fragmentation, not so much as a functional division of scientific labour but as a specialized approach to reality, is based on the creation of a dichotomy between fact and value, both of which are seen as independent entities. It is assumed from the outset that the event can be dissociated from its meaning (or the meaning imputed to it).

This is the point at issue. Specialized, partial knowledge is necessarily dismembered, mutilated knowledge, with respect both to the general corpus of ideas from which it originally stemmed and to its own object. Carried to an extreme, it may come to exemplify the oft-quoted paradox of knowing more and more about less and less. To this charge it has repeatedly been replied that in the future, once the specialization of empirical knowledge has progressed sufficiently, its theoretical integration will be brought about by joining up the scattered bits and pieces of its partial research. This effort, it must be confessed, has not so far been successful; nor indeed, have any solutions yet been found for the preliminary methodological problems of how to put the puzzle together.

At all events, split-up social sciences

which set their sights on a universe of knowledge that is deliberately atomized, which neither manage nor even seek to explain causally and prospectively the overall processes of society, and which are concerned to be pragmatic and neutral, are an instrument of the first importance for the functioning and legitimation of a technocratic order. There are a number of reasons for this: they may easily be converted into social techniques with a specific scope; they intentionally keep their distance from the power struggle and refuse to be a source of controversy and conflict; and finally, by making a cleavage between facts and their implicit value, they attempt to dissociate themselves from the social processes of the formation of values, ideologies and utopias.

The connexion, therefore, between partial, self-limiting knowledge and authoritarian technocratic power can only work to the detriment of the former, i.e., by turning knowledge into an auxiliary of power. This was certainly the case in the past, and for a long time, but the internal conditions of the relationship and the type of knowledge involved (religious instead of secular, total and all-embracing instead of specialized and partial) made it into something with a very different social significance. The present conditions are so different that any comparison of this kind with the past would be entirely arbitrary.

Power of the technocratic kind, which is by definition monolithic and authoritarian, is incompatible with pluralistic, open knowledge, which offers free options instead of authoritarian impositions. Hence technocratic power is intellectually repressive, because it needs an 'official' knowledge, an 'official' science to legitimate its policies.

An open market of ideas and

informational alternatives on which to base action is not in keeping with a world of policies and strategies which must above all be consistent and exclusive in order to be efficient and viable. This is also why specialized social knowledge must adopt *malgré lui* a dogmatic stance, because only thus can it be at the same time a source of truth and of belief. Economic truth cannot be tempered by any other truth or judged by reference to a different framework

from that in which it arose. If it were pointed out that the market is really conditioned by institutional, social and political factors, the orthodox economists, those who provide sustenance for the 'official thinking' of the technocracies, would answer that those are not the legitimate rules of the game. The market and its dynamics must be judged only by their own nature; anything else would be sociology, politics, or — why not? — ideology.

VIII

The importance of knowledge as an instrument and the power it thereby acquires in modern societies constitute an extremely significant development. We are referring here not only to the technical by-products of knowledge but also to its critical and ideological projections. Its influence today is so great that it penetrates every pore of social life. Ours is a time that is under the government of instrumental knowledge backed up by the prestige of science.⁶ The question of the relationship between technical knowledge and domination, between pragmatic rationalism, economic organization and the structuring of power, is an important issue in reflection and discussion about

⁶ Revealed knowledge, magical and mythical, is a knowledge characterized by subordination and subjection to transcendental events and determinants whose nature escapes the control of reason; on the other hand, scientific and technical knowledge is a matter of self-assertion and sovereignty over reality, and it is therefore the knowledge which prevails in the Faustian world of industrial civilization.

the technocratic trends in the world of today.⁷

Of the various possible approaches to the question of the formation of this connexion between social knowledge and technocratic power, we shall give preference to an examination of the restructuring of power around the State and the organizations linked with it. The starting-point is the concentration of power in large bureaucratic organizations which tend to become increasingly interrelated. Let us examine very briefly how this process takes place in connexion with the social sciences. Just as there has been an increasing technification of economic production, with considerable changes in the scale, nature and integration of productive organizations and patterns of division of labour, in equipment and in dependence on

⁷ As indicated earlier, the idea of *technocracy*, is interpreted in rather broad terms here. We shall attempt below to define more precisely the meaning attributed to it in this paper.

information and control as essential sources of co-ordination of the economic process, a broadly comparable process is occurring in the structure and functions of the State. The functional units of the old public administration of a bureaucratic type are undergoing a process of hierarchization in the course of which some of them gain power and relative autonomy, largely based on the quasi-monopolization of rational sources of knowledge. Briefly speaking, the tops of the bureaucratic pyramids are becoming technocratized, which implies to some extent a new kind of power based on the predominance of technical knowledge.

In this process of technocratization it is difficult to draw a distinction between the private and public sectors. The top ranks of the State administration, of the armed forces, and of the public and private productive enterprises undergo a radical change in their decision-making systems and in the scope and interdependence of the decisions adopted, as well as in the cross-linkage of their activities, personnel and interests. They all depend on a knowledge of relevant situations and on the timely availability of the right information. Power in the technocratic order is made up of a conglomerate of organizations, its bastions being the State, the military institutions and the large enterprises, particularly the transnational corporations.

However, the relations between these entities, or between the top political circles and the highest technical levels which largely control information, are far from harmonious and easy. In general, the importance of the professional political class is declining, and therefore a good many of its leaders tend to project the image of technical experts, realistic and pragmatic men with practi-

cal knowledge and the capacity to organize and execute.⁸

This trend towards the conversion of politics into a technical matter was inevitable, since so much homage is paid to the truth of technical knowledge, whose infallibility is worshipped. This is not to say that it is the technocrats who are in charge, or that they form a 'power corporation'. The point we are making is that political authority is outwardly taking technical forms and expressing itself through them, and that the people who exercise it define themselves as persons of technical competence, even though they do not all possess it. In such conditions, technical knowledge becomes mythified as an *idée-force* which underlies the doctrine of efficiency as a social ideal and rational planning as a basic instrument needed to achieve it. In politics, corporativism is the régime which best reflects and adapts to the logic of a technocratic order.

Whatever the real situation, the specific nature of technocratic power stems from the monopoly of practical knowledge which it claims and largely manages to achieve, thus acquiring a great capacity to organize, manipulate and control, as well as to impose its purposes. And this has been possible with the help of science, which has thereby become a source of legitimation of technocracy and an instrument of its power. It is invoked both as a means of rationalizing reality and the processes

⁸ The case is different in a régime of political parties in which the leaders of the technocratic organizations or their representatives become "politicized", assuming political roles and playing their part in the representative political bodies, without thereby losing their status of technocrats.

deliberately designed to reach certain planned goals, and also as a source of inputs for the definition of political objectives. This latter aspect is flatly repudiated by its more orthodox practitioners, but it none the less exists, although the real bases of decision-

making do not strictly derive from science. What really matters, as far as instrumental rationality is concerned, is that the different components of the technocratic order's power apparatus can justifiably invoke it as an ultimate source of legitimation.

IX

A complementary aspect of this question may be found in the course followed by the social sciences in the recent past and the significance acquired during that period by social knowledge in a historical context which has changed enormously. Left to their own devices, since hardly anybody took them seriously as a source of power, the social sciences for a long time enjoyed considerable autonomy and sufficient liberty to develop without repressive restrictions. Both inside and outside academic walls there was an intellectual flowering such that the creativity and originality of that period has never been surpassed before or since. In general terms, it may be said that this phase of foundation and consolidation extended throughout the nineteenth century and came to an end with the advent of fascism and the technocratization of power in the years between the two world wars. During that interval the top circles of the fascist Establishment began to discover the political importance of knowledge and the need for an alliance with scientific circles. For totalitarian countries, an official science which not only nourishes but also validates their policies, legitimating the means and ends of State action, becomes an imperative. Their ideological monolithism also embraces science, and just as they have only

one party and one official ideology, they develop one official science.

Although to a lesser degree and more slowly, a similar process occurred in the democratic capitalist countries. While an official science was never established, conditions became such as to imply preferences, facilities, financing, differences in prestige and other subtle and often disguised forms of recognition and reward, or rejection and penalization, of the different scientific currents and schools. A process of social selection thus began which gives priority to certain problems and kinds of scientific work at the expense of others.

This selectivity has been more visible in the social than in the natural sciences, both because of their immediate ideological connexion and because they began to acquire particular importance in the policies and planned decisions of the technocratic world.

These trends have continued to grow stronger, accompanied by the decline and fall of the epistemological belief that the desideratum of the social sciences was withdrawal into independent academic institutions, and a platonic, self-indulgent retreat into pure, abstract knowledge, aloof from the conflictual vicissitudes of social life and from the struggle for power.

The technocratization of State power took place on this basis. Technological reason became the foundation of the cult of efficiency, which in turn became the main criterion of validity. Efficiency as a doctrine depends on the instrumentalization of knowledge, its conversion into technology, so that it may be used as a tool to control nature and also society.

When these conditions arose, the institutionalized neutrality of knowledge was no longer possible because technocratic power naturally could not forgo so valuable a resource. Consequently, its development could hardly be left to the hazard of its own rules or of the enterprise and mystique of its initiates and practitioners.

In other words, modern science, by becoming the main source of technical innovation and of elements for the formulation of ideologies and utopias, and by thus turning into a resource of major importance for the upholding of a technocratic order, has almost completely lost any possibility of isolating itself so that it could be governed by its own rules and adapt itself to objectives of all kinds.

This problem is no longer the exclusive concern of epistemologists and philosophers, as it was when they wrangled over what an independent science was or should be like. Rather than this—which today seems a somewhat irrelevant issue—the real question now is what kind of political option is chosen, because commitment to the real world is already assumed in the very organization of scientific work.

Under the aegis of the technocratic order, the social sciences, which constitute its intellectual foundations and provide it with the necessary technology,

or, in other words, are an organic part of the order which they *de facto* support or legitimate, present a number of features which closely correspond to the nature of their structural position. Let us pause to examine some of the more significant: specialization in subject-matter is becoming increasingly pragmatic and instrumental; the growing preference for quantitative methodology and the mathematical formulation of problems, whose most obvious symbols are the computer and information sciences, have led to formalistic encapsulation and a considerable degree of disciplinary isolation; their language has become private and hermetic, and thus untranslatable for non-specialist society; the impoverishment of their subject-matter is indirectly reflected in a concern for methodology, which has paradoxically become the most important form of knowledge in some academic circles. In other words, it might be said that there is a sharp contrast between the critical fundamentalism of a past period and the present baroque methodologism, largely occupied with socially irrelevant subjects and the treatment of crucial problems without a critique of society and also without reference to their causes. Hence the recent epistemological criticism which repudiates all probability of establishing causal connexions, and instead speaks only of possibilistic relations.

There is no room, in the technocratic view of the social sciences, for intellectual competition and debate; hence its persecution of critical ideas. Thus a dialectical process begins, with use of repression as a defence mechanism increasing while criticism grows in response to the repression and strives to

expose it. While attempting to create an abstract entity, in accordance with its conception of the social sciences, the technocratic order splits up and alienates the social scientist by considering him separately as a scientist, an intellectual, an ideologist and a citizen. Such a separation of man-the-scientist from his

scientific activity is an arbitrary act which assumes that the commitment to science – which is a social product – does not imply a social commitment as a scientist. This problem, epistemologically elaborated in great detail, becomes a paradox when approached from the social angle at the present point in time.

X

The traditional university has undergone a number of changes in its structure and specific and social functions which are related to the problems discussed above. In a technocratic social order the classic type of university is no longer what it was; it loses to a large extent its unrivalled position as the nucleus of secular knowledge and source of social rank. Consequently, the formation of élites moves outside the mass university, and even outside the whole university system, which has ceased to be the fount of socially important knowledge. Under the control of the technocratic apparatus, a whole network of new public and private institutions becomes responsible for forming the candidates for the upper ranks of the organizations which produce and control a major share of technical and scientific knowledge, while the universities are made responsible for the wholesale vocational training of the middle- and high-level 'human capital' needed for economic growth.

At the same time as the importance of the university's contribution to the generation of new knowledge has declined, its intellectual and ideological influence on politics and society has diminished considerably. Other media, such as highly selective and low-profile private or public institutions military

academies, research centres organized as non-profit enterprises or foundations, and government bodies, are now responsible for the elaboration of official technocratic thinking, whether in planning the present or in forecasting the future. It is they that in the interests of the 'Establishment' define the most important issues and carry out its most confidential projects. Options for change are monitored and carefully weighed to ensure that the transformations do not take an undesirable course. The persons who are trained and act in these circles are examined meticulously and, when the results are favourable, co-opted, particular importance being attached to their loyalty to the technocratic order.

Largely deprived of their previous function of training élites, the universities have been confined to positions beneath and generally outside the inner circles of technocratic power. That is why the student movements challenge it, questioning it as outsiders. This is more clearly evidenced in the fact that Latin American student revolts have grown increasingly frequent and violent in the provincial universities, where the relegation and exclusion of their graduates from the commanding positions in society is more obvious. In these circumstances, the claims of the student

movements are more and more characteristically those of social sectors and classes which have to a large extent been cast out of the paradise in which they used to dwell.

In the era of the mass university, only a few of them will be chosen, and that only once they have given sufficient proof of their identification with the system, which means denying their contentious past.

The passage from one position to the other is unquestionably charged with tensions which are lived out in anticipation and which are perhaps at the root of the largely unprecedented conflicts currently taking place in the mass universities, now that they have ceased to be the natural environment for the formation of élites. The student conflict with the technocratic order has reached such a pitch that the confrontation has almost become polarized. Against the hermetic technocratic order the students take up

ideological positions loaded with anarchistic, irrational elements, and launch a Chinese-style anti-bureaucratic cultural rebellion which is the natural antithesis of the technocratic order as the culmination of a process of rationalist bureaucratization.

In extreme cases, the protest of youth and of students, which overlaps to a great degree, takes the form of withdrawal from society ('drop-out'), as in the 'hippie' movements which reject the advantages of industrial civilization and advocate life-styles better adapted to nature. The attraction of the return to more austere life-styles in tune with the natural world is today a major force which has spread beyond the framework of youthful rebellion and student struggles, creating strong movements of rejection of the present industrial, consumerist and predatory civilization closely linked with the technocratic order.

XI

Towards the end of the 1950s some authors in the United States jubilantly announced that we were entering upon the era of "the end of ideologies", implying that the constellations of values and knowledge generated by the class situation and class struggle had disappeared. Thus social knowledge would finally be rid of the distortions introduced by ideology, and the social sciences would be able to fulfil completely their function as producers of neutral, objective knowledge; in other words, thenceforward their social impact would be technical and not ideological.

The ideal of aseptic social sciences with no commitment to the world of

man had reached its zenith. Already stripped of myth and revelation, knowledge was now freed from its last fetter, ideology. The moment seemed ripe for raising a paean announcing the kingdom of God on earth.

Henceforth, the only utopia would be that of technocracy. Prepared by experts and planned by means of reliable techniques, the transformation of society and the orderly march of the world towards a future full of promise would be achieved through practical knowledge, flexible compromise and agreement among the parties concerned, together with the predominance of a continuing consensus based on mutual

understanding, and the institutionalization of change as the master key for the settling of conflicts. The passage was a swift one from the prophetic utopias of the past to the scientific utopias of the futurologists. Suddenly, the world of the future could be predicted, and planning would ensure well-synchronized progress, without fluctuations or unnecessary conflicts, towards the universal consecration of the consumerist utopia under a technocratic order.

The millenarianist ecstasy over the downfall of ideologies was far shorter, however, than many supposed and desired. The return to class confrontation and to the politicization of social differences and conflicts once again made itself felt at many levels, both national and international. A series of university conflicts and youth movements rocked the majority of the developed capitalist countries a few years later. The displacement of the 'hot' and 'cold' wars towards the developing peripheral countries, and various reactions against dependence and discriminatory policies, created conditions which encouraged the organization of blocs of developing countries at the regional and world level, converging in the formation of the Third World movement. In other cases, and along the same lines, the countries exporting certain commodities united to defend their common interests in the international arena.

These claims and demands appeared alarming, and were accompanied by a growing concern about the future of the world. The problems which were being identified —some of them without precedent in human history— were so great that some people began to think that they could never be resolved as long as the central features of the present world persisted, i.e., a consumerist life

style which destroys the natural environment and is based on predatory international relations at the expense of the majority of the world's population and countries, and on the limitless growth of economic production, in combination with a population explosion which threatens to swamp social institutions and human settlements. The nature and scale of these problems cast doubt upon the possibility of solving them without generalized conflict, i.e., using the conciliatory resources of negotiation alone, and in the framework of the present stratification of the international order; in other words, while respecting the hegemonic position of the central countries and their right to retain their immense relative advantages in terms of standards of living and consumption of natural resources.

In Latin America the social and intellectual climate was rather one of ideological confrontation, which heavily influenced the social sciences. From Cuba (1960) to Santo Domingo (1965) the historical parameters of social thought changed. An intellectual and political effervescence bubbled up which greatly influenced the new generations of social scientists and university members, whose intellectual and ideological criticism of academic 'escapism' or the commitment latent in the denial of social conflicts became so forceful that it prevailed over the predominant and still influential currents in the conception of the social sciences. Different variants of marxism gained ground in academic circles, and among teachers and preachers enjoyed a recognition without precedent in the region.

The validity of the neo-positivist conception of the social sciences was questioned from these and other posi-

tions. The time was one of militant commitment, in which the social scientist could not be a mere observer but had to assume the role of a witness, alert and sensitive to the course of events, if not directly to become a militant using science as an ideological and political weapon, as suggested by the more radical. However, those who took this extreme position were few and of slight importance. The others, while believing that the social sciences could not stand aloof from the criticism of reality, held that their main function continued to be the pursuit of knowledge. But their conception of knowledge too had changed. Now that pursuit demanded that they should immerse themselves in reality and penetrate to the very core of its major problems and contradictions. Marginalism, dependence, alienation and class struggle were the dominant issues in the early days of this questioning movement. Others were added later: the State and the new forms of power, the techno-bureaucracies and their alliances, the economic domination and political influence of the transnational corporations, income distribution and social justice – problems which reflect some of the most important features of the

internal composition and external relations of Latin American societies.

Whether this choice of problems and analytical approaches was sound, in other words, whether they were fully in keeping with the aspirations and aims of those who put them forward, is a very important question, which however, lies outside the scope of the present paper. Besides, whatever the answer, it would not change the significance of the above remarks. What really matters here is that this concern did exist, i.e., that the overriding motivation at the time was the pursuit of knowledge which would be relevant for the transformation of social reality. And thus many were convinced that the path to the society of the future, to a living utopia, lay mainly via a different kind of social knowledge, felt rather than thought out, because its epistemological foundations and methodological tools had never been clearly and explicitly formulated, despite some significant attempts to do so. Hindsight seems to justify the belief that this shortcoming did not weaken the initial strength of this drive, although later it was of some importance in cooling the fervour of those won over by such convictions.

XII

What contribution have the Latin American social sciences made to the generation of concrete social thinking, i.e., realistic and viable ideologies as well as guiding utopias, either to ensure the continuity of the *status quo* or to replace it by new conceptions of social life? It would not be easy, or even in order here, to give a specific answer to this question, which is certainly funda-

mental for evaluating the importance of the social sciences. However, there are signs that this contribution has not been lacking when different types of actors (groups, sectors, classes) have defined their aims, formulated strategies and chosen forms of action. Suffice it to recall in this connexion the influence of the 'CEPAL doctrine' on the course followed by Latin American develop-

ment in the 1950s, and—in a different direction—that of monetarist theory and of conservative and authoritarian political thinking on the structuring of several technocratic orders from the late 1960s onwards.

A more detailed review of the predominant subject-matter in the Latin American social sciences over the last twenty-five years could offer some interesting information in connexion with the problem dealt with in this paper. For the time being we can only make a more limited and modest survey. Since the 1950s the bigger, more frequently studied issues were undoubtedly those concerning national development, i.e., in economics the growth of production, in sociology the formation of modernized national societies, and in political science the political development and transformations of the State.

These comprehensive issues are temporarily and causally interrelated in a historical sequence in which—as envisaged by the major theorists of the time—the drive for economic growth encounters social obstacles and resistances which are only finally overcome when political development moves towards a democratic State. In order to avoid the complexities of causality, some maintained that at most there were temporary lags in what was nevertheless a consistent movement towards ultimate convergence in a utopia of liberal stamp—somewhat reminiscent of the philosophy of progress—in which the growth of production, social justice and political democracy would be finally harmonized.

These problems to which the social scientists of that time devoted their attention did not spring from their imagination alone but were deeply rooted in the reality of that period of history. They were very much in keeping

with the capitalist development style then being put into practice, with a broad internal political consensus and the firm external support of the United States.

This coincidence between scientific subject-matter and social reality appeared to derive from the nature of things, so much so that many believed that nothing in it was incompatible with the canons of neo-positivism, which insisted on independence and neutrality as basic requirements of scientific practice. Furthermore, it was widely believed that this ideal was being fulfilled and thus that there was no ideological dependence between the way in which the social sciences were conceived and what they were doing, on the one hand, and the course of social and historical events, on the other.

Towards the beginning of the 1960s, with the Cuban revolution and other events, these fashionable beliefs came under heavy fire in what has been called the 'crisis of developmentalism'. It took the form of criticism, very often militant and radical, of the prevailing model of development, from positions which were strongly influenced by marxism. This was accompanied by a return to a historicist approach⁹ as well as a rejection of the prevailing conception of the social sciences. The goals set instead

⁹ At this time, through different channels, the social sciences, primarily sociology and political science, turned towards history, to such an extent that sometimes they became confused with social history and political history. True, this trend towards historicism occurred without loss of concern for critical interpretation. Similarly, at the other extreme, history itself became critical and took up positions and problems that brought it close to the social sciences, which in turn influenced it considerably.

were greater participation in real life and a commitment to the social forces which were generally in opposition to, if not actively contesting, the capitalist style of democracy with limited popular participation, which was then entering upon a period of crisis.

The most radical criticism tended to focus on two connected issues: internal social marginality and external dependence. Its influence among the new generations of sociologists and political scientists, whether academic professionals or students, reached such truly impressive proportions that being 'up-to-date' implied being able to handle its sources and problems with ease. Despite the very strong attraction they exerted, and the abundant and sometimes contradictory literature which grew up about them, the fact is that neither of these two problems—still less the two of them together—ever came to be incorporated in a coherent body of theory. A few years later, some of their most dedicated and lucid original proponents recognized this limitation.

A related concern was that of identifying the possible agents of change and modernization, on the one side, or the presumed agents of revolution, on the other. Students, peasants, the military, workers, intellectuals, businessmen, politicians, the middle class and other groups were studied from the standpoint of the overriding concern for modernizing change and the revolution of development. The ideas of course varied, as did the interests at stake; but there was nevertheless a shared focus on expectations of change. This could be defined, from one position, as a process of peaceful transition towards modernization by means of planning and institutionalization of conflict, while from another position particular atten-

tion was paid to the points of breakdown and discontinuity in the prevailing development style and social order. Political instability, populist movements, internal colonialism and marginality, agrarian reform and revolts, peasant movements, external dependence and imperialism, were some of the topics which aroused the keenest interest.¹⁰

More recently there has been a shift of emphasis towards concentration on the structure of political power in the State, techno-bureaucracies, public policy, authoritarianism, the political participation of the armed forces, repressive trends and the decline of political democracy, the transnational corporations, national economies and international economic and political relations. These topics frequently appear in combination because generally they are viewed as fundamental elements in the national and international hegemonic system, and in the action and policies launched from its decision-making centres.

Sensitivity towards the basic problems and contradictions of society has remained great, but now a more mature and responsible attitude can be seen with regard to the possibilities of the social sciences, which are no longer supposed to be the *deus ex machina* of change through revolution and of the advent of the happiest of utopias. This greater soundness and diminished belief in omnipotence are perceptible in the relevance of the problems considered, in the less chauvinistic slant in the analysis of intellectual models and their heuristic possibilities, and in the use of a greater variety of methodologies and sources of information. Horizontal links among the disciplines are not negligible, and there is

¹⁰ Cf. A.E. Solari *et. al.*, *op. cit.*, *passim*.

a strong awareness of the importance of more comprehensive approaches to problems in order to deal with meaningful wholes. Concern for relevance remains

central and the choice of issues and problems responds, as always, to a variety of stimuli, including more realistic and better-substantiated diagnoses.

XIII

From the standpoint of the problems discussed in this paper, the social sciences may be considered to contribute in general to the pursuit of three objectives which are fundamental for society. The first —the most direct and visible— is to increase and deepen social knowledge; the second, to prepare social techniques to be used for different pragmatic ends; and finally —the most indirect, but no less important on that account— to assist in the definition of social targets and societal models, present and future, and, very closely linked to that, the formation of values and ideologies. Such contributions are made to a varying degree, according to historical circumstances, whether the social scientists like it or not, and although some of the effects and projections actually resulting are not included among their conscious, manifest aims, or, in fact, even if pains are taken not to produce them.

If the varying contribution of the social sciences to the different objectives is taken as a starting-point, and a meaningful connexion with the features and trends currently prevailing in Latin America is established, there appear to be two contrary options as to the role of the social sciences and their responsibilities as such towards society. We shall call the first the technocratic and the second the critical option. Obviously, these are merely typical, schematic constructs idealizing real trends which are never as clear-cut or uncompromising as is sug-

gested. To grasp the significance of these two options in the context of the present notes, they should be viewed primarily from the standpoint of what each of them emphasizes, i.e., their focus of attention and main functions. The technocratic option is characterized by its accent on the instrumental function, the critical by its concern for questioning and assessing present reality and future possibilities.

The *technocratic* option can be presented through a few very broad questions. What kind of social science, what questions and issues, what sort of methodological approach and what results are more relevant for a technocracy? Here, obviously, it is assumed from the outset that social knowledge is subordinate to the technocratic order. This subordination is primarily the result of the mimetic process undergone by the social sciences when they come to form part of the technocratic order. In other words, they become technocratized when they accept from the start fundamental values of the technocratic order and identify with them to such an extent as to make them an essential part of their own nature. Thus the social sciences become a highly important component of the technocratic Establishment.

The technocratic conception of the social sciences lays emphasis on the production of social techniques; a great variety of these are needed, ranging from the macrosocial to the extremely specif-

ic. Broadly speaking, their orientation is pragmatic and realistic, and they deal with practical, fragmentary, specialized and sectoral problems where clear-cut policies can be formulated and plans organized and implemented. Pragmatic knowledge is a sort of mortar for technocratic policies, not only because of the problem of how to attain their ends but also because of the justification it can furnish for their claims to legitimacy. The technocratic ideology is based on the apologia of pragmatic and technical knowledge, while technocratic power is founded on its possibilities of monopolizing the knowledge in question.

In short, the social sciences become an organic part of technocratic power and lead a peaceful, conflict-free existence so long as they toe the line, i.e., so long as they do not call in question the justice of its nature and policies.

This is a line of development which can be followed without high cost or needless risk. However, it presents certain problems which should be mentioned, although discussion of them would be out of place here. The chief of them could be summarized as follows: What will happen to the social sciences in future if they are little more than organic components of the power apparatus and merely react to its demands? In such a situation, what will remain of the social sciences as producers of critical knowledge, perennially renewed and relevant, which continuously reviews its data, discarding whatever does not stand up to the test of its truth criterion? Can the technocratic social sciences retain enough independence to surmount the barrier of the constraints of power when they have assimilated some of its essential ideological elements and when their foremost practitioners have

been co-opted and won over by its privileges and sinecures?

In its conception of the social sciences the *critical* option stresses other aspects, which are by no means foreign to the epistemological view of science but which have been of less importance in its scientific practice. A central point is the conception of science as a critical discipline which continuously revises its knowledge on the *a priori* ground that its truth is always temporary, historically conditioned, and therefore logically and empirically refutable. A social knowledge built on the basis of unremitting self-criticism must by extension also be a knowledge arising out of the constant criticism of reality, which must be studied with reference to the great humanistic values that have been converging, from different channels, in the progress of critical reason since the Renaissance, and in so doing have, *inter alia*, laid the foundations of modern science.

Those who adopt this position view the critique of society not only as a fount of truer and deeper knowledge but also as a potential source of intellectual renewal and social orientation. In this view, rather than being "pure", knowledge is testimony and judgement; whence its tendency to view society as a contradictory, problematic process which can only be revealed by subjecting it to objective, penetrating criticism.

What is more, criticism of the present is a projection of the past, on the one hand, and an anticipation of the future, on the other. Since the criticism of present society involves from the very outset taking up a position, the relationship between a critical science and ideological options and perceptions of the future is obvious —not that any particular effort is made in this case to

disguise it. On the contrary, although social science should not become confused with the ideologies and utopias with which it is linked in this task of critical appraisal, an approach which focuses analysis on the problems of society is adopted both as a justified and desirable epistemological position and also as a potential means of contributing to the shaping of the future. Thus, knowledge of society as a possibility of overcoming its problems and contradictions becomes a moral imperative.

Once again social knowledge is judged according to its potential for relevance and for change, although in a direction and with a meaning quite other than in the case of the technocratic option. In the first place, the critical position explicitly and positively assumes its responsibility for contributing through the critical study of society to the formation and transformation of social values, ideologies and utopias. In addition, the criticism of reality is aimed at enriching, through objective reason and social knowledge, the stock of solutions to the contradictions which constitute crossroads and deadlocks in the development of society.

The critical position centres its intellectual problems on a series of basic questions: What is the role of the social sciences in the progress of society? Should they share in any way in the definition and formulation of social objectives? Should they be concerned with the materialization of ideas such as liberty, dignity, justice, peace, creativeness, love, solidarity and others of a similar nature, on which the happiness and development of mankind depend? In short, what is the responsibility of the social sciences towards the world of man?

It has been said that the fate of the

social sciences will depend on their capacity to help man in his perennial struggle for justice and survival. It may be that they lack the possibility of judging the soundness of values and 'scientifically' recommending options and ends, but it is equally true that they can critically examine the validity of their foundations. Furthermore, every social science implies a social ethic. It may therefore be deduced that the different conceptions of them inevitably involve different social ethics, which imply various forms and degrees of relationship with and responsibility towards the world of man. What apparently cannot be demonstrated, on the other hand, is that there is any conception of the social sciences which does not have a social ethic.

Contrary to the assertions of critics, the fundamental questions of the real world can be raised without going to extremes, either in the shape of a complete ideologization of knowledge, which turns it into a science of the barricades, subject to the swings of the political pendulum, or in that of a folkloric and traditionalist fallback which views the present merely as a projection of the past. Critical science is neither of these things. Without renouncing the epistemological requirements of science, it consciously and openly accepts its social conditioning and responsibilities.

The critical study of reality is frequently accompanied by criticism of the hegemonic situation, its power and decision-making centres and its policies: seldom an easy matter, particularly in times of crisis when the weakening of consensus increases the dominant order's sensitivity and vulnerability to criticism. Its reactions may vary, but generally

speaking they tend to be openly repressive. In such conditions criticism becomes difficult but not impossible, as history has demonstrated over and over again. Fortunately, it has never been possible to root out criticism altogether. The day that happens, knowledge will cease to be what it has represented since the distant times when it was first secularized and then organized according to precise rules of method, thus

acquiring the characteristic of scientific knowledge, i.e., critical knowledge. In the course of history, secular scientific knowledge has travelled through much difficult territory, and has managed to survive despite all obstacles. It has done so precisely because it has never lost its capacity to renew itself under the purging influence of self-criticism and by watchful, independent observation of reality.

XIV

We have come to an end, and we seem to be back at the beginning, once again posing the question of intellectual freedom as a requirement of social knowledge and, in general, of scientific truth. No final conclusions can be drawn, however, from a few thoughts such as these, which have been put forward for the sole purpose of sketching a very general historical outline of the problems of the relationship between knowledge and social reality, and of the meaning acquired by the conceptions of intellectual responsibility and autonomy in some of their varying frameworks in Latin America's past and present.

The above remarks may perhaps serve to suggest that the discussion about the neutrality of the social sciences has been couched in terms which might now be considered out of date. The viability of free knowledge nurtured in an independent academic world is something which today may be recalled with nostalgia and even advocated as an ideal, but which can hardly be reconciled with the possibilities of the world around us.

The autonomy and freedom of knowledge are problems which will

always be a matter of concern and discussion in the social sciences, although their specific referents and their meaning will vary with the changes in the real world. Since there is no way of conceiving social knowledge without at the same time posing the problems of its objectivity and relevance—and hence inevitably the question of intellectual freedom, without which there can be neither truth nor objectivity—perhaps the most important issue is to determine what specific forms are assumed by those relationships in concrete historical-social contexts. To do so is to assert the relativity of scientific truth in the social sciences, and hence the constant need of re-examining the problems concerned in the light of the changes in the historical situation.

Neither wholly dependent nor unconditionally autonomous, social knowledge evolves in historically variable circumstances and conditions which shape it; but it does not thereby lose all its possibilities of relative independence, which it can retain in the face of all constraints, *only* so long as it does not renounce its critical calling.

External finance and commercial banks

Their role in
Latin America's capacity
to import between 1951 and 1975

*Robert Devlin**

Since the mid-1960s a radical change has come about in international financial flows which has placed commercial banks at the heart of the process. It is they that handled substantial funds deriving from the expansion of the Eurocurrency market and later recycled a considerable portion of the surpluses generated by OPEC; and for several reasons, paramount among which is the expectation of profit, they have channelled a considerable proportion of these resources towards the developing countries. The article analyses the positive and negative effects of this process on the nations in question. On the one hand, it has relieved the external bottleneck, increased the capacity to import, provided incentives to investment and economic growth, made it possible to weather the oil price crises, and afforded freedom from the constraints of official loans. But, on the other hand, it has also increased dependence upon foreign capital and debt service requirements, and has 'commercialized' development financing; this last consequence generally implies more onerous loans with variable rates of interest, shorter terms, less tolerance, 'commercial' criteria for estimating a country's creditworthiness, and intervention of banks in government policy. In face of these negative effects, the author proposes a series of remedial measures, of which the most outstanding is to augment the available funds of multilateral financial institutions with resources from the central countries and from OPEC.

*Staff member, Economic Development Division, CEPAL.

Introduction*

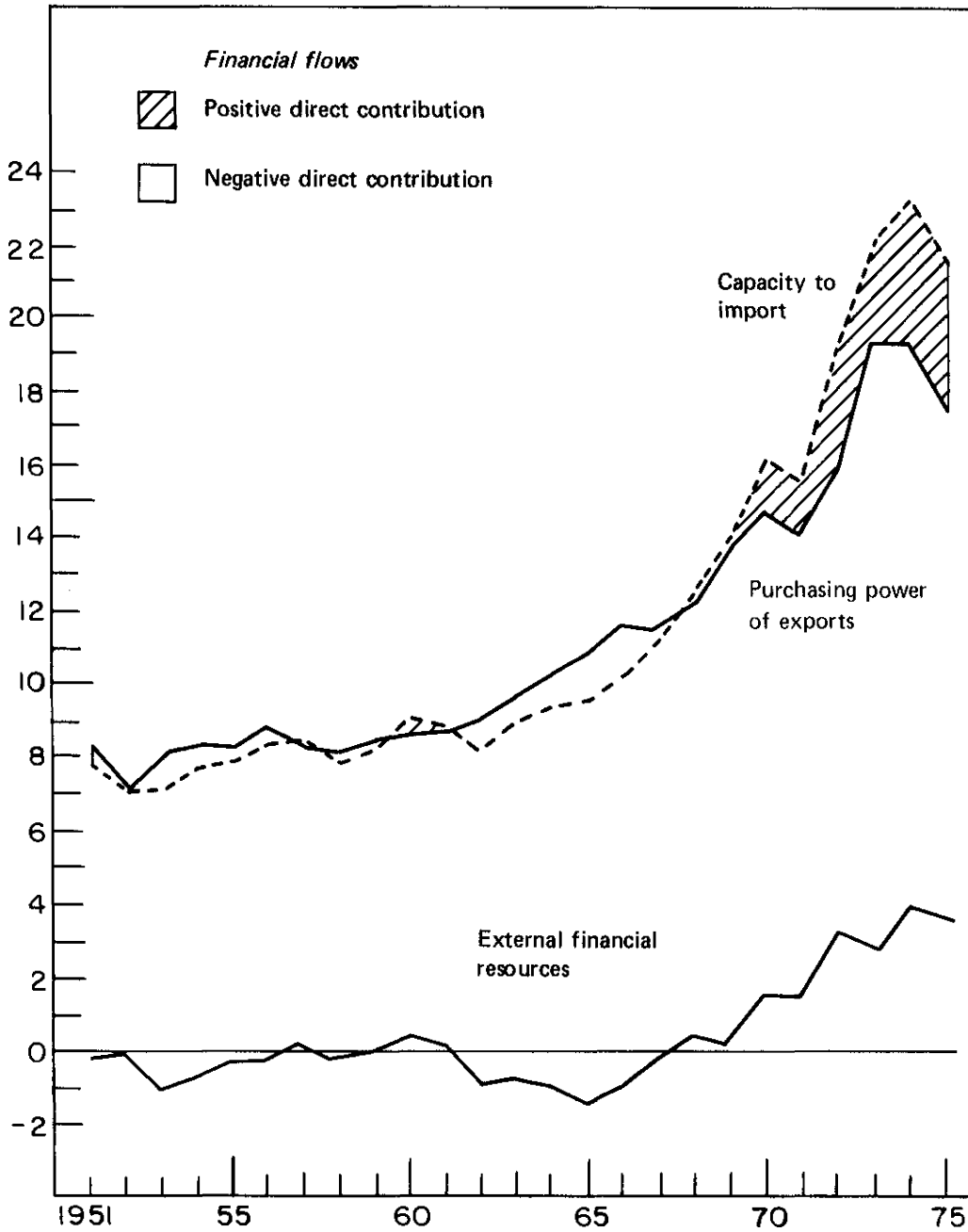
As can be seen in figure 1, in the mid-1960s Latin America¹ experienced the beginning of a dramatic rise in its capacity to import foreign goods and services.² If 1965 is used as a base, the region's ability to import, before having recourse to compensatory finance, more than doubled in 9 years, representing an annual average growth rate of 10.5 per cent in real terms. This is in sharp

*I should like to express my gratitude to Héctor Assael, Andrés Bianchi, David Hoelscher, Carlos Massad, John McDermott and Anibal Pinto for their comments on earlier drafts of this paper. Their individual views do not, however, necessarily coincide with those presented in the paper. Also, any errors that the paper may contain are solely the responsibility of the author.

¹ Comprising Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay. Venezuela has been excluded because its status as a major oil producer has long set it apart from regional trends.

² The concept of capacity to import used here corresponds to CEPAL's traditional definition, i.e., the amount of goods and services that can be purchased with the annual net inflow of foreign exchange resources, excluding, however, inflows of resources under the heading of compensatory capital. Thus, capacity to import can be expressed as $Z = X + EF$ where Z is capacity to import, X is the purchasing power of exports and EF is the net flow of financial resources, exclusive of inflows of compensatory capital. For the sake of clarification, $EF = (AI - AO - Fa) - (CO + Fc) + (N + Fn) + E$, where AI represents foreign autonomous capital inflows; AO , foreign autonomous capital outflows; Fa , factor pay-

Figure 1
LATIN AMERICA: NET CONTRIBUTIONS OF PURCHASING POWER OF EXPORTS AND
EXTERNAL FINANCIAL RESOURCES TO CAPACITY TO IMPORT, 1951-1975
(Billions of dollars at 1970 prices)



Source: CEPAL, on the basis of official data.

contrast to earlier years, as capacity grew by less than a third during the period 1951-1965, or at an annual average rate of only 1.7 per cent.

It is clear from the figure that the major thrust behind the expansion of capacity to import was an unprecedented increase in the purchasing power of the region's exports, which came about largely because of an unusually prolonged period of favourable trade prices. But the figure also makes it evident that the rise was attributable in part to an unusually large net inflow of external financial resources. It is to the analysis of the latter phenomenon that this paper will be devoted.³

The format of the paper is as follows.

The first section will examine the evolution of external financial flows over the past 25 years and show their impact on the region's capacity to import. The

ments on autonomous capital; CO, outflows of foreign compensatory capital; Fc, factor payments on foreign compensatory capital; N, net movement of assets held by residents of Latin America; Fn, factor receipts on national assets; and E, the net errors and omissions entry of the balance of payments. Note: national assets include government transactions; thus there is an element of double counting in the data.

³ An analysis of the evolution of exports and trade prices and their impact on the region's ability to import can be found in CEPAL, "The economic and social development and external relations of Latin America" (E/CEPAL/AC.70/2), Santiago, Chile, February 16, 1977.

analysis will focus on two basic sub-periods, 1951-1965 and 1966-1975, because of the rather distinct behaviour of key variables in these years.

Because analysis will show that a heavy influx of foreign loan capital was the principal determinant of the increase in financial flows during 1966-1975, section II will be devoted to examining the factors underlying the movement of loans. It will be seen that much may be attributed to structural changes in world finance which encouraged banks to penetrate into the field of the external finance of developing countries.

The third and last section deals with some of the implications of recent trends in external finance. It finds that not only has external dependency and debt increased, but that with the recent emergence of banks as the major agents of external financing, the nature of the debt problem itself has been seriously complicated.

Finally, before going on to the body of the paper, the reader should be forewarned that most of the statistical analysis will be confined to the region as a whole, with little disaggregation or none to speak of. Therefore, care should be taken to remember that the statements discussed may not be equally applicable to all countries of the region. Clearly, analysis of trends at such a high level of aggregation has serious limitations. But there nevertheless is some value, however small, in looking at events with respect to the region as a whole, and it is just such a modest contribution that this paper proposes to attain.

I

The evolution of external financial flows and their impact on the region's ability to purchase foreign goods and services, 1951-1975⁴

A. *The general picture*

A glance at the bottom half of figure 1 will show that during the period 1951-1965 external financial flows behaved in a rather erratic fashion. But in spite of short-term fluctuations, it can be said that the financial resource flow tended to be negative; only in three out of the fifteen years (1957, 1960, 1961) was a positive financial resource balance recorded. Moreover, towards the end of the period there was a noticeable enlargement of the negative resource balance, as it reached 1.4 billion dollars by 1965.

The behaviour of external financial resources during this period tended to exacerbate an already serious external bottleneck; not only was the purchasing power of the region's exports showing sluggish growth (2.1 per cent per annum), but significant proportions of these resources were generally claimed by requirements to cover the deficit in the external financial balance. The gravity of the problem is revealed in the upper portion of figure 1 by the rather large gaps between the purchasing power of exports and the capacity to import; indeed, at the close of the period the capacity to import was fully 13 per cent less than the purchasing power of exports.

⁴ In this section all data are deflated into dollars at 1970 prices.

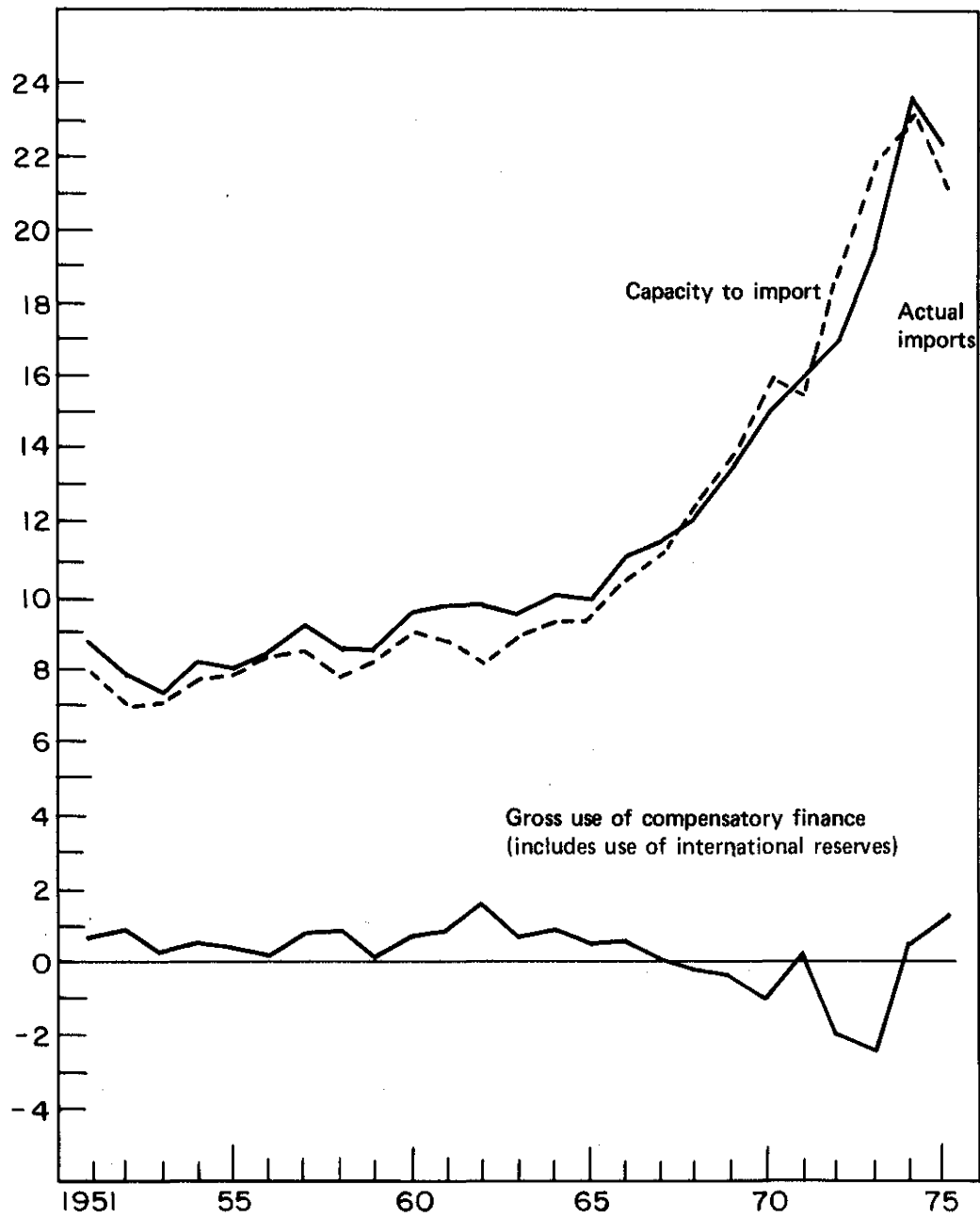
Faced with this situation, Latin America resorted heavily to compensatory finance in order to keep imports at acceptable levels. As seen in figure 2, there was active use of compensatory instruments in every year during the period 1951-1965, and this helped to support purchases of foreign goods and services for amounts in excess of the capacity generated by autonomous resource flows. But even so, actual imports grew by only 2.5 per cent per annum in real terms and the coefficient of imports to GDP showed a marked downward trend over the period.⁵

In the second half of the 1960s the flow of financial resources started to show a remarkable change in behaviour (see again figure 1). Over 1966-1967 the negative financial balance began to decline from the peak level of 1965. Then, in 1968 a positive balance of 0.4 billion dollars was recorded, causing capacity to import to exceed resources made available from exports for the first time in 7 years. From then on the positive financial balance underwent strong expansion, reaching a peak of 3.9 billion dollars in 1974.

As can be seen, the shift to a large and sustained positive financial resource

⁵ The coefficient declined from 16.8 per cent in 1950-1952 to 10.9 per cent in 1964-1966 (including Venezuela). See CEPAL, *op. cit.*, p. 47.

Figure 2
LATIN AMERICA: CAPACITY TO IMPORT, ACTUAL IMPORTS AND
GROSS USE OF COMPENSATORY FINANCE, 1951-1975
(Billions of dollars at 1970 prices)



Source: CEPAL, on the basis of official data.

balance caused the capacity to import increasingly to exceed export earnings. By 1974, capacity exceeded export earnings by 20 per cent; this figure even rose slightly higher in 1975 because the fall in the financial balance (5 per cent) was less than the drop in the purchasing power of exports (9 per cent).

It can also be observed that the positive external resource balances after 1967 helped to push the capacity to import to levels that were for the first time in excess of actual imports. Figure 2 shows that while actual imports expanded rapidly (8.8 per cent per annum in real terms), the capacity to import exceeded the imports effected in every year except 1971 and 1974-1975, thereby indicating a substantial accumulation of foreign exchange reserves.

Figure 3 breaks down the external financial resource balance into its basic components: foreign resources, the net movement abroad of national assets and the errors and omissions entry of the balance of payments (the two last being designated as "Other" in the figure⁶). The figure reveals that the sustained positive financial balances that were recorded from the start of the late 1960s were due principally to the movement of foreign financial resources.

During 1951-1965 the foreign financial balance displayed a mixed behaviour. At the beginning of the period it was negative, modestly positive at the middle of the period, and then negative again at the end. However, in the latter half of the 1960s there was a profound change in trends. In 1966-1967 the nega-

tive balances diminished. By 1968 the balance had once again turned positive, and at 0.5 billion dollars was larger than any previous positive resource flow. But, more importantly, thereafter the positive financial balance grew very rapidly—at an extraordinary average pace of nearly 50 per cent per annum—reaching 5.5 billion dollars by 1974. In 1975 the positive foreign balance declined by 20 per cent, but nevertheless remained very large *vis-à-vis* historical experience.

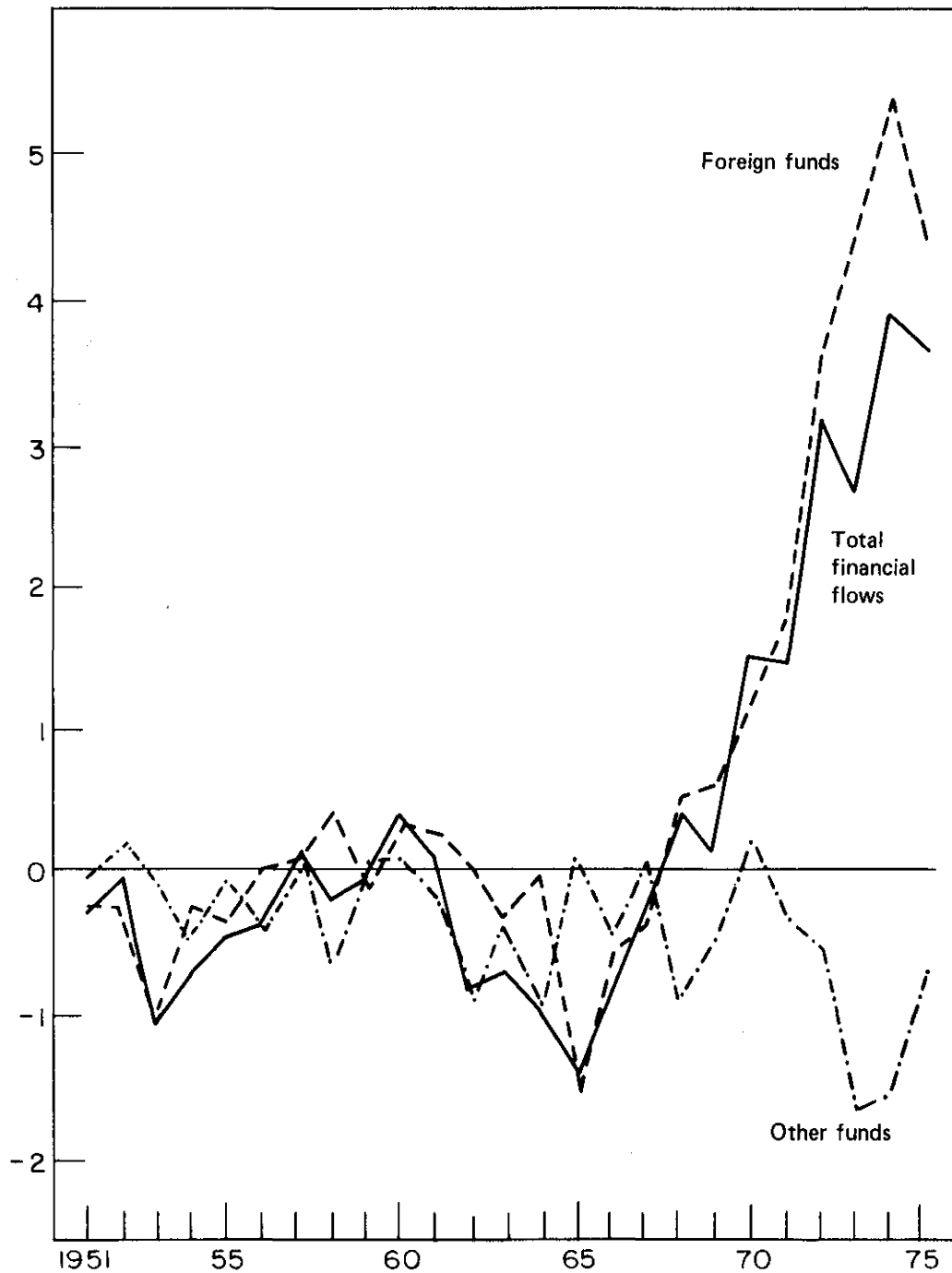
The rise in the positive balance was generally less in the case of total financial resources than in that of the foreign component because of the tendency for negative balances to be recorded under "Other" financial resources. As can be seen in the figure, the negative balance was exceptionally large in 1973-1974, exceeding 1.5 billion dollars in both years. The reason behind this big deficit will be examined shortly.

The radical change in the behaviour of external financial resources can perhaps be better appreciated if averaged data for 1951-1965 and 1966-1975 are compared. Table 1 presents just such a comparison.

It can be seen that during the first period the region experienced an average negative balance for financial resources in the order of 0.4 billion dollars per annum, which is equivalent to 5 per cent of the average purchasing power of exports for the same period. This contrasts sharply with the behaviour pattern followed over the succeeding 10 years, as the average balance of financial resources showed a surplus of 1.6 billion dollars, representing an increase in absolute terms of 2.0 billion dollars with respect to 1951-1965, and implying that nearly one-quarter of the increase in average capacity to import between the two periods was attributable to the more favour-

⁶ The errors and omissions entry has been included in the financial data since it is thought to be more reflective of unregistered flows of factor income and capital than of movements of tradeable goods.

Figure 3
LATIN AMERICA: EXTERNAL FINANCIAL RESOURCE BALANCE, 1951-1975
(Billions of dollars at 1970 prices)



Source: CEPAL, on the basis of official data.

Table 1
LATIN AMERICA: NET CONTRIBUTIONS OF EXPORTS AND FINANCIAL FLOWS TO THE CAPACITY TO IMPORT
(Billions of dollars at 1970 prices)

Averages	Purchasing power of exports ^a	Foreign ^b	External financial flows			Total (2+5)	Capacity to import (1+6)
			Other				
			National funds	Errors and omissions	Total (3+4)		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	
1951-1965	8.8	-0.2	-0.1	-0.1	-0.2	-0.4	8.4
1966-1975	15.1	2.2	-0.5	-0.1	-0.6	1.6	16.7
1966-1970	12.8	0.3	-	-0.1	-0.1	0.2	13.0
1971-1975	17.3	3.9	-0.8	-0.1	-0.9	3.0	20.3

Source: CEPAL, on the basis of official statistics.

^aIncludes private transfers.

^bNet effect of direct foreign investment (net) less profit remittances; short- and long-term non-compensatory loans less amortization and interest payments; net official transfers and amortization of obligations stemming from compensatory financing operations.

able behaviour of financial resources. Significantly, most of the increase occurred after 1970, the average balance being 3.0 billion dollars in 1971-1975, compared to only 0.2 billion dollars in 1966-1970.

This turnaround in the average financial resource balance was due, of course, to the behaviour of the foreign component noted above. Whereas the net balance on average was a negative 0.2 billion dollars in 1951-1965 (equivalent to roughly 2 per cent of the average purchasing power of exports), it rose to a positive figure of 2.2 billion dollars in 1966-1975, which signified an absolute increase of 2.4 billion dollars. Most of the influx took place in the latter half of the period, as reflected in the fact that the positive balance averaged 3.9 billion in 1971-1975, while in 1966-1970 financial flows behaved in such a way that the

average was a rather modest 0.3 billion dollars (see again table 1).

With regard to "Other" financial resources, average balances were negative in both periods because annual deficits generally resulted from the movement of national funds combined with the errors and omissions entry of the balance of payments. However, the outflow in 1966-1975 was triple that experienced in the previous 15-year period.

The factor underlying the increased deficit was a notably higher negative balance with regard to national funds: the average rose fivefold, from 0.1 billion dollars in 1951-1965, to 0.5 billion dollars in 1966-1975. The increase, however, largely reflected events in the years 1972-1974, when the deficit averaged 1.3 billion dollars per annum; moreover, more than three-fourths of the latter fi-

gure was concentrated in Panama, which is an international banking centre.

To summarize up to this point, the behaviour of financial flows differed greatly in the two basic periods under consideration here. During 1951 to 1965 there was a significant negative balance of external funds, which, when coupled with a rather sluggish growth of the purchasing power of exports, formed a severe external bottleneck. Even with considerable recourse to compensatory capital, imports increased at a very slow pace in real terms. In contrast, the period 1966-1975 was marked by a shift to a large positive external financial balance for the region, and this conveniently coincided with a similarly sharp expansion of the purchasing power of exports. The result was a phenomenal rise in capacity to import; indeed, capacity increased to such an extent that it often exceeded actual imports, thereby facilitating an accumulation of foreign exchange reserves. The key factor behind the favourable shift in the behaviour of external financial resources was the movement of foreign funds, which entered the region on a net basis in unprecedented proportions as from 1968.

Given that the foreign financial component played such a vital role in the rise in the capacity to import during 1966-1975, it is useful to examine these flows in greater detail.

B. The foreign financial resource component

Before proceeding with the analysis of the behaviour of the various types of foreign resources, it will be wise to clarify just what is meant by the net contribution of foreign finance to the capacity to import.

Foreign financial flows can be said to have a direct and an indirect impact on the region's capacity to import. The direct impact refers to the accounting of resource flows, i.e., the degree to which annual inflows of new foreign funds exceed outflows stemming from service payments (income remittances, interest and amortization payments, etc.).

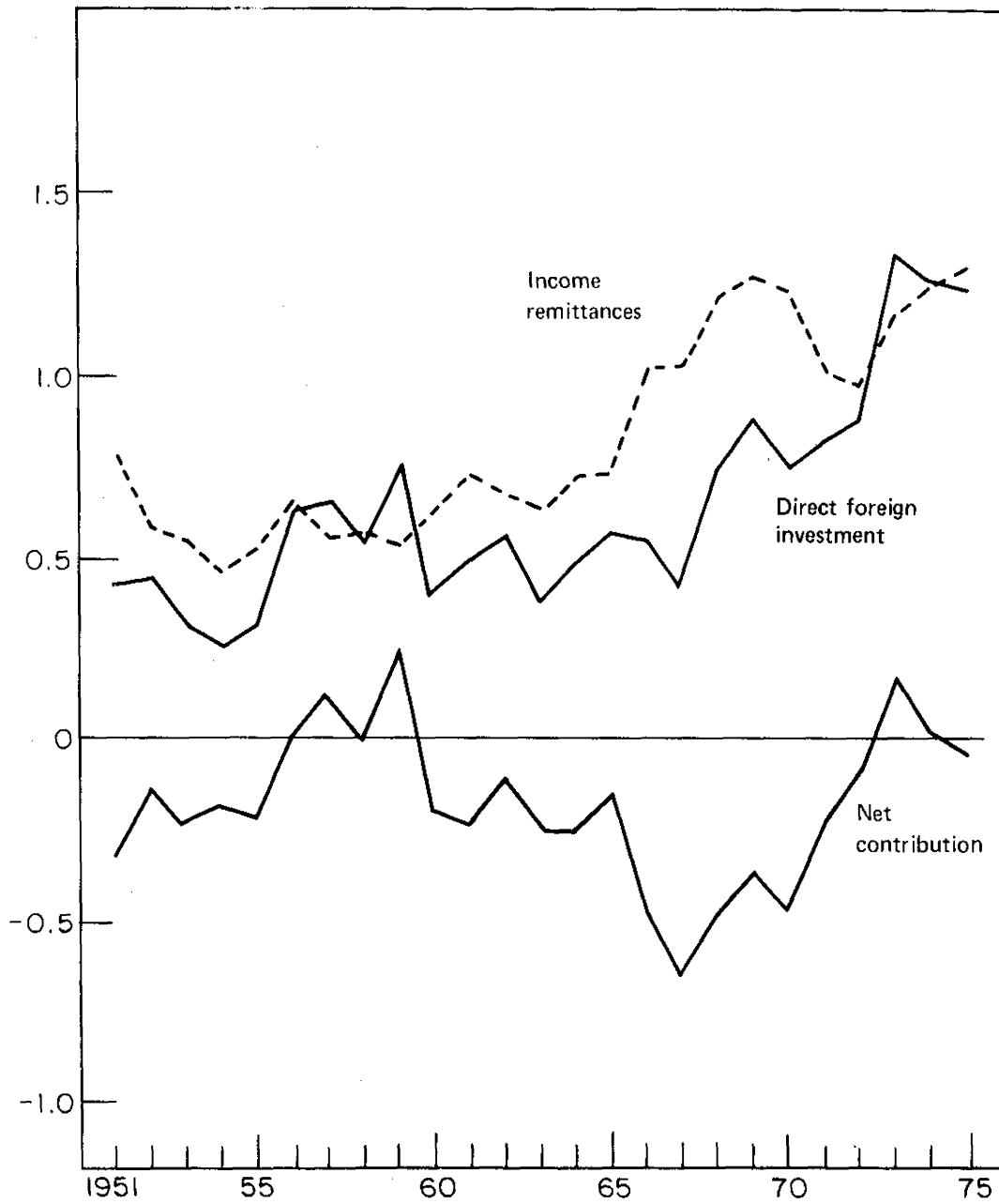
The indirect impact of foreign flows consists in any favourable effects that resources may have on a country's ability to generate foreign exchange: for example, new foreign investment in an export industry would tend to boost export earnings. This paper will deal only with the direct effects of foreign flows on capacity to import. As will be seen shortly, from this viewpoint some types of foreign funds have at times had a negative impact on capacity to import. However, reference to a negative net resource balance does not mean to imply that these funds have been necessarily detrimental to the region's interests; only an analysis with a more ample perspective could determine this point.

1. Direct foreign investment

Direct foreign investment includes capital contributions to private direct investment enterprises of non-residents and reinvested earnings from these investments. But direct foreign investment carries with it a reverse flow in the form of income remittances. It is the net balance of these two flows that determines the direct impact on the region's capacity to import.

Figure 4 presents the evolution of new investment flows to the region and the outflows stemming from payments of foreign income. It is clear that there was generally a large deficit associated with foreign investment operations

Figure 4
LATIN AMERICA: NET DIRECT CONTRIBUTION OF DIRECT FOREIGN
INVESTMENT TO CAPACITY TO IMPORT, 1951-1975
(Billions of dollars at 1970 prices)



Source: CEPAL, on the basis of official data.

viewed in the aggregate. During 1951-1965 the resource flow was positive for only 2 years, 1957 and 1959, while in 1966-1975 positive balances were recorded only in 1973-1974. The tendency towards a negative resource flow had the general direct effect of reducing the region's capacity to import.⁷

A notable feature is that in the late 1960s direct foreign investment flows began to show a new dynamism as compared to the rather flat growth of earlier years. However, income remittances also underwent a marked expansion, and on average the negative balance for foreign

investment operations doubled between the two basic periods (see table 2). But it should be noticed that most of the increased deficit was accumulated during 1966-1970, when the negative balance averaged 0.5 billion dollars. In 1971-1975 the gap narrowed considerably and on average the resource flows were in rough balance. It can be said, then, that while not making a positive direct contribution to the capacity to import, the relative balance between investment and remittances nevertheless effectively helped to accentuate the sharp rise in capacity to import in the early 1970s.

Table 2
LATIN AMERICA: NET FOREIGN FINANCIAL FLOWS
(Billions of dollars at 1970 prices)

Averages	Foreign investment net (1)	Foreign investment income (2)	Net balance (1-2) (3)	Non-compensatory loans ^a			Net balance (6-7) (8)	Other flows (net) ^b (9)	Total (3+8+9) (10)	
				M-L/T (4)	S/T (5)	Total Interest payments (4+5) (6)				
1951-1965	0.5	-0.6	-0.1	0.5	0.2	0.7	-0.3	0.4	-0.5	-0.2
1966-1975	0.9	-1.1	-0.2	3.1	1.1	4.2	-1.6	2.6	-0.3	2.1
1966-1970	0.7	-1.2	-0.5	1.6	0.5	2.1	-0.9	1.2	-0.4	0.3
1971-1975	1.1	-1.1	-	4.5	1.7	6.2	-2.2	4.0	-0.1	3.9

Source: CEPAL, on the basis of official data.

^aShort-, medium- and long-term loan disbursements less amortization payments.

^bThe net balance of official transfers and compensatory capital outflows other than use of reserves.

2) *Short-, medium- and long-term loans (including portfolio investment)*

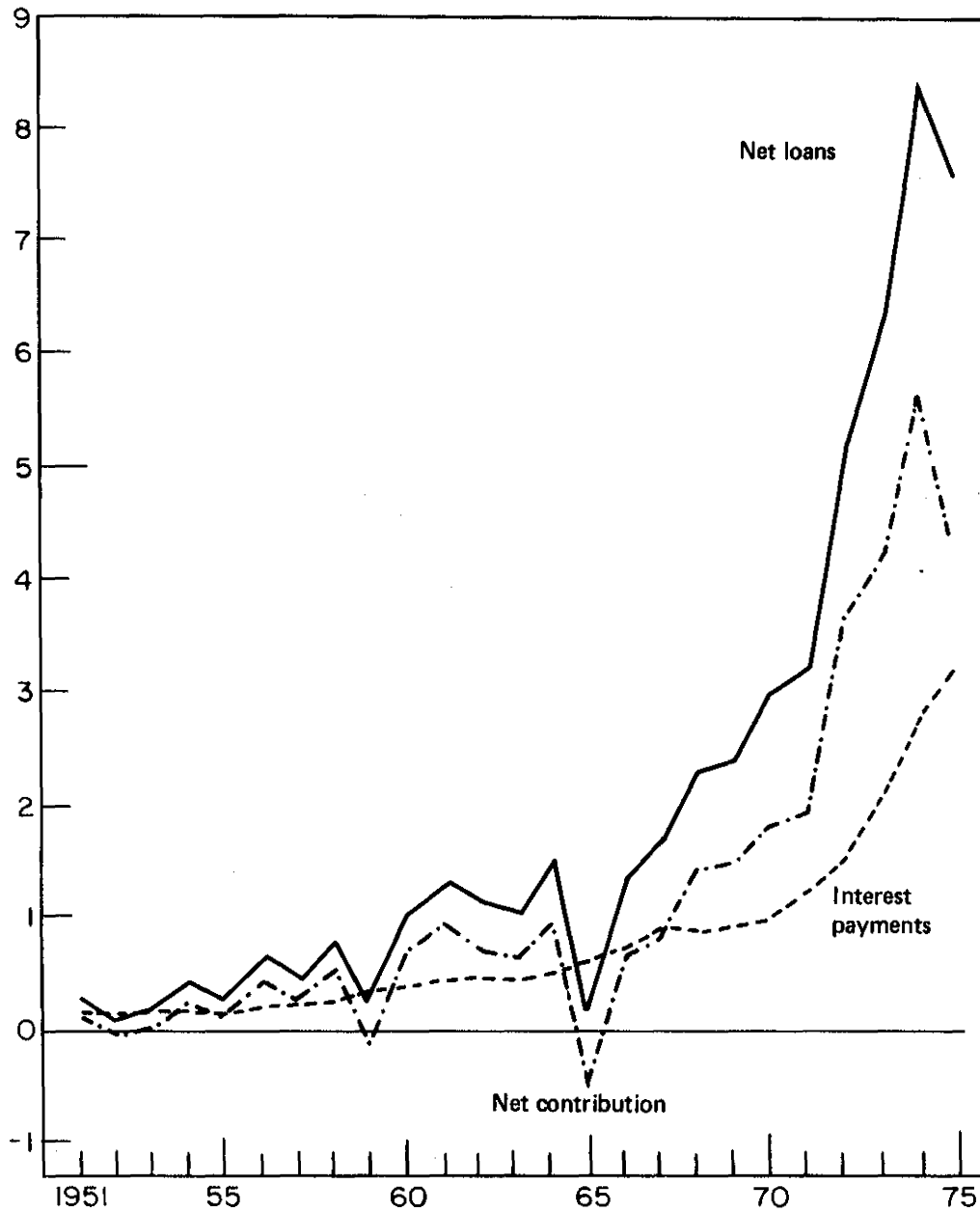
These resources include funds lent by private and official foreign sources to Latin American governments and private

⁷It is worth emphasizing that this measurement does not include any other benefits such as those derived from exports, tax revenue generated from exports, transfer of technology, etc.

enterprises. Short-term loans are understood to carry a maturity of up to one year, while medium- and long-term loans are characterized by a more extended maturity. The net direct impact of these funds on capacity to import is determined by the balance of net loan disbursements (gross disbursements less amortization) and interest payments on outstanding loan balances.

Figure 5 shows that during the 25

Figure 5
LATIN AMERICA: NET CONTRIBUTION OF FOREIGN LOANS
TO CAPACITY TO IMPORT, 1951-1975
(Billions of dollars at 1970 prices)



Source: CEPAL, on the basis of official data.

years under consideration, transactions related to foreign borrowing operations generally resulted in a positive net resource balance for the region; indeed, only in three years (1952, 1959 and 1965) was the net balance negative. What is striking, however, is that after 1967 the net balance on loan operations reached unprecedented proportions and was the principal factor behind the strong contribution of foreign financial resources to the accelerated growth of capacity to import.

The main reason underlying the rise in transfers deriving from foreign borrowing operations was a rapid and remarkably sustained expansion (average growth of roughly 50 per cent per annum) in net loan disbursements, as loans were contracted at a much faster pace than they were repaid. Thus, the net disbursement from foreign loan capital rose from 0.2 billion dollars in 1965 to a peak of 8.5 billion in 1974.

Notwithstanding sharply increasing interest payments—their average growth rate rose from 11.9 per cent in 1951-1965 to 17.3 per cent in 1966-1975—the resource transfer closely paralleled the movement in net disbursements. By 1974 the net balance reached 5.6 billion dollars, or more than the cumulative net balance for the whole of 1951-1965 (5.2 billion dollars). In 1975 a 10-per cent fall in net disbursements, coupled with a 13-per cent rise in interest payments, caused the positive balance from loan operations to show a decline (21 per cent) for the first time in 10 years. Nevertheless, at 4.5 billion dollars the positive resource flow remained higher than that recorded for any year prior to 1974.

The unprecedented influx of loan capital after 1965 becomes all the more

striking when averaged data are examined. This procedure can also shed light on the relative importance of short- and longer-term maturities.

Returning to table 2, it can be seen that the average net contribution of loans to the region's capacity to import rose from 0.4 billion dollars in 1951-1965 to 2.6 billion in 1966-1975—an increase of over 500 per cent. This reflects the fact that average net disbursements of loan capital rose by 3.5 billion dollars and average interest payments by 1.3 billion. Both figure 5 and table 2 make it clear that it was after 1970 when the transfer was most significant; the average net flow in 1971-1975 was over 3 times larger than the average for the previous 5 years and 10 times larger than the annual average balance for 1951-1965.

It is also notable that the influx of loan capital came mostly in the form of medium- and long-term funds as opposed to short-term funds; fully 74 per cent of the increase in average disbursements between the two basic periods reflected loans with a maturity of more than one year. This is an important distinction, since, all other things being equal, longer maturities are more advantageous to development strategy because repayment is less of a burden on a country's 'cash flow'.

3. Other foreign resources

This last group of foreign financial data incorporates the net effect of official transfers and debt service payments on compensatory finance operations. Although the combined impact of these flows on the capacity to import was negative in both the major periods under consideration (see again table 2), the

average net outflow declined by 40 per cent and this in itself tended to enhance capacity to import.

The reduction for the most part reflects the behaviour of amortization payments on obligations related to compensatory finance (since the impact of these flows tends to dominate the group). During 1951-1965 Latin America's balance of payments was generally in disequilibrium, necessitating relatively active use of compensatory loan instruments. This generated a sizeable reverse flow because of the need to amortize obligations. But after 1965 the inflow of

autonomous capital tended to be sufficient to meet external financing requirements, thus permitting Latin America to resort less to compensatory finance, which in turn resulted in reduced service payments.

It is clear from the analysis in this section that there was a radical change in the behaviour of financial flows after 1965 and that it was due basically to a heavy influx of foreign loan capital. Since loans played such a key role, it will be useful to examine the factors underlying events. This will be the task of the next section of the present paper.

II

Dynamics behind growth of foreign loans: private international bank capital

The preceding section has shown that a major reason behind the dramatic growth of Latin America's capacity to import after 1967 was an unusually sharp rise in net inflows of foreign loan capital. This surge of foreign loans was largely attributable to the activities of international commercial banks.

Prior to 1965, Latin America traditionally relied on direct foreign investment, suppliers' credits and official bilateral and/or multilateral loans for the bulk of its external finance. As for banks, they played an important, but restricted role, generally confining themselves to short-term trade finance and occasional project loans that carried an external guaranty such as that of an official export credit agency. However, in the late 1960s, some countries—nota-

bly Brazil and Mexico—began to tap foreign commercial banks for sums that would not have been considered feasible in earlier years. Once more, much of the lending was of a medium- to long-term nature. By the early 1970s these two countries were already heavily reliant on private bank finance, and many other countries—for example, Peru, Colombia and Panama—were able to secure sizeable loans from such banks as well. Then, with the advent of the oil crisis in 1974, most countries experienced severe external disequilibrium, and it was private commercial banks that extended most of the funds to cover external deficits.

But why the change in access to bank credit? Evidence suggests that some special forces came into play.

A. *Structural transformation of banking*

It appears that to a large extent Latin America's increased access to bank credit was the result of its being caught up in the centrifugal forces created by a profound structural change in banking. Of major importance to the process was the expansion of the Eurocurrency market, which was first formed in the mid-1950s out of dollars generated by United States balance-of-payments deficits. The market was largely unregulated and proved to be highly profitable to banks. Using this market as a springboard, in the 1960s many banks attempted to break out of national frontiers and into the international arena, where profit growth was much more dynamic than at home. American banks led the parade, but soon European, Japanese and Canadian banks hopped on the bandwagon.

The unregulated nature of the Eurocurrency market, together with a newly-placed emphasis on the growth of earnings, caused banks to abandon their traditionally conservative posture and display unwonted boldness. A major innovation in this period was the regular extension of longer-term loans. Banks had been in the habit of restricting themselves largely to shorter-term lending because of the current nature of their deposit base. But they found that on the Eurocurrency market they could regularly "buy" 6-month deposits, and then by continuously rolling them over at interest-fixing dates, use these deposits to fund much longer-term loans, typically going up to 5 years.

During most of the 1960s the Eurocurrency market catered primarily to the industrialized countries. But as the pool of Eurocurrency expanded, and

more and more banks, attracted by the high yields of international lending, entered the market, competition for customers became very keen. By the late 1960s, the forces of competition and the desire to maintain the growth of earnings were prompting a search for new customers in developing areas.

Latin America (more specifically Brazil and Mexico) became a prime candidate for loans because of the relatively higher level of growth and development to be found there. Banks were also attracted by the fact that developing countries were willing to pay risk premiums in excess of 2 per cent over base interest rates in order to secure loans.

In the early 1970s competitive pressures became so hectic that banks—many of them new entrants into the international scene—saw their lending spill over into the smaller, less-developed countries of the region; countries traditionally accustomed to obtaining capital from official sources thus found the Eurocurrency market to be a more than willing supplier of funds.⁸ Indeed, by 1972 countries had discovered it to be a borrower's paradise; not only was there easy access to credit, but competition caused margins to be drastically reduced and maturities to reach unprecedented lengths. By way of example, Brazil, which was a leading borrower within the developing world, found that it could regularly secure credits with a 10-15-year maturity. As for spreads, they declined from 2 1/4 per cent in 1971 to 1 1/2 per cent by mid-1972 and to 3/4-1 per cent in 1973. At the same time lending was so

⁸ Most lending in absolute terms went to countries like Mexico and Brazil, but Argentina, Colombia, Peru and smaller countries like Nicaragua, Costa Rica and Panama were also able to secure sizeable loans from the Eurocurrency market.

voluminous that the country even found it necessary to introduce policies to discourage foreign bank loans.⁹

With the advent of the oil crisis in late 1973, the forces behind lending changed somewhat. In consequence of the lack of international mechanisms for dealing with the oil crisis, OPEC countries placed more than 50 per cent of their surplus receipts in private bank deposits.¹⁰ This left international banks awash with funds and needing to find an outlet for loans. Thus, the so-called recycling process began.

If the euphoria surrounding international lending waned a trifle on account of the uncertainties associated with the oil crisis, it was a series of major bank failures—the most publicized being the

Herrstatt bankruptcy of mid-1974—that called a halt to the “go-go” expansionary phase of banking. The failures gave bankers the jitters, and many of the smaller institutions were pushed out of the market by “tiering” of money rates and the perceived higher risks of international lending. Big established banks also became cautious and revaluated their international portfolios.

The bankers’ uneasiness was reflected in a radical change in lending behaviour. Loans suddenly became more difficult to secure. As is shown in table 3, the volume of lending to Latin America fell by more than 50 per cent in the third quarter of 1974.¹¹ Lending recovered somewhat in the last quarter (probably because of roll-over requirements), only to go flat again in early 1975.

Table 3
PUBLICIZED EUROCURRENCY CREDITS FOR LATIN AMERICA

(Billions of dollars)

1973	1974				1975			
	I	II	III	IV	I	II	III	IV
3.2	1.0	1.3	0.6	1.1	0.7	1.1	1.5	2.1

Source: IBRD, *Borrowing in international capital markets*, various issues.

This cautiousness was accompanied by a severe hardening of terms. Interest rates skyrocketed (6-month deposit rates reached over 14 per cent in August

⁹ For additional information on Brazil’s experience with foreign bank loans see the study on Brazil in CEPAL, *Economic Survey of Latin America, 1975*.

¹⁰ Morgan Guaranty Trust Company, *World Financial Markets*, October 20, 1975, p. 4.

1974) and spreads rose to the neighbourhood of 1 1/2-1 3/4 per cent. Moreover, maturities showed a sharp contraction. As can be seen in table 4, in the second half of 1974 long-term loans became much less plentiful; by the first half of

¹¹ Data in table 3 are for authorizations and therefore are not necessarily in conformity with the trends for loans indicated in section I, which are based on actual disbursements.

Table 4
**PUBLICIZED EUROCURRENCY CREDITS, BY MATURITY, FOR ALL
 DEVELOPING COUNTRIES**
(Percentages)

	1973	1974				1975			
		I	II	III	IV	I	II	III	IV
1-6 years	8.1	20.6	12.5	12.5	25.9	65.6	74.7	76.1	78.2
7-10 years	47.7	58.8	67.9	74.1	52.8	24.8	16.5	16.8	18.1
Over 10 years	36.2	14.6	14.6	5.4	13.9	5.7	4.5	—	—
Unknown	8.0	6.0	5.0	8.0	7.4	3.8	4.3	7.1	3.7
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IBRD, *Borrowing in international capital markets*, various issues.

1975 only 31 per cent of all publicized Eurocurrency credits to developing countries had a maturity in excess of 6 years, as against 73 per cent for the corresponding period of 1974.

As 1975 progressed, bankers found that they had to relax somewhat their restrictive attitude towards lending to LDCs. In the first place, demand for loans in the industrialized countries was slack because of the recession there, so banks, still flooded with OPEC receipts, were in need of an outlet, and therefore had to lend to the only area where demand remained strong—the developing world. Secondly, by that time some developing countries—for example, Brazil—had become important clients of the banks, and if their loans were not rolled over, the banks themselves would face the possibility of serious losses.

While banks resumed their lending to Latin America, conditions at the close of 1975 were dramatically different from those prevailing in the expansionary peri-

od. Banks remained very cautious about lending and tended to favour larger borrowers who had established themselves as clients; smaller borrowers in the developing world were often marginalized. Of greater importance was the fact that lending terms became even more onerous. Although the London Interbank Offer Rate (LIBOR) subsided from the high levels of 1974, spreads rose to 2 per cent or more and, as seen in table 4, longer-term maturities all but disappeared from the market.

B. Other factors

The above remarks suggest that the increased access to foreign loan capital after 1967 was to some extent supply-led, reflecting first the forces of a dramatic restructuring of the world banking industry, and then later on the financial upheaval created by the oil crisis. But there were other important factors in play as well.

The cyclical export boom that was experienced by many countries in the late 1960s and early 1970s—and is evidenced in figure 1 by the rise in the purchasing power of Latin America's exports—made them appear more creditworthy, from the banks' point of view, precisely at the time when these institutions were vigorously competing for secondary markets in developing areas. And there was considerable demand for such loans.

Many governments had found the growth of official financing inadequate with respect to their ambitions for increased investment and economic growth. The Eurocurrency market was therefore a welcome source of new finance. Moreover, conditions were attractive. In 1971-1973, when Latin America's borrowing from banks began its real take-off, premiums on interest rates were declining and the margins between commercial rates and official rates were significantly reduced.¹² And while commercial maturities of 10-15 years were shorter than those of 20-30 years usually offered by official institutions, some compensation was afforded by the avail-

ability of credit and the quickness with which banks habitually authorized and disbursed funds.

Another factor in the initiation of bank loans was the enormous penetration of transnational corporations into the countries of the region (particularly Brazil and Mexico). For various reasons, including a desire to enhance earnings growth and security, these corporations often followed an investment strategy that minimized equity contributions in favour of debt financing. Being intimately associated with private banks, transnationals naturally sought to finance the hard currency costs of their expansion with international bank capital.

Finally, the oil crisis greatly increased the current-account deficits of most countries in the region. In order to forestall drastic reductions in economic growth and avert socio-political stress, they were compelled to borrow. Since adequate assistance was not forthcoming from official institutions, the countries turned to banks. As noted earlier, banks had their own vested reasons for wanting to respond to this need.

¹² The average Eurodollar rate for the period 1967-1971 was 7.34 per cent. Brazil and Mexico were able to contract spreads hovering around 1.1/2 and 1 per cent in 1972 and 1973, respectively, suggesting a historical rate of 8.34-8.84 per cent. The World Bank lending rate at the time was 7.25 per cent. (The difference between the two rates would have

been somewhat greater for other countries in the region.) For short-sighted borrowers, Eurodollar credits could have proved extremely attractive. In 1972 the Eurodollar rate averaged 5.46 per cent, and even with a spread as high as 2.1/2 per cent, the margin over the World Bank rate would have been less than 3/4 per cent.

III

Some implications of the enlarged influx of foreign financial resources to Latin America

It is clear from the preceding considerations that the marked increase in flows of loan capital from private banks brought with it some very tangible benefits.

First, it initially helped Latin America to overcome an external bottleneck and achieve a very sharp rise in its capacity to import goods and services, which in turn stimulated an expansion of investment and economic growth. Then, with the advent of the oil crisis, bank capital was of particular benefit in helping to insulate the region from the full impact of oil-induced deficits, thereby warding off a jarring adjustment process.

Secondly, while banks had long played an important, if restricted, role in the finance of developing countries, the expansion of their lending activities at the beginning of the late 1960s introduced a refreshing plurality into development finance. Many countries found that they could break out of the straitjacket of official finance, which was available only in limited quantities and was often tied up in an excessive amount of red tape and politico-economic conditionality. Moreover, in the expansive phase of lending to developing countries (1971-1973), borrowers even found that there was a high degree of independence with regard to selection of banks because, as noted earlier, these institutions were competing keenly among themselves for new customers.

While bringing many tangible benefits, the increase in bank finance was also accompanied by some side-effects that

have to be viewed with a more wary eye. The most notable of these is that with the rise in loan finance came a marked increase in Latin America's dependency on foreign capital. But more importantly, because banks (which extended more than 50 per cent of total foreign capital resources in 1975) effectively displaced official institutions and direct foreign investment as the major agents of financing, the nature of the foreign dependency problem underwent radical change. This section will examine some of the quantitative and qualitative aspects of Latin America's dependence on foreign finance and then suggest that recent trends have generated some special problems for the region.

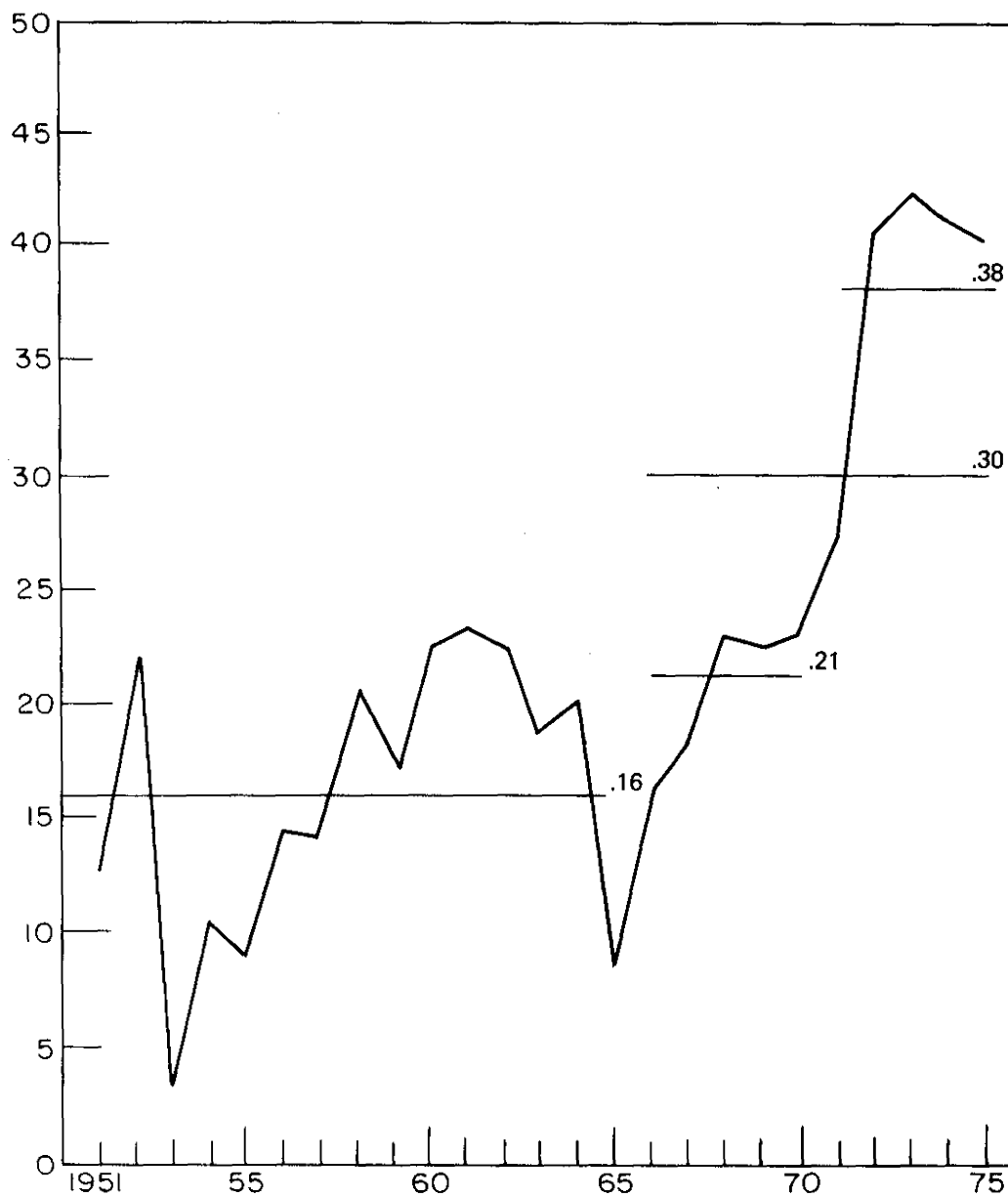
A. The extent of Latin America's dependence on foreign capital

The quantitative aspect of the dependency problem can be viewed from many angles. Here it will be examined in terms of import requirements and debt service obligations.

1. Foreign capital in relation to imports

Figure 6 presents the annual level of a coefficient relating net foreign capital inflows (including compensatory capital) to imports of goods and services over the periods 1951-1965 and 1966-1975. It also uses horizontal lines to indicate the average level of the coefficient for the basic periods considered in this paper.

Figure 6
LATIN AMERICA: NET FOREIGN CAPITAL FLOWS/IMPORTS OF
GOODS AND SERVICES, 1951-1975
(Coefficient)



Source: CEPAL, on the basis of official data.

As can be seen, the coefficient showed considerable variations during 1951-1965, but averaged 16 per cent for the period. After 1965 it climbed sharply and relatively steadily, indicating a much greater reliance on foreign capital flows to sustain the region's imports of goods and services. Notwithstanding a brief pause in 1968-1970, the coefficient rose from 8 per cent in 1965 to 28 per cent in 1971. Then in 1972 it shot up to such an extent that fully 41 per cent of the region's imports were underpinned by foreign capital. The coefficient remained above 40 per cent for the rest of the period.

What the above trend clearly shows is that during 1965-1975 Latin America dramatically increased its reliance on foreign resources for maintenance of imports. Not surprisingly, this dependence has also been reflected in much higher requirements for debt service.

2. Debt service requirements

While it is not the purpose of this paper to enter into detailed study of Latin America's debt *per se*,¹³ it is nevertheless worth while to review briefly the region's debt service requirements in respect of foreign capital, because this will help to give a clearer idea of the extent to which the region is reliant on external resources. The first step is to define just what is meant here by debt service on capital.

In its broadest sense debt service could include remittances of foreign investment income as well as amortization and net interest payments on outstand-

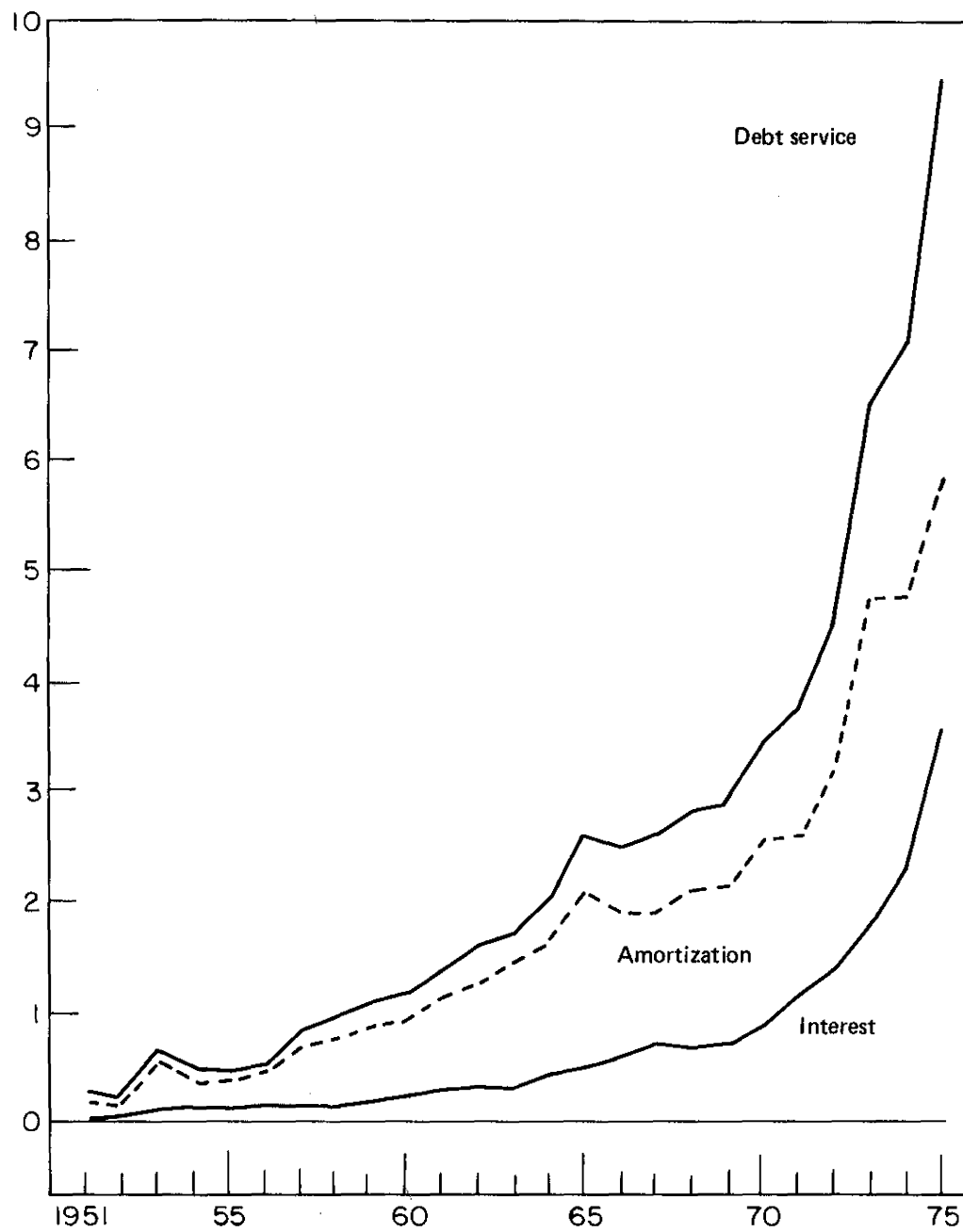
ing foreign loans. But it is more customary when reviewing the burden of service to apply a narrower concept that involves only payments on loans.

Loans display characteristics that clearly place them in the category of debt. When they are secured, the borrower is under a contractual obligation to repay the loan in a specified period. This usually involves a precise repayment schedule—often based on semi-annual or annual installments—that the borrower agrees to meet. Traditionally, repayment schedules are considered binding and foreign creditors usually take a dim view of attempts to modify them; indeed, failure to meet installments, or even indications that difficulty is being encountered, can jeopardize a country's creditworthiness and make it difficult to secure new loans and other finance. Thus, if a country is undergoing a foreign exchange crisis, and cannot roll over debt payments with new debt, it must compress imports or face the rather traumatic consequences of default and/or rescheduling.

Remittances of profits on direct foreign investment, on the other hand, do not display the binding characteristics of loans. Remittances are determined by earnings on investments and thus cannot be governed by a predetermined and fixed schedule. Although controls on remittances are generally frowned upon by industrialized countries, and can even provoke retaliation, it appears that latitude exists for governments to alter the outflow of remittances on any given level of investment. For instance, governments can introduce incentives for foreign companies to reinvest their earnings in the country instead of remitting them abroad. In the event of a short-term foreign exchange crisis, a government can often successfully exert

¹³ For a good survey of the debt situation, see Carlos Massad and Roberto Zahler, "Dos estudios sobre endeudamiento externo", *Cuadernos de la CEPAL*, Santiago, Chile, 1977.

Figure 7
LATIN AMERICA: DEBT SERVICE PAYMENTS, 1951-1975
(Billions of dollars at current prices)



Source: CEPAL, on the basis of official data.

“moral suasion” to induce foreign enterprises to delay or restrict their remittances; and in extreme cases governments have sometimes been able to introduce legal measures to restrict payments temporarily without doing irreparable damage to the so-called ‘foreign investment climate’.¹⁴

It is the greater degree of flexibility associated with foreign investment income that will cause it to be excluded from consideration of debt service. Remittances do, however, represent a charge against export earnings and reduce resources available for debt service. As will be seen, this factor will be taken into account when considering the burden of such payments.

(a) *Payments*

Figure 7 displays the evolution of the region’s debt service payments in *dollars at current prices*. Reflecting the increase in recourse to foreign loans, service payments follow an almost uninterrupted path of expansion during the 25-year period under review. The average nominal rate of growth is roughly 14 per cent per annum for both 1951-1965 and 1966-1975. There is, however, a noticeable acceleration of growth after 1969. The region’s debt payments rose from 2.9 billion dollars in 1969 to 9.5 billion dollars in 1975; in other words, they more than tripled in 6 years, representing an average growth rate of nearly 22 per cent per annum in current terms.

This sharp growth of payments reflects the increase in the level of borrowing that began to take place in

¹⁴ It should be noted that controls are not always completely effective because foreign corporations can disguise remittances in the form of transfer pricing or other accounting techniques.

the late 1960s. Another factor contributing to the expansion of payments was the greater recourse to commercial bank credit. As Latin America shifted its reliance from relatively soft to hard commercial loans, interest costs rose and maturities shortened accordingly.

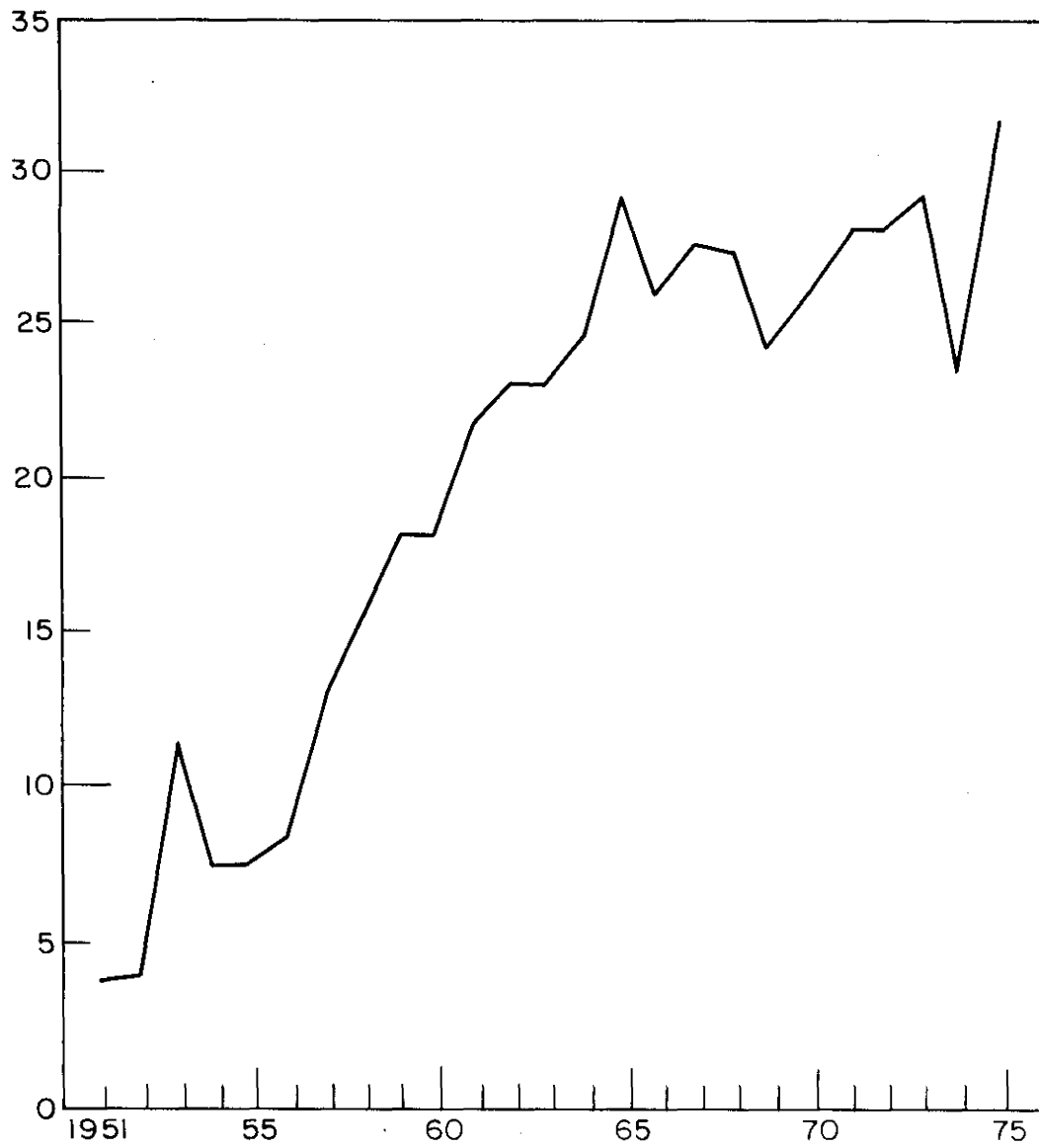
(b) *Burden of payments*

The burden of debt service payments is determined not so much by their absolute magnitude as by their size *vis-à-vis* ability to repay. A traditional ‘rough and ready’ measure of the burden is the debt service coefficient, which relates debt service to export earnings net of foreign investment income remitted abroad.¹⁵

Figure 8 presents the evolution of the region’s debt service ratio over the 25-year period under study. It shows that from 1951-1957 this ratio remained comparatively modest at less than 15 per cent. But in the next few years a new plateau was reached: by 1961 the ratio exceeded 20 per cent and by 1965 it had reached nearly 29 per cent. Thus, Latin America already had what could be termed a relatively burdensome load of

¹⁵ The ratio is only meant to be indicative as by itself it provides an incomplete picture of the burden. No single indicator or group of indicators can provide adequate information about the burden of service payments because many of the key components of a debt problem are not easily quantifiable. For instance, it is often difficult to ascertain at what point development objectives are becoming compromised by requirements to meet debt service obligations. Another crucial element that is difficult to assess is creditors’ willingness to “roll over” payments with new loans. Finally, indicators cannot adequately forecast events such as a bad harvest, political upheaval, etc., which can quickly convert a manageable debt service into a severe problem.

Figure 8
LATIN AMERICA: DEBT SERVICE RATIO, 1951-1975
(Coefficient)



Source: CEPAL, on the basis of official data.

debt prior to the massive rise in borrowing and service payments that occurred in 1966-1975.

It is interesting that the apparent burden of debt service did not change dramatically after 1965, even though, as noted earlier, payments grew very rapidly; indeed, until 1975, when the ratio rose to 32 per cent, the service coefficient actually remained below that recorded in 1965.

The movement of the debt service ratio was relatively restrained despite sharply accelerating payments, largely because export earnings were expanding as fast as debt payment obligations, or even faster. The year 1975 witnessed an abrupt change in trends, however, as export earnings stagnated because of the recession in the centre countries, while payments rose very sharply (33 per cent) because of the inevitable reverse flow on a rapidly growing mountain of debt. With roughly a third of the region's export earnings claimed by debt service, and prospects of a continued need for

heavy borrowing, it is not surprising that 1975 was marked by the beginning of a heated controversy in both the North and the South about the debt problem of developing countries.

The magnitude of the debt problem, and how it relates to the dependency issue, can perhaps be better appreciated if trends are viewed from another, less traditional angle, i.e., that of the manner in which debt payments are really effected.

In order to repay debt, Latin America has had to generate sufficient amounts of foreign exchange. The principal sources of foreign exchange, exclusive of new loans, are exports, direct foreign investment and transfers (private and official). However, in order to determine the real availability of this foreign exchange, net balances must be accounted for, that is, exports less imports, foreign investment less remittances, and transfers net of similar flows going abroad.

Table 5 presents the current annual

Table 5
LATIN AMERICA: NET FOREIGN EXCHANGE EARNINGS,
EXCLUSIVE OF NEW LOANS

(Millions of dollars at current prices)

Year	Trade Balance	Direct foreign investment	Transfers	Total
1966	100	-360	236	-24
1967	-222	-538	249	-511
1968	-456	-398	201	-653
1969	-4	-330	227	-107
1970	-769	-474	334	-909
1971	-2 095	-222	305	-2 012
1972	-1 674	-79	340	-1 413
1973	-980	340	457	-183
1974	-9 471	521	472	-8 478
1975	-11 205	461	526	-10 218

Source: CEPAL, on the basis of official statistics.

values of the region's trade balance, net foreign investment flows, and net transfers for 1966-1975, the period in which foreign borrowing operations showed a marked acceleration. It is seen that when the net flows are taken together there was a deficit on the resource flow in every year.¹⁶ In other words, foreign exchange income consistently fell short of general payment obligations, not to mention obligations stemming from debt service.

If there was a chronic shortfall of income, how then, it may be asked, did Latin America manage to meet its debt service obligations? The answer is that

repayment was effected by securing new loans to cover interest and amortization obligations falling due on older loans, i.e., by a roll-over. Indeed, during the period under consideration, Latin America secured loans in quantities sufficient not only to roll over debt payments, but also to cover the deficit on general payments noted above and to accumulate foreign exchange reserves. The latter phenomenon would lead one to conclude that the remarkable accumulation of foreign exchange reserves after 1966 (see table 6) was generated not by surplus real income, but by foreign borrowing.

Table 6

**LATIN AMERICA: ANNUAL NET ACCUMULATION OF
FOREIGN EXCHANGE RESERVES**

(Millions of dollars at current prices)

1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
262	364	622	840	1 443	-4	2 554	3 381	-772	-2 348

Source: CEPAL, on the basis of official statistics.

The practice of paying off old loans with new ones is not uncommon in development or in commercial finance; indeed, few countries would probably actually want to repay their debt. However, the success of a roll-over policy is highly dependent on the willingness of creditors to respond. Furthermore, as interest is effectively capitalized, the amount creditors must consider for roll-over increases each year, with the pace of the spiral accelerating as interest rates rise and maturities shorten.

¹⁶ The negative resource flow is even larger when the net impact of errors and omissions, national assets, and SDR allocations is taken into account.

Many countries in Latin America are now largely dependent on banks for their roll-over operations. This appears to have made the region more vulnerable, because, as will be seen, the "commercialization" of external development finance has introduced some new and serious complications into debt management and development policy.

*B. Banks and the question of
vulnerability*

Banks have in a fairly short time come to dominate the external finance of developing countries. But their institutional and operational framework remains

wholly commercial. This can create complications because a developing country that has a disproportionate amount of finance channelled through banks becomes vulnerable to the exigencies of commercial finance, which are not always consonant with the requirements of development. Moreover, under the adverse conditions prevailing in the world economy today, complications deriving from the commercialization of development finance can become so severe as to threaten the development aspirations of the countries concerned.

The purpose of the following pages is to outline some of the characteristics of bank finance which are seen either to complicate or actually to conflict with the goals of development. The paper will then conclude with some ideas on ways in which the pressures generated by current trends can be relieved.

1. *Variable interest rates on loans*

With regard to interest paid on official finance, rates are usually kept cons-

tant throughout the life of a loan. Commercial loans, however, carry variable rates that are adjusted periodically (usually every 6 months) to the movement of LIBOR or a similar interbank rate. This may seriously complicate debt management, as interest charges are subject to the vagaries of financial markets and can rise suddenly without warning, as was the case in 1974, when uncertainties over the oil crisis, inflation, and jitters induced by a series of bank failures all caused LIBOR, and therefore interest payments, to skyrocket.

The available data presented in table 7 show that the London banks' bid rates for Eurodollar deposits—which represent a conservative approximation to LIBOR—rose from a monthly average of 8.3 per cent in the first half of 1973 to 10.6 per cent in the first half of 1974, i.e., increased by 28 per cent. Even more telling is the degree of variation that is encountered if the low bid of 1973 is compared with the high bid of 1974; at the beginning of the former year the rate was as low as 6.8 per cent, while towards

Table 7
SIX-MONTHS DEPOSIT RATE FOR EURODOLLARS
(Per cent per annum)

		<i>Highest</i>	<i>Lowest</i>	<i>Monthly average</i>
1973	1st half	9.3	6.8	8.3
	2nd half	11.5	8.8	10.3
1974	1st half	13.4	8.5	10.6
	2nd half	14.1	10.1	11.8
1975	1st half	7.8	7.0	7.5
	2nd half	8.7	6.6	7.7
1976	1st half	7.3	5.9	6.4
	2nd half	6.5	5.3	5.9
1977	1st half	6.3	5.7	5.8

Source: World Bank, *Borrowing in International Capital Markets*, various issues.

the end of the latter it had climbed as high as 14.1 per cent.

Admittedly, the period referred to above was a rather turbulent one in the banking industry, and as seen in the table, fluctuations smoothed out considerably in 1975-1977. However, the point to be made here is that variable rates render countries with heavy commercial debt more susceptible to the shocks of international finance and thereby introduce another element of uncertainty into economic management, already made difficult by the volatile nature of world commodity trade.

It should be remembered, too, that the Eurocurrency market is particularly susceptible to shocks and turbulence in view of the fact that it operates in a kind of regulatory limbo.

As is by now well known, the Eurocurrency market originally developed in a rather *ad hoc* fashion, in part out of attempts of commercial banks to evade financial restrictions imposed by national governments. Thus, the market operates in a free-wheeling environment in which banks are able to escape regulations—such as reserve requirements—that national banking authorities customarily feel it prudent to apply in their domestic financial markets. Consequently, there is at present little information on, or control of, international banking operations.

The lack of control has created problems for many countries, as billions of dollars have sloshed around world markets, often contributing to radical fluctuations in the balance of payments, exchange rates and domestic liquidity. But more importantly, because international banking transcends national boundaries, there is often no clearly-

established bank of last resort to bolster institutions weakened by bad loans or investments. This characteristic (which might well be the Achilles' heel of the international banking system), coupled with a high degree of interdependence among banks, can cause international bankers to become nervous over events which would normally be viewed more or less calmly at home. This in turn can be disruptive to Latin American countries dependent on bank finance, since a nervous market usually manifests itself in rising interest costs, and possibly a contraction in the volume and/or the maturity structure of new loans.

2. *Hard lending terms*

Generally speaking, the cost of bank credit is greater than that of credits available from official institutions. Even in the realm of commercial rates, developing countries usually have to agree to accept considerably higher spreads than are commonly granted to the industrialized countries, on the grounds that greater risks are involved. When developing countries borrow at spreads as high as in 1974-1977 (1 1/2-2 per cent or more), they lock themselves into a rate structure which—given the variable nature of interest rates—may involve very burdensome payments. Moreover, spreads often understate effective costs, since recent trends have shown banks willing to conceal margins in a labyrinth of bankers' fees.¹⁷

¹⁷ Given that spreads are supposed to correspond to the bankers' perception of risk (creditworthiness), countries are often reluctant to have unusually large spreads publicized. In consideration of this concern, bankers often hide margins in the myriad fees that customarily accompany syndication of a loan.

It is true that in many cases the cost of commercial credit is reasonable when viewed in real terms and/or in comparison with the cost of domestic credit. Moreover, if the rate on the loan remains below the marginal return on capital—something that may be hard to ensure, given variable rates—the higher cost can be fully accommodated.

More serious, however, is the problem of the rather short maturities associated with commercial loans. While official institutions commonly offer 20-30 years on their credits, banks extend much shorter maturities; since 1975 they have been in the habit of offering a maximum of 5-7 years on theirs. Loans with such a repayment schedule do not seem generally suitable for project finance, as the number of investments with a payout upon maturity would appear limited. It is possible, of course, for banks to refinance their loans when they fall due, but this is clearly an unsatisfactory and dangerous method of financing long-term capital investment in developing countries; it introduces more uncertainty and makes a country more vulnerable to the changing attitudes of bankers and the variable conditions of financial markets.

It has already been mentioned that in the earlier part of the decade the terms for commercial bank credits could prove to be more favourable, as it was not uncommon for developing countries to attract margins below 1 per cent and maturities in the range of 10-15 years. What is the likelihood of commercial lending terms returning to the levels of the early 1970s? This is purely a matter of speculation, but it is worth noting that there has been considerable resistance on the part of bankers to a softening of terms, as it seems that there is now a new awareness that internation-

al lending is not immune from the allegation of “borrowing short and lending long”. Indeed, the terms extended during the expansive period of banking may have been a novelty stemming from exceptional circumstances; evidently bankers will (or should) be reluctant to depart radically from their restrictive posture, which is much more in line with traditionally prudent lending practices.¹⁸

3. *The short-term horizon of commercial finance*

Banks, as traditional lenders of short-term commercial finance, naturally had an infrastructure geared to these operations. Their creditworthiness criteria and analyses reflected this situation, being largely financial, commercial and short-term in nature. These institutions adjusted to the rise in bank lending to developing countries by incorporating more country analyses into their creditworthiness evaluations, but attention was still primarily focused on short-term financial criteria such as exports, inflation rates, money supply, reserves levels, etc.; minimum emphasis was placed on long-term trends and indicators of development *per se*, such as the amount of critical poverty in a country, its employment situation, income distribution, mortality and literacy rates, etc. The trouble is that under these circumstances a country that is heavily reliant on bank credit may be encouraged to pursue a style of development which maximizes indicators of external solvency at the expense of important socio-economic development objectives.

¹⁸ Richard Cummings, “International Credits — Milestones or Millstones”, *Journal of Commercial Bank Lending*, January 1975, pp. 40-52.

Another problem associated with the banks' short-term and essentially commercial orientation is that they can have a rather low threshold with regard to the weathering of the debt problems that frequently attack developing countries. When a country first encounters difficulties, banks normally roll over credits because it is in their interest to do so. However, in providing finance they naturally want to minimize their risk, with the result that they extend new credits on a short leash, that is to say with the briefest maturity and a high interest rate. Thus, instead of accommodating a country with terms that help to smooth out payments and provide extended relief, banks generally prefer stopgap financing that often provokes the need for further tinkering and may even contribute to a crisis that makes formal rescheduling necessary. (The latter can be somewhat traumatic and associated with abrupt changes in political and economic policy.)

It is important to note that some of the sharper edges of the commercial orientation of banks may have been blunted slightly by recent trends. As already noted, since the Herrstatt collapse the banking market has been taken over by larger institutions. Some of these banks have had the resources and the good sense to contract senior personnel with extensive experience in development issues; this presumably will help to sensitize top management to the problems encountered by developing countries and the diverse strategies that can be employed to overcome them. But there is nevertheless a limit to how far banks can adapt themselves to the longer-term requirements of development, inasmuch as they are constrained by commercial considerations and the laws of prudent banking; after all, a

bank's primary interests are correctly linked to those of its depositors and private shareholders.

4. *Bank involvement in government policy*

One of the consequences of the banks' assumption of the major role in Latin America's external finance is that these institutions have gained enough leverage to exert direct influence on the formulation of government policy. And it is natural for banks to want to exercise this leverage, because when they are involved in broad-based balance-of-payments support, as has been the case since 1974, it is obvious that public policy decisions are a crucial factor in repayment, or, more exactly, requirements for new lending. In other words, balance-of-payments support is generally extended on the basis of the goodwill of government policy.

One of the first open expressions of intent in this regard appeared in early 1976, and is to be found in the following extract from a publication of a major international bank:

"...It is incumbent on banks to improve further their competence in appraising borrowing countries' economic and financial policies. The Fund (IMF) generally will be involved only in the critical cases where the necessity for internal adjustment is clearcut. But, in the less-than-critical cases, bank credit decisions also involve a judgement on the way an economy is managed and on the prospects for the balance of payments. In deciding whether to extend credits, and in setting the terms and conditions for loans, banks can influence the nature and timing of borrowing countries' poli-

cies. This is a heavy responsibility, and admittedly one which is difficult to carry out, particularly in the face of competitive pressures. However, from the viewpoint of the borrower, the discipline of the marketplace can have an important bearing on whether sound economic and financial policies are taken on a timely basis."¹⁹

The intent expressed on this occasion was quickly acted upon, as witnessed by the widely-reported case of Peru. In July 1976 a large loan was organized for Peru by a group of big international banks on the condition that an acceptable stabilization programme be adopted. Furthermore, the loan was to be disbursed in two tranches, with the second tranche made contingent on the performance of the programme, which was to be monitored by the country's private creditors.

What appeared to be open involvement in Peruvian public policy generated concern in many circles, largely on account of doubts about whether banks were institutionally equipped to cope with the highly technical and political nature of a stabilization programme. Thus, these banks subsequently retreated somewhat from their original position on direct involvement in government policy. Some of them are now suggesting direct or indirect collaboration with IMF as an alternative way to protect their interests.

The point to be made here is that as long as banks dominate a country's development finance they have *de facto* leverage to exert pressure on public policy, and if it is not used directly as in the case of Peru, they will be tempted to

exercise it in a myriad more subtle ways that need not be discussed here. (It must be remembered that banks have a logical desire to protect their depositors and private shareholders.) And involvement in policy, whether direct or indirect, is undesirable by virtue of the fact that banks are commercial and not development institutions. Not only can their short-term commercial orientation be prejudicial to the continuity of public development programmes, but in the exertion of influence on public policy the possibilities for conflicts of interest obviously loom quite large.

C. Conclusions

The preceding discussion has shown that the commercialization of external finance places new uncertainties in the path of development and seriously complicates economic management. This in itself is cause for concern, although one might expect that public officials in some of the more advanced developing countries like those in Latin America could perhaps mobilize their talent and imagination to surmount or at least neutralize some of the difficulties associated with dependence on bank finance. However, conditions are not normal; indeed, the heavy reliance of countries on bank finance is in part a symptom of the abnormal events that are having to be faced by Latin America and the developing world.

As is well known, since the oil crisis the international economy has been highly unsettled and plagued by stagflation, high unemployment, grave financial imbalances and a severe and prolonged recession. In such an adverse external environment it is not surprising that even the best-managed non-oil developing economies are finding themselves taxed by

¹⁹ Morgan Guaranty Trust Company of New York, *World Financial Markets*, May 1976, p. 9.

the weight of their commercial obligations. While countries continue to honour these obligations, they do so at the cost of disruptions in growth, in employment and in overall development objectives. Moreover, with little prospect of an early straightening-out of the world economy, more serious problems may develop, as countries are now beginning to feel the impact of the bunching of maturities brought on by the contraction of bank lending terms in 1975.

These conditions alone would suggest that internationally-sponsored corrective measures are in order if serious and ill-afforded setbacks are to be avoided in the Third World. But the argument for a bold multilateral approach to current difficulties is strengthened if one takes it into account that developing countries' commercial debt evolved in rather haphazard fashion and as the result of autonomous forces over which borrowers at times had only limited control.

As noted earlier in this paper, the initial penetration of banks into external finance appeared to be largely supplied. In the race for marginal earning, banks were extremely eager to extend credit, the attitude of the times perhaps being best summed up in a remark made by one local banker of the region:

"Foreign bankers wanted to give us money before we asked for it. The Italians had lira for our dam. The French had francs for our steel mill."²⁰

And the offer of loans was accompanied by highly attractive terms which proved to be unsustainable. Also, in the

²⁰ See Everett Martin, "Peru's economic woes are worrying bankers who aid Third World", *Wall Street Journal*, September 1, 1977.

eagerness to expand, the institutional machinery for evaluating credits often lagged far behind the ability and willingness of bankers to lend, with the result that sometimes insufficient attention was given to key issues such as the use of credit, facility of maturity transformation, and even the medium-term ability of a country to generate foreign exchange to service its debt.²¹

The excesses of the period were then compounded by the oil crisis. Since the industrialized countries and OPEC were unable to respond with an official multilateral mechanism to handle the recycling of surplus receipts to deficit countries, the job fell in *ad hoc* fashion to the banks. These institutions were therefore forced to assume a role for which they were neither prepared nor well-suited. As a result banks lent and countries borrowed considerably more than they would have considered wise if viable alternatives had been made available to them. Another consequence was that the initial plurality that banks gave to the development finance scene was eroded as they came virtually to control access to credit.

Thus, the justification for international action appears to be strong. First, a commercialized type of external finance is not altogether satisfactory for the longer-term needs of development.

²¹ Perhaps the most glaring example of prudence taking a back seat is the much-publicized case of Zaire. This African country has a per capita income of only 140 dollars (1973). Yet banks saw fit to lend this relatively backward country resources in the neighbourhood of 800 million dollars (including guaranteed export credits); much of it seemingly on the basis of the euphoria generated by cyclically high copper prices. When copper prices plummeted, the country found itself unable to repay the banks.

Secondly, the process of commercialization itself was haphazard and lacked discipline. Thirdly, the present state of the international economy is slowly sapping the strength of non-oil developing countries to resist the quantitative and qualitative effects of a highly commercialized finance structure.

What then are the solutions?

On paper the formula is simple. In practice, however, implementation will prove difficult because much depends on the willingness of the centre countries to assume responsibilities which they have shown reluctance to accept. OPEC too, and the deficit developing countries themselves, cannot escape hard decisions.

One solution that has received much attention to date is the need for adjustment by deficit and surplus countries, with its consequent reduction of the need for bank finance. While this proposal has merit, it encounters serious practical limitations for reasons that are well stated by J.A. Kirbyshire, Chief Advisor to the Bank of England:

“To recognise that there is indeed a large –and continuing– adjustment element in the recent [world] situation is not necessarily to admit that financing has been excessive or that more adjustment should have taken place. That question calls for very difficult judgements, and it is fortunately not my primary concern today. I would only say, against the present background of high world unemployment and rates of inflation, that unless the adjustment can be initiated by the countries which are externally stronger, it is likely to be very costly in terms of world economic activity. On the other hand, if too much of the adjustment is borne by these countries, there is

an obvious danger of recrudescence of inflation. If policies destructive of world trade and widespread financial disruption are to be avoided, we may have to err on the side of more financing and slower adjustment than might otherwise seem desirable.”²²

And it can be added to Kirbyshire's remarks that the requirements for finance are likely to remain especially high for deficit developing countries because their ability to adjust is limited by their sheer poverty.

Given the likelihood of continued heavy financing requirements, the first and most obvious measure to relieve problems is for the centre and OPEC to make a determined effort to correct once and for all the glaring imbalance in the types of finance available to developing countries. To this end, a sharp increase in funding of official institutions, especially of the multilateral type, is called for. Funding should be sufficient for these institutions to continue to attend to the very poor and at the same time provide a better response to the financial needs of ‘middle-class’ developing countries like those in Latin America, which have been marginalized from official finance in part because of the inability of industrialized nations to meet their commitments for international development assistance (1 per cent of GNP). The new 10-billion-dollar IMF facility would be a step in the right direction, although most observers feel that it falls considerably short of financing requirements. Moreover, it will

²² J.A. Kirbyshire, “Should developments in the Euro-markets be a source of concern to regulatory authorities?”, *Bank of England Quarterly Bulletin*, vol. 17, no. 1, March 1977, p. 43.

not be sufficient merely to fund the IMF; the capital base of institutions like the World Bank, Inter-American Development Bank, Asian Development Bank, Caribbean Development Bank, etc., must be greatly expanded so that they can provide much-needed long-term investment funds to developing countries.

In addition to the funding of more official finance, there must also be a reversal of recent trends towards pressure on official institutions to commercialize their lending terms.²³ While some firming of interest rates might be necessary to attract capital, this should be counterbalanced by a softening of maturities; indeed, it seems reasonable that even middle-class countries should have regular access to loans with repayment periods of up to 30-40 years in order to meet their longer-term investment requirements.

Furthermore, official institutions should be encouraged to streamline their operations so that there is less red tape and delay in disbursement of their funds. With regard to balance-of-payments assistance, institutions should design conditionality so that it is more reasonable (especially with regard to the period of adjustment) and accommodates developing countries' legitimate efforts to maintain growth and minimize unemployment and socio-economic dislocation. If conditionality and red tape can be moderated, developing countries will

²³ In 1976 some industrialized countries had put pressure on the World Bank to harden its interest rates (even to the extent of charging a floating rate) and reduce the accelerated growth of lending. Meanwhile, official export agencies had been attempting to implement a gentleman's agreement to harmonize (read: reduce competition) on the terms offered to borrowers.

be less tempted to seek out inappropriate sources of finance.

With regard to private finance, industrialized countries should take active measures to give developing countries easier access to their bond markets. To the extent that developing countries have access to private sources of development finance, it is these capital markets which are best suited to cover such countries' long-term investment needs.

The increased financing from official institutions and capital markets will remove pressure from banks, which are now showing clear signs of concern about the share of developing countries' deficits that they are being asked to finance.²⁴ The banks, while maintaining a high profile in external finance, will then be able to withdraw to the area where they are best equipped to operate, that is, trade financing.

With a rejuvenation of official finance and promotion of readier access to more suitable sources of private investment finance, the middle class of the developing world would have a proper opportunity to select the mix of credit flows – from banks, official institutions, bonds, suppliers' credits, foreign direct investment, etc. – that is most suitable to their needs and level of development.

In conclusion, it may be said that developing countries themselves should

²⁴ Opposition has arisen to channelling more funds to international organizations on the grounds that this would represent a "bail-out" for banks. While such an argument may be ideologically pleasing to some, it is clearly counterproductive to the interests of developing countries which are suffering from the weight of their external obligations. It is also against the interests of the industrialized countries, because an overburdened banking system can be a source of instability in both domestic and international financial markets.

also reevaluate their development strategy of the last 10 years, which has involved very heavy recourse to external debt finance, in an endeavour to see if similar objectives cannot be achieved through greater reliance on national resources and ingenuity.

In many commercially indebted countries domestic policies have perhaps been geared too hard and too long on external debt. In some cases there is room for improvement in the domestic savings effort. In others, monetary and exchange rate policies can be adjusted to eliminate artificial incentives to borrow abroad. A further measure would involve continuation of export promotion activities. And, as some countries in the region have found, there may now be new opportunities for lowering import requirements through substitution.

In so far as countries find it necessary to borrow, they should carefully monitor loans to ensure that conditions

for maturity transformation are satisfactory and that the best available terms are secured.

Finally, special attention could be given to the investment strategies of transnational corporations. As noted earlier, there has been a tendency to finance expansion with ever-growing amounts of debt as opposed to equity contributions. Steps should be taken to see if subsidiaries of these corporations can be encouraged to substitute increased equity contributions from the parent firm for some of their foreign borrowing. This would have the effect of transferring some of the pressures of reverse payment flows on foreign private investment capital from debt service—over which governments have little control—to income remittances, which are more pliable and can be influenced by government policy (notwithstanding evasive techniques such as transfer pricing).

Informal-formal sector interrelationships

An exploration
into their nature

*Victor Tokman**

The essential object of this article is to put some order into the discussion of the informal sector. Since the ILO adopted the new term, there has been a spate of somewhat entangled discussion which has at least served to reanimate the debate on underdevelopment and give a better grasp of the relevant problems and solutions. The aim here is to study the limited but crucial question of the relations maintained by the informal sector with the rest of the economy.

The analysis of these relationships is very useful as a point of departure, since it permits a more orderly marshalling of the various theories propounded on the informal sector. They can be distinguished by the type of links they establish between the informal and the formal economy. Thus, in the first section, the author presents, with their different variants, the contrasting approaches which envisage these relationships as 'benign' or as characterized by exploitation, and outlines a view of his own, maintaining that they are relationships of 'heterogeneous subordination'.

In the second section he attempts to estimate, for Chile, the 'balance of payments' of the informal sector in relation to the rest of the economy, on the basis of information obtained from the national accounts; ending, in the third section, by interpreting the data from surveys carried out in Santiago on the characteristics and performance of informal commerce.

* Director, Regional Employment Programme for Latin America and the Caribbean (Programa Regional del Empleo para América Latina y el Caribe - PREALC).

A.

The theoretical discussion*

Although somewhat beyond the proposed scope of the present paper, I consider it important to describe at the outset what is understood by the informal sector. No universally-accepted definition of it exists, since, as will be seen later, the assumptions introduced with respect to its operation are diverse. There is, however, a measure of consensus to the effect that one general characteristic of the activities constituting the urban informal sector is the possibility of obtaining entry to them more easily than to those of the formal sector, owing both to technological factors and to the structure of the market. Predominant in the informal sector are activities structured on the basis of very small production units with low levels of technology, implying very modest capital requirements, both human and physical. The structure of employment in these activities is characterized by the identification of the enterprise with the individual, and if by any chance other labour is brought in, it is unpaid family help. In production units of this kind there is no marked division between the owners of capital and of labour such as exists in the formal sector, and, therefore, wages are not the most usual mode of remuneration, despite the fact that production is mainly for the market. From the foregoing features it can be deduced that

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informal activities are carried on in competitive markets.

The question posed by Hart (1973), who asked whether the reserve army of unemployed and underemployed really constitutes a passive, exploited majority or whether its informal economic activities possess some autonomous capacity for generating growth in the incomes of the urban poor is very relevant, since the answer to it will shed light on the nature of the sector, on anticipated trends and on policy requirements. To provide this answer an analysis of the accumulation process is required, and the discussion of that subject approaches it in two different ways.

On the one hand, it is argued that informal-sector activities generate a surplus, or can do so, provided that the policy environment does not discriminate against them. On the other, the opposite is sustained and it is argued that the main characteristic of informal activities is their incapacity for accumulation, which, in turn, is determined by the process of accumulation outside the sector and, in the last analysis, at the world level. The first approach assumes that the relationships between the informal sector and the rest of the economy are 'benign', while the latter allocates a subordinate or dependent character to informal activities.

Within each of these approaches, there is no agreement as to the degree of integration of the informal sector, and hence no single interpretation of the process exists. The closed or autonomous nature of the informal sector or its integration will imply different modes of insertion and will affect the accumulation process in a different manner.¹

¹ For a survey of the literature on the informal sector, see Tokman (1977).

1. *The benign relationship approach*

Those who introduced the discussion of the informal sector (Hart, 1970 and 1973; ILO, 1972), saw in it the potential for a more adequate pattern of growth with a more equalitarian distribution of income. For them, working in the informal sector was the way in which those who could not obtain a well remunerated job managed to produce or sell something which generated an income. Their ingenuity in making a living out of a situation of lack of access to resources and to markets and their capacity for survival under unfavourable conditions were for these authors the proof that they have the potentiality for developing their activities further. However, questions such as where this potential growth is located, what are the expected trends and what are the areas to which policies should be directed are closely linked to the question of whether the informal sector is envisaged as an autonomous self-contained segment of the economy or as a sector integrated with the rest of the economy in a complementary and hence benign manner.

(a) *Under conditions of autonomy: the duality approach*

The informal sector is seen by several authors (the ILO, 1972; Oshima, 1971; Sethuraman, 1975) as an autonomous segment characterized by providing employment and goods and services for the lower income groups of the urban population. As Oshima (1971) clearly explains, "proprietors and their family help and employees work for each other and buy each other's products" (p. 170). This, of course, implies that the sector is

also characterized by lack of links with the rest of the economy.

The autonomous informal sector is economically efficient and has comparative advantages in relation to similar activities developed in the formal sector. Its main advantage lies in the socially justified factor proportions used in the process of production, since labour is used to the maximum without exerting heavy pressures on capital or on foreign exchange. The latter is possible because, owing to the technology applied, only a small amount of capital is required and, in addition, second-hand or (judged by formal-sector criteria) obsolete machinery is generally used.²

The efficient use of the factors available generates an economic surplus which, if properly reinvested, can foster further growth. Most of the surplus is reinvested within the sector to minimize risks, while part of it is channelled through an informal financial system, usually at high rates of interest, or directly invested in relatives' businesses (Hart, 1970). Personal savings are indeed small³ and are largely devoted to house improvements and new constructions. This type of investment is not recorded in national accounts, but examples such as that given by Frankenhoff (1967) of

² This does not imply inefficiency, since it is explicitly argued both by Oshima (1970) and, especially, by the ILO (1972) that there is a wide range of operations in which the informal sector uses less capital per unit of production or can be made to do so through upgrading of techniques.

³ Oshima (1970) explicitly disagrees with this observation, since he considers that most of the persons within the informal sector are usually forced to dissave to survive. He further maintains that one of the positive effects of a policy in favour of the sector will be the elimination of dissavings.

capital formation in housing in 'favela' communities of Rio valued at more than 50 million dollars as of June 1966 give the impression that it reaches significant values and that the rehabilitation of such communities can constitute an economically more feasible alternative than their eradication and subsequent resettlement.

(b) *Under conditions of integration:
the complementarity approach*

The growth potentiality of the autonomous informal sector is reinforced when the sector is integrated with the rest of the economy, since the linkages are assumed to be complementary. The informal sector is envisaged within this analytical context as an 'exporter' of all types of products, but mainly services.⁴ It plays a crucial role in the circulation process by being located near to the consumers, by providing credit, by selling in as small units as required, and by keeping adequate stocks (Weeks, 1971; McGee, 1974). As McGee (1973) notes, informal traders are engaged in the vertical exchange of goods, either in selling foodstuffs to the urban population in upward vertical exchanges or selling urban-produced goods in what are often systems of downward vertical exchange, as in the case of textiles. The informal sector is also seen as supplying important services, such as transport and communications, in countries where those basic services are insufficient (Hart, 1970).

⁴ Hart (1973) suggests that illegitimate services are the main export of the informal sector. The terms importing and exporting are used with reference to inter-sectoral relationships, i.e., to the informal sector's purchases and sales from and to the rest of the economy.

The informal sector is then highly integrated with the rest of the economy, 'exporting' three-quarters of its production and 'importing' a similar proportion of its consumption. In addition, such integration is benign, since most of the exports are service activities—commerce and domestic services—which are complementary to formal production and are, only gradually affected by technological change (Webb 1974). The sector's capacity for accumulation is then enhanced by its access through these trade flows to the expanding markets of the rest of the economy.

(c) *Anticipated trends*

Those who visualize the informal sector as a source of potential growth, whether autonomous or integrated, argue that such growth can be evolutionary in the sense that an increasing labour force can be incorporated at higher average income levels.⁵ These trends cannot be anticipated *a priori* if the sector is autonomous, since although it is recognized that a capacity for accumulation exists within it, its rate of expansion is independent of the growth in the formal sector and of the increases in the labour supply of the informal sector. It is possible to imagine different types of situations which could imply, under autonomous conditions, either involutory or evolutionary growth.

Under integration conditions, in contrast, it can be anticipated that the

⁵ Weeks (1973) maintains that there is no doubt that the informal sector will grow: the only question is whether the growth will be involutory or evolutionary. In the first case a larger labour force is accommodated at a stagnant or declining level of real income, while in the second, the absorption is at higher income levels.

size of the informal sector will expand *pari passu* with the size of the formal sector, since complementary relationships prevail. This is consistent, however, with different patterns of growth within each sector, since it is more likely that productivity and average income in the informal sector will remain constant, while employment expands rapidly, whereas productivity per worker is rising faster than employment in the formal sector (Webb, 1974). Mazumdar (1976) develops this approach further and concludes that given stable propensities to consume informal-sector goods in the informal and in the formal sector, both can be expected to grow at the same rate. If a downward trend is anticipated because of the greater integration of the informal sector into the rest of the economy and the existence of a bias against the consumption of informal-sector goods within the formal sector, the rate of growth of the former will lag behind that of the latter.

The formulation of policies in favour of the informal sector is seen in the light of this approach not only as feasible, but also as highly necessary. As the ILO (1972) points out, "although the informal sector has potential for dynamic, evolutionary growth, under the existing nexus of restrictions and disincentives, the seeds of involutory growth have been sown" (p. 505). Since it is argued that the informal sector presents structural disadvantages⁶ because it has developed not only without the support of State policies but even in spite of

⁶ Emmerij (1974) uses the term 'inherent disadvantage', where it is assumed that the informal sector is always less efficient, as opposed to 'structural disadvantage', where the advantage of the formal sector is a consequence of the privileges it enjoys.

continuous harassment, an improved policy environment will shift resources towards the informal sector, allowing it to absorb the increasing labour force at higher levels of productivity (ILO, 1972; Weeks, 1973; Sethuraman, 1976). Policies can then be devised either within a framework of autonomy, as for instance, for technological improvement in the informal sector (Oshima, 1970), or in the context of a more integrated sector, with a view to strengthening its links through subcontracting with the public and the formal private sector, to increasing the sales of informal products (such as tools and equipment) to the agricultural sector, and to redistributing income in favour of the lower income groups (ILO, 1972; Weeks, 1972).

2. *The subordination approach*

The majority of the authors who conclude that informal activities are subordinated analyse the accumulation process at the world level and take the existence of the informal sector as the national counterpart of the prevailing unequal international system. The analysis of such relationships has been based on consideration of trade and price relationships (Prebisch, 1963; Amin, 1973), the transfer and incorporation of technology (Pinto, 1965; Quijano, 1974), and the role of transnational capital in the process (Arrighi, 1970; Sunkel, 1973; Bienefeld, 1975). The main thrust of the argument is that the process of accumulation in the developed countries is such that productivity gains are retained within the centres, while simultaneously, the gains in productivity registered on the periphery are appropriated through different mechanisms. Such mechanisms vary from international price determination and

market controls to institutional arrangements fostered by transnational capital.

As a result, the accumulation process on the periphery is subordinated and gives rise to a heterogeneous structure because technical progress does not penetrate uniformly but concentrates on the modern segments of the economy without destroying the old techniques, thus generating an overlapping process rather than one of substitution. The capacity for diffusion of such technical progress is in turn restricted by the low income-elasticity in respect of food products characterizing those who benefit from it, and by the bias of such technological change against the production of capital goods and the use of raw materials and in favour of using more capital-intensive techniques. The economic surplus is concentrated in the oligopolistic —mostly foreign-owned— firms, whose propensity to invest is mainly determined by the availability of foreign exchange for profits realization.⁷ The outcome of this accumulation process is a slow growth of labour demand and an upward shift in the labour-skill profile required. Both elements are combined with a rapid increase in the urban labour supply, creating an informal sector or marginal pole. In this sense, the relationships between the informal and formal sectors should be analysed as a component of a

⁷ Arrighi (1970) estimates that to ensure that foreign exchange is available to allow foreign corporations to repatriate profits and capital, gross foreign investment in tropical Africa should grow at an annual rate higher than 10-12 per cent. As such rates are unlikely according to historical records, it may be concluded that a downward accumulation process of falling propensity to invest and growing shortage of foreign exchange will take place.

subordinated system of interrelationships at the international level, and the transfer of the economic surplus generated within the informal sector to the rest of the economy should be viewed as an intermediate step in the transfer of the surplus from the periphery to the centre countries.

The mechanism of surplus transfer from the informal sector will be different, however, depending on whether the sector is autonomous or integrated into the rest of the economy.

(a) *Under conditions of autonomy: the marginality approach*

Several authors who maintain the thesis of the subordinated role of the informal sector, and especially those writing about marginality in Latin America (Quijano, 1974; Nun, 1969; Santos, 1972), implicitly assume that the informal sector is autonomous, i.e., independent of the rest of the economy. The mechanisms by which surplus extraction operates and by which the capacity for accumulation is thus restricted are mainly the effects of the existence of surplus labour, both in the formal sector and within the informal sector, and of the restricted access to modern inputs and to product markets.

The first classical mechanism is the depressing effect of the existence of a labour surplus on wages outside the informal sector. In Marxian terms this argument is similar to that of the industrial army reserve. Are the people employed in the informal sector playing the role of an industrial army reserve? Quijano (1974), Nun (1969) and Villavicencio (1976) deal directly with this question, differentiating the informal and marginal population from the industrial army reserve in the sense that

they are not temporarily but permanently excluded from that reserve, that they are not temporarily but permanently excluded from the formal sector, and that, owing to the nature of technical progress, the labour surplus is not needed for capitalist production and hence no longer constitutes a condition of existence of the system of production.⁸ On the other hand, the empirical evidence available suggests that technical progress in the formal sector has been followed by wage increases rather than price reductions. With capital mobility, increases in productivity should be absorbed by wage increases or price reductions: otherwise, the raising of the rate of profit will attract capital, in line with the known trend towards profit rate equalization. Under oligopoly conditions, rates of profit can be different, but even in this case the data show that increases in the productivity of the formal sector have been partly passed on in the form of higher wages.⁹

To explain why this situation prevails in contradiction with the existence of a labour surplus, several arguments have been presented. First, institutional factors, mainly trade union action but also government intervention, determine labour market segmentation in which labour mobility is restricted (Harberger, 1971; Nelson, 1971; Reynolds, 1965;

⁸ Cardoso (1971), discussing Nun's paper, does not accept this point and argues that the marginal population should be considered as part of the industrial army reserve.

⁹ The intensification of unequal exchanges between sectors within the developed economies with capital mobility gives rise to pressures for their elimination which are released mainly through inflation or more usually through transfers that lead to internationalization. This argument is clearly discussed by Bienefeld (1974).

Kerr, 1954; Doeringer and Piore, 1971; Gordon, 1971; Watchel and Betsey, 1973). This argument usually allocates the main responsibility for market imperfections to labour aristocracy, but obviously it overlooks the fact that monopoly power exercised by trade unions follows and does not precede the present labour market situation, or, in other words, is an effect of it and not its cause.¹⁰ A second argument, which is mainly used in neoclassical analysis, is that wage differentials are due to different skill requirements (Becker, 1964 and 1967; Mincer, 1970). However, empirical analyses show that income differentials between the informal and formal sector are only partially explained by differences in human capital, and that for equal skills sectoral differentials are around 50 per cent (Souza-Tokman, 1976; Merrick, 1976; Webb, 1974).

The main causes of such differentials are to be found within the formal sector. For the firms operating in it, the main consideration as regards labour is the stability of a large part of their working force, for which they are willing to pay higher wages. This willingness is combined with their ability to pay, since the highly capital-intensive technologies they use in their production processes reduce the share of labour in total income. There are additional secondary reasons which influence wage behaviour in the formal sector, connected with the fact

¹⁰ Indeed, as Arrighi (1970) points out, although trade unions will play a role of this kind in the future, the main cause lies in the structure of the labour market rather than in institutional factors. Mazumdar (1975) maintains the same argument on the basis of his study of the Bombay textile industry, where he found a segmented labour market well before the era of trade unions and government intervention.

that price reductions could lead to instability in product markets under oligopoly conditions, to the political advantage of having good industrial relations, and to the upward bias introduced by the greater international mobility of the hierarchical personnel (Arrighi, 1970; Bienefeld, 1974). Although the labour force employed in the informal sector does not play a role as an industrial reserve army for the formal sector, it can still play it within the sector by depressing labour incomes below the level that would otherwise prevail if a labour surplus were not present. This argument has been developed by Quijano (1974), who sees the marginal segment of the population playing such a role for the remaining segments under competitive capitalism and thus depressing wages within the sector and creating a surplus which will be transferred to the formal sector through financial mechanisms. Quijano, however, fails to see that demand for the informal sector's products is also restrained because of market subordination.

The second mechanism for subordination under conditions of autonomy is the lack of access to certain inputs and to product markets. The impossibility of obtaining stable access to basic production resources because these are monopolized by the formal sector means that informal activities can only operate on the basis of residual resources and are thus excluded from the possibility of technological improvement. The oligopolistic organization of product markets leaves for informal activities only those segments of the economy where the conditions of minimum size or stability are not attractive for oligopoly firms because they do not permit economies of scale and do not guarantee

adequate capital utilization. The possibilities of expansion of the informal sector are thus subordinated to product market access which, in turn, is determined by the oligopoly firms operating in the formal sector. In these conditions, growth is limited and can only be of a temporary nature, since after a certain minimum market size is reached, oligopoly firms will take over (Labini, 1966; Bienefeld, 1975; Souza-Tokman, 1976).

To sum up, the subordination of an autonomous informal sector operates mainly through the lack of access to resources of production and product markets. The industrial army reserve argument does not appear to hold good either intersectorally or within the informal sector. The outcome is that informal activities do not generate surplus and that their expansion does not depend on accumulation capacity within the sector, but rather on the size of the labour surplus which cannot be absorbed in the rest of the economy and on the market possibilities left by the formal sector. In this sense, subordination operates through lack of access and not through economic surplus extraction.¹¹ This subordination is reinforced through various mechanisms when the informal sector is integrated into the rest of the economy.

¹¹ This conclusion differs from that reached by Quijano (1974), who contends that the subordination operates through surplus extraction. He argues that the marginals contribute to the capital accumulation of the intermediate level not only as an industrial reserve army but also as exploited consumers. If capital accumulation at the intermediate level were reinvested at that level, it would not experience a tendency towards relative deterioration but, on the contrary, would have every possibility of developing in the same way as in the pre-capitalist period (p. 425).

(b) *Under integrated conditions of integration: the exploitation approach.*

Market subordination and lack of access to basic resources are reinforced by several other mechanisms when the informal sector is integrated into the rest of the economy in such a way that the surplus produced, if any, is extracted from it. These mechanisms are related to the higher prices paid for its purchases and the lower prices obtained for its output, the difference being reaped by the large-scale sector (Bose, 1974; Gerry, 1974; Bienefeld-Godfrey, 1976). The main purchases of an integrated informal sector are inputs, capital goods and final products for retailing while the output sold outside the sector consists of wage goods, intermediate products and personal services.

Gerry (1974) argues that there is an overwhelming degree of dependence upon capitalist industry for the provision of essential raw materials (both national and, mostly, imported). However, his data for informal manufacturing activities in Dakar (Senegal), where a bias in favour of closer integration is expected, show that the degree of dependence in respect of input supply varies with the type of product. Around 80 per cent of furniture producers, the majority of plastic shoemakers and most of the vehicle repairmen and metal workers using iron or steel depend on the formal sector for the supply of their inputs, whereas most of the shoe repairers and sandal-makers and the majority of those working with glass and aluminium obtain their supply from the informal sector, through the recovery or conversion of discarded materials.

A similar argument of dependence has been developed as regards the provision of capital goods, the depen-

dence being direct when new equipment is bought or indirect when it is a question of second-hand equipment. In both cases, it is agreed that the sector is dominated by a virtual monopoly of supply, repair and maintenance on the part of another form of production (Gerry, 1974). As in the case of inputs, the very scarce data available relate only to informal manufacturing activities and show that those using machinery and equipment are a small part of the total (13 per cent of furniture-makers and 31 per cent of shoemakers) and that the proportion of new machinery (generally paid for cash down) in relation to second-hand machinery varies with the type of product, although the former is always smaller than the latter, except in the case of metal transforming activities (Gerry, 1974). In informal commerce, the main part of the capital is kept as stocks (McGee, 1973), and in this case the interrelationships with the rest of the economy are to be found in the purchase of final goods for retailing.

Another subordination link through purchases from the formal sector is found in informal commerce, where it is argued that these activities are dependent for their supplies upon the formal sector, usually having to pay high prices which they cannot transfer to the consumer because of market constraints. In this sense, they serve as a cheap-labour commercial outlet for the formal production sector, whose firms appropriate the surplus generated at the production level (Marulanda, 1976). A distinction should be made between the types of goods traded, since the degree of dependence and the direction of the links will vary accordingly. For those who trade in raw foodstuffs, the main supplier is the agricultural sector, either directly through open market operations

or through wholesalers; while for those who trade in textiles and processed foods, the links are generally direct with the formal producers or with wholesalers. This pattern can be clearly seen in the case of hawkers in Hong Kong, where 70 per cent of those trading in textiles buy their goods direct from the factory or wholesale, as compared to 36 per cent of those operating in processed foods and to 15 per cent of raw-foodstuffs traders (McGee, 1973).

On the output side, the subordination links can operate through the sale of wage goods, through the subcontracting system, and through the supply of personal services. In the first case, it is argued that the sale of low-priced wage goods to the workers of the formal sector helps to generate a higher degree of exploitation in that sector by depressing wages (McGee, 1973; Leys, 1973; Bienefeld-Godfrey, 1976). This low price of wage goods is in turn made possible by the existence of a labour surplus within the sector and of market restrictions.

The previous discussion of the validity of the industrial reserve army argument is also relevant here, since if wages in the formal sector are benefiting from the productivity growth in that sector, the transfer of surplus will occur at least in part within the labour force. On the other hand, the fact that a large proportion of wage goods are raw foodstuffs makes the urban informal sector activities an intermediary rather than the main source of cheap food.

A similar argument applies in the case of subcontracting, since the sale of cheap intermediate products permits the formal enterprise to enlarge its profit rate by exploiting labour in some parts of the production process. Informal activities which sell their output to large

firms are then subordinated to them for prices and quantities and generally receive a smaller income than permanent workers within the formal sector for performing the same function. This type of activity is not very important within the informal sector, however, and it is concentrated in the clothing industry (Servicio del Empleo, Mexico-UNDP-PREALC, 1975; Gerry, 1974).

Finally, subordination also appears in the sale of personal services, where the labour surplus, lack of alternative job opportunities and low income-elasticity combine to determine small and rather stagnant returns.

On the whole, dependency in the case of an integrated informal sector affects both the sources of supply and the markets for the sector's products, as well as prices. Prices of purchases are generally higher because those in the sector can buy only small quantities and they do not have access to credit facilities, while the prices for their products, mostly services, are lower because of the market they depend on. In both cases prices tend to be fixed and markets controlled outside the sector. This subordinative relationship is, however, concentrated on the importing of goods for retailing and on the exporting of personal services (Frankenhoff, 1967; Bienefeld, 1974).

(c) *Anticipated trends*

The mechanisms through which the subordination of the informal sector operates depend on its degree of autonomy, but the outcome is always the same. In both situations, the prediction is that growth will be involutory, since either the market share will decrease or else it cannot expand permanently and the pressure of

an increasing labour supply will force average income downwards. This involution is inevitable, since informal activities present inherent disadvantages in comparison with formal activities (Quijano, 1974; Bienefeld, 1974; Arrighi, 1970). Room for policy formulation within this approach is indeed very narrow, since the main causes of underdevelopment lie not within the informal sector, not even within the peripheral economies, but in the accumulation process of the centre countries.

3. *A third approach*

(a) *The conceptual framework*

In this section a conceptual framework will be proposed which might allow adequate discussion of the informal sector. This framework is not entirely different from the two approaches discussed, since it presents common features with both of them, but it is much closer to the subordination approach than to the benign relationship approach.

Subordination at the international and national levels is a characteristic of underdevelopment, and the informal sector analysis is only one way to look at a much more comprehensive phenomenon. Internal subordination is expressed in lack of access to resources and markets, resulting in a limited capacity for accumulation and hence for expansion of the sector. The dependence nexus found in an integrated informal sector generally involves price differentials against the sector, but in the last analysis these are merely reflections of the said lack of access. The existence of subordinate relationships would be accepted even by those who support the

view that benign relationships predominate. The problem is to determine how strong is the subordination and whether there is room left for evolutionary growth. The informal sector should be seen neither as a completely integrated nor as an autonomous sector, but rather as one which has significant links with the rest of the economy but simultaneously presents a considerable degree of self-containment. Exports are mostly constituted by personal services, while the main imports are raw foodstuffs from the agricultural sector and processed foods and inputs from the urban formal sector. Subcontracting links will not generally be significant and will be restricted to clothing. For these operations to be important, a more integrated industrial structure than that which prevails in most of the less developed countries would be required. The installation of new industries generally implies the inauguration of national production of previously imported products or confrontation with an incipient industry which proves unable to survive. The possibilities of complementarity or survival in a competitive framework are higher in those cases where informal manufacturing activities are already well advanced.¹²

It is expected, however, that the informal sector will possess some degree of autonomy, not only because it internally supplies its own demand for most of the industrial goods, but mainly because of the influence of informal commerce activities and the importance of second-hand goods. The addition of

¹² This was seen to be the case when the industrial structures of Ecuador, Peru and Venezuela were compared. The degree of structural heterogeneity found was inversely related to the level of industrialization. See Tokman (1975).

informal commerce mark-ups to practically all imports from outside the sector will accordingly reduce the value transferred outside the sector, and the existence of a widespread second-hand market for durable consumer goods and machinery will diminish direct dependency while minimizing import expenditure.

(b) *A heterogeneous subordination*

Although a subordinated relationship with the rest of the economy prevails for the informal sector as a whole, this is the result of different processes occurring within it. In this sense, it is necessary to distinguish those groups of informal activities which are currently operating under oligopoly conditions from those where that is not the case. This dividing-line will generally coincide, though not always, with the breakdown of informal activities by type of product (manufacturing goods, personal services and services connected with distribution and finance) (Souza-Tokman, 1976; Bienefeld, 1975; Godfrey-Bienefeld, 1976; Tokman, 1976).

Those informal activities already operating under oligopoly conditions cannot be expected to expand permanently. The evolution of this type of market passes through different phases where informal activities will expand or contract depending on the rate of expansion of demand, minimum scale of operation for different sizes of establishments, economies of scale, etc. Although they may benefit from short-term profits, in the long run they will tend to lose markets. This is the case for most of the informal manufacturing activities.

The above argument does not necessarily imply that the informal activities operating under these conditions will

disappear, nor that they will do so in a fixed period of time. On the contrary, there are several factors which could produce a less pronounced trend or even an opposite one (Tokman, 1976, Steindl, n.d.). These factors are mainly related to the constraints on the expansion of the oligopolistic firms and to the existence of imperfect competition in product and especially in factor markets. Clientèle relations, location, and minimum size of sales are among the factors which operate within the former, while the predominance of family labour makes wages more flexible and allows for greater social security evasion.

In addition, there are political factors, such as the convenience for the large firms of not being presented to the government and public as monopolies, which lead them to tolerate the existence of informal activities. Finally, those employed in the sector are reluctant to leave their present jobs and are willing to take high risks at a very low level of income, especially when job opportunities outside the sector are limited.¹³ These economic causes are also associated with structural factors, which are specially important in the case of low-skill activities such as those of hawkers. In these cases, their location close to their home and public make them reluctant to move, and this in turn is linked to age, education and the non-existence of employment opportunities (McGee, 1973).

¹³ This reluctance to change activities is explained in economic terms. As family labour predominates within the sector, workers are willing to accept an income reduction rather than to reduce employment, since, given the lack of job opportunities outside the sector, this would imply open unemployment for those members of the family leaving the informal productive unit.

Within those informal activities which do not currently confront an oligopoly market, a distinction must be made between those cases where a trend in such a direction can be anticipated and those where that situation appears unlikely. The former possibility seems to apply to most of the manufactured products which are still entirely supplied by the informal sector, as in the case with shoe production in many developing countries. However, such a situation will prevail only until the size of the market justifies the establishment of an oligopoly firm, whereupon analysis under oligopolistic conditions will be applicable.

There are other informal activities, mainly personal services, where a trend to oligopolization seems unlikely over the medium term. Technological change in these activities is more gradual, and their subsistence in economies with higher income levels gives grounds for anticipating their expansion. Given their low income-elasticity, however, the expansion of such activities will not be rapid, and this is combined with the fact that income improvements based on productivity changes are not likely to occur. Under these conditions, as Bienefeld (1975) notes, if other activities do not pass on to prices the benefits of productivity gains, a form of 'unequal exchange' will then develop against the service workers.

An intermediate case which should be discussed further is that of informal commerce activities. Technological change within these is also gradual and oligopoly trends are slower. In addition, the factors which determine the survival of informal units under oligopoly conditions are very much present in this case. Market imperfections (especially demand behaviour at low income levels) intro-

duce a sort of product differentiation which ensures the permanence of these activities for longer periods than can be expected for, say, informal manufacturing activities. Location, personal owner-customer relationships, credit, infinite possibilities of product subdivision, permanent availability because of the inexistence of 'business hours', etc., are factors which allow them to maintain a share in the overall market. It is true that many of these factors are linked to insufficient purchasing power, and in the long run the introduction of supermarkets will imply much the same conditions as in the case of oligopoly markets. They are, however, entangled with cultural patterns which make changes in consumption patterns more difficult, as is well illustrated by the development of these activities in economies with higher levels of income.

(c) *Anticipated trends: some tentative conclusions.*

In conclusion, it would seem that we should expect a declining trend in the share of income for the sector as a whole, but this does not imply that the informal sector will disappear, not only because the pattern of development followed by the present developed countries has shown that informal activities subsist at very high income levels (Hobsbawn, 1969), but also because the resistance factors, together with market evolution, will allow their survival (Souza-Tokman, 1976; Bienefeld, 1975; Arrighi, 1970).

Given the composition of the informal sector's balance of payments, there are also grounds for expecting a declining trend in its terms of trade. This aspect should, however, be a matter of

further discussion, since the international dependence analysis cannot be automatically transplanted to the internal level. Although it is clear that both prices and markets are determined outside the sector, hence implying a dependence relationship, its balance-of-payments composition is diversified and mostly constituted by low income-elasticity goods. The prices of exports of personal services are not expected to grow at a rapid rate, but that rate should be mainly compared with price changes in foodstuffs (both processed and unprocessed), which are also characterized by their low income-elasticity. Weights, elasticities and prices of these balance-of-payments components should be further subjected to empirical analysis before trends can be anticipated.

The anticipated smaller share in total income, together with the expansion of the labour supply for the sector, give grounds for forecasting that if no measures are taken, involutory growth will occur. Informal-sector activities may display inherent disadvantages, if judged by formal-sector criteria, but they, in turn, depend on policy decisions, and in this sense the disadvantage of the informal sector should be considered structural. Evolutionary growth should then be feasible, but that implies going much further than providing a 'favourable policy environment' to avoid discrimination against the sector or supporting informal activities without attacking the causes of underdevelopment. Indeed, a substantial change in the prevailing international economic order is required, but this will not in itself be sufficient. Neither should national institutional changes alone be expected to change the observed pattern of growth. For such measures to be effective, they should be complemented with changes in

surplus distribution and allocation and with changes in the pattern of growth.¹⁴ This means that measures should be taken not only to favour informal activities but to affect directly formal-sector activities as well.

B.

The informal sector's balance of payments

1. *Objective*

In this section an attempt will be made to estimate the informal sector's balance of payments with the rest of the economy. Much of the theoretical discussion reviewed above 'assumes' different degrees of interrelationships between sectors, but very few data are supplied to test the alternative hypotheses presented. The quantification of the informal sector's balance of payments will enable us to analyse the degree of openness of the sector, if any, and the characteristics of the intersectoral links, and it will also provide some basis for exploring the behaviour of the terms of trade and market possibilities. The analysis will refer to the case of Chile.

2. *Sources and methodology*

In order to estimate the informal sector's balance of payments, a prerequisite is to calculate the complete set of production and income accounts of the sector. This task, in turn, makes it necessary to work with the national accounts of the country to avoid inconsistencies. In short, a disaggregation of the national accounts is needed, and, given the information available, such a task is

confronted with a number of problems. For this reason, the figures presented in this section should be considered as illustrations of a methodology and the conclusions reached should be carefully qualified.

No attempt will be made to describe in great detail the methodology and sources used. However, it is important to mention briefly the principal sources which were drawn upon, as well as the principal methodological steps followed. The national accounts served as the point of departure. To disaggregate the informal sector from the rest of the economy, several sources were used, mainly the population census of 1970 and the manufacturing industry census of 1967; the unpublished pre-census of manufactures in 1967, which made it possible to analyse the industrial establishments with fewer than five employees that were not included in the census; a national survey of small industrial establishments and artisan workshops (1967); a Greater Santiago household budget survey (1968); a national household income survey (1969); the periodical national survey of commercial and service activities; an input-output table for 1962 disaggregated by 54 sectors and its new 1965 version prepared by the RAS method; and additional unpublished information supplied by the Planning Office for this study.

The information was worked out at

¹⁴ This conclusion is also reached by Arrighi (1970) for tropical Africa.

the maximum level of disaggregation that the sources allowed. This implied working with manufacturing industry at three digits, construction, commerce divided into wholesale and retail, transportation divided into passenger, goods and means of transport, and services divided into nine different categories.

The first step was to estimate employment, production and value added in the informal sector, by branches. For this purpose, employment was estimated with the total labour force broken down by subsectors and by occupational position. In addition, the population and industrial censuses were

also used. Production and value added per employed person in each informal activity were then estimated on the basis of industrial pre-census and census data, the national survey of small industrial establishments, and the national survey of commerce and service activities (see table 1).

The second step was to estimate total consumption of the informal sector. Savings and direct taxation were assumed to be nil, since family savings are negative in the case of Chile, especially in the lower income brackets, and payments of direct taxes are also negligible at those income levels. Hence,

Table 1
CHILE: EMPLOYMENT, PRODUCTION AND VALUE ADDED IN THE
INFORMAL SECTOR, 1967

(Percentages)

	Employment ^a	Production ^b	Value added ^c
Foodstuffs, beverages and tobacco	(21.2)	(4.0)	(6.2)
Textiles, footwear, clothing and leather	(47.8)	(18.8)	(20.4)
Wood, cork and furniture	(44.4)	(15.9)	(19.2)
Non-metallic minerals	(15.7)	(2.0)	(2.0)
Metal products, machinery and transport equipment	(28.0)	(12.0)	(14.0)
Other industries	(37.9)	(22.3)	(20.4)
Total manufacturing industry	32.3	9.7	12.0
Construction	29.4	17.6	17.6
Personal services	44.9	20.8	24.8
Commerce	57.3	42.9	34.4
Transport	20.0	11.3	11.2
Housing	—	27.9	26.3
Total informal sector	757.5 ^d	7 395 623 ^e	4 876 489 ^e
Percentage of urban total	39.9	17.6	19.7
Percentage of total for country	27.5	14.7	15.7

Sources: Employment: ODEPLAN (1973); production and value added: INE (1971), DEC (1969) and unpublished data from INE and ODEPLAN.

^aAs percentages of total employment in each sector.

^bAs percentages of total production in each sector.

^cAs percentages of total value added in each sector.

^dIn thousands of persons.

^eIn thousands of escudos.

consumption was equal to net value added after deducting indirect taxes. The consumption of the informal sector by sector of origin was estimated by grouping the items which constitute the household expenditure of the lowest income bracket (those earning less than twice the minimum legal wage) into those goods and services produced and marketed outside the sector (electricity, gas, kerosene, etc.), those produced and marketed within the sector (bread, shoes, clothing, etc.), those produced by the rural sector and marketed by the informal sector (fruits and vegetables, milk, etc.) and those produced by the formal sector and marketed by the informal sector (processed foodstuffs, tobacco, beverages, appliances, etc.).

The third step was to estimate the intermediate production of the informal sector by sector of destination. For this purpose, the input-output tables of 1962 and 1967 were used. The fourth step was to allocate final demand between consumption and investment uses. Value added in informal construction activities was considered the only investment component, and consumption was estimated as a residual, assuming that no exports outside the country were made from the sector. As the amount of informal sector consumption supplied through goods and services generated within the sector was known from the second step, the remainder constituted sales of consumer goods and services to the rest of the economy.

Finally, the inputs of the informal sector were estimated by deducting the value added from total production. The allocation of inputs by sector of origin was effected by assuming that intermediate sales to the informal sector itself were known from step three, and by allocating the balance between the rural

and formal sectors on the basis of the input-output tables.

The basic information estimated with the methodology outlined above made it possible to estimate the balance of payments of the informal sector with the rest of the economy for 1967. Furthermore, intersectoral balances of payments between the informal and rural sectors and between the informal and formal sectors were also constructed (see table 2).

3. Findings

No attempt will be made to analyse the size and characteristics of the informal sector, though in fact this can be done with the information presented in the tables. It is worth noting, however, that employment in informal activities represented around 40 per cent of total urban employment and 27 per cent of national employment, while in urban production the sector's share was 18 per cent and in urban value added 15 per cent. The data also show that informal-sector employment and value added are highly concentrated in personal services and commerce, which account for 70 per cent of employment and 72 per cent of value added. Manufacturing accounts for 23 per cent of employment and 21 per cent of value added.

(a) *The balance-of-payments position*

The balance of payments of the informal sector with the rest of the economy registers a surplus equivalent to about 20 per cent of its exports. This implies that the sector is contributing that amount of resources to the expansion of the other sectors. However, the situation is not homogeneous, since

Table 2
CHILE: INFORMAL-SECTOR BALANCE OF PAYMENTS, 1967

	<i>Thousands of escudos</i>	<i>Percentages</i>
1. With the formal sector		
<i>Exports</i>	2 581 245	100.0
Intermediate goods	614 661	23.8
Consumer goods	1 877 874	72.8
Investment goods	88 710	3.4
<i>Imports</i>	1 795 039	100.0
Inputs	344 303	19.2
Consumer goods	1 450 736	80.8
<i>Surplus</i>	786 206	30.5 ^a
2. With the rural sector		
<i>Exports</i>	456 774	100.0
Intermediate goods	339 276	74.3
Consumer goods	117 498	25.7
<i>Imports</i>	642 237	100.0
Raw materials	93 310	14.5
Consumer goods	548 927	85.5
<i>Deficit</i>	-185 463	-40.6 ^a
3. Overall balance of payments		
<i>Exports</i>	3 038 019	44.7 ^b
<i>Imports</i>	2 437 276	35.9 ^b
<i>Balance</i>	600 743	19.8 ^a

Source: For the methodology used, see text. The main sources used were as follows: (i) the informal-sector production accounts by sector of origin were calculated on the basis of ODEPLAN (1973, 1965) and M. Gómez (1969); (ii) the uses of informal-sector income by sector were allocated by applying coefficients calculated on the basis of the DEC household budgets survey (1968-1969); (iii) the informal-sector production accounts by sector of distribution were calculated by disaggregating the input-output tables presented by ODEPLAN (1965) and M. Gómez (1969); (iv) the balance of payments was calculated from the three main accounts mentioned above.

^aAs percentages of exports.

^bAs percentages of available goods and services (production minus exports plus imports).

the breakdown of intersectoral trade flows clearly shows that while the informal sector transfers resources to the formal sector corresponding to around 30 per cent of its exports to the sector in question, it is in turn receiving transfers from the rural sector amounting to 41 per cent of its exports to that sector.

These results suggest that the informal sector is playing an intermediary role in the transfer of resources between the rural and the formal sector, but they also show that it is contributing in net terms to the resource availability of the latter (see again table 2).

Investment, mostly in housing, plus

the existence of a positive balance on the current account with the rest of the economy, indicates that the informal sector is generating a surplus of around 20 per cent of its income.¹⁵ This surplus coincides with the difference in the level of consumption per family between the population employed in the informal sector and the total urban population earning less than twice the nominal minimum wage. It seems difficult to explain this high propensity to save in a situation of underconsumption, but several hypotheses can be advanced for further research.

First, the accumulation process in the informal sector is greatly biased towards housing, both of the low-cost type and for the open market. The direct link between savings and either direct construction or the financial market acts as a strong incentive to sacrifice present consumption. In this sense, the payment of a house mortgage or the deposit made in order to be entitled to a subsequent loan constitutes a financial investment that could be consistent with the surplus registered in the balance of payments.¹⁶ The same argument can be applied in the case of vehicles, especially taxis, trucks and small buses. Secondly, the role of the State in this context should be

¹⁵ Given the difficulties of estimating investment in machinery and vehicles, total investment of the sector is taken as being equal to construction. However, a positive investment in vehicles or machinery will only affect the share of physical and financial investments, since an increase in imports of capital goods will reduce the balance-of-payments surplus.

¹⁶ This seems to be especially true of domestic services, which account for half of the balance-of-payments surplus. In this case, the very partial evidence available suggests that most of the savings are channelled through the low-cost housing market or through the public savings and loan system.

carefully analysed. The majority of the surplus generated by the sector is extracted by the State, mainly through indirect taxation; but it can also return directly tied to investment. Such is the case, for instance, with the net subsidy component of public housing programmes and with the replacement of vehicles for public transport. In this respect, the State will be directly financing all, or at least part, of the physical and financial investment made by the sector.

The results also suggest that the informal sector is in an intermediate position as regards to its degree of openness, since, contrary to the assumptions of numerous authors, it is neither completely self-contained nor closely integrated with the rest of the economy. The export share of the available goods and services within the informal sector (informal sector production minus its total exports plus its total imports) comes to 45 per cent, while the import share is around 36 per cent.

Analysis of the import structure by sector of origin and by type of goods shows that while the informal sector is relatively autonomous on the inputs side, supplying around 82 per cent of its requirements from within, it registers a greater degree of dependency on the consumption side. Around 51 per cent of total consumption is supplied from outside sources, especially the formal sector, which satisfies 37 per cent of total consumption (processed foodstuffs, basic services, durable goods, etc.).

The export structure reflects a mixed situation as regards the importance of the other sectors' markets as outlets for informal-sector production. Around 80 per cent of the investment made by the informal sector, mostly in construction, is placed within the sector, while

one-third of the informal intermediate products sold are exported to the rest of the economy, mainly commercial and transport services to the rural sector and all types of intermediate goods and services to the formal sector. The importance of markets outside the sector is greater in the case of consumer goods and services, since more than half of its total production of this type is sold to the formal sector, and comprises mainly commerce and personal services, but also a significant amount of informal manufactured goods (see table 3).

Table 3
INCOME-ELASTICITIES OF INFORMAL-SECTOR EXPORTS AND IMPORTS

	<i>Percentages</i>	<i>Elasticities</i>
<i>Exports</i>	100.0	1.943
Commerce and transport	34.4	1.446
Personal services	35.9	3.253
Construction	4.6	1.050
Manufactured goods	25.1	0.915
<i>Imports</i>	100.0	0.923
Rural inputs	3.8	0.446
Manufactured raw materials	14.1	1.171
Rural final goods	22.5	0.446
Processed foodstuffs	29.6	0.694
Basic services	17.9	0.806
Durable goods	12.1	2.414

Sources: Structure of exports and imports from table 2.
Elasticities from R. Roldan (1974).

To sum up, the balance-of-payments position of the informal sector shows that the sector is relatively integrated into the rest of the economy and that its main links are with the formal sector. Such links are mostly concentrated in exports of consumer goods and services (mainly commerce, personal services and some manufactured goods) and in imports of goods and services, also for consumption purposes (mainly processed foodstuffs, durable manufactured goods and basic services). On the other hand, it also shows that the formal sector receives resources from the informal

sector but that, in part, those resources are only channelled through the latter, since they originate primarily in the rural sector.

(b) *The balance-of-payments outlook*

Given the structure of the intersectoral trade flows, some exploration can be made of anticipated trends and historical price evolution. The first of these areas can be approached, very roughly, by analysing the income-elasticities for the different tradeable products, while the second can be

studied by analysing the changes registered in the terms of trade.

The study made by Roldan (1974) on consumption functions for Greater Santiago gives information on expenditure-elasticities by sector of origin and by income level for 1969. He presents two sets of elasticities: one for those families receiving less than twice the minimum wage, and the other for families with incomes higher than that limit. The first set of data can serve as a proxy for expenditure-elasticity of the persons employed in the informal sector and hence can provide an idea of changes in demand for imports on the part of the informal sector. The second set of data can be used to estimate the expected behaviour pattern of market possibilities for exports from the informal sector.

If the elasticities are weighted by the share of each type of good or service in total exports and imports, it can be seen that the average elasticity for exports of the informal sector is more than double the average elasticity of its imports. This is explained by the structure of imports and exports, since the former are concentrated on foodstuffs (processed and unprocessed), which are characterized by very low elasticities, while the latter are concentrated on commerce and personal services (mostly domestic services), which both show high elasticities (see table 3).¹⁷ This suggests that, if the distribution of income does not change significantly, one would expect an increasing surplus transfer from the informal to the formal sector. However, the trend followed will largely depend on the situation of the personal services

¹⁷ Even if domestic services are excluded, the elasticity of exports is still 36 per cent greater than that of imports.

market, since although the elasticity suggests a growing demand for such services, the net contribution will depend on the income paid, which, in turn, will be closely linked to labour force availability.

Finally, a terms-of-trade index comparing the changes in export and import prices during the 1960s can be constructed in order to analyse whether the surplus is being extracted from the sector through the same mechanism as is observable at the international level between peripheral and centre countries. For this purpose, different indexes were applied for each export and import component. On the export side, changes in commerce returns were calculated on the basis of the changes in retail prices of foodstuffs, assuming that margins were constant; changes in personal services incomes, on the basis of an index of domestic servant's wages; changes in construction returns, on the basis of an index of wages of unskilled construction workers; and changes in manufactured goods exports, on the basis of an index of prices of shoes and clothing. On the import side, the indexes used were: for unprocessed foodstuffs, an index of prices of ten fruits and vegetables; for processed foodstuffs, an index of prices of 14 goods; for public services, an index of electricity tariffs; and for durable goods, an index of electric iron prices (see table 4).

The resulting terms-of-trade index shows that the export and import prices of the informal sector changed at practically the same rate during the 1960-1970 period. If anything, the data suggest that the prices paid by the informal sector for its imports grew at a slower rate than the prices received for its exports, the result being an improvement in the terms of trade of around 12

Table 4
CHILE: INFORMAL-SECTOR TERMS OF TRADE, 1960-1970
(1967=100)

	<i>Export prices</i>					<i>Import prices</i>					<i>Terms of trade</i>
	<i>Comerce and transport</i>	<i>Personal services</i>	<i>Construction</i>	<i>Manufactured goods</i>	<i>Total exports</i>	<i>Rural goods</i>	<i>Manufactured goods</i>	<i>Basic Services</i>	<i>Durable manufactured good</i>	<i>Total imports</i>	
1960	19.0	13.3	13.7	21.7	17.3	17.5	17.9	17.4	18.5	17.7	97.7
1961	20.9	17.7	14.4	21.9	19.8	19.8	19.1	21.7	19.0	19.7	100.5
1962	24.5	20.3	18.0	24.0	22.5	24.5	22.2	21.7	21.6	22.6	99.6
1963	36.6	25.0	26.4	33.2	31.1	32.0	31.7	26.1	31.4	30.8	101.0
1964	55.0	36.3	41.1	45.6	45.2	48.8	44.2	39.1	43.6	44.4	101.8
1965	71.3	52.7	56.6	59.9	61.0	65.0	65.6	65.2	58.8	64.6	94.4
1966	87.4	78.3	79.3	77.2	81.2	85.6	83.7	87.0	73.3	83.6	97.1
1967	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1968	125.5	166.7	124.8	131.0	141.6	112.2	131.3	134.8	133.4	127.1	111.4
1969	163.9	227.0	153.5	175.2	189.0	185.3	170.5	191.3	172.3	178.2	106.1
1970	221.9	297.7	212.3	258.8	258.0	228.0	235.4	247.8	229.6	235.1	109.7

Sources: Export prices: Commerce and transport and food prices component of cost-of-living index for Greater Santiago, from Banco Central de Chile (several issues); personal services, domestic servants' wages from Superintendencia de Seguridad Social (several issues); construction, unskilled construction workers' wages, unpublished data from Cámara de la Construcción; manufactured goods, footwear and clothing prices, from INE (several issues).
Import prices: Rural goods, prices of 10 fruits and vegetables, from INE (several issues); manufactured goods, prices of 14 processed foodstuffs, from INE (several issues); basic services, electricity tariffs from INE (several issues); durable manufactured goods, changes in electric iron prices from INE (several issues).
Terms of trade: Export price index divided by import price index.

per cent in the course of the whole decade. The improvement is, however, concentrated in domestic services, and if these are excluded, the terms of trade deteriorate by about 8 per cent. The data should not be taken at face value, but they do shed some doubt on the significance of the deterioration of the terms of trade of the informal sector as a mechanism of surplus extraction.

At the beginning of this section, it was mentioned that employment and output of the informal sector are mainly concentrated in personal services and commerce. Although, as shown above, an expansion in the market for the former type of activities is reasonably

likely if growth and concentration of income are combined, the income differentials and the semi-feudal working relationships prevailing in this market (especially in domestic services) will not allow such a development to contribute to the improvement of incomes of those employed in the informal sector. A different situation may prevail in the case of commercial activities, which account for 26 per cent of employment in the informal sector and almost half of its output. The special characteristics of activities of this type and the scant empirical knowledge of their operation call for a more thorough analysis. This will be attempted in the next section.

C.

Competition in retail services: the case of Greater Santiago

The evolution of the share of the informal sector in total income will largely depend on the anticipated changes in service activities. A large proportion of informal-sector employment is concentrated in 'traditional' services, such as those provided by domestic servants and street vendors, and its inverse relationship with development gives grounds for anticipating a declining trend in the long run. The problem arises, however, in trying to forecast the informal sector's share in 'complementary' services. For these activities a high correlation between its total output share and growth has been found (Katousian, 1970; Sabolo, 1975). This question has been analysed for Chile by Sansone (1977), who found an income-elasticity for commercial activi-

ties of around 0.80, and anticipated an expansion of commercial output practically *pari passu* with that of total income.

The main question, however, is what will happen within the sector, since competition between different production units could lead to a decrease in informal commercial activities in spite of an increasing market share for the sector as a whole. Indeed, this is the conclusion reached by Sansone, who anticipates a reduction of the present level of employment in petty commerce of around 33 per cent in the next two decades, while the share of modern units (supermarkets) in total sales will increase from 35 to 82 per cent during the same period. His conclusion is mainly based on the assumption that demand substitu-

tion within the sector will follow the present correlation observed between higher income levels and greater preference for buying in modern units (supermarkets).

This linear extrapolation of present behaviour should be carefully analysed, since many factors complicate the functioning of this particular market, making prognostication a difficult and risky task. Although a single rather homogeneous market can be distinguished for commercial services, imperfections in both product and factor markets may affect the competitive position of the different units, the result being that the declining trend of informal-sector commercial activities does not occur at the anticipated rate or may even not occur at all in the medium term.

For the sake of simplicity, we will deal only with established commerce, since street vendors can be included within the 'traditional' services group. Furthermore, the analysis will be mainly restricted to the established commerce of processed and unprocessed foodstuffs.¹⁸ On the other hand, the information available will further bias the analysis towards the Greater Santiago area, on which the few studies already undertaken shed most light (Collins-Garrod, 1971; Sansone, 1977; PREALC-SENDE, 1976).

1. Competition in the foodstuffs trade

The first factual question which should be answered in order to evaluate the degree of competition in this particular market is whether there is a single set of

¹⁸ Unfortunately, the information available did not allow us to analyse informal commercial activities in markets, especially in those dealing with fresh fruit and vegetables.

prices for similar products sold by informal units (small shops) and modern units (supermarkets). The data available (see table 5) show that the same products, when bought in informal units, cost on average around ten per cent more than if bought in supermarkets. The price differentials are not homogeneous but vary with the type of products, being practically nil in the cases of sugar, detergent, tea and soap, while they are concentrated in rice, oil, beans and eggs. Some products, such as flour and spaghetti, are found at lower prices in small stores (see table 6).

Three factors should be considered when analysing price differentials. The first is that part of the differentials are normal deviations in commercial activities. This can be clearly shown by

Table 5
PRICE DIFFERENTIALS IN THE FOOD
TRADE
(Percentages)

Years	Price differentials
1966	11-20
1969	24
1970	30
1975	14
1976 ^a	7
1976 ^b	3

Notes and sources: 1966, P. Barahona: this study refers to a large low-income sector of Santiago (Manuel Rodríguez); the 11-per cent differential does not include quality differences while the 20-per cent figure does.

1969 and 1970, Collins and Garrod: this refers to a sample survey of Greater Santiago. 1975: case studies made by UNICOOP in several medium-and low-income sectors of Santiago. 1976: ^a joint PREALC-SENDE survey of small commercial establishments in Ñuñoa, a middle-and low-income district of Santiago. Meat products are not included. 1976: ^b estimates made on the basis of 8 in-depth case studies undertaken for the aforesaid survey.

Table 6
PRICE DIFFERENTIALS BY MAIN PRODUCTS
(Percentages)

	<i>Between small shops and supermarkets</i>		<i>Differences between supermarkets</i>
	<i>A</i>	<i>B</i>	
Rice	14.0	9.0	-3.0
Oil	7.0	5.0	-1.0
Eggs	5.0	8.1	-30.0
Sugar	1.0	-0.5	0.0
Tea	-5.0	0.0	2.0
Detergent	1.0	—	-2.0
Soap	-2.0	-3.4	-5.0
Chicken	—	-6.2	-4.0
Beans	27.0	17.5	35.0
Lentils	—	-16.3	12.0
Potatoes	13.0	7.1	26.0
Onions	—	54.9	87.0

Sources: *A*: PREALC-SENDE survey of small shops, 1976, and prices collected directly on the same date at UNICOOP and ALMAC supermarkets. *B*: Case studies of small shops.

comparing the prices for the same products in the two largest supermarket chains of Santiago (UNICOOP and ALMAC), where the price differential found is around 3 per cent. In this case, however, the largest price differentials are concentrated in vegetables and beans and lentils, and are partly offset by small differences from 1 to 5 per cent between different brands in most of the other products; whereas in the case of small stores the majority of the prices were at least equal to those registered by the supermarket. The second factor which makes price comparisons difficult consists in quality differentials. The study undertaken by Barahona (1966) shows that if quality differentials are taken into account, price differentials practically double, while Collins and Garrod (1971)

show that the products considered, although apparently homogeneous, are not found in both types of establishment. If the product bought in the small stores is replaced by the nearest substitute, the price differential changes from 24 to minus 17 per cent in 1969 and from 30 to minus 8 per cent in 1970. Finally, the question of location and vicinity of competing units becomes important for evaluating price differentials. In the study made by UNICOOP (1975) it is shown that price differentials increase with the distance between the small shop and the supermarket, reaching their maximum at three or four blocks from the supermarket. The data also show that even the small shops located in the same block as the supermarket charge between 8 and 10 per cent more than the supermarket for the same products.

Considering all the factors mentioned above, it can be safely concluded that the small stores sell their products at least at the same price as the competitive unit and that, most likely, price differentials are around 7 to 10 per cent.¹⁹ With these price differentials one would expect that demand for food-stuffs would shift from small shops to supermarkets. This, however, has not happened in the case of Chile, where, on the contrary, UNICOOP has recently (March 1977) closed all its branches in low-income sectors of Santiago after more than ten years of unsuccessfully trying to break the competition of the small shops.²⁰ The survival of small

¹⁹ This gives little support to the argument that the surplus of the informal sector is transferred through lower prices to other sectors.

²⁰ In a recent public announcement (March 1977) UNICOOP notified the closure of five supermarkets operating in San Joaquín, La

shops in the face of competition and their capacity to retain demand even at higher prices than are charged by their competitors can be explained by the existence of imperfections in both the product and the factor markets.

2. Imperfections in the product market

Imperfections in the product market are the consequence of demand segmentation caused by different factors which sometimes require certain characteristics in the production unit that are more easily found in small shops than in supermarkets. The small purchasing power of the majority of consumers, combined with their income instability and the need to consume a fairly diversified basket of goods, results in a pattern of demand characterized by daily purchases of small quantities of different products.

This hypothesis can be confirmed from the data available, since a high correlation is found between low income levels and greater preference for buying in small shops (see table 7). Between 72 and 81 per cent of total expenditure on foodstuffs of the lower income levels is effected in small shops, whereas the proportion decreases to 16-21 per cent in the higher income strata. Furthermore, the persons with lower income levels show greater income instability and shorter periods between paydays. In the Las Condes district 51 per cent of the lower income groups received unstable incomes, while at the higher income levels the proportion dropped to 26 per cent (Sansone, 1977). In addition, a third of the persons in the

Pincoya, Peñalolén, Pudahuel and Villa O'Higgins: all sectors where the lowest-income population of Santiago is concentrated.

Table 7

PREFERENCE FOR BUYING FOODSTUFFS IN SMALL SHOPS, BY INCOME LEVELS

Income levels	Small shops' sales as percentages of total demand	
	A	B
High	16	21
Medium	59	35
Low	81	72

Sources: A: Collins and Garrod (1971);
B: Instituto de Administración, Universidad Católica (1974), cited by Sansone (1977).

lower income strata received their income fortnightly or weekly, while all the persons in the higher income levels were paid monthly (see table 8). These income characteristics²¹ result in a high prevalence of daily purchases in the lower income groups, where around 50 per cent of the people go to the market daily and 37 per cent go weekly; at the higher income levels nobody goes to the market daily, while half of the persons concerned make their purchases monthly (see table 8).

Consumption diversification, due not only to habit but also to nutritional and standard-of-living requirements, leads to the limited daily average purchase being spread over some 18 uses, thus resulting in a demand for very small units of each product. According to several studies made by Aldunate (1974, 1975) a daily

²¹ In addition, and also as a consequence of their low income level, they have limited storage capacity. For instance, only 2 per cent of the families with lower incomes have refrigerators, while in the 20 per cent of families located in the top income bracket the corresponding proportion rises to 87 per cent (Sansone, 1977).

Table 8
DEMAND PATTERN BY INCOME LEVEL

Period <i>Income level</i>	<i>Income received</i>		<i>Frequency of purchases</i>	
	<i>High</i>	<i>Low</i>	<i>High</i>	<i>Low</i>
Daily	0	0	0	47.4
Weekly	0	22	41.7	36.8
Fortnightly	0	11	8.3	10.5
Monthly	100	67	50.0	5.3

Source: Instituto de Administración, Universidad Católica (1974), cited by Sansone (1977).

basket for five persons purchased by the lowest income groups is composed of five non-foodstuff products and 13 foodstuffs, most of them bought by the quarter-kilogramme (tea, rice, beans, spaghetti, onions), by one unit (eggs), or by one-sixteenth of a litre (cooking-oil).

This pattern of demand imposes special characteristics on the production unit, namely, capacity to sell in small amounts, little product-mix diversification and accessibility in terms both of location and of business hours. All these factors reduce the return of modern units (supermarkets), since technological change in commercial activities is closely linked to scale and product diversification, and in order to ensure the former—especially in markets characterized by a low per capita income level—the distance between establishments should be maximized.

Small shops, however, are able to fill the requirements imposed by the consumer. As may be seen in table 9, they usually sell in whatever small quantities are required. About 80 per cent of the establishments sell sugar, rice, spaghetti and tea by 1/8 or 1/4 of a kilogramme,

60 per cent sell beans and lentils by 1/4 of a kilogramme, 82 per cent sell oil by 1/8 of a litre, 88 per cent sell potatoes by the half-kilogramme, and almost all of them sell onions, eggs, detergent (1/4-kilogramme package), soap, chicken and bread by one unit.²² The opposite occurs in supermarkets, where the minimum sale quantities are two kilogrammes for sugar, one kilogramme for rice, spaghetti, beans and lentils, three kilogrammes for potatoes, five units for onions and one dozen for eggs.

The question immediately arises of why the supermarkets cannot reduce their minimum sales units to attract customers. The answer is related to technological constraints, since a large part of the supermarket profit is made by buying in bulk and packing mechanically in standard units. In addition, this method makes it possible to minimize labour use in the sales stage. A clear example of this constraint is given by

²² Product divisibility sometimes reached such lengths as in the cases of sugar and spaghetti, which were sold by 100 grammes, and oil, sold by 1/10 of a litre.

Table 9
MINIMUM SALE UNITS, BY TYPE OF PRODUCT AND ESTABLISHMENT

Product	Small shops					Supermarkets (minimum unit)
	1/10	1/8	1/4	1/2	1	
	<i>(percentage of establishments)</i>					
Sugar (kg)	2	37	54	2	5	1
Rice (kg)	—	17	60	9	13	1
Beans (kg)	—	2	62	33	2	1
Lentils (kg)	—	—	62	33	5	1
Spaghetti (kg)	2	27	67	2	2	1/2
Potatoes (kg)	—	—	—	88	12	3
Tea (kg)	—	100	—	—	—	1/8
Oil (lt)	2	82	14	—	2	1/8
Onions (units)	—	—	—	—	100	5
Eggs (units)	—	—	—	—	100	12
Detergents (unit 1/4 kg)	—	—	—	—	100	1
Soap	—	—	—	—	100	1
Chicken (unit) ^a	—	—	—	—	70	1
Bread (unit of 100 grammes) ^b	—	—	—	—	80	1/2 kg ^c

Sources: Small shops: PREALC-SENDE (1976), Supermarkets: direct observation.

^a10 per cent of the establishments sell chicken by the 1/4 kg and 20 per cent by the 1/2 kg.

^b3 per cent of the establishments sell bread by 1/10 of a kg, 2 per cent by the 1/4 kg, 9 per cent by the 1/2 kg and 6 per cent by the kilogramme.

^cUntil very recently only wrapped bread of different quality and higher price was sold at supermarkets.

Sansone (1977) in the case of sugar, where the supermarket (UNICOOP) minimum sale quantity used to be five kilogrammes. To reduce the minimum sale quantity to two kilogrammes, the supermarket had to close its packing plant and buy sugar already packed from a larger plant which operated at lower average costs. The two-kilogramme package constituted the minimum limit in view of the technology available and the price of paper and other inputs.

The second factor is the limited product-mix diversification required, in terms of number of products, brands and qualities. Most small shops operate on the basis of 15 main products of a single

quality, while product differentiation constitutes an important way for supermarkets to compensate for those products where profit margins are small. All the small shops interviewed in Nuñoa (PREALC-SENDE, 1976) sell processed foodstuffs (grains, oil, eggs, etc.), 76 per cent also sell non-alcoholic beverages, 67 per cent sell bread and 63 per cent fruit and vegetables. According to the cases studied, half of their sales are concentrated in three products: bread, sugar and oil.

Finally, the short purchasing frequency requires that shops be accessible, since time and transport costs influence consumer decisions. The majority of

supermarkets tend to be concentrated in higher-income sectors, while the opposite occurs with small shops, which are largely located in lower-income sectors. Eighty per cent of the supermarkets of Santiago in 1975 were located in the high-income districts, while 60 per cent of the small shops were concentrated in the lowest-income districts. Moreover, all supermarkets are located on main street or in shopping centres, while, for instance, the survey of Ñuñoa shows that 56 per cent of the small shops interviewed were located in secondary streets or dead-ends without public transport and 65 per cent of them were isolated from other shops. The requirement of accessibility also imposes long and flexible business hours. Because of labour costs and regulations, supermarkets work 70 hours per week, while small shops open every day, including Sundays, totalling in the lower-income sectors about 80 hours per week.²³

Finally, there is an additional factor which also introduces imperfections in the product market: i.e., that linked to the special relation which is developed between customer and owner of the small shop. This relationship affects the functioning of the market in different ways, which range from helping the consumer to buy the right products to offering the possibility of sending children to shops, meeting the neighbours and reading the newspapers there. The most important consequence of this relationship, however, is that it provides the owner of the small shop with a mechanism for evaluating the creditworthiness of his customers, so that he is in

²³ A recent change in regulations and the demand recession affecting this particular chain of markets has led UNICOOP to open on Sundays and to lengthen business hours.

a position to give credit on a personal basis and thus bolster up the low purchasing capacity of his clientèle. More than 41 per cent of the small shops of Ñuñoa gave credit to their customers in 1976, and the proportion rises to 50 per cent if the shops serving the lower-income districts are considered.²⁴

3. Imperfections in the factor market

The higher prices charged by the small shops should ensure a larger gross margin, provided that they pay much the same prices as the supermarkets for their purchases. The evidence available suggests, however, that the extra amount paid by the small shops on their purchases exceeds the price differential they are able to pass on to the consumer.

The Ñuñoa survey reveals that direct purchases from producers account for only 13-19 per cent of the small shops' total purchases and are predominantly of bread and chicken (see table 10). The main source of supply for the small shops is located in La Vega (the largest wholesale market of Santiago)²⁵ where they make about half of their purchases. In some cases (around 10 per cent) they even buy from supermarkets or other retailers, the gross margin in these cases being limited to the price differentials. In addition, the majority of the small shops (69 per cent of them) have to pay delivery charges, since they do not own

²⁴ It must be noted that at the time of the survey, Santiago was registering a 10-per-cent monthly rate of inflation coupled with demand contraction. Hence, in normal times a much larger coefficient should be expected.

²⁵ La Vega constitutes the main entry to the Santiago market for fruit and vegetables, and it also concentrates a large number of wholesalers of all kinds of foodstuffs who sell in large and small quantities.

Table 10
SOURCES OF SUPPLY, BY PRODUCTS

Products	Informal establishments ^a				Supermarkets ^b	
	La Vega	Wholesaler	Producer	Supermarket or other retailer	Producers	Wholesalers
Sugar	55	31	2	7	15	85
Oil	63	15	13	3	80	20
Rice	49	36	7	8	90	10
String beans	37	12	7	21	100	—
Lentils	29	14	9	33	100	—
Spaghetti	24	24	33	8	94	6
Potatoes	67	—	—	—	100	—
Onions	77	3	—	3	100	—
Eggs	37	14	39	7	100	—
Tea	56	28	2	5	78	22
Detergents	63	15	8	4	92	8
Soap	50	22	9	9	—	—
Chicken	—	10	90	—	100	—
Bread	—	2	89	2	—	—

Sources: SENDE-PREALC Survey, 1976, and information given by UNICOOP for 1976-1977.

^aAs percentages of establishments. The figures include double counting in those cases where an establishment stated that it buys the same product from more than one supplier.

^bAs percentages of total purchases of each product.

means of transport; 55 per cent pay cash for their purchases, while those who buy on credit are charged 7 per cent per month for an average credit of 19 days. In sum, these data clearly suggest that the small shop has to pass through a chain of middlemen in the marketing, transport and financial circuits.

The opposite occurs with the supermarkets, which possess enough bargaining power to obtain discounts for large quantities and credit facilities on better terms. In addition, they own their means of transport, thus reducing expenses under this head. The data available on the sources of supply of UNICOOP clearly show that approximately 86 per cent of the purchases are

made directly from producers, while the remainder are made from large wholesalers. In the former case, the savings made through bypassing some of the middlemen are added to the discounts obtained for buying in large quantities (see table 10).

It is difficult to estimate the differentials in the prices paid, because data on the supermarkets' real cost are not available. Studies made on the marketing process of rice, potatoes and tomatoes (Fletschner, 1971) and on fruit and vegetables (Programa Chile-California, 1965; ECA, 1966, 1968) illustrate the order of magnitudes involved in the different stages. In the case of rice, a product subject to price control, the

distributor margin found was between 6.5 and 13 per cent; while the wholesale and auction expenditure margins on potatoes and tomatoes were 31 and 32 per cent, respectively. For the ten main vegetables consumed in Santiago, the average wholesale margin was 21 per cent if no allowance is made for damaged goods,²⁶ while for the 12 staple fruits, the wholesale margin was 16 per cent, and that charged by the middleman between the wholesaler and the retailer amounted to 5.5 per cent.²⁷ This evidence suggests that through savings on their purchases supermarkets are able at least to absorb the lower final price received. This, in turn, would imply that gross margins are larger for the supermarkets. How, then, can the small shops survive with a lower rate of return?

Apart from the imperfections already mentioned in the product market, there are also imperfections in the factor market which are mainly related to the type of organization and mode of production of the small shops. Thus, the most common form of organization of production for the latter is on a family basis. Those operating such shops are generally self-employed and the shop constitutes a unit where the productive function is very loosely linked with the consumption function. In this sort of unit, implicit factor prices are determined in a different manner from those prevailing for the production factors used in the rest of the economy. It can be postulated that the implicit price for labour is lower than the price the

supermarkets have to pay because of the existence of family labour and the restricted opportunities for outside employment. Moreover, although the implicit price of capital relative to the price of labour may be larger because of capital scarcity, the low capital requirements of this activity, together with the dual use of capital for both production and consumption, could result in a lower implicit price for this factor too.

(a) *Imperfections in the labour market*

The information available for 1969 (Collins-Garrod, 1971) and 1976 (REALC; SENDE, 1976) shows that the average income received by the owner of an informal-commerce unit was 2.12 and 2.33 times the minimum legal wage paid in each year. Total income received by the owner was equivalent to 2.6 and 3.2 times the minimum wage in each year, but allowances have to be made for unpaid family members working in the shop. If the 25 per cent constituted by the largest shops were excluded from the 1969 sample, owner income would decrease to 1.02 times the minimum wage and if family members incomes were imputed the owner's net income would fall below that minimum. The 1976 survey also shows an income decrease when the largest units are excluded, but its magnitude is smaller. In this case, the owner's income after deducting incomes imputed to family members is 1.9 times the minimum wage.²⁸

The income received by paid workers and that imputed to unpaid family

²⁶ The vegetables included were: lettuces, potatoes, tomatoes, carrots, onions, squash, spinach, celery, beet, cauliflowers.

²⁷ The fruits included were: apples, pears, lemons, oranges, avocados, bananas, peaches, apricots, grapes, watermelons, melons, plums.

²⁸ This suggests that the 1976 survey is biased towards average-sized establishments, a slant which, in turn, is the result of the district chosen for the sample (Ñuñoa).

members is similar to what they could obtain as unskilled workers in modern commercial establishments. The alternative income for the owner is larger, since white-collar employees in supermarkets earned on average around 3.2 times the minimum wage and the self-employed in other commercial activities received 2.52 minimum wages in 1969 as compared to 2.12 received by the owners of informal units.²⁹ Part of the differentials could be attributed to differences in human capital, since the owners are older people, less educated and with less than average previous experience. Collins and Garrod (1971), who analysed the influence of personal characteristics on income differentials, found that even when sex, age, education and hours worked are identical, the difference between the income received by informal-unit owners and that obtained by the self-employed in the rest of the economy is still 19 per cent, or 7 per cent if compared to the incomes of the self-employed in services.³⁰

The question which immediately arises is why the informal shop owners continue their operations when they could obtain a larger income by working as employees in modern establishments. Apart from the limited occupational opportunities available and the unfavour-

able personal characteristics which restrict mobility, the organization of production on a family basis also helps to keep them in their present position, generating a sort of labour market segmentation. We have shown that the income received by the owner is lower than the alternative income if allowances are made for unpaid family members. If such deductions are not made, their income is similar to the alternative income. To move out of their present activity would imply closing job opportunities to the other members of the family, who would have difficulty in finding new jobs and who are frequently not available for full-time jobs, as is usually the case with housewives and school-age children, who share their time between the shop, the housework and the educational system.

This organization of production can be clearly seen by analysing the employment structure. Forty per cent of the self-employed of Greater Santiago were engaged in commercial activities in 1969, and three-quarters of those employed in the food trade were family members. Furthermore, the proportion of family members increases as the size of the establishment decreases, reaching 97 per cent in the smallest shops. It may be noted that while the informal shop-owner works more intensively than the supermarkets both in terms of hours worked and days open, unpaid family members work only about 56 per cent of the hours worked weekly by the owner and 84 per cent of the hours worked at supermarkets.

(b) *Imperfections in the capital market*

The organization of the establishment on a family basis is also reflected in the capital market, and this in turn

²⁹ Confirmation of these data is found not only in the sample analysed by Collins and Garrod, 1971, but also in the periodic survey on commercial activities published by the Instituto de Estadística. Both samples refer to Greater Santiago.

³⁰ Differences are also found between incomes of white- and blue-collar workers when personal characteristics are identical. In these cases the differentials are 12 and 31 per cent, respectively, in relation to the same occupational position in the rest of the economy, and 7 and 16 per cent, respectively, in comparison with services.

restricts capital mobility. Around 70 per cent of the total capital in informal-commerce units is constituted by buildings, vehicles and machinery.³¹

Eighty-two per cent of the owners live in the same building in which the shop operates, and 85 per cent of them own their house. Only 12 per cent possess a vehicle, and in all these cases the vehicle is a car or station-wagon. Hence, both capital components serve also a dual purpose by filling welfare needs (housing and transport) and simultaneously playing a productive role. Returns on capital obtained from operating the shop are thus only a part of the total implicit return: in other words, the actual business capital is smaller than it nominally appears.

Assuming that the total income of the owner of an informal commercial establishment in Ñuñoa was 2,094 Chilean pesos in September 1976, and deducting the wages imputed both to unpaid family members (equivalent to the minimum wage) and to his entrepreneurial function (equivalent to 1.25 times the minimum wage),³² a net return on capital of 770 Chilean pesos can be estimated. Since according to Sansone (1977) the capital of small shops amounted on the average to 30,627 Chilean pesos at the same date, a capital return of 2.3 per cent monthly is obtained by the owner.

If this rate of return is compared with the 1.9 per cent estimated for UNICOOP, it can be seen that capital is used efficiently in the informal sector.

³¹ The equipment usually found in small shops is limited to one manual pump for the sale of oil, one scale and (not always) one refrigerator.

³² This is equal to the minimum wage legally fixed for white-collar employees.

On the other hand, if the owner decided to close his shop he could invest his capital either in the financial market (at 2 per cent monthly in real terms)³³ or in other modern commercial ventures (at about the same rate). This investment would give him a monthly income of 612 Chilean pesos, and he would have to obtain a job paying the equivalent of 2.5 times the minimum wage to reach the same income that he is earning by operating his own establishment.

However, as noted above, not all his capital can be transferred, since its dual purpose (welfare and production) implies that he cannot sell his house unless he can find alternative accommodation and he cannot sell his car unless he is prepared to sacrifice comfort and defray additional expenses for transport. If these two factors imply that the capital available for outside investment is restricted to, say, 50 per cent of the total, he would have to obtain a job for himself at 2.9 times the minimum wage in order to supplement his capital returns and reach the same income level that he is attaining at present. This, in turn, would confront him with the difficulties of finding a suitable job at that level of income and simultaneously it would restrict job opportunities for the rest of the family. In short, the labour market problems already analysed would make themselves felt.

4. Summary

To sum up, the evidence analysed in this section suggests that the informal-sector food shops are able to compete with the

³³ It should be noted that this real rate of interest is exceptionally high, owing to the special conjuncture affecting the Chilean economy, where interest rates on savings are inflated.

modern units. Indeed, not only can they survive but they can even, as in the recent case of UNICOOP, push the latter out of the market.

Secondly, the analysis of income differentials and returns on factors of production also suggests that this informal-sector activity represents an efficient use of resources, given the overall framework of job scarcity in the modern sector, the low purchasing power which characterizes the market, and the organization of production in the informal units.

Finally, trends are difficult to anticipate because competition between

units can be diminished by imperfections in the product and factor markets. Although the general behaviour anticipated for informal units in concentrated markets can be predicted for the long term, the rate is difficult to forecast and the trend might differ in the medium term. In addition, changes in the market will probably occur discontinuously rather than following a smooth path. Until substantial changes have come about in the purchasing capacity of the majority of the population and the prevailing mode of production of these units, it is highly likely that their ability to compete will ensure their survival.

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Transnational corporations and export-oriented primary commodities

A general conceptual framework for case studies

Benny Widyono*

This article presents in some detail a general conceptual framework intended to provide guidelines for the study of negotiations between governments and transnational corporations in connexion with export-oriented primary commodities. If the developing countries have greatly improved their bargaining position *vis-à-vis* the transnational corporations during the past few decades, this is due not only to changes in economic and political power relations at the world level but also to the pooling of increasingly detailed knowledge of all the factors which strengthen the hand of the governments in their dealings with the corporations.

The agreement concluded in each specific case between transnational corporations and governments depends upon a constellation of interrelated factors, pre-eminent among which are certain economic, political and administrative characteristics of the host countries, the nature of the commodity concerned and its world market, the basic features of the corporation, and the international scenario in which the negotiation is conducted. After describing these factors, the author shows the complexities of the negotiation process, the various types of pacts and agreements that have been established, the direct and indirect gains to which they give rise and the ways in which the host country can participate in these.

*The author was formerly a staff member of the CEPAL/CTC Joint Unit on Transnational Corporations, Economic Development Division, CEPAL. He is now Chief, ESCAP/CTC Joint Unit on Transnational Corporations in Bangkok.

A. Introduction*

In July 1977, an *aide-mémoire* was signed between Mr. Enrique Iglesias and Mr. J.B.P. Maramis, the Executive Secretaries of CEPAL and ESCAP, respectively, dealing with the possibilities for regional co-operation between the two regional commissions in the field of transnational corporations.¹ In this *aide-mémoire*, the two Executive Secretaries agreed to co-operate in the conduct of case studies on the involvement of transnational corporations in export-oriented primary commodities of interest to both regions. Provision was made for the gradual extension of this co-operation to other interested regional commissions.

It was agreed that all case studies should have a common focus and should concentrate on the specific issues surrounding the following two areas of concern:

- (1) Factors determining the relative *bargaining positions* of host governments and transnational corporations;
- (2) The resulting structure of *distribution of gains* between the host countries and transnational corporations.

The emphasis in the case studies will therefore be on the bargaining process between the two parties concerned. It is

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¹ *Aide-mémoire* between the Executive Secretaries of CEPAL and ESCAP on Interregional Co-operation among Regional Commissions in the field of Transnational Corporations, Geneva, 26 July 1977.

believed that the interplay of several key factors in the government's bargaining position will be very important in determining the outcome of the negotiations. These in turn will result in an agreement which determines the structure of the distribution of gains accruing from exports of primary commodities.

The dimension and complexities of the problems vary from country to country, from commodity to commodity and from project to project. Generalized policy recommendations to host governments are, therefore, difficult to formulate at the present stage and will have to await the accumulation of enough evidence from case studies being undertaken by researchers in different parts of the world and for as many commodities as possible. The underlying approach to the case studies to be carried out in this interregional project will, therefore, be that of *descriptive pragmatism* rather than *prescription*. In order to provide a common focus and aim to all the case studies, a general conceptual framework applicable to all case studies has been developed and is presented in this paper. It has been kept very broad in order to accommodate the multifarious conditions and situations which exist in the industry. It will also be applicable to renegotiations and to negotiations associated with nationalization of a given production facility operating in the country.

1. *Transnational corporations and exports of primary commodities*

In spite of the rapid increase during recent years in manufactured exports from a few selected developing countries, primary commodities continue to figure prominently in developing coun-

tries' exports.² For the developing countries as a whole, the share of exports of primary commodities in total exports was 84.7 per cent in 1975. Petroleum accounted for 60.9 per cent in 1975, as compared to 28.3 per cent in 1960.³

Concomitant with the above phenomenon has been the slow growth of primary commodity exports in relation to other exports. During 1950-1975, in terms of current prices exports showed the following annual rates of growth: foodstuffs and raw materials, 7.3 per cent; fuels, 14 per cent; and manufactures, 12.7 per cent. In terms of constant prices, the percentages are as follows: foodstuffs and raw materials, 4.2 per cent; fuels, 6.8 per cent; and manufactures, 8.3 per cent. The declining share of foodstuffs and raw materials in total exports during the period is reflected in the decreasing importance of such products in world exports. During the period, the share of food and raw materials declined from 46.4 per cent to 19 per cent, whereas that of fuels increased from 9.9 per cent to 18.6 per cent and that of manufactures from 43.7 per cent to 60.4 per cent.⁴

It is generally recognized that such factors as rapid technological progress, reducing demand for raw materials as a proportion of total demand through

² Throughout this paper, commodities are defined as those in SITC categories 0 to 4 (inc.) and 68 (non-ferrous metals).

³ International Bank for Reconstruction and Development (IBRD), Report N° EC-166/77, *Commodity Trade and Price Trends*, August 1977.

⁴ These shares are for exports in current prices. Source: CEPAL, *The economic and social development and external relations of Latin America*, E/CEPAL/1024, Santiago, Chile (mimeographed text), 15 March 1977.

technological innovations, with, in advanced countries, the development of synthetic raw materials and the rapid increase of food production, rising prices of manufactured goods because of inflation and restrictive import policies, are among the most important determinants of the above trends.

Structurally, primary-exporter countries receive only a small fraction of the final prices paid for their commodities by consumers and by manufacturers in importing countries. It has been roughly estimated that final consumers pay over 200 billion dollars (excluding taxes) for the developing countries' major primary exports, excluding oil (after further processing, packaging and advertising); but the exporter countries receive only 30 billion dollars; or roughly one-seventh of the total.⁵ The spread is largest for commodities requiring complicated processing techniques. For example, 4 to 5 tons of bauxite worth between 40 and 80 dollars will yield 1 ton of primary aluminum metal worth 700-800 dollars, and this in turn will yield semimanufactured products worth between 1,000 and 1,500 dollars.⁶ Even for foodstuffs exports requiring little further processing, there is a considerable spread between export value f.o.b. and consumer prices. Banana-exporting countries, for instance, receive in gross export revenues between 12 per cent and 30.8 per cent of the retail consumer price in Italy and in the United States, respectively.⁷

⁵ See Mahbub Ul Haq, "The Third World and the International Economic Order", *Turkeyen Lectures*, Georgetown, Guyana, 1975.

⁶ See Norman Girvan, *Corporate Imperialism: Conflict and Expropriation*, New York, M.E. Sharpe, 1976, p. 101.

⁷ See FAO, Committee on Commodity Problems, "Review of the economic aspects of

International efforts to improve the economic performance of developing countries which rely heavily on primary commodity exports have recently been intensified in many international forums and by producer associations. The struggles of the developing countries have centred around demands for such measures as the linking of the prices of raw materials to those of manufactured goods, the stabilization of raw material prices and of the incomes of developing primary-exporter countries, the removal of tariff and non-tariff barriers and the increasing of the export price of specific commodities.

While all these international efforts directed at improving raw material prices and access to markets will undoubtedly benefit the developing countries which depend on primary commodity exports, a comprehensive and long-run solution to the problems faced by such countries will have to be found by placing primary commodity problems in the wider context of the international marketing of such commodities, and by examining the overall structure of the distribution of gains from such activities, i.e., the entire operational chain from the producer to the consumer. To this end, international efforts will have to be complemented by national efforts aimed at altering the distribution of gains⁸ in favour of the developing exporter country. These national policy measures should be directed at two different

production, trade and distribution of bananas", CCP:BA 75/8, April, 1975.

⁸This paper will concentrate on the economic or monetary gains derived from the export trade, and will leave aside such other effects of foreign investment activities as are felt, for example, in employment and at the cultural level.

stages of the process. One is the distribution of gains from a given f.o.b. export value. The second set of policies are directed towards increasing the value added from exports, either through forward linkage operations from primary commodity exports to capture a larger share of the overall gains from such exports, or through a rise in the unit value of exports (as in the OPEC case, for example).

Since the overall gains from primary commodity exports are closely linked to the operations of transnational corporations, the key to understanding the structure of these global gains lies in an analysis of the nature and operations of these transnationals and of their impact on the economic development of producer countries.

Through their global network of subsidiaries and associated companies, linked together by an intricate system of common financial, managerial, technological and organizational services, a small number of transnational corporations continue to exercise control, directly or indirectly, over the crucial stages of the operational chain of most primary commodity exports, from exploration to production, processing, exportation, transport, marketing, distribution and financing. Complex constellations of horizontal and vertical integration have been established by transnational corporations in primary commodity exports, especially in the mining sector, often producing oligopolistic structures in the markets for these commodities.

During the past twenty years or so, there has been a marked decline in the degree and extent of the control exercised by transnational corporations over export activities in respect of many commodities. An important factor con-

tributing to this trend is the strengthening of the bargaining power of host governments and the mutually reinforcing policies introduced by them to improve the distribution of gains in their favour.

Host governments have at their disposal a series of policy instruments with which they can attempt to shift the international distribution of gains in favour of their countries. They may renegotiate the terms of the agreement and fiscal concessions, levy royalties and taxes, or require the expansion of purchases of goods and services and of processing activities in the host country; finally, they can assert sovereignty over natural resources by partial or total nationalization of subsidiaries of transnational corporations operating in the country. It goes without saying that host governments' policy instruments are not mutually exclusive and that one policy measure may reinforce another. Internationally, the emergence of many firms independent of the oligopoly in each commodity has enabled host governments to widen their options and to purchase independently the services formerly available only in the package called direct investment. These services include technology, management, marketing and distribution.

2. Criteria for the selection of case studies

The selection of specific commodity-country combinations for the case studies to be carried out in the project under discussion, on the basis of the general conceptual framework developed in the present paper, is guided by the following criteria:

a) The commodity selected should be of export interest to several countries

in Latin America and preferably in Asia. If this project is extended to other regions, the criterion will naturally be expanded to include other commodities of specific interest to Africa and West Asia. Statistically, therefore, commodities selected must figure prominently in the exports of the countries concerned. Secondly, the countries selected must make an important contribution to the world supply of exports of the commodity in question;

b) The degree and extent to which transnational corporations exercise control—whether directly or indirectly—over the production and marketing of the commodity concerned must be significant. Since indirect control over the marketing of the commodity is included, most of the commodities exported by developing Asia and Latin America can qualify for selection as objects of case studies. Even if production is in the hands of smallholders, as is the case with certain agricultural export commodities, the final business of marketing and distribution in the consumer countries is conducted by a handful of transnational corporations;

c) Recent government policies *vis-à-vis* transnational corporations in respect of the commodity selected must have yielded substantial improvements in the gains accruing to the host governments concerned. This criterion is adopted because it is believed that case studies describing such successful host government action will enable other governments trying to improve the gains from primary exports to move up on the 'learning curve' of bargaining power.

Using these three criteria as a basis, case studies were undertaken by CEPAL, the possibilities of expanding them to Asia and eventually to Africa being kept in mind. The three case studies selected

were; tin in Bolivia, bauxite-aluminum in the Caribbean (specifically in Jamaica, Guyana and Surinam), and bananas in Central America and Panama. In all three cases, the gains from the commodity exports concerned have been shifted substantially in favour of host countries as a result of changes in the policies of host governments. This satisfies criterion (c) outlined above. These case studies will incorporate, whenever possible and appropriate, data on the experience of South-east Asian countries exporting identical commodities and involved with the same transnational corporations. The comparison of different control relationships maintained by the same transnational corporations in various parts of the world will contribute further to the accumulation of case study evidence in this still largely unexplored area of research. Since all three commodities are exported in significant quantities by certain African countries as well, the extension of the study to that region will obviously increase the validity of the conclusions reached.

Criterion (a) was met as follows. During 1973-1975, tin represented 41.3 per cent of total Bolivian exports. The corresponding figures for bananas were: Costa Rica, 27.1 per cent; Honduras, 22.3 per cent; and Panama, 27.8 per cent; while those for bauxite were: Guyana, 19.6 per cent; Surinam, 24.2 per cent; and Jamaica, 19.4 per cent.

Another criterion is the importance of the country's exports in total world exports of the commodity. During 1973-1975, Bolivia accounted for 14 per cent of world exports of tin, being the second largest exporter of tin after Malaysia. The corresponding figures for bananas were: Costa Rica, 16 per cent; Honduras, 8.3 per cent; and Panama, 8.2 per cent. The percentages for bauxite

were: Guyana, 9.5 per cent; Surinam, 10.2 per cent; and Jamaica, 23.3 per cent. During the same period, the Latin American and Caribbean region's share in world exports of the three commodities was: bananas, 75.2 per cent; bauxite, 47.2 per cent; and tin, 15.4 per cent. The corresponding shares of developing countries in Asia were: bananas, 10.7 per cent; bauxite, 5.6 per cent; and tin, 58.5 per cent.⁹

Criterion (b) concerns the degree and extent of control exercised by transnational corporations over the commodity concerned. Although recent government policies are introducing significant changes in patterns of ownership and control, transnational corporations are still dominant in the bauxite-aluminum and banana sectors of the Caribbean and the Central American isthmus, respectively, and, for that matter, in those of South-east Asia and Africa.

Six vertically-integrated transnational corporations control the bulk of the world aluminum industry. The four largest operate in Jamaica: the Aluminum Company of America (ALCOA); the Aluminum Company of Canada, ALCAN Aluminum Limited; the Reynolds Metals Company; and the Kaiser Aluminum and Chemical Corporation, along with two others which are important in the copper industry: Revere and Anaconda. ALCOA also operates in Surinam and the Dominican Republic, whereas Reynolds is active in Haiti. In Surinam, the other important producer is Billiton, a Dutch transnational corporation which has its origin in the Indonesian tin industry and is still important in the tin industry of Thailand. ALCOA also explores for bauxite in

Indonesia, while the Malaysian production is owned by ALCAN.

In the banana economy of the Central American Isthmus, three transnational corporations from the United States dominate the scene, although often operating through associate producers. These three companies are: United Brands (a merger between the United Fruit Company and AMK Corporation); Castle and Cook (parent company of Standard Fruit); and Del Monte Corporation. Together with the Japanese transnational Sumitomo, they control Philippine banana exports through a system of associate producers and market control.¹⁰

The tin industry has been selected because of the dynamic modifications which have occurred in the control exerted by transnational corporations over the industry, especially since World War II. The tin industry has always been relatively unstructured, and has not been dominated on a worldwide basis by fully-integrated companies, as is the familiar pattern in other non-ferrous metals.

The nationalization of the three largest companies in Bolivia in 1952 and of the Billiton Company in Indonesia in 1957 has further significantly weakened the control of transnational corporations over the industry (Bolivia and Indonesia are respectively the second and third largest producers of tin in the world). The Indonesian State monopoly in tin, P.T. Timah, and the Bolivian mining corporation (Corporación Minera de Bolivia — COMIBOL) — which accounted for 75 per cent of Bolivia's tin exports in 1975 — are now the two largest com-

⁹ Source: IBRD, *Commodity Trade and Price Trends*, *op. cit.*, tables 19 to 22.

¹⁰ Data obtained from annual reports of companies and government sources.

panies in the world.¹¹ More recently, in 1976, control over the world's remaining largest transnational corporation producing tin (the London Tin Corporation), with production in Nigeria, Malaysia, Thailand and Australia, passed into the hands of PERNAS, a holding company owned by the Government of Malaysia. This was brought about through a successful take-over bid for the parent company in London and the transfer of the company headquarters to Malaysia.¹²

Control over the smelting of tin, which in turn influences the marketing of the metal by transnational corporations, is also diminishing rapidly. The State enterprises in Bolivia and Indonesia are expanding their tin smelting capacity and will soon smelt all their domestic production. The world's largest tin-smelting transnational corporation is Amalgamated Metal Corporation (a 1976 merger between Consolidated Tin Smelters and Amalgated Metal Corporation), which owns smelting facilities in Nigeria, Malaysia and Australia. AMC is controlled by Patiño N.V., which also owns a tin smelter and production faci-

lities in Brazil. The Williams Harvey tin smelter in England, owned by AMC, which formerly smelted the bulk of Bolivian tin, was closed down in 1974.¹³

Finally, the three commodities selected provide good examples of how co-operation and concerted efforts among producer countries can improve the bargaining position of each host government. The concerted action taken through the International Bauxite Association and the Union of Banana-Exporting Countries considerably enhanced the bargaining power of the producer countries. Although the International Tin Agreement, which is now entering upon its fifth phase with the recent ratification by Bolivia,¹⁴ embraces both producer and consumer countries, the producer countries have frequently been able to join forces to serve their common interest in the International Tin Council, the executive arm of the Agreement. The tin agreements have above all been successful in exerting a stabilizing influence in the tin market, dominated as it is often is by speculative elements.

B. The bargaining framework

This section presents the general outline for the study. Central to this outline is the bargaining framework depicted in diagram 1, which shows the relationships among the various elements entering into

the bargaining process and determining its outcome. The framework has been drawn up on simple lines so that it can be applied to all cases under study. At

¹¹ Excluding the People's Republic of China.

¹² Government sources for Bolivia and Indonesia. On the PERNAS take-over story, see: Andrew Davenport, "Bargaining for Vital Tin Stakes", *Far Eastern Economic Review*, April 1, 1977; "Country Profile". *Asian Finance*, April-May 1977.

¹³ United States Bureau of Mines, "Tin", *Mineral Facts and Problems*, Washington, D.C., 1975; Walter Skinner's *Mining International Yearbook*, London, The Financial Times, 1975, 1976 and 1977 issues: company reports; William Fox, *Tin: The Working of a Commodity Agreement*, London, Mining Journal Books, 1974.

¹⁴ *Metals Week*, 20 June 1977, p. 3.

Diagram 1

TRANSNATIONAL CORPORATIONS IN PRIMARY COMMODITY EXPORTS: ELEMENTS IN THE BARGAINING FRAMEWORK

**A
THE BARGAINING
SITUATION**

The relative bargaining positions of host governments and TNCs are shaped by a process of mutual interaction among the following four sets of factors:

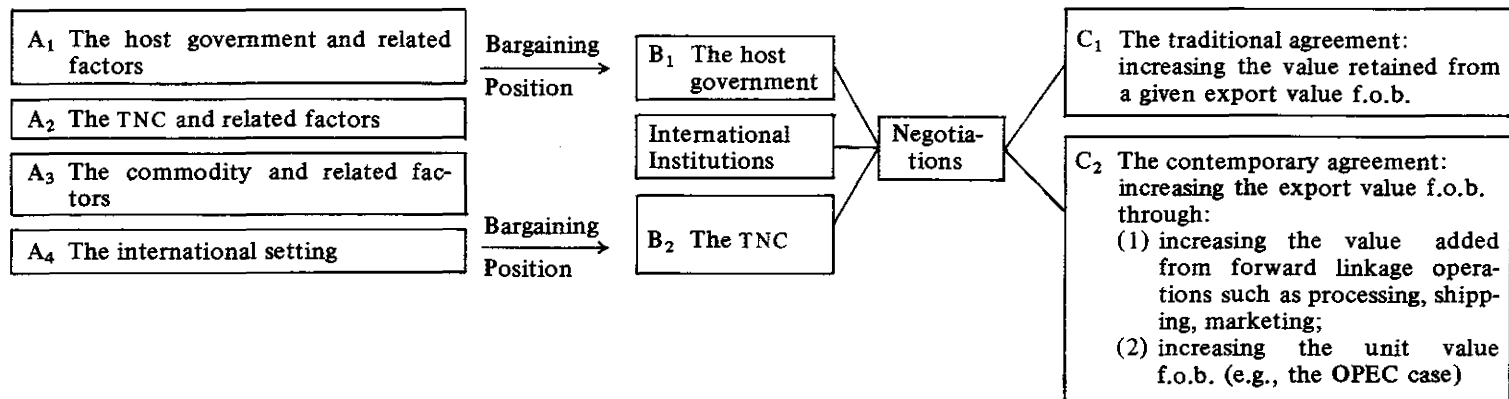
**B
THE BARGAINING
PROCESS**

The terms and conditions of the agreement are the subject of negotiations between the two negotiating parties, influenced by international institutions.

**C
THE AGREEMENT AND THE
DISTRIBUTION OF GAINS**

There are three types of agreements:
 (a) the specific contract (e.g., mining contract)
 (b) the standard contract (e.g., a forestry concession)
 (c) the implicit agreement (e.g., projects operating under general investment laws).

In all cases, the host government is interested in improving the distribution of gains in its favour at the following two levels:



the same time, it introduces into the situation a dimension of continuous change which will make it possible to analyse changes in host-government/transnational-corporation relationships over time.

In the bargaining framework it is assumed that both the host government and the transnational corporation are interested in maximizing their respective gains from the potential project (or the existing project in the case of renegotiations), and that therefore the bargaining process plays an important role in the determination of the distribution of gains. The negotiations between the two parties concerned take place in a certain *bargaining situation* in which both parties are equipped with their respective bargaining capacity. The relative bargaining capacity of each party is determined by a process of mutual interaction among numerous factors, which have been grouped in four sets in box A of diagram 1. In a particular bargaining situation, *negotiations* will commence between the two interested parties, under the influence of international institutions (diagram 1, box B).

There are three types of agreements. In the case of an important mining project involving hundreds of millions of dollars, the pertinent negotiations may entail years of hard bargaining, resulting in a formal specific contract. In other cases, where the procedures have been standardized, no formal negotiations may be conducted at all and the company may start operations after signing a standard contract. Thirdly, a company may enter operation under general laws applicable to foreign investment projects, i.e., the agreement is implicit. The formal or implicit agreement concluded will form the basis of the *distribution of gains* among the

transnational corporation, the host government and the other parties concerned (see diagram 1, box C).

Box C of diagram 1 distinguishes between two levels of agreements: *the traditional agreement*, which concerns itself with the distribution of the proceeds from gross value of exports alone; and the *contemporary agreement*, which is concerned with the overall distribution of benefits from commodity exports, i.e., from the final consumer value of such exports, including the margins accruing to shipping, processing, manufacturing, distribution and marketing. The distribution of gains can also be improved by simultaneously raising the unit value of exports and the retail consumer price. Both the producer country and the transnational corporation will gain at the expense of the consumer, as, for example, in the OPEC case.

As the name suggests, the contemporary agreement evolved from the traditional agreement. However, as the process of change is not uniform for all commodities and all countries, there are countries today which still allow transnational corporations to operate under a traditional agreement.

The actual distribution of gains depends on the process of implementation of the project, in which the transnational corporation executes the project and the government exercises its regulatory and control functions. A further complication is that the actual distribution may differ considerably from what was agreed on paper. In the case of an implicit agreement, automatic renegotiations will take place to adjust the provisions originally agreed upon. Where a formal contract is involved, however, renegotiations are more com-

plicated and will result in a new agreement.

Since the evolution of the different types of agreements and the implications for the distribution of gains are closely associated with the changes in the bargaining power of the two parties concerned, it is useful at this stage to examine in greater detail the four sets of factors which appear in diagram 1, box A.

1. *The bargaining situation* (*box A*)

A tabulation of the main elements entering into each of the four sets of factors that determine the bargaining situation is presented below. The list is by no means exhaustive, but it includes what are considered to be the important elements in each set.

(a) *The host government and related factors (A₁)*

(i) *Political factors*

- Degree of independence and links with politico-economic groupings;
- Political philosophy of the government, especially its attitude towards foreign capital investment;
- Stability and strength of the government and the extent of its authority throughout the country;
- Foreign penetration and control over various sectors of production in the country concerned.

(ii) *Administrative factors and legal framework*

- Quality of the bureaucracy: skills and efficiency; the role of education and training;

- Skills and experience in negotiations with transnational corporations;
- Qualifications of technical cadres for running corporate functions independently;
- Extent of information available to the public administration on the industry and the corporation concerned, as well as on terms and conditions imposed by other host governments;
- Extent of information available on the relationship of the transnational corporation with the home government and institutions like the Overseas Private Investment Corporation (OPIC) or the Export-Import Bank (EXIMBANK);
- The laws and regulations of the country, especially those pertaining to foreign investment.

(iii) *Economic factors*

- Dependence on foreign exchange earnings from exports in general, and from the commodity concerned in particular; the degree of export diversification;
- Position of the country in world trade in the commodity concerned;
- Position of the country in world production and reserves of the commodity concerned;
- The proportion of the commodity exported in relation to the host country's production;

- Relationships with international economic systems;
 - Economic and financial dependency; balance of payments and debt position, etc.
- (b) *The transnational corporation and related factors (A_2)*
- (i) *International control relationships*
- Structure of the oligopoly: degree of vertical and horizontal integration and control over production and exports, shipping, processing, marketing and distribution;
 - Existence of cartel arrangements, including gentleman's agreements, in the industry;
 - Oligopoly dynamics: weakening of the oligopoly through emergence of independent firms in the industry;
 - Position of the particular transnational corporation in the industry: share in markets, raw material supplies, production and processing capacity;
 - Corporate strategies in respect of global control over raw material supplies;
 - Necessity of securing a 'hurdle rate' of return; i.e., a risk-adjusted minimum acceptable internal rate of return.
- (ii) *Relationships with the host country concerned*
- Structure of the transnational corporation in the host country:
 - status of subsidiary (-ies) in the system);
 - related and associated companies through interlocking directorships and management and technology contracts;
 - Transnational mobility of the corporation:
 - dependence on raw materials from the particular host country and possibilities of shifting to other sources of supply;
 - debt/equity factors in the investment project;
 - investment planned or already placed in host country concerned;
 - Home country support for the corporation.
- (c) *The nature of the commodity (A_3)*
- (i) Trends in demand and supply, including projections of such trends. Importance of trade in world production of the commodity;
- (ii) Trends in demand for and supply of substitutes;
- (iii) Income- and price-elasticities and elasticity of substitution;
- (iv) Market structure. Importance of formal markets and of arm's-length trading versus intra-company transactions;
- (v) Geographic concentration of countries in production, processing, trading and consumption of the commodity;
- (vi) Nature and structure of the industry. Proportion represented by export value of primary commodities in final consumer value in importing country;

- (vii) Dynamics of resource discovery and, in the case of minerals, trends in reserves related to current production;
 - (viii) The trend towards massive size in mining projects: increasing capital investment required per metric ton of production of the specific commodity concerned.
- (d) *The international setting (A₄)*
- (i) *World political order: post-world-war political emancipation and decolonization.*
 - (ii) *World economic order*
 - The calls for economic emancipation to accompany political independence, culminating in demands for a New International Economic Order; and on the other hand, the steadily-growing power of transnational corporations in all spheres;
 - The role of international institutions: United Nations agencies (especially UNCTAD), IMF, IBRD, etc.;
 - International commodity agreements, e.g., the International Tin Agreement;
 - Producers' associations, e.g., Organization of Petroleum Exporting Countries (OPEC), International Bauxite Association, Union of Banana-Exporting Countries, Association of Natural Rubber-Producing Countries;
 - Multipolarization of the world economy;
 - Preferential schemes extended to a particular group of countries by cer-
- tain importer countries and other policies imposed by consumer/importer countries;
- Potential or real sanctions imposed by home governments and/or international institutions on countries which embark on policies such as expropriation.
- (e) *Shaping the bargaining situation*
- It would be difficult, if not impossible, to assign meaningful values or weights to the above factors, most of which are qualitative in nature. Moreover, although in the short run many factors are assumed to be constant, in the long run they all vary, which creates a climate of continuous change and often tension in the bargaining situation.
- Until a more rigorous general theory on the bargaining framework including both qualitative and quantitative factors has been developed, the most reasonable approach would appear to be to carry out case studies, which is the methodology adopted in this project.¹⁵ The foregoing catalogue will then act purely as a checklist. Thus, an appreciation of what matters might be formed by looking at otherwise very similar cases in different countries or industries or in the same industry at different points of time. It is believed that the accumulation of such case study evidence will enable other host governments to apply similar strategies in respect of transnational corporations operating in their countries.
- Although as a general rule the improvement of a host government's
- ¹⁵ Of course, many rigorous bargaining models exist, in which the non-qualitative factors are ignored or assumed to be constant. None of these will have an operational value in the approach presented in this paper.

bargaining power will automatically weaken the other party, there are cases where the zero sum of game theory does not apply, as both parties can increase the gains to be distributed through jointly-conceived strategies. The petroleum price hike is, of course, the most obvious example, whereby both host governments and transnational corporations increased their benefits by jointly capturing the consumer surplus.

Broadly speaking, transnational corporations are almost by definition able to capture a larger share of profits through their structural and inherent characteristics. Their unique advantages include their transnational mobility and their control over vital resources, which in turn gives them control over the crucial stages in the export of primary commodities; their strong point is their very 'transnational-ness', a characteristic which governments in particular do not possess.

The TNC subsidiary's strength lies in the large central expenditure borne by the corporation as a whole, and not necessarily by a particular subsidiary. Through their heavy expenditure (on exploration, advertising and marketing, or on research and development),¹⁶ TNCs control most turnstiles of entry to the industry. Depending on where the key scale factors are, and where heavy expenditure is made, the crucial turnstiles of entry will be located either after the production stage, as in the case of bananas (and other tropical agricultural products), tin, bauxite and iron ore, or else at the production and exploration stage, as in the case of petroleum, copper, nickel and natural gas.

¹⁶ Paul Streeten, "Policies Towards Multinationals", *World Development*, vol. 3, no. 6, June 1975, pp. 393-397.

Accordingly, the oil and copper companies that are challenged by economic nationalism in the countries where the wells and mines are located cannot easily capture oligopoly control at a later stage. In the cases where oligopoly control is strong at the post-production stage, on the other hand, TNCs may continue to maintain it even if production facilities are nationalized.¹⁷

Despite the difficulty of assigning values or weights to the factors in the list above, one can make certain generalizations about the magnitude and intensity of the impact of each factor on the relative bargaining power of host governments and transnational corporations.

Ceteris paribus, from the standpoint of the structure of transnational corporations, a country owning a resource for which substitutes are readily available is *de facto* in a weaker position than the owner of the sole source of a material, and the latter's position is stronger if it does not depend on that resource alone for its export revenue.

In a given host country, a transnational corporation which depends to a large extent on raw materials from that country will be in a weaker position than other corporations which have a more diversified resource pattern. The ability of host governments to play off one company against another will depend on the oligopoly dynamics, which differ from commodity to commodity. In commodities in which the control of the few dominant companies is constantly being challenged by the proliferation of new independent companies, host go-

¹⁷ Theodore H. Moran, "Transnational Strategies of Protection and Defense by Multinational Corporations: Spreading the risk and raising the cost for nationalization in natural resources", *International Organization*, vol. 27, no. 2, Spring 1973.

vernments will be in a better position to bargain than in cases where a handful of companies control the crucial technology or marketing of the commodity.

Host governments possessing few bargaining skills or first-hand experience, owing to the absence of qualified personnel and lack of information about the market, will be able to take advantage of the knowledge and experience of other countries which have been successful in concluding contracts favourable to them or in renegotiating existing contracts. Concerted action and solidarity among host countries will automatically strengthen individual positions, whereas lack of solidarity will allow corporations to play off one country against another.¹⁸ Although all transnational corporations are by definition able to move easily across national boundaries, when it comes to mineral exploitation the corporations with mineral reserves in many parts of the world will be placed at an advantage over companies with limited resource mobility. In this connexion it should be remembered that in both the successful instances of concerted action by producer countries, i.e., in respect of petroleum and bauxite, the initiative was taken by a group of countries with similar problems and interests: the Arab countries in the case of oil and the Caribbean countries in the case of bauxite.

¹⁸ After having succeeded in raising revenues from bauxite exports by 600 per cent in 1974, the Jamaican Government sent out missions to other bauxite-producing countries, which introduced similar levies. Solidarity benefited all parties. The other countries took advantage of Jamaican skills and knowledge in planning their strategies, while Jamaica's position was strengthened by concerted action on the part of other producers.

The market structure of the commodity is an important determinant of the bargaining power of host governments. In the absence of an open market for the commodity concerned, host governments, even after nationalization, will have to sell their output to the handful of transnational corporations controlling the industry. If nationalization does not take place, the export price is essentially a transfer price between two subsidiaries of the same company. It can, therefore, be arbitrarily set by the company, which is aiming at profit maximization at the global rather than at the subsidiary level.

Finally, information is a very important source of strength. For example, if a government knows the 'hurdle rate' of return to the company it can impose heavy taxation on profits in excess of this return, as they represent economic income. Unfortunately, this hurdle rate is often a closely-guarded secret, although instances can be cited of successful renegotiations due mainly to the information on it possessed by the host government (e.g., the case of the Jamaican bauxite levy).

To move from essentially static to medium-term conditions, the changes over time in bargaining positions can be discussed at two levels: the project level and the general level.

At the project level it is generally observed that the bargaining position of host governments is weakest before the project starts. This is especially the case in big mining projects, as the first stage involves risk capital for large-scale exploration expenditure which the transnational corporation can supply. Once the corporation has sunk substantial amounts of capital, which is frozen over the short term, the bargaining position tilts in favour of the host governments,

to which the original terms of the agreement may come to appear excessively generous. They may then introduce new tax laws, or tighten the control and regulation provisions within the existing agreement, or demand the renegotiation of the original contract. The balance of bargaining power may eventually swing back in favour of the transnational corporation at the time when it is considering a further large investment outlay, until the new bargain again becomes obsolete. This cyclical pattern of the bargaining process has been described by Raymond Vernon as the "obsolescing bargain".¹⁹

Analysing the dynamic changes which have taken place at the global level, one can observe that the cyclical trend described above oscillates around a secular trend in which host governments have continuously managed to strengthen and improve their bargaining position *vis-à-vis* the transnational corporations. This is reflected in the ability of host governments to conclude agreements with increasingly better terms and conditions or to apply to existing projects policy measures such as renegotiations or nationalization, all of which have shifted the distribution of gains unmistakably in favour of the governments concerned.

Among all the factors listed above, three in particular have contributed to

this trend: the improving international climate in favour of Third World participation in global economic activities; the improvement in the negotiating skills of host countries; and the emergence of new industrial powers with their own independent corporations challenging the supremacy of the handful of companies controlling each commodity. These three factors are discussed below.

In the past, it was taken for granted that colonies and peripheral countries should specialize in the production of raw materials and cheap foodstuffs for the metropolitan countries. The dynamism generated by commodity flows from the peripheral countries and colonies was felt mostly in the metropolitan countries where the whole decision-making process with respect to processing, manufacturing and marketing of the commodities was concentrated, while the commodity-producing countries were relegated to the position of dependent entities. Whatever dynamism trickled down to them was very often confined to the foreign-oriented export-enclaves.

Private capital investment played an all-important role in this international division of labour between the metropolis and the periphery. Until the late nineteenth century, Western Europe's main interest in the colonies was as a source of cheap foodstuffs and agricultural materials. Private companies, some of them possessing in embryo the characteristics of today's giant corporations, developed the plantation economy and the trading facilities to satisfy these metropolitan needs. At the beginning of the twentieth century a new dimension was introduced into this typical relationship. As the industrial sector in Western Europe and Japan expanded rapidly and domestic sources of fuels and minerals

¹⁹ Raymond Vernon, *Sovereignty at Bay*, New York, Basic Books, 1971, pp. 46 *et seq.* For a distinction between the bargaining power of host governments at the pre-exploration, pre-exploitation and post-execution stages of a mining project, see Rex Bosson and Bension Varon, *The Mining Industry and the Developing Countries*, World Bank Research Publication Series, Oxford, University Press, 1977, pp. 137-139. See also Theodore Moran, "Economic Nationalism and the Copper Industry", *Development Digest*, vol. XIV, no. 3, July 1976.

were swiftly depleted, these countries embarked upon an aggressive overseas search for fuels and minerals.

In this search, too, private companies played a major part, and the era witnessed the birth of the fully-integrated company with the establishment of Royal Dutch Shell in 1907, followed by other petroleum companies and companies engaged in prospecting for all the major metals of those days: copper, tin, bauxite and iron ore. Although the United States had always been relatively self-sufficient in these basic materials, to the extent that the country did require overseas supplies its companies not only participated in this worldwide hunt for fuels and minerals but were often in the lead.

The international climate was heavily weighted against the colonies and peripheral countries. The 'host governments' in the colonies were colonial administrations having the same objective as the transnational corporations: namely, to ensure the regular, orderly and cheap flows of raw materials and foodstuffs needed by the metropolis, with little regard for the economic needs of the local population in the colonies. Even in the case of the independent peripheral countries of Latin America, the bargaining position of transnational corporations, often backed by powerful home governments, was very strong and, at the same time, that of host governments very weak. The second factor explaining this weakness in those days was the complete ignorance of host governments regarding their natural resources, and their lack of experience in dealing with complicated issues such as mining contracts. Host governments had to rely entirely on company reports on the nature and extent of their natural wealth, to their obvious disadvantage,

and corporations could virtually dictate the terms and conditions of the contract.

The international climate has changed considerably, especially since the Second World War. The political emancipation and decolonization which took place in the 1950s and 1960s have created independent countries out of erstwhile colonies. Transnational corporations now have to deal with host governments instead of colonial administrations.

However, the new nations very soon found out, as had their fellow Third World countries in Latin America long before, that political independence did not automatically bring about economic independence. Improved international communications, coupled with the increasing skills of bureaucratic machinery and the growing awareness of the intelligentsia in the Third World, fed by a swelling flow of university graduates (often from universities in the home countries of the transnational corporations), have stepped up the collective bargaining power of host governments. The countries of the Third World realize that economic independence cannot be achieved if they plod on in their marginal role of providers of raw materials for the metropolis and continue to receive only a minute portion of the total gains derived from their commodity exports.

Third World solidarity and awareness, as demonstrated in the many existing international forums, have contributed significantly to these changes in the international climate. In addition, improvements in international communications have enabled host countries to learn from one another's experience so that new agreements will have better terms and conditions than old ones. The successive waves of nationalizations and

renegotiations are mutually reinforcing, and often have repercussions on relationships in the same industry elsewhere or even in other industries.

An important factor in the decline of oligopoly power has been the emergence of numerous independent companies, some of them fully-integrated transnational corporations, others purveyors of separate services such as technology, and still others State enterprises. This is a consequence of the multipolarization of world economic power among the countries of Western Europe, the Socialist countries and Japan in the 1960s and 1970s, with its challenge to the post-war economic supremacy of the United States. This does not mean, of course, that the older companies have declined in absolute importance. On the contrary, through continuous mergers, consolidation and vertical and horizontal integration, these companies have individually all become statistically stronger. However, there is no doubt that the relative share of the oligopolies in production and exports of most commodities has declined over time.

2. *The bargaining process* (box B)

Given the bargaining situation, the success of a government in maximizing gains derived from primary commodity exports will largely depend on the skill with which it exploits its bargaining position. Several stages can be distinguished in the bargaining process between the transnational corporation and the host government. Stage one takes place prior to the initiation of a new project. Here the bargaining process will establish the terms and conditions of the agree-

ment, which in turn will determine the distribution of gains from the project. In contemporary agreements, the terms and conditions agreed upon include such issues as transfer prices, the kind of technology to be used and its cost, tax and royalty rates and tax reporting techniques, concessions and the time limit involved, management and patent fees, the structure of debt and ownership, including the extent of local participation, local processing requirements and local purchases of goods and services.

Once the project is in process of execution by the transnational corporation, the government, exercising its regulatory and control functions, will attempt to ensure that the actual gains derived are in accordance with previously agreed-upon terms and conditions. It may pass new tax or other laws affecting the distribution of gains, within the confines of the original agreement. If, however, it demands significant changes, such as the imposition of a new production levy or equity participation in the companies concerned, or other issues are raised requiring changes in the original provisions of the agreement, the bargaining process enters its second stage, i.e., the renegotiation of the agreement. Renegotiations are nowadays quite common in the relationship between host government and transnational corporation, in view of the changing bargaining position described at length in the previous section.

When renegotiations break down, the government may decide to nationalize the facilities owned by the transnational corporation. Nationalization may occur without previous attempts at renegotiation, which is the case if a government decides to resort to it either as a matter of principle, or on an *ad hoc* basis at

the prompting of given events. Unless nationalization is accompanied by confiscation, it will entail a certain type of negotiations as well, which may be labelled stage three of the process; they will centre on the issue of compensation payments, but will often also include negotiations on a new relationship between the two parties, i.e., the signing of management, technology or marketing contracts. Nationalization of a dependent "cell" or subsidiary will not necessarily be followed by a severance of all ties with the transnational corporation network.

3. *The agreement and the distribution of gains (box C)*

Turning now to the *volume of distribution of gains* itself, this study will employ the concept of *retained value* as a basis for measuring the distribution of gains. Under this concept, the gains to the host country are measured as the sum total of all components of foreign-exchange export earnings which are retained in the country. Table 1 shows that in the case of the traditional agreement, the most important components are: (a) wages and salaries; (b) domestic purchases of goods and services;²⁰ (c) the government's share of revenues (royalties, taxes, levies, dividends); (d) reinvested profits.

Table 1 also shows that the contemporary agreement has two components. One is the gross value of exports (XR), where the distribution of gains problems are of course, identical with those of the traditional agreement, i.e., $XR = RV +$

²⁰ Defined net of import content of local purchases. Import content may be very large, especially in small countries with a narrow industrial base.

OP. The second component deals with the gains from forward linkage activities. If the government succeeds in transferring the later-stage processing activities—refining, smelting and eventually manufacturing—to the host country, but continues to rely on transnational corporations for the operation of the activities in question, additional distributive implications emerge. Here again, the components of retained value become important. Governments are also interested in securing shares in lucrative operations such as shipping, marketing and distribution, which are carried on outside the host country and would presumably yield foreign exchange revenues. The important magnitudes are not the gross margins accruing from these operations, but the net surplus gains that the host country can earn from engaging in such activities.²¹

The concept of retained value employed in this study has been applied by Mikesell in case studies on copper, petroleum and other products.²² It is by no means the only way to calculate the nation's benefits; it is perhaps not even the best, as it suffers from various defects such as the inability to compute social opportunity cost and the social rate of discount. Nevertheless, from the standpoint of host government policy, it is a useful approach for comparing alternative means of developing a project. Furthermore, estimation problems at the case study level due to lack of data would prevent the use of a more

²¹ See the introduction to this paper.

²² See Raymond F. Mikesell, *Foreign Investment in the Petroleum and Mineral Industries*, Resources for the Future, Inc., The Johns Hopkins Press, Baltimore, 1971; and by the same author, *Foreign Investment in Copper Mining*, Resources for the Future, Inc., The Johns Hopkins Press, Baltimore, 1975.

Table 1
THE DISTRIBUTION OF GAINS UNDER THE TWO TYPES
OF AGREEMENT

<i>The traditional agreement^a</i>	<i>The contemporary agreement^a</i>
A. Components of gross export revenues (XR):	Components of the distribution of gains from final consumer value (FCV)
1. <i>Components of retained value of exports (RV)</i>	A. <i>Components of gross export revenues: same as under the traditional agreement (XR)</i>
(a) Wages and salaries (W)	
(b) Domestic purchases of goods and services (DP) ^b	$XR = RV + (OP) \quad (1)$
(c) Government's share of revenues (GR)	
(d) Reinvested profits (RP)	
2. <i>Components of outflow payments (OP)</i>	B. <i>Components of forward linkage activities (FL)</i>
(a) Imports of goods and services, including invisibles such as patents and licences (MGS)	(a) Refining and smelting (or ripening in the case of foodstuffs such as bananas)
(b) Salaries of expatriates accruing abroad (SE)	(b) Manufacturing
(c) Loan repayments abroad, including interest (LP)	(c) Shipping and insurance
(d) Corporate profits transferred abroad (TP)	(d) Marketing and distribution
$XR = RV + OP \quad (1)$	$FCV = XR + FL \quad (2)$

^aSee diagram 1 for an explanation of these two types of agreement.

^bDP is defined net of the import content of domestic purchases.

sophisticated measure of the distribution of gains, such as the concept of net present value of the investment project developed by Mikessell, McKern and Kindleberger.²³ In the latter concept, the time element is taken into account by introducing an appropriate social rate of discount. In addition, the equation includes such measures as the social

value of external economies and the social opportunity cost of domestic inputs, all of which are difficult to estimate.

Table 1 simplifies the picture in that it assumes an ongoing project earning foreign exchange from exports. This makes it possible to calculate, on an annual basis, how the export earnings are

²³ Charles P. Kindleberger, "Direct Foreign Investment in Economic Development", in *Direct Investment in Asia and the Pacific* (Peter Drysdale, ed.), University of Toronto Press, 1972. For further elaboration of the concept, see Raymond F. Mikesell, "Foreign Direct Investment in External Finan-

cing", paper presented at the Conference on External Financial Policies, sponsored by OAS and the Central Bank of Chile, Santiago, March 1977. See also Bruce McKern, *Multinational Enterprise and Natural Resources*, Australia, McGraw Hill, 1976, pp. 23-33.

distributed among the various agents: the transnational corporation, the host government and others.

A key element in the negotiations is the determination of *direct gains*, or gains in the narrower sense of the word, i.e., the surplus accruing from the project. Since surplus is the difference between revenue and cost, its size will depend on the method by which the various items determining these two magnitudes are calculated. The methods of calculation are often a major source of conflict. Primary export projects involve complicated inflow and outflow transactions between various subsidiaries of the transnational corporation, and the calculation of cost and revenue therefore depends very much on the corporation's transfer pricing practices.

In order to obtain a better understanding of the relationship between the investment of the transnational corporation and the surplus generated by the project, the project's balance-of-payments flow must be traced from its beginning. This is done in table 2, which distinguishes between the two phases of each project: the initial investment or pre-exportation period and the sustained-exportation period. In both periods inflow payments are equal to the retained value plus outflow payments ($IP = RV + OP$ (1)).

The pre-exportation period varies from project to project. In the mining and petroleum sectors, it will include the exploration period, during which the corporation brings in equity or loan capital for high-risk activities which may turn out to be unsuccessful. On this investment, therefore, the company expects a higher than normal rate of return, which it will recover in the form of profits when the project starts production. Even if the activity is less

risky, as in the case of banana plantations, there will be an initial period in which expenditure is made and nothing is earned. Very often the inflow is in the form not of cash but of heavy machinery, drilling equipment, etc., so that the inflow item is automatically offset by the import item. During this period, the main components of retained value are wages and salaries (W) and domestic purchases of goods and services (DP).

In Phase II, the sustained-exportation period, the problem of the distribution of gains will loom up in earnest, as there are foreign exchange earnings from exports to be divided. Corporations often justify their high rate of profits, or returns, on the grounds that they have to write off expenditure incurred in Phase I and take into account the high-risk activities undertaken during that phase. While this may be true, it is difficult in practice to estimate the magnitudes of a just return for risks undertaken in Phase I, because of the use of transfer pricing and because the corporation maximized returns on a global scale. A government will find it hard to understand that against earnings from exports of its own country's products a company will write off unsuccessful investment in another country.

Conceptually speaking, the ability of governments to capture the direct gains from export activities is related to the various categories of economic returns within the overall gains. It is useful to distinguish between three types of economic returns which accrue from primary commodity exports:

1. Resource income, first introduced by Ricardo many years ago in agriculture. Today this concept is much more applicable to mining, especially when differences in the quality and in the

Table 2
DISTRIBUTION OF GAINS DURING THE TWO PHASES OF THE
INVESTMENT PROJECT

<i>Inflow payments (IP)</i>	<i>Retained value (RV)</i>	<i>Outflow payments (OP)</i>
<i>Phase I: The initial investment period</i>		
1. Transfers from transnational corporation's headquarters (THQ)	1. Wages and salaries (W)	1. Imports of goods and services, including designs, blueprints, etc. (MGS)
(a) equity capital (EC) (cash and subordinated loans)	2. Local purchases of plant, equipment goods and services ^a (DP)	2. Salaries of expatriates accruing abroad (SE)
(b) debt (foreign loans) (DE)	3. Changes in cash balances in local banks (CLB)	3. Changes in cash balances in foreign banks (CFB)
		4. Interest payments (IP)
<i>Phase II: The sustained-exportation period: operating results in year i</i>		
1. Export revenues (XR)	1. Wages and salaries (W)	1. Imports of goods and services, including royalties, patents, licences, etc. (MGS)
2. Transfers from transnational corporation's headquarters (THQ): same as 1 (a) and (b) under Phase I	2. Local purchases of goods and services (DP)	2. Salaries of expatriates accruing abroad (SE)
	3. Government's share of revenues (GR)	3. Profits and depreciation transferred abroad (TP)
	4. Retained earnings and depreciation reinvested or in local banks (RP)	4. Debt amortization (DA)

^aDefined net of import content.

Note: In both periods: $IP = RV + OP$ (1).

accessibility of mineral deposits produce differential resource incomes;

2. Quasi-income. This type of income is earned by factors of production brought into combination by the transnational corporation, such as capital and technology. It also includes the services of experts, which, owing to the oligopolistic position of managers, are not readily available;

3. Monopolistic and monopsonistic income accrued. Since perfect competition does not exist in primary-commodity trade, oligopolies controlling the barriers to entry earn these types of income on the buyer and seller sides.

In practice, it is difficult for a host government to identify the three kinds of income and demand a share of each type. Usually, quasi-income is shown

among the cost items of the transnational corporations and will be part of the outflow payments. Attempts to capture such forms of income are difficult, but a tax on licence fees, for example, has been introduced successfully by some countries.

For obvious reasons the differential resource incomes are the most easily captured by host governments earning them. Finally, the burden of the recent successes of governments in demanding a larger share of the gains from oil and bauxite has been shifted by the transnational corporations on to the consumers, allowing both host governments and transnational corporations jointly to maximize the monopolistic income gained in these industries.²⁴

Nowadays, the distinction between the two types of agreement is rapidly disappearing. Between the two extremes—i.e., a host government receiving a minimal share of earnings under a traditional type of agreement and a government which participates in all activities, including forward linkage, in the shape, for example, of a fully-integrated nationalized firm—, a wide range of variations on the basic theme has come into existence, especially with the proliferation of new types of agreements replacing the traditional foreign-direct-investment package, such as joint ven-

tures, turn-key operations, management or technology contracts, production-sharing agreements, etc.

The host government, during the negotiations, will not merely confine itself to the narrower question of distribution of direct gains, i.e., of how to capture its share of surplus or economic returns. It will also be concerned with increasing indirect gains, i.e., the shares falling to the other domestic agents (wages and salaries and domestic purchases of goods and services), and, under the contemporary type of agreement, with the forward-linkage effects of the project. In other words, the total impact on development depends not only on the magnitude of the retained value, but also, to a more important extent, on its composition, which determines the strength of the various linkages described in the following pages.

Better control and regulation of existing stipulations in the agreement as to proportions of local personnel, of domestic purchases of goods and services, and of processing in the host country, will often yield considerable increases in indirect gains, i.e., in the country's share of the gains accruing from various components of retained value of exports. If the agreements is of the traditional type or is strongly biased in favour of the corporation, only drastic renegotiations of the contract or nationalization can resolve the problem of increasing the host country's primary-export earnings.

It is useful to clarify further the impact of distribution of gains on economic development. This is important in view of the fact that discussion on gains from transnational corporations is often coloured by conceptual con-

²⁴ The income concepts are from a paper by Helen Hughes, "The Distribution of Gains from Foreign Direct Investment in Mineral Development", Southeast Asia Development Advisory Group, *Papers on Development Problems in Southeast Asia*, New York, The Asia Society (mimeographed) 1974. For an analysis of the incidence of new taxes or levies introduced by governments, see Malcolm Gillis and Charles E. McLure, Jr., "The Distributional Implications of the Taxation of Natural Resources", *Rice University Studies*, Houston, Texas, vol. 61, no. 4, Fall 1975.

fusion, which renders it meaningless to policy-makers.

Since this paper deals with an export-oriented sector, the discussion should logically concentrate on the financial gains derived from export projects. It would be beyond the scope of this paper to introduce issues such as effect on employment, income distribution, choice of investments, or environment, all of which are, of course, of great importance in the actual repercussions of projects on economic development. Nevertheless, it seems useful to dwell on the various development effects of the investment project, as its global impact on development depends on their strengths and weaknesses. In this regard, the system of generalized linkages worked out by Hirschman and others will be a useful guide.²⁵ The concepts of forward and backward linkages of investment introduced by Hirschman are now well-known in economic development literature.²⁶ The linkage effects of a given product line have been defined by Hirschman as investment-generating forces that are set in motion through input-output relationships. Backward linkages refer to purchases of domestic goods and services on the part of an investment project, leading to new investments by the suppliers.²⁷ Forward linkages refer to investment in output-using facilities, or the downstream integration of the

project in processing, manufacturing, marketing and distribution.²⁸ These may be called production linkages, and are of the greatest concern to host governments in negotiations with transnational corporations.

In addition, host governments should take into consideration what Hirschman calls the consumption and fiscal linkages of the investment project. Both of these relate to the income aspect of the export-oriented project. The consumption linkage works as follows: new incomes generated by the production and export of primary commodities may initially be spent on imports, but a consumption linkage is considered positive if these imports, once they have grown to a sufficient volume, can eventually be replaced by domestic manufactures. Of course, the consumption linkage may be negative if imported consumer goods compete against domestic products and price them out of the market.

The fiscal linkage relates to the fiscal revenue generated by exports of primary commodities. While host governments are primarily interested in increasing their share of the economic returns on exports of primary commodities, the ultimate impact on economic development will depend upon whether the government spends the revenue on productive investment, i.e., upon the existence of the fiscal linkage. Of course, the bigger the pie, the more likely it is that at least part of it will go to feed productive investment.

It often happens that one kind of linkage is to be had only at the expense of another. Thus, fiscal linkages have made a strong showing in mining and petroleum activities which have all the

²⁵ The following discussion draws heavily on Albert O. Hirschman, "A Generalized Linkage Approach to Development, with special reference to Staples", *Economic Development and Cultural Change*, vol. 25, Supplement, 1977.

²⁶ Albert O. Hirschman, *Strategy of Economic Development*, New Haven, Connecticut, Yale University Press, 1958.

²⁷ DP in tables 1 and 2.

²⁸ FL in table 1.

earmarks of an "enclave". If the enclave is defined as the absence of involvement with the rest of the economy, it automatically implies absence of the consumer and production linkages.

A small country receiving huge amounts of tax revenue from petroleum exports, for instance, will be less concerned with promoting forward and backward linkages. The consumption linkage may also be absent if the high propensity to import proves self-sustaining and no encouragement is afforded to domestic industry. The only

consumption linkage may be the improvement of port and highway facilities to cope with the astronomical rise in imports.

It would exceed the scope of this paper to follow through in greater detail the workings of the various linkages. With exception of those relating to production, i.e., forward and backward linkages, which are of direct concern in negotiations with transnational corporations, the other linkages are more closely connected with domestic policies and with the multiplier effect.

C. Summary

The broad conceptual framework set forth above will serve as a general guide for case studies in this field of enquiry. In each case study, modifications will have to be made in the broad terms of reference propounded in this paper. Nevertheless, certain common hypotheses developed in this framework will have to be tested in all the case studies, so that a comparative study can be made in the future. The basic hypotheses presented include the following:

1. During the past twenty-five years, there has been a significant change in the distribution of gains in favour of host governments and countries;
2. The improvement in the distribution of gains is a direct result of the strengthening of the relative bargaining position of host governments;
3. The relative bargaining position is determined by the mutual interaction of four sets of factors, namely, (a) the host governments, (b) the transnational corporations, (c) the nature of the commodity and (d) the international climate;
4. The list of the four sets of factors tabulated in the paper should be used as a checklist by researchers undertaking the case studies. The use of a common checklist for these studies will enable general conclusions about the relative importance of certain factors to be drawn;
5. Basically, the government can influence the distribution of gains in its favour through negotiations with the transnational corporations;
6. Negotiations take place at various points in time. Before the initiation of a project, negotiations are conducted to conclude an agreement. After the project has been executed, renegotiations may take place to alter the terms and conditions of the contract. Finally, should the government decide to nationalize the subsidiary of the transnational corporations, negotiations may take

- place regarding compensation and perhaps marketing or other arrangements;
7. There exist considerable variations of the basic model above. In the case of small projects, negotiations may not take place at all, as corporations may execute a project under a standard contract or an implicit agreement. Automatic renegotiations will take place from time to time if governments decide to alter the basic contracts and the rules and regulations governing foreign investment;
 8. With regard to the content of the agreement, two types of agreement can be distinguished: (a) the traditional agreement, which is concerned with the distribution of a given f.o.b. export value, and (b) the contemporary agreement, which is concerned with increasing the export value through forward linkage effects;
 9. A distinction can be made between (a) direct gains, i.e., the surplus generated by export activities, and (b) indirect gains, i.e., the retained value accruing to domestic agents of the export project other than the government (domestic purchases of goods and services, and wages and salaries, as well as profits reinvested by the corporation);
 10. Direct gains: governments are interested both in their percentage share and in the volume of the surplus, since the latter is determined by such negotiable factors as transfer pricing and depreciation practices;
 11. Indirect gains: governments can influence the value of indirect gains by introducing laws requiring more extensive use of local personnel and of local goods and services, or others requiring government and host-country participation in forward-linkage activities associated with its primary commodity exports (such as processing, marketing, shipping, distribution and financing).

Prices and gains in the world coffee trade

*Alberto Orlandi**

There is now an abundant literature on the need to protect the prices of the developing countries' primary export products, but few studies trace in detail the evolution of these prices through all the stages of production and marketing up to that of final consumption in the central countries. The purpose of the present article is to examine this process with reference to coffee, a product which is of great importance in Latin America's foreign trade, and whose final price, as is common knowledge, has risen significantly in recent years. The data considered lead the author to conclude that much of the increase has occurred in the consumer countries, where, of course, a major proportion of the surplus thus generated has remained.

After giving some account of the world coffee market, the study focuses on the analysis of coffee production and exports in some of the producer countries, in particular Colombia, and on the distribution of coffee income among the various economic agents.

The second half of the article, which analyses the price of coffee in some of the European consumer countries—the Federal Republic of Germany, France and Italy—ends by suggesting measures which would enable the producer countries to capture a larger share of the final price.

* Staff member, International Trade and Development Division, CEPAL.

Introduction

The interest attaching to this study stems from concern with a basic factor in the relations between the Latin American economies and the developed centres; the production, marketing, industrial processing, distribution and final consumption of primary commodities. Its main object is to meet the widely-felt need to identify and elucidate the successive stages in the complex process extending from the production of a primary commodity to the phases nearer to final consumption, which are strongly influenced by the technological innovations proper to our time. An analysis of this type seems indispensable for the purpose of enriching, —while incorporating it into the study— the traditional approach based on the study of the relation between supply and demand on the world market and, in its more perfected form, on examination of the terms of trade as between primary commodities and manufactures.

The natural procedure in this terrain —little explored as yet although not completely virgin ground—¹ seems to be to break down the final retail price, starting from production costs in the producer country, and taking into account all the other various elements entering into the price formation process.

Because of the difficulties of obtaining adequate information, in the present instance the analysis has been confined to a single commodity, coffee. The choice of coffee is due, on the one hand, to its basic importance both in world trade² and for many Latin

¹ See in particular UNCTAD, *Marketing and distribution system for bananas* (TD/B/C.1/162), Geneva, December, 1974.

² In 1973 coffee represented about 10 per cent of the developing countries' primary commodity exports (excluding fuels).

American countries,³ and, on the other hand, to the interest of the discussion on it recently stirred up by its wide range of price fluctuations.

The research of which this paper presents the findings was subject to serious limitations. Its object—apart from the above-mentioned aim of clarifying the factors that come into play at the various stages in the formation of the final retail price—is to awaken interest in studies of this type, both inside and outside CEPAL, whether in the direction of analysing the case of

coffee more satisfactorily and in greater depth, or in that of extending the analysis to other products.

A brief account of the world coffee market (world and Latin American exports, price trends, etc.) will be followed by discussion of the distribution of coffee income among the various economic agents participating in the production, export, processing and distribution of coffee, both in the producer and in the consumer countries; and, lastly, the results will be presented in synoptic figures and tables.

I

The world coffee market and Latin America

With a total export value of 4,180 million dollars in 1975, coffee was the primary commodity which—with the exception of petroleum—made the biggest contribution to Third World exports. Its aggregate importance in world trade, however, showed a marked decline, from 1.6 per cent in 1965 to 0.5 per cent in 1975.⁴

The importance of coffee for Latin America can be clearly seen from a glance at its percentage share in the total exports of a number of Latin American countries (see table 1).

Latin America's share in world coffee exports, although it has considerably diminished since the Second World War, has settled down at about 62-63 per cent. This trend is essentially due to the

notable relative decline in Brazil's contribution. In the coffee year 1927/1928, for example, Brazil produced 29.6 million bags of coffee—more, that is, than in any year after 1965/1966—and at that time it practically held the monopoly of world exports. In 1950/1951, it still controlled more than 55 per cent of them, whereas by 1972-1974 its average share had dropped to 25.8 per cent. The other Latin American countries, and, to a still greater extent, the countries of Africa, occupied the ground lost by Brazil.

On the demand side, too, there have been substantial changes, albeit in this case of more recent date. Between 1965 and 1975 the share of the United States and Canada dropped from 47.9 per cent to 37.4 per cent; it was Europe that replaced North America as the leading market of destination for Latin America's coffee exports, since the proportion for which it accounted rose from 45.8

³ See table 1.

⁴ The rise in world coffee prices in the last two years has made a substantial difference to these figures, as to all others relating to commercial values of coffee exports.

Table 1
**SELECTED LATIN AMERICAN COUNTRIES: COFFEE EXPORTS AND THEIR
 PERCENTAGE SHARE IN TOTAL EXPORTS, 1972-1974**

<i>Country</i>	<i>Exports (millions of dollars)</i>	<i>Percentage share in country's total exports</i>
Colombia	590.0	52.3
El Salvador	158.8	42.4
Haiti	20.3	36.6
Guatemala	141.2	30.9
Costa Rica	96.5	27.5
Brazil	1 032.6	17.1
Honduras	37.9	16.4
Latin America	2 434.4	7.4

per cent in 1965 to 54.4 per cent in 1975.

The problem of coffee price fluctuations and their harassing implications for many Latin American countries has been the object of analysis and of international negotiation during the last two decades.⁵

From figure 1 emerges, together with a picture of coffee price fluctuations over the very long term, a fact to cause still greater concern: the steady reduction of the purchasing power of the coffee-exporting countries, expressed in terms of dollar cents per pound, deflated by the United Nations price increase index for manufactured goods as from the end of the Second World War. In reality, with the exception of the period 1931-1944, which was affected first by the great depression and then by the war, the figure shows that in 1975 the value represented by this indicator was medium-to-low in relation to 1885-1930, and definitely lower than in any year after 1946.

⁵ Mention should be made here of the three international agreements which, with a brief interval, have been in force from 1962 to the present day.

While it is true that the situation has strikingly altered since June 1975, by reason, of course, of the severe frosts in Brazil, which raised coffee prices to record levels in both current and constant terms, a responsible analysis of the coffee market can be made only on the basis of the long-term trends, which are unquestionably the most significant.

As has already been noted, in the last two or three years there has been a marked improvement in coffee's position in relation to that of other primary commodities, owing to the joint effect of the rise in the price of coffee and the fall in other primary commodity prices. This inference can be clearly drawn from table 2.

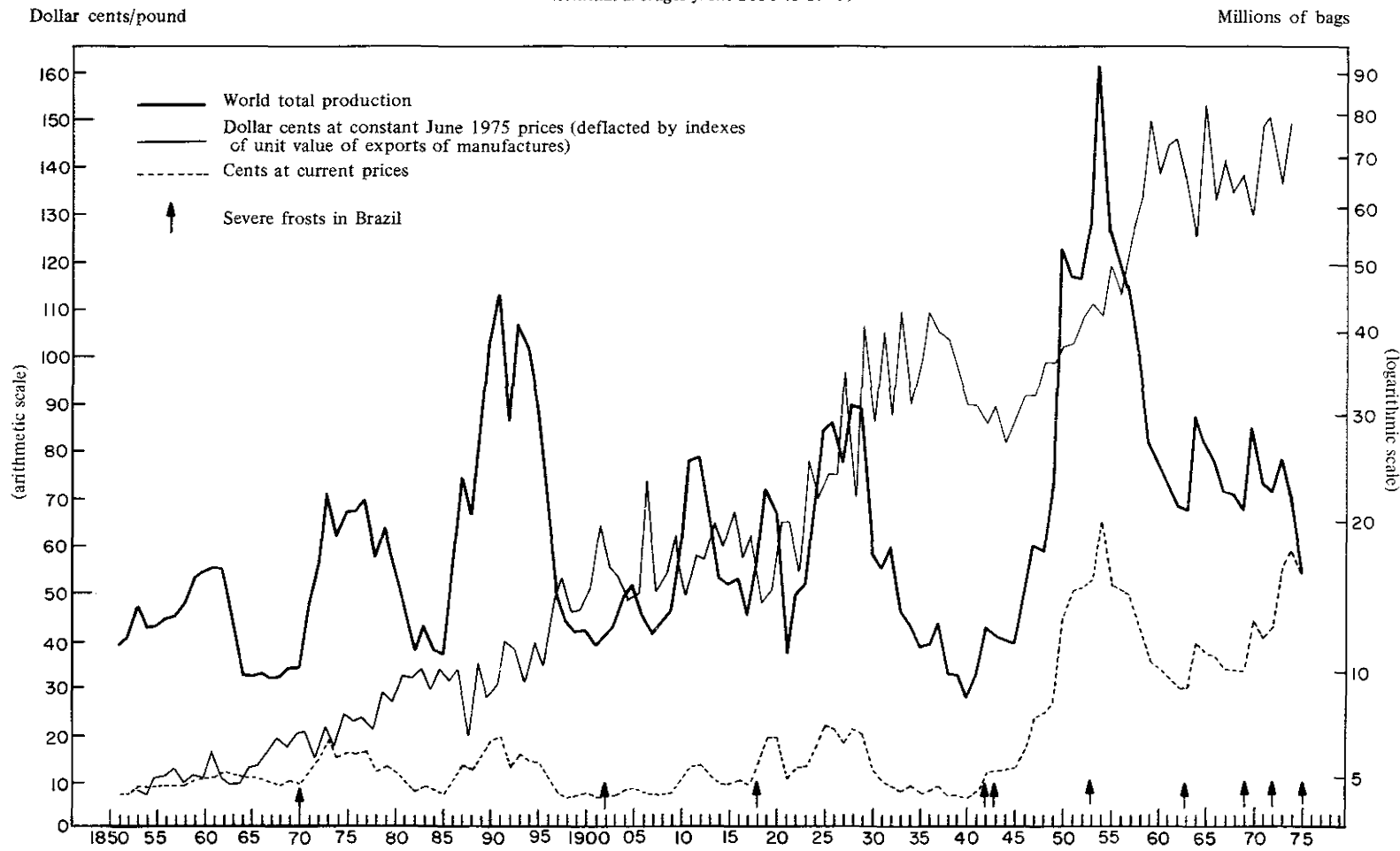
A comparison of the coffee price series (annual averages) for the years 1954⁶ to 1976 with the United Nations index of world market prices for exports of manufactures gives the results presented in table 3.

It can be seen that coffee prices, in

⁶ It is true that 1954 was a year of exceptionally high coffee prices, although they were only 29 per cent above the average for 1951-1957.

Figure 1
WORLD TOTAL PRODUCTION OF COFFEE AND IMPORT PRICES OF COFFEE IN THE
UNITED STATES OF AMERICA IN CURRENT AND IN CONSTANT TERMS

(Annual averages from 1850 to 1975)



Source: Inter-American Coffee Organization (ICO), *Long-Term Historical Data on Production, Stock, Exports and Prices of Coffee*, London, 1975.

current terms, went through a long period of depression, from which they did not emerge until 1976; but even in that year they failed to bridge the gap which sundered them, throughout the period under consideration, from the prices of exports of manufactures. Only the increases which occurred towards the end of 1976 and were intensified in the early months of 1977 enabled the price of coffee to outstrip the growth of manufactured export prices. Thus, the monthly index for December 1976 made it possible to surpass the annual index of prices of manufactures for the same year.

Table 2
PRICE INDEXES
(Base 1968=100)

<i>Commodity</i>	<i>1974 (annual average)</i>	<i>December 1976</i>
Coffee (Colombia)	183	495
Sugar ^a	1 504	378
Wheat (Argentina)	303	149
Copper	166	104
Tin	262	268

Source: UNCTAD, *Monthly Commodity Price Bulletin*.

^aIn the case of sugar, it must be borne in mind that a major proportion of the volumes traded on the world market was covered by agreements, and that therefore the price fixed on the free market corresponded to relatively marginal volumes.

Table 3

<i>Year</i>	<i>Index of average annual increases in coffee prices (Colombia)</i>	<i>Index of increases in export prices of manufactured goods</i>
1954	100	100
1960	53	108
1965	56	114
1970	65	129
1973	78	171
1974	82	208
1975	82	234
1976	179	235
December 1976	257	

II

Colombia: coffee production and exports

1. *Introductory remarks*

Colombia exported 8,175,000 bags of coffee in 1975, when world exports totalled 57,910,000 bags. Accordingly, Colombia's share in world trade was 14.1 per cent, which places the country second in the world, below Brazil and above the Ivory Coast.

The importance of coffee in the Colombian economy has declined considerably in recent years, owing to the development of 'non-traditional' sectors, but it is still substantial, as can be seen from table 4.

Coffee is a key sector because of the roles it plays as provider of employment (for about 2 million workers), leading source of foreign exchange income (accounting on an average for 55.6 per cent of total exports between 1966 and 1975), and supplier of funds for the national budget (about 20 per cent of fiscal revenue in 1972).⁷

All this goes to show that the

specific importance of coffee for the Colombian economy is still very great, and that it seems unlikely to undergo any drastic reduction, at least in the near future.

Colombian coffee belongs to the group known as 'Colombian milds', of which, in the period 1966-1975, the country exported about 80 per cent on an average, the rest being shared between Kenya and, to a lesser extent, Tanzania. Higher prices are generally quoted for 'Colombian milds' than for other grades of coffee.

In June 1976, for example, while the average price of 'Colombian milds' was 183.60 cents per pound, quotations for 'Other milds' (essentially, Central American coffees), unwashed *arabica* (essentially Brazilian coffees) and *robusta* (essentially African coffees) reached only 149.58, 151.08 and 130.06 cents, respectively.⁸

Tables 5, 6 and 7 present the basic annual data for production, exports and prices of Colombian coffee.

Table 4

COLOMBIA: SHARE OF COFFEE IN THE GROSS DOMESTIC PRODUCT (GDP)

(Millions of pesos at 1958 prices)

Year	(a) GDP	(b) Agricultural GDP	(c) Percentage	Production of coffee	Percentage of (a)	Percentage of (b)
1950	14 689	5 553	37.8	1 430	9.7	25.8
1960	23 123	7 512	32.5	1 951	8.4	26.0
1970	38 492	10 691	27.8	2 092	5.4	19.6
1972	43 605	11 563	26.5	2 117	4.9	18.3

⁷ Estimates prepared by the National Federation of Coffee-Growers of Colombia (Federación Nacional de Cafeteros de Colombia).

⁸ Monthly averages taken from UNCTAD, *Monthly Commodity Price Bulletin*, Geneva.

Table 5

Year	Production (thousands of bags) a	Production for export (thousands of bags) a	Exports (thousands of bags)	Value of exports (millions of dollars)	Percentage share of coffee in total exports	Percentage share of Colombia in value of world exports
1966	7 600	6 350	5 565	339	67	15
1967	8 000	6 700	6 094	322	63	15
1968	7 900	6 570	6 588	351	63	15
1969	8 450	7 080	6 478	344	57	15
1970	7 800	6 390	6 509	467	63	15
1971	7 200	5 750	6 569	400	58	13
1972	8 800	7 430	6 528	430	50	13
1973	7 800	6 250	6 766	598	55	14
1974	8 500	6 900	6 906	625	(38)	(46)
1975			8 175	(710) ^b	(41) ^b	

^aThese figures refer to coffee years, so that the year 1966 really corresponds to the period between 1 October 1966 and 30 September 1967, and so on.

^bOwing to the rise in world prices during the first half of 1976, coffee exports amounted to 444 million dollars, i.e., 56.56 per cent of total exports.

Table 6
AVERAGE QUOTATIONS FOR 'MAMS' COFFEES
(COLOMBIAN MILDS)
(Dollar cents per pound)

1948	32.5	1963	39.6
1949	37.4	1964	48.8
1950	53.3	1965	48.5
1951	58.7	1966	47.4
1952	57.0	1967	41.9
1953	59.8	1968	42.6
1954	80.0	1969	45.0
1955	64.6	1970	56.4
1956	74.0	1971	49.3
1957	63.9	1972	56.7
1958	52.3	1973	72.7
1959	45.2	1974	77.8
1960	44.9	1975	81.3
1961	43.6	1976 ^a	131.05
1962	40.8		
1948-1963: Average:	53.0	Standard deviation:	10.9
1964-1975: Average:	55.7	Standard deviation:	11.1

^aAverage for January-June.

Table 7
COLOMBIA: STRUCTURE OF LAND TENURE IN THE COFFEE SECTOR, 1970

<i>Size of enterprise (number of hectares)</i>	<i>Percentage of total number of farms</i>	<i>Number of hectares under production as percentage of total</i>	<i>Number of 60- kilogramme bags as percentage of total production</i>
Distribution by farms			
Under 1	12.6	1.6	1.5
from 1 to 3.99	33.2	11.7	10.8
from 4 to 7.99	18.3	12.6	12.2
from 8 to 11.99	9.5	9.7	9.5
from 12 to 15.99	5.9	7.5	8.0
from 16 to 19.99	3.9	5.9	5.9
from 20 to 99.99	14.5	36.1	36.0
Over 100	2.2	14.8	16.1
<i>Total (in absolute figures)</i>	<i>(302 495)</i>	<i>(1 070 429)</i>	<i>(9 505 342)</i>
Distribution by coffee plantations			
Under 1	33.5	4.7	4.3
from 1 to 3.99	43.8	25.1	22.2
from 4 to 7.99	13.0	20.3	19.1
from 8 to 11.99	4.3	11.8	11.6
from 12 to 15.99	2.0	7.6	8.3
from 16 to 19.99	1.1	5.6	5.8
from 20 to 99.99	2.2	21.2	24.1
Over 100	0.08	3.7	4.6
<i>Total (in absolute figures)</i>	<i>(302 945)</i>	<i>(1 070 429)</i>	<i>(9 505 342)</i>

Source: Estimates based on 1970 *Coffee Census (Censo Cafetero)* data.

2. Organization of production

Coffee is grown in Colombia in the temperate zones, between 1,000 and 2,000 metres above sea level.

With respect to the distribution of coffee-growing land, the 1970 census data are available,⁹ broken down both by whole farms and by coffee plantations, i.e., by coffee production units irrespective of farm size.

⁹ See National Federation of Coffee-Growers, *Censo Cafetero*, Bogotá, 1970.

As can be seen from the foregoing tables, in the land tenure structure it is the farms (*fincas*) and coffee plantations (*cafetales*) of medium size that predominate in Colombia. Farms and plantations of 4 to 99.99 hectares cover respectively 71.9 per cent and 66.6 per cent of the total area and 71.6 per cent and 68.9 per cent of production;¹⁰ and it is assumed

¹⁰ A careful comparative analysis of the two series of data will bring out the fact that the average size of a coffee farm tends to be much larger than that of the coffee plantation

that the land tenure structure in the coffee sector has not altered much since the date of the census. According to these figures, the structure of coffee holdings would be as shown in table 7.

Differences in yield by size of farm (or of plantation) are among the smallest in Latin America (see table 8).

As a general rule there are two coffee harvests in Colombia, one of which,

Table 8
**COLOMBIA: YIELDS PER HECTARE OF DRY PARCHMENT COFFEE,
 BY FARM AND COFFEE PLANTATION SIZE GROUPS**
(Kilogrammes per hectare)

<i>Size of enterprise (number of hectares)</i>	<i>Farm yields</i>	<i>Coffee plantation yields</i>	
Under 1	515	485	
from 1 to 3.99	490	471	
from 4 to 7.99	514	502	
from 8 to 11.99	522	523	
from 12 to 15.99	567	577	
from 16 to 19.99	531	549	
from 20 to 99.99	531	606	
Over 100	579	674	
			Average productivity in Colombia; 533 kilogrammes per hectare in 1974

however, is more important than the other. In the principal coffee-growing Departments, Antioquia and Caldas, the main crop is harvested in October-December and the secondary crop in April-June, while in Quindío, Tolima and Valle the opposite is the case. Total production levels do not vary much from one year to another, since Colombia enjoys relatively stable weather conditions, and at all events, rainfall and drought are distributed differently in different years among the country's various coffee-growing areas.

as such. This means that on coffee farms other crops are grown in addition, and on a fairly large scale. Consequently, in evaluating the income of coffee producers the income accruing from these other crops should be taken into account, a task which obviously exceeds the scope of the present study.

In Colombia coffee is processed on the farm by the growers themselves. The harvested berry (also called the coffee cherry) is depulped and left to ferment, for a period ranging between 12 to 24 hours, in wooden vats with plenty of water, which is continually stirred. Then the berries are washed, to get rid of the syrupy residues, and are dried in the sun. At this stage the product is called 'parchment coffee', and this is the form in which it is sold to the purchasers, as described below. The final phase of processing is 'threshing', which consists in removing the parchment-like outer skin of the berries, and thus leaving the coffee beans ready for consumption or export. This last operation, unlike the first, which, as was pointed out, has markedly artisan characteristics, is carried out in plants of an industrial type.

Approximately 5 pounds of parchment coffee are needed to obtain 4 pounds of green coffee (i.e., coffee ready for export); accordingly, for the purposes of any sort of calculation about volumes and prices in relation to the transformation of parchment coffee into green coffee, it will be necessary to apply a factor of 1.25 to the prices paid for parchment, so as to make it possible to compare, for example, domestic prices with international prices.¹¹

Several agro-economic and social factors (such as the predominance of smallholdings, transport difficulties, etc.) determined the adoption of this system of processing coffee in Colombia. And it is of great advantage to the producer, since in this way he captures a proportion of the value added which would otherwise benefit the large industrial units. The equipment required for processing coffee up to the parchment stage is minimal,¹² and the procedure quite simple, which means that in addition, advantage can be taken, at least in part, of the post-harvest periods of which otherwise no use could be made. Further advantages consist in the possibility of using the waste left by the processing operations as compost; the lesser weight of the loads that have to be transported to the buyer markets; and the greater ease with which that same transport operation can be carried out,

¹¹ For this reason, parchment coffee is usually sold in Colombia in 'loads' of 125 kilogrammes or in 'arrobos' of 12.5 kilogrammes, which correspond, after threshing, to 100 or to 10 kilogrammes of green coffee, respectively.

¹² It consists of a quite rudimentary hand-operated depulping machine, with a few wooden vats for fermenting and a space prepared for the drying process.

because of the non-perishability of the dry berry.

Before being sold, the coffee is sorted by hand, and the lower-grade beans are classed as what is known as *pasilla*, or coffee for domestic consumption.¹³

It is estimated that there is one coffee mill in Colombia for every 4 hectares under coffee, a figure which gives some idea of the artisan level at which this activity is carried on.¹⁴

Only a few farms go as far as undertaking the threshing operation, for as a general rule it is regarded as requiring too heavy capital inputs to be economically viable on such small scales.

Once threshed, the *excelso* coffee or green coffee for export which meets the quality criteria established by the National Federation of Coffee-Growers passes into the sphere of the international circuits.

3. Production costs, taxation and producer's gains

The first of these three elements is very difficult to quantify, especially in a country like Colombia, where coffee production is to a great extent concentrated at the low and medium levels of land tenure and therefore the bulk of the labour inputs are supplied by the owner himself and his family.¹⁵ Other elements, too, such as fertilizers and

¹³ As will be noted, *pasilla* also plays a part in export activities, since one of the export taxes consists precisely in 6 per cent of the volume exported payable in *pasilla*.

¹⁴ In El Salvador, for example, the corresponding figure is about one processing plant per 700 hectares.

¹⁵ This state of affairs, however, has its limits, since on an average-sized farm (3-5 hectares) weeding and above all picking necessitate up to five hands for every one who normally works on the coffee plantation

transport costs, are often impossible to estimate in monetary terms. This is no doubt why sources of information on the subject are so few and far between.

A fairly typical example, although of relatively little interest today because the information is out-of-date, is afforded by a CEPAL/FAO study.¹⁶ Other sources,¹⁷ although less exact than the foregoing study, are more recent, and can be used as a basis for the present analysis, notwithstanding all the difficulties posed by reference to an 'average' farm which in reality corresponds to only about 10 per cent of total production.

An estimate prepared by the Economic Research Section of the Coffee Research Centre (Centro de Investigaciones sobre Café - CENICAFE)¹⁸ for the year 1972 gave a total cost of 4,332

pesos per hectare for a farm of 3.5 hectares with yields of 541 kilogrammes per hectare (which represents an ideal medium-sized Colombian farm); of this cost about 85 per cent corresponds to labour and the rest to fertilizers, tools, financing and fixed costs. The data prepared by the World Bank¹⁹ and the International Coffee Organization²⁰ show similar results. The World Bank presents a series of estimates of current costs (excluding taxes and miscellaneous contributions, depreciation and interest, which amount to 7-10 per cent of total costs) for the years 1960-1969. The International Coffee Organization gives indexes of increases in costs (production inputs),²¹ up to 1975. If these indexes are applied to the World Bank estimates, the figure obtained for the year 1975 is 81.63 pesos per *arroba*, i.e., 3,533 pesos per hectare with a medium yield (541 kg); the addition of 10 per cent for fixed costs not taken into consideration by the World Bank brings this sum up to 3,886 pesos. For the sake of simplicity, we will take total costs to be the average of these two estimates, namely, 4,109 pesos per hectare (541 kg);²² that is, 7.6 pesos per

throughout the year, and accordingly additional labour is very often engaged for these operations.

¹⁶ See CEPAL/FAO, *Coffee in Latin America. Productivity problems and future prospects*, United Nations publication, Sales No 58.II.G.4, 1958, vol. I, chapter X. In this study labour inputs are reckoned in man/hours, fertilizers in kilogrammes per hectare and other costs in terms of pesos at current prices. After going into a detailed analysis of several methodological problems (such as that of distinguishing between hired labour and family labour), the study presents a monetary estimate of total costs for 1955/1956.

¹⁷ See *Economic Growth of Colombia: Problems and Prospects. Report of a mission sent to Colombia by the World Bank in 1970*, Baltimore-London, The Johns Hopkins Press, 1972; International Coffee Organization, *Tendencia de los precios percibidos por los productores de café en nueve países*, 1298/75 (c), 1975; and Roberto López Alzate, "El cafetero medio colombiano", in *Revista Cafetera de Colombia*, Bogotá, vol. XXII, January-April 1973, pp. 63-77.

¹⁸ R. López Alzate, *op. cit.*, p. 71.

¹⁹ *Economic Growth of Colombia: Problems and Prospects*, *op. cit.*, p. 270.

²⁰ *Tendencia de los precios percibidos por los productores de café en nueve países*, *op. cit.*, annex table 6.

²¹ *Ibid.*, annex 2.

²² In a study by Roberto Junguito, *Objetivos de la política cafetera*, Bogotá, Fundación para la Educación Superior y el Desarrollo, May 1974, the figure given is 24.3 dollars per 60-kg bag, i.e., 3,834 Colombian pesos per hectare (541 kg) for the year 1970. If this figure is extrapolated to 1972 by means of the ICO indexes, a total of 4,645 pesos is obtained, i.e., 7 per cent more than the CENICAFE figure and 13 per cent more than our estimates based on World Bank and ICO data.

kilogramme, or 950 pesos per carga (125 kg), of parchment coffee. Projection of this figure to 1974 gives the results which in table 9 below are compared with average producer prices.

Although these figures are merely indicative, they may be regarded as close enough to reality to be acceptable.

The domestic prices considered represent an average of the prices establi-

Table 9

<i>Year</i>	<i>Production costs (per 125-kg 'carga')</i>	<i>Average prices paid to producer (per 125-kg 'carga')</i>
1972	950	1 498.94
1973	1 067	1 937.09
1974	1 500	2 262.50

shed by the National Federation of Coffee-Growers. In accordance with the world market coffee situation, private exporters can intervene by purchasing at prices above the floors established by the Federation. This happens whenever – as in present circumstances – international prices are high enough to allow exporters a margin of profit even if they have to pay the producer prices exceeding the Federation's minimum. It is on account of this factor that the percentage of total coffee purchases effected by the Federation varies greatly from one year to another, and may rise from figures near zero, as in the first half of 1976, to 80 per cent, as was the case in 1972.²³

²³ The National Federation of Coffee-Growers (FEDECAFE), in theory a private association of coffee producers, in practice enjoys a semi-public status. Its faculties, which will be described in greater detail later, include the following: fixing of support prices and standards of quality; purchases of coffee from producers; formation and management of inventories; sales to private exporters or direct exportation of coffee; utilization of the National Coffee Fund, which is fed by coffee taxation at several levels and by the profits on

On the basis of negotiations with the government, the Federation fixes the support price of parchment coffee, so that the producer may be assured of a remunerative income and, at the same time, incentives to production may be kept under control (to which end tax measures are also used).

The purchases made by the Federation under the internal support-price régime are financed by the National Coffee Fund (a special account in the Banco de la República, managed by the Federation), which in its turn generally obtains loans for that purpose from the Banco de la República, and pays them off as the coffee is delivered to private exporters or directly abroad.

the Federation's sales; control of the domestic consumer market; and, in general, primary responsibility for the country's coffee policy at both the domestic and the international level. The Federation is the arena in which the interests of small-scale producers, major producers, exporters, the State and other economic agents connected with coffee production or trade confront one another, and coffee policy decisions are as a general rule the result of these confrontations.

In table 10 the evolution of domestic prices, measured in terms of the floors established by the Federation (annual averages), is compared with that of average f.o.b. export values over the period 1962-1975.²⁴

Table 10

	1962	1963	1964	1965	1966	1967	1968
(a)	478	556	718	717	757	759	889
(b)	760	741	905	1 373	1 372	1 395	1 507
	1969	1970	1971	1972	1973	1974	1975 ^a
(a)	889	1 304	1 246	1 499	1 937	2 262	2 675
(b)	1 587	2 292	2 130	2 514	3 666	3 884	3 646

Source: National Federation of Coffee-Growers and International Coffee Organization (ICO).

Note: For (a) prices are expressed in terms of Colombian pesos per 125-kg load, and for (b) in pesos per 100 kg, to compensate for the transformation from parchment coffee into *excelso* coffee.

^aProvisional.

As can be seen, the relation between domestic and international prices has fluctuated considerably, although always within certain limits. In percentage terms, these limits have ranged from 52 per cent to 79 per cent (the percentage represents the proportion of the international price received by the producer), the average for the period being 61 per cent.

With the aim of more precisely specifying how the relative position of the coffee producer has developed, the evolution of domestic prices in the

various countries is next compared with a series of indicators other than mere export prices, i.e., the index of consumer prices, the index of cost of production inputs and the index of domestic prices received by producers of other export lines, although for reasons of climate these crops cannot be regarded as possible substitutes for coffee. The results of this comparative analysis are presented here without further comment, for want of space, but they speak clearly enough for themselves (see table 11).

Tax incidence is very heavy in Colombia. There is a decidedly complex set of tax or paratax instruments which bear on coffee export activities.²⁵

²⁴ In June 1976, this price stood at 5,650 pesos per load, plus a special bonus of 1,000 pesos per load, because of coffee's particularly favourable world market situation. This total (6,650 pesos per load) compares with an export value of 13,693 pesos (c.i.f.) which corresponds to about 13,000 pesos f.o.b. The special bonus was introduced on 7 June 1976 to enable the Federation to make purchases of coffee which otherwise would have been monopolized by private exporters.

²⁵ On the other hand, tax incidence on production (income tax, land tax and additional taxes) is minimal, and does not amount to 5 per cent of production costs. At least, this was the case until a short time ago, when, in order to moderate the inflationary effects

Table 11

COLOMBIA: COMPARISON OF DOMESTIC COFFEE PRICES WITH OTHER RELEVANT VALUES TO DETERMINE THE EVOLUTION OF THE COFFEE-GROWER'S POSITION

Year	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
1962	479	100	100	100	100	100	100	100	100	100	100
1963	556	116	132	116	98	118	128	91	117	118	111
1964	618	150	155	150	119	126	155	97	159	127	150
1965	717	150	160	100	120	83	185	81	179	129	180
1966	757	158	192	105	120	88	194	81	187	142	187
1967	759	159	208	98	105	93	193	82	206	148	203
1968	889	186	220	99	105	94	199	93	194	170	214
1969	982	206	242	103	105	98	241	85	208	232	212
1970	1 304	273	259	128	142	90	256	107	249	262	218
1971	1 246	261	282	112	120	93	277	94	265	250	269
1972	1 499	314	323	124	130	95	292	108	275	258	307
1973	1 337	405	396	146	175	83	328	123	s.d.	s.d.	s.d.
1974	2 262	473	493	165	179	92	378	125	s.d.	s.d.	s.d.
1975	2 675*	560	652	168	144	117					

Source: Estimates prepared on the basis of ICO data.

(a) Domestic prices received by producers for parchment coffee (Federation), expressed in pesos per 125-kg load (annual averages).

(b) Indexes of increases in (a).

(c) Indexes of consumer prices.

(d) Indexes of domestic prices received by producers, expressed in dollars at constant 1962 prices.

(e) Indexes of FOB values of coffee exports, expressed in terms of dollars at constant 1962 prices.

(f) Relation between (d) and (e) $\frac{(d) \times 100}{(e)}$

(g) Index of costs of production inputs.

(h) Relation between (b) and (g) $\frac{(b) \times 100}{(g)}$

(i) (j) and (k) Indexes of domestic prices received by producers of bananas, cocoa, and cotton, respectively.

* Provisional.

The 'reintegró mínimo cafetero' (minimum exchange surrender requirement) determined by the Monetary Board represents the amount of foreign exchange per 70-kilogramme bag exported which private exporters are obliged to change at the official rate in the Banco de la República. A special exchange rate for

deriving from the coffee boom a system of compulsory bonds was imposed on coffee producers.

purposes of coffee was in force, from 1957 to 1967, but thenceforward was abolished. This exchange differential really constituted an additional tax, which varied according to Colombia's exchange policies.²⁶

As they operate at present, these payments do not constitute a tax proper,

²⁶ The difference between the exchange rate known as the 'coffee dollar' and the rate used for other types of exports averaged 29 per cent between 1957 and 1967.

except when the Monetary Board fixes the refund levels above the external price level, as happened, for example, in mid-1976. In such cases, private exporters find themselves compelled to purchase additional foreign exchange in order to comply with the provisions of the law. In normal periods, that is, when minimum coffee refund levels do not exceed international f.o.b. price levels, the disadvantages²⁷ suffered by the exporter who has to change his dollars into pesos are not quantifiable.

The *ad valorem export tax* was introduced in 1951 and was established at 15 per cent of total dollar export earnings. When world market coffee quotations fell the tax was reduced to 9 per cent and in 1962 it was abolished altogether. It was reintroduced, however, in 1967 simultaneously with the abolition of the differential exchange rate, and was set at 26 per cent, a percentage which was progressively reduced until by December 1968 it had dropped to 20 per cent. Out of this 20 per cent, 4 per cent went to the National Coffee Fund, and the remainder to the Banco de la República.

Subsequent provisions further reduced the *ad valorem* tax, and in June 1976 it stood at 18 per cent, of which 14 per cent was allocated to the national budget through the Banco de la República, 3.2 per cent to the National Coffee Fund and 0.8 per cent to the Departmental Committees of Coffee-Growers.²⁸

²⁷These disadvantages would consist in the loss of possibilities of exporting capital or importing goods, of safeguard against currency devaluation, etc.

²⁸The Departmental Committees of Coffee-Growers finance infrastructure projects relating to coffee activities.

The '*retention quota*' is the quantity of export coffee which all private exporters have to surrender to the Federation and which is allocated to the National Coffee Fund. This tax is measured in percentages of the volumes of green coffee exported, and is payable in parchment coffee equivalent. It should be recalled that the rate of conversion of parchment coffee into green coffee is 1:08 (1 kilogramme of parchment coffee corresponds to 0.8 kilogrammes of green coffee), which means that for every 70-kg bag of green coffee exported, the exporter has to hand over the legally-established percentage of those 70 kg, multiplied by a fixed coefficient of 1.25. For example, if the retention quota is 25 per cent, the amount of coffee that the exporter will have to surrender per 70-kg bag exported will be equal to $70 \times 0.25 \times 1.25$, i.e., 21.875 kg. The exporter has the option of handing over, instead of the coffee itself, its equivalent in money.

This tax serves the purpose of bringing in capital for the National Coffee Fund, establishing centralized inventories and regulating the exportable supply, to which particular importance attaches when quota commitments are in force.

Coffee retention was introduced in 1958, and between 1958 and 1972 its level did not exceed 25 per cent of the amount of green coffee exported. Thenceforward, the authorities gradually increased the proportion until by June 1976 it had climbed to 85 per cent. Accordingly, at that date, the exporters were surrendering to the Federation for every 70-kg bag of green coffee exported, 74.373 kg of parchment coffee,²⁹ or its equivalent in money.

²⁹ Result of multiplying $70 \times 0.85 \times 1.25$.

The tax known as '*Pasilla y Ripio*' corresponds to a fixed quantity of two lower-grade coffee (5.5 per cent of *pasilla* and 0.5 per cent of *ripio*) which every exporter has to hand over to the Federation. This tax serves the twofold purpose of obtaining coffee for domestic consumption and reserving the higher-grade coffee for export. The volume is calculated on the basis of green coffee exports, i.e., for every bag of green coffee exported the exporter has to surrender 3.85 kg of *pasilla* and 0.35 kg of *ripio*.

This set of instruments, with the exception of the *pasilla y ripio* tax, which has undergone no substantial change since its establishment in 1941, and of an additional 'export tax', which has always represented a minimal sum,³⁰ and was abolished altogether at the end of 1972, has constituted a standing object of negotiations between the Federation, producers, exporters and the State. Measures relating to modifications of the retention quota, the *ad valorem* tax, the minimum exchange surrender requirements and the domestic support price have a powerful impact on the Colombian economy as a whole, especially as regards the available supply of financial resources, inflationary trends, and both public and private investment rates.

Noteworthy examples of the results of these negotiations are the 1969 agreements between producers and the government, in which the mode of dealing with any rise in world coffee prices is settled in advance, a scheme being drawn up for the distribution of such increases between the producer, the

³⁰ Revenue from this tax for the whole of the year 1972 totalled 1,399,000 pesos, i.e., barely 0.25 pesos per 60-kg bag exported. It must not be confused with the *ad valorem* export tax.

National Coffee Fund and the Departmental Committees of Coffee-Growers. All this does not affect inflows received by these two agencies under other heads, such as the *ad valorem* tax and the coffee retention quotas.³¹

In evaluating the impact of taxation on Colombia's coffee production, emphasis must be placed on the role played by the National Coffee Fund and the Departmental Committees of Coffee-Growers, which retransfer to the producers, through the execution of infrastructure projects, extension of credits and technical assistance, a considerable proportion of the resources disbursed in the form of tax payments.

The National Coffee Fund (Fondo Nacional del Café - FNC) constitutes a special account on the National Treasury's books, in which the receipts, apart from the tax revenues mentioned above, derive from sales of coffee to private exporters or directly abroad. The Fund is administered by the general Manager of the Federation of Coffee-Growers. Foreign exchange export earnings are handed over to the Banco de la República, which in its turn remits to the FNC, subject to approval by the

³¹ The 1969 agreement laid it down that once the international price exceeded 57 dollar cents per pound, 35 per cent of the increase would go to the producers (through a rise in support prices), while the National Coffee Fund and the Departmental Committees of Coffee-Growers would receive 30 per cent respectively. In 1972 the agreement was amended on the following lines: as from 54 and up to 61 cents per pound a margin of 5 cents was established, to be distributed in the same way as under the 1969 agreement. Above 61 cents this margin was widened to 6 cents. The agreements in question have never been fully implemented, and in practice recourse has always been had to the tax measures described.

Monetary Board, the foreign exchange resources which the Federation of Coffee-Growers needs to meet its external commitments. In recent years, the Federation has found itself obliged to negotiate internal and external credits to eke out the FNC's resources. Currently, however, the FNC has debts outstanding only with the Banco de la República. It also collects funds by the issue of 'coffee bonds' on the national financial market.

Through the FNC purchases of coffee from producers are financed, and through these in turn inventories are built up. The FNC likewise participates in the current expenditure of the Federation of Coffee-Growers, as well as in its 'technical campaigns' and other activities on behalf of producers, and in the capitalization of institutions concerned with aid and credits, such as a rotating fund for coffee loans (*Fondo Rotatorio de Crédito Cafetero*), the Banco Cafetero and the Departmental Committees of Coffee-Growers.³²

Lastly, the FNC finances the payment of bounties to foreign purchasers.³³

The work of the Departmental Committees includes improvement of infrastructure (highways, educational services, etc.), and technical assistance. To that end they can obtain advisory assistance from the Technical Services of the Federation of Coffee-Growers and financial contributions from the FNC, apart from their own receipts, which are constituted mainly by their portion of the revenue from the *ad valorem* tax

³² A detailed analysis of the activities carried out with the support of the FNC appears in the *Annual Reports* of the General Manager of the National Federation of Coffee-Growers.

³³ See p. 179.

and their participation in the 1972 sharing agreement.

Taking it into account that producers and population in coffee-growing areas in general recover a considerable proportion of coffee tax revenue through the public services rendered by the National Federation of Coffee-Growers and the Departmental Committees —although exactly how much it is difficult to assess—, a synoptic chart may now be constructed to present a breakdown of coffee prices from the phase of production to the export stage. For this exercise the year studied is 1973 (see figure 2).

4. Exports

Almost the whole of Colombia's coffee exports take the form of green coffee.

There are three plants for processing soluble coffee (one belonging to the Federation at Chinchiná; one of Nestlé's, SICOLAC; and one national private enterprise, COLCAFE), but their export levels are very low. The plants receive coffee at prices subsidized by the Federation, but even so it would seem that Colombian coffee, because of its high prices, is not in a position to compete with the *robustas*, which are the type of coffee most used for transformation into soluble coffee.³⁴

Better prospects seem to be offered by the processing of coffee abroad, whether in respect of roasted and ground or of soluble coffee, on the possible basis

³⁴ In this process the rate of extraction (whether the freeze-dry or the spray-dry method is used) is still low, and, furthermore, solubilization involves a loss of the coffee's natural aroma, which is an incentive to use lower grades for this purpose, such as the African coffees.

Figure 2
**COLOMBIA: BREAKDOWN OF PRICE PER KILOGRAMME
 OF COFFEE EXPORTED, 1973**
(Dollars)

1.603 c.i.f. price of 'green' coffee	
0.076	Freight and insurance
0.127	Exporter's gross income
0.305	'Pasilla' tax
0.258	<i>Ad valorem</i> tax
0.362	'Retention quota'
0.445	Producer's profit ¹
0.445	Production costs

0.807
Domestic price

}

¹ By 'producer's profit' is meant here the difference between the average domestic price during the year and the production costs calculated earlier in this paper for an 'average coffee farm'. This is, of course, an approximate estimate.

of blending the Colombian product with other African or American coffees. In this case, the difficulties will be mainly institutional, since the country lacks experience alike at the financial and at the industrial and commercial levels in making investments of this type. The success of a pilot project executed in Argentina for the production of roasted

and ground coffee, however, has awakened the Federation of Coffee-Growers' interest in attempting the experiment on a larger scale.

Apart from these exceptions, Colombia exports green coffee, and once the product has reached the ports of destination has nothing to do with the subsequent phases of processing and

marketing.³⁵ But through its merchant marine (the Flota Mercante Grancolombiana), the country controls a good deal³⁶ of the transport of its coffee exports.³⁷

The high level of taxation on coffee is an incentive—especially in periods when international prices are also high—to smuggling it, particularly into Venezuela, a country which also exports coffee, although in limited quantities (978,000 bags, on average, between 1964 and 1974). Nevertheless, the distance of the coffee-growing areas from the frontier, and the difficulties of transport, reduce this contraband to presumably small volumes.³⁸

Colombian coffee is exported by the National Federation of Coffee-Growers or by private exporters listed in a special register kept by the Federation itself.

In 1973 the total volume exported by the Federation was 2,823,425 60-kg bags, as against 3,942,843 bags exported by private traders; in proportional terms, the Federation and private individuals exported in that year 42 per cent and 58 per cent of total sales abroad, respectively.

With regard to the distribution of markets, the Federation accounts for the lion's share of exports to Europe, while

³⁵ It should be noted here, however, that Colombia does play a very large part in the advertising of its product in the consumer markets.

³⁶ On this point no data were available.

³⁷ Between 70 and 75 per cent of coffee exports are shipped from the Pacific Ocean port of Buenaventura, while almost all the rest leaves from a port on the Atlantic (Barranquilla).

³⁸ The case is different with cattle, for example, which, as the stock-farming areas are so close to the Venezuelan frontier, are smuggled *en masse* into Venezuela.

private individuals control the sales to the United States, as can be seen from table 12.

The Federation as a monopoly on exports to the countries with which bilateral agreements exist (Spain, the Democratic Republic of Germany, Yugoslavia, Hungary, Poland and the Soviet Union), and in general its exports to Europe are larger than those of private individuals. The latter, nevertheless, retain an appreciable proportion of the European market (33.5 per cent in 1973), while in the United States market the Federation has a much smaller share (12.71 per cent in 1973).

Between 1961 and 1973, the Federation covered between 25 and 44 per cent of exports, according to the year concerned, the average being 34 per cent. In recent years, this proportion seems to have become stabilized at about 40 per cent, at least up to 1976.

A highly original element in the external marketing of Colombian coffee lies in the granting of 'bonuses', or, in other words, discounts, to importers;³⁹ these are normally paid by the FNC, and in practice reduce the existing price differentials between Colombian coffee and the other milds. When the bonuses are taken into account, these differentials do in fact decrease considerably, although it seems true that they do not disappear altogether.

This system of bonuses, whose existence is recognized by the National

³⁹ A figure which was estimated in the course of discussions with those responsible for another country's coffee policy, and which should be taken with extreme caution, is about 21 dollar cents on the international price quoted in June 1976, i.e., 183 cents.

Table 12
EXPORTS BY COUNTRIES OF DESTINATION
(60-kilogramme bags)

Country	1972		1973	
	Federation	Private individuals	Federation	Private individuals
United States	285 082	2 240 255	382 226	2 623 346
Other American countries	167 167	66 410	102 261	72 270
Federal Republic of Germany	476 957	1 072 431	713 685	602 032
Sweden	69 825	251 551	138 285	201 119
Spain	400 505	—	301 262	—
The Netherlands	243 016	73 219	385 788	25 433
Other European countries	619 138	451 275	671 802	384 441
<i>Total for Europe</i>	<i>1 809 441</i>	<i>1 848 476</i>	<i>2 210 828</i>	<i>1 219 025</i>
Other countries	81 012	30 595	128 109	28 203
<i>Total</i>	<i>2 342 702</i>	<i>4 185 736</i>	<i>2 823 424</i>	<i>3 942 844</i>

Source: National Federation of Coffee-Growers, *Boletín de información estadística sobre café*, Bogotá, nos. 46, 47.

Federation of Coffee-Growers itself, represents the continued application of a formula that was devised while the International Agreement of 1962 was in force (under which export quotas were increased in relation to price levels), and has been kept up, apparently, by mere trade custom.

Although fluctuations in production levels from one year to another are limited in comparison, for example, with what happens in Brazil, Colombia has maintained a considerable reserve of inventories, as can be seen from table 13.

Colombia has taken a very active part in the attempts to organize coffee production and marketing at the world level. Its intervention in the 'Bogotá

Group' and in the 'Geneva Group' on behalf of world control of supply, as well as the position it adopted jointly with Brazil in connexion with the negotiation of a new International Agreement, are important cases in point. Generally speaking, it may be said that Colombia has been able (because of the degree of official control exercised over coffee activities through an agency such as the Federation), and has given evidence of its political will, to harmonize its domestic policies with organizational requirements at the international level relating to the control and 'equalization' of demand and supply and, above all, to the maintenance and increase of the purchasing power of the producer countries.

Table 13
COLOMBIA: COFFEE INVENTORIES, 1962/1963-1974/1975

<i>Coffee year</i>	<i>World inventories</i>	<i>Inventories in Colombia</i>	<i>Percentages of exportable production</i>
1962/1963	71 707	2 024	31
1963/1964	71 340	2 139	30
1964/1965	69 678	3 589	55
1965/1966	88 796	4 746	68
1966/1967	82 804	5 369	25
1967/1968	78 826	5 499	82
1968/1969	69 182	5 050	77
1969/1970	65 336	5 583	79
1970/1971	54 637	5 635	88
1971/1972	54 267	4 216	70
1972/1973	55 295	5 434	83
1973/1974	40 896	3 839	48
1974/1975	49 277	3 000 ^a	38

Source: ICO, Documents EB 1290/74 and E 1402/75.

^aEstimates.

III

Brief notes on coffee production and exports in El Salvador and Brazil

In these two cases the analysis will be reduced to the barest essentials, stress being laid on the elements of differentiation from the situation in Colombia.

1. *El Salvador*

In the first place, attention must be drawn to two points of capital importance:

(1) El Salvador produces 'arabica mild' coffee, which is quoted among 'other milds' on world markets;

(2) The extreme density of the population, plus the skill and tenacity of the Salvadorian farmers, and adequate use of fertilizers and pesticides, have raised the country's coffee production to the highest yields in Central America and virtually in the world (1,149 kilogrammes per hectare in 1975).

The figures for production and exports in recent years are given in table 14.

Table 14
EL SALVADOR: COFFEE PRODUCTION AND EXPORTS

Year	Production (thousands of bags)	Exports (thousands of bags)	Value of exports (millions of dollars)	Share of coffee in total exports
1966	(1 960)			
1967	(2 430)			
1968	(1 990)	1 982	93.56	44 ^o /o
1969	2 190	1 899	89.36	44 ^o /o
1970	2 310	1 865	120.76	51 ^o /o
1971	2 410	1 689	107.56	44 ^o /o
1972	2 490	2 083	131.44	44 ^o /o
1973	2 140	2 489	159.52	45 ^o /o
1974	2 660	2 554	194.72	42 ^o /o
1975		3 062		

Source: Pan American Coffee Bureau, International Coffee Organization, Banco Central de Reserva of El Salvador.

As regards land tenure, fairly complete data --shown in table 15(a)-- are available for 1961, and others less complete for 1971. For the sake of comparability with the 1971 figures, those for 1961, have been regrouped in table 15(b) in accordance with the same criteria used for 1971.

Table 15(a)
EL SALVADOR: STRUCTURE OF LAND TENURE IN THE COFFEE SECTOR, 1961

Size of enterprise	Number of farms	Percentage of total number of farms	Area under production (hectares)	Percentage of total area under production	Percentage of production
From 0 to 4.9 hectares	26 000	71.1	11 525	9.1	6.2
From 5 to 99.9 hectares	9 789	26.8	59 200	46.4	42.8
100 hectares and over	749	2.1	56 600	44.5	51.0
Total	36 538	100.0	127 325	100.0	100.0

Source: Second Agricultural Census, p. 238.

Table 15(b)
**EL SALVADOR: STRUCTURE OF LAND TENURE IN THE COFFEE
 SECTOR, 1961 AND 1971**

Size of enterprise	Area		Production	
	Percentage 1961	Percentage 1971	Percentage 1961	Percentage 1971
From 0 to 9.9 hectares	15	17	10.3	12.1
From 10 to 49.9 hectares	24	27	22.8	26.2
Over 50 hectares	60	55	66.8	61.7

As can be noted, land tenure is much more concentrated than in Colombia,⁴⁰ which holds true, for other crops as well. The figures for the differences in yields between small, medium-sized and large farms also relate to 1961, and are as follows:

	<i>Kilogrammes per hectare</i>
Small farms (0-15 hectares)	491
Medium-sized farms (15-100 hectares)	704
Large farms (over 100 hectares)	796

Another fundamental difference from Colombia lies in the existence of 'mills' (processing plants), which cen-

⁴⁰ An ICAP study on coffee taxation in Central America, referring to the year 1968, drew attention to the fact that in El Salvador and Guatemala ownership of land is more concentrated than in the other Central American countries: about 5 per cent of the farms cover approximately 60 per cent of the coffee-growing area. See ICAP, *Estudio sobre la tributación del café en Centroamérica* (CIAP/321), Washington, D.C. (mimeographed text), December 1968, p. 2.

tralize the transformation of the coffee crop into parchment coffee, whereas in Colombia, as has been shown, this process is in the hands of the producer himself.⁴¹ This problem does not affect the large-scale producers, since as a general rule most of them are at the same time 'processors' and centralize the processing of their own coffee output together with that of neighbouring farms.

The Salvadorian Coffee Company (Compañía Salvadoreña del Café - CSC) possesses only a limited number of processing plants, but their strategic location and their size⁴² should ensure the small producer protection against possible abuses on the part of private processors.

The CSC also establishes—and this is its basic activity—a floor for the

⁴¹ Despite the difficulties due to lack of space and water resources which are invoked in order to justify the existence of the processing plants, it may well be asked whether the presence of groups of vested interests such as the 'processors' (who are sometimes the exporters themselves) does not constitute an even stronger determining factor in the persistence of this marketing system.

⁴² The CSC's largest processing plant dealt with 400,000 bags of coffee in the year 1975.

producers' price which serves to guarantee farmers a minimum income, when there is no possibility of selling coffee at higher prices. In this respect, the situation is much the same as in Colombia.

A table similar to that constructed for Colombia (see again table 11) was prepared for El Salvador, and presents the results deriving from table 14. On the basis of information supplied by ICO, ICAP and local institutions produc-

tion costs were estimated for the year 1973 at an average of 63 colones per quintal,⁴³ the methodology used being similar to that outlined for Colombia (see table 16).

As regards taxation, El Salvador's is the highest in Central America. The tax on the coffee plantation itself is of relatively minor importance; in 1968 its incidence was calculated at 84 cents per hectare, or 0.05 cents per bag of coffee produced.⁴⁴ Moreover, coffee-growers are

Table 16

EL SALVADOR: COMPARISON OF DOMESTIC COFFEE PRICES WITH OTHER RELEVANT VALUES TO DETERMINE THE EVOLUTION OF THE COFFEE-GROWER'S RELATIVE POSITION

Year	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
1962	55.20	100	100	100	100	100	100	100
1963	53.20	96	102	102	101	94	95	99
1964	64.40	117	103	119	103	114	114	97
1965	71.20	129	104	134	103	125	125	97
1966	66.46	120	103	129	115	104	104	94
1967	57.20	104	104	112	114	91	91	103
1968	58.46	106	107	108	118	90	90	105
1969	61.60	112	107	108	117	96	96	91
1970	58.60	106	110	140	123	86	86	98
1971	57.39	104	110	130	133	78	78	112
1972	65.20	118	112	145	137	86	86	121
1973	75.80	137	119	164	146	94	94	132
1974	81.00	146	139	186	192	76	76	234
1975			117	135				

Source: Calculations based on ICO data.

(a) Average domestic prices received by the producer for green coffee, expressed in colones per quintal (100 pounds).

(b) Indexes of increase in (a).

(c) Indexes of consumer prices.

(d) Indexes of f.o.b. value of coffee exports in dollars at constant 1962 prices.

(e) Indexes of costs of production inputs.

(f) Relation between (b) and (d) $\frac{(b \times 100)}{(d)}$

(g) Relation between (b) and (e) $\frac{(b \times 100)}{(e)}$

(h) Indexes of domestic prices received by cotton producers.

⁴³ The world market price for that year was 53.98 cents per pound, i.e., 134.85 colones per quintal (100 lbs.).

⁴⁴ A. Rochac, "La tributación del café" (mimeographed text), San Salvador.

exempt from income tax, which is, however, levied on processors and exporters.

The major source of revenue for the State is undoubtedly the *ad valorem* tax on exports, which is applied at a basic rate of 6.75 dollars, plus 30 per cent on anything over 45 dollars obtained as the f.o.b. price per quintal of coffee on the world market. In June 1976, this tax amounted to 38.25 dollars per quintal.

The 'retention quotas' which were in force for some time were abolished in the coffee year 1972/1973.

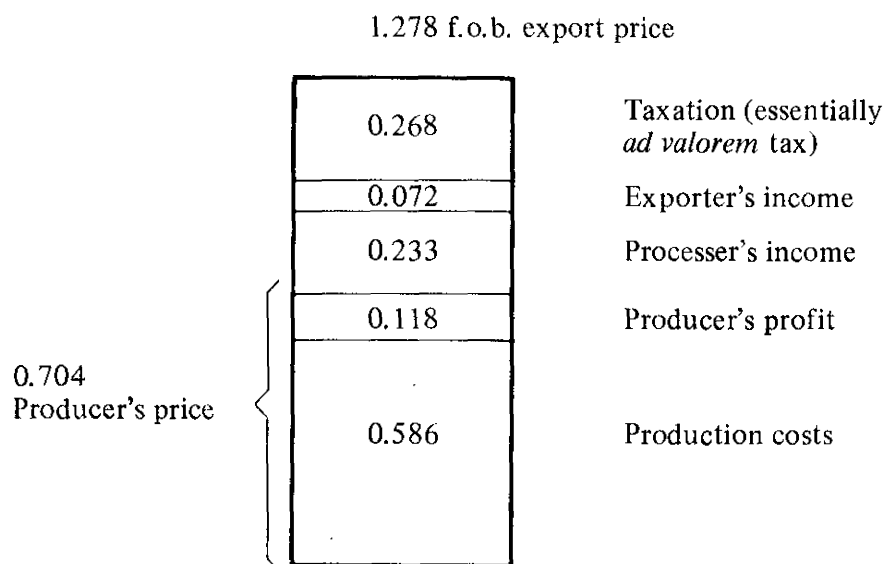
As stated above, tax rates are a good deal higher in El Salvador than in the other Central American countries, and this has given rise to many smuggling

problems, which have sometimes profoundly affected the Salvadorian economy.

To summarize the distribution of coffee income, figure 3 may now be constructed, similar to that already prepared for Colombia (see again figure 2).

Most of El Salvador's exports of green coffee (about 60 per cent in 1975) go to the European Economic Community, by way of private national exporters, listed in a special register kept by the Salvadorian Coffee Company (CSC); this institution also signs coffee contracts on international stock markets, although on a lesser scale than the National Federation of Coffee-Growers in Colombia.

Figure 3
**EL SALVADOR: BREAKDOWN OF PRICE PER
 KILOGRAMME OF COFFEE EXPORTED**
 (Dollars)



2. Brazil

Although Brazil is the world's leading coffee producer, its case will be discussed in very brief outline, because it was impossible to obtain estimates of production costs or statistics on the structure of land tenure in the coffee sector. Moreover, the analysis of these indicators would be more difficult in Brazil's case, owing to several factors, among which special importance attaches to the wide diversity of the country's various coffee-growing areas, in contrast to the relative uniformity existing in Colombia and El Salvador.

Brazil produces 'unwashed *arabica*' coffee on farms that are generally of larger size than those of Colombia; and it is sold on the domestic market at minimum guarantee prices fixed by the Brazilian Coffee Institute (Instituto Brasileiro de Café— IBC).

Production is subject to sudden slumps caused by recurring frosts in the southern States (Paraná and São Paulo), and these contractions have a marked influence on world prices.⁴⁵

It is also of interest to point out that Brazil, with an annual consumption of about 6 million bags, constitutes the second world coffee *consumer* market, after the United States.

Table 17 shows production and exports of Brazilian coffee as from the coffee year 1950/1951.

As can be seen, there is no secular trend towards an increase in production for ever since the 1920s it has remained at relatively stable levels, if circumstantial fluctuations are discounted. On the contrary, it might be truer to say that exportable production has decreased, owing to the sharp upswing in domestic consumption.

Table 17
BRAZIL: PRODUCTION AND EXPORTS OF COFFEE, 1950/1951-1974/1975
 (Millions of bags)

Coffee year	Production	Exports	Coffee year	Production	Exports
1950/51	20.6	16.6	1963/64	24.1	19.8
1951/52	18.9	16.3	1964/65	15.1	12.9
1952/53	20.2	15.0	1965/66	38.8	15.3
1953/54	19.3	14.3	1966/67	19.8	16.3
1954/55	18.8	10.8	1967/68	24.8	18.2
1955/56	26.5	17.0	1968/69	18.1	19.3
1956/57	17.1	14.9	1969/70	18.7	19.0
1957/58	26.3	13.6	1970/71	10.4	15.6
1958/59	31.7	14.8	1971/72	29.1	20.3
1959/60	44.1	17.9	1972/73	27.1	19.2
1960/61	29.8	16.1	1973/74	16.2	19.7
1961/62	35.9	17.4	1974/75	26.9	12.3
1962/63	36.1	16.6			

⁴⁵ See table 17.

Coffee taxation in Brazil is based on two items: the tax on circulation of merchandise (Impuesto de Circulación de Mercadería – ICM) and the contribution quota (Cuota de Contribución – CC).

The ICM is paid to the States, and its amount is normally included in the domestic price received by the producer; the CC is fixed in dollars per 60-kg bag exported, and the national authorities periodically determine how much it is to be. Figure 4 shows an annual average weighted for 1973.

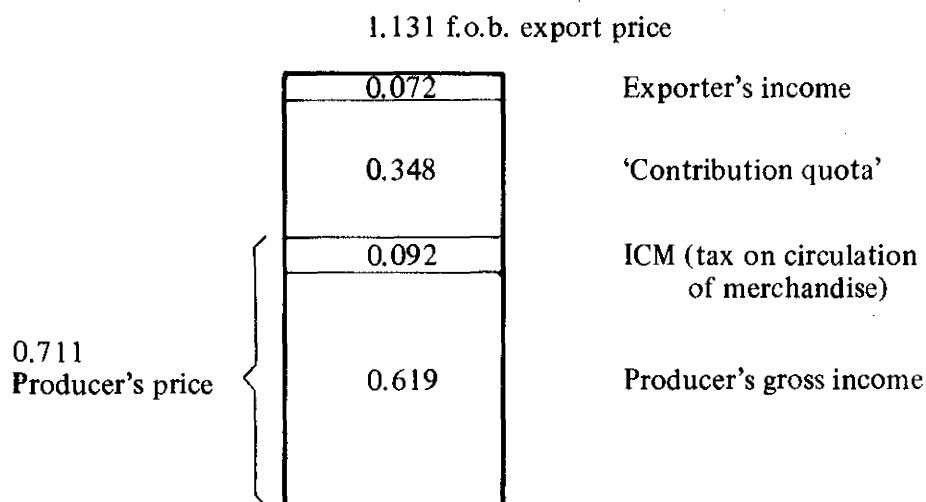
Coffee exports, as in Colombia, are subject to a 'minimum export price' ruling, established in relation to the price

conditions prevailing on the world market.

Figure 4 gives a breakdown of the price per kilogramme of coffee exported by Brazil, with the reservation, already made above, that as estimates of production costs are lacking, all that can be identified is the producer's gross income.

Lastly, it is worth while to point out that Brazil is the only Third World country which has come to export a substantial proportion of its production in the form of 'soluble' coffee. This process has not been without its difficulties,⁴⁶ but today the share of soluble coffee in Brazil's coffee exports is stabilized at about 15 per cent.

Figure 4
**BRAZIL: BREAKDOWN OF PRICE PER KILOGRAMME
 OF COFFEE EXPORTED, 1973**
(Dollars)



⁴⁶In this connexion the controversy between Brazil and the United States in 1971 may be recalled.

IV

Coffee prices in consumer countries

The differences between green coffee import prices and the retail prices of roasted and ground coffee vary considerably from one country to another, essentially owing to the different incidence of taxation in each case.

The comparability of import prices with retail prices is a technical problem which is easy enough to solve. In reality, coffee loses 19 per cent of its weight during the roasting process. Accordingly, the retail prices given below are expressed in terms of green coffee equivalent, i.e., they represent the real prices paid by consumers divided by a factor of 1.19.

This point having been explained, a comparison between import prices and retail prices in thirteen consumer countries may be observed in table 18, prior to analysis in greater depth of the component elements of price formation in some of these cases.

As table 18 shows, the range of difference extends from a minimum (in 1973) of 31.4 cents in Canada to a maximum (in the same year) of 170.6 cents in the Federal Republic of Germany.

A more detailed analysis will be made of three cases on which it was possible to obtain more precise information: the Federal Republic of Germany, France and Italy.⁴⁷

⁴⁷ The data relating to the three cases are not uniform, and this explains the different ways in which they are dealt with, although an attempt was made to achieve a maximum of comparability, at least in the final tables.

1. *The case of the Federal Republic of Germany*

The Federal Republic of Germany displays a manifest preference for mild coffees, for which higher prices are quoted on world markets; this tendency can be clearly noted when annual average import prices in Germany are compared with those in the other main importer countries.⁴⁸ For the period under review (1962-1974), with the exception of a single year, 1971, the values for the Federal Republic of Germany are the highest in the world. During the year 1972, for example, German industry paid an average of 51.8 dollar cents per pound of green coffee imported, whereas the equivalent sums for the United States, France, Italy and the Netherlands, were respectively 43.0, 43.7, 41.1 and 48.0 cents. 1972 was also an exceptional year in the sense that imports of *arabica* coffee⁴⁹ to the Federal Republic of Germany came to represent 77 per cent of total imports of green coffee. This figure tended to settle down from that year onwards at about 72 per cent, which still constitutes an unusually high proportion.

In 1975 a marked upswing occurred in imports of 'milds', which amounted to 2,224,390 bags of 'Colombian milds' (39.0 per cent of the total) and 2,230,768 bags of 'other milds' (39.1 per cent of the total). The Federal Republic of Germany is also among the countries which import proportionally most coffee

⁴⁸ See again table 18.

⁴⁹ 'Colombian milds' and 'Other milds'.

Table 18
**COMPARISON BETWEEN IMPORT PRICES AND RETAIL PRICES OF COFFEE
 IN THE MAIN CONSUMER COUNTRIES**
(Annual averages)

Country	1962		1965		1968		1971		1972*		1973*		1974*	
	A	B	A	B	A	B	A	B	A	B	A	B	A	B
Belgium	32.2	84.8	41.8	95.2	39.5	98.0	51.2	126.9	49.2	122.5	60.7	140.0	76.3	182.5
Canada	31.7	58.9	40.3	72.2	36.4	68.7	44.1	82.9	46.5	81.7	57.8	89.2	63.2	98.0
Denmark	31.9	109.0	41.4	124.7	36.5	118.0	46.9	148.4	49.5	149.7	60.7	173.5	74.9	211.2
Spain	33.0	—	39.9	78.8	38.6	67.7	48.5	81.0	49.3	84.1	61.6	101.9	70.4	108.7
													(est)	(est)
United States	30.4	70.8	37.6	83.3	34.0	76.4	40.7	93.4	43.0	92.7	54.3	104.0	59.1	122.9
France	31.4	73.1	33.7	74.7	34.8	79.4	42.9	106.4	43.7	108.9	50.8	123.6	—	—
The Netherlands	31.4	—	40.7	77.6	38.0	80.1	49.5	106.9	48.0	104.8	61.3	126.8	73.9	—
													(est)	
Italy	27.3	135.6	36.9	142.2	33.0	142.3	39.4	156.3	41.1	151.5	47.9	160.3	58.0	—
													(est)	
Japan	29.7	—	34.0	128.0	27.9	129.2	30.6	160.1	29.9	166.9	40.4	180.0	63.9	181.4
													(est)	(est)
United Kingdom	27.2	84.4	32.8	85.5	33.6	71.8	41.9	89.3	38.5	80.1	48.8	86.0	—	—
Federal Republic of Germany	41.3	163.8	46.9	157.5	42.0	151.0	48.7	193.7	51.8	192.1	65.1	235.7	—	—
Sweden	35.7	64.6	45.9	73.4	39.6	68.4	50.6	94.5	50.6	96.8	62.1	114.0	80.4	141.4
													(est)	(est)
Switzerland	34.7	—	40.5	103.8	39.1	101.1	48.8	117.2	49.0	121.9	61.3	154.7	82.3	197.6
													(est)	(est)

Source: Calculations based on ICO statistics.

A: Average green coffee import prices (expressed in dollar cents per pound).

B: Average of retail prices for roasted coffee, expressed in terms of green coffee equivalent (retail prices: 1.19).

* For the countries indicated, and for all countries in the years indicated, the margins of approximation are fairly wide, owing to exchange fluctuations.

from Latin America, with 71.8 per cent in 1975, as against, for example, 65.5 per cent in the case of the United States, 29.1 per cent in that of France and 58.7 per cent in that of Italy.

The high cost represented by the unit price of imports, together with the heavy burden of domestic taxation, combined to make retail prices of coffee in the Federal Republic of Germany the highest to be found among the leading consumer countries.

Nevertheless, owing to the stability of internal taxation, and above all to the vigorous revaluation of the mark against the dollar, these prices have not increased in current terms since 1962, and in fact in that year they were higher than in 1973, as can be seen from table 19.

Table 19

**FEDERAL REPUBLIC OF GERMANY:
RETAIL PRICES OF ROASTED COFFEE**

(Deutschmarks (DM))

1962	17.2
1963	16.7
1964	16.6
1965	16.6
1966	17.1
1967	16.8
1968	15.8
1969	15.6
1970	16.8
1971	16.6
1972	16.1
1973	16.7

This price stability allowed consumption to increase steadily, and, consequently, imports also expanded; in 1975 they reached a record level of 5,701,837 bags, reaffirming the position of the Federal Republic of Germany as the

second importer country in the world after the United States.

In the Federal Republic 80 per cent of the coffee consumed is taken in the form of roasted and ground coffee; the remaining 20 per cent constitutes the part of the market reserved for soluble coffee, of which 35 per cent—a proportion that seems likely to increase—is produced by the 'freeze-dry' method. This country also imports small quantities of soluble coffee (the equivalent of 120,474 bags of green coffee in 1975), which are more than offset by exports of the same product (155,893 bags in 1975).

The figures for the year 1971 may be used to exemplify how the retail price of coffee is formed in the Federal Republic of Germany.

To the cost of the raw material, i.e., 3.72 DM per kg, 25 per cent has to be added at the outset on account of the loss of weight undergone by coffee during the roasting process. This brings the price of the raw material up to 4.65 DM per kg. Supplementary expenditures on customs duties⁵⁰ (0.33 DM), freight and insurance (0.22 DM) and importers' margins (0.05 DM) combine with this figure to make the cost to the roaster 4.93 DM per kg of green coffee.

The processing (roasting) costs proper, plus costs of packing, come to approximately 1.00 DM per kilogramme.

The special tax on coffee,⁵¹ which is

⁵⁰ As in the other EEC countries, in the Federal Republic of Germany the common tariff rate is in force, which, for green coffee, is 7 per cent.

⁵¹ Pressure is being exerted with a view to the abolition of this tax, in the framework of tax harmonization within the EEC, but up to now it has been ineffectual.

paid to the *Länder*, is 4.50 DM for non-decaffeinated roasted coffee.⁵²

The roasters' profit margins, which have to cover internal freight and advertising costs, amount to 2.86 DM per kg.

All this goes to make up the cost for the retailer, which is 15.39 DM per kg; if to this figure are added the retailer's profit margins (2.50 DM per kg) and the VAT (0.66 DM), the final consumer price is reached, which, as already stated, was 16.5 DM per kg in 1971.

The distribution of income and profits is as follows:

	<i>DM per kg</i>	<i>Percentage</i>
Gross income of exporter countries	4.65	28
Tax revenue	5.49	33
Industrial profit margin	2.86	17
Industrial costs	1.00	6
Commercial profit margin	2.50	15
Others	0.05	0
<i>Total</i>	<i>16.55</i>	<i>100</i>

Both industrial and commercial margins are of course subject to income tax and the tax on net wealth, which in some degree increases the amount taken over by the State, at the expense of these two factors.

For information purposes, a synoptic table of the structure of the price of soluble coffee, according to whether the 'spray-dry' or the 'freeze-dry' method is used, is presented below, again with reference to 1971 (see table 20).

⁵² On decaffeinated roasted coffee, this tax is 4.75 marks per kilogramme, and on non-decaffeinated soluble coffee, 10.80 marks per kilogramme.

2. The case of France

In consequence of the special relations it maintains with its ex-colonies, France imports most of its green coffee (about 70 per cent) from Africa. This grade of coffee, apart from being the lowest-priced on the world market, enjoys complete exemption from tariff duties in the European Economic Community, under the Yaoundé and Lomé Agreements (the former in the first place and the latter at the present time). Other types of coffee are subject to the EEC common external tariff (7 per cent), and to this is added, in the case of France, an additional stamp tax (2 per cent of the tariff duty) and a plant sanitation tax of 0.7 per cent. France imported 4,646,000 bags of coffee in 1974 and 4,295,000 in 1975. Almost all its imports consist of green coffee, and nearly the whole of the remainder (soluble coffee equivalent to 140,000 bags of green coffee⁵³ in 1974 and 1975) comes from EEC countries, the exception being Brazil, which exported soluble coffee to France equivalent to 20,900 and 13,200 bags in 1974 and 1975 respectively. In addition, France exports soluble coffee in quantities which represent approximately double its imports. In 1974 and 1975 it exported the soluble coffee equivalent of 318,300 and 249,600 bags of green coffee, respectively, mainly to the United States and EEC.

The average unit value of 1 kilogramme of green coffee imported in 1972 was 12.00 francs. To break down the formation of the retail price a distinction

⁵³ To obtain the green coffee equivalent of a volume X of soluble coffee, this volume must be multiplied by a coefficient of 2.8/3.

Table 20
**FEDERAL REPUBLIC OF GERMANY: STRUCTURE OF INDUSTRIAL COSTS
 OF SOLUBLE COFFEE**
(DM per kg)

	'Spray-dry' method	'Freeze-dry' method
Raw material	9.30	12.40
Tariff duties	0.65	0.87
Freight and insurance	0.40	0.52
Importer's margin	0.10	0.13
Cost to roaster	10.45	13.92
Industrial costs and margins	14.10	15.98
Cost to retailer (including coffee tax)	37.95	42.90
Retailer's margin	10.00	14.00
Retail price before VAT	47.95	56.90
VAT	2.05	3.10
Final retail price	50.00	70.00

must be made between (1) real costs and (2) profit margins.⁵⁴

Under the first head may be included unloading costs (0.12 francs), the loss of 20 per cent in the roasting operation (1.10 francs) and the roasting (industrial) costs proper (0.36 francs), plus the costs of packing (0.42 francs) and distribution and 'other' costs (0.54 francs).

Under the second item may be noted the gains of the industrial companies' agents and middlemen at the import level (0.13 francs), customs duties and supplementary charges (0.33), VAT (0.9) and roasters', wholesalers' and retailers' profit margins (0.42, 0.96 and 1.2 francs, respectively).

⁵⁴ The source of this information is, essentially, a study by the London Graduate School of Business Studies, "The European Coffee Market", London, n.d.

With these components it is now possible to construct table 21, in which the formation of the consumer price of one kilogramme of roasted coffee is recapitaluted.

Table 21
**FRANCE: BREAKDOWN OF RETAIL PRICE
 OF 1 KILOGRAMME OF COFFEE, 1973**

	<i>Francs</i>
Green coffee	5.50
20-per-cent loss	1.10
Margins of middlemen	0.13
Unloading costs	0.12
Tariff duties	0.33
Roasting costs	0.36
Packing	0.42
Distribution, etc.	0.54
Roasters' margins	0.42
Wholesalers' margins	0.96
Retailers' margins	1.20
VAT	0.90
<i>Total</i>	<i>12.06</i>

Consequently, the distribution of income and profits is as follows:

Gross income of exporter	
country	46 per cent
Tax revenue	10 per cent
Costs	20 per cent
Industrial margins (roasters' plus wholesalers')	11 per cent
Commercial margins	10 per cent
Other items	2 per cent

3. *The case of Italy*

Like most of the consumer countries, Italy imports coffees from various sources, which the domestic industries blend in order to obtain the standard product that generally reaches the consumer in the form of roasted and ground coffee. Consumption of soluble coffee is very limited in Italy.

The relative percentages of imports of various types of coffee fluctuate little from one year to the next, and remain at about the following levels:

Unwashed <i>Arabica</i> :	20 per cent
Other <i>Arabicas</i> :	20 per cent
IBC (Brazil):	30 per cent
<i>Robusta</i> (Africa):	30 per cent

For the year 1972 the c.i.f. import prices for these various types of coffees were fixed respectively at 550, 550, 500 and 530 liras per kg of green coffee, of which the unit value in that year was 529 liras.

On this basis, it is possible to reconstruct the price formation up to the level of 2,300 liras, which, as will be seen, was the average retail price in the year under consideration.⁵⁵

⁵⁵ Most of the data are taken from "The European Coffee Market", *op. cit.*

The first item to be added is the unloading costs, established for 1972 at 15 liras per kilogramme of green coffee.

The second thing that must be taken into account is tax incidence, which in Italy's case is particularly heavy. The taxes are of four types: customs duties, tax on consumption, value added tax (VAT) and compensatory duty.

Table 22 shows the incidence of domestic taxation on coffee imports.

From the four final figures in this table can be deduced the cost of green coffee for the blend of varieties used in Italy. The weighted average of the four results thus obtained places this cost at 1,236 liras.

However, the real cost of the coffee blend to the roaster, which comprises the 20-per-cent loss of weight in roasting, is 1,545 liras.

To this figure must be added processing costs (roasting operation), which are very low, and for 1972 were estimated at 20 liras per kg, and those of advertising, packing and distribution (140 liras per kg). The margin left between this cost level (1,705 liras) and the wholesale price (1,965 liras) constitutes the roaster's net profit, which in 1972 was estimated at about 260 liras. Between the wholesale price and the retail price (2,300 liras in 1972) comes, of course, the retailer's profit margin, estimated at 335 liras. Thus a table can be constructed similar to those prepared for the Federal Republic of Germany and France:

Gross income of exporter	
country	23 per cent
Tax revenue	29 per cent
Costs	20 per cent
Industrial margins	12 per cent
Commercial margins	15 per cent

Table 22

<i>1 kg of green coffee</i>	<i>Unwashed Arabica (20 per cent)</i>	<i>Other milds (20 per cent)</i>	<i>Robusta (30 per cent)</i>	<i>Brazil (30 per cent)</i>
c.i.f. price	550	550	500	530
Port costs	15	15	15	15
Tariff duties	38.5	38.5	exempt	37.1
Tax on consumption	500	500	500	500
VAT	161	161	146	128
Compensatory duty	19.8	19.8	18	19.1
Cost of green coffee	1 284	1 284	1 179	1 229

4. Synthesis

As a general observation, it should be noted that the sample selected is not the most indicative of the real world situation, since at least two of the countries chosen (the Federal Republic of Germany and Italy) are among those that have the highest internal taxation on coffee. For lack of time and want of data no account has been taken of so important a case as that of the United States, which would be found at the opposite extreme as regards the level of retail prices.⁵⁶

Attention must be drawn, however, to the predominance of components not directly related to unavoidable industrial costs (the various profit margins and taxation) in the formation of the final retail price. It is interesting in this connexion to recall the position with respect to bananas, a product for which the level of 'real' industrial costs is even lower, since it undergoes no transformation process. Notwithstanding this, UNCTAD⁵⁷ points out that the producer captures a mere 11.5 per cent of the

final retail price, while the f.o.b. price represents only 26 per cent of that final price.

To return to coffee, a schematic representation of the situation in the Federal Republic of Germany, France and Italy can now be constructed (see figure 5). If this figure is compared with those presented earlier (figures 2, 3 and 4), which traced the formation of the f.o.b. export price, it will be noted that between the Federal Republic of Germany, France and Italy there are certain differences with respect to the green coffee import price, and that in turn this price is not easily comparable with the export prices indicated.

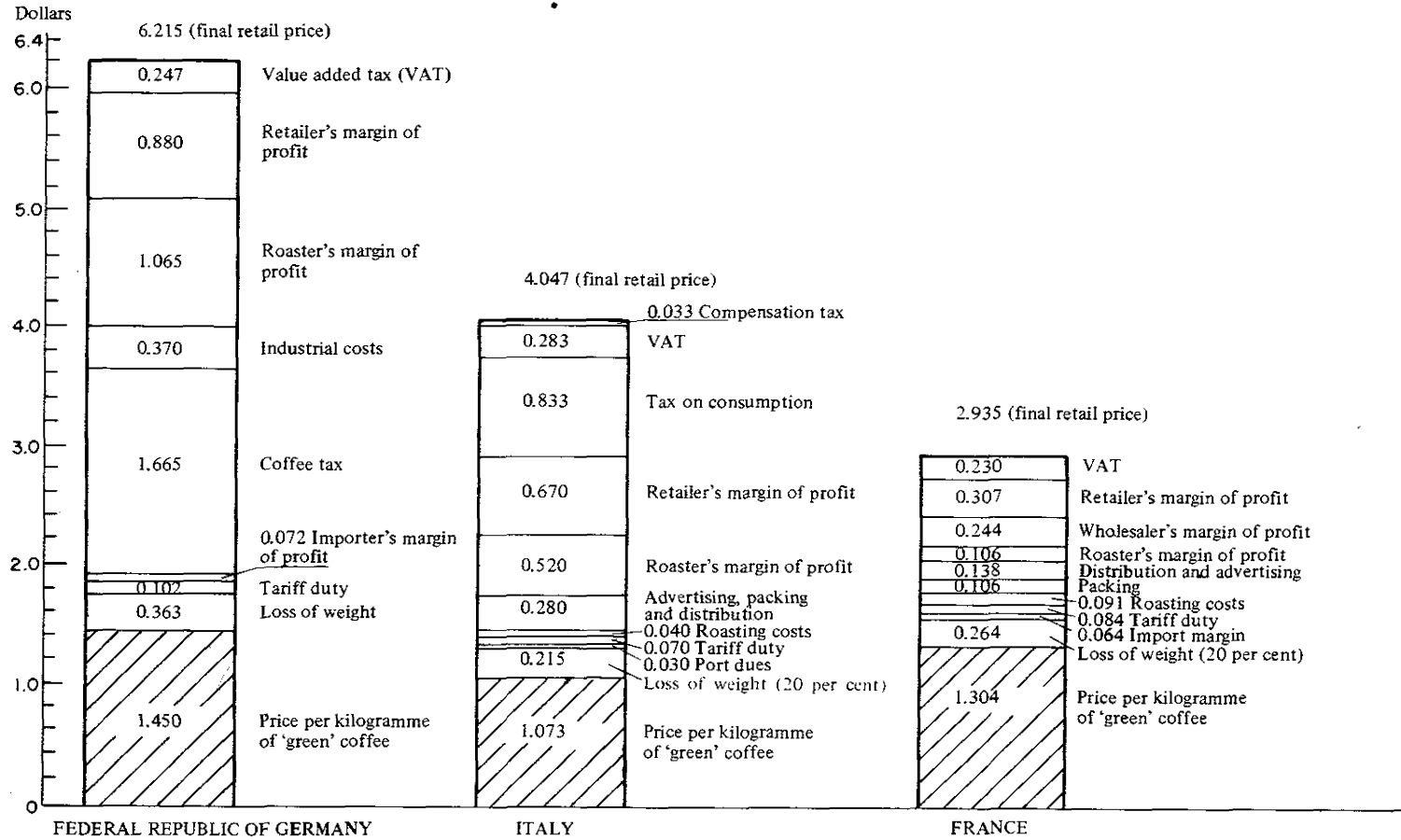
The price differentials are due, on the one hand, to the larger or smaller proportion of African coffee (of which the price is much lower) imported by each country, and, on the other hand, to exchange fluctuations, which were particularly sharp during the year 1973.⁵⁸

⁵⁸ The exchange rates used are annual averages; this involves a certain margin of error, especially if it is taken into account that the currencies of the Federal Republic of Germany and of Italy, for example, fluctuated in opposite directions.

⁵⁶ See table 18.

⁵⁷ UNCTAD, *op cit.*, table 8.

Figure 5
BREAKDOWN OF RETAIL PRICE KILOGRAMME OF ROASTED COFFEE,
IN THE FEDERAL REPUBLIC OF GERMANY, FRANCE AND ITALY
(Dollars)



With these reservations, which only marginally affect the estimates, it is now possible to measure the share in the final retail price obtained by the producer in Colombia, El Salvador and Brazil, as well as that of the exporter country as such and thus to attain the main objective of the present study (see table 23).

Table 23

**COMPARISON OF PRODUCER'S PRICES AND FOB EXPORT PRICES IN COLOMBIA,
EL SALVADOR AND BRAZIL, WITH FINAL RETAIL PRICES IN THE FEDERAL
REPUBLIC OF GERMANY, ITALY AND FRANCE**
(Percentages of final retail price)

	Colombia		El Salvador		Brazil	
	Pro- ducer's price	f.o.b. export price	Pro- ducer's price	f.o.b. export price	Pro- ducer's price	f.o.b. export price
Federal Republic of Germany	13.0	25.8	11.3	20.6	11.4	18.2
Italy	19.9	39.6	17.4	31.6	17.6	28.0
France	27.5	54.6	24.0	43.5	24.2	38.5

V

Conclusions

It is clear from the situation described that the producer countries need to obtain a larger share of the value added in relation to the retail price paid in the consumer country. There are several alternative ways of attaining this end, which will be examined here very briefly, and which include both action aimed merely at the maintenance of international prices and measures bearing on the actual mechanism of distribution of gains at the world level.

(1) Supporting export prices by means of international agreements (fixing of quotas, creation of inventories, regulation of supply, diversification, etc.) may be regarded as the traditional method, since longstanding experience exists in this respect. Without embarking

upon discussion of the efficacy of the international agreements signed in the past or currently in force (1962, 1968 and 1976), it may be pointed out that the last of these has been severely criticized on more than one occasion, and that in any event its objective is only to mitigate world price fluctuations and not to make any substantial change in the distribution of the value added.

(2) Unilateral action on the part of the producer countries as a whole (voluntary and concerted restriction of supply) would have better possibilities of bringing about a stable and substantial improvement in international quotations. But there are forty-six coffee-producing countries in the world, and hitherto it has been very difficult to

secure agreement among them even for less ambitious purposes. Moreover, a producers' association of such a type would need financial support in order, for example, to build up inventories. Lastly, there is some doubt as to whether the price-elasticity of world demand for coffee is as low as has always been thought, and the consumer response to the increases in 1976/1977 is highly suggestive in this respect.

(3) Exporting of processed coffee (roasted and/or soluble) has proved feasible in only a limited number of cases up to now. The difficulties of exporting roasted coffee stem, on the one hand, from the consumer's customary preference for blends of coffee from different sources, and, on the other hand, from the consumer markets' greater protection against the more highly processed forms of coffee and other primary commodities in general. Lastly, the control of consumer markets by relatively few enterprises, which are

sometimes big transnational corporations such as Nestlé, General Foods, Procter and Gamble, etc., seriously hinders access to marketing mechanisms (distribution chains, supermarkets, etc.). Much of what has just been said applies to soluble coffee too, and the conflict between Brazil and the United States in 1971 clearly shows what limits are set to the possibilities of marketing Latin American coffee in this form.

(4) Direct intervention in the consumer countries' markets, through the purchase of local enterprises or the establishment of new ones, is an interesting mechanism which so far has been tried out in only one instance: the purchase of the United States firm of Hills Brothers by a private group in Brazil. This might conceivably be one of the objectives of the proposed multinational Latin American coffee company. If a project of this type were to materialize, more than one country would have to take part, and an essential requisite would be an unequivocal political will on the part of governments.

Wage disparities in the urban labour market

*Paulo R. Souza**

A number of studies have confirmed that in all capitalist economies which have attained a certain degree of industrial development a segmentation of the urban formal labour market occurs, one of the consequences of which is greater inequality in wages and salaries. The author explains this phenomenon by postulating as a general hypothesis that the level of remunerations is determined by the overt or latent conflict between entrepreneurs and workers, and that many of the changes in the industrial structure derive from the efforts of entrepreneurs to obviate its destabilizing effects.

The first of the article's three sections analyses the case in the developed countries, and attention is drawn to the important influence exerted on salaries and wages by the internal labour markets of the large enterprises and by increases in productivity. The second section deals with the developing economies and outlines the factors which account for their higher degree of heterogeneity, such as the abundant supply of unskilled labour and the greater monopolistic power of the enterprises. Lastly, in the third section, the writer presents an analysis of the disparities between rates of pay in Brazil.

*Staff member, ILO Regional Employment Programme for Latin America and the Caribbean (Programa Regional del Empleo para América Latina y el Caribe - PREALC).

A. Introduction*

During the past few years attention has been devoted in an increasing number of studies on the developing economies to the problem of the segmentation of the labour market that has accompanied the recent industrialization process. The topic has awakened interest in several international agencies as well as in some important academic centres. A characteristic common to almost all the studies concerned is the division of the urban labour market into two sectors —the formal and the informal—, with a tendency to concentrate the analysis on the second of these, i.e., the one comprising those whose situation in the labour market is worst. But as several of the studies recognize, this does not mean that two homogeneous sectors are in question, and a point is made of stressing that the distinction drawn between the two is prompted by a methodological concern to establish the 'essential features' of the operation of the labour market in developing countries. While not denying that a policy to reduce income disparities necessarily calls for the elimination or the narrowing of the productivity gap between the two sectors, the present paper aims at drawing attention to the income dis-

* This study was partly prepared at the Institute for Advanced Study, Princeton, New Jersey, to which I would like to express my gratitude for the facilities it provided. Several people read earlier versions of the present paper and contributed very valuable suggestions which have made it possible to introduce substantial improvements in the text; my special thanks are due to my colleagues in PREALC and to Alberto Couriel, Paulo Vieira da Cunha, Richard Edwards, Raúl Prebisch and Víctor E. Tokman.

tribution mechanisms operative in the formal sector.

Some recent studies indicate that the past few years have witnessed an expansion of the spectrum of salaries and wages within the formal sector of the economy in some developing countries.¹ Of the relevant analyses, those that have been carried out in greatest depth relate to Brazil, and respond to the need to seek explanations for the income concentration process that was observable at least throughout the decade 1960-1970.² This discussion bears the imprint of contingencies in the recent evolution of Brazil, to which allusion will be made later, but on some occasions explanations of a more general type, linked to the operational characteristics of enterprises in the present 'monopolistic' phase of capitalism, are also invoked.

One of the objectives of the present paper is to put forward a few hypotheses

which, from this last standpoint, may help to account for the increasing disparities in salaries and wages,³ and another is to analyse their repercussions in the case of Brazil. The said hypotheses attempt to relate this process of wage differentiation with that of segmentation of the labour market. Since the latter is taking place throughout the capitalist world, and is a characteristic of the evolution of the system in the past few decades, the following analysis is initially of a general nature, and allusion is sometimes made to the more industrialized countries, in order to deduce, by contrast, what is likely to have been happening in economies such as those of Latin America. Lastly, in the section relating to Brazil, an endeavour is made to test these hypotheses, and at the same time to point out other characteristics peculiar to Brazil which complete the picture of the causes that account for the broadening of the pay spectrum in recent years.

B. Some basic assumptions

The present paper is based on the assumption that the factor underlying the wage determination process is the

real or potential contest between entrepreneurs and workers for the distribution of the product. The process

¹ This is a process that has been taking place in some of the developing countries in particular, but not in all. The most important determinants of this difference are connected with the disparities in the power of the social forces contending for the distribution of the product and with the capacity of the society's ruling groups to impose an economic model which, as a whole, implies an increasing differentiation of the social strata and a higher degree of economic concentration.

² The discussion on income distribution in Brazil has been prolific of literature in recent

years. See, in this connexion, Langoni (1973); the essays included in Tolipan and Tinelli (1975); and also the excellent *résumé* prepared by Bacha and Taylor (1977).

³ Unless otherwise indicated, these disparities should be interpreted in broad terms, that is, as existing between various types of manpower (by skill) and also between different workers with similar personal qualifications. Likewise, wages include all fringe benefits, which, strictly speaking, imply both an income for workers and a cost for the employer firms.

itself is approached from a long-term standpoint; past experience, in the course of innumerable conflicts, has taught the entrepreneurs certain lessons, which have been to some extent assimilated and are therefore very carefully taken into account when firms establish their wage policy.

On the basis of this general assumption, three trends in the behaviour of wages can be postulated as existing in the current phase of the development of capitalism.⁴ Admittedly, moreover, none of the three suffices in itself to explain the wage differentiation process noted in recent decades. On the contrary, only from the *interaction* of the three trends can the mechanisms which have established this differentiation be deduced.

1. *Trend towards wage differentiation deriving from the operation of internal labour markets*

(a) *Internal labour markets*

Doeringer and Piore (1971) drew a distinction between intra-firm and extra-firm labour markets. The former—in contradistinction to specialized or competitive markets—are characterized by behaviour patterns relatively independent of the situation in the labour market outside the enterprise. In the view of the writers mentioned, the principal factors generating such internal structures are enterprise-specificity of skills, jobs and technology and on-the-

⁴ What is understood here by the current phase of development of capitalism is the stage through which the system has been passing during approximately the last half-century, and which has involved, *inter alia*, a progressive increase in the size of firms and in the degree of monopolism in the economy.

job training. Obviously, these are problems which raise the cost of staff recruitment, selection and training for the enterprise and also set up barriers to the mobility of labour. Accordingly, the 'internalization' of the labour market enables firms to reduce the costs deriving from a high rate of labour turnover.⁵ Thus internal promotion ladders have been established by virtue of which the recruitment of workers for the higher posts is effected among the firm's employees themselves; and as a counterpart, opportunities of joining the firm are confined to the vacancies existing among the less responsible or less skilled posts for each type of manpower required.

This has been the experience of capitalism in the United States during the present century. For example, Edwards (1975) underlines the relation between degree of concentration, firm size and operation of internal labour markets. The growth process of the enterprises and the tendency towards monopolism in the economy led them to 'internalize' everything that might, at one time or another, constitute a threat to their existence and expansion: competition, orientation of consumer preferences, financing, research and labour markets. In this last respect, contributory factors were the expansion of the firm and the creation of many subsi-

⁵ The difficulties encountered by American capitalism in relation to intra-firm stability of labour during the early decades of the present century have been analysed by several authors (Edwards, 1977; Stone, 1975; and Maltese, 1975). A famous case is that of the Ford Motor Company, which, in 1913, passed through some periods in which the labour turnover was so high that it had to engage 500 new workers daily in order to maintain its labour force of 15,000 employees (cited by Maltese, p. 88).

diaries; the institution of norms of bureaucratic control and the constitution of the hierarchy *pari passu* with the enlargement of the number of post and functions; and the increasing stability of the activity concerned, which permitted long-term planning of the firm's labour requirements.

The result of all this was the bureaucratization of intra-firm relations and the establishment of rigid hierarchical channels of communication. The labour force appropriate to the new system does not need new technical skills, but it does require a new attitude as regards adaptability to established norms, identification with the objectives of the enterprise, etc. In this connexion, performance within the enterprise acquires a great deal of importance as a criterion for the evaluation of workers, while all the attributes susceptible of objective measurement *prior* to the workers' entering the firm are relegated to a secondary plane.

(b) *Effects on the labour market outside the firm.*

The effects of these practices on the operation of the labour market as a whole were of two types. In the first place, at the level of the labour force employed in large enterprises, the stabilization mechanisms led to the organization of promotion ladders and to the granting of particular benefits to the manpower employed which, in abstract terms, were supposed to be specific to *each individual* enterprise. Nevertheless, since all the big firms shared in the same process in respect of the expansion of their economic power and the need to introduce the aforesaid practices of 'internalization' of the labour market, for workers in all large

firms labour market conditions tended, *very broadly speaking*, to be fairly homogeneous.⁶

Secondly, from the standpoint of the labour market as a whole, the fact that the large enterprises do not employ the *entire* labour force, and that small and medium-size enterprises did not witness the same increase in their economic power, meant that demand for labour became more and more differentiated. On the one hand, the smaller scale of such establishments, the lesser degree of complexity in their management, the lower level of 'sophistication' in their production processes—still as compared with the experience of the large enterprises—offered them no inducement to 'internalize' the labour market, at any rate to the same significant extent. Moreover, the subordinate part they play in the accumulation and concentration processes—of which it is not they that are the motive force—did not allow them to increase their share in the product,⁷ with the result that they were less able to follow in the footsteps of the large enterprises in respect of

⁶ This does not mean, however, that no major differences are observable in the norms governing the operation of the labour market in each individual enterprise, or that all workers of identical skill or rank in all enterprises enjoy exactly the same benefits and wages. As was noted earlier, the homogeneity of this particular stratum of the labour market must be interpreted in broad terms and derives from the operation of intra-firm markets.

⁷ According to the theoretical model of accumulation in a situation of concentrated oligopoly, in view of the technology and the overall demand conditions prevailing, small and medium-size enterprises gain an increased share in the product only over short periods. Hence it may be inferred that over the long term their participation in the product followed a downward trend. Some relevant data are included in the following section.

granting certain benefits to their workers in order to ensure that they would stay with the firm.⁸

2. Trend towards linking wages to level of productivity in each enterprise or sector, deriving from the contest for the distribution of the product

This tendency derives directly from what is generally assumed to be the very essence of the wage determination process; the contest between entrepreneurs and workers for a share in the product. As noted above, it need not necessarily be apparent at every stage in the process, since it may take latent or potential forms. Moreover, the differing structural characteristics of countries in different phases of their history determine a relationship between the forces taking part in the process which is peculiar to each country and each situation. The participating agents (entrepreneurs, workers through their trade unions and the government as the pilot of overall development and welfare policy) may also make their presence explicitly felt in different degrees in each specific situation. The existence of institutional factors (trade unions, labour legislation, etc.) strengthens or consolidates the tendencies towards segmentation of the labour market which have their *origin* in economic

⁸ Alexander (1976) measured some relationships for the 10 industries which showed the highest and the lowest levels of employment stability in the United States during 1965-1966, and reached the conclusion that the degree of concentration in the former groups was four times higher than in the latter, the value added per worker nearly three times larger and the investment per employed person almost five times greater.

factors: differences in productivity, internal organization of the enterprises, need to stabilize the labour force, etc.

What is important for the wage differentiation process is not the existence of all these mechanisms and agencies: it is the different capacity for pressure and, above all, for response to them which is found in the various sectors that make up the economic structure. The capacity for response is a direct function of the level of productivity attained by the system as a whole or by its various component parts.

If account is taken of the dizzy speed with which the product per worker has grown in the last few decades, especially in the large enterprises, it may be concluded that these latter are relatively better placed to negotiate the distribution of the product between capital and labour in such a way as to avert possible conflicts. The counterpart of the process of introducing new techniques and increasing the product per worker is that wages dwindle to a progressively smaller proportion of the firm's total costs, so that marginal relative variations become less important.

Analyses of the evolution of the centralization and monopolization process in economies like that of the United States suggest that an increasing proportion of the market for goods has been taken over by the large enterprises (Averitt, 1968; Edwards, 1977). Although such firms are the most productive and keep in the front line of technology, and are therefore the 'leaders' in indexes of productivity growth, this greater participation in the market for goods has been simultaneously accompanied by a growing participation in employment. But the increase in the large firms' share in the product has

exceeded that of their share in total employment in the economy. In other words, the following relation can be noted:

$$\frac{r_{pg}}{r_p} > \frac{r_{eg}}{r_e}$$

where r_{pg} is the growth rate of the product in large enterprises

r_p the growth rate of the total product

r_{eg} the growth rate of employment in large enterprises

r_e the growth rate of total employment.

This means that a proportionally larger part of the product is generated by a proportionally smaller part of the labour force.⁹

To follow up this line of argument, it will be convenient to divide the whole economy into two separate sectors, and to examine what would have happened to wage levels in each of them *if the other had not existed*.

In the sector formed by the large enterprises (central nucleus), improvements in productivity would allow the labour force to be successful in its demands for higher wages. The workers' requests would gain strength from the lack of a manpower surplus and employers could comply with them without adversely affecting their rate of profit,

⁹ There is empirical evidence to show that this is what has occurred, for example, in the United States (Edwards, Reich and Weisskopf, 1978). The present paper is concerned particularly with the case of developing economies, where the process in question displays even more striking and manifest characteristics.

since productivity too would be increasing.

In the sector comprising the small and medium-size firms (peripheral area), productivity would likewise be rising (always provided that the growth rate of the product was higher than that of employment), but more slowly than in the central nucleus. Efforts to speed up the pace would find themselves cramped by a less dynamic market than that of the large enterprises.¹⁰ Accordingly, workers in these smaller firms would be less successful than those of the central nucleus, although probably they too would achieve some improvements in their wages.

3. *Trend towards equalization of wages deriving from competition in the labour market*

Obviously, large and small enterprises do not operate in separate worlds. Thus, recognition that trends exist which reduce competition in the labour market by no means implies that there may not *also* be a tendency to competition in that market as in any other.

Accordingly, given the co-existence of those two sections of the economy, adjustment on the wages side, as already pointed out, is obviously bound to present some fairly serious complications. That is, the central nucleus could not grant a *blanket* wage increase because this would cause severe disequilibria in the market, particularly in the case of those categories of workers

¹⁰ As explained above, in view of the prevailing oligopolical structure, the market for small and medium-size enterprises shows little or no sign of steady expansion over the long term.

where the peripheral area plays a major part in employment.

It must not be forgotten, however, that the period when this process of centralization and monopolization began (the early decades of the present century) was also a time when the intra-firm conflict between employers and workers, as mentioned above, was still unsettled (Stone, 1975; Maltese, 1975; Edwards, 1975, 1977). For the central nucleus, the solution seems obvious: to use the firm's increasing surplus (the part which the workers should receive if the peripheral area did not exist, but surrender of which is *not compelled* by the market) in order to fix wage differentials in promotion scales,

obviate conflicts with workers and stabilize the labour force within the firm.

This differentiation process has one basic characteristic: at the lower levels, through the operation of market forces, wage levels slightly higher than those current in the peripheral area are established, in order to ensure an elastic supply of manpower without upsetting the balance of the labour market. Higher up the ladder, wage differentials as between the various levels are very marked. The criteria applied to determine these differentials and to rationalize them in microeconomic terms are described by Doeringer and Piore (1971) and by Edwards (1977).¹¹

C.

An explanatory hypothesis on differences in pay

1. *The general case*

Analysis of the interaction between the three tendencies defined in the following section makes it possible to draw some conclusions as to how wage scales should be structured in any economy, and what should be the predictable trends in their evolution.

The tendency in the central nucleus would be to diversify its wage structure,

in line with other than market criteria, extending the gamut of wages upwards.¹² The effects of this on the operation of the labour market and the wage differences between the central nucleus and the peripheral area have some special aspects that are worthy of mention. In the first place, differences can be noted in the pay received by workers with the same skill or rank employed in different enterprises in the

¹¹ But since Doeringer and Piore disregard the growth of the surplus handled by the enterprises, the impression is created that in general the establishment of wage scales is subject to *constraint* on account of a total wage bill which cannot be greatly increased. In contrast, the hypothesis adopted here assumes that the growing surplus obtained by the enterprise enables it to be much more flexible in fixing wage scales.

¹² There is nothing new about this conclusion, however. Other writers, on the basis of different arguments, have reached very similar positions. Bacha (1975), for example, as a result of the findings of several studies relating to the intra-firm hierarchical and bureaucratic structure, divides workers into managers (persons with some supervisory responsibility at any level) and subordinates. And he comes to the conclusion that the extra

central nucleus. However, these disparities are not very marked, and by and large would tend to offset one another if a comparison were made between enterprises, in consequence of the similar degrees of intensity of the three trends described earlier. But the wage differentials between different types of labour within the labour market of the large enterprises have a tendency to grow bigger in the course of time.

In contrast, striking pay differentials would be observable as between the workers of the central nucleus and those in the peripheral area. Such differences would tend to increase with progress up the occupational ladder, i.e., from the simpler and less skilled jobs to those of greater complexity or greater responsibility in the hierarchical structure. This is a result of the interaction of the three trends mentioned above, of which the first two would prevail among the more skilled types of labour, while the operation of the market would tend to counteract their influence where unskilled labour was concerned. Another possible postulate is that in dynamic terms the maintenance of the trend towards an increase in the large firms' share of the total product would lead to

amount received by managers is explicable only in terms of their predominant position in capitalist production relationships, which under that system associates them with the owner class (p. 132). Again, Belluzzo (1975) examines the similarities and dissimilarities between the marxist postulates on the distribution problem and those of some contemporary authors linked to the Cambridge School, endeavouring to draw conclusions as to the evolution of personal income distribution. This writer points out that changes in the structure of the enterprise and an increase in the 'degree of monopoly' are conducive to a slower growth rate for wages than for productivity, and to differentiation in the pay range of the bureaucratic hierarchy (p. 35).

a widening of wage disparities. Thus, the differences between the higher categories would increase faster than those between the lower categories of workers.

On the other hand, it is quite possible that this general trend may be offset by market forces in respect of those categories of workers where other factors (relative shortage, geographical mobility, etc.) tend to favour the operation of a competitive labour market. This might be the case, for example, with 'professionals' in general, and particularly with some careers of which spatial mobility in international terms is a fairly marked feature.

In addition to the problems of market disequilibrium already pointed out, it must be noted that, if the central enterprises were to opt for a *blanket* wage increase, they would not succeed in establishing the 'social peace' necessary for the 'efficiency' with which they operate, since these factors stem from control of labour,¹³ facilitated by the establishment of hierarchical scales and by the wage differentials which tend to undermine class solidarity and make labour conflicts a more remote possibility. Moreover, it is stratification itself that explains why the central-nucleus enterprises, although they are the firms that characteristically constitute the *primary* labour market, also participate,

¹³ The expression 'control of the labour force' is used here in the sense of application both of methods to prevent or reduce labour conflicts of any kind, and of those designed to guarantee the firm's operation at a satisfactory level of efficiency. For example, in an economy where some types of labour are very plentiful, the enterprise will not need to apply 'sophisticated' control techniques in those activities where the mechanics of the work itself suffices to guarantee an appropriate level of efficiency, irrespective of the specific training of the workers.

to some extent, and in relation to some very specific activities, in the secondary market.¹⁴ In other words, in the case of jobs where labour control problems can be resolved by other methods and where stability in employment is not important, the central enterprises can 'allow themselves the luxury' of applying practices that are typical of the secondary market (intensive turnover, subcontracting, piece work, etc.), thus obtaining an even bigger surplus, part of which can subsequently be used for the diversification of wage structures.

In short, the evolution of capitalism during the last few decades shows a tendency towards more and more diversification of the wage structure, in consequence of the 'internalization' of labour markets within the firm, the increasing size of enterprises and the growing monopolism of the economy.

2. The special case of developing economies

Considerable attention has been devoted to the study of Latin America's development process, especially by writers linked to the CEPAL tradition, and the present paper makes no claim to go into this subject in detail. (See Tavares, 1964; Pinto, 1965, 1970, 1971; Tavares and

¹⁴ As an offshoot of the studies on its segmentation, the labour market is usually divided into two sectors: the primary and the secondary market. Prevalent in the former are "high wages, good working conditions, employment stability, chances of advancement, equity, and due process in the administration of work rules. Jobs in the secondary market, in contrast, tend to have low wages and fringe benefits, poor working conditions, high labour turnover, little chance of advancement, and often arbitrary and capricious supervision" (Doeringer and Piore, 1971, p. 165).

Serra, 1971.) It is worth while, however, to emphasize three of its aspects that are related to the points summarized above.

In the first place, it is common knowledge that the development of Latin America is characterized by a relatively high degree of concentration and of monopolism in the economy, a circumstance which gives large enterprises a chance of playing a more important role than is usually the case, in view of their greater power over the market and their higher rates of return; and this factor would seem to be determining a more heterogeneous structure of production than is prevalent in the developed economies. All this is reflected in productivity differentials between sectors of the economy, or between enterprises in one and the same sector, which may result in bigger wage disparities as will be seen below.

Secondly, the transfer of consumer patterns from the developed economies has also implied imitation of their production processes and entrepreneurial structures. The latter has to some extent involved a transfer of management principles too, as well as of many control mechanisms common in the developed countries. It should be noted that this does not necessarily depend upon the ownership of the enterprise set up in a developing economy; true, should it be foreign-owned, the transfer mechanisms would be direct and more in evidence, but they have also been present in the case of enterprises owned by nationals (or even by the State), given the nature of the process to which reference has been made.¹⁵

¹⁵ The case of State enterprises deserves special attention in view of their importance in Latin America. Generally speaking, such enterprises enjoy monopolies within the economy, a

Lastly, certain features of the recent evolution of the Latin American economy have tended to enhance the two foregoing aspects of the question. In the first place, even in sectors which began their industrialization process with a reasonably competitive structure (traditional industries, retail trade, certain services), in recent years a notable concentration process, with a high index of denationalization, has occurred. Secondly, problems relating to the small size of the domestic market for durable and capital goods have been resolved in three ways: concentration of income and expansion of the purchasing power of the most affluent tenth of the population (Tavares and Serra, 1971); concentration of the industrial structure in the branches producing durable consumer goods (increases in degree of monopolism and firm size and consolidation of the power of monopolistic state enterprises in several branches) (Tavares and Serra, 1971); and, lastly, internationalization of the economy through the operation of two mechanisms; (a) greater participation of subsidiaries of transna-

situation which gives them great power over the market and a high capacity for generating surpluses in the most profitable sectors (petroleum, steel-making, mining). Although in this instance it is by definition impossible to speak of social conflicts between capitalists and workers, which would account for the adoption of entrepreneurial practices characteristic of large firms, the fact that the States enterprises form part of the central nucleus of the developing economies compels them to adopt practices of this kind (Souza, 1971). What is more, the need to retain highly-skilled personnel and the possibility of transferring costs enables them to extend benefits to their labour force which exceed those granted by transnational corporations.

tional corporations in total supply; and (b) participation of the same subsidiaries in the new system of international division of labour (Fajnzylber, 1970).

Interaction between the processes so far mentioned, in a scenario characterized by great economic dynamism and soaring growth rates of the population and of the labour force (particularly urban labour, owing to in-migration from rural areas), has helped to build up a much-segmented labour market with a high proportion of inter-sectoral disparities.

Firstly, despite the vigorous dynamism of the economy, the jobs created in the most productive sectors have not been sufficient to employ the manpower which, to an increasing extent, has become redundant in rural areas. Thus, because of the large amount of surplus labour possessed by these economies, a substantial proportion of the labour force cannot find employment in the more organized and productive enterprises (or even in those belonging to the peripheral area). For this reason, those to whom no better alternative is open *organize themselves* in a sector composed of very small enterprises and independent workers, seeking to operate on the fringe of the market in activities which bring them in barely enough to live on (PREALC, 1974; Souza and Tokman, 1974, 1976, 1977). Hence we can divide the peripheral area into two new sectors: the *small-enterprise sector* and the *informal sector*. The first would include the small and medium-sized enterprises organized on capitalist lines; the second, the very small enterprises (employing fewer than five workers, to set a ceiling), under-organized in every respect, and the self-employed, as well as some 'special cases' characteristic of

developing economies: domestic service and casual or occasional workers.

Secondly, economic dynamism has been generated principally in the central nucleus of the economies in question, formed by the large enterprises –*generally* foreign or State-owned– that operate in highly concentrated branches of activity which carry a great deal of weight in the market and use more modern and capital-intensive technology than is commonly applied in the other sectors. The existence of a large labour surplus explains why the central-nucleus firms have tended to diversify their wage structure to a greater extent than the rest. In the first place, the wages of their unskilled workers were closer than those of other types of manpower to a level far below any that had to be met in the developed economies.¹⁶ Secondly, at the upper extreme, the high degree of mobility –even in international terms, as was explained above– strengthened the trend towards wage differentiation. In macroeconomic terms, moreover, this procedure is consistent with income concentration and the creation of a dynamic market for durable consumer goods. In the case of the ‘small enterprises’, the growth of the surplus was not so significant, nor the structure of employment so diversified, as to enable them to keep in step with the behaviour patterns of the large enterprises. Possibly, however, for certain types of skilled manpower in respect of which they compete with the central nucleus, they may have to adhere, up to a point, to the large firms’ wage scales. This depends, in any event, upon the degree of relative shortage of these types

¹⁶ The reason is that the equalizing tendency of the market means more in these categories than in the rest.

of manpower.¹⁷ Lastly, the informal sector displays a much more homogeneous occupational structure, made up of workers of whom the vast majority have little training in skills or general education, and, generally speaking, is in a disadvantageous position to compete with the firms belonging to the formal sector (central nucleus and small enterprises) in the market for goods, so that its productivity and income are unlikely to have increased steadily.¹⁸

The effects of all this on the distribution of aggregate income depend on the relative growth rates of the product and of employment in each of these sectors. In developing economies the basic assumption that the share of the central nucleus in the product grows faster than its share in employment seems even more patently true, and this difference would strengthen the tendency towards an increasing disparity in the distribution of salaries and wages.

With regard to what happens within the peripheral area as between the small-enterprise and informal sectors, at a first glance the trends do not seem clearly-defined. Available analyses point

¹⁷ Hence follows an important corollary: the degree of relative shortage has less influence on the *level* of the wages earned by a given category of workers than on the range or gamut of their wages, according to the sector in which they are employed (central nucleus or small enterprises).

¹⁸ This is not intended to imply that all informal activities are ‘dysfunctional’ or that they are tending to disappear. As emerges from other studies (Souza and Tokman, 1976; Tokman, 1978), a part of the informal sector admittedly offers real possibilities for growth and expansion, and this proportion might be significantly increased if appropriate economic policy measures were applied. What is meant here is that, as a whole, the product of the informal sector shows an asymptotic tendency to decline in relation to the rest.

out that in the goods market the general tendency is towards a relative decrease in the informal sector's share in the aggregate product of the economy (PREALC, 1976; Souza and Tokman, 1976; Tokman, 1978).

In turn, the growth rate of the informal sector's labour force depends upon many variables: the overall growth rate of the labour force, the rate of rural-urban migrations, and the rate of absorption by the other sectors (central

nucleus and small enterprises). The pertinent figures would indicate for each country whether the evolution of the informal sector has made for the widening or for the narrowing of the income gap in relation to what has occurred in the other sectors. This point is of particular significance not only for the relative distribution of income, but also in order to define the volume of 'critical poverty' existing in each country.

D.

Wage disparities in Brazil

1. *Income distribution in recent years*

Income distribution in Brazil has deteriorated during the past few years. This conclusion is reached by almost all the researchers who have analysed the problem in relation to the period 1960-1970, for which the requisite data are available. The most detailed measurement was made by Langoni (1973), who, despite certain methodological difficulties which led him to underestimate the degree of concentration recorded during the period, concludes that all deciles of the population lost part of their share in total income, with the exception of the top decile, which increased its share by more than 20 per cent, and the group immediately below this, which, strictly speaking, experienced no change in its relative position. The greatest losses would seem to have been concentrated in the middle (5th, 6th and 7th) distribution deciles, with reductions of

more than 20 per cent in their share of total income.¹⁹

This phenomenon of income concentration resulted not only from the fact that the share of profits in the product was greater than that of wages,²⁰ but also from the diversification and concentration of salaries and wages in the urban sectors, as is pointed out by several writers (Bacha and Taylor, 1977; Wells, 1975). Some aspects of the evolution of the wage structure in Brazil will next be summarized and discussed, in an attempt to identify not only the causes of a conjunctural type but also those linked to the operation of the economic system.

¹⁹ In any event, according to Langoni all deciles would appear to have witnessed increases in the absolute level of their average real income.

²⁰ The share of salaries and wages in urban income dropped from 57 to 52 per cent between 1949 and 1957 ("Contas Nacionais", *Conjuntura Econômica*, Rio de Janeiro, July 1977).

2. *Trends in the employment situation and the existence of an urban informal sector*

Since the Second World War the Brazilian economy has been characterized by great dynamism, which enabled it to achieve average annual growth rates of 6.7 per cent throughout the period 1950-1975.²¹ The publication of the results of the 1970 Census also provided evidence that up to a point this growth was reflected in rapid rates of absorption of labour in high-productivity sectors. For example, a comparison between the population censuses of 1950 and 1970 shows that employment in manufacturing increased at an annual rate of 3.6 per cent; in trade, finance and transport, the corresponding rate was 4.1 per cent; and in social services, 5.8 per cent.²² Moreover, the industrial censuses for the same years indicate an annual growth rate of 3.5 per cent for employment in manufacturing establishments. Setting aside the methodological problems posed by the use of population and establishment census figures, a comparison of this rate with the one mentioned above would suggest at least a similar expansion of what might be called unregistered artisan industry.²³

But this is only one aspect of the question. The non-agricultural labour force was expanding at a rate of 4.5 per cent per annum during the same period; this was the result of rural-urban migration, which caused the population

of the large towns in Brazil to increase at an annual rate of 5.2 per cent, whereas the rural population did so at a rate of only 1.1 per cent.

The rapid growth of the population, over against the inflexibility of the system of access to land and production resources in rural areas, led to a flow of labour city-wards at a rate far exceeding the capacity for response of the more productive sectors of the urban economy.²⁴ Thus, for example, employment increased at a higher rate in 'other services' than in industry or distribution services (4.9 per cent per annum).

Moreover, the increase in employment in more productive sectors, such as commerce or industry, also conceals some expansion on low-productivity fringe activities of this kind (peddling and hawking, artisan industry, subcontracted services, etc.).²⁵

This proportion of the labour force which migrates to the cities and does not find employment in the more productive activities has to make a living somehow. The most obvious means is to produce or sell something or some service, taking advantage of the 'empty spaces' left in the market by the organized enterprises. As has already been mentioned, these gaps exist on the fringe of the concentrated oligopolistic market and in those activities where the more productive and organized enterprises have not

²¹ CEPAL (1977), table 8.

²² Faria (1976), chapter V, table 16.

²³ In both years, according to the industrial censuses, the number of workers employed in manufacturing represented a little over 80 per cent of the total recorded as employed persons in the population censuses.

²⁴ This is by no means intended to imply that supply was the only problem. The growth pattern of these more productive sectors was also characterized by little absorption of manpower in comparison with experience in the more industrialized countries.

²⁵ PREALC (1976) estimated that the size of the urban informal sector in the Brazilian economy during the 1960s must have increased in absolute terms despite the more rapid expansion of formal employment.

yet penetrated (Souza and Tokman, 1976). Since sustained expansion of these 'empty spaces' is impossible, an increase in the number of persons who have to subsist by finding a place on this fringe means that the level of real income per person employed is bound to decrease or at least not to rise. Accordingly, after the rapid growth referred to, a large sector of marginal population is still to be found in the big towns of Brazil. It is one of the factors that explain, for example, how it came about that in 1972, 24 per cent of the non-agricultural labour force in the States of Sao Paulo and Rio de Janeiro received incomes below the legal minimum wage.²⁶ Naturally, a labour contingent thus exceeding the direct demand of the more organized sectors has a depressive effect on the wages of unskilled workers in general, a point which acquires a great deal of importance in the operation of the system as a whole, as will next be shown.²⁷

3. Wage trends in the formal sector of the economy

(a) Evolution and coverage of urban minimum wages

Mata and Bacha (1972), in analysing the evolution of employment, productivity and wages in the transforming industries during the period 1949-1969, found evidence of a process of pay concentra-

²⁶ Of course a not inconsiderable part of this total must be made up of minors and of part-time workers who, by definition, may have incomes below the minimum even though they are working in organized enterprises.

²⁷ This is not meant to suggest the existence of a labour market that is completely competitive among unskilled workers; the

intention is merely to stress that the trend towards competition is more apparent in respect of this type of labour than of others, in view of its relative abundance and the lack of incentives for firms to 'internalize' labour markets.

tion. In the first place, they noted that the increase in the average wages of white-collar employees (214 per cent in the course of the period) was much bigger than the corresponding rise for blue-collar workers (66 per cent). In connexion with the average wage of the latter, two facts stand out: the greater increase (in absolute terms and in relation to productivity) during the 1950s; and the downward trend in the relative position of the average wages of workers in low-wage branches *vis-à-vis* the average for those in high-wage branches, especially during the following decade. Hence these writers conclude that although the type of evidence available does not permit of analyses in greater depth, the data studied suggest an explanation of the concentration process in which major roles must be attributed to trade-union-action --existent to a reasonable degree in 1949-1958-- and to wage policy, admittedly constrictive in 1964-1966, and somewhat more liberal as from 1968 (*op. cit.*, p. 100).

This reference introduces the subject, of the role played by trade unions in the evolution of wage disparities in Brazil; but that is a question which will not be discussed in the necessary depth in the present paper. At all events, it must be emphasized that during the period 1945-1964 the trade unions gained an increasing share in wage-fixing in the various branches. On the one hand, the independent character of bargaining by branches allowed real wages in industry to rise, up to a point,

intention is merely to stress that the trend towards competition is more apparent in respect of this type of labour than of others, in view of its relative abundance and the lack of incentives for firms to 'internalize' labour markets.

in a fashion relatively irrespective of the existence of a large subsistence sector. On the other hand, the trade-union structure in Brazil was organized during the 1940s by branch of industry, not by enterprise, which makes its level of aggregation very low in several traditional branches (the food industries, for example) and very high in the branches which at that time were not important. (For example, the metal-workers' trade union groups together all workers in the metallurgical and metal-transforming industries.) This means that wage increases negotiated by the trade unions in the more dynamic branches have to be levelled 'downwards' in order to accommodate the less productive groups of industries in the branches concerned.

In this context, wage policy after 1964, and especially after 1967, did even more to reduce basic salaries. Up to the latter year, the lack of collective agreements between entrepreneurs and workers was supplied by the labour courts, which decided the wage adjustment in each individual case. As from 1967, the government laid down a specific formula for calculating adjustments applicable in such cases (the so-called *'dissídios coletivos'* or 'collective disputes') which implied a greater degree of homogenization of the increases offered to all categories of workers.

By virtue of the data available for more recent years, this assertion can be corroborated in part and made more exact. In actual fact, the policy of restricting the minimum wage, especially after 1964, had more importance as an indicator of the behaviour of the wages paid to blue-collar workers in general than would derive from its mere direct effect on the income of unskilled workers.

The real minimum wage has declined sharply in the past fifteen years (at least since 1963), after having shown a slightly rising trend over the period 1956-1962. The decrease was particularly marked in 1963-1967 (see table 1). On the other hand, there are signs that the proportion of people receiving up to one minimum wage dwindled in 1965-1968, but remained constant or tended to increase a little between 1969 and 1971 (Bacha and Taylor, 1977). But the importance of minimum wage policy for the evolution of wages in general can be gathered from the same table 1, via the index of the wages of unionized workers appearing in columns 2 and 3, and also from the evidence brought by Bacha and Taylor (1977) to show that the elasticity of average wages in the Rio de Janeiro manufacturing sector in relation to the minimum wage was approximately 0.5 in 1952-1975 (*op. cit.*, p. 40).²⁸

(b) *Evolution of wages for various categories of workers*

The decrease in the real wage of the worst-paid categories which is reflected in the figures cited, over against the increase in average wages, constitutes an unequivocal indicator of the extent to which the gamut of salaries and wages has widened out in recent years. Other studies make it possible to compare the evolution of real wages for various categories of workers. Table 2, based on figures presented by Suplicy (1977),

²⁸ As the writers say, this is a highly significant ratio, since after 1965 workers receiving less than the minimum wage do not account for as much as 40 per cent of the labour force in the manufacturing sector in Rio de Janeiro (*op. cit.*, p. 40).

Table 1

**BRAZIL: INDEX OF REAL MINIMUM WAGE AND OF AVERAGE REAL
WAGES OF UNIONIZED WORKERS, 1952-1976**

<i>Year</i>	<i>Index of average real minimum wage in Rio de Janeiro Base 1952=100 (1)</i>	<i>Wage index for unionized workers 1965=98 (2)</i>	<i>Index of average real wages for 18 trade unions 1960=100 (3)</i>
1952	100	—	
1953	88	—	
1954	108	—	
1955	116	—	
1956	119	—	
1957	131	—	98
1958	114	—	103
1959	130	—	94
1960	115	—	100
1961	132	—	105
1962	120	—	105
1963	110	—	107
1964	111	—	103
1965	103	98	98
1966	95	90	92
1967	91	83	89
1968	92	84	92
1969	89	86	94
1970	86	86	95
1971	87	88	98
1972	89	92	102
1973	92	96	107
1974	88	94	107
1975	93	—	—
1976	92	—	—

Sources: (1) Suplicy (1977), p. 102; (2) Bacha and Taylor (1977), p. 34, on the basis of data supplied by the Ministry of Labour of Brazil; (3) Bacha and Taylor (1977), p. 34, on the basis of estimates prepared by the Departamento Intersindical de Estatística e Estudos Socioeconômicos (DIEESE), São Paulo.

contains the index of real wages for various categories of workers and managerial personnel in industry in São Paulo. From this it can be seen that the average increase in the wages of workers on the lower steps of the ladder was far below the corresponding figure for the higher categories. The latter, in their turn, received smaller pay increases than did managers (see tables 2 and 3). The

indexes for civil engineering workers also show the same trend as can be noted in industry (see table 3).

For example, by 1975 the pay of a general manager in manufacturing industry had come to be 162 times as large as that of a helper in civil engineering, whereas in 1969 the corresponding ratio had been 65:1 (Suplicy, 1977).

Table 2
**SÃO PAULO: INDEXES OF REAL WAGES FOR VARIOUS CATEGORIES
 OF WORKERS, 1968-1975**

<i>Category</i>	1968	1969	1970	1971	1972	1973	1974	1975
Low wages (average for 27 jobs)		100	106	110	107	107	110	116
Medium wages (average for 28 jobs)		100	109	114	120	123	132	135
Medium salaries (average for 20 jobs)		100	105	117	128	129	133	142
High salaries (average for 24 jobs)	98	100	118	127	136	142	150	163
Very high salaries (average for 5 jobs)		100	123	128	137	148	148	182
Selected categories of managerial personnel:								
General manager		100	124	122	127	151	151	187
Financial manager		100	134	140	153	170	159	200
Divisional manager		100	147	131	127	145	179	205
Treasurer		100	104	126	135	160	138	187
Auditor		100	104	130	134	154	122	161

Source: Various wage surveys quoted by Suplicy (1977), pp. 74 and 75.

Table 3
**SÃO PAULO: INDEX OF WAGES PER HOUR IN CIVIL
 ENGINEERING, 1969-1975**

<i>Year</i>	<i>Carpenter</i>	<i>Foreman</i>	<i>Mason</i>	<i>Painter</i>	<i>Helper</i>
1969	100	100	100	100	100
1970	102	95	97	97	97
1971	95	94	100	102	95
1972	95	124	94	94	97
1973	111	159	108	102	106
1974	108	172	109	112	130
1975	109	232	105	112	133

Source: Suplicy (1977), p. 76.

Again, Wells (1975), in analysing Gini's pay distribution coefficients, and drawing upon sources other than those already mentioned, reaches the conclusion that the process of wage concentration in the period 1966-1972 is observable not only in industry but also in

commerce and services.²⁹ The data for the years 1959-1965, in contrast, point to the maintenance of the wage distribution structure.

²⁹ There are other indicators of this trend: for example, Hoffman (1975) estimated Gini's

(c) *Wages by size of firm*

Bacha (1975) made a special analysis of the evolution of wages of workers and managers in large enterprises during the period 1966-1972; and the conclusion he reaches is that undoubtedly the pay spectrum in such industries widened. The real wages of unskilled workers (helpers) dropped during the period, whereas on an average workers obtained annual increases of 2.3 per cent and managers of 8.1 per cent in real terms.

The figures suggest that, in the period under analysis at least, the large enterprises adopted as their wage policy certain practices which are in keeping with the theory of segmentation of the labour market; they participated on a large scale in what was previously called the 'secondary labour market' in respect of some specific jobs, taking advantage of the existence of a plentiful supply of cheap unskilled labour and notably diversifying their wage structure. This implied, of course, operating with high indexes of staff turnover in those specific jobs for which they contracted unskilled labour at very low wages.

This characteristic of the behaviour of the large firms in relation to the labour market for unskilled workers is described by Morley, Barbosa and Souza (1977); these authors sought to discover evidence of the existence of the 'internal' labour market in enterprises in São Paulo, and were able to pin it down, generally speaking, in relation to

coefficients for those employed in the transforming industry, distinguishing administrative personnel from workers, in respect of the years 1966, 1968 and 1969; whence he concludes that the increase in the index was substantially larger for the first group than for the second.

skilled workers and at the bureaucratic levels. They note, however, that "...intrafirm job ladders for manual labour appear to be short in Brazil, which is another way of saying that job markets at the bottom are relatively open" (*op.cit.*, p. 19).³⁰

Through the information available on average wages some progress can be made towards identifying different behaviour patterns in wage levels by size of firm. The average wages of workers in the transforming industry in 1969, analysed by establishment size, show certain characteristics which, *grosso modo*, are common to *all* branches of industry, no matter whether the aggregate data for all Brazil are taken or only those for Greater São Paulo. For example, confirming the general rule in industry, average wages of workers increase with the size of the enterprise and with the level of output per person employed. What is of greater interest, however, is to note that the coefficients of variation of the average wages of workers in each size stratum by branch of industry (two digits) are, generally speaking, lower than the coefficients noted in considering each branch in the context of the ten size strata (see table 4).³¹

³⁰ Possibly, however, some differences between small and large firms may be observable even so in the evolution of income and in the indexes of turnover of unskilled personnel. But these differences should be very much smaller than in other categories of workers. As no relevant empirical tests have been carried out, the last word on the subject cannot yet be said.

³¹ This characteristic holds good even if the criterion for classification by size is altered (number of persons employed instead of value of production), and even if the analysis is confined to the Greater São Paulo area instead of covering Brazil as a whole.

Table 4
 BRAZIL: COEFFICIENTS OF VARIATION IN AVERAGE WAGES OF
 PERSONNEL EMPLOYED ON THE PRODUCTION SIDE IN
 MANUFACTURING, 1969

<i>Coefficients of variation of average wages, by size of establishment measured by value of production (Thousands of cruzeiros at 1969 prices)</i>				<i>Coefficients of variation of average wages by branches of production</i>	
(1)	Under	10	—	Non-metalliferous ores	40
(2)	10 —	50	25	Metallurgy	38
(3)	50 —	100	19	Metal-transforming industry	38
(4)	100 —	200	17	Electrical and communications apparatus	32
(5)	200 —	500	19	Transport equipment	53
(6)	500 —	1 000	21	Wood	29
(7)	1 000 —	2 000	25	Furniture	33
(8)	2 000 —	5 000	21	Paper and board	41
(9)	5 000 —	10 000	26	Rubber	49
(10)	10 000 and over		29	Leather, skins and similar products	36
	Simple average		22	Chemical products	61
				Pharmaceutical products and medicaments	38
				Perfumes, soaps, etc.	44
				Plastic products	31
				Textiles	38
				Clothing, footwear and similar products	23
				Food products	41
				Beverages	53
				Tobacco	68
				Printed matter and publications	50
				Miscellaneous	47
				Simple average	42

Source: Prepared on the basis of data published by the Instituto Brasileiro de Geografia e Estatística (IBGE), *Produção Industrial 1969*, Rio de Janeiro, IBGE, 1971.

The figures would seem to indicate somewhat more homogeneity in the behaviour of the average wage by size than in that of the average wage by branch, despite the trade-union structure referred to above. Part of the explanation of the behaviour noted is to be found in the different composition of the labour force as between skilled and unskilled workers and the different hierarchical structure of production in

establishments of different sizes.³² In the light of other partial evidence, however, it might be said that the wage differentials observed could be partly attributed to the existence of the internal markets discussed and to the

³² An additional problem that could be introduced here is that of the participation of intermediate and higher-level technicians connected with production. But given the weight carried by the manual workers, both on

differences in wages which that would imply.³³

Unfortunately, the information available precludes much further progress in identifying the behaviour of enterprises of different sizes in the labour market. At all events, two aspects of the question merit treatment in greater depth from the empirical standpoint: labour turnover by size of enterprise and level of skill; and the comparison of wages for different categories of workers by different sizes of enterprise within each branch of industry. Nevertheless, much of the evidence assembled in the present section affords support for the hypothesis adopted in this paper as a possible explanation. Particularly important are the data appearing in table 2, where the managerial categories refer to personnel employed in large firms; and so are trends in the wages of unskilled workers in this same group of enterprises.

account of the volume of wages and the number of persons employed, this is a minor problem; hence it is possible to speak of the wages of blue-collar workers and of personnel linked to production as equivalent concepts without perpetrating serious inaccuracies.

³³ Baltar (1977), working with more disaggregated data, appears to reach a somewhat different conclusion. In his opinion, the breakdown of the labour market by branches of industry (as an approximation to its division into trade union groups) is the factor which accounts for the average wage differentials in the transforming industry, rather than the productivity of industrial groups or the characteristic size of establishments in each group of industries. (Industrial branches are defined as the two-digit and industrial groups as the four-digit levels in the breakdown of manufacturing industry. The term characteristic size refers to the average size weighted by the value of production of establishments in each industrial group). In other words, average wages in industry seem to be influenced more by the action of the trade union structure which still subsists today —despite official policy—, than

(d) *Salaries and wages in the public sector*

In view of the weight carried by the public sector in the Brazilian economy, and particularly in the labour market,³⁴ a pause must be made, however brief, to analyse its behaviour. Macedo (1974) attributes great importance to the wage policy of the public sector in relation to its low-level staff during the period subsequent to 1964. The restriction of wages at these levels was very considerable and must be reckoned as one of the most important determinants of the increasing degree of concentration of salaries and wages. Moreover, the evidence that State enterprises pay higher wages than private firms is partly confirmed in other essays by Bacha (Bacha, 1976; Mata and Bacha, 1973). But there are no systematic studies

by that of factors stemming from the recent development of industry in terms of productivity and growth of enterprises. It must be pointed out, however, that the contradiction with our proposition is only apparent. In the first place, the operation of the trade union structure has been especially incorporated in the present analysis as one of the mechanisms through which the struggle of the social groups for a larger share in the product finds expression. Secondly, the fact that average establishment sizes in each group do not count for much in explaining the variations in average wages may be only a consequence of the above (operation of an outdated trade union structure), which does not mean that *within* each trade union branch or category there are no wage differentials deriving from the action of internal markets and from the greater capacity of the more productive firms —those of larger size— to grant their workers additional fringe benefits.

³⁴ Bacha and Taylor (1977) estimate that within the non-agricultural sectors, the public sector, including State enterprises, absorbs about 50 per cent of total 'white-collar' employment (p. 53).

which afford unequivocal corroboration of this assertion, although it seems to be amply borne out by what is usually estimated to be the structure of wages in Brazil.

The explanation of this fact lies precisely in the predominance of the first two wage trends previously noted. State enterprises in Brazil operate in highly dynamic sectors, where they enjoy a front-line position in the market which even enables them to transfer possible increases in costs to prices. This circumstance undoubtedly enhances the bargaining capacity of the employees,

which is buttressed by the power the trade unions derive from their strategic position in the economy. Furthermore, a hierarchical and bureaucratic structure is even more necessary than in the private sector, precisely as a means of preventing possible labour conflicts in sectors which are really strategic. Owing to the need for highly-skilled manpower and the necessity of maintaining efficiency, the State enterprise not only ends up by following the same behaviour patterns as private enterprise, but also finds itself compelled to grant its strategic personnel larger benefits as a means of retaining them in face of private competition.³⁵

E.

By way of conclusion

The central idea put forward here is that mechanisms conducive to greater concentration of income do exist and result from the operation of the enterprise in the present 'concentrated-accumulation' phase of capitalism.

These mechanisms not only derive from the traditional struggles for the distribution of the product between capital and labour, but also play a special part in the process of distributing the wage bill among the various levels of workers involved in the production process or in the bureaucratic functions of the enterprise. The pattern of accumulation, in which the share of big

firms in the product increases while that of the labour force does not increase so much, is favourable to a widening of the pay spectrum, especially in the large enterprises, without ill-effects on the capacity of the latter for accumulation and growth.

In a developing economy this process becomes more marked, owing to the relative abundance of unskilled labour, the low absolute wage levels for this category of workers and the greater monopolistic power enjoyed by enterprises. In the special case of Brazil, these factors have operated in an extremely *favourable scenario*, especially during the last 15 years, in view of the success of the official policy of restricting the growth of basic wages through the manipulation of minimum wage policy. Thus, utilizing the same wage bill in real terms (or the same proportion of the

³⁵ In an earlier case study on Chile (Souza, 1971), it was noted that the behaviour of State enterprises as regards their wage policy was not distinguishable from that of private enterprises operating in the same sector.

product), enterprises have been able to grant huge benefits to the personnel holding the better positions in the hierarchical structure. In this way, a *highly diversified* wage structure has been shaped, through which the enterprises' internal promotion mechanisms are brought into operation. At the various levels of these scales inter-firm competition for labour appears, thus consolidating the wage structure by the major sectors mentioned above (central nucleus and peripheral area). In so far as this consolidation takes place, it is obviously impossible to improve wages on the lower steps of the ladder without affecting the entire scale, or at any rate without encountering powerful opposition on account of the changes in the relative positions of the various social groups which such a move would imply.

This fact has far-reaching implications for economic policy. It is generally agreed by Brazilian economists that a change in minimum wage policy in the direction of granting substantial improvements to unskilled workers would not affect the dynamism of the system, inasmuch as the large enterprises in the 'spearhead' sectors would not feel any ill-effects on their capacity for accumulation and expansion, since they employ practically no workers at the minimum wage level. The sectors using abundant manpower at those wage levels, on the other hand, would be affected, but they are of no importance from the standpoint of the dynamism of the system.

In contradiction to this general belief, however, we infer from the present study that a change in minimum wage policy will have some effect on the entire system. In so far as substantial

increases in the minimum wage are granted, pressures will emerge which are capable of shifting the whole wage structure, and which if they became operative would damage the system's capacity for accumulation. It must be taken into account that the policy of restriction of basic wages in face of a vigorous expansion of productivity, which had been adopted with the object of giving that capacity a 'breathing-space', threatened as it was by widespread wage increases due to trade union pressure in the early 1960s, made it possible to widen the range of salaries and wages. This helped to maintain 'social peace' within the enterprise, in the sense that it permitted the establishment of channels for economic and social upward mobility, which partly undermined class solidarity and reduced the possibility of conflicts. Since then, however, an element of inflexibility has once again been introduced into the wage structure, so that new wage increases at the bottom would be liable to affect the dynamics of the system, as happened in the early 1960s, or to produce inflationary effects by the possible transfer of costs to prices as a result of the concentrated structure of the market. The only possibility of avoiding this, within the scheme of analysis put forward here, would be to change the operational parameters of the labour market in such a way as to lessen the disparities between the growth rates of wages in the various groups or to reduce margins of profit. In either case, however, the economic solution necessarily calls for a policy definition which will result from the thrust of the various social groups to maintain or change their position on the socio-economic ladder.

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Notes and Comments

The International Monetary Fund in a new international financial constellation: An interpretational commentary*

David H. Pollock and Carlos Massad

1. A 'new' IMF appears to be just now in process of emerging. If so, it will probably possess at least four central characteristics, namely: (a) it will be endowed with a significantly larger volume of loanable resources than before; (b) it will dispense those resources as part of a deliberate global policy primarily in order to find a way of recycling OPEC surpluses more efficiently than before; (c) it will undertake those new lending functions with a greater degree of 'conditionality' than before; and finally, (d) it will be granted a greater degree of 'surveillance' authority in so doing. These judgements stem from the following lines of reasoning.

2. From the time of the 'oil shock' in late 1973 to the end of 1976, the OPEC countries ran an enormous cumulative

*This 'commentary' reflects the main points of an internal discussion held in CEPAL, Santiago, in late 1977, during which Mr. David H. Pollock (Director of the CEPAL Washington Office) expressed his views concerning a possible new IMF role in the emerging international financial and monetary constellation, and the potential significance of that role from the Latin American angle. After the discussion Mr. Pollock, in close collaboration with Mr. Carlos Massad, Co-ordinator of UNDP/CEPAL Joint Project RLA/77/021, synthesized the ideas that had been expressed. Although they do not necessarily reflect the views of CEPAL, they are being reproduced in the Review in order to bring this important issue, which is still unfolding, to the attention of a wider audience (Editor's Note).

current-account surplus of some 145 billion dollars. One half of this was represented, in counterpart, by the cumulative current-account deficit of the NOPEC developing countries. Indeed, their deficit was so large that the total outstanding external debt of these developing countries rose by more than 50 per cent in 3 years, reaching the very large total of around 160 billion dollars by December 1976.¹ Viewed in aggregative terms, therefore, it is clear that the international monetary system is now faced with a new and very important problem: namely, how to match the *overall* OPEC surplus with the *particular* deficits of individual NOPEC countries, developed and developing alike.

3. Some solutions to this new problem have of course already been forthcoming. But not in a manner very satisfactory to developing countries. This is basically because OPEC countries have been depositing their surpluses primarily in private banks located in the United States and Euro-markets, which, in consequence, became 'spontaneously' involved in the matching (recycling) process. This short note is not the place

¹ Latin America accounted for approximately one-half of this total by the end of 1976, the countries mainly concerned being Brazil and Mexico (54 billion dollars combined) and Peru, Argentina and Colombia (26 billion dollars combined). By end-1977, the total debt of NOPEC developing countries reached around 180 billion dollars.

to assess the costs and benefits of how the private banks have handled the global recycling process since 1974. What should be stressed, however, is that, although private banks have handled most of the required matching-of-funds, they have done so on an essentially day-by-day and *ad hoc* basis. No conscious policy framework has been brought into play, either by donor or recipient governments, or by the private banks, and certainly not by the international community considered as a whole. To repeat, this note was not intended to analyse how well or how poorly the private banks have carried out the post-1973 recycling process. What it does wish to stress, however, is that, in the absence of any international policy framework, the time would inevitably come when private banks could not, or would not, continue handling so much of the global recycling. Clearly, private banks cannot indefinitely carry on their books the ever-growing debt of all the developed countries with weaker balance-of-payments positions, plus that of the developing countries as well. And whatever they can do in this regard, they cannot maintain their future lending volume *pari passu* with OPEC's huge current account surpluses, which have averaged around 45 billion dollars per year since 1974 and are generally expected to average nearly 40 billion dollars per annum for many years to come. Thus it is our opinion that a watershed was reached during 1977, when private international commercial banks were estimated to have held roughly one-half of the total outstanding debt of all NOPEC developing countries, compared to only one-tenth of a much smaller debt volume back in 1970. If we are correct in such a watershed thesis, then debtor NOPEC countries will have

to turn increasingly to intergovernmental channels like IBRD and especially IMF to help finance their foreign exchange gaps. To these ends the IMF will presumably have to follow a two-pronged approach, consisting in undertaking more loans, and of a riskier nature, on the one hand, and imposing stricter lending prerequisites ('conditionality') related to foreign borrowing, on the other. In other words, IMF will have to deliberately increase its lending volume and at the same time it will presumably have to urge borrowing NOPEC governments to modify the 'inadequate' policies that were contributing to their prior balance-of-payments deficits and hence their external debt. In even blunter language, to the same extent that IMF expands its future loans to NOPEC developing countries with weaker balance-of-payments prospects, IMF's conditionality will tend to be more stringent than that imposed by private banks since the 'oil-shock'.

4. If all this should come to pass—as we believe is likely—it would presume an ever-growing fiscal involvement on the part of the developed countries in the international recycling process; i.e., the treasuries of the developed countries would in effect be taking up some of the slack resulting from the decline in net new private bank lending. Furthermore, as governments in developed countries face up to the prospect of ever-growing contributions to IBRD and IMF, there will undoubtedly be increasing demands for closer scrutiny by the congresses and tax-payers in those same developed countries. The final stage in this entire sequence could be growing recriminations and strains between nations of the north and south, unless things were done differently from in the past.

5. Thus, the sequence of events traced above might be summarized as follows:

- (i) continuous OPEC current account surpluses for many years to come, generating continuous deficits and thereby an ever-growing debt on the part of NOPEC countries.
- (ii) with private banks handling most of the transitional recycling task,
- (iii) until eventually the private banks reach a limit of their new net lending.
- (iv) in consequence placing more pressure on IBRD and especially on IMF to take up the slack,
- (v) but with the private banks, taxpayers and legislatures in developed countries insisting on growing 'conditionality' in this emerging stage of global recycling, and
- (vi) as a final element in this sequence, the endowment of IMF with greater disciplinary authority ('hard surveillance'), at least in so far as developing countries are concerned.

6. As already mentioned, this sequence of events, under way since 1974, has been essentially *ad hoc* and extemporaneous in nature. Clearly, therefore, a global policy – to transfer more real resources to developing countries in the long run, and to ensure a smoother distribution of global liquidity to both developed and developing countries in the short run – must eventually emerge. Otherwise a cloud will continue hanging over the international monetary system; a cloud involving a new and different sequence of events, such as defaults on debt payments by one or more developing countries, leading to a loss of confidence in the private banking system of the western world and thence

to a slow-down of the rate of growth in both developed and developing countries, and ending with the economic and political trauma that would result in the latter eventuality. For we cannot reiterate too often what we consider to be the central reality facing the international monetary system today: namely, that very large OPEC surpluses will continue being generated for many years to come. This being so, something will have to change. Otherwise the world's major banking and trading systems, the rates of growth in many developed and developing countries, and finally the degree of political stability in those countries whose growth slows down, could all be very seriously affected. This may sound unduly dramatic. Yet, given the ever-growing degree of interdependence that characterizes global trade and payments, it does not seem to us too far-fetched. Hence our stress on the need for a *deliberate policy* that will augment long-term real resource transfers from developed to developing countries on the one hand, while simultaneously facilitating shorter-term liquidity transfers between OPEC and NOPEC countries on the other. If such a policy were to evolve, presumably IMF would play an important if not the central role therein.

7. This last is a very interesting conclusion from an institutional point of view, since, only half a decade ago, the Bretton Woods concepts were in disarray and the authority and prestige of IMF seemed to have significantly dwindled. Floating currencies had deprived IMF of its long-standing role as manager of the international exchange rate system. Sudden and large exchange restrictions had been imposed by a few major developed countries without prior IMF consultations. Huge private capital flows were occurring outside the IMF frame-

work. IMF lending resources had become depleted and its lending volume had stagnated proportionately. Today, in contrast, all this seems on the verge of reversal. Private banks in developed countries may want to institutionalize their loans to developing countries, and if so IMF would undoubtedly be their preferred institution for doing so: indeed probably their only one. The OPEC governments must recycle their vast liquid assets, and they will wish to do so with both safety and profit. One way would be for them to recycle some portion of their liquidity through IMF, given its guarantees against exchange-rate as well as other economic and political risks.² Governments in developed countries will want a more effective global balance-of-payments 'surveillance' system, since they realize the need for ensuring a more effective approach to the international adjustment process. Thus we see the convergence of recent statements by the previous Chairman of the United States Federal Reserve System, by private transnational banks, and by most governments of the G-10 developed countries, all stressing their support for IMF. And thus we see the attention being given by Mr. Witteveen to finding new ways of revitalizing and enlarging the Fund.

8. What can IMF do in response to these new challenges? One answer seems clear: it can expand its volume of loanable resources. How to do this? A number of different approaches might be considered. *One* entails increases in quotas. As mentioned earlier, it is expected that a 33 per cent quota expansion will

²Of course, there are other outlets, such as direct investment or private portfolio placements, which OPEC countries will wish to use for both economic and political reasons.

be ratified shortly, entailing an increase of some SDR 10 billion. Still another quota increase is now in process of negotiation, though its timing may be quite distant.³ A *second* approach would be for the G-10 industrial countries to lend further amounts of hard currencies to IMF through the General Agreement to Borrow (GAB), as was recently done in the case of the United Kingdom Standby of 3.9 billion dollars. Here, however, there is a basic shortcoming—from the developing countries' point of view—in that the GAB is an exclusive lending facility available only within the developed G-10 countries. A *third* approach could be for a new issuance of SDR's. However, only SDR 12 billion have been issued to date (none since 1972) and the possibility of more than a modest new SDR issuance currently seems slight. Hence the great emphasis that was recently placed on another alternative, namely, creation of the new 'Witteveen' facility.

9. Yet useful as this new 'super-tranche' facility will be, too much should not be expected from it. For one thing it is considerably smaller than had originally been anticipated. Only a year ago, for instance, expectations concerning its size had ranged as high as 15 billion dollars or even 20 billion. Now it is expected at best to total not over 10 billion. Secondly, it will involve a structure of charges that is expected to be almost

³The amount of the next quota increase is still problematic. The developing countries are currently talking in terms of a 100 per cent increase, whereas some developed countries are understood as wanting one of only 25 per cent. The current expectation is of an eventual increase of around 50 per cent, which would imply a total IMF quota of some SDR 60 billion in the future. As mentioned, however, the timing of this will probably be some years away.

purely commercial. Thirdly, it will operate separately from although parallel to the normal IMF tranche arrangements. To put all this another way, the Witteveen Facility places IMF in the role of an agent trying to recycle surplus liquidity from OPEC to non-OPEC countries. None the less, the new Facility will enable IMF to impose its own forms of conditionality upon this recycling process. And last but by no means least, an important indirect effect of this new Facility will be to insert Arab countries with large balance-of-payments surpluses directly into the western monetary system. An interesting political issue emerges in consequence. The key Arab donor for the new Witteveen Facility is Saudi Arabia, and its support will undoubtedly be linked to an insistence upon very conservative measures by those developing countries drawing upon IMF. In short, the new Facility could make IMF become, even more than before, a global 'policeman' acting on behalf of private banks, developed countries, and the key Arab OPEC donor countries. The central emphasis, in short, will be on caution and conservatism.

10. To conclude, IMF seems to be entering upon a new stage of global resurgence. *Its volume of resources will undoubtedly be considerably augmented*, mainly through new quota increases plus the creation of the new super-tranche facility. But *it will increase its conditionality prerequisites*, in order to safeguard the new resources entrusted to it, and also to reduce the balance-of-payments deficits that are assumed to arise because of 'inadequate' policies applied by NOPEC countries. To such ends, *it will be given stronger surveillance authority*. Here we draw some final (and even more conjectural) interpretative conclusions about the signifi-

cance of a 'new' IMF. Future IMF surveillance authority will undoubtedly be demonstrated by an insistence on greater 'internal discipline' within developing deficit countries: i.e., by the placing of stress on more conservative domestic monetary, fiscal and investment policies. But a very important related question is this: will IMF also use its enhanced surveillance authority to urge or compel *developed countries with a surplus* to adjust via appreciated exchange rates, larger imports, an expansion of capital outflows, or all three? Or will it concentrate its surveillance efforts primarily if not solely on *developing countries with a deficit*, as was so often the case during the 1950s and 1960s? In a nutshell, will IMF become more symmetrical than before in its distribution of the costs and benefits deriving from global trade and payments? This is a very important question for many Latin American countries. Their continued economic growth will require continued capital flows. Such flows will, in part, come *directly* from IMF. But they will also come from other suppliers (such as private banks, IBRD, OECD and OPEC governments), each of which in turn will be influenced *indirectly* by IMF judgements on the 'adequacy' of national policies within individual Latin American countries. All this suggests that stronger surveillance by IMF could, if not carefully handled, lead to a revival of the old charges of 'interference in internal affairs' which were heard so often during the 1950s and 1960s and which abated in the 1970s.

11. One last thought. A basic conclusion here is that private United States and Euro-banks will tend to lend progressively more to those NOPEC developing countries that have accepted

strong IMF conditionality prerequisites. This would, as stated above, be especially important to Latin American countries that rely so extensively on funds from private banks. Yet a certain contradiction is present in such logic: to get money at commercial rates from private banks, developing countries will have to be in such balance-of-payments straits as to accept strong surveillance. It would therefore appear to be desirable for the Latin American (and other developing) countries relying on private money to think of new alternatives. One might be the CEPAL 'refinancing facility'. Another might be to contemplate the idea of a new and better-balanced

'country evaluation' process, which could include the views not only of one agency but rather of several, together with those of the government concerned and a group of high-level independent consultants. In any event, there appears to be a clear need, from Latin America's point of view, to search for some new institutional process that would involve greater flexibility in IMF lending and borrowing powers on the one hand, with the ability to undertake co-financing with commercial banks on the other. In this search, it will be incumbent upon Latin American countries to lead the way, since they will have so much to gain or lose in the process.

Some CEPAL publications

Dos Estudios sobre Financiamiento Externo, by Carlos Massad and Roberto Zahler. Cuadernos de la CEPAL series, N° 19, Santiago, Chile, 1977, 60 pages.

The first of the two studies presented in this Cuaderno starts with a broad picture of the external financing of the developing countries in general and of Latin America in particular during the past decade. It analyses the terms of such financing for different groups of developing countries and shows how these terms have gradually deteriorated in Latin America's case.

It then proceeds to concentrate on Latin America's external debt situation and shows how external financing from private sources has substantially exceeded that of official origin. It also examines the indicators used to measure a country's borrowing capacity (or credit-worthiness) and notes that changes in it depend upon the behaviour not only of the debtor but also of the creditor countries, both from the standpoint of export expansion possibilities and from that of the terms on which credits are extended. In addition, it draws attention to the positive role that Latin America has played in recent years in the maintenance of international economic equilibrium by helping to keep up the rate of world economic activity, and stresses the need to take world economic conditions into account in evaluating the external financing of the Latin American countries.

Lastly, the study analyses the various proposals which have been put forward in different forums for solving the external debt problem, and suggests the desirability of establishing a special refinancing service, financed by the creditor countries, as a way of helping to palliate external payments difficulties that may arise in some countries and thus obviate the necessity of recourse to unduly stringent reduction of internal or external economic activity. Furthermore, it lays emphasis on the linkage between the financial and the commercial fields, pointing out that the burden of

financial measures can be substantially lightened if significant progress is made in increasing exports. It likewise suggests that measures should be devised to regularize the expansion of the Eurocurrency markets and make it less erratic: such as, for example, the establishment of collective rediscount mechanisms in an appropriate international agency.

The second study analyses the methods used in the type of research that has ended by maintaining that world inflation eases the real burden of debt servicing for the developing countries. Countering this assertion, it contends that generally speaking such studies have tended to underestimate this real burden because they divide the outstanding debt figure by an index of import prices; and that an increase in import prices adds to the real burden of debt servicing rather than reducing it. Furthermore, since a rapidly growing proportion of the debt is contracted at floating rates of interest, the debt service burden is not necessarily relieved by world inflation.

The suggestion is therefore made that the ideal deflator would be a social exchange rate, and in default of this, an index of the terms of trade, and tables are included to show the differences produced according to whether one or the other procedure is applied. The study also recommends that the base for deflation should not be the value of the existing debt, but the present value of the future flow of amortization and interest payments.

Políticas de Promoción de Exportaciones, E/CEPAL/1046. Santiago, Chile, October 1977, vols. I and II, 99 and 103 pages, respectively.

The development strategies of the Latin American countries and their handling of economic policy instruments are undergoing a radical transformation. Industry is considerably increasing its efficiency, with the ensuing reduction of costs and improvement of qualities. At the same time, most of the countries of the region are developing industrial sectors that had been lagging behind, mainly those producing certain capital and intermediate goods. The stage of import substitution undertaken with a high degree of protection within the narrow framework of each national market has been left in the rear, although it is true that a great deal of unexploited potential still exists in the

fields of import substitution and development of basic industries in the context of broader subregional or regional markets.

Exports have vigorously speeded up their rate of growth and have been diversified up to the point of including industrial items and even manufactures with a measure of technological complexity, such as durable consumer goods and capital goods. Latin America is no longer a region that exports solely primary commodities, although these still represent a high proportion of its total sales abroad; the most dynamic component of its exports is constituted by manufactures, which for that reason powerfully influence the growth rate of total exports.

The handling of economic policy instruments, especially those relating to the external sector, is also undergoing a change. The national economies are opening up to the outside world, reducing and rationalizing protection and using their accumulated stock of experience to perfect systems of export promotion that have come into being since the mid-1960s. Not only are exchange policy, tariff and non-tariff restrictions, fiscal and financial incentives, very different now from those of the 1960s, but they are still being altered and amended.

As a result of these changes, certain basic questions form the core of the controversy, and are the focus of attention when it comes to drawing up development policies.

These questions can be grouped around two major themes. The first of these is development strategy or policy. In this respect, queries such as the following are posed: Should import substitution and export of manufactures be regarded 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?

The second topic relates to the instruments wherewith these guiding principles for development policy or strategy can be put into practice. Here the pertinent questions bear on the cost of promotional instruments, their direct effects on the external sector and their indirect effects on the structure of production and the development process.

For the purposes of technical analysis and discussion of these subjects, CEPAL, with the support of the United Nations Development Programme (UNDP), has analysed the cases of four Latin American countries which are among those that have made most progress with promotion policies for exports of manufactures: Argentina, Brazil, Colombia and Mexico. To these studies have been added four others on developing countries outside Latin America (Korea, India, Israel and Yugoslavia), prepared by World Bank staff members or consultants. These eight case studies formed the basis for a discussion meeting jointly sponsored by the three agencies mentioned, and held in November 1976 in Santiago (Chile).

This set of documents will be published in five volumes (with an annex), of which the first two have appeared so far. Volume I contains summaries of twelve studies (the eight mentioned above, and four others on more general lines) together with some of the comments to which they have given rise, while volume II presents the complete text of those by Angel Monti ("Las exportaciones manufactureras en América Latina: experiencias y problemas") and by Barend A. de Vries ("Exports in the new world environment: the case of Latin America").

These studies are published in the hope that they may be of use to any who are concerned with the formulation and implementation of Latin America's economic policies, especially those relating to exports of manufactures; a further aim is to provide background information for the dispute on development orientations and the instruments that countries of the region should apply — a controversy which is currently in full swing.

Documents pertaining to the UNESCO/CEPAL/UNDP project on Development and Education in Latin America and the Caribbean

Educación e industrialización en la Argentina, by Juan Carlos Tedesco, with an introduction by Germán W. Rama. DELAC/1/Rev.1, Buenos Aires, 1977, 77 pages.

The composition of Argentina's industrial labour force by educational levels is the central topic of this study, which seeks to provide a detailed description, substantiated by copious census data, of the educational profile of the labour force in question, and to investigate the different variables which may afford a consistent explanation of it. The most general inference to be drawn from the study, further corroborated from various points of view by the statistical evidence adduced, is that the educational level of the manpower employed in industry rose appreciably between the beginning and end of the period delimited by the two national population censuses (1960 and 1970).

This process, however, while its main direction is clearly defined, presents certain specific features which, besides revealing its limits, help towards a better understanding of the complexity with which it has developed. In the first place, the improvement noted in levels of formal education occurred in a sector which, in both absolute and relative terms, showed a decline in its capacity to create employment, although its share in the generation of the gross domestic product had increased. The good average productivity figure for industry as a whole is influenced by the labour-saving bias which characterized the introduction of modern technology. Intrasectorally, in turn, the immediate impact of the new technology was reflected in a reduction of the number of directly productive jobs and in the generation of others, connected with the tasks of management and control that were necessitated precisely by its *modus operandi*. The decline in labour-force participation in industry and the appearance of new jobs requiring different skills in a process marked by technical change are therefore the initial data on which to base observation of the problem.

Secondly, as a counterpart of the above, it can be seen that industry is ceasing to be a source of employment for the educationally backward sectors. About 80 per cent of the increase in the economically active population was absorbed by the commerce and services sectors; almost all the rest went into construction activities. These sectors provided job opportunities for labour with low levels of formal education and with a high proportion of foreign immigrants, and in them, in contrast with what happened in industry, the introduction of new technologies was more sluggish.

To revert to the changes that took place in the internal occupational structure of industry, differences are to be found between branches as regards the level of schooling and type of education of the manpower recruited. While the sector as a whole absorbed school-leavers faster in the case of technical education than in that of general secondary education, in some branches these trends were reversed, and demand was slanted towards manpower with a non-specific educational background.

Similar instances of asymmetry are also to be found if a comparison is made, within each branch, between levels of education and jobs involving definite skills. The imperfect correspondence between the formal education received and jobs with the same characteristics, besides suggesting that the former is not an essential requisite for the performance of the latter, follows very different behaviour patterns according to the enterprise and the intra-branch technological strata. The topic is attractive by virtue of its theoretical implications, and the discussion of it is justifiably incomplete, since in order to deal with it in depth, better-quality and more extensive information would have to be available. Furthermore, the data reveal that although the increase in the number of jobs held by those who have had a technical education exceeds the corresponding figure for the other streams, it fails to keep pace with the growth of enrolment in the schools providing technical training, which implies that job opportunities have to be sought outside what would presumably be the strict bounds set by the skill that the educational system has im-

parted. Once again the data bear witness to effects of the type noted above, and point to the fact that personnel with specific skills are working in all sorts of jobs and even carrying out tasks for which their formal educational attainments are higher than necessary, since identical jobs are held by workers with a much lower educational level.

This observation, which is linked to the usual educational devaluation hypotheses, led on to the idea that other institutional means must exist for getting the skills and training required to meet demand for skilled labour. The relevant research findings presented by the author confirm that the direct apprenticeship for which the performance of a job provides opportunity, as well as the various kinds of non-formal training, play a key role both in the acquisition of skills and know-how recognized by the labour market, and in internal promotion within the enterprises themselves. In both cases, the existence of a certain minimum level of education seems an almost inescapable requisite for taking advantage of experience on the job or for reaping the benefit of internal training courses.

Lastly, it should be emphasized that both the broader findings —those which clearly indicate the direction of the changes noted in the educational level of industrial workers— and the more detailed aspects of the research which focus on internal differentiations in industry, gradually lead to the proposition of arguments that converge upon two central questions, underlying the whole of the analysis, but not specifically or systematically dealt with.

The first is the question of the interaction between education and employment; or, to put it more specifically, of how far it can be asserted that the technology existing in the production apparatus imposes educational requirements, irrespective of the point of reference represented by the average educational level of the labour force.

Strictly speaking, to judge from the material presented, no categorical answer is possible, and in order to work one out its various component concepts would have to be incorporated into an integrated model. But the existence of significant disparities in recruitment criteria, the lack of correspondence between skill-specific jobs and levels of education, and the differentiations by technological strata constitute, *inter alia*, primary

evidence which appears to suggest that the requisites for access to the jobs generated on average by industry are not univocally defined by a given educational curriculum. Nevertheless, the growth of productivity in a context of technical change has been observed to run parallel with a rise in the educational level of the labour force employed in the sector.

While it can certainly be argued that this is due to a general improvement in the average educational level of the population —and for that a mere comparison between enrolment and employment suffices— it is none the less undeniable that a demand exists which leans towards recruitment of better-educated labour.

The fact, on the one hand, that there is a wide range of interchangeability between educational levels and even special skills acquired within the formal educational system, and, on the other hand, the behaviour pattern noted above, would suggest that education apparently provides, in a context combining different variables whose effects are difficult to separate, certain general attributes rather than specific training immediately applicable in productive occupations.

This reflexion leads on to the next step, which is important to educational policy, for it cannot disregard the results set forth: in the first place, because of the indisputable fact that the generation of employment is markedly out of phase with the increase in enrolment; and, secondly, because of an issue whose importance transcends the mere concern for adjustment between supply and demand. If education helps to equip the labour force with skills in a fashion different from that traditionally accepted, there is still a long way to go in this domain, since it will be necessary to start from a formula for satisfactorily integrating the real relation between education and the expression of demand for labour.

These questions are not explicitly formulated in the study by Juan Carlos Tedesco, partly because the methodology chosen for the analysis pertains to a stage preliminary to examination of the above-mentioned phenomenon, and partly because they appear as logical derivatives of an investigation which set itself different limits from the start.

In any event, what has been expounded represents an incentive to continuity rather than an impediment to subsequent research, since the study constitutes an excellent des-

cription of certain initial conditions that it is essential to know in order to study in depth a topic which offers many different facets, although it is not without its difficulties as well.

Educación y Desarrollo en Costa Rica, by José Fernando García, with an introduction by Germán W. Rama. DEALC/2, Buenos Aires, 1977, 55 pages.

After outlining the characteristics of the development of Costa Rica since 1960, the author reviews the educational situation, mainly on the basis of the data contained in the 1963 and 1973 censuses. It thus becomes evident that after the 1940s Costa Rica attained relatively high levels of educational development in urban areas, since it progressively incorporated most of the population into the primary cycle, concurrently with the start of an upward trend in enrolment in the secondary and higher cycles. The rural areas, in contrast, remained relatively backward over the same period. From 1960 onwards, primary education in the rural areas, on the one hand, increased considerably, making up some of its leeway with respect to the urban areas; and, secondly, in these latter too a significant expansion took place, basically concentrated in secondary and higher education.

The author's analysis in the latter part of the study shows the results of educational trends within the overall framework of Costa Rican development; and in view of the country's characteristic development style, his opinion is that it will be difficult for the labour market to absorb the mass of secondary school leavers in jobs that match their educational background and their expectations. An indicator that to some extent this is already the case is to be found in the relative deterioration of the income of wage-earners with secondary education, and also in the substantial increase in the number of persons with that level of education working in jobs that correspond to the lower urban strata.

Financiamiento de la Educación en América Latina. Una aplicación a la Argentina, by Héctor R. Gertel, with an introduction by Ricardo Cibotti. DEALC/3, Buenos Aires, 1977, 81 pages.

Educational planning, habitually envisaged from the viewpoint of human resources (the 'manpower approach'), has neglected the im-

portance of looking at education in its proper place within a broader context. Moreover, the existence of economic cycles and their influence on the nature of educational expansion means that some thought must be given to the necessity of including in projections possible alternatives for maximum or minimum structures.

The long-term approach presented in the first part of the study aims at analysing educational expansion within the framework of the changes that have taken place in the structure of production. The periodic crises by which the economic process is characterized modify both the extent to which the benefits of education reach the different social sectors, and the State's actual capacity to finance high rates of expansion of the educational system.

In any society in which meritocracy plays an important role, the unemployment generated in periods of economic depression constitutes an incentive to acquire more education. But the decline in real income reduces public revenue, handicapping the application of compensatory policies in the education sector. Thus, the critical fiscal situation of the State affects its possibilities of satisfying pressures for rapid educational expansion.

The introduction of the economic cycle into the analysis of the nature of public education helps to shed some light on the existing crisis in education and provides background material for its analysis.

The educational crisis is imbedded in the fiscal crisis of the State and stems from the cyclical nature of the growth of market economies. Hence financial planning for education is at the present time confronted with extremely serious problems, and its future seems linked to the incorporation of new paradigms offering escape from the virtual stagnation in which it is sunk.

One alternative path seems to open up wide horizons for educational planning: the formulation of minimum or maximum courses of action, with an eye to probable changes in the structural parameter values which determine different social options, or styles of development. The preparation of planning models, from this point of view, undoubtedly implies a serious challenge to the researcher; but not to accept it would involve weakening the power of programming as a tool in educational planning.

The systematization of economic thought during the past ten years has enabled progress to be made in the resolution of many social problems linked to income distribution in general and to the distribution of public services in particular. Similarly, useful techniques have been perfected for evaluating the benefits that could be obtained by successful plan implementation.

Expansión Educativa y Estratificación Social en América Latina (1960-1970), by Carlos Filgueira. DEALC/4, Buenos Aires, 1977, 124 pages.

In this study Carlos Filgueira makes significant contributions to knowledge of the educational process in Latin America; in doing so, he has had to overcome serious difficulties due to the heterogeneity of criteria reflected in the data supplied by the different countries, and he notes the limitations imposed on the analysis by the use of the census samples that constitute the empirical basis of the study. The effort made is crowned by a comprehensive account of the development of education in Latin America, with its expression in statistical terms—at the global level and broken down by countries and educational subgroups—and its characteristics, presented through a systematic analysis of the data, until the conclusion is reached that the generators of educational status are not basically the requirements of the structure of production. Thus the causal explanations most commonly accepted with respect to the relations between education and social situation, based on the 'manpower approach' criterion, are called in question.

The study shows how in Latin America during the 1960s there was a boom in education at the secondary and higher levels in particular, while primary education expanded fairly slowly in comparison, and illiteracy, although it has decreased, is still a major problem in not a few countries. This expansion of education, however, is not a homogeneous phenomenon. In the light of the marked differences between their processes of educational change, the various countries can be classified in two subgroups: one traditionally formed by a few educationally 'advanced' countries (Argentina, Uruguay, Chile and Costa Rica); and another comprising almost all the other more backward countries, although exhibiting great heterogeneity of conditions and characteristics.

All these aspects of the question are discussed by the author in chapter II, with the support of a vast accumulation of data on the different educational levels in the various countries, their growth rates, etc.; and he then goes on, in the following chapter, to analyse educational inequality by years of schooling and by institutional costs, showing how the education 'value' is distributed among the various countries. The conclusion reached is that inequality in education is no different from economic inequality, and that the educational system, for its part, on the basis of criteria not strictly coinciding with those applicable to income distribution, for example, stratifies individuals just as uncompromisingly as the other dimensions of social stratification.

Chapter IV is devoted to analysis of the overage problem in relation to school attendance: the lack of correspondence between age brackets and school grades is, according to the study, a striking phenomenon in Latin America, and the overage structure is similar for all countries, although its magnitudes are different. Almost every country has substantially reduced the dimensions of the overage problem in primary education; it is much worse at the secondary level and is also very marked in higher education. The analysis of the data reveals a high negative correlation between levels of educational coverage and overage figures. Nevertheless, the fact that some countries are atypical in this respect, as the study stresses, demonstrates that high overage rates do not always indicate educational deficits and negative situations; evidence is adduced to show that rapid educational expansion efforts starting from educational situations where the deficit is very serious probably aggravate the overage problem as an inevitable part of the process.

As regards the factors influencing the overage question, attention is drawn not only to those of an individual nature but also to those of social origin, with their typical problems of nutrition, language, etc., and those relating to the rural-urban genesis and the characteristics of the educational system.

After thus dealing in several ways with the expansion of schooling in the Latin American countries, Carlos Filgueira enters upon the study and analysis of the interaction between education, expressed in average years of schooling, and the occupational structure, defined for operational purposes in terms of seven socio-

occupational levels. It is empirically established that in a large number of countries, the greater the increase in education, the more marked is the relative differentiation between the manual and non-manual strata. The magnitude of this differentiation is directly correlated with the stage of development of the countries concerned, although this does not mean that in the more advanced phases of modernization such discrepancies tend to disappear; what is plainer to be seen is that the educational profiles of occupations alike in the manual and in the non-manual strata are becoming more homogeneous.

From his analysis the author deduces that the occupational structure in Latin America has remained fairly stable. Since in addition—still according to the data in the study—there is on the one hand a relatively skill-specific overeducation whose products cannot be satisfactorily absorbed in jobs that theoretically ought to require the type of education in question, and, on the other hand, overeducation for other occupations also exists, it seems logical to infer a 'devaluation' of education, or, in other words, that education is of steadily diminishing significance as an instrument for attaining higher status; while, paradoxically, as the author points out, the trends towards educational expansion shown in the period under study are on such a scale as to warrant the assertion that the educational system, *per se* has constituted the region's principal channel of upward social mobility.

In this analysis of the expansion of education and social stratification Carlos Filgueira improves upon the type of studies on the subject prevalent in Latin America, which have been confined to a descriptive sociography on economic bases uncritically adopted as theoretical contexts for the interpretation of educational growth as a variable depending on economic structures and the dynamics of their expansion. While contending that, on the contrary, the educational system is developing a sort of autonomy in relation to economic growth, he indicates at the same time the new orientation that needs to be given to regional studies on the educational movement in relation to its requirements and prospects in the sphere of social change and economic development.

The weakening of economic assumptions that the author's analysis achieves creates an urgent need for research to identify the forces

that influence educational systems, the power relations they represent, who manages them, and what are the medium and short-term objectives pursued. In other words, a search must be made for the true causes of major educational expansion movements and the social rationales they presuppose. Hence an indispensable requisite is analysis of the content, selection, variation and transmission of the learning afforded by educational expansion and the ideological positions on which it is founded. The comparatively disproportionate growth of secondary and higher education, on whose technical and qualitative improvement other studies provide information, calls for a reorientation of research of this kind.

In this connexion it seems relevant to point out a lacuna that the author failed to fill in his study, perhaps because of those very limitations imposed by the census samples: the true extent of illiteracy. The data offered hardly reflect the real state of affairs; there is no recognition or quantification of illiteracy due to lack of practice. Moreover, the entire problem of the definition of illiteracy arises here; in the case of Latin America it implies a whole state of social and cultural marginality. What real content of social promotion in the Latin American rural sector do the increases in the proportion of literates signify? What degree of social promotion do the lower levels of primary education involve? These questions are of the greatest importance in view of the quantitative disproportion between the numbers that climb to the secondary and higher levels of education and the masses that will barely touch the fringes of the educational system.

These are interrogatives and points of view that arise out of the analysis and the findings of Carlos Filgueira's study, and answers will have to be supplied in the theoretical contexts which the author propounds.

Modelos Educativos en el Desarrollo Histórico de América Latina, by Gregorio Weinberg, with an introduction by Germán W. Rama. DEALC/5, Buenos Aires, 1977, 65 pages.

In a historical review covering a span of over a hundred years, the author shows that during the prolonged gestation period of the Latin America of today education was always envisaged with reference to the construction of a national society. Educating was taken to mean training the citizen to participate in the conso-

validation of social life. Nevertheless, the history of our countries has vacillated ideologically and in practice between the horns of a great dilemma: participation or exclusion. This means that discussion of education has always had to be conducted in political terms, taking the specific form of determining what values should be transmitted, to whom, and which should be the agencies of education.

The author, after explaining the adoption of the modern terminology of 'model' or 'style of development', states that, despite the general nature of the study, stress will be laid on certain similarities and differences between the processes recorded from one end of the continent to the other, the currents of ideological influence, the peculiar features which they acquire upon incarnation in actuality and the limitations which that actuality imposes. By way of illustration, he alludes to the realism of the Argentinian Juan Bautista Alberdi, who in a visionary period advocated education geared to industrial training and later, as a result of analysis of the type of relations established with his country by industrial development in Europe, recommended instead that education should be related only to primary extractive activities. In this example education appears clearly linked, at different points of time, to such concepts as work, consumption, production and saving.

The study goes on to consider the educational models that preceded, accompanied and followed the national independence movements in Latin America.

The first chapter, devoted to the 'Enlightenment', records the influence of Spain, without neglecting that of France or Italy. The Enlightenment model is of a modernizing character: it implies the secularization of life in general, the diversification of production, the bringing of culture and education up to date, but all this only for the benefit of the ruling classes. Its educational model incarnated opposition to the rigid orthodoxy of thought which was imposed by Spain during the colonial period, and of which the author cites several examples. Its thinking helped to undermine traditionalism and the absolute principle of authority, and furthered the incorporation of new values and activities into social life. Both in Spain and in our own America the Societies of Friends of the Country came into being, and were followed here by the Consulates, the driving forces of that renovating spirit syno-

nymous with 'progress', whose central values were 'happiness and liberty', together with 'utility'. In all these connexions education played an outstanding role and was regarded as a 'factor of change'. Since traditionalism had left the universities languishing during the eighteenth century, many of the Enlightenment's proposals for a new society were elaborated in less rigid and notably dynamic forums, such as journalism—then nascent—, the great scientific expeditions and the controversies stirred up by the appearance and diffusion of heterodox scientific and philosophical ideas engendered in the Old World. All this breathed fresh life into most of the aforesaid universities: for instance, new careers (law, medicine, etc.) and programmes were introduced and gained ground at the expense of the almost exclusive monopoly held until then by theology. At the same time, other teaching establishments, inspired by a new spirit, were set up. And yet another factor was the wider circulation of books, which had become an authentic instrument at the service of the current ideas. Various references to the Argentinian Manuel Belgrano or the Chilean Manuel de Salas reflect the evolution of the Enlightenment model in their respective countries.

During the following period, known here as that of the Emancipation, and corresponding approximately to the second decade of the nineteenth century, despite the large-scale population shifts caused by the wars of independence with their suite of civil wars, and the uncertain situation of the State with regard to its responsibility for education, the current of thought springing from the Enlightenment was strengthened and enriched. The ruling class brought up in its principles now introduced politics as a new value: the ideals of equality, justice and liberty were added as fundamentals and the participation of the entire people in the educational process was encouraged. Schools were set up in clear relation to the necessity of creating a new country. The references quoted by the author confirm the emergence and persistence of new values which implied a new social project. For example, catechisms were written to justify independence, and there was even a politico-Christian catechism, a sign of the new times. In respect of education, the most significant innovation was the Lancasterian school (devised for many pupils with few teachers), which, although it failed to take root, shows the interest of the emancipators in

finding ways of coping with the lack of resources.

The decades following the Independence were also perturbed by armed hostilities, as well as by the formation of ideological groups: on the one hand, the Conservatives, traditionally allied with the State and defenders of an economy and a society based on the latifundios and on monopolies; on the other hand, the Liberals, an urban-type group of intellectuals, more closely linked with the business world, champions of such values as equality before the law and the freedom of the individual, and having their own ideas on contracts and labour. These groups represent two opposing styles: independence as the disruption of political ties but not of the existing order, versus the emancipation of America from any outside power whatever, accompanied by concern for the social improvement of its peoples. Both groups were aware of the importance of education for the material improvement of their countries and for the training of the city-dwellers; but neither did much to improve the education of the rural masses, in the case of the liberals because they were a predominantly urban group, and in that of the conservatives because they were not sufficiently interested, since they were primarily great landowners. The former, with their secularizing bent, opposed the political power of the Church, and particularly its influence in the educational field; the latter, on the other hand, regarded the Church as a factor of order and assigned it a decisive role in education.

The expression of these principles is appropriately illustrated by examples such as those of José María Luis Mora, Lucas Alamán and Lorenzo de Zavala in Mexico.

The liberal conception of educational freedom led to neglect of education in several countries, because it was felt that to make it compulsory was at variance with the idea of liberty, even when this notion was not carried to so exaggerated a pitch as in Colombia, where by a law promulgated on 15 March 1850 the universities were abolished. In Buenos Aires, in contrast, the attitude of the Rivadavian liberals was different; they advocated a model marked by institutional democratization and modernization, proposing and attempting to implement a genuine educational policy. Their thinking, affiliated to the ideas of the Enlightenment, and linked to those of the 'ideologists', adopted the Napoleonic model;

that is, they envisaged the educational system as centred on the university, upon which the other levels depended. As stated in an edict issued on 9 August 1821, the end in view was to develop a new order. Thus a new ruling class was to be formed, composed of professionals and technical experts, and incorporated into the new pattern of development. True, this implied a different conception of the national State and the transfer of Argentina's political, demographic and cultural centre of gravity from the centre of the country to the expanding littoral.

As regards popular education, in which for many reasons significant progress had not as yet been made in Latin America, the author expounds the thinking and the influence of three major personalities of the region, whose conception of education derived from careful analysis of real conditions in their societies.

In Mexico, Benito Juárez postulated popular, free and compulsory education as an indispensable requisite for consolidating democracy, liberty and order, and in his opinion it was incumbent upon the State to provide it; but lack of support on the part of some liberal groups and the country's political instability did not allow him to achieve the rapid expansion of primary education that he had intended.

Domingo Faustino Sarmiento, in his turn, viewed the problem from the standpoint of the transformation of a stock-farming into an agricultural Argentina, under a specific migration and colonization plan, and assigned political, economic and social functions to education. This necessitated a system of popular education, whose medium-term results, despite vicissitudes, can be set down as successful.

A Uruguayan, José Pedro Varela, after making a noteworthy socio-economic diagnosis of his country, advocated popular education of a scientific character; thus he passed from spiritualist rationalism to positivism.

Both Sarmiento and Varela regarded popular primary education as the fitting instrument for overcoming economic and cultural backwardness and political instability; accordingly they favoured an order based on education and participation.

The last part of the study, devoted to the 'Positivist Phase', deals with the incorporation of Latin America into the international market dominated by the industrial revolution, a development which naturally gave rise to require-

ments in respect of 'political order' and 'economic liberty'. Positivism seemed to offer an adequate response to these needs. It was no longer a theological or any other metaphysical order; nor did it represent the kind of freedom postulated by liberalism; it stood for order and liberty at the service of progress. One of the countries where the influence of the positivist spirit was strongest seems to have been Mexico, from whose thinkers and achievements numerous examples are drawn. Justo Sierra considered that to attain material welfare and to guarantee liberty the State needed strengthening, and that one of its obligations was to impose compulsory education. Under Porfirio Díaz, positivism was consolidated as an official doctrine, in accordance with whose principles it was laid down that primary education should be compulsory, public education free of charge and all levels secular. But the model achieved nothing fundamental, came up against serious contradictions, and specifically neglected the incorporation of the indigenous masses.

In Argentina, on the contrary, the so-called generation of the 'eighties', with the consolidation of the economic development model based on 'outward-directed growth', placed the accent on the political function of education. Its aim was an educational system which, on the one hand, would succeed in ensuring consensus and, on the other hand, would bring up a ruling and administrative class. An abundant literature bears witness to the widespread ideological influence of positivism in Argentina.

Despite the wealth of bibliography and the vast spectrum of conceptions of education with which Gregorio Weinberg reveals the evolution of educational ideas and conditions in Latin America, the study does not cover the whole panorama of the educational process in the region. Basically the study deals with a few countries. It constitutes, therefore, hardly more than a first glance at the subject, and its author, is already working on its expansion and the improvement of its analysis. At all events, this preliminary text, inasmuch as it presents various educational models corresponding to different phases in the social formation of Latin America and rigorously analyses the relations between education and society, becomes a significant contribution within the line of studies undertaken by the Project on Development and Education in Latin America and the

Caribbean; as a historical survey it helps to define more clearly the bases of the new theoretical contexts in which the Project is tackling empirical research in the educational field.

Educación, Imágenes y Estilos de Desarrollo, by Germán W. Rama. DEALC/6, Buenos Aires, 1977, 61 pages.

This study adopts a critical attitude to the operational theories and techniques predominant in Latin America during the past quarter of a century in the field of educational activity, all of which can be covered by the generic term *education for development*. In this connexion, the alternative theoretical models assumed by the various development styles are set forth as a point of departure for analysis of the region's educational process. After going deeply into the significance of each style as a power relation between social classes and groups, and as regards the situation and possibilities of the economy and the societal image that the said groups wish to set up, with the consequent economic project, the author concludes by formulating hypotheses the testing of which will contribute to a better understanding of what is really happening in the educational systems of the Latin American social structures.

After highlighting the crisis of the economic conceptions of education, Germán Rama goes on to propose a new conceptual framework via five educational styles which appear to cover the diverse situations that exist in Latin America, according to the different role played by education in various aspects of the process of social change; each of them is related to the nature of the social structure (articulation of economic, political and social dimensions), the development style of the society, and real demand for education on the part of the various social groups. They are styles which are not necessarily or exclusively identified with given national situations and moreover simply constitute a typological frame of reference.

A brief description of the *traditional style* of social and educational development is followed by an analysis of the *social modernization style*, which is apparently the one that has exercised most influence in the region as a whole.

Social modernization has predominated in Latin America over other forms of social

change. It is characterized by the changes deriving from a certain degree of economic expansion, which take the form of urban growth; access to higher levels of consumption, culture and political participation for broad sectors of the population; social mobility and growth of the middle strata; consolidation of the proletariat; the presence of an urban sub-proletariat with a measure of market integration; and demographic change — all this alongside the existence of large marginal groups.

In this process of social modernization education plays a central role: that of integrating the masses and teaching them participation values, as well as easing interclass tensions, by transmuting social mobilization into expectations of upward mobility, with some probabilities of success for certain sectors of the middle and lower classes. Thus, education legitimates the domination system, ensures its maintenance, and assumes the function of selecting individuals for stratified positions by what are apparently cultural criteria.

The *cultural participation style* corresponds to a society whose rapid economic growth permits the formation of an élite on the basis of the upper social strata whose superiority is grounded on the cultural level attained.

Education opens the door to this code of legitimation by culture, which, in its turn, becomes a barrier to the social mobility of lower urban and rural sectors, to whom facilities are provided for integration in other ways instead. Through the cultural monopoly heterogeneous groups are legitimated and incorporated into the meritocracy of power. The lower strata see education as a channel of mobility that has little to offer, and find their compensation in the broadening of the market, in rapid urbanization and in access to new occupations.

The *technocratic and human resources training styles* correspond to two different patterns of power. The first incarnates a type of political and technical socialization which creates, in particular through higher education, specialists qualified for the exercise of formal rationality and for service as loyal subordinates in the implementation of economic policies. The second proposes training of human resources suited to a given economic system. The society to which these two sub-styles correspond is characterized by rapid economic

growth, with foreign investment for the expansion of the domestic market and the export of industrial goods, and strong political power.

In these cases the educational system faithfully reproduces the rigid system of social stratification; primary schooling covers only the sectors integrated into the market; secondary education offers, with low rates of coverage, a variety of terminal cycles for lower middle class groups, without much prospect of higher education; and the segmentation of higher education into sub-systems of different academic value preserves for certain groups the training which paves the way to the upper levels of the employment market. And for them alone the educational system has unity.

The *political freeze style* reflects the crisis of social modernization. In face of the intractability of the contradictions created by this process, the social groups plunge into a conflict which culminates in the domination of some groups over others. Under the leadership of the upper classes and with the fluctuating support of the middle classes, certain groups take control of the State, eliminate plurality from the centres of power, demobilize the lower classes, and freeze all aspects of the modernization process which may threaten their interests. This style shapes an ideology, as well as measures and propaganda against opponents who are seen as enemies. Education is one of the major concerns of this style, since it enables control to be exercised over political socialization by constraint of both academic liberty and ideological pluralism. The increase in expenditure on security systems redounds to the detriment of investment in education, with the consequent decline in the quality of teaching and research, in addition to deterioration and dispersion of teaching staff. The rectorship of academic institutions is confused with functions of coercion and control. In this scenario minimum vocational training is provided for the most backward youth groups (therefore considered subnormal) so that they can enter the labour market at a low level. In secondary education, technical and manual streams are established for the purposes of immediate entry into the labour market; another of a general type for forming cadres of which only modest intellectual performance is required; and a stream directed towards higher education. And higher education in its turn is divided into short and long courses, the latter

being the road of access to the intellectual aristocracy of post-graduate studies.

Lastly, it should be stressed that this study constitutes a proposal for educational analysis in a direction qualitatively different from the line habitually adopted. The typological picture of the styles of education with their various possibilities of relation and combination which appears to cover the complex and varied educational situations existing in Latin America, is of special interest for new analytical studies and educational planning projects.

Educación y Desarrollo en el Paraguay. La enseñanza básica, by Domingo Rivarola, with an introduction by Germán W. Rama. DEALC/7, Buenos Aires, 1977, 111 pages.

This essentially descriptive study gives a panoramic view of formal education in Paraguay up to 1975.

As Germán W. Rama points out in the introduction, the evolution and trends of education in Paraguay constitute a unique case in Latin America. Considering the country's low economic level, primary education underwent a remarkable expansion, especially outside the capital, parallel to a long period of virtual stagnation at the secondary and higher educational levels, which only in recent years have started their 'take-off' in respect of growth.

The author begins by commenting upon the factors conditioning entry into the school system, and then traces the evolution of education at its three levels—primary, secondary and higher—through a number of statistical tables in which various global and disaggregated aspects are presented: public and private education, origin of demand, location of supply in the rural-urban context, age groups, etc. He stresses the role played by the State in the growth of the educational sector and the importance of so-called 'private' enterprise in the spread of primary education, through community initiatives to establish schools and through the pressure exercised on the State to supply the means of consolidation and expansion.

Subsequently, Domingo Rivarola explores the question of the efficiency of the Paraguayan educational system via annotated data on repetition, drop-out and retention; after which he goes on to deal with the determinants of educational performance, including the differential educational opportunities conditioned

essentially by the rural-urban distribution of supply in terms of years of schooling, the location of educational establishments, and the number and training of teachers. With regard to demand for education, the author depicts the situation created by Paraguay's Spanish-Guaraní bilingualism, which emerges as one of the factors exercising most influence on various aspects of the development of education in the country. He then discusses other variables such as social stratification, family help and juvenile labour, and dwells on another of the most noteworthy characteristics of Paraguayan life, namely, the existence of intensive internal migratory flows as well as a good deal of emigration.

Lastly, he describes Paraguay's structure of production, in which subsistence agriculture predominates, alongside very limited industrial development and a strikingly hypertrophic tertiary economic sector with many traditional functions, where levels of over-education are evident even in domestic service activities.

The conclusions of the study point to the obvious asynchronism between the economic and social structure of Paraguay—a predominantly rural country with a low gross domestic product (almost static between 1950 and 1970) and an under-differentiated social structure—and its original educational development, since this was concentrated at the primary level, where growth continued while the other countries of Latin America were expanding secondary and higher education.

By reason of its strictly descriptive character, Domingo Rivarola's study merely shows, without explanation, the atypical character of Paraguay's educational process. Clearly, in view of the characteristics set forth above, the educational system has had a vigorous dynamism of its own and has been articulated to internal regional policies, but its growth seems to be exceeding the requirements of a highly traditional employment market, and is accompanied by a flow of migration of skilled labour whose magnitude is controversial but whose significance is obvious. All this suggests that the socializing functions of education might possibly be more relevant than that of training human resources.

Concern for analysis of the Paraguayan situation poses the necessity of a study in different dimensions: if the State has given priority to primary education, it would seem that there have also been other very important

sources of support for educational expansion, given the singularly lofty educational motivations of the Paraguayan people. This is plain enough in the case of rural primary education, and might also satisfactorily account for the expansion at the secondary level. It is a topic which could be dealt with in an in-depth study of the educational values and expectations of the Paraguayans, with concomitant analyses of the philosophy and objectives of the educational system in force. And despite the obvious difficulties, a study of these same values and expectations among the groups of Paraguayan emigrants living abroad would also be of the greatest interest.

While the case of Paraguay seems unique in Latin America, it is precisely that atypism, in the sense defined above, which may make it possible to analyse in depth the internal dynamics of educational systems, with the role they play in our societies, and, furthermore, to reveal the part played by educational expansion in the maintenance of social equilibrium or in the generation of disequilibria favourable to social change.

La Planificación Educativa en América Latina, by Norberto Fernández Lamarra and Inés Aguerrondo. DEALC, Fichas/1, Buenos Aires, 1977, 46 pages.

In its analysis of educational planning activities this document distinguishes various stages. The first might be termed the phase of *reactive planning*, since it originated as a reaction to crucial educational problems, and during it approaches to planning were formulated both in Latin America and in other regions. All the studies habitually cited as typical of Latin American planning fall under this head, but while some countries kept to the same approaches, others, in contrast, began to steer new courses, and originated *programmatic planning*, which incorporates a broader view of education and proposes a series of alternatives for the reform of some sector, or level of the educational system, if not —on occasion— of the system as a whole. A third stage might be called that of *rolling planning*, and is being initiated in certain countries outside the region, basically those of Scandinavia. These countries have entered upon a new phase, in which the sort of changes in the structure, content and methods of education and in access to the system that characterized

reforms in the past decade, and the attempts at reform in Latin America —conceived from the angle of what has here been termed programmatic planning— give place to rolling planning, which is continuously self-correcting, and which furthermore is largely produced and oriented by the internal forces of change in the educational system itself: participation and research.

The document emphasizes the fact that participation and research are two elements of supreme importance, since their function is to generate and feed the internal dynamics of planning activity. The planning process calls for participation, both on the part of the educational administration and on that of the general public, and the various mechanisms (some of which are outlined) should involve both. The essential importance of incorporating research lies in that it constitutes one of the two props, of the new planning model, since by its means scientific knowledge with its permanent dynamism is introduced into planning activities, forming part of them as an indispensable working tool. The authors therefore propose that each phase of the planning process should be organized in such a way that it can be carried out on the basis of participation mechanisms, through research work.

Given this general framework, the next step is to analyse the process of educational planning in Latin America, beginning with the study of the main factors which contributed to its emergence and expansion during the last two decades. With due regard to its importance and extent, three phases of its evolution are established and their characteristics described: the first extending from the initiation of planning to the early 1960s; the second comprising the latter half of that decade; and the third covering the period from the late 1960s or the early 1970s, according to the country concerned, up to the present day. It is pointed out that in Latin America the phase corresponding to reactive planning has in practice been completed, and that only in certain countries and at specific moments have programmatic planning activities been undertaken.

With respect to the main results of educational planning in the region, the authors assert that the earliest plans were not properly such, but rather documents of varying content which attempted more scientific approaches to educational problems. The initial examples were of two types: studies and diagnoses, and

the chapters corresponding to the education sector in overall development plans. Later, towards the end of the 1960s, sectoral education plans began to make their appearance.

The study shows that the plans produced in the region are many, but the characteristic shared by most is that they are not 'implemented'. Their typical structure consists in the presentation first of a diagnosis, then of objectives and policies, and finally of the programmes drawn up. Seldom is much detail included, and although a chapter on financing is frequently to be found, it is not usually clear how costs were established. Outstanding among the commonest features of the plans are their lack of internal coherence, their globality and the scant attention they pay to the administrative aspects of the education sector.

Lastly, the document analyses the main contributions which educational planning is recognized to have made in the region. They include the help it has given in attaining a more scientific approach to education problems; wider diffusion of the problems of concern to the sector; incorporation of professionals from other disciplines; the influence exerted on administrative changes in some educational systems into which more rational patterns have been introduced; the utilization of more objective criteria for quantifying the phenomena studied; and the formation of a more comprehensive and multidisciplinary view of education.

La Inserción de los Universitarios en la Estructura Ocupacional Argentina. DEALC, Fichas/2, Buenos Aires, 1977, 31 pages.

The aim of this document is not to advance theories, but to systematize the scattered and in some cases unpublished statistical information on the placing of university graduates in Argentina's occupational structure.

The information comes mainly from the 1970 Population Census, but is confirmed or expanded in some cases by data from other sources.

The study is divided into two sections: the first relating to the evolution of enrolment; and the second to the occupational placing of university graduates.

In the first section attention is drawn to the gradual upward trend in university enrolment (over the period 1920-1975), with marked fluctuations that can be explained by the changing conditions of the socio-political structure. The more extensive coverage results from the progressive access of lower social strata to the university and the increasing equalization of the two sexes reflected in the gradual rise in enrolment of women.

As from the 1960s, the annual growth rate of Argentina's university enrolment began to outstrip that of the other Latin American countries. In 1973 the rate of enrolment, in relation to the population in the 20-24 year age group, was 20.6 per cent, thus exceeding the figure for most of the European countries, the exceptions being Italy and Sweden. Notwithstanding this striking expansion, the number of university graduates is not correlative with the increase in enrolment. Unfortunately the existing data only permit the suggestion of certain hypotheses on retention at the university level.

The second section shows how university graduates are incorporated *en masse* into the expanding secondary and tertiary sectors. During the last inter-census period, 76.3 per cent of the new university graduates entering the labour market went into commerce and services, a figure which indicates the important role played by the tertiary sector in the absorption of manpower with high average levels of formal education.

Lastly, an attempt is made to analyse the occupational position in the economically active population held by university students that have or have not completed their studies; the findings are that whereas in some occupations there is underutilization of capacities, in others there is keen competition between university graduates and non-graduates and between university students that have and that have not completed their course.

The topic of higher education in Latin America, and particularly in countries like Argentina, where the distribution of university graduates in the occupational structure and the relations between human resources and occupational roles offer so complex a picture, calls for the pursuit and expansion of research of this type.

Directorio del Medio Ambiente en América Latina y el Caribe, CEPAL/CLADES, Santiago, Chile, 1977, 576 pages.

In 1976, when the Latin American Centre for Economic and Social Documentation (CLADES), of CEPAL, published the provisional text of the *Directorio del Medio Ambiente en América Latina y el Caribe*, it did so in the conviction that the study represented only a first approximation to identification of the institutions concerned with the region's environmental problems, and that consequently it was necessary to complete the information received in order to convert it into a useful work of reference.

Aware that lack of information constitutes a serious impediment to maximum utilization of the resources existing in the region and that only the institutions themselves could provide reliable and up-to-date information on their capacities and services, CLADES invited them to reply to a brief questionnaire. By means of this procedure, data were obtained not only from the institutions already placed on record but also from other new ones, which on the initiative and through the action of the countries themselves were gradually incorporated into the inventory, until a list of 470 institutions established in the region was completed.

The *Directorio* is divided into two sections: the first comprising national institutions, presented in alphabetical order by country; the second composed of international organizations, both those belonging to the United Nations family and others whose work in the region is recognized. In this part are also to be found the indexes of descriptors —or retrieval by subject headings—, institutions and acronyms.

National and international institutions in their turn are listed in alphabetical order by name of institution. To the left of each name a correlative number is given for purposes of information retrieval through the indexes. For example, if the user wishes to know what institutions are concerned with the study of arid zones, he should look in the text for the correlative numbers indicated under that descriptor.

Next, in a first information block, the data pertaining to the basic identification of the institution are given: its responsible authority, its physical and postal address, its adminis-

trative affiliation and its nature. The next information block consists of an account of the objectives of the institution reproduced verbatim from the description given in the questionnaires received. The subsequent blocks deal with the activities carried out and the subjects with which the institution is concerned. All information is given in the original language of the countries covered by the survey —Spanish, Portuguese, English or French—, and Spanish is used for presentation purposes.

CLADINDEX, Resúmenes de Documentos, CEPAL/ILPES 1970/1976, Part I, Vol. 1, N° 1, 233 pages.

With this publication the Latin American Centre for Economic and Social Documentation (CLADES) embarks upon the task of analysing and technically processing the documents produced by CEPAL and ILPES, using the Integrated Set of Information Systems (ISIS). Its objective is diffusion of the ideas of the Economic Commission for Latin America by means of a publication through which a contribution can be made to the transfer and exchange of socio-economic information in the region and a basis of easily accessible data can be constituted for consultation.

This first volume corresponds to the period 1970-1976 and includes conference documents, studies, annual reports, books, textbooks, articles, and working drafts (when the final text has not yet been published).

As new documents appear they will be included in the forthcoming issues of CLADINDEX, which it is hoped will be published half-yearly on a continuing basis; concurrently, the documents that appeared between 1948 and 1969 will be analysed, so that everything published by CEPAL since its establishment will thus be covered.

The present volume comprises summaries and a descriptor index which refers to the accession number of each document. Each item is formed by the following components: accession number, author, institutional author, title in Spanish (and in Spanish and English when the text is published in both languages), imprint, symbol, series, explanatory notes, summary of the content of the document and an indication of the language in which it is published.

The summary, in the body of which the descriptors are contained, is in two parts. In the

first, mention is made of the main concepts embodied in the document and the most relevant descriptors are marked with an asterisk. In the second, separated from the foregoing by a dash, these concepts are specified with greater precision.

The indexing is based on the OECD Macrothesaurus, although it has been necessary to include some new terms for the purpose of more precise exposition of the specific problems of the region.

THE ILPES PLANNING BULLETIN

Since its establishment in 1962, the Latin American Institute for Economic and Social Planning (ILPES) has done a great deal of varied and fruitful work in relation to the improvement and consolidation of planning in Latin America.

In the field of *advisory assistance*, its most important task has consisted in providing support for governments in the establishment and improvement of their planning systems and the organization of units located at different administrative levels: central, sectoral, institutional, regional. At the same time, it has co-operated with a large number of Latin American countries in the formulation of plans and programmes and, in some cases, in the definition of long-term development strategies which have served as a framework for specifying the basic objectives of plans. It has also contributed to plan implementation by strengthening national planning mechanisms, going progressively deeper into sectoral and regional aspects and improving basic tools to make the plans more operative, such as short-term planning techniques, programme and performance budgeting, investment projects, etc.

The *training* activities undertaken by ILPES constitute the greatest effort so far made in Latin America to impart knowledge in the field of development planning. In round figures, more than 6,000 professionals have taken the various courses given by the Institute, which has organized more than 100 courses of this kind. The basic course, the special courses, the intensive courses for individual countries, have tackled planning and development problems

and techniques, and such questions as industrial and agricultural planning, analysis of projects, operational plans, regional planning and so forth; all of them have made a very important contribution to the technical training of thousands of Latin American professionals.

The Institute's *research* has been basically of three types: research on development problems and policies in Latin America; studies aimed at the completion and improvement of planning instruments and methodologies; research with a view to the preparation of text books and documents usable for professional training in the fields of development and planning.

All these activities have given rise to various publications: textbooks, cuadernos and lecture notes. The lecture notes have been reproduced in several thousands of copies; hitherto 21 books have been published, various re-éditions of which have brought the number of copies up to 188,000; the number of copies of the cuadernos, of which there are over 30 titles, exceeds 140,000, and five of them have been translated into Portuguese.

On the occasion of its fifteenth anniversary, the governments have assigned to ILPES a new function, that of supporting the operation of the System of Co-operation and Co-ordination between Planning Agencies in Latin America, set up in 1977. And the *Bulletin*, to be published quarterly, is the organ of that system, and is intended to serve as a vehicle of communication among all institutions and individuals concerned with planning in Latin America.

Two issues appeared in 1977 (September and December), essentially devoted to the reproduction—in some instances in summarized form—of the documents which served as a basis for the Conference of Ministers and Heads of Planning of Latin America held at Caracas in April 1977. N° 1 contains the text of the papers presented by Brazil, Ecuador, Chile, Colombia, Peru and Venezuela; and in N° 2 appear those of the Dominican Republic, Cuba and Haiti. In both issues, moreover, other articles, information, notes and comments are included, which are of unquestionable interest for all those concerned with development planning.

Other publications

CIFCA and its Cuadernos

The last few decades have witnessed a growing awareness of the seriousness of environmental problems, which culminated in the resolution of the General Assembly of the United Nations to convene a world conference on the subject. This Conference, which was held in Stockholm in 1972, deemed it necessary to establish the United Nations Environment Programme (UNEP), and since 1973—the year in which the agency was created—national and international efforts in connexion with environmental questions have gained vigorous impetus.

In the economically more developed countries there is great anxiety to control the continuous deterioration of the environment brought about by the rapid industrialization process and the mismanagement of their natural resources. This same concern is to be found in the developing countries, where the quality of life is being seriously affected by identical causes, with the aggravating circumstance that they have to face up to the problem with the handicap of underdevelopment.

In the latter countries—which include those of Latin America—the necessity of preventing conflict between the development that they need and the environmental problems that afflict them is becoming increasingly evident. Accordingly, all environmental action in these countries, far from debilitating their commitment to development, should imbue the process with new prospects, energies and resources, besides giving it a new qualitative dimension. This has been recognized at various recent international meetings in Latin America and particularly—at the more general level—in the meetings of the Governing Council of UNEP.

The attempt to combat all these problems has brought to light a question which is of really crucial importance for their solution: the lack of trained professionals not only in the State administration but also in the provincial corporations and private enterprise. Hence a start has been made on the establishment of environmental training programmes in various universities and research and study centres.

From the time of its establishment, UNEP has accorded priority to this matter, to whose importance and urgency no one can be blind, and the Governing Council has given deep thought to the idea of encouraging the establishment of institutions to meet the need in question in various countries of the world, and granting them the necessary technical and financial co-operation.

The Government of Spain opportunely proposed to the Council that an international environmental training centre for the Spanish-speaking countries might be set up in Madrid, and offered substantial financial and technical contribution to its establishment. UNEP warmly welcomed this proposal, and in agreement with the Spanish Government a project was designed which in October 1975 resulted in the creation of the International Centre for Training in Environmental Sciences (Centro Internacional de Formación en Ciencias Ambientales—CIFCA).

Since it entered operation in May 1976, CIFCA has organized courses and seminars at its headquarters in Madrid, as well as in various Latin American capitals, in collaboration with other international agencies and national institutions. In view of the fact that, by reason of the characteristics of its programmes, not more than 30 or 40 professionals participate in these activities, the CIFCA authorities have decided to begin publishing lectures and other material relating to its courses in order to ensure that the widest possible diffusion may be given to its training effort and that the results can be utilized in university circles and research centres in the Spanish-speaking countries.

It was thought appropriate to call these first CIFCA publications *cuadernos* for several reasons, with which a feeling of humility and a sense of scientific precision have something to do. Apart from more flexibly and promptly serving the ends of divulgation and diffusion that they pursue, the *cuadernos* can reproduce as they go along, almost as fast as the courses are held, the work being done by CIFCA. On the other hand, the *cuadernos* in themselves reveal the experimental character which still marks environmental studies. And the approximations to these new topics which are being made by CIFCA professors and experts are better and more simply reflected in the pages of a *cuaderno* intended to assemble a few teaching notes or a series of lectures than in the more ambitious—and doubtless still premature—pu-

blication of a book, an enterprise which always has a more definitive character.

Thus, these cuadernos will present —occasionally even in a deliberately provisional form, because they are forerunners of research still in progress— the results of CIFCA's training activities. Nevertheless, attention having been now drawn to their general characteristics, it may be said that the cuadernos seek to place at the disposal of specialists and students of the subject —and of the general public if it cares to look at them— the contributions that CIFCA is making to the elucidation and analysis of environmental problems, one of the most enthralling challenges with which man in our time is faced in relation to development and the quality of life.

In 1977 the following cuadernos were published:

El CIFCA y la formación ambiental, by the CIFCA Secretariat with the collaboration of Professor P. J. Newbould;

Las evaluaciones del impacto ambiental, by María-Teresa Estevan Bolen;

Evaluación económica del impacto ambiental, by José López de Sebastián y Gómez de Agüero;

Tres casos de impacto ambiental, by Hilario Domínguez Hernández (*et al.*).

Additional information on these cuadernos can be obtained on request from: Centro Internacional de Formación en Ciencias Ambientales (CIFCA), Serrano 23, 1º, Madrid-1, Spain.

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