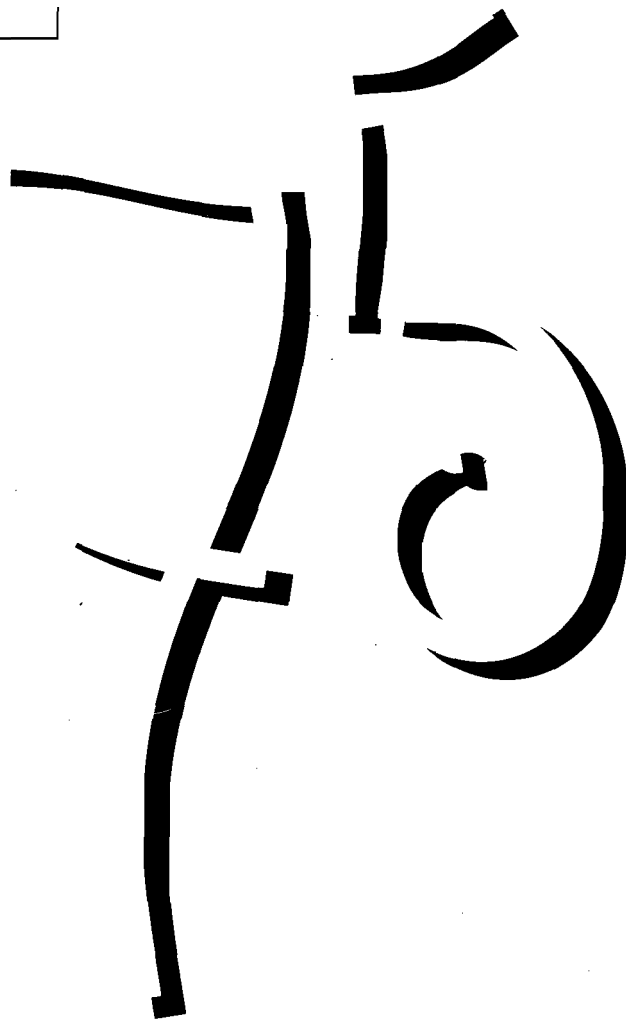


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ECONOMIC  
COMMISSION FOR  
LATIN AMERICA  
AND  
THE CARIBBEAN



UNITED NATIONS

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UNITED NATIONS

E C L A C

ECONOMIC COMMISSION  
FOR LATIN AMERICA AND  
THE CARIBBEAN

**JOSE ANTONIO OCAMPO**  
*Executive Secretary*

**REYNALDO BAJRAJ**  
*Deputy Executive Secretary*



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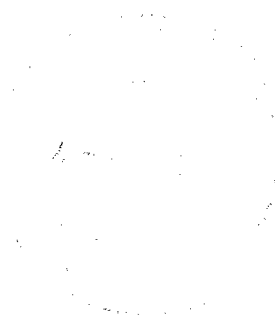
## REVIEW

NUMBER 75  
DECEMBER 2001  
SANTIAGO, CHILE

**OSCAR ALTIMIR**  
*Director of the Review*



UNITED NATIONS



**Notes and explanation of symbols**  
*The following symbols are used in tables in the Review:*

(...)	Three dots indicate that data are not available or are not separately reported.
(—)	A dash indicates that the amount is nil or negligible.
	A blank space in a table means that the item in question is not applicable.
(-)	A minus sign indicates a deficit or decrease, unless otherwise specified.
(.)	A point is used to indicate decimals.
(/)	A slash indicates a crop year or fiscal year, e.g., 1998/1999.
(-)	Use of a hyphen between years, e.g., 1998-1999, indicates reference to the complete number of calendar years involved, including the beginning and end years.

References to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated. Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates. Individual figures and percentages in tables do not necessarily add up to the corresponding totals, because of rounding.

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The editorial board of the Review are always interested in encouraging the publication of articles which analyse the economic and social development of Latin America and the Caribbean. With this in mind, and in order to facilitate the presentation, consideration and publication of papers, they have prepared the following information and suggestions to serve as a guide to future contributors.

—The submission of an article assumes an undertaking by the author not to submit it simultaneously to other periodical publications.

—Papers should be submitted in Spanish, English, French or Portuguese. They will be translated into the appropriate language by ECLAC.

—Every article must be accompanied by a short summary (of about 300 words) giving a brief description of its subject matter and main conclusions. This summary will also be published on the ECLAC Home Page on the Internet.

—Papers should not be longer than 10 000 words, including the summary, notes and bibliography, if applicable, but shorter articles will also be considered.

—One copy of the original text should be submitted, accompanied by a copy on diskette (Word for Windows 95 or 97 format), to CEPAL Review, casilla 179-D, Santiago, Chile. In the absence of the copy on diskette, two printed or typed copies should be provided. Texts may also be sent by e-mail to: edesolminihac@eclac.cl.

—All contributions should be accompanied by a note clearly indicating the title of the paper, the name of the author, the institution he belongs to, his nationality, his address, fax and telephone numbers, and his e-mail address.

—**Footnotes should be kept to the minimum**, as should the number of tables and figures, which should not duplicate information given in the text. When preparing figures it should be borne in mind that they will be printed in black and white. Finally, the location of tables and figures should be indicated at the appropriate point in the text, but they should be included separately at the end of the article.

—Special attention should be paid to the bibliography, which should not be excessively long. All the necessary information must be correctly stated in each case (name of the author or authors, complete title (including any subtitle), publisher, city, month and year of publication and, in the case of a series, the title and corresponding volume number or part, etc.).

—The editorial board of the Review reserve the right to make any necessary revision or editorial changes in the articles, including their titles.

—Authors will receive a one-year courtesy subscription to the Review, plus 30 offprints of their article, both in Spanish and in English, at the time of publication in each language.

## CONTENTS

## TRIBUTE TO RAÚL PREBISCH

<b>Foreword</b>	<b>7</b>
<i>Oscar Altimir</i>	
<b>Raúl Prebisch on ECLAC's achievements and deficiencies: an unpublished interview</b>	<b>9</b>
<i>David Pollock, Daniel Kerner and Joseph Love</i>	
<b>Raúl Prebisch and the development agenda at the dawn of the twenty-first century</b>	<b>23</b>
<i>José Antonio Ocampo</i>	
<b>Prebisch: the continuing validity of his basic ideas</b>	<b>39</b>
<i>Octavio Rodríguez</i>	
<b>The return of "vulnerability" and Raul Prebisch's early thinking on the "Argentine business cycle"</b>	<b>51</b>
<i>Arturo O'Connell</i>	
<b>The ideas of young Prebisch</b>	<b>67</b>
<i>Adolfo Gurrieri</i>	
<b>Raúl Prebisch: his years in government</b>	<b>81</b>
<i>Roberto Cortés Conde</i>	
<b>Markets and the State in the evolution of the "Prebisch manifesto"</b>	<b>87</b>
<i>Edgar Dosman</i>	
<b>The motive ideas behind three industrialization processes</b>	<b>103</b>
<i>Norberto González</i>	

## ARTICLES

<b>Technological change and opportunities for development as a moving target</b>	<b>109</b>
<i>Carlota Pérez</i>	
<b>Sectoral regimes, productivity and international competitiveness</b>	<b>131</b>
<i>Jorge Katz and Giovanni Stumpo</i>	
<b>Participation by the poor in the fruits of growth</b>	<b>153</b>
<i>Mario La Fuente and Pedro Sáinz</i>	
<b>Seduced and abandoned: the social isolation of the urban poor</b>	<b>163</b>
<i>Rubén Kaztman</i>	
<b>Employment in Latin America: cornerstone of social policy</b>	<b>181</b>
<i>Barbara Stallings and Jürgen Weller</i>	
<b>Trade in transgenic products: a review of the international debate</b>	<b>201</b>
<i>María Angélica Larach</i>	
<b>Static and dynamic impacts of MERCOSUR: the case of the pharmaceutical sector</b>	<b>217</b>
<i>Marta Bekerman and Pablo Sirlin</i>	
<b>Recent ECLAC publications</b>	<b>235</b>



# Foreword

This year marks the hundredth anniversary of the birth of Raúl Prebisch.

ECLAC –the organization Prebisch endowed with its first basic ideas and set in motion in its beginnings– has celebrated this centenary with various events. *CEPAL Review*, which Prebisch set up and directed for its first ten years of life, pays tribute to him in this issue by collecting together in a special section a set of articles by distinguished personalities in the field of social sciences who have helped to shape Latin American thinking.

Raúl Prebisch's vigorous personality left its mark on his own country in critical stages of its development, decisively influenced development ideas and lines of action in Latin America and the Caribbean, and helped in the United Nations' efforts to achieve a more equitable international economic order. There are therefore any number of different ways of honouring his memory. Here, however, we have chosen in particular to follow the evolution of his ideas and the contexts in which they developed, together with their continuing importance for dealing with the current dilemmas of Latin American development.

This set of tributes opens with an unpublished interview which Prebisch gave to his friend and colleague David Pollock in 1985 on his ideas and actions during the period when he was with ECLAC (1948-1963). Professors Kerner and Love edited the material obtained in this interview for its publication among these tributes.

In the contribution by José Antonio Ocampo, the Executive Secretary of ECLAC proposes that the current Latin American development agenda should be enriched by projecting three central elements of Prebisch's thinking –the asymmetrical relations of the centre-periphery system, the need for active endogenous development strategies to overcome structural heterogeneity, and the critically important role of regional integration- onto the present development scenario of the region, and by making an interactive comparison between those elements, the more recent proposals put forward by ECLAC, and the contributions offered by other schools of thought.

Octavio Rodríguez analyses the elements making up Prebisch's structuralist view of Latin American

development –or underdevelopment– and their significance for dealing with the problems of employment and the external bottleneck today.

Arturo O'Connell describes the characteristics of the Argentine economy that Prebisch had before him as an example when he was developing his ideas on peripheral economies, analyses the early stages of the development of those ideas in the late 1920s and early 1930s, and argues that the similarity of the present problems of Latin America to those of that period has given those ideas renewed validity.

Adolfo Gurrieri also deals in particular with the work of the young Prebisch. He shows how, from his earliest work, Prebisch already began to shape the overall scheme of ideas that he was to develop in ECLAC, and he argues that this scheme stems from a perception of the shortcomings of the development pattern that was already in existence before the 1929 crisis.

Roberto Cortés Conde, for his part, highlights the economic circumstances in which Prebisch developed his ideas and applied his actions in the Argentina of the 1920s to 1940s, concentrating on the years when he was in the Government and the role he played in the design and execution of policies which were to be of momentous importance for that country.

Edgar Dosman's article deals with the period between Raul Prebisch's exit from the Argentine Government and his drafting of the "Manifesto" in ECLAC. He provides new material –together with many biographical details– which documents the evolution of Prebisch's ideas during that period, thus helping to enrich the academic literature on the origins of ECLAC's theories.

Finally, Norberto González proposes that the ideas of Prebisch and ECLAC on Latin American industrialization in the period following the war should be compared with the literature analysing the ideas behind the policies applied in two great industrialization processes of the past: those of the United States and Germany.

*Oscar Altimir*  
**Director of CEPAL Review**

*(Original: Spanish)*



# Raúl Prebisch on ECLAC's *achievements and deficiencies:* an unpublished interview

David Pollock, Daniel Kerner  
and Joseph L. Love\*

## Introduction

This issue of *CEPAL Review* attests to the lasting influence of Raúl Prebisch's ideas and policies on development in Latin America and the Third World in general. Prebisch's thesis of unequal exchange and his conception of the world economy as organized in a Centre-Periphery relationship, however controversial, has earned him a recognized place in the history of development thought. Through ECLAC and later UNCTAD, Prebisch's ideas affected governments and institutions throughout Latin America and around the world. The theoretical origins and evolution of Prebisch's thought have received extensive treatment by economists and historians.<sup>1</sup> Yet how Prebisch built his team at ECLAC and how he conveyed his theses at the regional and international levels have not been widely treated. The following interview given by Prebisch to his longtime assistant and friend, David

Pollock, goes a long way toward filling that gap. In this conversation, conducted in 1985—a year before his death—Prebisch reviews some of the key moments in his life and that of ECLAC. The material covers the period from 1948 to 1963, from Prebisch's incorporation into the organization up to the early sixties, when he left ECLAC to become the first director of the United Nations Conference on Trade and Development (UNCTAD).

In this interview, Prebisch discusses the politics as well as personal aspects of his entry into ECLAC, as well as providing an account of how he wrote the agency's manifesto, *The Economic Development of Latin America and its Principal Problems* (first published in Spanish, in 1949). Prebisch's international role is also treated in the interview. For instance, he explains the part he played in the creation of the Alliance for Progress in 1961, making it clear that although he was involved, he was not the originator of the programme. His relations with the United States government, the Organization of American States, and the Bretton Woods agencies (the IMF and the World Bank) also receive attention. Prebisch's passion for advancing the economic integration of Latin America, and his candid estimate of the success of that endeavour, are both presented here.

Readers may be surprised by the frankness of the views expressed by Prebisch, famous for his discretion and diplomatic skills. In addition, Prebisch treats the personalities of the early ECLAC team, as well as those

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<sup>1</sup> See for example the bibliographical essay in Love, "Economic Ideas and Ideologies in Latin America since 1930" in Leslie Bethell, ed., *The Cambridge History of Latin America*, Cambridge, U.K., Cambridge University Press, 1994, vol. 6, part 1, pp. 595-601.

of actors in U.S. and international agencies. One gets a clear view of Prebisch's style of leadership, and the political possibilities and constraints ECLAC faced in a region subject to the enormous influence of the United States.

The following interview was conducted by David Pollock in Washington, D.C., in May 1985, a year before Prebisch's death. Pollock, a Canadian, was Prebisch's assistant and close collaborator in both ECLAC and UNCTAD, and knew intimately his interviewee, the issues Prebisch faced, and the milieu in which he moved. Pollock held important posts in ECLAC between 1950 and 1963 (in Santiago, Mexico City, and Washington), and moved with Prebisch to UNCTAD in the latter year, remaining in that organization until 1967. Later, Pollock was head of the Washington Office of ECLAC. He had long intended to record Prebisch's reminiscences on tape, but the opportunity to do so only arose when Prebisch underwent eye surgery in Washington and was temporarily unable to work. At that moment, he invited Pollock to interview him at length. Pollock recorded twelve hours of conversation, of which this material is an excerpt.

In the following text, the words are those used by Raúl Prebisch and his interlocutor, David Pollock, except for a few connecting words and phrases, indicated by square brackets. The conversations were edited by Joseph L. Love and Daniel Kerner to eliminate digressions and repetitions, and the ellipses ( ... ) were removed in order to facilitate the flow of the text. Footnotes have been supplied to identify persons and institutions mentioned in the conversations.

### The interview

**David Pollock (D.P.)** What brought you into ECLA in 1948?

**Raúl Prebisch (R.P.)** I read in a newspaper that there was a meeting in the United Nations whereby they had created an Economic Commission for Latin America. I read that with indifference. However, a few days later, members of the French delegation to the United Nations approached me in Buenos Aires, telling me that the French government would wish me to present my name as a candidate [for the post of Executive Secretary] in the United Nations. After I'd been the head of the Central Bank of Argentina, it appeared to me as a demotion<sup>2</sup>. They would not explain to me the meaning

of the words "Executive Secretary." In my view it was just to make reports of meetings and so forth. So I wasn't interested. I was rather attracted by what the President of the Academy of Economic Science in Buenos Aires had then offered me, to start a Review. Then, sometime afterwards, a few weeks after, I had a call from Benjamín Cohen. [He was] a distinguished Chilean, whom I had met at student meetings in Buenos Aires. He was Under-Secretary for Public Information and he said to me, "I am sent by Trygve Lie<sup>3</sup> to formally offer you the post of Executive Secretary of ECLA."

At that time, I still had the illusion to continue being a Professor at the University of Buenos Aires. The salary was rather small, but I had reduced my standard of living to fit it. I had sold my Cadillac and rented my house on the Barranca de San Isidro. Adelita<sup>4</sup> was willing to accompany me on this type of life. I had decided to devote some years to research, so I said to Benjamín, "I am not tempted." On the other hand, I had seen the League of Nations as a young consultant for the World Economic Conference of 1933 and I saw that we—members of developing countries—had nothing to do in that atmosphere. We were at the margin. So I said, on the phone, "I'm not interested. I'm very thankful, but not interested. On the other hand, I am leaving tomorrow morning to Venezuela because the Minister of Finance there, whom I do not know, has invited me to write a report on two projects of law: reforming the Central Bank and the Banking Laws." "Well," he said, "I'm a very close friend of Pérez Guerrero, the Minister. So I will go there and try to persuade you to accept." I said, "Benjamín, you will lose your time. My determination is very firm." Well, I went to Venezuela and I did what I had to do. Anyhow, when [Gustavo] Martínez Cabañas was appointed [as ECLA's first Executive Secretary], he and [Eugenio] Castillo, a Cuban who was at that time the third man in ECLA, went to Buenos Aires to ask me to spend a few months in Santiago, to write the introduction to the first *Economic Survey of Latin America*. I accepted for two reasons. First, because I said, "Well, let us try." Second, it coincided with a resolution of the University of Buenos Aires to dismiss me as a Professor. I was not a man looked at with sympathy by some highly nationalist groups who were trying to get room for themselves.

<sup>2</sup> Prebisch was Director-General of the Central Bank of Argentina between 1935 and 1943.

<sup>3</sup> Trygve Halvdan Lie (1896-1968), a Norwegian who was the first Secretary-General of the United Nations (1946 to 1952).

<sup>4</sup> Prebisch's first wife, née Adela Moll.



*D.P. So the consultancy came at just the right moment.*

**R.P.** And I went to Santiago. I never had lived in Santiago. I had spent a night there en route to Mexico. I was impressed by this nice city, with the beautiful view of the mountains, the friendship of the people, the running water in the street, the nice atmosphere.

*D.P. And good wine.*

**R.P.** Good wine. And last but not least, Louis Swenson. Louis, as you well know, was a man who inspired sympathy.

*D.P. Yes.*

**R.P.** And we used to talk and walk, and I started thinking about the nature of this Introduction. As usually happens, I sat down for days without taking any notes. This helps me to speak without notes, because of the sequence of the ideas, and during the month I did not write a word (*laughs*). Castillo would visit me saying, "Raúl, how is your writing going?" "Nothing yet. Nothing yet" I would say. And Louis, "Raúl, you know you have two girls who are excellent typists and who can take dictation." I don't dictate these important things, you know. And I saw their great concern. They probably said to themselves: "Well, this man is a failure."

*D.P. Wasting their money.*

**R.P.** A good Central Banker [perhaps they thought], but we need this report. Finally I decided to write, and in three or four days I wrote the whole Introduction to the first *Economic Survey*. It contained our view of the problems at that moment, international as well as Latin American problems, and the close interrelationship between them. These were the result of all my readings and reflections in those three, four, or five years of meditations. They sent the Introduction to Headquarters in New York. I signed the report. Nobody had told me I should not sign. A few days later, New York sent the longest cable that I have ever seen in my life and that, regrettably, does not exist in New York or in Santiago (according to regulations these things are destroyed after 30 years). It's a pity, because in this cable they made a series of considerations that ended in the following form: "The report is a document with a great content. But it speaks about development, industrialization, terms of trade, and many other matters that ECLA is not supposed to deal with. ECLA

has no instructions to deal with these problems. But as the document is a serious and responsible document, we suggest to you (Martínez Cabañas), to present the document as an Introduction signed by the author, so that you will attribute the responsibility to him and not to the organization." I remember that Martínez Cabañas came to see me with great concern, believing that I would react furiously. I said, "Gustavo, I never supposed that I would not sign the document. I put my personal ideas there. I have not diluted these ideas. So I agree fully." Believe me, in the ECLA Conference in Havana the reception of the document by Latin American countries, including Argentina, was inconceivable. Words of praise everywhere. On the other hand there were conventional minds on the part of the U.S., the same on the part of the U.K., a little better from the French.

David Owen, whom I met for the first time in Havana, was so impressed that he took me aside before the end of the Conference and said "Raúl, I cannot offer you any more [the] Executive Secretary [post] because it is in the hands of Martínez Cabañas. But I can [make] you Director of Research with a salary as a consultant at least equal to his salary and with full intellectual independence." I said, "David, are you willing to accept the following three conditions? *First*, what is the meaning of intellectual independence for me? Not to receive instructions from Headquarters nor from Cabañas about what ideas I should put on paper. Instead I should follow my own responsibility. I think that now, no longer being a consultant as I was before, but a man integrated into the body of ECLA, I would have to follow certain rules. With a sense of responsibility, but at the same time with the possibility of presenting problems that the developed countries would not receive with pleasure." He said, "Raúl, this is what we wish in the United Nations; to open new paths." "*Second*," I said to him, "I understand that you should approve the appointments that I would like to make. But every appointment should be the result of my proposal. You can reject or accept but it has to be my proposal. Being a man in the field, I know the people. I know the requirements, and if you act at a great distance, we will incur great mistakes. *Third*, I would want freedom to travel. Not to ask for authorization. Give me an amount of money and I will use it to the best of my judgment." "I accept your conditions," he said. These were the bases of my incorporation as a regular staff member.

**D.P.** *How did you become Executive Secretary so quickly?*

**R.P.** Well, it was obvious that the situation existing at that time would not last for long. Martínez Cabañas was an excellent fellow. But he was a young man who never before had that type of responsibility. Our personal relations were good. But everybody understood that the real authority was mine. Then, in a trip of mine to New York, to Lake Success<sup>5</sup>, David Owen said to me, "We are going to create a new entity in the United Nations for technical assistance. The Secretary General offers this to you, or the post of ECLA Executive Secretary, in which case we will accommodate Martínez Cabañas in the new organization. Which do you prefer?" I said, "tell Trygve Lie that I would accept whatever he likes. If he wants me to come to New York, to this new institution, I would go. If he likes me to stay as ECLA Executive Secretary, I will accept because I like this organization and I see the problems and challenges as I could not see them before." That afternoon, he said: "Trygve Lie said you should be Executive Secretary."

**D.P.** *Why did you reorganize ECLA the way you did? The Development Division was very large and powerful.*

**R.P.** Due to the role of development in Latin America.

**D.P.** *Describe some of your key early staff, some of the important beginners. You had Ahumada, Urquidi, Furtado, Melnik, Santa Cruz, Boti, Noyola, Vuscovic. Did you pick them all or were they there when you came?*

**R.P.** When I came there were Furtado, Boti, García and Rey Álvarez. They were consultants, the last two. Urquidi, Ahumada, Melnik, Noyola, and Vuscovic came later. How did [Pedro] Vuscovic come? A Peruvian professor was hired as a consultant in statistical matters and brought a young man, Vuscovic. I remember that Vuscovic was working in a small room at the entrance of Calle Providencia with a calculating machine. He showed intellectual abilities and he made a good career.

[Jorge] Ahumada entered later and Melnik too. We took Melnik from the Corporación de Fomento. He was a very effective man, very effective, a great man and a nice person. Different from Ahumada. Ahumada, at the

beginning, entered with a great arrogance. But gradually he was integrated. And once in Brazil, five years later, in a cocktail party that was prolonged until late, he said, "Don Raúl, I don't know, I cannot understand how you have tolerated me for such a long time because everything that you said, I disagreed with. And you were patient enough not to say, Jorge, why do you disagree?" And we became good friends. He was a very intelligent man, a good writer, and full of force.

**D.P.** *Did your staff write papers and give them to you to read? How did you work with them? Did you ask them questions? I wasn't in ECLA really until 1953, but I had the impression that you did most of the key writing in the first 3 or 4 years. What was the way in which you worked? Did you invite papers, read them, and absorb what they said? Or did people write on their own?*

**R.P.** Well as you said, there were different sections. Indeed they produced papers, a series of reports, many of which were published in the pre-[CEPAL] *Review*, the *Bulletin*, or printed in mimeograph and distributed. I took advantage of some of their ideas, I used to discuss with them, [but] was not very fond of big staff meetings, rather meetings with one, or two, or three people.

**D.P.** *You used to keep your office closed for certain hours each day?*

**R.P.** Yes, in order to produce my own papers. I didn't have open doors. But most of what I wrote was after everybody went to their homes, on Saturdays, and on holidays. The final decision was made by me, but always after listening. I would not try to present papers with the style of presenting compromises saying: "There are some who believe this and others who believe that." I would only put what I believe, and I would not eliminate the presentation of other papers with different views, but my personal ideas, my personal papers, would not be compromise papers.

**D.P.** *You had a few key U.S. staff members: Louis Swenson, Alex Ganz and Richard Mallon come to mind. Did you pick them to have a U.S. presence or was that part of the game? In other words, there was always a gulf between you and the U.S. government. Did you pick some staff to make a showing to the U.S. government that you wanted Americans or were they picked for you?*

**R.P.** Not at all. I promoted Louis Swenson because he was very able, intellectually very open, and morally a

<sup>5</sup> Lake Success, New York, was the first site of the United Nations headquarters, while permanent facilities were being constructed in New York City.

superb man. He would be in charge of ECLA for a month or two while I was outside, and neither one of us would be suspicious of the other. It was a perfect team. Louis had a great critical mind. This is one of the reasons why I did not prefer to have a collegium office. Rather, I'd give a paper of mine to Louis, to let him make the criticism. He was free to criticize everything and he had a sharp mind.

**D.P.** *Yes. I remember he wrote that first paper on European-Latin American economic relations, which was very solid. And Alex Ganz? How come you picked him? You wanted somebody on national income and Alex had worked in Puerto Rico?*

**R.P.** Alex Ganz was a very good example of the cooperation of an American economist. He worked strenuously. He introduced new techniques.

**D.P.** *National income techniques especially.*

**R.P.** He was integrated personally with the boys, and was not eager to go back to the U.S. and publish on the basis of what he'd learned from us. He tried to live for ECLA. This is something that I always remember as one of the great merits of Alex Ganz. Others went there with the idea of taking easy fruits. Of publishing articles, not always paying tribute to ECLA. On the contrary, transforming ideas of ECLA in technical terms.

**D.P.** *Into political documents?*

**R.P.** Yes, and reaping the merit of the work for themselves.

**D.P.** *I want to talk now about your initial relations with the U.S. government. You said that I knew more about this than you because I wrote an article in 1978<sup>6</sup>, but obviously I don't. Relations were often very strained between ECLAC and the U.S. government, and between you and the U.S. government from the very beginning. Why?*

**R.P.** When Hernán Santa Cruz presented to the Economic and Social Council [ECOSOC] his project for the creation of ECLA, naturally he encountered much opposition from the great powers, and especially from

the U.S. He persuaded Mendès-France<sup>7</sup> and some others to support ECLA. And finally the U.S. had to accept. Especially taking into consideration that the Commission was initially established for only three years, and perhaps with the idea in the back of their minds of merging ECLA with the Organization of American States. Indeed, when I was appointed Executive Secretary, an ambassador who was representing the United States at the O.A.S., a very nice gentleman, invited me for a cocktail party in his house. And he said to me, "My government does not like two organizations dealing with the same problems. So we have elaborated a project of merging the two. I may say, first of all, that you are our candidate for being the Director of the two organizations. And you will have more resources than before. Here is the text: two pages." I read the text carefully, and I said the following, "Mr. Ambassador, I fully understand your position. But I have to speak very frankly with you. The basis of our new organization, ECLA, is intellectual independence. This is the first opportunity for Latin Americans to start thinking with their own minds on economic problems. This has not been the case up to now." I was persuaded of that, after years of meditation when I had to leave the University of Buenos Aires. I added "I have to tell you frankly that you would be the dominating power in the new organization, as you dominate the Organization of American States. The Economic Department of that Organization is dominated by the State Department. I understand this quite well. But understand my point of view. If I would have yielded my intellectual independence, perhaps I could have continued to serve the Argentine government. But I didn't. And I'm not going to change at this age. And if I had the weakness to accept your offer, not one of the young men who are accompanying me would continue in ECLA. Believe me, it is an exceptional group of brilliant young men who never before happened to work together in Latin America. Not for the salary, but for the idea of a Latin America working in the right direction. So I'm sorry to say to you that I cannot accept." Well, it was a nice drinking party. We changed the subject, and the matter ended as a civilized parting. This was a few weeks before the third meeting of ECLA, which in turn was my first meeting as ECLA Executive Secretary.

<sup>6</sup> David Pollock. "Some changes in the United States attitude towards ECLA over the past 30 years" in *CEPAL Review*, No. 6, second half of 1978, pp. 57-80.

<sup>7</sup> Pierre Mendès-France (1907-1982), subsequently Prime Minister of France, 1954-1955.

**D.P.** *In Mexico?*

**R.P.** In Mexico. First the constituting meeting in Santiago. The second in Havana, when I spoke as Director of Research, and this one in Mexico was my first as Executive Secretary. Immediately before the meeting, Antonio Carrillo Flores, the Mexican Secretary of Finance, invited me for dinner with Alberto Baltra, Minister of Economy in Chile, with another member of the Chilean delegation, with Merwin Bohan,<sup>8</sup> and with a high official of the Department of Finance. The second Chilean was Oscar Schnake who was an old friend. We had a nice dinner. [This was] in Mexico City. Right away Antonio Carrillo Flores said at the table, "Don Raúl, how do you like this Mexican wine?" (*laughs*). I replied, "Dear Mr. Minister, this is not Mexican wine." (*laughs*). He was a man of good humor. Well, after dinner, there were two sofas, with the difference that there was room between the second sofa and the wall. Carrillo was there with Merwin Bohan and Baltra. I was on the side, facing them, with Schnake. The high Mexican official was standing behind the sofa. Then Carrillo said to Merwin, "Will you please read your project, your draft project for the merging of the O.A.S. with ECLA?" Merwin read it. Then Carrillo said to me, "What do you think about it?" I told him, "I do not need to reflect on it because this is precisely what they consulted me [about] in Washington and I reacted absolutely against it, on the following grounds." And I repeated those grounds. You know what Carrillo did? There are gestures in life one never forgets! "Give me this paper," [he] tore it up and threw it away. The matter was settled. And poor Merwin Bohan was silent. The U.S. had expected Mexico to support it, and Mexico was silent. This was known, naturally. President Vargas sent a cable to his delegation, the Brazilian delegation, supporting ECLA. Chile was hesitating. It gathered force. And the impetus was such that I had to help Merwin Bohan soften a draft resolution that was extreme (*laughs*). The man who established peace was Philippe de Seynes, a member of the French delegation.

**D.P.** *Were there any Latin American countries that did not support you in ECLA?*

**R.P.** All, including Argentina [supported me]. Argentina never put me in a difficult situation, I have to recognize this.

**D.P.** *Tell me one small footnote, Don Raúl. Why was the Washington Office set up in the first place? Was it because one of the aspects of the agreement was, "All right, if you Latin Americans are going to have a regional commission, and we already have the O.A.S., then let us at least co-ordinate our work programmes so that there will not be duplication and overlap." Was that why it was set up?*

**R.P.** I could see the extraordinary importance of being in Washington. First, as a source—as you subsequently developed the office—of contacts between Latin Americans and [North] Americans. As a source of collecting information and papers.

**D.P.** *In addition to coordinating with the O.A.S.?*

**R.P.** That was just an excuse. The real idea was to have a foothold there.

**D.P.** *I see. Tell me a bit about the relationship between Santiago and New York. You always had very good contacts with the Secretary-General, as I understood it. Tell me about the Secretary-General, about ECOSOC, and about the Headquarters Administration. Three different levels. Start with the Secretary-General. You were always on good terms with Hammarskjöld<sup>9</sup>, with Trygve Lie, with U Thant<sup>10</sup>. You never had any trouble with the Secretary-General?*

**R.P.** Absolutely none.

**D.P.** *What about the ECOSOC and the Economic Department? Did they try sometimes to edit your output?*

**R.P.** No. I may say that I had the most cordial and soft relationship with the Department. There were several personalities the first year, David Weintraub and Harold Kostin. David was sacrificed by Trygve Lie in the time of McCarthy.

David Weintraub was a man who saw the problem of development and was enthusiastic about the work of ECLA. The same for Harold Kostin, a Briton. But under

<sup>8</sup> Member of the United States delegation to the GATT conference in 1949-1950 and United States Ambassador to the Inter-American Economic and Social Council in the early 1950s. He knew Prebisch when the latter was Director of the Central Bank of the Argentine Republic in 1941-1943.

<sup>9</sup> Dag Hammarskjöld (1905-1961). Secretary-General of the United Nations, 1953-1961.

<sup>10</sup> U Thant (1909-1974.) Secretary-General of the United Nations, 1962-1972.

the circumstances, David Weintraub had to resign. Harold Kostin was transferred to other functions and new men came. David Owen came a little later.

**D.P.** *What about the Secretaries-General? Tell me a little bit about your personal relations with Hammarskjöld, Trygve Lie and U Thant. You knew them all personally?*

**R.P.** Trygve Lie, only when I went to see him, on accepting to be Executive Secretary. When he was in Santiago for the ECOSOC he visited ECLAC. He visited my office and said to me, "Well, I'm very happy with you –because you don't give me any political problems." Period! (*laughs*). He never interfered at all. With Hammarskjöld I established a very cordial relationship. To such an extent that he made an exception: Never before had an Under-Secretary accompanied him on a trip. He asked me to travel with him in Latin America and we had very extensive talks on many matters. The man was intellectually brilliant, and he supported me in every sense.

**D.P.** *When I was in Santiago in 1955, I worked with José Antonio Mayobre<sup>11</sup> and Alex Ganz on an early ECLA document called An Introduction to the Techniques of Planning. When that report went to New York, a cable came back to you that got Mayobre very excited. He showed it to me. It said, "The report is all right, but every place where you say "planning", delete it and insert the word "programming", because here in New York we cannot have anything that supports planning." And you said, "O.K." Explain to me how come, with all this support you had –from the Secretary-General and all those people at Headquarters– the United Nations decided that "planning" was a bad word and "programming" was a good word?*

**R.P.** Not in New York. I was not concerned about heads in New York. It was in the State Department and in the World Bank. The Bank would not speak of "planning", but of "programming". By the way, [for] many years after, I never used the word "planning". It was a slip of José Antonio Mayobre to speak of "planning". I was speaking of "programming".

**D.P.** *Why has ECOSOC, which in theory is ECLA's parent body, never been influential? Why was it always a weak instrument? How did ECLA manage to be so powerful when ECOSOC itself –the parent body– was so weak?*

*There's something odd about that. In many ways, ECLA transformed Latin American economic thought and action, for better or for worse. Import substitution, industrialization, the whole concept of Centre and Periphery, terms of trade, regional integration, planning, and so on. ECLA went ahead, wrote, did things, and influenced reality whether ECOSOC listened to it or not. ECOSOC almost seemed irrelevant. Somehow, there's an anachronism to ECOSOC which I don't understand.*

**R.P.** After Gunnar [Myrdal]<sup>12</sup> left the ECE [Economic Commission for Europe], I could captivate attention by speaking without reading from notes, by speaking forcefully, by affirming my convictions. And people like that. It is an element of persuasion. If they do not always act in that sense, at least they respect what you do and the organization that you are representing. But if you go and read your speech, or speak in a monotonous voice and present many figures, you lose influence. You have to go and discuss, as an actor. I think this is an important element and Gunnar would do that. He was a powerful man, and I think this was an element. Remember, in a body like this, there are always three or four persons with intellectual ability. They shape the opinion about the intellectual quality of the man who is speaking. I never have seen a face of a man who was sleeping while I was talking. And that is important.

**D.P.** *[Returning to ECLA itself,] let's begin with three main initial contributions of ECLA to Latin American development. One was theory. The second was let us say technical assistance, training, and advisory activities. And the third was political: ECLA provided a forum for Latin Americans to meet. ECLA also provided statistical and other such services. But, fundamentally, the main contribution of ECLA and yourself in those early years was in theory. You began by identifying the dichotomy of the centre and the periphery. From 1948 until 1963, you focused fundamentally on the external sector. Your terms-of-trade approach, your emphasis on the need to industrialize through import substitution, your stress on more buoyant exports. Why did you focus so heavily on external vulnerability?*

<sup>12</sup> Gunnar Myrdal (1898-1987). Swedish economist. He became Executive Secretary of the United Nations Economic Commission for Europe in 1947. Author of *The Asian Drama* (1968), Myrdal shared the Nobel Prize for economics with Friedrich von Hayek in 1973.

<sup>11</sup> Executive Secretary of ECLA, 1963-1966.

**R.P.** Because the external bottleneck was the most important obstacle to development at that time.

**D.P.** *Early in your life in Argentina, you were very impressed by the vulnerability of the Argentine economy to international shocks. But in the ECLA thesis, there was very little emphasis on domestic phenomena. You looked fundamentally at the problem of the foreign exchange constraint. True, Latin America was enormously vulnerable then. But presumably your emphasis was also partly because you and ECLA wanted to get political support, in those early years, from the Latin American governments?*

**R.P.** And because we were not prepared to extend our thinking, suddenly, to every aspect of the economy. We took those parts that were more important at the moment. And gradually we extended our ideas to other subjects.

**D.P.** *Did your theory evolve over time? Your thesis was very intricate. Everything was linked to everything else. Did that evolve slowly between 1948 and 1963, or did you have it in mind from the beginning? That is to say, the tendency toward a secular deterioration in the terms of trade; therefore, an effort to reduce dependency on primary production for exports; therefore, accelerated internal industrialization.*

**R.P.** It was a gradual evolution. We had to industrialize in Argentina without previously building a theory, because we needed to supply more goods to the population. But we could not pay for all the imported goods, due to the fall of our exports and the deterioration in our terms of trade. That's the simple fact. Without any theory, the whole of Latin America did the same. From Mexico all the way down. Then, in my years of quiet thinking, after I left the Central Bank, I started theorizing. The concept of centre and periphery emerged, and the concept of industrialization.

Let us deal with the latter and then with the former. There was and there still is a great deal of confusion about deterioration in the terms of trade. I was accused many times of projecting into the future a tendency to deteriorating terms of trade. I never said so. What I said is, it is necessary to introduce technological progress into agriculture. The more you increase productivity, the less manpower you need per unit of product. It is true you can increase production and exports, but here comes the external part. If external markets are open, and you can sell in them whatever you produce, all right, that would be the most

economical way of employing manpower. But it so happens that the laws of income elasticity are very narrow. Very low income elasticity for primary products; very high income elasticity for manufactured products. How to deal with this? It is a very simple arithmetic problem.

**D.P.** *I remember, when I was in Santiago in 1955, that Alex Ganz had calculated the overall U.S. income elasticity of import demand for Latin American primary products at 0.6, and Latin America's income elasticity of import demand for U.S. manufactured goods at 1.6. So there was the gap.*

**R.P.** And if you extend this reasoning to all the centres of the world, given the very low price elasticity of our exports, there is a certain moment when the attempt to export more gives you less foreign exchange. What is the role of industrialization and protection? Reasonable protection gives an incentive to establish industries and to divert factors of production to industry from agriculture. Not to displace, but to divide the increments of factors of production; one part to continue increasing agriculture and one part for industrialization. This was one of the reasons for the programming that we advocated, to try and keep a dynamic balance between the two activities.

**D.P.** *One of the odd criticisms of you and ECLA was that you were "against agriculture" because you favoured industry.*

**R.P.** Well, that's absolutely nonsensical. Anyone reading our literature will see that we put emphasis on both things. One of the first things I did in 1955 when I was consulted by the new Argentine government was the establishment of an Institute for Technological Research in Agriculture –INTA– with financial independence. What I was trying to convey to people was the idea of a dynamic balance between the two sectors. I said, if there is no industrialization in the developing countries, in the periphery, and if there is technical progress in agriculture, then there will be a tendency to deterioration in the terms of trade. The only way to stop that is through industrialization. This was my simple argument. I did not make any forecast about the future. I presented my thesis as an argument in favor of industrialization. Against agriculture? How could I be? A man born and educated in Argentina, who recognizes that the high standard of living in Argentina by the beginning of the century was due to agriculture? And I said in Brazil (in reply to the arguments of Jacob

Viner<sup>13</sup>, who said "Prebisch ignored agriculture") that agriculture can be the source of wealth. Now, the thesis of the orthodox economists was: If you need to stimulate industry, then devalue. Devaluation would increase the price of imports and would stimulate exports, without any intervention in the free play of the market. My reply was: Devaluation made for that purpose, and not as a response to a previous process of inflation, will promote inflation. It will be a socially costly way of protecting. And those exports (and this was the case of exports of primary products in Argentina, that were already competitive) will see their prices increase, and therefore production will increase, and therefore prices will finally fall. Then Viner said, "Put a tax on exports". "But my dear [sir]," I replied, "This is intervention into the market. What is the difference between a tax on exports to prevent a fall in prices of exports, and a selective tax on imports?" Nonsensical. This is all. Even when I qualified these points, when I explained these points, still I was accused of incredible things in this matter.

**D.P.** *Why do you think that happened?*

**R.P.** Because of second- and third-hand reading. And because there is a prejudice that probably you have seen, [as] a member of a northern university. Really, David, there is a certain arrogance and disparagement. They don't take us seriously. I'm sure that in Harvard they don't take us seriously. We are second-class economists, or even third class. We are underdeveloped economists.

**D.P.** *But could it also be because you represented a challenge to U.S. exports, through your import substitution measures? And also because of your criticisms of transnational corporations? The U.S. private sector and the U.S. government were worried that your theories would have a doubly adverse effect on them.*

**R.P.** You are right. Let us take it bit by bit. I went to see Frank Southard<sup>14</sup> about the Latin American Common Market. He was an open-minded man. I put as a case that we were thinking of producing cars. "But would you deprive us of our export market?" "Yes," I replied, "but as a result we could import more."

**D.P.** *Import more capital goods?*

**R.P.** "Well," he said, "the immediate effects would be this. In the longer run something else may or may not happen." He saw the immediate effects. There was no long-term policy conception. It was a plea of immediate interests. But I was thinking not only of immediate measures, but in longer run development terms. Don't forget that the long term starts now. You have to build the short-term programmes within the framework of your conception of long-term programming.

**D.P.** *[What about] transnational [corporations]?*

**R.P.** As always happens, the pendulum went too far. We have seen transnationals everywhere. We have built a theory of transnationalization. I think that it is necessary, here again, to try to build a policy. Let me take the case of oil. In 1955, during the short period when I was advising the Argentine government, I opposed with great firmness a policy of "open-door" to oil companies. Argentina, for several reasons had to increase its production of oil. So it was necessary to have the cooperation of the oil companies. I said to the President [Aramburu]<sup>15</sup>, "Don't give concessions. Try to get service contracts from the companies." The attitude of the companies was against this. Do you remember Mr. Vance, who was head of the Export-Import Bank? He went to Santiago. He said to me: "I am a Republican. I consider that oil companies should be free to invest without conditions. And I may tell you that I'm willing to recommend to my government (he was a very influential man) a different policy; a policy of negotiations, joint ventures and service-contracts, as you had preached." I took the first plane, at 12 o'clock precisely. I went immediately to see the Minister of Finance. Unfortunately, the day before, President Aramburu made an ambiguous declaration that was to change our policy. When this was known in New York and Washington, they retreated. And the country would have to wait for many years. Now the companies are prepared. They have learned. We need the transnationals, but with very clear rules of the game: duties, obligations and rights. We have to find new policies. First, a selective policy, we have to define where we need them and on what basis. The danger is that, in this very difficult situation, they would try to force the governments to give very favourable conditions.

<sup>13</sup> Jacob Viner (1892-1970), the leading trade theorist of his generation in the United States.

<sup>14</sup> United States representative to the IMF, 1948-1950.

<sup>15</sup> Pedro Eugenio Aramburu (1903-1970), President of Argentina 1955-1958.

**D.P.** *This all leaves me with the feeling that the ECLA thesis or the Prebisch thesis of 1950-1960 continues to have considerable relevance for Latin America today.*

**R.P.** [For instance,] import-substitution, not as a theoretical preference, but insofar as we cannot find sufficient markets for our exports. That's all. We need to increase our income. We need to import more. Insofar as we cannot import more by paying with exports, then we have to pay with our own production.

**D.P.** *What's interesting to me is how the analytical rationale still goes back to the writings of 30 years ago. There are really very few new thoughts today on "what to do" about the external constraint that were not contained in the ECLA thesis of the early 1950s.*

**R.P.** I regret to say so, but the Centre-Periphery concept has not changed very much.

**D.P.** *Nor has the terms of trade theoretical rationale; nor has the import substitution industrialization concept; nor has the concept underlying regional cooperation.*

**R.P.** I would like to see –really, David– a revolutionary presentation of new ideas.

**D.P.** *You were in ECLA from 1950 to 1963 as Executive Secretary. I want to go back to some things that happened during that period. I'm going to start with the Alliance for Progress<sup>16</sup>. That was, for its time, a noble experiment. Tell me how you got involved in the Alliance.*

**R.P.** I would say that for me there were two different episodes. Adlai Stevenson<sup>17</sup> visited Buenos Aires with Senator Benson, who was a very sympathetic man. Both of them asked to see me. Stevenson put some very pertinent questions. This was before the Alliance. At the end, after thanking me for the hospitality, [Stevenson] asked me to write a memorandum to him. I did so. And he used this memorandum as a basis for an article that he published soon afterwards in *Foreign Affairs*. I don't know if he was influential or not with John Kennedy.

Now, let's turn to the Alliance for Progress. I was not the promoter of the Alliance for Progress, but I jumped on the wagon when the train was starting to move. Not because I was against, but it so happened. I underline this because many people believe that I was the intellectual author of it. The Organization of American States, during Kennedy's early years, attempted to introduce new life into itself, and formed a committee of some 15 or 20 people, the majority of whom were Latin Americans.

**D.P.** *The OAS asked ECLA to send some people to Washington to help?*

**R.P.** Yes. The papers of ECLA were the basis, and our presence contributed further. The OAS saw the opportunity to get new force. Some weeks later, after the presentation of this document by the OAS to the State Department, I had a meeting with José Antonio Mayobre (the Venezuelan Ambassador [to the U.S.]) plus Felipe Pazos<sup>18</sup> and Felipe Herrera, who was already President of the Inter-American Bank. Alfonso Santa Cruz was in Washington and Jorge Sol was very active. He was the head of the Department. [I drafted a letter for the group to President Kennedy, saying] "This is the moment to act: to have a hemispheric policy toward Latin America." And Mayobre, as the most important man, being Ambassador, delivered this letter personally to the President. And the President received it so well that, a few days later, he said that the fundamental ideas were ideas of the Economic Commission for Latin America of the United Nations. Imagine how we felt, how excited! Well, this is the positive part. What is the negative part? That Richard Goodwin,<sup>19</sup> without consulting us, gave to this document the name "Alliance for Progress." This title sounded to me [like] a "Holy Alliance!" It was not an Alliance: a mistaken and an unfortunate name. I was supposed to be Chairman of a Committee for coordinating the activities. But the Argentine delegation opposed me.

**D.P.** *Why? I thought you said earlier that they supported you?*

**R.P.** They did in ECLA. But I was acquiring too much power and influence, and this is very serious in

<sup>16</sup> The Alliance for Progress, a Latin America-wide development programme, was announced by President John F. Kennedy in March 1961. Through it, US\$20 billion in foreign aid was to be channeled into the region over a 10-year period.

<sup>17</sup> Adlai Stevenson (1913-1965). President Kennedy appointed him U.S. Ambassador to the United Nations, with cabinet rank.

<sup>18</sup> Felipe Pazos (1913-2001). Cuban economist, IMF staff member from 1946 to 1949.

<sup>19</sup> Richard N. Goodwin was special adviser and speechwriter for President Kennedy (1961), Assistant Under-Secretary of State for Inter-American Affairs (1961-1962), and Director of the International Secretariat of the Peace Corps.



Argentina, I'm sorry to say. So I had to help on this Committee as a consultant, without any power. The Alliance, as you know, was attacked both in the U.S. and in Latin America. In [the] U.S., business interests had the following thesis: "Why think in terms of social reform? First stimulate growth, and then afterwards take measures for better distribution of income." And in Latin America the landowners resisted the idea of agrarian reform. Only the personality of President Kennedy, and his personal influence on government, could have saved the Alliance. But he died.

**D.P.** *The U.S. business community was against the Alliance because of what?*

**R.P.** For them Latin America was a source of profit. Anything that could adversely affect those profits was bad. Land reform in itself was convenient. But wait until the country is prosperous, very prosperous, before introducing all these types of reform.

In some countries the landowners said they would raise the flag against foreign companies. In Chile for example. This was utterly unfortunate. Then came CIAP [the Inter-American Committee for the Alliance for Progress]. The World Bank did not pay any attention to it, it continued taking its independent decisions. At the beginning, Latin American countries sent good delegations. When the group of "Nine Wise Men" was replaced by the representatives of governments in Washington, Embassy Secretaries were sent, people without any qualifications. I always remember that, due to the efforts of [Carlos] Sanz de Santa Maria, the American government went there. [He] made a great effort to get the presence of high-level representation from the U.S., and he obtained that. The Latin American representation was disastrous. No questions from them. So that Carlos Sanz, Walter Sedwitz<sup>20</sup> and myself had to put the questions. This persuaded me that all this experiment was condemned to failure.

**D.P.** *One of the implicit criticisms that you are making of the Alliance for Progress is that there never was a boss.*

**R.P.** That's it.

**D.P.** *I'd also like to talk briefly about ECLA and you on the one hand, and the IMF and the World Bank on the*

*other. There has been a long-standing history of an adversarial relationship, at the intellectual and analytical level. During the 1950s and the early 1960s (until you went to UNCTAD), ECLA and the IMF saw the problems and therefore the solutions of Latin American development from very different lights.*

**R.P.** Yes. The theory of the Fund was based on the conception that a balance of payments deficit was the result of internal mismanagement. ECLA would not deny internal mismanagement. I would have been the last man to do that, because of my long experiences in Argentina and my reading and writing of Argentine monetary history. But to attribute to internal factors what very frequently was the result of external factors was a real calamity, a real theoretical calamity. For instance, a favourable balance of payments during a boom in the centres would increase imports that were the source (the sole source or the greatest part) of taxes. And the Treasury was worried as expenditures would increase. And when the slump came, the deficit in the balance of payments was unavoidable. The thesis of the IMF was always "restrict credit to decrease imports." And we said, "Yes. But the way to decrease imports is through a selective policy, that would at the same time give impetus to new import substitutions." Because, in the long run, import substitution is essential. The Fund would not link the two things, import substitution (because it too was against the laws of the market), and selectivity of imports (because it was an unacceptable interference in the market). This was from the point of view of monetary policy, the most important element in our disputes with the Fund. Years later, many years later, when Pierre-Paul Schweitzer<sup>21</sup> became head of the Fund, we got along personally very well. And I remember that in one of the dinners of the Fund he told me, "You know, Raúl, when I joined the Fund you were presented to me as the Devil. I was told to be cautious with you." Then there was de Larosière,<sup>22</sup> [I remember] once, in the middle of his first period, he said in a speech in Switzerland, "the Fund has always considered that balance of payments disequilibrium in developing countries is due only to internal factors. That is not so. We have to give importance to external factors also."

<sup>21</sup> Head of the IMF, 1963-1973.

<sup>22</sup> Jacques de Larosière, Managing Director of the IMF from 1978 to 1987; Governor of the Banque de France from 1987 to 1993, and President of the European Bank for Reconstruction and Development from 1993 to 1998.

<sup>20</sup> Senior official of the OAS and Secretary of the Inter-American Economic and Social Council responsible for supervising the Alliance for Progress.

**D.P.** *He was the first one to say that publicly?*

**R.P.** [He was] the first one to say that out loud and clearly. A few days later, I was at a cocktail party at the Fund when they said goodbye to one of the high officials, I said, "Monsieur de Larosière, I congratulate you. You were an innovator when you said what you said in Switzerland." And he replied, "Yes, but I would like to innovate much more. However I have resistances." "Well," I said, "Pope John XXIII had the same resistances!"

**D.P.** *I want to talk to you about the IBRD, the other Bretton Woods twin<sup>23</sup>. You and ECLAC had intellectual difficulties with the Bank. Not quite so strongly adversarial [as with the IMF], but adversarial nonetheless. Was that because the World Bank was not so important? They were equally orthodox for a long time.*

**R.P.** I will tell you an anecdote that will give you a glimpse of this. In my Argentine report in 1955, I was preaching industrialization, and the need to promote private initiative in industrialization. [First, use] macro intervention of the State to create the broad lines, and then let private initiative take advantage of this. Some weeks after, I had to visit the Vice-President of the World Bank, Burke Knapp, a very cordial and sympathetic man. And Demuth<sup>24</sup> was there. Demuth said, "Why are you opposing private initiative in industrialization, and promoting the growth of State enterprise? Why are you recommending this?" "What?" I said to Burke Knapp, "That's utterly disconcerting to me. I was attacked in my own country (as well as in other countries of Latin America) for the way I was speaking in favour of private initiative in industry as well as in agriculture and other activities. How is it that the Bank, that should be well informed, ignores this and instead presents me as a man promoting the growth of State enterprises? I never did, because I never believed in that." Well, that shows you how—even in institutions and circles where they should know better—they hear something but they do not take pains to see what is the degree of truth. And this is built up as a consistent theory against you and against your own thinking. This is the unfortunate part.

**D.P.** *So ECLA was a gadfly to the Bank and Fund. You were considered as not paying sufficient attention to neoclassical theory?*

**R.P.** Yes. Because I was not a neoclassical in the sense that I considered that, even if it is true that private initiative was absolutely important, it also had to be combined with planning, with the broad lines of planning, and this is what they did not accept.

**D.P.** *All right. But after Eugene Black left [the World Bank] and Robert MacNamara<sup>25</sup> came in with Hollis Chenery,<sup>26</sup> the attitude wasn't quite the same. It began to be a little better.*

**R.P.** Yes, with MacNamara and with George Woods.

**D.P.** *Yes, he was in between.*

**R.P.** MacNamara was always very cordial with me, but that's all. Chenery knew ECLA. Once before, we [had] invited Chenery to spend a few months with ECLA.

**D.P.** *So with Hollis Chenery, Mahbub Ul Haq<sup>27</sup>, Drag [Avramovic]<sup>28</sup> and MacNamara, there was a different intellectual atmosphere in the Bank. [But in general] in Washington, even our little ECLA Washington office was considered somehow a beachhead of intellectual opposition. Not only to the U.S. government, but also to some of the specialized agencies of the United Nations. In other words, ECLA had the reputation of being a potential threat to the policies of the U.S. government, of the Bank and [the] Fund, and GATT.<sup>29</sup>*

**R.P.** Well, there are two sides in this picture. One thing is the intellectual power that was one of our objectives, with political implications. Not the transfer of power from these institutions to UNCTAD; the most that it could get (and this could have been very important), was to be the centre of elaboration of new ideas, and the transformation of these new ideas into political forces. Not to try to manage the Bank or the Fund, but rather

<sup>25</sup> Robert MacNamara, U.S. Secretary of Defense, 1961-1968. President of the World Bank, 1968-1981.

<sup>26</sup> Professor of Economics at Harvard University and Chief Economist of the World Bank under MacNamara.

<sup>27</sup> Mahbub Ul Haq (1934-1998), Pakistani economist and Vice-President of the World Bank under MacNamara.

<sup>28</sup> Deputy Director of Economic Development of the World Bank in the early 1960s and subsequently a member of the Board of Governors of the Bank.

<sup>29</sup> General Agreement on Tariffs and Trade.

<sup>23</sup> International Bank for Reconstruction and Development, the original name of the World Bank.

<sup>24</sup> Richard Demuth, a World Bank economist, who worked on agricultural matters, among others.

to examine what they were doing, to criticize, for instance in the case of the Fund, its policy of conditionality. One of the most important roles of UNCTAD could have been a severe criticism of the policy of conditionality. Not to say "We do not like conditionality," but [rather] "how conditionality could be applied."

**D.P.** *Don Raúl, I want to ask you about why you created ILPES?*<sup>30</sup>

**R.P.** I did not create ILPES. The first idea about creating the Institute came from David Owen. He said, "Raúl, when you retire, you should have a research centre as part of ECLA." I said, "Fine idea." This was a conversation perhaps at the end of the 1950s. Once, I was asked by Paul Hoffman to go to New York and visit him. I did. "I will [allocate] resources for you to create a planning institute for Latin America," he said. Probably David Owen explained this idea to Paul Hoffman, and Hoffman—who established the International Development Institute—was a businessman with a very broad view of the world. We became good friends and he gave me the idea, but I did not ask anybody [to create] ILPES.

**D.P.** *Now that we've mentioned ILPES, how do you feel about it now?*

**R.P.** Not enthusiastic, ILPES is lacking in resources. It has been living a very precarious life. It doesn't have a research staff with continuity. And Latin America needs a research staff as a complement to ECLA.

**D.P.** *Let me go to regional integration. One of the great achievements of ECLA was to expand the concept of import-substitution industrialization from the national level to the regional and sub-regional level. And then to actually do the staff work for the creation of LAFTA,<sup>31</sup> the Central American Common Market, the Andean Group, and in some ways too, CARICOM.<sup>32</sup> So that was one of the specific practical and pragmatic achievements of ECLA. You were a father of regional integration in Latin America. How do you feel on looking back? What should have been done differently? How do you assess ECLA's contribution to Latin American regional cooperation?*

<sup>30</sup> Latin American Institute of Economic and Social Planning, now Latin American and Caribbean Institute of Economic and Social Planning.

<sup>31</sup> Latin American Free Trade Association.

<sup>32</sup> Caribbean Community.

**R.P.** This is a matter very close to my heart. I consider one of the most vital interests of Latin America [is] to give a strong impulse to this idea. Why has it not advanced beyond a certain point? It was not a failure. It was not a success. It was a mediocrity, a typical Latin American mediocrity. Let us start by saying that during the long years of prosperity of the centres, when Latin America was finally persuaded about the need and the possibility of exporting manufactured goods, the pendulum went the other way. First, the pendulum was in favour of import substitution, forgetting about the export of manufactures. We were the first to say (and I wrote this report at the beginning of the 1960s) that industrialization in Latin America was asymmetrical. We gave impetus to import substitution but we did not give symmetrical treatment to the export of manufactures. Duties on the one hand and subsidies on the other, we were the first, and I underline this because we were accused of being responsible for import substitution and against exports. That was not the case.

The Latin American countries took advantage of the boom years. Some of them were highly successful, following a very intelligent policy (like Brazil) and a consistent policy. Argentina started too, but then came the disaster of lowering import duties, believing that other countries would follow and we would liberalize the trade of the world. An overvaluation of the currency and plenty of money to pay for imports of manufactures destroyed a great part of the industry in Argentina, and therefore of the exports that had started in Argentina. Now we have to rebuild all this. Lack of consistency, David, was the main sin. And wrong ideas. I put in a parallel way Brazil and Argentina. We have to learn from the past, we cannot repeat ideas that we conceived 25 years ago. I was personally under the neoclassical conception of free trade ("Let us assure a growing free trade area in Latin America. Give time for industry to adapt to a lowering of duties. Give as much time as necessary"). In the light of experience, I think that was a mistake. Let us see what is the real problem. It is our deficit with the centres, for well known reasons. To this you must add oil imports. Let us concentrate on import substitution of those goods that are responsible for our deficit with the centres (insofar as we cannot export in sufficient amounts to pay for these imports).

**D.P.** *Imports of capital goods and intermediate products?*

**R.P.** Yes. And the new goods produced by technology, all these gadgets that you take enthusiastically. It so

happens that these are the goods that generally need broader markets. The old idea, this is the positive part of our preaching of a quarter of a century ago. Not the rest. But what is the lesson of this experience? Countries such as Brazil, Argentina and Mexico (not so many others) that are in [a] condition to export capital goods, but not at international prices, according to their own schemes, could do that via a system of trade preferences by the other countries. Let us say by Uruguay or Ecuador giving preferences to Brazil, Argentina and Mexico. But who pays the cost of this? Not Brazil. Not Argentina. The cost is paid by Uruguay and Ecuador. Why would they pay this cost? The idea was that they would receive –that they would be able to export– manufactures or other products to Brazil, Argentina and Mexico, receiving preferences from them. That may happen. My present idea is the following. Countries interested in exports should give a subsidy, according to certain established rules, in order to offer prices equivalent to international prices. So that the less developed countries of the area would be tempted to import from them. Even so, this could create a surplus in favour of the great markets. Part of the surplus should be used in a fund [created by Brazil, Argentina, and Mexico] to promote the establishment and development of industries that could export at competitive prices, with subsidies if necessary. [This scheme would not require] from Brazil the full opening of markets, but at prices competitive with internal prices. Not cutthroat competition.

**D.P.** *If this Fund was created and Brazil had an export surplus, and was going to give part of the Fund to Uruguay (to produce industrial goods that Brazil wanted to import), who would own the industry in Uruguay: the Brazilians or the Uruguayans?*

**R.P.** Both. I would like to see Brazil, Argentina and Uruguay working together. Not only for developing these industries but also for export purposes. So that, if they established one plant in Brazil, another plant would be established in Argentina. They would divide the work. In Brazil for certain types of capital goods; in Argentina for other types of capital goods. But the same enterprise, if possible. To merge interests.

**D.P.** *It makes sense for Brazil and Argentina. But does it make sense for Uruguay and Ecuador?*

**R.P.** If they will receive imports at international prices or close to international prices, at the same time they will have resources for developing their own industries.

**D.P.** *From this new fund?*

**R.P.** Yes. And if this could be matched by the Inter-American Bank or the World Bank—if they recognized the need for import substitution on broader lines— this would be perfect.

**D.P.** *So what you're really saying is a scheme like LAFTA or the Central American Common Market, but one that could be implemented at the level of two countries or more. It could be very practical.*

**R.P.** Yes, and another advantage is that, at present, according to the new ALADI<sup>33</sup> system, Brazil (let us say) obtains from Uruguay a preference, giving Uruguay a concession. Then Mexico comes and says, "I am willing to give a concession to Uruguay. Give me a preference similar to that of Brazil." Brazil may say, "But I gave it this concession on the basis of having this advantage. Now let us renegotiate." On the contrary, in this system, it is open. Brazil is given a subsidy for the export of machinery to any Latin American country entering into the system. If Mexico or Argentina would like to export the same goods, all right. There's more competition. All of them would have to contribute to the fund and follow certain rules. Subsidies could not be given on wild terms. Some rules would have to be established. It's not easy. We would have to abandon preferences.

**D.P.** *You mean abandon GSP<sup>34</sup>?*

**R.P.** No, preferences inside the area. This deserves careful consideration. I may be wrong –I accept that possibility– but also I may be right.

*(Original: English)*

<sup>33</sup> Latin American Integration Association.

<sup>34</sup> Generalized System of Preferences, established by UNCTAD under Prebisch's leadership.

# Raúl Prebisch

## *and the development agenda*

## at the dawn of the

## *twenty-first century*

José Antonio Ocampo\*

The hundredth anniversary of the birth of Raúl Prebisch is an invaluable opportunity for us to take another look at the ideas of this great Latin American, one of the thinkers from the developing world who has had the strongest influence in world economic debates. His ideas have been the subject of heavy criticism, but much of this has been based on distorted versions of his thinking or of its practical application, rather than his true intellectual work. Taking his proposals out of their historical context has also been a frequent practice, even by some of his own followers. It should be remembered, in particular, that many of his proposals were made in the light of the collapse of the international trade and financial system in the 1930s, whose reconstruction had barely begun when he published his most influential works (Prebisch, 1949, 1951 and 1952).

This essay tries to show that some of the basic ideas in Prebisch's thinking remain valid, and it reformulates them as a function of ECLAC's most recent proposals and the contributions of other schools of economic thought.

### 1. Three main elements in Prebisch's thinking

"The spread of technical progress from the countries where it had its source to the rest of the world has been ... relatively slow and irregular" (Prebisch, 1951, p. 3). This assertion, which forms the opening words of what is perhaps his best-known work, has two fundamental methodological implications. The first is the recognition of the key role of technical progress in economic growth and, hence, the importance for the developing countries of the channels through which that progress is transmitted from the "countries of origin": the derived demand for raw materials; technology transfer proper, including technology embodied in production equipment; the transfer to the developing countries of branches of production which are already "mature" in the industrialized countries, and the participation of developing countries in sectors of rapid technological progress. The second is the impossibility of analysing the dynamics of developing countries independently of their position within the world economy. Their development processes are qualitatively different from those of the most advanced nations. This means that there are no uniform "stages of development" and that "late development" –or "peripheral capitalism", to use Prebisch's own term– has a dynamic which is quite different from that of nations which developed earlier and became the "centre" of the world economy.<sup>1</sup>

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<sup>1</sup> The best analysis of these points of view is undoubtedly that of Furtado (1961).

This is the view which underlies the idea of an inherently hierarchical “centre-periphery” world economic system (or “North-South”, if we prefer the terminology which gained currency in the debates of the 1970s). The essence of this view is its emphasis on the basic asymmetries characterizing the world economy, and their persistence over time, in contrast with the perception of the world economy as a place of relations between equals, or a “level playing field”, to use a concept which has been in vogue in recent years. In terms of the recent controversies on economic growth, this alternative view of the world economy means that these asymmetries give rise to “divergence” in levels of development, or at the very least represent a serious obstacle to the “convergence” assumed in orthodox economic growth theory.<sup>2</sup>

These asymmetries are reflected primarily in the structure of production. According to a version which is very close to Prebisch’s thinking, “unlike the production structure of the periphery, which is *specialized and heterogeneous*, that of the centres is *diversified and homogeneous*” (Rodríguez, 2001, p. 105). As technical change originates in the centre countries and they also have higher consumption capacity, at any given moment they tend to have a concentration of the branches of production which are most dynamic at the world level. In Prebisch’s view, this gives rise to a tendency towards specialization by the industrialized countries in products of high income elasticity, while the countries on the periphery tend to concentrate on the production of goods of low income elasticity (raw materials and, increasingly, the manufacture of mature goods), which in turn reflects a trend towards divergence of growth rates and /or the rise of balance of payments problems in the latter countries, i.e., an external gap or bottleneck. These problems are particularly severe at times of crisis, reflecting the high cyclical vulnerability of the developing countries to shocks coming from the centre of the world economy.

In Prebisch’s view, overcoming the basic asymmetries of the international system requires not only a change in the international economic structure, but also an effort to transform the structures of the

peripheral countries themselves – “development from within”, to use Prebisch’s original terminology, as recovered by Sunkel (ed., 1991). In terms of the more recent debates, this “development from within” is essential because the accumulation of national human capital and technological capacity (“knowledge capital”) and institutional development are essentially endogenous processes. This explains the decisive importance of “programming development”, which was a term used in the first stages of ECLAC’s work and, in general, designing explicit State strategies to change the internal structures of the country, in order to break down the obstacles to development and make possible new forms of integration into the world economy.

Industrialization was initially seen as the main way of changing the production structure – “spreading technical progress” – and import substitution as its main instrument. This view was in keeping with the characteristics of the period when these ideas were formulated: the absence of a dynamic international market for manufactures;<sup>3</sup> the “empirical” way in which the import substitution strategy had arisen, as a response to the collapse of the international economy in the 1930s; and the protectionist past which many Latin American countries had shared with the United States and various countries on the European continent, even during the stage of primary-export development.<sup>4</sup> The possibilities of inefficiency in import substitution, especially in highly fragmented markets, as well as the need to ensure that industrialization was not carried out at the expense of agriculture or export development, were evident to Prebisch even in his earliest publications in ECLAC (Prebisch, 1949, sections I and VI). Therefore, from the late 1950s on, Prebisch and ECLAC began to advocate a “mixed model”<sup>5</sup> which combined import substitution with the promotion of new exports, especially of industrial origin.<sup>6</sup> Over time, ECLAC’s view became increasingly pro-export, although it never

<sup>3</sup> “No emphasis was placed on exports of manufactures to the centres in this stage, in view of the unfavourable conditions prevailing in those countries and the absence of a suitable industrial infrastructure for this” (Prebisch, 1987, p. 17).

<sup>4</sup> For more details of Latin American protectionism during the export stage, see Cárdenas, Ocampo and Thorp (eds., 2000a, chap. 1). For a comparison of Latin American tariffs with those of a number of Western European countries and the United States, see Maddison (1989, pp. 45-47).

<sup>5</sup> This is the term used in a recent study on economic history (Cárdenas, Ocampo and Thorp, eds., 2000b, chap. 1).

<sup>6</sup> This coincides with what Prebisch called the third stage in his thinking (Prebisch, 1987, pp. 9-21). One of its clearest expressions is to be found in Prebisch, 1963.

<sup>2</sup> In this formulation we are leaving aside the controversy over the terms of trade, which has been given an excessive amount of attention in the analysis of Prebisch’s work. We therefore concentrate on the divergence in levels of development or –in terms of the controversy in question– the role played by the deterioration in the factorial terms of trade. See, in this respect, Ocampo (1991).

favoured the abrupt elimination of protection arrangements.<sup>7</sup>

For Prebisch, the industrialization of the peripheral countries also involved a further problem: modern industry was less able to absorb the surplus labour made available by the rural sector. This fact was further aggravated by technological dependence, which meant that “best practices” corresponded to patterns of labour use dictated by the levels of development of the industrialized countries. One way or another, patterns of development came to be marked by greater “structural heterogeneity” of the productive sectors, to use the term coined later by Pinto (1970): while some workers were absorbed by the high-productivity sectors, a generally much large proportion were relegated to low-productivity sectors. This high level of domestic heterogeneity was one of the basic forces exerting adverse pressures on income distribution, and moreover, in the case of Latin America, this took place in countries which had already inherited a high degree of inequality and marked social segmentation from their previous stages of development.

Under the mixed development strategy, integration processes were seen, from the early 1950s on, as key elements for rationalizing the costs of import substitution: both those associated with the absence of competition and those due to the inefficiency deriving from the sub-optimal scale of the industrial plants. A decade later, when the possibilities of exporting manufactures to the industrialized countries began to be perceived, they were likewise seen as a means of building up export experience, as a prelude to winning other markets. Regional integration –the various subregional processes, LAFTA/LAIA, and the Latin American common market, which was the most ambitious project– thus became a decisive element in the “mixed model” advocated by Prebisch and ECLAC

from the late 1950s (ECLAC, 1959). Thus, it was seen as a way of expanding the spaces within which “development from within” could take place, in order to make it more efficient.

The asymmetrical features characteristic of the “centre-periphery” system, the need to adopt active “development from within” strategies (including those designed to deal with the special problems caused by “structural heterogeneity”) and the critically important role of regional integration are thus three central elements in Prebisch’s thinking. In the rest of this paper I shall seek to show their ongoing importance in the development agenda of this dawning twenty-first century.

## 2. International asymmetries

The tendency towards the further expansion of inequalities has been a persistent feature of the world economy for the last two centuries. Empirical studies show that convergence of per capita income levels has been a relatively rare occurrence and has been limited in fact to the most highly industrialized countries in the period after the Second World War and, in particular, during the 1950-1973 “Golden Age”. It was not a feature of the industrialized countries before that war (Maddison, 1991), nor has it been a feature of the developing countries since then (Ros, 2000, chap. 1). There have been episodes of rapid growth in the developing world in certain periods, however. In fact, Latin America was the fastest-growing region in the world between the two world wars, and some Asian countries have led the world in growth in some periods after the Second World War: the oil-producing countries of the Middle East, the “Asian Tigers”, and China and India in different sub-periods (Maddison, 1995). Except in the case of Japan, however, these processes have not brought about convergence with the patterns of development of the industrialized world, and in most cases they have now been interrupted. It may be added that even within Latin America there is no clear tendency towards convergence: the inequalities which grew up a century or so ago have tended to persist over time (Cárdenas, Ocampo and Thorp, eds., 2000a, chap. 1, and 2000b, chap. 1).

The persistence and even accentuation of these international inequalities has occurred despite the impressive industrialization process registered by the developing countries in the last half-century (and even earlier in Latin America). This process has been reflected in greater diversification of the structure of

<sup>7</sup> See, in this respect, three recent versions of the history of ECLAC thinking: Bielschowsky (1998), ECLAC (1998) and Rosenthal (2001). The reasons for this view (now mainly of historical interest) were based on three considerations: i) the transmission costs that the elimination of protection arrangements would cause; ii) the idea that the structure of export incentives could be rationalized to offset the costs of protection, and iii) the belief that there was some degree of complementarity between protection and export development; in particular, where economies of scale existed, the local market served as a “base” for winning foreign markets (an argument that Krugman, 1990, chap. 12, subsequently called “import substitution as export promotion”). Prebisch and ECLAC always acknowledged, however, that high levels of protection could give rise to inefficiency and insoluble anti-export biases.

production of the developing world, except in the most backward areas. Serious imbalances have persisted, however, in the structure of production at the world level: there is a high degree of concentration of technical progress in the centre countries, which has determined their sources of competitiveness; they have continued to dominate the world in the production of machinery and equipment, and they also continue to predominate in the make-up of the great transnational corporations.

The most important consequence of the imbalances in the world economy is that the economic opportunities of the developing countries continue to be largely determined by their place within this international hierarchy. There has undoubtedly been some "spread of technical progress" from the centre, through the channels already mentioned. In the words of Prebisch, however, this spread has continued to be "relatively slow and irregular", and its benefits have been distributed unequally among the developing countries, thus maintaining or even accentuating their "structural heterogeneity". Within the context of the "moving target" represented by the world technological frontier (Pérez, 2001), only a few countries –and few sectors and enterprises within them– manage to move faster and thus reduce their technology lag; many others only manage to more or less keep up with the advance of the frontier, and quite a few fall back.<sup>8</sup>

Furthermore, the vulnerability of the developing countries to external shocks continues to be very high and has even tended to worsen with the growing integration of the world economy. The nature of this vulnerability has been changing over the last half-century, however. Although the transmission of external shocks through trade –both directly, through lower sales, and indirectly, through the cyclical deterioration in the terms of trade– has continued to be important, financial shocks have now taken on the leading role, repeating patterns which had already been observed in the past in many Latin American countries, especially during the financial boom and bust of the 1920s and 1930s.

This vulnerability is the result of basic imbalances in the financial structures and in macroeconomic dynamics, especially the depth of financial development and the degree of macroeconomic autonomy of the countries (Ocampo, 2001c). There are four basic financial asymmetries: i) the disparity between the size

of the financial markets of the developing countries and the speculative pressures they face;<sup>9</sup> ii) the nature of the currencies in which the external debt is denominated; iii) the structures of maturities provided by the financial markets, and iv) the scope of the secondary markets. These last three characteristics mean that in developing countries, those agents who have access to international markets (the government and large firms) are subject to currency mismatches, while those who do not have such access (small firms) are subject to maturity mismatches, but it is generally impossible to secure a financial structure which simultaneously obviates both these risks. All in all, this means that the financial markets of developing countries are much more "incomplete" than the international markets, so that part of the financial intermediation must necessarily take place through the international market. It also means that international financial integration is integration between unequal partners.<sup>10</sup>

The macroeconomic asymmetries, for their part, are associated with the fact that the international currencies are those of the industrialized countries and with the nature of capital flows: whereas the capital flows among developed countries are of a counter-cyclical nature (Eatwell and Taylor, 2000), those between developed and developing countries are clearly pro-cyclical. This behaviour is connected with the residual nature of capital flows to developing countries or, to use the terms coined by Palma (2001), the fact that the latter countries are "debtors of last resort".

The overall result of these factors is that whereas the industrialized countries have more leeway for adopting counter-cyclical macroeconomic policies –and this leeway is even greater in the case of the United States than in the other industrialized economies, since the U.S. dollar is the main international currency–, which thus gives rise to a stabilizing response from the financial markets, in contrast the economies of the developing countries largely lack such leeway, since the financial markets tend to accentuate the cycles and the market actors expect the authorities to behave in a pro-cyclical manner. Looking back over the past, this has meant that whereas the industrialized countries were largely able to free themselves from the rules of the gold standard, those rules continue to determine the macroeconomic behaviour of the developing countries and have even become increasingly influential in this

<sup>8</sup> For recent information on this topic, with regard to Latin America, see Katz (2000) and ECLAC (2001a).

<sup>9</sup> See, for example, Council on Foreign Relations, 1999, chap. III.

<sup>10</sup> ECLAC, 2000, chap. 8, and Studart, 1996.



respect. Thus, the macroeconomic imbalances between the centre and the periphery which were characteristic of the gold standard era (Triffin, 1968; Aceña and Reis, eds., 2000) have been further aggravated. Although multilateral arrangements—especially the intervention of the International Monetary Fund—provide short-term relief, they are aimed at ensuring the adoption of austerity measures during crises: a “depression (macro)economics”, to use the expression of Krugman (1999). To be more specific, the characteristic feature of the economies of the developing countries is the alternation of boom and depression macroeconomics (ECLAC, 2000, chap. 8, and 2001b).

There is also a further asymmetry in the international economy which is associated with the contrast between the growing mobility of capital and the restrictions on the international mobility of labour, especially less-skilled labour. As Rodrik (1997) has indicated, asymmetries in the international mobility of the different factors of production give rise to pressures in income distribution which favour the most mobile factors and adversely affect the less mobile ones. These imbalances have a “centre-periphery” component in that the developing countries have a relative abundance of the least mobile factors of production: unskilled labour and natural resources. Indeed, the absence of international mobility of labour was seen by Prebisch (1951) as a basic flaw in the international economy which played an essential role in the tendency towards the deterioration of the terms of trade of the developing countries.

Finally, it should be added that the international economy is also marked by basic imperfections which are of a “systemic” rather than a “centre-periphery” nature. The first of these is the contrast between the rapid development of markets and the lag in building global governance, which has led to a sub-optimal supply of “global public goods” (Kaul, Grunberg and Stern, eds., 1999). The second is the enormous difference between the rapid globalization of some markets and the flagrant absence of a true international social agenda or, more precisely, the lack of effective international instruments to ensure the fulfillment of the development goals which are periodically reiterated, most recently in the United Nations Millennium Declaration. The third is the incompleteness of the international agenda, which also has, to some extent, “centre-periphery” dimensions, in view of the absence of issues of great interest to the developing countries, such as international mobility of labour or the more rapid opening-up by the developed countries of markets

which are of great interest to the developing nations (Ocampo, 2001a).

The analysis thus indicates that the global agenda should include “systemic” issues, connected with the supply of “global public goods”, as well as those connected with the correction of the existing international asymmetries. These “centre-periphery” issues fundamentally involve correction of the asymmetries in the fields of production and technology, the financial and macroeconomic asymmetries which are responsible for the high degree of cyclical vulnerability of the developing countries, and those associated with the different degrees of international mobility of the factors of production.

After the establishment of UNCTAD, under the direct influence of Prebisch,<sup>11</sup> there was explicit recognition of the need to correct the imbalances which marked, and continue to mark, the international economic system. The pledges with regard to official development assistance and “special and differentiated treatment” for the developing countries in trade were among the partial, albeit relatively frustrating, results of this effort to construct a “new international economic order”. In recent decades, however, this approach has been seriously eroded (ECLAC, 2001c, chap. VIII) and has been replaced with an alternative model whereby the basic goal in reordering the international economy should be to ensure a “level playing field” to guarantee the efficient functioning of the free market forces. In this new scheme, the main benefits for the developing countries lie in the eventual dismantling of the industrialized countries’ protection of “sensitive” sectors, the guarantees offered for export development by an international trade framework with clear and stable rules, and the design of preventive macroeconomic policies which will serve as automatic protection against international financial volatility. In this approach, the aim of correcting international imbalances is only maintained in terms of the acknowledgement of international responsibility vis-à-vis the least developed countries, thus repeating at the international level the idea that social policy should be a strategy designed to target State action on the poorest sectors.

Although all these actions are desirable, will they be sufficient in themselves to give rise to greater convergence of development levels? In view of the foregoing considerations, the answer may be no. This

<sup>11</sup> See, for example, his first report to UNCTAD (Prebisch, 1964).

agenda does not address the asymmetries which tend to generate divergences in development patterns. Moreover, ensuring a “level playing field” implies imposing restrictions on the developing countries, especially the middle-income ones, which the industrialized countries themselves never faced in earlier periods of their history: standards of intellectual property protection typical of countries that generate technology, and limitations on the adoption of policies designed to promote new sectors of production, whether for the domestic market or for export (Chang, 2001). Finally, the problems generated by a manifestly incomplete set of international financial institutions, together with the policy of less intervention in financial markets in order to avoid “moral hazard” and the measures designed to reduce the risks run by large financial agents (the higher risk weighting proposed in the new Basle Committee bank regulation criteria), may end up by helping to “solve” the problem of capital account volatility in the most undesirable way: by bringing about an excessive rise in the cost of external indebtedness for the developing countries and thus possibly leading to a permanent reduction in capital flows to them.

In these circumstances, the design of a balanced international agenda inevitably calls for the correction of the imperfections in the international economic system through action in three areas: i) the application of mechanisms to speed up the “spread of technical progress” from the centre by different forms of “special and differentiated treatment”; ii) efforts by the international financial institutions to increase the developing countries’ leeway for adopting counter-cyclical macroeconomic policies, to check the concentration of credit by placing resources at the disposal of countries and agents which do not have access to credit on private international markets, and to speed up the financial development of the developing countries, as the only way of offsetting in the long term the imbalances that mark the international financial system, and iii) to ensure that international mobility of labour receives the same attention on the global agenda as the international mobility of capital.

### 3. Development from within

In Prebisch’s view, the importance of action to correct the imbalances characterizing the international economic system necessarily involved recognition of the equally important role of the policies adopted by the developing countries themselves to transform their

economic and social structures. Correcting those imbalances would help to establish an “enabling environment” for the efforts to generate “development from within”.

It is now generally recognized, at the institutional level, that a development strategy must help to generate solid social compacts which will ensure political stability; non-discretionary legal systems and forms of behaviour of the agents which will make contracts secure; and an impartial and sufficiently efficient State bureaucracy. Although these institutional frameworks serve as the backdrop for the development process, however, they do not explain the concrete growth impulses that economies receive, nor their exhaustion.<sup>12</sup> These impulses are related more directly with the matters mentioned in the previous sections: the reduction of macroeconomic and financial vulnerability, the rate of change of the structure of production, and the connections between growth patterns and equity, especially the “structural heterogeneity” of the productive sectors.

#### a) *Reducing macroeconomic and financial vulnerability*

As already noted, the emphasis in the first of these fields has been shifting from trade-related matters, on which Prebisch largely concentrated his attention, to those of financial origin. In this respect, Latin America’s experience in recent decades makes it possible to deduce some “stylized facts” which should be borne in mind for designing better macroeconomic policies (ECLAC, 2000 and 2001b; Ffrench-Davis, 1999; Ocampo, 2000):

- i) There is no simple definition of macroeconomic stability. The return to fiscal discipline and low rates of inflation has not been reflected in greater stability in real terms, that is to say, in GDP growth and greater employment. Nor has it been reflected in better results in the external accounts, since private deficits have not been kept under control. Consequently, concern for the soundness of the fiscal accounts must be accompanied by measures to prevent the accumulation of unsustainable private deficits.
- ii) Real stability is also costly. It gives rise to defensive strategies by firms, which put off their investment

<sup>12</sup> In the terminology used by Maddison (1991), they refer to the ultimate causes rather than the immediate causes of economic growth. See also Ocampo (2001b).

decisions, thus causing adverse effects on economic growth. In downward phases of the cycle there are also irreversible losses of both tangible and intangible business assets (“tacit” technological and organizational know-how, trade contacts, reputation of the firm), especially when those phases are accompanied by financial crises. For these reasons, there is an inverse relation between economic growth and real instability. As we shall see below, serious social imbalances are also generated during the cycle.

- iii) In financial matters, balance sheets are just as important as flows. Financial crises have been originated not only by unsustainable current account deficits, but also by unsuitable financial structures in the public and especially the private sectors: that is to say, structures which have an excessive proportion of short-term liabilities or are open to risks from higher interest rates or rates of devaluation.
- iv) In the absence of a fiscal policy with a medium- or long-term horizon, backed up by suitable institutions (stabilization funds), keeping fiscal deficits low is really a pro-cyclical policy approach. It encourages expansion of spending during boom periods on the basis of transitory public revenue. Subsequently, however, the cuts made due to short-term falls in revenue aggravate crises and thus lead to further reduction of public sector revenues.
- v) In the developing countries, monetary policy autonomy is limited under all exchange-rate regimes. This fact has always been recognized in connection with fixed or semi-fixed exchange-rate systems, but in fact the same thing occurs when interest rates are managed in a pro-cyclical manner in flexible exchange-rate regimes in order to avoid exchange rate fluctuations. In view of the vital role played by the exchange rate in open economies –it is a determinant both of competitiveness and of price levels– some degree of intervention in foreign exchange markets may be necessary, but pro-cyclical management of interest rates is undoubtedly the wrong road to follow. For this reason, in spite of its limitations prudential regulation of capital flows can do a lot to increase the autonomy of monetary policy.
- vi) Credibility is not necessarily attained by the use of “automatic pilots”. If capital flows are pro-cyclical, explicit renunciation of monetary policy autonomy (as for example by adopting systems based on a currency board or the use of a foreign

currency as an anchor) can result in more severe economic cycles. In that case, it is quite possible that the market may not validate the hypothetical increase in “credibility” by reducing the country risk accordingly. Furthermore, the country loses some degree of freedom to cope with external or domestic shocks. In both cases, the private agents may question the sustainability of the rules themselves and the high costs of breaking them. Prudent management of macroeconomic flexibility may therefore be a better way, in the long run, to build up greater policy credibility than the adoption of excessively rigid rules.

These lessons indicate that the concept of macroeconomic stability should be expanded to include not only price stability and the maintenance of low fiscal deficits, but also stability of economic growth rates, employment, the external accounts and the national financial systems, as well as the use of pluriannual horizons in fiscal policy design. They also mean that it must be recognized that the authorities are faced with complex dilemmas in seeking to ensure macroeconomic stability in this broad sense of the term, since there is no simple, straightforward association between its different components.

The most promising approach in order to achieve this result would appear to be to pragmatically combine three sets of policies. The first of these is made up of consistent but flexible macroeconomic policies –fiscal, monetary and exchange-rate– designed to prevent the public and private agents from building up heavy debts, to avoid the generation of imbalances in the most important macroeconomic prices (the exchange rate and interest rates) and in the prices of fixed assets and securities in boom periods, and to facilitate reactivation in the event of crises. The second is a stringent system of prudential regulation and supervision of financial systems, with a clear counter-cyclical orientation, which provides for stricter rules in periods of financial euphoria in order to counteract the increasing risks run by intermediaries at such times. The third element is a “liability policy” designed to ensure that a suitable profile of internal and external debt maturities is maintained in the public and private sectors (ECLAC, 2000, chap. 8; Ocampo, 2000).

Prudential regulation of the capital account, applied in periods of euphoria in order to prevent over-indebtedness, can play a vital role as a “liability policy”, promoting an external finance structure in which long-term liabilities predominate, but also, as already noted,

as an instrument designed to give monetary policy more leeway to adopt counter-cyclical policies. In the long term, however, the main instrument for breaking the asymmetries typical of the international financial system, which are accompanied by the pro-cyclical macroeconomic performance of the developing countries, is deeper financial development in those countries which will ensure suitable development of the long-term segments of the market and of the corresponding secondary securities markets.

Applying counter-cyclical macroeconomic policies is no easy task, since the international financial markets generate strong incentives to over-spend during periods of financial euphoria and over-adjust during crises. For this reason, counter-cyclical macroeconomic policies of the developing countries must be backed up by suitable international institutions. In particular, international financial institutions must take on the essential function of offsetting the pro-cyclical effect of the financial markets, damping down financial cycles from their source by suitable regulation in the industrialized countries, and must also give the countries more leeway to adopt counter-cyclical policies, both through suitable surveillance and incentives to reduce macroeconomic and financial risks at times of euphoria, and through mechanisms to soften adjustments when there are sudden interruptions in capital flows (Eatwell and Taylor, 2000; Ocampo, 2001c).

#### b) *Dynamic changes in production patterns*

Greater macroeconomic stability, even in the broad sense in which we have defined this term, is a necessary but not of itself sufficient condition for rapid economic growth. This is precisely what the various historical variants of structuralist economic thinking, to which Prebisch belongs, are trying to get across when they emphasize that different economic sectors have very different capacities to "spread technical progress" and, ultimately, boost the economy, generating a strong interaction between structural change, investment and economic growth. In this view, the leading role played by some sectors and companies, which form the "dynamic nucleus" at any given point in time, is the essential element in economic growth.

Many schools of thought have analysed the features of these structural dynamics. Some of them have noted that, because of the complementarity (linkages) between production firms and sectors, the macroeconomic and distributional effects of the growth

of a sector can give a strong boost to the growth process or, alternatively, halt it (Rosenstein-Rodan, 1943; Taylor, 1991; Ros, 2000). These sectoral dynamics can give rise to successive phases of imbalance, as noted by Hirschman (1961). Technological dynamics can also give rise to processes of "creative destruction", to use the terminology of Schumpeter (1962, chap. VIII). Since technical knowledge, and indeed knowledge in general, is not transmitted through detailed manuals, the growth path of firms involves an intense adaptation and learning process which is intrinsically linked with the experience acquired in the production process and largely determines the capacity for the accumulation of technical, commercial and organizational know-how (Katz, 1976; Amsden, 2001).

Although other formulations could be used, one which captures the essence of structural dynamics centres on two fundamental concepts: i) innovations and the associated learning processes, and ii) the development of production linkages (ECLAC, 2000, chap. 9; Ocampo, 2001b). In this context, "innovation" must be considered to cover every new way of doing things: not only new technologies, but also the development of new sectors or products, new marketing strategies, and the opening of new markets. In the developing countries, many of these "innovations" are associated with the successful adaptation of technologies and activities developed earlier in the industrialized world, in this case through import substitution and/or export promotion. All innovations, in this broad sense of the term, involve learning and dissemination processes, many of them marked by the generation of dynamic economies of scale. This also applies to technological innovation and the development of new productive sectors, as well as new marketing networks, in which such economies are associated with the reduction of transaction costs over time. The second concept highlights the role of the externalities which the economic agents and sectors generate among themselves (Hirschman, 1961) and which determine the degree of "systemic competitiveness" of the relevant production structures (ECLAC, 1990).

These ideas have been used recently by a number of authors to bring out the need for a production development strategy as a fundamental ingredient of a dynamic developing economy, a long-standing subject in the literature on "late industrialization". In line with an old tradition in industrial policy, Chang (1994) has highlighted the importance of lowering the "coordination costs" associated with the development of new sectors subject to substantial complementarities.

Rodrik (1999) has pointed out the importance of a “national investment strategy” which would make it possible to give an initial boost to growth, while ECLAC (2000) refers to the need to adopt a structural change strategy. Amsden (2001), for his part, has emphasized the crucial importance of close collaboration between the State and the business sector and the need for “mutual control mechanisms” which establish a link between incentives and results, so that incentives do not simply become a source of “rent-seeking”.

This interpretation brings out one of the most important characteristics of successful cases of development in the past: a strong industrialization drive based on firm and close collaboration between the State and the private sector. Can it be that the opening-up of markets will do away with the need for active production development policies?

The results obtained so far in Latin America are not very encouraging in this regard as in the last decade of the twentieth century, the fastest export growth in the economic history of the region was accompanied by only mediocre economic growth. The “destructive” elements deriving from the disintegration of domestic production linkages and national innovation systems have been stronger than the opportunities generated by the expansion of transnational corporations or export development patterns which make highly intensive use of imported inputs or natural resources (ECLAC, 2001a). Figure 1 sums up this situation, showing that the economic growth rate in the 1990s was over two percentage points lower than that of the 1950s to 1970s, but gave rise to a trade deficit similar to that of the 1970s and higher than that of the two earlier decades. Furthermore, as noted in UNCTAD (1999, chap. IV), this adverse shift in the relation between economic growth

and the trade balance is virtually universal in the developing world.

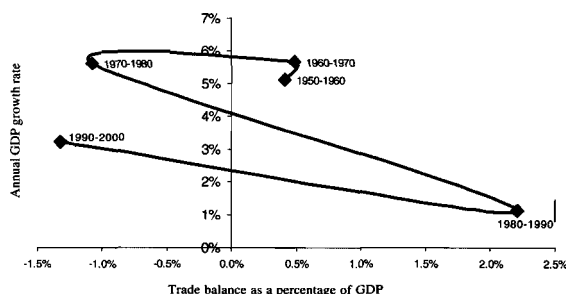
All this emphasizes the importance of combining macroeconomic stability, in the broad sense, with an active production development strategy. According to the foregoing considerations, the two essential elements of such a strategy are: i) to speed up the rate of innovation, including the transfer of technology, the development of new production sectors and the conquest of new markets, and to support the learning processes involved in all these processes; and ii) to promote the reduction of coordination costs in order to exploit the synergies between enterprises and production sectors which help to generate “systemic competitiveness”. This policy requires a considerable institutional and organizational effort in order to develop the right instruments for today’s open economies, with a view to playing an active part in international markets. These efforts will have to be all the greater to the extent that the old intervention arrangements have been dismantled or significantly weakened during the liberalization phase of the economies in question.

A policy of this type also requires that the international community should recognize that such strategies are an essential component for dynamic growth of the developing countries. In the light of the problems currently being faced by those countries in seeking to bring about a dynamic change in production patterns, this means that “special and differentiated treatment” must be given in three areas: i) intellectual property protection schemes which help to promote the transfer of technology; ii) temporary promotional arrangements for import substitution industries; and iii) especially in the present conditions, temporary promotional arrangements for new exports (“infant export industries”), through the use of incentives designed to diversify the exportable supply and mechanisms to make it possible to increase the national content of exports (for example, through sectoral agreements backed up by agreements on export performance). All this obviously means seeking the right instruments to ensure that these mechanisms do not give rise to sterile competition among countries to attract industries that are candidates for relocation.

### c) *The effects of economic changes on equity*

The deep significance of Prebisch’s observations on the difficulties that industrialization has faced in the developing countries in general, and in Latin America in particular, in

FIGURE 1  
The trade balance and GDP growth rates



Source: ECLAC.

absorbing labour is shown in figure 2. Both at the beginning (1950) and the end (1980) of the most rapid industrialization phase, the share of industrial employment in total employment in Latin America was nearly ten percentage points smaller than that which had been displayed by the countries of the Organization for Economic Cooperation and Development (OECD) when (about half a century earlier) they were at the same levels of per capita GDP. Excess labour was absorbed first by the rural sector, but by 1980 the majority of the labour force was employed in urban services. In the light of the form of absorption of excess labour that characterized the mid twentieth century, Prebisch (1951) associated that phenomenon with the deterioration of commodity prices. Three decades later, it had become a source of pressure on urban income distribution in Latin America.

The concept of “structural heterogeneity” developed by Pinto (1970) to take account of this phenomenon is undoubtedly preferable to the traditional concept of “dualism”, because the heterogeneity characteristic of developing countries and societies cannot be described simply in terms of the contrast between a “modern sector” and a “traditional sector”, since low-productivity sectors are constantly arising and changing, and only a few segments that lag behind can be defined as “traditional”. This is what happened in Latin America in the 1990s: the region generated more “world-class” firms (many of them subsidiaries of transnational corporations) capable of successfully integrating into the world economy, but at the same time there was an increase in low-productivity activities, which absorbed seven out of every ten urban workers (ECLAC, 2001a and 2001d).

Structural heterogeneity means that there are no automatic mechanisms which will ensure that rapid

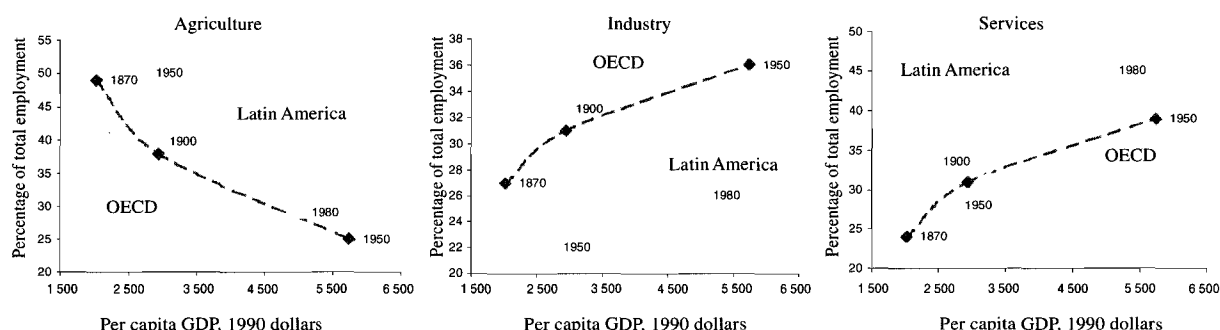
technological innovation in dynamic sectors will promote general economic growth. In the absence of suitable internal linkages, or when the “destructive” effects of production restructuring and the defensive microeconomic strategies that accompany them are predominant, structural heterogeneity can even become more pronounced. If this happens, the effects on economic growth will only be weak and there will be still further pressures on employment and equity (see for example Taylor and Vos, 2001).

The linkages between the modernized dynamic sectors and the rest of the economy are therefore important not only for growth but also for equity. Production development strategies can play a fundamental role in promoting such linkages. The evidence also shows that good distribution of assets which gives rise to a universe of solid small enterprises is associated with better income distribution and less concentration of power in general. Policies designed to democratize the access of small urban and rural producers to production assets –capital, technology, training and land– are therefore of the greatest importance, both in terms of growth and of equity.

In addition to these linkages of a structural nature, there are also others associated with macroeconomic volatility: the serious asymmetries in the social effects of business cycles. Thus, in the downward phases of cycles jobs are destroyed and there is an increase in poverty, but when the economy returns to the pre-crisis level of per capita GDP, this does not necessarily mean that there is a return to the previous levels of unemployment or poverty. This is certainly what Latin American history of the last two decades shows: although in the mid-1990s per capita GDP returned to the levels of before the debt crisis, even by the end of

FIGURE 2

### Sectoral structure of employment: Latin America 1950-1980 and OECD 1870-1950



Source: Maddison (1989, 1995).

the decade the pre-crisis levels of poverty had still not been restored. It may be added that at the level of the individual, unemployment has a permanent effect on workers' careers: the loss of working experience, reputation and connections means that when workers find employment again they earn significantly lower wages or else are only able to enter the labour market again through self-employment activities (ECLAC, 2001d). The problems are obviously even more serious when the need to contribute to the family's income forces young people to abandon their studies, thus permanently affecting their future careers. Furthermore, when there are no institutions to protect workers against unemployment, unstable demand for labour is in itself costly in social terms.

These interconnections of economic growth patterns with equity highlight a basic fact: equity undoubtedly depends on very active social policy, but it does not depend solely on that. The rate and stability of economic growth are also important, and so too in particular is the way in which patterns of change in the production sector help to reduce or increase "structural heterogeneity". For this reason, even ambitious efforts in the field of education will be futile unless there is dynamic generation of good-quality jobs. When this is absent, the hypothetical connections between human capital accumulation and growth do not materialize, and instead there is still greater "educational devaluation" (occupation of the same jobs by persons of a higher educational level) or emigration of well-educated labour abroad.

The persistent and even increasing levels of urban informal employment and the increase in non-permanent jobs clearly show the importance of universal, solidary and integral social security policies which include measures to incorporate informal-sector workers and (depending on the degree of development of the countries concerned) to advance towards the provision of unemployment insurance. It is also important to initiate arrangements to promote greater adaptation of the labour force to technological change and to business cycles, so that unemployment will not be the basic means of adjustment: especially arrangements that combine aggressive labour training policies with a "social dialogue" at the national, sectoral or enterprise level in order to restructure production sectors within a framework of stable employment (ECLAC, 2000, chap. 5). Social safety nets and permanent schemes for the timely initiation of emergency employment programmes should be viewed, in this context, as intermediate arrangements that should

develop, in the long term, into integral social security systems.

The above-mentioned interconnections also show the importance of designing integrated policy frameworks. One of the weakest points in this respect is the lack of institutions that facilitate this. In the last two decades there has even been a tendency to strengthen the macroeconomic institutions disproportionately, not only over the social institutions but also over those responsible for production development policies. It is therefore necessary to radically reorient the institutional schemes in order to build up systems which make possible coordination between the economic and social authorities, in which social priorities are incorporated as a central part of economic policy design, and which make visible both the immediate and the structural social effects of economic policies.

It should be noted that the foregoing considerations do not of course cover all the positive linkages that can exist between equity and development: apart from the interactions between human capital and good-quality employment and the beneficial effects of better distribution of production assets, there are also favourable economic policy linkages, positive effects on the capital market, and links between social cohesion, investment and productivity. The relations between equity and development were one of the favourite subjects of the development literature of the 1960s, and fortunately they have also come to occupy a leading place in recent economic debate (see for example Ros, 2000, chap. 10). It may be noted, however, that not all connections are positive. Thus, Prebisch's later work (Prebisch, 1976, 1981 and 1987) is full of reflections, based on the Latin American experience of those years, on the way in which pressure on wage levels and public expenditure can generate forms of macroeconomic instability which end up by interrupting economic growth.

#### 4. Regional integration

In the classical views of integration associated with Prebisch's thinking, the history of Latin American integration holds a double paradox. On the one hand, the protectionist forces which prevailed in the region in the 1960s and 1970s gave rise to integration processes which fundamentally restricted their scope to non-competitive sectors. Thus, one of the fundamental virtues of integration, the rationalization of import substitution (ECLAC, 1959), was only achieved to a very

limited extent. Moreover, during the debt crisis of the 1980s the regional integration schemes were on the point of collapsing because of the generalized use of protection and competitive devaluation as means of adjusting the economies.

The vigour displayed by the regional integration process from the late 1980s on was likewise paradoxical, for in the most orthodox views that dominated development concepts at that time integration was seen as a source of distortion of trade flows. The fact that unilateral trade openness coincided with the revitalization of regional integration was therefore a belated concession to the views which had served to justify regional integration in previous periods and, in particular, to the idea that integration was a source of creation rather than diversion of trade and, moreover, a source of trade flows with a greater content of technology than those resulting from unilateral openness.

These virtues have in fact materialized in practice. Thus, the growth of intra-regional trade was extremely vigorous between 1990 and 1997, especially in the two South American integration agreements—MERCOSUR and the Andean Community—where such trade grew by a factor of 5 and 4.2, respectively, during those years. As a result, there was a reversal of the historical situation whereby the intensity of intra-regional trade was greater for the smaller economies. By 1997, the greatest relative intra-regional trade flows were in MERCOSUR. All the regional integration agreements still have a long way to go, however, if the yardstick is the European Union, where intra-regional trade has represented around 60% of total trade in recent decades. It should also be noted that intra-regional trade suffered a pronounced drop with the Asian crisis. The hardest-hit flows were those among South American countries, but these recovered strongly in the year 2000. This indicates that the elasticity of such trade to economic activity is now very high (ECLAC, 2001c).

Furthermore, the intra-regional trade flows consist to a substantial extent of manufacturing goods, especially those of higher technological content. This pattern is particularly evident if we exclude Mexico, whose sales of manufactures to the United States have grown rapidly since the signing of the North American Free Trade Agreement. In 1999, for example, 81% of intra-regional exports corresponded to manufactures, compared with 65% of total external sales (excluding Mexico). The contrast is even greater when only non-traditional products are included. In this case, intra-regional trade then absorbed 35% of exports of

manufactures, concentrated in products with the highest content of technology.

The view that there is a relation of complementarity between general trade openness processes and integration was branded by ECLAC (1994) as “open regionalism”. This complementarity indicates that, in spite of the advances made in information and communications, external economies and economies of scale (including economies of specialization) and the transaction costs associated with geographical distance continue to be substantial. The latter include not only transport costs, but also those associated with the establishment of trade networks, especially those involving small and medium-sized firms. Regional processes also make it possible to advance further in the harmonization of the rules affecting economic activity and to promote deeper economic relations which also have effects on trade. This is why regional networks create additional trade, over and above that created through unilateral trade openness.

It should be noted, however, that the new regionalism differs from similar efforts made in the past because of the increased number of areas of action involved and the scope of tariff liberalization. Nevertheless, efforts to secure convergence of the existing agreements in order to form areas of larger relative scale and measures to build up customs unions continue to be pending issues, and the existing institutions are still somewhat fragile.

In addition to trade itself, the future of regional integration also clearly depends on the “depth” of the corresponding agreements. In this era of globalization, the space available for regional-level arrangements depends on two different forces. The first of these is the tendency towards the weakening of national autonomy, which means that the efficacy of policies is shifting to the regional or global levels. The second is the relative weight, in these processes, of two factors: i) the regional (rather than the global) scope of the “public goods” that it is sought to promote; if they are not of truly global scope, the principle of subsidiarity would indicate that they should be handled at an intermediate (regional) level; ii) the capacity of the different institutions to generate a sense of “ownership”; from this point of view, the subregional and regional levels are at a marked advantage.

In macroeconomic and financial matters, the loss of autonomy is obviously an ongoing process, so that, as we already noted, there is a need not only for global action, but also for arrangements at the regional level. Possible coordination of macroeconomic policies could



be a first area for action. Indeed, the demand for action of this type has been heightened by the great vulnerability of intra-regional trade to the recent business cycles. However, the difficulties involved in this process have been brought out clearly in the three decades of experience accumulated by the European countries in this field. In the short term, therefore, the objectives in this respect should be relatively modest.

A measure which is highly complementary to the foregoing would be the establishment of mechanisms to coordinate policies for the prudential regulation and supervision of financial systems. A desirable objective in this field would be the development of mechanisms for the mutual supervision of such policies and, perhaps, the design of minimum standards which are more specific than those of the Basle Rules. The fact that some of the main international banks are operating in a number of countries of the region further emphasizes the importance of coordination in this area, in order to secure more suitable regulation and supervision and to avoid arbitrage by these banks between different regulatory systems.

As emphasized in ECLAC (2001b), similar attention should be given to the development of regional and subregional financial institutions. In this respect, Latin America and the Caribbean already possess important assets in the form of a network of multilateral development banks comprising the Inter-American Development Bank, the Andean Development Corporation, the Central American Bank for Economic Integration, and the Caribbean Development Bank. Furthermore, the experience already built up by the Latin American Reserve Fund (FLAR, formerly the Andean Reserve Fund) opens up the possibility of giving support to countries in crisis with extraordinary resources of regional origin, either through significant expansion of the membership and resources of FLAR, or through mutual support arrangements (through swaps) between Central Banks.

The advance of trade itself also creates a demand for harmonization of the different regulatory schemes. This includes harmonization of technical regulations (including phytosanitary regulations), customs codes, government purchasing standards, and those governing the supply of services. Some progress has already been made in some of these fields in the region. It is also important to make similar progress in other fields, especially as regards rules on competition and the regulation of public utilities. With respect to the first-named of these, it may be noted that there are reasons for believing, on the basis of the experience of Europe,

that as common markets and an active process of intra-regional investment become more firmly established, regional agreements on competition, and the eventual adoption of a common policy on competition, have obvious advantages over rules on unfair competition which apply solely to foreign trade. Among other things, a framework of this type would also make it possible to cope more effectively with possible anti-competitive practices by big transnational corporations.

Furthermore, the considerable proportion of goods with a high technological content in intra-regional trade points to the possibility of joint action to develop the corresponding sectors, but of course without the rigidities of the old (and mostly unsuccessful) sectoral complementation agreements. Such action should rather form part of broader schemes to complement the efforts being made in the field of technological research and development, which should also serve as a means for the transfer of technology to the relatively less developed countries.

In the area of physical infrastructure, in addition to developing harmonized rules on transport, energy and telecommunications it is extremely important to develop infrastructural networks conceived with a view to regional and not solely national integration. The development of infrastructure with this aim in view also highlights the need to visualize spaces as common rather than purely national. An interesting case in this respect was the establishment in 1994 of the Association of Caribbean States, in order to promote greater cooperation in that subregion. Steps have also been taken towards this type of objective in the case of sustainable development, specifically of shared ecosystems (the Amazon and Andean areas, or the Mesoamerican Corridor) or river basins. The establishment of various plans for border area development is another example of the change caused by integration.

Going beyond all this, there are also the immense possibilities opened up by social and political integration. The agreements on cultural matters and education—some of them associated with the first stages of integration—are only the first small step towards an integration agenda centered on social development. The “democratic clauses” of integration agreements and the various forums in which the Heads of State of the region now meet, together with the incipient subregional and Latin American parliaments, are further examples of promising initiatives on the broad agenda of political integration.

These considerations show that regional integration, based on the principles of open regionalism, has a

promising future whose actual materialization will depend on the political will of the parties concerned. Indeed, their ability to survive within a hemispheric free trade area or within the process of globalization will depend on their capacity to deepen their achievements by further developing the agenda outlined above.

At all events, Prebisch's categorical admonition continues to be fully valid, not only in relation to trade but also to the international economic (and political) system as a whole: "There is an aspect of fundamental importance to which the governments of the developing countries have not paid sufficient attention. We have

not yet managed to break out of the isolation these countries inherited from the old pattern of the international division of labour. Thus, the greater part of world trade has been among the centres themselves. The trade of the developing countries has converged on those centres, overlooking the enormous potential of mutual trade, although it should be recalled that, ever since its earliest days, ECLAC has vigorously advocated such a structural reform of world trade" (Prebisch, 1987, p. 29).

(Original: Spanish)

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# Prebisch: the continuing *validity of his basic ideas*

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## 1. Introduction

Prebisch's analytical contributions, which are particularly valuable and numerous in the fields of development theory and policy, have sometimes been called "pre-economics". This term is used to denote those points of view which seem to be based on and justified by common sense—for example, the desirability of industrialization and of the application of protection in order to achieve this—but which are at variance with conclusions backed up by economic science.

The present article takes an opposite view to this. It begins by briefly presenting Prebisch's seminal ideas—that is to say, the so-called "centre-periphery concept"—, going on to show succinctly that those ideas are reshaped and formalized in both economic theory and policy analyses based on the patterns of coherence of conventional economics (section 2). His basic ideas and their subsequent formal expression thus form a special field of economic theory which may be termed a "theory of underdevelopment".

This latter theory forms the main basis of Latin American structuralism. In reality, however, the true importance of that theory—that is to say, of the set of contributions by Prebisch which make it up—becomes

"manifest" in its appropriateness for analysing some of the priority issues of recent Latin American development (section 3). In the light of certain notable aspects of the current technological revolution and the globalization process that accompanies it, these contributions are useful for addressing problems which seem to be getting worse, such as unemployment and underemployment, and others which repeatedly arise in the external sector. Furthermore, these conceptual bases are also useful as a framework for the debate on the conditions of viability and efficiency needed to renew the development effort.

The application of Prebisch's ideas and contributions to the present situation highlights their key (and also general) substrate: the perception of development as a dynamic of the structures of production of goods and services and of labour force employment: that is to say, as a set of changes in the sectoral and subsectoral composition of those structures which are inherent to their expansion and growing complexity.

If we go along with Prebisch's view that the market is not capable of inducing these changes alone, this means that the structural perception of development referred to earlier is hence "non-reductionist": that is to say, it is a perception whereby the analysis of economic phenomena must fit within a broader framework of social and political phenomena. This methodological implication means that we must reconsider the whole matter of the State and question

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certain quasi-minimalist positions on its role, which seem to be compromising the development of various Latin American countries and adversely affecting the already serious levels of inequality prevailing in the region.

## 2. Main contributions

The concept of the centre-periphery system was originally expressed in the essay entitled "The economic development of Latin America and its principal problems", which was republished a little later in the first five chapters of the *Economic Survey of Latin America, 1949*.<sup>1</sup>

It will be seen below that this concept consists of a set of ideas of a general nature expressed at a pre-analytical level and thus not representing a fully formalized theory. They are clearly harmonious and complementary to each other, however, and form a new view of underdevelopment or, rather, of the characteristics and long-term evolution of the so-called underdeveloped economies in the period immediately after the war.

Prebisch refused to consider as an anomaly what he saw, in his experience, as a way of being.<sup>2</sup> He understood that underdevelopment cannot be identified with a mere state of backwardness, often attributed to the burden of non-economic factors supposedly connected with the social structure. Rather, he saw it as a pattern of operation and evolution specific to certain economies and thus deserving of a likewise specific effort to develop a corresponding theory.

This effort hinges fundamentally upon the identification of a basic content –that is to say, of a general view of the object of investigation– and takes this as its starting point.<sup>3</sup> This view –or the basic concept mentioned earlier, which amounts to the same thing– may be briefly described through three key concepts:

<sup>1</sup> The first of these publications dates from late 1949 and the second from early 1950. Hereafter, however, the quotations from them will refer to the publications listed in the bibliography as Prebisch (1962) and Prebisch (1973a).

<sup>2</sup> This experience is directly and specially related to the important functions he was called upon to discharge in the management of the Argentine economy during the 1930s crisis and the Second World War: especially putting into operation the Central Bank of that country and acting for a long period as its Director. For a short description of this see Rodríguez, 2001, pp. 100-104.

<sup>3</sup> The term "view" is used here in the sense given to it by Schumpeter (1971, p. 78) in his *History of Economic Analysis*. This term expresses and sums up the point of view that every new theory, or every renovation in depth of an existing theory, begins when a set

heterogeneity, specialization and unequal development.<sup>4</sup>

### a) Structural heterogeneity

Structural heterogeneity refers to a prime characteristic of peripheral economies: the simultaneous existence in them, on the one hand, of activities and/or branches of production in which the average productivity of labour is normal, in that it is relatively close to that permitted by the available techniques, together with others in which productivity is quite high, in that it is relatively similar to that prevailing in the main industrial centres, but also, on the other hand, substantial numbers of technologically backward activities in which the levels of productivity are very limited: well below those of the other, "modern" activities.

Of these two broad classes of activities, the former generate true employment, while the latter are responsible for underemployment. This simultaneous existence of true employment and underemployment –of one labour force where productivity is high, side by side with another where it is low– is a directly visible expression of structural heterogeneity.<sup>5</sup>

The basic concept also accepts the fact that underemployment tends to persist over time. In essence, underemployment reflects a huge supply of redundant labour whose dimensions seriously compromise the possibility of rapid absorption of the labour force as a whole into activities with normal or high levels of productivity. Continuing to view this from the supply

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of key hypotheses is assembled which express the fundamental content of the new ideas. It is from such a basic content that different formal expressions are developed –different formal theories structured with academic rigour– in whose construction the original content is reshaped and refined.

<sup>4</sup> Using these concepts, sections 2a, 2b and 2c below refer briefly to the content of Prebisch's basic concept. Section 2d, for its part, refers to various works by Prebisch himself in which this content was progressively formalized. These works are mentioned in order to "manifest" the decisive importance of his contribution to Latin American structuralism. There is no intention, of course, of belittling the great contribution made to this approach by ECLAC and various authors associated with it.

<sup>5</sup> The underemployed, employed and openly unemployed make up the economically active population (EAP). It should be noted that the first of these three categories is defined solely and strictly on the basis of the physical productivity of labour, so that although it may come close, the notion of underemployment does not coincide with "informality" or "marginality". This differentiation does not mean denying that they all seek to take account of phenomena related with social exclusion in peripheral economies such as those of Latin America.

side, this redundancy is also seen to be associated with demographic variables, that is to say, the increase observed in the growth rates of the population as a whole and the active population of peripheral countries when their mortality rates go down, while their birth rates take longer to decline. From the point of view of demand, it may be noted that the labour-saving nature of the technical progress originating in the main centres and the relatively small rates of accumulation and growth that can be reached on the periphery also make it more difficult for underemployment to be converted into employment there.<sup>6</sup>

Underemployment persists in the stage in which the development of the periphery comes to be led by expansion of the industrial sector. Although it persists, however, there are significant changes in its composition in this stage. The attraction exerted by the cities, or the straightforward expulsion of labour from backward agricultural activities, mean that in urban areas the percentage of the labour force which is underemployed (employed in low-productivity occupations) is higher than nationwide underemployment, while in rural areas it is correspondingly lower. In other words, over time structural underemployment shifts from rural to urban areas, while nevertheless remaining a key expression of heterogeneity.<sup>7</sup>

<sup>6</sup> The persistence of structural underemployment is referred to in Prebisch, 1973a, pp. 69-70.

<sup>7</sup> For an early overall reference to the problems of the periphery connected with the agricultural sector, see Prebisch, 1973b, pp. 47-51 (the first version appeared in 1951). This document contains the following telling assertions: "This is a very important aspect of the problem of the spread of technical progress in Latin America, but has not yet been given all the attention it deserves. It is possible that, because of the shortage of capital to absorb the surplus labour force caused by agricultural mechanization, the saving of labour may have led ..... to poor employment in rural areas or big concentrations of city-dwellers .....". "Not much can be done to raise the standard of living of the masses tilling the soil (especially the poor soil of traditional agriculture) unless the redundant rural population due to technical progress is eliminated and that part of it which is not needed for working the new land opened up for cultivation is reabsorbed into activities with satisfactory levels of productivity". It may be inferred from such assertions that the process of structural change that makes up development is linked with the transformation of the peripheral economies from rural to urban and from agricultural to industrial. The employment problems of those economies are likewise seen to be linked with such changes. By way of example, it may be noted that in Brazil in 1960, underemployment affected nearly 50% of the working population and about three-quarters of it still corresponded to agricultural underemployment.

#### b) *Production specialization*

The specialization of the production structure of the periphery was originally connected with the long period in which its growth depended on the export of foodstuffs and raw materials. Later, when industry spontaneously became the main source of growth, the initial primary export specialization conditioned the new pattern of development. This specialization at the starting point (in extreme cases, the almost exclusive production of primary exports and almost complete absence of exports of manufactures) means that industrialization progresses from simple to more complex levels. In other words, a country begins by producing simple consumer goods and only gradually progresses to the production of more technologically complex goods: consumer durables, intermediate goods, and certain capital goods.

Precisely because countries begin with simple goods and then gradually embark on the production of other goods located "further back" in the production chain, the pattern of industrial development peculiar to the peripheral countries means that the specialized nature of their production structure is maintained, because in view of the initial specialization of the export sector in primary commodities and the need to progress from simple to more complex levels typical of that pattern, the degrees of intersectoral complementation and vertical integration of production achieved by the periphery are only small or incipient.

The foregoing basic argument is clarified and complemented if we take into account Prebisch's assumptions on technical progress, which he perceived as a variable exogenous to the economy. He also accepted that such progress is more rapid in industry than in primary production, and also more rapid in industrial activities situated "further back" in the production chain, especially in the production of capital goods, in which it is embodied. This acceptance means that the industrialization of the periphery repeatedly has to progress from simple to more complex levels, since it is obliged to embark on activities in branches where technical progress is slower. This means, in turn, that the specialization of the periphery persists, while its possibilities of achieving greater intersectoral complementation and vertical integration of production are repeatedly limited.<sup>8</sup>

In addition to the low level of initial development of industry, the new specialization aspect just mentioned

<sup>8</sup> With regard to these views on technical progress, see Prebisch, 1962, pp. 1 and 4.

has some other noteworthy connotations. On the one hand, there is repeated difficulty in exporting manufactures and thus achieving successive increases in the value of total exports.<sup>9</sup> On the other, there tends to be ever-increasing growth of imports, because of the low level of complementarity of domestic production and/or the demand for imports of goods located “further back” in the production chain, because of the low level of vertical integration. These implications of specialization, regarding the behaviour of exports and imports, lie of course at the root of the persistent tendency of the peripheral countries to register trade deficits, which are repeatedly observed during the process of spontaneous industrialization. This tendency is also responsible for the fact that external saving –i.e., the inflow of foreign capital– can only make a limited and supplementary contribution to the development of the periphery.<sup>10</sup>

### c) *Unequal development*

The unequal (bipolar) nature of development in the centre-periphery system is related primarily with the special structural features described in previous sections. These features mean that the production structures of the peripheral economies keep on changing over time, especially during the stage in which the expansion of industry spontaneously acts as their leading source of growth.<sup>11</sup> As pointed out in the

previous observations, however, even after they have been changed these structures continue to be heterogeneous and specialized. Those characteristics and their persistence are in marked contrast with those of the great industrial centres: the latter also go through ongoing changes and become more complex, but they maintain or even further increase their already comparatively high degrees of homogeneity and diversification.

Development in the centre-periphery system is also unequal in a second respect: average income (per employed person and/or per capita) tends to differ considerably between its two poles. The reason for this difference is the disparity between the growth rates of the productivity of labour, which is higher in the centres because technical progress is faster in them. Another factor which operates in the same direction in peripheral economies is the persistence of heterogeneity in them: that is to say, the existence of great masses of workers employed in very low-productivity activities, which adversely affect average productivity. A further factor which causes average incomes to be lower is the deterioration in the terms of trade,<sup>12</sup> for the decline in the relative prices of the peripheral countries’ exports means that in the sectors producing those goods the workers’ income increases less than the productivity of labour. The opposite is the case, however, in the export sectors of the central economies.

It is easy to see that the differences in incomes and the inequalities of the production structures are related with each other. The differences in incomes, like the unequal performance of labour productivity levels and the deterioration in the underlying terms of trade, mean that the peripheral economies are weak in terms of their capacity to achieve and maintain high rates of accumulation. It will likewise be readily understood that this weakness makes it harder for those economies to overcome their structural backwardness or, more precisely, adversely affects their possibilities of gradually reducing their prevailing heterogeneity and specialization. In turn, the persistence of such structural conditions means that there will also be a tendency for the inequality of average incomes to persist between the two poles of the system.

<sup>9</sup> The difficulty in achieving such increases is also connected with the decline in primary commodity prices that would result from a major increase in their volume, because of the low income-elasticity of the demand for them in the main centres.

<sup>10</sup> A growth pattern (the most simple in analytical terms) in which no effort is made to export manufactures would mean that industrialization would have to progress with a gradual decline in the export coefficient and the degree of openness to the exterior. It can be demonstrated that reduction of the share of foreign ownership in the total assets of the periphery (defined as the percentage ratio between the total value of that property and the value of the external debt regarding that total) is a logical requisite for continued growth, in the growth pattern in question. Such a requisite must also be satisfied in analytically more complex cases where both coefficients increase, where it is a case of peripheral economies structurally conditioned by external constraints. In the final analysis, the argument is based on the accentuation of that restriction because of the effects produced in the long term on the balance of payments current account by the remuneration of foreign capital. With regard to this argument, which is taking on renewed importance nowadays, see ECLAC, 1953, pp. 52-54.

<sup>11</sup> The documents by Prebisch and ECLAC maintain that problems of employment and those caused by the tendency towards external imbalances are connected with the patterns of change in the structures of production and employment due to the “spontaneous

industrialization” which gained pace in various Latin American economies as a result of the Great Depression and the Second World War. In contrast is the “planned industrialization” approach which forms the essential basis for a development policy capable of ensuring that the changes in those structures follow a proper path.

<sup>12</sup> This question is referred to briefly again in the following section.



#### d) *Formalizing the initial content*

In order to gain a fuller perception of the significance and importance of Prebisch's basic concept, we should also associate it with another of his contributions and briefly consider its different formal expressions.

The first documents in which this concept was put forward contain the first two formal expressions of the theory of deterioration of the terms of trade. An "accounts version" (using only ratios of definition) describes it accurately and brings out its hidden significance: that is to say, its influence on the differentiation of average incomes between the centre and the periphery.<sup>13</sup> A second formal expression, known as the "cycles version", was designed to explain the phenomenon of such deterioration on the basis of cyclic movements in the central economies and the way those cycles spread from those economies to the periphery.<sup>14</sup> In the first half of the 1950s, various equally precise formal expressions were developed of another two theories, one designed to explain the tendency towards an over-abundance of labour, and the other the tendency towards an external imbalance.<sup>15</sup> In 1959 a third formal

version of the theory of deterioration of the terms of trade was published, seeking to explain this as the natural result of the industrialization process or, more exactly, the forms and characteristics of spontaneous industrialization in peripheral economies.<sup>16</sup>

Thus, in the course of the 1950s suitable formal expressions were being made of those key aspects of the initial content needed in order to make the interpretation of the long-term development of those economies intelligible and coherent. In other words, what may be termed a "theory of underdevelopment" was worked out, made up of the combination of the basic content and of the various theories which replicate, in abstract form, the phenomena of external imbalance, deterioration of the terms of trade, and structural underemployment.

The mere fact that this set of theories comply with the logical requirements usually demanded in conventional economics entitles them to be considered as forming a "theory of underdevelopment". It should also be borne in mind, however, that they were prepared in close connection with economic policy analyses which were also carried out with precision, so that they too complied with the same requisites of logic and internal coherence.

Only brief reference needs to be made to the economic policy proposals. The first field which may be mentioned is that of resource allocation, for which criteria aimed at optimizing the accumulation effort are established, both with regard to the form of distribution between production for the domestic market and production for export and with regard to the impact of that effort on agriculture and the possible effects of agricultural modernization on employment problems. The second field concerns "international cooperation" and covers such key issues as protection, Latin American integration and external finance. Policy bases are established for all of these which are compatible both with each other and with the resource allocation criteria, with the aim of achieving a pattern of reinsertion in the international economy which is compatible with sustainable growth and is also efficient.<sup>17</sup> The third field revolves around the *idée-force*

<sup>13</sup> The significance of the deterioration in the terms of trade and its perception as a long-term trend typical of centre-periphery relations was already recognized in the study *Postwar Price Relation between Underdeveloped and Industrialized Countries*, prepared in February 1949 under the direction of Professor Hans Singer.

<sup>14</sup> Everything seems to indicate that the terms centre and periphery were used for the first time in 1946. The following assertions by Prebisch illustrate the meaning then given to them: "Why do I call the United States the cyclic centre? Because that country, because of its size and economic characteristics, is the starting point of the impulses resulting in the expansion and contraction of world economic activity, and especially that of the Latin American periphery. I believe that the cyclic movement is universal, that there is only a single movement which spreads from country to country ..... but with markedly different characteristics, depending on whether it is a question of the cyclic centre or the periphery" (Prebisch, 1946, pp. 25-26). Later on, the centre and the periphery came to be conceived in the light of the nature of their production structures and to be related not so much with cyclic movements as with the long-term development of those structures, within the system that they formed. The "cycles version" of the theory of deterioration corresponds to one of these concepts, while the "industrialization version" mentioned below corresponds to the other.

<sup>15</sup> Both of these were already outlined in the initial documents mentioned earlier but were expressed more precisely in other documents during this half of the decade. Of these, special mention may be made of two documents: *Problemas teóricos y prácticos del crecimiento económico* (Prebisch, 1973b; first version: 1951), and *La cooperación internacional en la política de desarrollo latinoamericano* (Prebisch, 1973c; first version: 1954).

<sup>16</sup> The "industrialization version" forms part of the article by Prebisch (1959) entitled *Commercial policy in the under-developed countries*. The basic arguments of this theory are set out in Rodríguez, 1980, pp. 108-122.

<sup>17</sup> The resource allocation criteria and international cooperation policies are referred to respectively in the two documents mentioned in footnote 15 above. Both these documents maintain that "planned industrialization" is the essential path for the development of the

of planning, as reflected in the development of instruments designed to help the State to design and implement long-term development policies capable of attaining the objectives of continuity and efficiency.<sup>18</sup>

The above-mentioned theory of underdevelopment, or, if preferred, the existence of a systematic appraisal of the characteristics and tendencies of "peripheral status" in economic matters, serves as an explicit or implicit point of reference for many of the Latin American approaches to development. This is why they display common features which differentiate them from the theories in this respect that come within the framework of conventional economics.<sup>19</sup> This special quality clearly imbues the works in which Prebisch tries to make an interpretation of Latin American development which transcends a purely economic approach: that is to say, a long-term interpretation which is both economic and socio-political.<sup>20</sup>

peripheral economies, and seek to outline ways of following that path without setbacks. It should be borne in mind that neither these nor other documents advocate industrialization at all costs or excessive and unlimited closure of the peripheral economies to the exterior: positions which have often been insistently attributed to ECLAC. On the contrary, these documents emphasize the need to expand different types of activities only for reasons of relative economic gain and to keep them exposed to the stimulus of external competition through moderate and decreasing levels of protection. Temporary financial support, together with what Prebisch called "asymmetrical protection" – i.e., more rapid reduction of protection in the centres than on the periphery –, are elements of international cooperation which will lead to a scheme of international division of labour that will gradually extend to the industrial sector. This new scheme of production and trade, which is seen to be beneficial for both poles of the system, may be termed "joint industrialization".

<sup>18</sup> In this field, an early work by ECLAC (1953) bore the title *Estudio preliminar sobre la técnica de programación del desarrollo económico*. Planning naturally means that the State must actively participate in the process of industrialization and development, leading it forward in a deliberate and determined manner. This position must not be identified with over-intervention, however, as the documents of that institution fully recognize the importance of the market and advocate different degrees and types of intervention, according to each particular case.

<sup>19</sup> The book *Cincuenta años de pensamiento de la CEPAL: textos seleccionados* (ECLAC, 1998) covers a broad range of such approaches, and the foreword by Ricardo Bielschowsky contains a useful summary of them.

<sup>20</sup> These efforts were mainly reflected in three of his books: *Hacia una dinámica del desarrollo latinoamericano* (Prebisch, 1963), *Transformación y desarrollo: la gran tarea de América Latina* (Prebisch, 1970), and *Capitalismo periférico. Crisis y transformación* (Prebisch, 1981). They also contain various other undoubtedly important contributions by Prebisch to Latin American structuralism which will not be dealt with in this essay, which is limited to the subjects enumerated in the Introduction.

### 3. The continuing validity of structuralism

Everything indicates that the technological revolution which is under way and the accompanying process of globalization are responsible for the efforts to reformulate the theory of technical progress which have been made in the last fifteen or twenty years. The new approaches depart from neoclassical usage (and that of Prebisch himself), which sees such progress as exogenous and embodied in capital goods. These new approaches now consider technical progress as accumulative and as endogenous to enterprises and economic systems.<sup>21</sup>

It is considered that the revolution in question – or, if preferred, the installation and rapid spread of a new techno-economic model<sup>22</sup> – is also accompanied by a difference between the capability of the great centres to generate and incorporate technology and the corresponding capability of the peripheral countries. At the beginning of a period in which technical progress is taking on renewed dynamism, the peripheral pole lags behind or is at a disadvantage. It is held that this lag at the starting point means that this pole will have less capability to make successive technological advances in the future. In other words, it is accepted that the initial disadvantage – since it involves a smaller accumulation of scientific and technical knowledge and research and development experience – tends to bring about its own reproduction: i.e., it tends to persist over time. There is yet another factor, however: the size of the enterprises and economies of the centres – so much greater than those of the periphery – represents another decisive element that further increases the latter's disadvantage in coping with the speed of technological change, together with their smaller capacity to cover the costs and risks that such change involves.

These are the basic reasons why it is recognized in the specialized literature<sup>23</sup> that the new model brings with it differentiation of the rates of technical progress

<sup>21</sup> For different versions of the new "endogenism", see Burgueño and Pittaluga, 1994. The same subject is dealt with at length in Malerba and Orsenigo, 2000.

<sup>22</sup> With regard to the concept of techno-economic model, see Freeman and Pérez, 1988.

<sup>23</sup> Various authors (such as Verspagen, 1993) refer to the role of technological disparity in competitiveness and, hence, its influence on the performance of countries which are lagging behind. A number of recent analyses on the impact of the technological revolution on the development of such countries are summarized and compared with ECLAC approaches from different periods in Hounie and others, 1999.

between the centre and the periphery or, to put it in a nutshell, “technological disparity” between them.

As we shall see in the following sections, this disparity has important connotations for the analysis of employment and external sector problems, and such analysis, for its part, backs up the views on the need for certain basic requisites for the viability and efficiency of the development of the periphery.

#### a) *Employment problems*

Consideration of the employment problems of a typical economy over a very long period of time backs up certain hypotheses on the subsequent evolution of such problems when this is left to the play of the market forces.<sup>24</sup>

The first hypothesis concerns open unemployment. It is generally recognized that it is tending to increase in both the centres and the periphery and that this trend is connected with the saving of labour due to rapid technological progress. It is also recognized in many cases, however, that this tendency is more marked in the periphery, and especially in the Latin American economies. It is noted in this respect that in these economies the new model began to be applied within a context of extremely rapid external openness, in economies which already registered unfavourable levels of productivity and competitiveness, thus endangering the survival of various industrial and other production activities.

This phenomenon, however, which was noticeable in the 1990s, is considered to be less important than the long-term effects of the new model and the accompanying technological disparity. In view of this disparity and the external openness which continues to be maintained, it may be expected that while many activities producing goods and services will be viable in the peripheral economies, many others will be out of their reach. Thus, the slow and difficult process of trying to catch up on technologies which are constantly being renewed will tend to be reflected in problems of high and persistent open unemployment, even if

relatively high rates of GDP growth are recovered and/or maintained.

The second hypothesis concerns the already existing underemployment or, more exactly, the difficulties now being faced in trying to absorb this labour. In the past, under the model known as “Fordism”, rapid growth was accompanied by negligible levels of open unemployment, and there were clear tendencies towards a fall in structural unemployment, that is to say, the absorption of the labour force in question in high-productivity activities.<sup>25</sup> Under the new model, however, this possibility is limited, if not completely prevented, by the presence and persistence of openly unemployed workers who compete with the existing body of underemployed workers for jobs which are relatively scarce because of the technological disparity.

The third hypothesis concerns the possible incidence of the new model on the expansion of urban underemployment. The information on the previous model reveals that, under it, slow growth gave way to an outright increase in that form of underemployment, in both relative and absolute terms. This increase may be considered to be the result of successful survival strategies in which the material wherewithal for survival is obtained through jobs which are of low productivity but are nevertheless capable of averting the still greater problem of open unemployment and thus preventing its excessive expansion.

Recent experience, however, reveals that the high levels of open unemployment have been accompanied by a reduction in urban underemployment in both relative and absolute terms. Although the available information is scanty, it thus gives grounds for thinking that the introduction of the new model does not only cause difficulties in terms of open unemployment but also gives rise to obstacles to the expansion of underemployment, thus preventing the success of the underlying survival strategies.<sup>26</sup>

<sup>24</sup> The case studied is that of Brazil, for which structural underemployment was estimated at various points during the period from 1960 to 1996. It may be noted that in this case underemployment displays similar trends in all six of the different forms of calculation used for its estimation. One of these estimates is summarized and commented upon in Rodríguez, 1998. For reasons of brevity, no detailed reference will be made here to the quantitative information on which the hypotheses described in the following paragraphs are based.

<sup>25</sup> It should be noted that the absorption of underemployed labour does not merely mean the hiring of labour in high-productivity activities, on a wage-earning basis. Its definition is broader: absorption is considered to mean raising the productivity of labour from the low levels typical of underemployment to higher levels corresponding to true employment. In this sense, employment is considered to comprise various forms of labour relations and/or “occupational status” (employer, own-account worker, unpaid family worker) and not just those involving wage labour.

<sup>26</sup> A good illustration of this is the very widespread reorganization of the sale of consumer staples. This is now carried out by big oligopolistic firms which not only compete advantageously with small shopkeepers but may well also be affecting the

All in all, the foregoing considerations reflect a sort of impasse. On the one hand, the rate of growth alone no longer holds out hope of a gradual albeit slow solution of employment problems, through the creation of jobs of high or moderate productivity. On the other hand, nor do there seem to be any possibilities of relieving these problems through the lesser evil of underemployment. Thus, in the new model, the problems referred to earlier would appear to be at the root of lasting situations of social exclusion whose persistence may lead to the emergence and repetition of extremely critical conflicts.

b) *The external bottleneck*

"Technological disparity" is associated with a trend towards trade deficits which seems to be taking a similar form –similar in more than one sense– to that which existed in the stage of industrial expansion carried out in the context of the old "Fordist" model. The arguments regarding this trend are also similar to those used by Prebisch and ECLAC, as briefly described earlier, and may be viewed as a renewed version of the latter which seek to take into account the change in the technoeconomic model and the technological disparity this has caused.

As already noted, technological disparity means that while certain activities and branches will be accessible to the periphery, access to others will repeatedly be inhibited by the faster technical progress of the centres. Likewise because of the different rates of technical progress, there will be difficulties in expanding the periphery's exports away from activities where that rate is comparatively low and hence increasing their global value. Furthermore, in conditions of strong and/or growing external openness, this same technological lag will make it difficult to undertake or maintain the domestic production of tradeable goods where the peripheral countries do not possess levels of productivity and competitiveness close to those of the centres, so that they will have to resort to repeated significant increases in imports of goods whose domestic production is not viable.<sup>27</sup>

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underemployment reflected in the activities of sidewalk vendors or its expansion.

<sup>27</sup> In early analyses on this subject (for example, Prebisch, 1973b, pp. 33-34 (first version: 1951)), the typical tendency of the periphery to register external imbalances was explained on the basis of the disparity between the income-elasticities of their export and import demands. A similar argument may now be put forward on the basis of "Thirlwall's Law" (see McCombie and Thirlwall, 1994),

The tendency towards a trade imbalance has a further connotation applicable to the periphery considered in abstraction or to the periphery as a whole and/or large underdeveloped economies: the impossibility of export-led growth based on the outright liberalization of those countries' markets. We will return to the importance of this further implication later.

The foregoing comments are connected with this trend, which is associated with the disparity of technical progress: this disparity adversely affects the possibility of increasing exports, while it also causes an increase in imports of goods whose domestic production is not feasible because of their technological complexity.

Underlying the foregoing argument is another more abstract argument of a structural nature. It is argued that in order to achieve sustained expansion of the production of goods and services it is necessary to comply with certain "laws of proportionality" between the activities, branches and sectors responsible for such production, or, if preferred, between the growth rates of the different components of global output. It is also argued that as production operates as a whole, these laws must also be complied with in respect of export production, production for the domestic market, and the production of the imports coming from the other pole of the system (i.e., these laws must be reflected in compatible patterns of insertion in the world economy). Thus, the explanation of the external imbalance rests on an analytical referent indicating the changes in the production structure required by its own expansion and increased complexity.<sup>28</sup> Later on in this essay we will

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which may be summed up through the expression  $\gamma = \varepsilon\omega/\pi$ , where  $\varepsilon$  is the income-elasticity of exports;  $\pi$  that of imports;  $\gamma$  is the growth rate of the periphery, and  $\omega$  is the growth rate of the centres. The rate of technical progress tends to be higher in the latter, and this tendency underlies the disparity of elasticities ( $\pi > \varepsilon$ ) and limits the growth of the periphery ( $\gamma < \omega$ ). As noted below, overcoming this limitation requires deliberate development policies designed to raise the periphery's domestic and external competitiveness so as to increase the elasticity of its exports ( $\varepsilon$ ) and reduce that of its imports ( $\pi$ ).

<sup>28</sup> This perception of development as a dynamic involving and requiring certain patterns of change in the production structure represents a key substrate (and at the same time a synthesis) of Prebisch's basic ideas. The presence of this perception in his work is clear from the following statements: "Economic development and the recent events are not only considered in themselves, in their episodic significance, but also as a sequence of dynamic phenomena, as living manifestations of a complex which is constantly growing and diversifying". "Economic growth is not just a question of increasing what already exists. It is a process of intense structural changes ..." (*El trimestre económico*, 1953, p. 46).

return to Prebisch's views on the inability of the market to bring on these structural changes.

### c) *Conditions for viability and efficiency*

It will be gathered from the previous section that, in order to achieve such continuity, or even to achieve high and steady growth of the product, it is necessary to impede the action of the external constraint deriving from the disparity of technical progress, by designing and implementing deliberate policies in the fields of technology and production. In essence, these policies should aim to achieve, in successive activities, the levels of productivity and competitiveness required in order to expand exports and avoid non-essential imports, so as to be able to make other imports of greater technological content that are made necessary by the disparity itself.

This deliberate guidance of external trade is considered to be a condition for the viability of development, since its aim is precisely to prevent its blockage by impeding the emergence of an external bottleneck. Such guidance is also perceived as a condition for efficiency, however, since it assumes that the process of catching up on new techniques will be carried out in a planned and orderly manner, beginning with those where it is easiest to attain the levels of productivity of the great centres and subsequently going on to those of increasing complexity, so as to reduce to a minimum the differences in productivity of the activities undertaken.<sup>29</sup>

The external constraints in the field of trade also give rise to conditionalities in the area of financial relations, the main one of these being the need to adapt the flow of external resources to the country's needs, bearing in mind that those constraints impose limits on the possibilities for remunerating those resources. In

other words, financing the development of the periphery cannot be based to a discretionary or unlimited extent on foreign direct investment and external indebtedness. This means that ultimately significant levels of domestic saving are needed to ensure viable growth, although this also depends, in the final analysis, on the degree of technological disparity.<sup>30</sup>

The above recognition and brief analysis of the importance of underemployment show that it is the basis for the tendency towards income concentration and the enormous magnitude of rural and urban poverty: phenomena which express the social exclusion typical of the periphery. At the same time, however, it can also be adduced that in spite of these perverse effects underemployment nevertheless represents an available resource, and indeed a resource whose better use is a requisite for the viability and efficiency of the peripheral countries' development.

It was noted earlier that the existence of the external constraints rules out any possibility of achieving high and sustained growth rates with the export sector acting as a spearhead sector capable of inducing global economic growth. Instead, in order to keep the average growth rate at a high level it must include a substantial component of increased production for the domestic market, but this means that the domestic market must expand accordingly, so that it can absorb that proportion of rapidly increasing production targeted at it.

A stylized and extremely simplified view of this expansion of the domestic market could be expressed as an increase in employment which could gradually absorb the increases in the economically active population in modern activities and also a sustained increase in the levels of productivity of the existing underemployed workforce and the achievement of high levels of productivity among new members of the underemployed economically active population.

Such increases form the basis for the growth in domestic demand needed for strong growth: i.e., they are necessary conditions for the viability of that growth. At the same time, however, these same increases –especially the absorption of the underemployed– are a necessary condition for efficient development.

This is directly visible from a static perspective. Such absorption of itself means making better use of

<sup>29</sup> A formal long-term growth model which takes account of the intensity of technical progress and the income-elasticities of export and import demand may be found in Cimoli, 1988. It shows that speeding up technical progress on the periphery would enable it to diversify its efficient activities, thus transforming its production structure and avoiding an external bottleneck. It should be noted that such a transformation does not mean that the domestic and external markets should be associated with "protected" and "competitive" activities, respectively, but should instead represent two areas expressing the technological capabilities that the periphery is gradually acquiring. It may also be deduced from the model that such acquisition of capabilities favours the growth of the system as a whole and hence benefits both its poles (like the "joint industrialization" advocated by Prebisch and referred to in footnote 17 above).

<sup>30</sup> This implication of the trade imbalance is similar to the concepts contained in Prebisch's basic ideas and the subsequent more precise formulation of them referred to in footnote 10 above. Similar arguments may also be formulated on the basis of "Thirlwall's Law" referred to earlier.

the available labour and gaining fuller access to the available range of technologies. It is important, however, to approach this matter from a dynamic perspective. The fact is that over time the absorption of underemployed labour is reflected in the generation of potential economic surpluses which are of vital importance for stimulating domestic saving and capital accumulation. Furthermore, as they are a source of domestic saving, the surpluses generated by this absorption of labour help to make development viable from the standpoint of the limitations on external finance and also from the angle of the balance of payments restrictions ultimately due to the technological disparity.

Alongside the arguments put forward in the previous section, it can also be argued that there is an analysis of a structural nature underlying the foregoing considerations. The laws of proportionality governing the changes in the composition of output by branches and sectors (and even between production for the domestic and external markets) which are needed for the continuity of growth also call for corresponding changes in the occupational structure of the labour force, as well as concomitant increases in the productivity of the latter, associated in turn with the generation of surpluses that make it possible to expand production and the creation of demand conditions permitting this.<sup>31</sup> The following section goes on to explore some aspects of such an analysis, addressing the question of the State and its role in development.

#### 4. The question of the State

In his last work, Prebisch repeats and emphasizes his views on the importance of the market, but not without drawing attention to its lack of a social (equity) dimension and a proper time horizon.<sup>32</sup>

<sup>31</sup> In order to simplify the arguments still further, they were set forth earlier as a straightforward dichotomy (between employment and underemployment). Somewhat more complex forms of reasoning, however, indicate that the viability and efficiency of peripheral development do not simply depend on expanding the former and absorbing the latter. They also call for a pattern of changes in production which, by overcoming the external constraints, will bring about increases in employment and productivity in successive "technical strata" in order to increase the levels of the surplus and domestic saving in them and thus keep up high rates of accumulation and growth. It may be noted that the expression "technical strata" is taken from Prebisch's last work (1981), where it is used in the same way as in this essay.

<sup>32</sup> See Prebisch, 1981, p. 257.

These views may be linked with the foregoing considerations and serve to sum them up. On the one hand, the lack of a social horizon is reflected in the continuing existence of heterogeneity or, in other terms, in the employment problems which the present technological model makes still worse and which are becoming a permanent element. On the other hand, the lack of a time horizon expresses a likewise continuing tendency towards production specialization which tends to limit or impede economic expansion, through the external bottleneck.

It is considered, then, that overcoming the market shortcomings referred to by Prebisch is equivalent to overcoming heterogeneity and specialization. As we saw in the previous section, this means seeking certain patterns of change in the production structure of the periphery, leading to corresponding changes in the periphery's international linkages, as well as similarly corresponding changes in the employment structure, with successive increases in labour productivity in the different "technical strata" making up that structure.

The structuralist approach holds that the market alone is incapable of effecting this set of changes. It has been asserted in this respect that "the ECLAC theory ... (which represents it) ... may be interpreted as an early attempt to adapt orthodox economics to conditions of systemic market failure".<sup>33</sup> Here, it is maintained that the proposals of Latin American structuralism are of a different nature: they do not refer to such imperfections, but rather to the need to fulfill certain laws of proportionality which the market is incapable of doing, even if its imperfections are corrected.

This approach, then, is "non-reductionist",<sup>34</sup> in the sense that it does not limit the types, functions and behaviour of the agents in question to those involving supposed economic rationality, connected essentially with the guidelines given by the markets, and in this respect it recognizes that the analysis of economic phenomena (although it initially considered them in abstraction) must in the long run be carried out within a broader framework of social and political phenomena.

From this standpoint, the question of the State becomes particularly important. It directly concerns the role that the State should play in running the economy and, in more general terms, in the design and achievement of objectives which are both economic and social. This key question of the role of the State is closely linked with two others: the socio-political

<sup>33</sup> These assertions may be found in Fitzgerald, 1998, p. 60.

<sup>34</sup> See, in this respect, Vercelli, 1991 and 1994.

relations that serve as its basis, and the geopolitical relations within which it exists.<sup>35</sup>

Consideration of these matters, whose complexity has been further increased by the recent globalization process, is well beyond the scope of these notes but – subject to this reservation – brief reference will be made to some points of view which seem to coincide in the present discussions on the crisis of Latin American development.

It is often noted that, in conjunction with the globalization process, a renewed and stronger presence of foreign capital and interests has been growing up in the countries of the region, and this presence is observed in more branches and sectors (especially the financial sector), with much higher levels of concentration than before. In view of its nature and magnitude, this presence has been accompanied by a reshaping of socio-political relations not only between internal classes and groups but also between them and foreign groups and interests. For example, there has been a change in the relative weight and connection patterns between production and/or financial interests linked with the big transnational corporations and those of an essentially local nature. Likewise, the new technological patterns – and also the bargaining power acquired by highly concentrated capital, even in its relations with the weakened public agents – affect the relations between capital and labour, reducing the capacity of the trade unions to exert pressures and the effectiveness of the latter.<sup>36</sup>

To put it another way, when a certain basic external structural relationship (mentioned in footnote 35 above) is changed, this changes the whole bases of the previous

political power structure. This upset in the bases of political power, however, cannot be divorced from its surrounding geopolitical relations. The great powers usually present their own positions as the rational basis for geopolitics. On the basis of these positions, they promote changes in world trade regulations which are implemented with the intermediation and support of the main international organizations.

It is also recognized that the implementation of these changes is having profound repercussions on the countries of the periphery. On the one hand, they continue to be subject to “enormous imbalances in the conditions prevailing in international trade”, yet little or no progress has been made in “building a new architecture for the global financial system”.<sup>37</sup>

Those countries are therefore subjected to loose and diluted forms of control over foreign direct investment and financial capital movements. The consequent heightening of their external vulnerability is accompanied by a reduction in the leeway open to States, which are particularly restricted in various areas of short-term macroeconomic policy.<sup>38</sup>

In short, socio-political relations have been significantly changed in line with the recent globalization process, making the possibilities for their future modification and improvement more obscure and complex. In the view of the peripheral countries, the resulting changes in geopolitical relations are unfavourable for them, giving rise to a new correlation of forces which makes it harder for them to agree on an international negotiation strategy of their own. These two changes are also associated with a third change: in contrast with the recognized need for decisive State intervention, the role of the State has been reformulated in line with positions of a more or less minimalist nature, with unfavourable effects for economic management and development, as well as for the improvement of the prevailing conditions of severe social inequality.<sup>39</sup>

The previous paragraph mentions a number of negative aspects. In contrast, however, some possible alternative paths to follow may be mentioned, although they involve serious difficulties. Nowadays, any effort

<sup>35</sup> This dual perspective evokes the more frequent concept of dependence, which defines it as an external-internal structural relationship. According to this concept, “the action of the social groups, whose behaviour in effect links together the economic and political spheres ... (concerns both the nation and) ... its links of all types with the world political and economic system. Dependence thus finds not only its internal expression but also its true nature as a particular form of structural relations: a specific kind of relationship between classes and groups which involves a situation that structurally determines the links with the exterior” (Cardoso and Faletto, 1969, p. 29).

<sup>36</sup> It is surprising how far the flexibilization of labour markets has been promoted in different countries of the region, all at the same time. Leaving aside the different features of the efforts made in this direction, it seems clear that – albeit with differing results and to different degrees – this has been due to the weakening of trade union power. With differences of detail, various aspects of the proposals for flexibilization are dealt with in *World Development Report 1995: Workers in an Integrating World* (World Bank, 1995).

<sup>37</sup> According to Faria and others (2000, p. 18).

<sup>38</sup> Ffrench-Davis (1999) gives a review of these policies in recent Latin American experience.

<sup>39</sup> Among the approaches which redefine the role of the State in line with the promotion of market-oriented development strategies, mention may be made of *World Development Report 1997: The State in a Changing World* (World Bank, 1997). Evans (1996) offers a review of recent approaches to the role of the State in development.

to reformulate development strategies must begin with the explicit consideration of political and geopolitical equations: that is to say, with the search for broad and inclusive internal agreements and, in that connection, with the building of consensuses among countries which will reduce their weakness and help them to defend their positions in international negotiations. These agreements and consensuses form the basis for

redefining guidelines on the role of the State, which, however, should also provide for proper use of its own relative autonomy. This is also important for outlining the new legal and institutional frameworks that its action requires, which in turn are related with the consolidation and deepening of democracy.

(Original: Spanish)

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# The return of “vulnerability” and Raul Prebisch’s early thinking on the “Argentine business cycle”

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

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

Protagonists of those criticisms were basically the advocates of liberalization of what were by then called

the developing economies. Import barriers had to come down, foreign exchange controls eliminated, and countries should stake all their fortunes on a fast expansion of exports that would supposedly result from the increased efficiency achieved through those measures. Their success, which was perhaps not only based on their capacity for intellectual argument, has been phenomenal. The following decades have witnessed the adoption, first gradual and reluctant in most cases but turning into a stampede in the last decade, of precisely those policies. And what have been the consequences of all those reforms? An extraordinary degree of instability, with repeated crises hitting what are now termed “emerging economies”, highly vulnerable to international economic shocks.

Those questioning Prebisch’s ideas, after having been successful in reinstating a world economy quite similar to that of the early twentieth century or the late 1920s, have ended up doing him the greatest possible intellectual favour. Prebisch’s thinking on the difficulties of a “peripheral” open economy under financial globalization has now become highly topical.

In this paper, therefore, an attempt will be made to show that Latin American economic problems mirror the circumstances of the late 1920s, to say nothing of the following depression decade. And, thus, all of a sudden Prebisch’s thinking regains its relevance for the present day. It is, in fact, to an early Prebisch that reference will be made in this article: the Prebisch of the late 1920s and early 1930s. At that time he was

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<sup>1</sup> See, for example, Paul Krugman’s comments in his article entitled “The fall and rise of development economics” (Krugman, 1994).

more worried with what could be termed short-run macroeconomic problems than with what were later to be called development issues, to which his ECLA years were devoted.

This paper is organized in the following way. First, the progressively more unstable character of the world economy in the last quarter of a century and its impact on our region will be surveyed. Second, some parallels will be drawn with the Argentine economy in the period between the wars. Third, the early development of Prebisch's thinking in the late 1920s, as related to the study of that economy, will be examined. And, fourth, his first reactions to the Depression years will be studied.

What will emerge from this analysis is an awareness of how clear and true even to present-day realities were Prebisch's views about the problems of an early "emerging market" economy, even though there may not be unanimous agreement on his specific economic policy proposals.

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

Beginning in 1975 –and as acknowledged for instance in several of the last issues of the IMF's *World Economic Outlook*– the world economy has undergone several slumps. According to that publication, up to recently there were four of these, although a fifth one in the mid-1990s can also be detected.<sup>2</sup> And right now –in 2001– another one which we could easily rate as a sixth slump is taking place (figure 1).

The frequency of crises seems to be increasing, since there have been six crises in about 25 years, but four of them have taken place in the last 10 years, three in the last five years, and two in the last three. Such a casual perusal of the frequency of crises is confirmed in, for instance, a recent study by Bordo, Eichengreen and others (forthcoming). In their examination of 120 years of financial history, crisis frequency after 1973 turns out to have been double that of either the Classical Gold Standard Period or the post-Bretton Woods one. Interestingly enough for the argument we are trying to develop in this paper, such frequency has been similar to that of the period between the wars. Furthermore,

FIGURE 1  
Word: Real gross domestic product  
(Percentage annual rate of change)

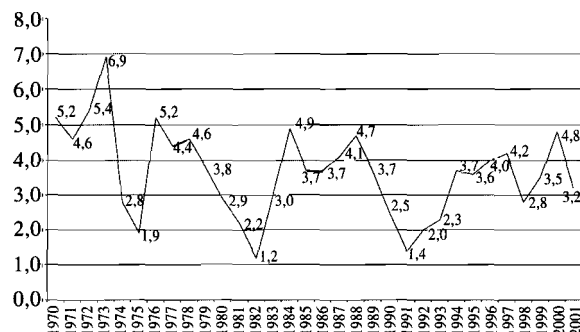
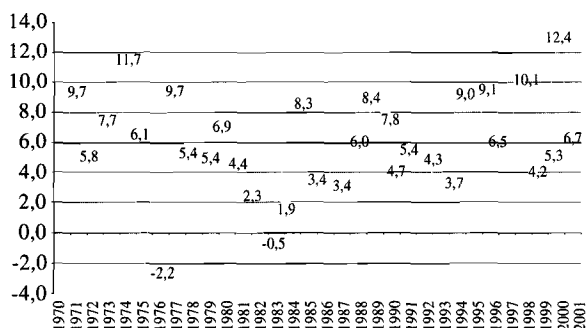


FIGURE 2  
World: Volume of goods and services trade  
(Percentage annual rate of growth)



the last 25 years show a higher frequency of twin crises (currency cum banking); these crises are known and have been shown to be particularly severe and have resulted in high output losses.

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

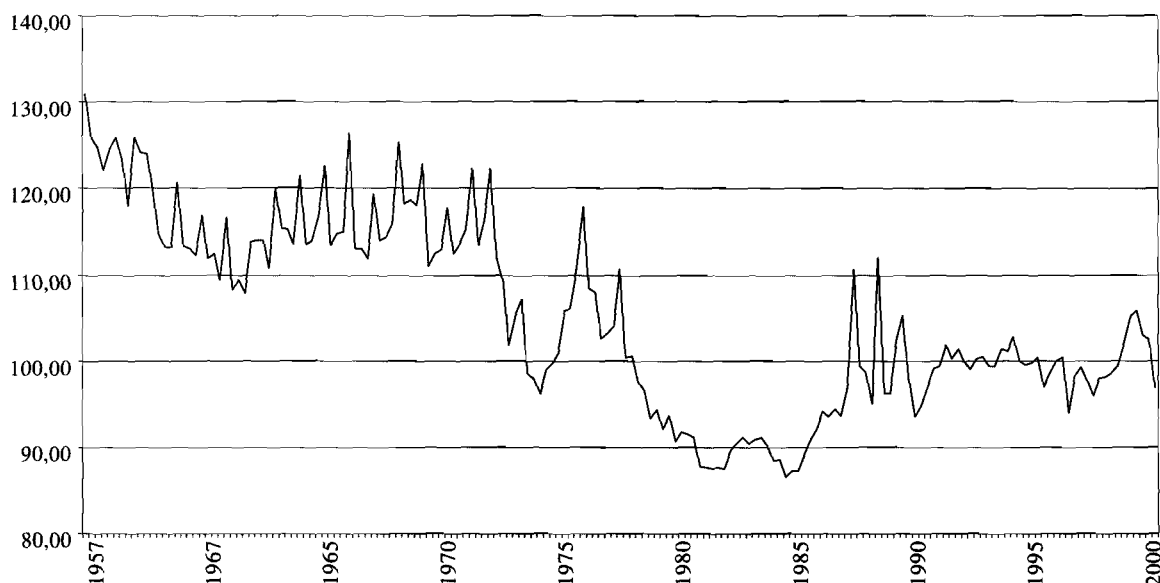
Besides frequent slowdowns in economic activity amplified by strong variations in international trade volume (figure 2) and volatility of interest and exchange rates, this last quarter of a century has shown extraordinary variability in two other aspects of great significance for developing countries, i.e., commodity prices and capital flows.

As for real commodity prices, on the one hand, recent studies have vindicated at least the facts of the Prebisch-Singer hypothesis, i.e., that there is a long-run trend –over a 140-year span– towards a decline in

<sup>2</sup> See, for example, IMF (1999, pp.2-5). In the graph on world industrial production –figure 1.2. on page 5– of that same report, a clear fifth slowdown may be detected in 1995, and not only in Latin America.

FIGURE 3

**Terms of trade: Non-oil developing countries 1957-2000**  
(1995=100)



these prices (at the rate of 1.3% per year). Moreover, there is a break around 1917 after which the decline accelerates to 2.3% per year and in the 1990s to 6.9% per year.<sup>3</sup> Not only there is such a declining trend, but also volatility has significantly increased in the later period, with larger swings in prices and cycles of higher frequency.<sup>4</sup>

It is also useful to remind ourselves that by the beginning of the year 2000, real commodity prices were fully 40% below their level at the beginning of the 1970s. The result of this on the terms of trade of developing countries could not be more obvious, as may be gathered from figure 3, on non-oil developing countries.

A very similar story could be told with regard to capital flows. Since the beginning of the 1970s, two distinct boom and bust cycles may be detected. The first one was the well-known cycle relating to bank loans in the 1970s, which led to the "sudden stop" of the early 1980s and to debt crises spanning the whole decade. The second was the more recent boom of the early 1990s, which was followed by the collapse which began with the Asian crisis of 1997.

<sup>3</sup> See Cashin and McDermott, 2001.

<sup>4</sup> "...rapid, unexpected and often large movements in commodity prices are an important feature of the behavior of commodity prices." (Cashin and McDermott, 2001, p. 25).

Quarterly figures for the last several years, when superimposed on those long cycles, make it easy to detect an extreme variability in the behaviour of private capital flows. Most specifically, bank lending –and also bond issues, although less so– displays extreme volatility moderated by a more stable performance of foreign direct investment. In fact, as may be seen from figure 4, net non-equity capital flows have not only been much more unstable but indeed in the last few years have been nil or even negative.

Summing up, as should be well known –although not always thoroughly recollected– the world economy has shown an extraordinary degree of instability in the post-Bretton Woods era and most specifically in the last decade.

Latin America, of course, by "opening-up" both to trade and financial relations with the world economy, could hardly avoid being subject to that instability. Growth rates of GDP and of international trade volume played their part, as well as the behaviour of interest rates, real commodity prices and capital flows.

Net transfers of resources, which on the whole were positive in the 1990s (compared with the negative figures of the 1980s) ended up the century by being negative again, after having likewise shown a slump in the mid-1990s (figure 5).

As it is well known, exports increased at a faster rate than in previous decades, but imports increased

FIGURE 4

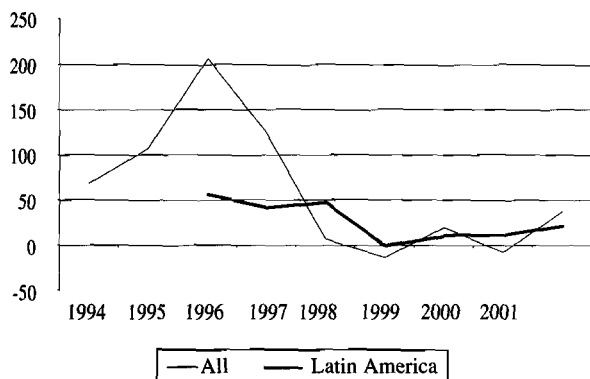
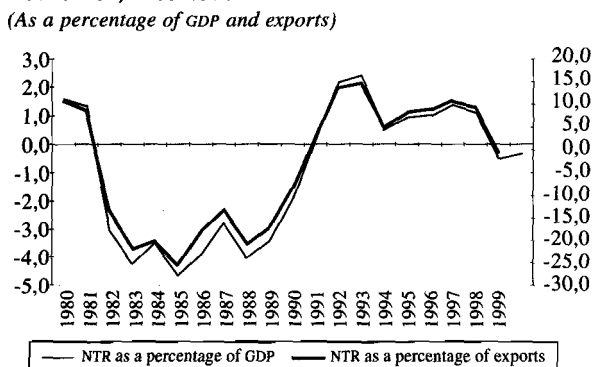
**Net non-equity private capital flows to emerging markets**  
*(In US\$ billion)*


FIGURE 5

**Latin America and the Caribbean: Net transfer of resources, 1980-2000**  
*(As a percentage of GDP and exports)*


even faster. The result was the emergence of sizeable trade deficits, only moderated or turned positive under recessionary conditions (figure 6).

Coupled with a negative balance on real and financial services, current accounts became increasingly negative, even in terms of a larger GDP (figure 7).

Furthermore, by the end of the decade external debt ratios –with respect to exports and to GDP– had started to climb again and were standing at levels similar to those that had prevailed at the beginning of the 1980s crisis. It was of course precisely the renewed accumulation of foreign indebtedness that led to the expansion in outflows on account of financial services.

And although short-term debt –as a percentage of foreign exchange reserves– was low and falling towards the end of the 1990s, financing requirements –short-term debt plus service on long-term debt coming due within a year– were building up as a consequence of the sheer growth of the external debt (figure 9).

FIGURE 6

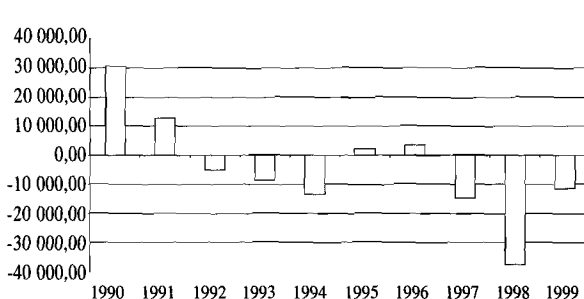
**Latin America and the Caribbean: Balance of trade**  
*(In US\$ million)*


FIGURE 7

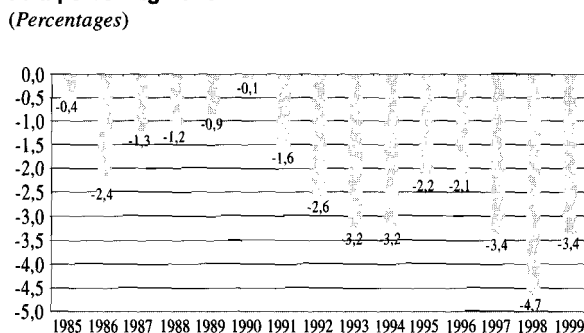
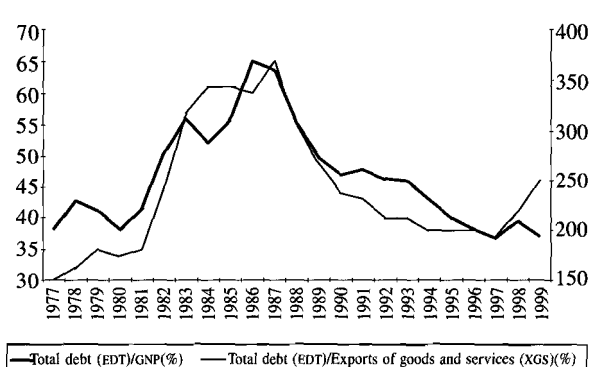
**Latin America and the Caribbean: Current account balance as a percentage of GNP**  
*(Percentages)*


FIGURE 8

**Latin America and the Caribbean: External debt ratios**  
*(In percentages)*


Rapidly growing imports plus large external financing requirements (figure 10) have made the region extremely vulnerable to the vagaries of the world economy. Country-risk spreads reveal the volatile evolution over time of the creditworthiness ratings of

FIGURE 9

**Latin America and the Caribbean: Short-term debt as a percentage of foreign exchange reserves, 1971-1999**

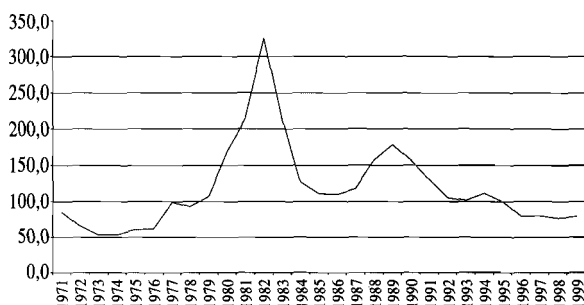


FIGURE 10

**Latin America and the Caribbean: Financing requirements (As a percentage of GDP)**

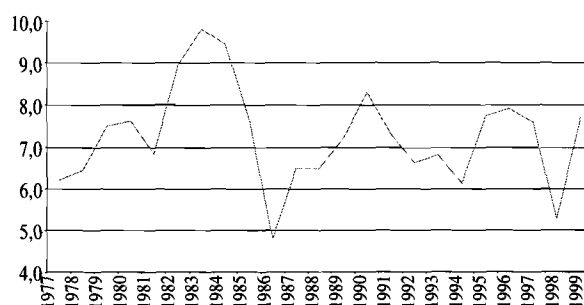
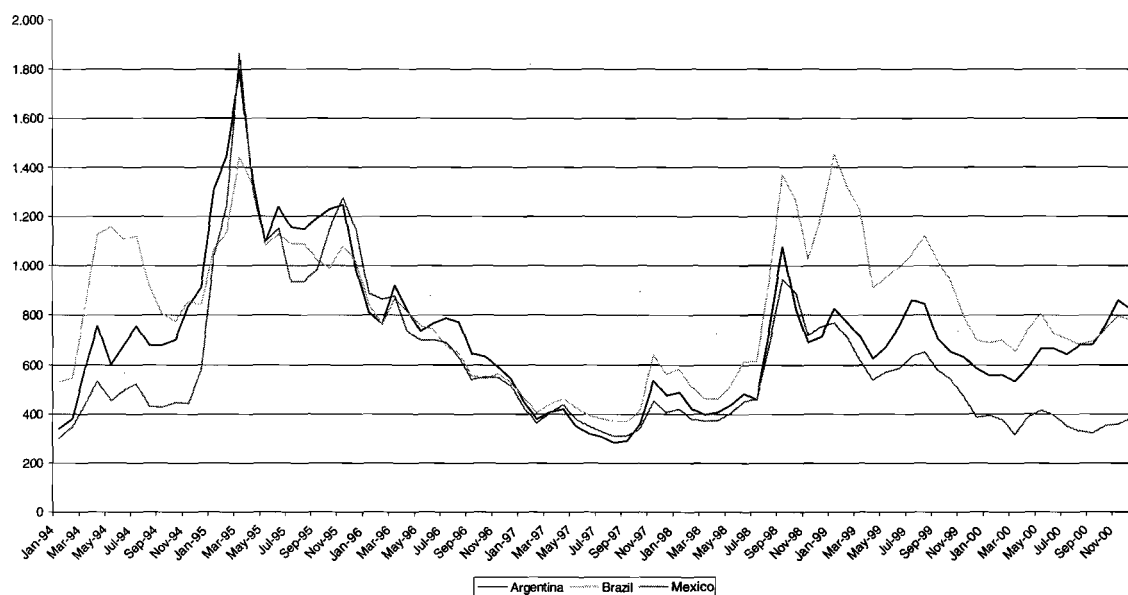


FIGURE 11

**Argentina, Brazil and Mexico: Country-risk ratios, 1994-2000**



the countries in the region in the eyes of the international financial markets, and the resultant instability of their access to resources.

No wonder, therefore, that under those various pressures crises have repeatedly visited the region and a number of countries—including all the major ones—have been placed at risk of a collapse in their exchange rate pegs and/or their debt service (figure 11).

Not surprisingly, vulnerability to an unstable international economy and most specifically to volatile financial flows has resulted in high “real instability” for Latin American economies, even if the much-praised price stability has basically been achieved. But what also must be recalled is that the last decade’s average

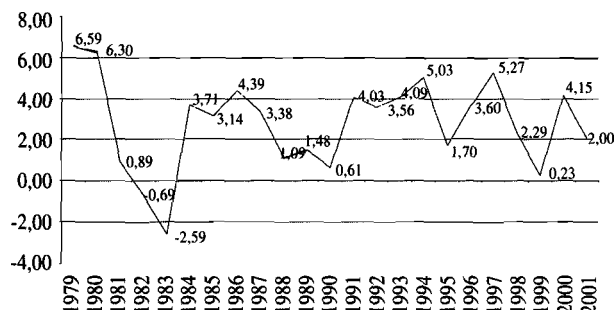
rate of growth on the whole was only marginally greater than that of the “lost decade” of the 1980s (3.0% compared with 2.1% per annum).<sup>5</sup> Thus, if the 1980s was the “lost decade”, then the 1990s may well be baptised the “roller-coaster decade” (figure 12).

## 2. The Argentine economy in the late 1920s

Parallels with the Argentine economy in the late 1920s—the period when Raúl Prebisch started developing his ideas about the “peripheral economy”—are many. We have already noted that in terms of frequency of crises

<sup>5</sup> See IMF, 2001.

FIGURE 12

**Latin American and the Caribbean: Real GDP growth rates, 1979-2001***(In percentage per year)*

as well as of the behaviour of commodity prices, the period between the wars was that –out of all the periods in the last 120-odd years– which was most similar to the post-Bretton Woods era and most specifically to the last decade.

Let us take a look at the Argentine economy of those years. Crises and fluctuations did not first visit the country only after 1929. The idyllic version of an exclusively prosperous 1920s is far from the facts. A clear pattern of economic fluctuations had previously emerged, to the point of being christened by Prebisch and his team as the “ciclo económico argentino” (“Argentine business cycle”). Unlike, for instance, the U.S. business cycle that was being analysed by Mitchell and the NBER in those same years, that of Argentina, Prebisch and his team posited, was dominated by the instability of exports and capital inflows rather than by that of domestic investment.<sup>6</sup>

The reasons for export instability were several. First, exports were overwhelmingly agricultural exports. In the period from 1923 to 1927, on average, 96% of exports originated in the agricultural sector.<sup>7</sup>

Moreover just four products (wheat, maize, linseed and beef) made up two-thirds of the total.<sup>8</sup>

Some studies published at that time or immediately afterwards would show a chronic trend, beginning by the end of the 19<sup>th</sup> century, for instance, for wheat prices to decline in real terms.<sup>9</sup> Additionally, Argentina was far from being a marginal supplier in some of these markets so that, as conditions of over-supply worsened after the First World War, her exports were bound to encounter barriers.<sup>10</sup>

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

Going back to fluctuations, however, a second characteristic of Argentine exports to which Prebisch’s attention was drawn and was confirmed again later was

<sup>8</sup> Wheat made up 22% of total exports, maize 19%, linseed 12% and beef 11%. Those exports had another very special characteristic distinguishing them from those of other primary producers, such as for instance Brazil, which exported coffee: i.e., those Argentine exports –being temperate-zone agricultural products– entered into competition with the domestic output of the more advanced Western European and North American countries.

<sup>9</sup> Mandelbaum (1953) shows that wheat prices had been falling –in real terms– since the early 1880s. For V. P. Timoshenko (1933), the prices of fifteen important agricultural products were already falling by the mid-1920s, not to speak to what happened later in the early years of the Depression. In Argentina, wheat prices fell from an average of 15.13 pesos per quintal (100 kg) in the 1920/1924 period to 10.50 pesos in 1927/1928 and 9.68 in 1928/1929, well before the Wall Street crisis.

<sup>10</sup> Argentina was the second world exporter of wheat –22% of the total– and the leading exporter of maize, with more than two-thirds of the total. Its shares of world exports of beef (61%) and linseed (80%) was also very high. See Taylor and Taylor (1943) for the shares of Argentine exports in world markets. By the 1920s, agriculture in the industrialized countries had become a sector in crisis, where protectionism and measures of direct support to domestic producers were becoming rampant. In fact the First World War had thrown the whole world agricultural sector out of balance. As output fell in continental Europe due to the ravages of trench warfare, the overseas producers had experienced a boom in output. The return to normal of European agriculture by the mid-1920s –under a panoply of support measures– produced a situation of chronic oversupply, however. For an account of the mounting tide of protectionism, whose roots lay in the late nineteenth century, see O’Connell, 1986 (this volume, by the way, was dedicated to “Raúl Prebisch - Elder Statesman of the Emerging Nations”, Prebisch having attended the seminar at St. Antony’s College, Oxford, at which most of the contributions for that volume were first presented).

<sup>6</sup> For an examination of the Argentine economy of those years, see *Revista Económica* (there is an English version published as *Economic Review*) of the Banco de la Nación Argentina (BNA, various issues), which was continued for a brief period after 1935 –as a new series– by the newly created Central Bank of Argentina. An Economic Research Department, which published that review, had been organized at the Bank under the direction of Raúl Prebisch. For a survey of its studies see the first section –“The Argentine Business Cycle”– of O’Connell, 1984.

<sup>7</sup> Fifty-five per cent were agricultural products and 41% produce from stockbreeding activity. See Dirección Nacional de Estadística y Censos (DNEC, 1921, 1922, 1923, 1924, 1926, 1927, 1928, 1929).

their extraordinary price volatility, further compounded in those years by an instability in volumes (figure 13) due to weather factors and a cobweb-type cattle cycle. As domestic consumption showed a steady trend, volatility in output translated into volatility of exports.<sup>11</sup>

In spite of some inverse relation between export prices and export volumes—to be expected of a country which was not a price-taker for quite a few products—export values also showed a high degree of instability. In fact, in the period from 1917 to 1929 this was much higher than in any other period of Argentine economic history and well above that experienced by developing countries in the Bretton Woods era.<sup>12</sup>

Had import prices fluctuated in the same direction and magnitude as export prices, the volatility would have been neutral for the country as a whole, although it would have had significant income redistribution consequences. But that was far from being the case. Thus, the terms of trade experienced wide swings before 1930 and only recovered the level prior to the First World War by 1946-1950.<sup>13</sup>

Not only did the terms of trade experience strong fluctuations but also, on average, over the 1920s they were at the same level as over the 1930s and in both cases 27% below that of 1913. Once again, a picture of the 1920s prior to the October 1929 Wall Street crash emerges which is anything but idyllic.

Imports, on the other hand, were quite a high share of GDP, almost 25% in 1925-1929. In this same period imports supplied 13% of consumption, while those of machinery and equipment represented 35% of domestic investment.<sup>14</sup>

Furthermore, as analysed by Prebisch's team, imports also displayed a high income-elasticity and a ratchet effect, as there was some inertia in their adaptation to lower levels of national income.

FIGURE 13

**Argentina: Exports-volume and prices, 1919-1939**  
(1913 = 100)

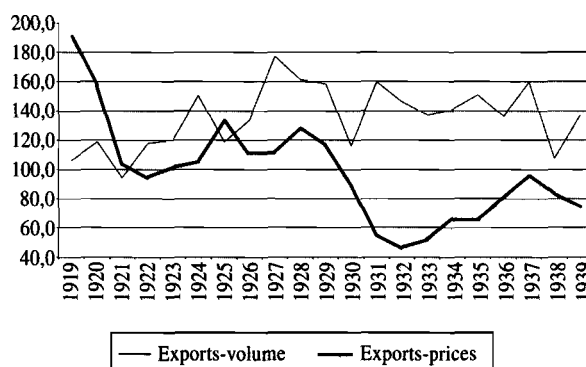
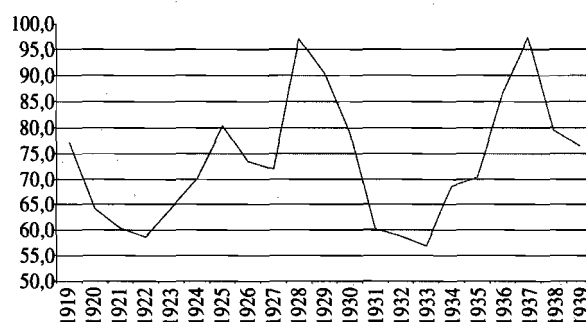


FIGURE 14

**Argentina: Terms of trade, 1919-1939**  
(1913 = 100)



Consequently, when an export downturn—or a drop in capital inflows—hit the country, leading first to a scarcity of foreign exchange and second to a drop in GDP, the preservation for a time of high levels of imports resulted in further pressure on the availability of foreign exchange. In fact, wide swings in trade balances were experienced as may be visualized in figure 15.<sup>15</sup>

The second element of instability identified by Prebisch was that originating in capital inflows. Gross capital inflows amounted to the equivalent of 10% of exports, making them a significant supplier of foreign exchange. Contrary to what is habitually asserted as

<sup>11</sup> For an analysis of export volume instability, see BNA (1930) and also BCRA (1937a and 1937b). For an instability index following MacBean see Diéguez (1972). Prices were normally less unstable than volumes, but in the period from 1917 to 1929 the instability of prices was slightly higher than that of volumes (12.5% versus 12.2% respectively).

<sup>12</sup> The instability index—à la MacBean—for export values in the 1917-1929 period was 16.8%, while that estimated by MacBean for developing countries in the 1948-1958 period was only 9.06% (Diéguez, 1972).

<sup>13</sup> For a terms of trade index see Ministerio de Finanzas de la Nación/BCRA, 1952.

<sup>14</sup> The years of the First World War had shown how essential imports were for the performance of the economy, when a dearth of supplies—plus, admittedly, a crisis of the building sector due to financial difficulties—resulted in the worst slump of the whole century.

<sup>15</sup> For figures on the share of imports in GDP, consumption and investment, see ECLAC, 1958, tables 24 and 25. In the 1996-1998 period, when Argentina was recovering from the “tequila” crisis, the import elasticity of the country was between 3 and 4. That is very similar to the levels of most present-day “emerging market economies”, consequently putting their external position in danger.

FIGURE 15

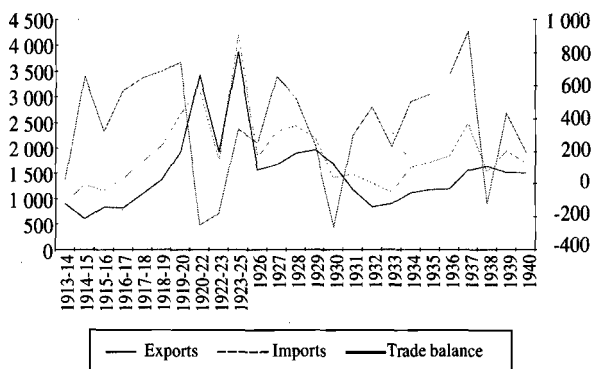
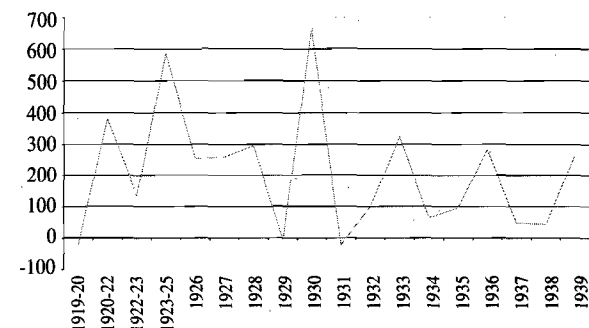
**Argentina: Exports, imports and balance of trade, 1913-1940***(In million pesos m/n)*

FIGURE 16

**Argentina: Gross capital inflows, 1919-1939***(In million pesos m/n)*

being different in that world compared with the present-day one, on average in the 1920s fully 53% of those inflows went to the private sector and only the remainder to the public debt.<sup>16</sup>

Capital inflows to the private sector were largely made up of foreign direct investment, which however, as it is today, was to a significant extent financed by debt issues. In stock terms, foreign direct investment (FDI) accounted for 32% of the estimated total capital invested in Argentina, and gross inflows were 10% of fixed capital formation.<sup>17</sup>

Capital inflows were notoriously unstable, however, as may be gathered from figure 16, concerning the period between the wars, which shows that this instability was already clearly present in the 1920s.

The instability of exports and capital inflows was transmitted to the economy through various mechanisms.

On the income side, exports in the period 1925-1929 represented 24% of GDP and more than two-thirds of the final demand for "Pampa" produce. Agriculture, for its part, accounted for between 25% and 30% of

GDP at 1950 prices, which were admittedly extremely low for these sectors, so that its true weight was surely much larger.<sup>18</sup> The upturns and downturns of exports, therefore, were bound to have a strong impact on GDP. As to capital inflows, both private and public sector expenditure levels had to accommodate themselves to their availability, as they were an important source of finance.

Shocks were also transmitted via the fiscal and monetary systems. Three-fourths of government current revenue came from customs duties and other taxes on foreign trade. Therefore, to a great extent, they oscillated with what we have seen were highly volatile exports and imports. The availability of resources for government expenditure was also determined by the capacity to acquire further indebtedness. But, as may be gathered from figure 17, showing strong variations in the stock of public debt, such capacity underwent significant instability.

It is in relation to the monetary mechanism, however, that the parallels with present-day preoccupations are more striking. The monetary system of Argentina in those years was called a "sporadic gold standard" by Mr. Hueyo, a Minister of Finance in the early 1930s.<sup>19</sup> In fact, Argentina had adopted a Currency

<sup>16</sup> See Ministerio de Finanzas de la Nación/BCRA, 1952.

<sup>17</sup> For these figures see ECLAC, 1958. Fully 60% of FDI originated in the United Kingdom; in turn, in 1929 Argentina accounted for 27% of all the UK's FDI and 42% of that in "foreign countries", i.e., in countries other than those of what was still the British Empire (see United Nations, 1949, table 7). For the United States, Argentina was much less important as a recipient of FDI—only 8% of the total—and ranked behind other countries in Latin America (see United Nations, 1949, table 6). However, many United States firms started to establish themselves in the Argentine market, manufacturing motor vehicles, electrical home appliances, cosmetics, and other things (see Phelps, 1936, and Whyte, 1945).

<sup>18</sup> See ECLAC, 1958.

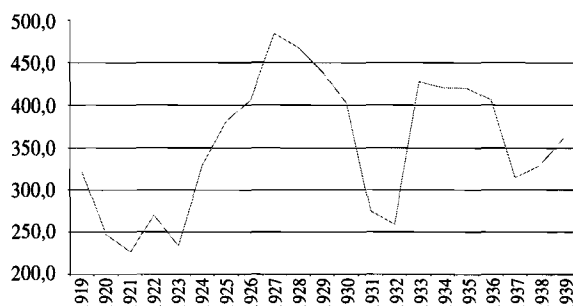
<sup>19</sup> Mr. Hueyo's pronouncements on the Argentine monetary system may be found in Ministerio de Hacienda y Obras y Servicios Públicos, Secretaría de Hacienda, 1932. Hueyo—following orthodox teaching and as Mr. Hoover did in the United States—tried in 1932-1933 to stabilize the economy through the reduction of fiscal deficits: a feat he almost succeeded in, but with less than favourable consequences for economic recovery.



FIGURE 17

**Argentina: Foreign public debt**

(In US\$ million)



Board system early in the twentieth century but had abandoned “convertibility” –to use modern Argentine parlance– at the beginning of the First World War, only resuming the operation of the Currency Board in August 1927.<sup>20</sup>

As with many other cases of premature resumption of the Gold Standard in the 1920s, the experiment failed by late 1929 and the country only returned to a Currency Board system in early 1931, this time on a U.S. dollar standard.

Of course, under the Currency Board system credit and money supply had to accommodate to the vagaries of the trade balance and of net capital inflows. The Central Bank was only created in 1935, so that some of the functions of “lender of last resort” were fulfilled by the Banco de la Nación Argentina, echoes of which may be detected under the “tequila” crisis and under today’s –what we should call it?– “tango” crisis.<sup>21</sup>

Instability of exports and capital inflows, therefore, not only directly hit the balance of payments position

but was also transmitted to the rest of the economy through the workings of income and monetary links.

The experience of the 1920s had shown, in fact, that a cycle based on the instability of exports and capital inflows, amplified by income and fiscal/monetary mechanisms, had become clearly established.

A slump in incomes of various sections of the population –remember again the significance of price deflation– had inaugurated the decade. The sharp reduction in agricultural prices after the end of the war had a special impact on Argentina, which was dependent on those products. After deflation had run its course, there was a recovery which was followed, in the 1922 to 1924 period, with good harvests and the beginnings of large capital inflows originating in the United States. A bad harvest in the 1924–1925 season, however, caused a new decline in economic activity (accentuated by renewed deflation), which extended into 1926.<sup>22</sup>

Beginning in that latter year, a new phase of expansion set in, but this time prices showed a slight downward trend. Due to a rise in exports and capital inflows, the peso started appreciating, leading to the reinstatement of the Currency Board system –a return to the Gold Standard– in August 1927. Government borrowing abroad expanded even faster, and gold entered the country, resulting in a big increase in reserves. This expansion found support in the policy of the U.S. Federal Reserve, which had cut interest rates by that time, resulting in an outflow of capital from the United States.<sup>23</sup>

During that expansive period, currency and deposits increased. Lending, however, did not expand at an equivalent rate as banks tried to rebuild reserves and cancel old credits: a hangover from the previous downturn. The Banco de la Nación Argentina –which in the absence of a Central Bank proper was half-playing that role and had extended credit to other banks during the previous period of stress– started recovering those loans.<sup>24</sup>

<sup>20</sup> The opening of the Currency Board, in 1927, pitted the politically powerful agricultural exporters against foreign investors. Exporters asked for a return to “convertibility” because the peso was appreciating too much, even beyond parity, while foreign investors were happy to see their earnings in pesos translated into larger amounts of pounds sterling and other foreign currencies.

<sup>21</sup> In 1932, an “Empréstito Patriótico” was launched –like those in 1995 and now in 2001– but for lack of demand it ended up being purchased by the Banco de la Nación Argentina (a publicly-owned bank created after the crisis of 1890), using for the first time a Rediscount Law that had been passed back in 1914 to counter the crisis unleashed by the war in Europe. Mr. Hueyo asked for the advice of the Bank of England in setting up a Central Bank. As “money doctor” the Bank of England sent down a high-ranking official, Sir Otto Niemeyer, who was extremely critical of the Gold Standard. See his opinions in *Revista económica* (BNA, 1934).

<sup>22</sup> See BNA (1929c) for an account of the early and mid-1920s cycles.

<sup>23</sup> For an analysis of the impact –not only on Argentina but on the world economy– of Federal Reserve Policy in the late 1920s, see BNA, 1929a. In August 1927, the Fed had lowered interest rates to 3 ½ % from 4% and engaged in an active “open market” policy of credit expansion. But beginning in early 1928 that policy was reversed because of increasing concern about the “irrational exuberance” of Wall Street; bonds were sold, and after successive increases interest rates stood at 5% by July 1928. Argentina’s international reserves increased from US\$ 466.5 million in January 1927 to a peak of US\$ 680.1 million in July 1928.

<sup>24</sup> From the high point of June 1927, interest rates fell from an average of 6.75% to 5.75% by July 1928. See BNA, 1929b.

The 1928-1929 period is extremely interesting for our attempt at drawing parallels with the most recent decade and the present-day situation. As might be gathered from the previous figures, exports increased less and imports kept growing at a faster pace than in the previous expansion. On top of this, capital inflows started declining and some funds left the country as the tightening up by the Fed, plus the Wall Street boom, attracted them towards New York. Beginning in the second half of 1928 –way before the Wall Street crash– gold started leaving the country, mainly as a consequence of its boom rather than of the later crash. By the end of 1929 –when the Currency Board was closed down again– all the gold –or even slightly more– which had entered Argentina after the return to the Gold Standard had been lost.<sup>25</sup> Bank reserves started declining after September 1928, reaching a point lower than that prior to the 1927-1928 boom. Once again the Banco de la Nación Argentina was playing a compensatory role by lending to the government and other banks.<sup>26</sup>

A drastic fall in export prices was the reason for lagging exports, which added to the crisis unleashed by the financial movements. Wheat harvests in the main producing countries in 1928/29 were much larger than in previous years and led to further accumulation of already heavy unsold stocks. Between May 1928 and May 1929 –again well before the Wall Street crash– wheat prices in Argentina fell 30%. Although not all agricultural prices fell so heavily, the general index dropped 7% between 1928 and 1929. Land prices fell in sympathy with these movements.<sup>27</sup>

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

### 3. The early development of Prebisch's thinking about the "Argentine business cycle"

Surveying that experience, Prebisch coined the expression "Argentine business cycle" to describe it.

<sup>25</sup> See BNA, 1929d. Between September 1928 and December 17, 1929 –when the Currency Board was closed down– gold outflows amounted to 187.6 million gold pesos (roughly equivalent to pre-1933 dollars), which was slightly more than the 179.4 million that had entered Argentina since the opening of the Currency Board back in August 1927.

<sup>26</sup> Thus, in spite of the outflows to New York, bank lending increased 15% between September 1928 and December 1929 (BNA, 1929d).

<sup>27</sup> For the behaviour of land prices see Sociedad Rural Argentina, 1979.

Economic policy and the conduct of private as well as public affairs, he insisted, had better take it for granted that a new downturn would always be just around the corner, even during what could look like the most solid of booms. This seems a very prescient outlook compared with that of the advocates of the "new economy" and of the endless indebtedness of the emerging market countries.<sup>28</sup>

Leaving aside the impact of weather on the volume of produce available for export, the other factors determining that cycle –prices and demand for agricultural goods and capital inflows– were intimately connected with international economic behaviour. In the case of Argentina, which did not have a domestic machinery-producing sector, the "accelerator" mechanism that Prebisch considered to be behind the cyclical behaviour of advanced countries was not applicable. In his opinion, therefore, all the instability originated abroad.

Furthermore, when analysing the instability of capital inflows, Prebisch came to a very up-to-date conclusion widely accepted nowadays: i.e., that capital flows are negatively connected with activity levels in what he was later to label the "monetary centres". As New York was almost the only such centre in the 1920s, capital inflows would be threatened when, as happened in 1928-1929, a boom in the United States economy and in the stock markets –accompanied by an attempt by the Federal Reserve to stop the "irrational exuberance"– would determine a capital drain from Argentina. The cycle in Argentina, therefore, tended to be the reverse of the United States one: something reinforced by the fact that sales to that country represented only a tiny fraction of total exports.<sup>29</sup>

In his view, the contrast between the high instability of exports and capital inflows and some rigid elements of the economic structure made Argentina extremely "vulnerable" to that instability.

<sup>28</sup> In a later pronouncement, Prebisch said: "Even though there may be no idea of how, in what form, or at what particular moment the cyclic reaction will take place after boom periods, the fact that we know of its inevitability is sufficient to justify the timely adoption of measures to moderate the size of the fluctuation or reduce its economic and social consequences". See BCRA, 1938.

<sup>29</sup> In 1925, only 8% of Argentine exports were directed to the United States market. Imports from that country, on the other hand, had come to account for 23% of total Argentine imports, and the United States had become Argentina's largest supplier, displacing the United Kingdom (see Dirección Nacional de Comercio Exterior, 1941).

To begin with, mention has already been made of the behaviour of imports: their rapid expansion resulting in trade imbalances in booms and temporary downward rigidity in slumps, thus making those imbalances even worse. Government finances, also, tended to behave in an asymmetrical manner. When funds were easily available, expenditure –which was also supported by the higher revenues fed by the ensuing expansion of the economy– would increase at a fast pace. But in a downturn, the reduction of such expenditure became more difficult because of the rigidity of commitments previously entered into. Consequently, in slumps there was a tendency for fiscal deficits to explode, thus preventing the economy from adapting to the new level of availability of foreign exchange.

Additionally, service on foreign debt in the 1920s, on average, absorbed 20% of export proceeds (this proportion shot up to 35% in the first few years of the Depression). Current account deficits plus amortization on private and public lending resulted in high financing requirements, so that although it normally registered trade surpluses, year after year the country had to find large new resources to finance service on foreign debt and investment.<sup>30</sup>

There were therefore two almost fixed charges against foreign exchange proceeds: somewhat rigid imports, and service payments on the foreign debt and capital invested in the country. In contrast, both exports and capital inflows were extremely volatile. According to Prebisch those were the circumstances that made the Argentine economy “vulnerable” to an unstable international economy.

Out of those observations on the sources of instability and the rigidity of some elements in the economy, in the late 1920s Prebisch developed his model of the “Argentine business cycle”. In this model the mechanics of the cycle hinged upon credit and monetary expansion and contraction and their impact on import levels. Only later, in the 1930s, did the Keynesian –or Khanian– income multiplier enter into his analysis.

In Prebisch’s scheme, expansion of exports –due to a bigger harvest but mainly to better market

conditions abroad– or larger capital inflows leads to the creation of “high-powered money”. Banks expand through the “monetary base” multiplier, creating purchasing power additional to that originally produced by the inflow from abroad. Trade and industry expand and imports –remember that they form a high proportion of GDP– surge up and the expanded availability of foreign exchange is rapidly exhausted. Either gold –under the “Currency Board” system– or “foreign exchange” start leaving the country or, under the floating exchange regime that predominated in Argentina for some time after the closing of the “Currency Board”, the national currency will experience a depreciation. A cyclical downturn in either export proceeds or capital inflows may add an additional recessionary force on top of all this. In the meantime, foreign obligations also have increased.

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

On the other hand, Prebisch took a strong stance vis à vis those advocating the use of bank credit to finance long-run investment. In his opinion, a confusion between credit and savings is the reason for advocating this, and banks should refrain from granting credit for such purposes unless funds from the public have been collected specifically for that purpose. Again the main reason for his opposition is based on the impact of such operations on imports, and consequently on foreign imbalances.

If the cycle has followed its course and the whole country has been subject to its ups and downs, however, the government’s financial position also suffers because of the impact on revenues. And, then, the rigidity of fiscal expenditure coupled with that of imports would only worsen the imbalances that the economy has run into. Prebisch also points out the pernicious character

<sup>30</sup> Financing requirements were around 25% to 30% of exports in the 1920s, increasing to almost 60% in the 1930s. On the whole, the net transfer of resources was clearly negative; in the 1925-1929 period it came to almost 5% of GDP. For figures on the debt burden and financing requirements in relation to export proceeds, see Ministerio de Finanzas de la Nación/BCRA (1952), and for the net negative transfer of resources, see ECLAC (1958), tables 24 and 28.

of short-run capital inflows: what he labels as “floating funds”. In his vision, these funds “...tend to duplicate foreign exchange demand; once to pay for imports that result from their inflow and (twice) for the need to support their later outflow”.<sup>31</sup>

Prebisch also introduced another element in his analysis of the short-run behaviour of an “emerging market economy”. Businessmen’s expectations are brought in as a motive force that could lead to the expansion or contraction of output and the consequent demand for credit. In the case of a rural country, however, he made those expectations dependent on the state of the rural sector, thus returning to the idea that weather and external prices are the main determinants of the cycle, coupled with the vagaries of capital inflows.

In all his writings and analyses, dependence on imports—with its high income elasticity to increases in GDP and its asymmetric downward rigidity—is the factor that plays the main role in erecting an insurmountable obstacle to expansion and also to any attempt at a counter-cyclical policy—such as an expansive monetary policy—in conditions of a balance of payments crisis.

Economic policy therefore had very limited autonomy for coping with the “Argentine business cycle”. With such a primitive fiscal and monetary system as the one described above, many instruments for such counter-cyclical policies simply did not exist. The only possible course was one of extreme prudence during expansionary periods so that excessive credit and government expenditure based on further indebtedness could be avoided. That would make what Prebisch considered to be the inevitable downturn more manageable.

#### 4. The Depression and further developments in Prebisch’s thinking

It was under such circumstances that a new downturn in the international economy—beginning in late 1929—hit the country. Export prices continued to fall until 1932, and import prices also fell, although less so. As a result, the terms of trade deteriorated over that four-year period.<sup>32</sup> Price levels were also important, and not

only their relative decline. Thus, in 1932 export prices stood at half their pre-First World War level, placing an enormous burden on the indebtedness of producers and their creditors.

For their part, capital inflows almost dried up, only partially recovering in 1933.<sup>33</sup>

The Argentine economy only began to recover in 1934 (and even more firmly afterwards) due to a prolonged serious drought in North America that later extended to Australia. On the one hand, this drought generated the famous “dust bowl” that brought misfortune to poor farmers in the United States, but on the other hand it brought prosperity to Argentina, which saw its export prices climbing by the second quarter of 1934 to unexpected levels. The country experienced a balance of payments bonanza fed by exports at those high prices, and on top of this a return of capital inflows partly due to political instability in Central Europe. This time, however, these inflows were mainly short-term and started leaving the country as soon as the situation began to deteriorate in 1937 (with the recovery of harvests in the main competing countries).

Argentina, which almost alone had not defaulted on its foreign debt service, actually repatriated part of it, besides engaging in major domestic sterilization operations.<sup>34</sup>

The consequences of the abundance of foreign exchange were obvious: imports shot up—by 74% between 1932 and 1937—and GDP expanded by 27% in that same period.<sup>35</sup>

<sup>33</sup> Some short-run “compensatory finance” (in reality, it was used to repay a previous loan from Phoenix Corp.) was provided—in the absence of a body like the IMF—by Brown-Harriman of New York, and the British railway companies managed to issue some debentures in both 1930 and 1931.

<sup>34</sup> Perusal of the minutes of the discussions for the Anglo-Argentine Treaty of 1933 reveals that the Argentine delegation was insistent in complying with full debt service, even under pressure from the British side to leave some resources for British exports and, above all, for profit remittances by British-owned firms—especially the railways—in Argentina. By the way, Raúl Prebisch was a member of that Argentine delegation as financial expert; in 1933 he was formally still an official of the Research Department of the Banco de la Nación Argentina, in which capacity he had been invited to attend the preparatory meetings (in Geneva) for that year’s World Economic Conference and had gained the appreciation of the head of the British delegation, Sir Frederick Leith-Ross. Later in the 1930s the newly created Central Bank and its General Manager, Raúl Prebisch, were widely praised, for instance by the League of Nations economic and financial section, for the debt repatriation and sterilization measures adopted.

<sup>35</sup> Export prices increased by 43% in 1933-34, 21% in 1935-36 and 22% in 1936-37. By 1937 the terms of trade were at their highest

<sup>31</sup> See BCRA, 1937c, chapter II for this sentence (my translation) and, more generally, for a succinct later account of Prebisch’s thinking about the “Argentine business cycle”.

<sup>32</sup> Export prices fell 64% between 1928 and 1932, while the terms of trade dropped 40% over the same period. For figures on foreign trade prices and terms of trade, see Ministerio de Finanzas de la Nación/BCRA (1952).

In opposition to both traditional and some modern scholarship, Prebisch himself, however, was careful not to claim that the recovery was mainly due to the policies followed. In the *Economic Review*, published since the mid-1930s by the Central Bank, Prebisch –speaking again about the cycle the country had been going through– said: “From 1934 up to the present there has been... a gradual improvement (of the economic situation in Argentina), partly brought about by the adoption of measures tending to facilitate readjustment of international accounts and revive internal economic activity, but mainly as the result of the gradual rise in the world prices of the country’s export products”.<sup>36</sup>

The way in which Argentina overcame the Depression, therefore, was more related to “exogenous” events –a prolonged and serious drought that hit foreign competitors– than to any shift in economic policy-making. At the same time, however, it is true that the crisis forced some changes both in economic policy and in economic structure.

In terms of shifts in economic policy “régime”, perhaps the most important event was the introduction of exchange controls right after the pound sterling went off the gold standard in September 1931. Priority was given to essential imports and the service of the foreign debt, with other imports and remittances of profits being relegated to a second order of importance.

Once again, rather than fed by a visionary policy of “import substitution”, rationing of foreign exchange became a necessity because of the balance of payments crisis. Exchange controls were to remain in place for decades, although undergoing significant changes, the first one inspired by Prebisch himself at the end of 1933.<sup>37</sup> Rationing of foreign exchange, in fact, took the place of a true real devaluation like those undergone by other countries in South America.<sup>38</sup>

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level in the century up to that moment. Export values rose explosively by 128% between 1932 and 1937. For an account of how the drought in North America determined the recovery of the Argentine economy, see O’Connell (1984).

<sup>36</sup> See BCRA, 1937c, page 1.

<sup>37</sup> Under the new régime instituted in November 1933, a “free market” was established, separated from the “official” market. In the free market exchange would be sold by the authorities by auction. That was thought to introduce an element of flexibility that would lead to the gradual fading away of the controls. The official market, in its turn, was divided between a buying and a selling rate, with some margin in between. This margin was to pay for the increased cost of foreign public debt service –after a devaluation of around 20% was introduced– plus a price support scheme for wheat, maize and linseed.

<sup>38</sup> In Argentina, the peso had become overvalued against the pound

Almost as soon as the new scheme was introduced in late November 1933, foreign exchange –boosted by good market conditions for Argentine exports– became abundant for reasons already mentioned. The market-determined “free rate” tended to fall towards the pegged “official” rate, at which point the authorities decided to fix the margin between the two. In this sense –as Prebisch acknowledged later in life– it was confirmed that the system was being used mainly as an element of discrimination in favour of Great Britain and some of the European countries and against the United States. Investors and exporters from those countries were to benefit from the official rate, while United States exporters and firms established in Argentina had to resort to the “free” market. Such a policy, of course, had to do with the extreme triangularity of Argentine trade, that worsened the sterling area deficit with the U.S. dollar area, and the leverage Great Britain had to force the country into a bilateral exchange agreement.

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

As already noted, Sir Otto Niemeyer –our British “money doctor”– was extremely critical of the workings of the Gold Standard, and although Prebisch disagreed with Sir Otto about some of his recommendations for the Central Bank, he did share those criticisms.

The Gold Standard –or the “Currency Board” system based on gold– was deemed to be too rigid a mechanism both in the upswing and in the downswing for a country whose economy was dominated by frequent movements in export values and capital inflows. It would lead to easy over-expansion in an era of abundant foreign exchange and to excessive contraction in a moment of slump.

Thus, Prebisch –who always had thought of himself as an orthodox economist– ended up defending the exchange control system. In his view, exchange controls were absolutely necessary in order to be able to introduce a “national monetary policy” that would gain some autonomy for the country from world forces beyond its control. He thought of exchange controls only as a mechanism in the financial sphere and not

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sterling over the 1929-1933 period, and this was not fully corrected by the devaluation of November 1933.

—at least in his writings— as an element of protectionism for the country's produce. For that, he said, Argentina must have its own customs policy; otherwise this would be imposed by the great powers.

The other novel element in Prebisch's thinking was that relating to the role of industry. Industrialization—a larger share of GDP originating in manufacturing activities— was reckoned as a further way to regain autonomy, as this sector would be less connected with developments abroad. At that time, however, his writings did not contain any of the other arguments in favour of industrialization that would make him and ECLA famous in the late 1940s.

For the rest, both in his writings, speeches and lectures and in economic policy making Prebisch resorted to consecrated orthodox solutions, i.e., a restrictive monetary policy and sound government finance as well as a banking system based on short-term credit and under strong supervision by the Central

Bank, and of course the honouring of debts. No wonder, then, that if a comparison is made between the availability of foreign exchange and the rate of growth of GDP or of manufacturing in Argentina and in other "emerging market" economies of the era—Brazil and Chile in South America as well as India or the Danube basin countries in Europe— the performance of Argentina was decidedly slower.<sup>39</sup>

In the present new era of financial globalization, however, Prebisch's vision of the problems of an "emerging market economy" in an unstable international system has regained significance and it stands as a source of insights about its mechanics. "Vulnerability" is back with us. From that point of view his enemies—advocating the reinstatement of "free" international trade and capital movements—have ended up paying him the greatest homage of them all.

(Original: English)

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<sup>39</sup> For such a comparison with Brazil see Abreu (1984), and for a comparison with other countries see O'Connell (1984).

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# The ideas of *young Prebisch*

**Adolfo Gurrieri\***

## 1. Introduction

Prebisch arrived at ECLA for the first time in 1949, to write a report in which he set out his views on the main problems then facing the economic development of Latin America (Prebisch, 1949). As he had been hired as an outside consultant, he did not receive the support of other members of the institution in its preparation, nor did he have much time at his disposal, so that the report was a reflection of the ideas he already held prior to joining ECLA. As the content of that work made a great impact on academic and political circles in the region and came to be considered one of the basic pillars of structuralist thinking, it has often been wondered when and why Prebisch incorporated those ideas into his thinking.<sup>1</sup>

In 1949 Prebisch already had a lengthy career as an academic and public official behind him and was, according to Furtado, “the only Latin American economist with an international reputation” (Furtado, 1985, p. 58). His first works date from the 1920s, and

the general opinion is that in those years he was a firm supporter of neoclassical ideas, but there is very little in them that could have served as a basis for the 1949 report, and only as a result of the crisis that began in 1929 does he appear to have begun to abandon his neoclassical views and to look for new interpretations of the economic process and heterodox policies for reshaping it.<sup>2</sup> The fact that Prebisch often confirmed this simple division of his thinking into two periods must have been one of the main reasons why this was accepted without question and a deeper study was not made of his thinking in the 1920s (Prebisch, 1983).

Attentive reading of the material he wrote during those years, however, shows that the continuity of his ideas was much greater than has been assumed, so that it would be very simplistic to divide the evolution of his thinking into two periods—orthodox and heterodox—separated by the 1929 crisis. Prebisch himself, when going into greater detail, recognized that the 1920s had not been a period of pure orthodoxy for him. For example, when referring in an interview to the first articles he had written, he said “In those articles I tried to interpret actual phenomena with my own eyes, and not with economic theories from outside. I attached

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<sup>1</sup> This question is different from another one which is also important but is not considered in this article: whether those were original ideas of Prebisch or not, and what sources they came from. See in this respect Love (1994 and 1999).

<sup>2</sup> “When Prebisch began his career as an economist and professor, in the late 1920s, he was an ardent supporter of neoclassical theories. The Great Depression of the 1930s—the first great crisis of capitalism—was the prime cause of Prebisch’s conversion” (Sprout, 1992, p. 188). Similar opinions may be found in many other authors.

great importance to the balance of payments... I began to understand Argentina's external vulnerability at that moment. This was between 1921 and 1923" (González and Pollock, 1991, p. 458). The fact that Prebisch often confirmed this simple division into two clearly opposed periods must have led those who have studied his thinking to take this for granted, with the already mentioned result that they did not study his thinking during the 1920s in greater depth.

The aim of this article, therefore, is to show that even from his first works, written in 1920, Prebisch began to shape the body of ideas that he formulated as a whole when he arrived at ECLA in 1949, and also that he did not need to go through the experience of the 1929 crisis in order to become aware of the defects of the primary export pattern, since these had already been clear to him even in the early 1920s, when the Argentine economic process was considered a shining example of successful growth. The brutal impact of the crisis merely served to confirm to him that he had not been mistaken about those defects and to lead him to definitively abandon his confidence in the Gold Standard as a basic criterion for economic policy management and seek new ways that would permit an improvement in the standard of living of the population.

## 2. The main ideas put forward in the 1949 report

The origin of the main ideas put forward in the 1949 report could hardly be traced back without first of all recalling them here, albeit in an extremely summary manner. In that report, Prebisch laid down the main lines of a strategy for promoting the economic development of Latin America, understood as a process designed to raise the standard of living of the population through a systematic increase in productivity.<sup>3</sup> His main thesis with regard to the orientation of that strategy is that it could not be successful if economic activity were concentrated around the production of primary commodities and their export to the industrial centres, so that it was essential to promote industrialization. The primary export pattern had of course lost its dynamism as a result of the difficulties caused to international trade by the great crisis and the Second World War, and although the most negative effects of those events were

coming to an end, Prebisch did not think it likely that that dynamism could be recovered, because of the protectionist policies applied by the United States since 1930, which had reduced external demand and the flow of capital. In view of that country's importance as the main cyclical centre, he concluded that those policies imposed conditions which ruled out the restoration of a world economy compatible with the primary export pattern. In any case, even if the United States were to change its policies with regard to the rest of the world and international trade and capital movements expanded once again, it would not be a good idea for the Latin American countries to return to the primary export pattern, because this had three negative aspects. Firstly, as primary exporting countries, their economic processes were a reflection of those of the industrial countries, so that they were subject to the fluctuations of the latter and to considerable external vulnerability. Secondly, when the world economic system has been made up of industrial countries and primary exporting countries, the income generated by the system as a whole through increases in productivity has tended to be concentrated in the industrial countries because historically the terms of trade between industrial and primary goods have evolved in favour of the former, due primarily to the subordinate role played by primary commodities compared with industrial goods in the production process of the system as a whole. Thirdly, in most of the countries of the region, primary export activities have not been and will not be capable of absorbing the growing labour force and systematically raising its productivity.

These are the basic reasons why Prebisch maintained that the Latin American countries should not base their economic development on the primary export pattern but should adopt a strategy in which industrialization plays a decisive role. He made it clear, however, that while his criticisms were directed against a type of development centered on the production and export of primary commodities, they were not directed against those activities as such, since they must form an important part of the new strategy. He noted in that respect that industrialization would not do away with external constraints, so that in order to grow without upsetting the balance of payments it would be necessary to give a decided boost to primary commodity exports. In view of the diversity of national situations, he emphasized that each country must choose the sectoral mix most appropriate to the main objective, which was to raise the standard of living of the population. He was concerned that approaches based on the primary

<sup>3</sup> The 1949 report can also be analysed as the basis for the structuralist theory of underdevelopment. Both these approaches are of course equally valid and mutually supportive. The work of Octavio Rodríguez represents the greatest contribution in this direction. See for example Rodríguez, 2001a and 2001b.

export sector should not be replaced outright with others based on industry, for selective sectoral development was a means rather than an end in itself. Yet although he expressed his ideas very clearly on repeated occasions, they have often been misrepresented either through ignorance or in order to serve particular interests, presenting them as though they advocated out and out industrialization and underrated or even despised primary activities.<sup>4</sup>

In his 1949 report, Prebisch also put forward several ideas on the means and conditions needed to promote this new development strategy. Two of these stood out above the rest. On the one hand, he stressed the need to combine the pursuit of development with the maintenance of monetary, fiscal and external sector balances. He rejected the idea that macroeconomic policy management should be guided by the automatic criteria of the Gold Standard, because these had shown themselves to be procyclical, when what was needed was to reduce fluctuations; deliberate intervention by the public authorities was essential in order to ensure that such management was both orderly and in keeping with the needs of development. On the other hand, he emphasized that development called for an enormous domestic saving effort and a considerable increase in the proportion of that saving used for productive investment. He explicitly rejected the idea of using inflation as a way of raising capital, because it put pressure on the balance of payments and was regressive in terms of income distribution: it was a kind of forced saving imposed on the mass of the population for the benefit of just a few, and there was no guarantee that the latter would use their growing income productively. At the same time, although he believed that it would be essential to use external saving in view of the shortage of domestic saving in many countries, he suggested that it should be employed with caution, because it too caused pressure on the balance of payments. It therefore seemed to him to be essential that most of the capital formation effort should be based on the domestic resources of each country, so that it was necessary to find "forms of (spontaneous or collectively determined) saving which... would make possible more appropriate use of resources for collective purposes", including in particular the reduction of unproductive fiscal spending

and of the conspicuous consumption of the highest income groups.<sup>5</sup>

Finally, this summary review cannot fail to mention that Prebisch fully acknowledged that his proposals were only tentative and that a great deal remained to be done in terms of research and practical action in order to improve our knowledge of Latin American development. In the pursuit of this greater knowledge, he recommended that we should avoid over-academic approaches, ensure that all ideas had a scientific basis, and not accept ideas formulated in the centres without first of all making sure that they take account of the special nature of our problems. He therefore advised us "not to confuse analytical knowledge of outside ideas with slavish mental subjection to them: something from which we are very slowly learning to free ourselves" (Prebisch, 1949, p. 107).

### 3. Inequality, vulnerability and the Gold Standard

Prebisch came up against the question of economic development right at the beginning of his intellectual career, but with reference to Europe. Thus, in 1921 he commented on the International Economic Conference which had been held at Brussels in 1920 in order to analyse and find solutions for the great economic and social problems caused by the 1914-1918 war, which affected millions of people all over that continent (Prebisch, 1921a). The central issue was the economic "reconstruction" of Europe, and Prebisch summarized the views of some of the economists invited to that Conference, who had made their diagnoses and prescribed the measures that should be taken. He did not share the views of Pantaleoni, who, as "champion of the old economic gospel", proposed the restoration of *laissez-faire* as the sole solution. Instead, he identified himself more with Gide, Bruins and Pigou (and indeed most of the other participants), who considered that it was not sufficient merely to balance the public finances and control inflation: those efforts would be no use unless the forces of production were reconstructed and developed through better use of the factors of

<sup>4</sup> See for example Viner, 1952. In contrast, Furtado understood very well the "limits" that Prebisch placed on industrial development, though he did not agree with them (Furtado, 1985, p. 62). Cattáneo (1991) gives an analysis of the relationship Prebisch envisaged between industry and agriculture.

<sup>5</sup> Prebisch, 1949, p. 136 (the page numbers of the quotations from Prebisch correspond to the editions mentioned in the bibliography). Despite the emphasis placed by many governments and international agencies in recent years on the so-called first –and second– generation structural reforms as necessary conditions for economic development, a recent study concluded that the countries which grew most quickly from the mid-1970s to the end of the twentieth century were those which invested a high proportion of their GDP and maintained macroeconomic stability (Rodrik, 1998).

production, reduction of consumption in order to increase capital accumulation, removal of hindrances to trade, increased international cooperation, and the integration of efforts within each nation in order to tackle those great economic, social and political difficulties more effectively. These proposals are remarkably similar to those which Prebisch made when he arrived at ECLA thirty years later, so it may be held that they were turning over in his head right from the start of his intellectual evolution. It was also obvious that he was greatly attracted by the ambience of the Conference, where leading economists and politicians were discussing solutions that would affect the lives of millions of persons: it was a situation in which he would have loved to take part, as in fact he was to do so many times in later years.<sup>6</sup> Prebisch did not take the ideas of the Conference as the starting point for his own thinking, because his main interest was in the Argentine economy, which did not need reconstruction or development at that time; on the contrary, its growth had been so successful that –for example– the value of its exports had increased fivefold in the first two decades of the century. That growth had its problems, however, and Prebisch drew attention to them, clearly showing that, as already noted, he was well aware of the shortcomings of the primary export-based growth pattern, even in an economy like that of Argentina which was growing at a rapid rate. He perceived two main problems: inequality and external vulnerability.

He referred to the economic inequality of Argentina above all in a lecture he delivered during a visit to Australia (Prebisch, 1924a). Very briefly, his view was that the benefits of the rapid growth attained in Argentina on the basis of the export of primary commodities were not equitably shared, mainly because land ownership was concentrated in a handful of big landowners. In order to change that situation, he maintained, it would be necessary to break up land holdings so that land ceased to be an instrument of privilege and became a means of efficient production in the hands of an extensive and more highly developed

rural population. The great landowners have been able to use their political power to avoid any actions which could weaken their position, however.<sup>7</sup>

This situation has impeded the settlement of a greater proportion of foreign immigrants in rural areas, has favoured extensive land use, and has given rise to an extraordinary degree of inequality between the living conditions of the rich and those of the middle and working classes. In other words, the concentration of land ownership, together with an oligarchic political power structure, has formed the basis, in conjunction with its external components, for a primary export pattern which has made possible a high rate of growth but has concentrated the benefits of that growth in only a few hands and given rise to great economic and social inequality. Prebisch did not return to the question of land distribution for many years, only doing so in the early 1960s (Prebisch, 1963), around the time when José Medina Echavarría was publishing in ECLA his analyses on the economic, social and political effects of the persistence of oligarchic power (Medina Echavarría, 1963).

With regard to the external vulnerability of the Argentine economy, he considered that this was due to the elementary fact that the dynamism of primary export activities depended on external demand and external capital, so that fluctuations in those two factors led to cycles of growth and crisis.

“Although Argentine monetary history appears to be confusing, it does in fact reflect a series of periods of boundless confidence and prosperity, of expansion of transactions, real estate speculation and financial bubbles, followed by more or less serious collapses causing outbreaks of panic which lead to the forced liquidation of operations, a slump in confidence, economic prostration and stagnation of business activities. Of course, these cycles are not exactly similar to each other in terms of their underlying conditions or their nature, but taken as a whole there are fundamental elements in them which are repeated and whose analysis can serve as the basis for theories on their evolution. In making this apparently *a priori* assertion, we have not

<sup>6</sup> At the Conference, the participants talked about “reconstruction” rather than “development”, but there are many similarities between these two concepts, as noted by the Latin American delegates who promoted the establishment of ECLA at the United Nations Assembly after the Second World War. They emphasized the many common features between the reconstruction of Europe and the development of Latin America: if an Economic Commission for Europe had been set up to aid in the reconstruction of that continent, then a similar Commission should be set up in Latin America to aid in its development (see Santa Cruz, 1995).

<sup>7</sup> In his comments on a government land settlement project he notes that “Every time an attempt to carry out agrarian reform is made in our country, the literature on these matters is copiously enriched by a flood of ideas and comments on foreign laws of this type. This great flood of words, however, contrasts vividly with the absence of effective action, which is smothered under lackadaisical legislative actions and washed out by the influence of the interests of the great landowners” (Prebisch, 1924b, p. 393).

been influenced by the description of the classical process of crises formulated by some economists: on the contrary, we will seek to demonstrate that in our crises –apart from some other minor differences– there is a fundamental factor which is lacking from the European crises and is peculiar to the country's degree of historical formation" (Prebisch, 1921d, p. 95).

Although his concern over inequality was only to re-surface a good many years later, his preoccupation with cyclical fluctuations was present in almost all his thinking throughout the next three decades, up to the time when he joined ECLA, when it was absorbed by the broader phenomenon of economic development. Prebisch embarked upon the historical study of the cyclical fluctuations of the Argentine economy because of his interest in finding the cause of the depreciation of the national currency, which had a highly negative impact on real wages: a very important matter in the Argentine socialist thinking of the period in which Prebisch was immersed.<sup>8</sup> Encouraged by his professor, Augusto Bunge, he studied the various proposals for stabilizing the purchasing power of the currency (Prebisch, 1921e) and criticised the approach taken by Juan B. Justo, the main Argentine socialist leader of the time, who considered that the determining factor in depreciation was excessive currency issue, overlooking the decisive role played by the balance of payments fluctuations caused by the external factors already mentioned (Prebisch, 1921b).<sup>9</sup>

In his analysis of the various cycles which had taken place in the Argentine economy he highlighted the importance of external factors, which represented the main "objective" elements originally promoting periods of upward growth. In schematic terms, and taking into account the existence of strong external demand, he considered that it was the inflow of foreign loans and investments, especially from 1865 onwards, which made possible the convertibility of the peso and

served as a basis for the increase in currency and credit which stimulated economic activity through the increase in opportunities for investment and gain and for the expansion of government expenditure, culminating in "excessive" expansion of the money supply –both with respect to the reserves and the volume of business– reflected in "artificial" growth marked especially by private speculation and fiscal irresponsibility. At that moment, he considered, the economic agents are full of "confidence" in the performance of the economy: a "subjective" factor of great importance in speeding up the cycles. The productive impulse is overtaken by an urge for speculation, however, which contains within it the seeds of its own failure: the balance of payments begins to register a deficit because of the disproportionate growth of imports and the increase in outlays on services, interest and other liabilities, so that reserves begin to flow out and the peso begins to depreciate, the bank reserves fall, credit becomes tighter, economic activity slows down, and the country finds itself in the midst of a downward phase, which normally makes it harder to obtain fresh external capital. At this point, the public and private actors who were originally responsible for the monetary and banking "excesses" that caused the "artificial" expansion of the economy try to check the downward trend through measures such as rediscounting and non-convertibility: these are the social forces which defend policies based on excessive currency issue or inflation. The crisis cannot be contained, however, and the fall in the reserves finally leads to a reduction in the money supply and credit, with consequent liquidation of assets and reduction of imports. The reduction of the latter makes it possible to obtain favourable trade balances which permit the payment of debts and reactivation of the economy, thus giving rise to a renewed climate of confidence which attracts foreign capital, setting off a new upward phase.

In those days, Prebisch supported the idea that the liquidation of assets promoted by the application of the Gold Standard would make it possible to "cleanse" the economy of the excesses of "artificial" expansion and defeat the forces advocating currency issue and practising speculation, but the economic history of Argentina shows that this is only a transitory defeat, since these tendencies will reappear in the next upward phase. The inflow of external capital, of course, depends both on its availability and on the expectations of confidence and profitability that the investors perceive in the borrowing country. Prebisch notes that there have been occasions when the abundance of capital and the

<sup>8</sup> The first article on this matter seems to have been that which he published in the newspaper *La Vanguardia* (Prebisch, 1920). I should like to thank José Besa for providing me with a copy of that article, from the documentary records of Mrs. Adela Mol de Prebisch.

<sup>9</sup> In criticising Justo he based his arguments on the study by Williams (1920) on monetary fluctuations in Argentina, which had a lasting influence on him, since it served as a guide both for his ideas and the method of investigation he used. At all events, he acknowledged a little later that his criticisms of Justo had been somewhat too harsh, because currency issues in the period studied had in fact been greater than Williams and he himself had stated (Prebisch, 1921d).

feeling of confidence prevailing in the lending countries have sometimes allowed Argentina to keep on receiving capital and putting off the start of the downward phase in spite of the existence of appreciable trade deficits, but such postponements have never succeeded in preventing the crisis from occurring eventually.

Although the foregoing outline of Prebisch's view of the formation of cycles has been extremely brief, it nevertheless shows the significance of that view for the ideas which he put forward in 1949.

Above all, as he himself acknowledged, that view of cycles is the origin of his conviction that the primary export pattern is intrinsically vulnerable to variations in external demand and in the flow of capital, which thus become one of the main elements explaining economic fluctuations. In other words, he asserts that the Argentine economy has established a form of relationship with the industrial countries in which its functioning depends on the demand and capital of those countries, which has brought considerable growth, but growth subject to fluctuations which it has not been possible to control. Prebisch's schematic view is a dichotomy: on one side are the industrial and creditor countries, and on the other is Argentina, as a primary exporting country and debtor. Between these two there is a difference in the degree of "historical formation" which is equivalent not so much to inequality of living conditions as to inequality of social and institutional solidity; at any rate, that is what emerges from the comparison he makes between the Argentine banks and the Bank of England. The concept which comes closest to this is the development-underdevelopment contrast, if understood in a manner which does not take account only of economic dimensions. In addition, however, there is not only a difference of degree between the members of that dichotomy, in the sense that they have unequal degrees of historical formation, but also a functional relation, in that they carry out functions and maintain relations of interdependence within the same structure, and furthermore that functional relation involves a relation of domination within the structure of the world market.<sup>10</sup>

Decidedly, Prebisch does not like the fact that Argentina forms part of a structure in which it obtains benefits, but at the cost of loss of control. Obviously, there is only a single step separating this view from the centre-periphery scheme: all that is needed is to extend

the approach to cover all primary exporting debtor countries. It will be recalled that external vulnerability is one of the defects attributed to the primary export pattern in the 1949 Report, although at that time Prebisch paid more attention to trade vulnerability than to financial vulnerability, because in those days the Latin American countries had very little access to international capital after the cessations of payment that followed the crisis. In recent decades, however, the financial vulnerability associated with the condition of debtor countries has recovered all its importance in Latin America.

Secondly, Prebisch placed great emphasis in his initial works on the importance of external factors in the cycle dynamics of Argentina, because he considered that they were not being given their due importance compared with internal factors. This did not mean, however, that he ignored the latter; on the contrary, his analytical approach is much more complex than one based on mere dependence on external stimuli, because it incorporates internal sociological and psychosocial stimuli. Both the feelings of the actors (especially their greater or lesser confidence in the economic outlook) and the "social forces" play a significant role in cycle dynamics.<sup>11</sup>

In his view, the most suitable approach for the study of cycles was one similar to that which ECLA sociologists were to propose forty years later for studying the historical development process in Latin America: to pay considerable attention to external factors, but to remain constantly aware that their impact on peripheral society is not manifested directly, because it is affected by the attitudes and behaviour of the domestic social forces. Prebisch summed up his view by stating that the dynamics of an economy are the consequence of "a series of mutual actions and reactions between the two types of factors" (Prebisch, 1921d). Although he appreciated the importance of domestic factors, however, he regretted that he could not study them, perhaps because he felt that he lacked the sociological knowledge for doing so; apparently no such study was made by any sociologist of the time either, thus losing the opportunity to lay the bases for a sociological theory of the Argentine business cycles.<sup>12</sup>

<sup>10</sup> This latter aspect concerns what Max Weber calls "domination based on a constellation of interests", which must be differentiated from domination based on authority (Weber, 1964, vol. II).

<sup>11</sup> The incorporation of subjective factors into the analysis of cycles shows the influence of Pareto. For that author, social phenomena take the form of cyclic fluctuations, and in them the feelings of the actors –the basis for non-logical actions– play a decisive role (see Prebisch, 1923b).

<sup>12</sup> This gap was filled for a time during the 1960s in ECLA studies by a number of sociologists, notably José Medina Echavarría and

Thirdly, and paradoxically, in those years Prebisch combined his critical view of the primary export pattern with a conviction that the rules of the Gold Standard would make it possible to “cleanse” the economy of monetary and fiscal excesses and external sector imbalances, thus recovering macroeconomic balance, disciplining the social forces and resuming growth. This was the orthodox dimension which remained in his thinking and only disappeared with the 1929 crisis, although there are some indications that he had already begun to have his doubts about it before that date. His confidence in the Gold Standard led him to reject the initiatives for the creation of some kind of institution designed to regulate the economic cycle. He called Norberto Piñero’s idea of setting up a bank to regulate cycles “banking orthopaedics” (Prebisch, 1921c) and likewise criticised Emilio Frers’ proposal to set up an International Convertibility Board. “All the countries with depreciated currencies long to get back to the Gold Standard. So why interfere with it? And some of them, through drastic disinflation of the money supply, through savings on public expenditure and through a determined effort to improve their international balance of payments position, are on the point of doing so. Such is the case of Great Britain. Noted economists are already pointing to it as an example to follow” (Prebisch, 1923a, p. 359).

The paradoxical aspect of this is that at the same time that he was drawing attention to the importance of external factors in the dynamics of cycles, he accepted that economic policy should be based on a mechanism which asserted that domestic factors were responsible for external imbalances. At all events, Prebisch believed that the policy of “liquidation” needed to restore order after the “excesses” should be used to ensure that they were not repeated, by reorienting the economy towards a more genuine form of growth. This meant that production and financial activities should be based preferentially on domestic saving (since external saving was a source of vulnerability and instability, because it always ended up by disappearing) and the money supply and credit should be adapted to the existing reserves and the real needs of the economy. In other words, he wanted a more productive and less speculative economy, with a solidity coming from within, based on domestic saving and

investment, whose growth is less spasmodic, and with a sound currency and solid banks. He did not say anything about changes in the development pattern and made no mention of industrialization, but it may be presumed that he must have had them in mind, for otherwise how could Argentina raise its degree of “historical formation” and reduce its external vulnerability?

Finally, it is very likely that the scant attention paid by the Argentine economists of that time to the role of external factors in the evolution of Argentine cycles (in keeping with the ideas then prevailing in the centres) brought home very clearly to Prebisch for the first time the danger of accepting out of hand theories developed in other contexts and leaving out of the reckoning the special features of the Argentine situation: a danger he reiterated in 1949. As already noted, this does not mean that he proposed ignoring those theoretical efforts: on the contrary, he considered that their elements of value must be extracted from them to the full, as he himself did in the case of the studies by Harvard economist John Williams, which showed him the importance that should be attached to external factors in Argentina’s cycles. He noted in this respect that the under-estimation of those factors has led to serious policy errors even in the centres, as for example in the case of the international recommendations made to the German Government at that time for tackling its grave monetary problems. Those recommendations, which were based on the classical approach, maintained that those problems were caused by the increase in the money supply, which must be reduced at all costs, and they failed to notice that that increase was due to the demands for the payment of war reparations. Prebisch concluded that it was useless to insist that the German Government must control monetary expansion without first reaching an international agreement to relieve the burden of the reparations (Prebisch, 1922a).

#### **4. The crisis, and the consolidation of his heterodox approach**

Prebisch formulated the foregoing ideas between 1921 and 1924. In the following years, he continued to be very interested in studying the cyclic problems of the Argentine economy, but was faced with the problem of the lack of empirical information, so he made a great effort to prepare and compile statistics that would enable him to make a deeper analysis. He first of all occupied the post of Deputy Director of the National Statistical Institute, then of the Statistical Office of the Sociedad

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Fernando Henrique Cardoso. This line of analysis has been interrupted in ECLA since the 1970s because an economic approach has prevailed.

Rural Argentina, and subsequently, from 1927, of the Bureau of Research and Information of the Banco de la Nación Argentina. The information collected served as the basis –especially in the last-named post– for the preparation of detailed descriptions of the economic situation; his approach continued to be that which he had developed in previous years, but –as was to be expected from an author working in a government office– he reduced his criticisms and increased the amount of empirical description.

These studies reflect his effort to unravel the significance of the recessive tendencies which he perceived from 1928 on. The first symptoms of what was subsequently to become the great crisis of 1929 allowed him to assert that once again Argentina –as a country which depended on outside demand and capital– was being affected by turbulences originating in the main industrial economies. In mid-1928 the inflow of external capital began to go down because of the increase in interest rates imposed by the Federal Reserve, which was very worried about the expansion in the amount of credit used for stock market speculation, and moreover the prices of Argentina's exports fell because of the lower demand by the industrial countries. This obliged the Argentine Government to cover its growing balance of payments deficit through an outflow of hard money, with its natural consequences for the monetary process (Prebisch, 1929 and 1930a). In those studies he also noted for the first time, however, that the fall in the prices of agricultural commodities was aggravated by the fact that those prices fell more than those of industrial goods. That process of relative deterioration of commodity prices compared with those of industrial goods could be due to various causes, but on that occasion he only argued that it was due to the fact that the inelasticity of agricultural supply had not allowed it to evolve in line with the drop in external demand.

Up to mid-1930, Prebisch (1930a and 1930b) held that those phenomena were merely specific manifestations of yet another cyclic decline, of the many that Argentina had experienced. "It may be considered as a short-term economic phenomenon, a downward period in the up and down movements that normally mark the evolution of any country; as a purely superficial event... which does not in itself affect the structure of the national economy or involve any significant departure from the ongoing upward trend in the country's economic activities" (Prebisch, 1930a, pp. 613-619).

It was in these circumstances that a new stage in Prebisch's life began when, in 1931, he took office as

Undersecretary of Finance and was called upon to make a decisive contribution to the task of formulating and applying policies to deal with the crisis. During that year and the next, government policy combined orthodox measures, such as the reduction of public expenditure, higher taxes and tighter credit, with other measures of a heterodox nature such as authorizing rediscounting operations in order to improve the situation of the banks and their creditors (Prebisch, 1931a), raising tariffs in order to check the balance of payments deficit and reduce the fiscal deficit, controlling the exchange rate in order to defend the value of the peso with respect to gold (Prebisch, 1931b), and introducing income tax in order to improve fiscal revenue (Prebisch, 1932a). These heterodox measures which Prebisch helped to formulate and implement as from 1931 were always presented as transitory and extraordinary, so that they were accepted by the rest of the members of the government and by the economic elite, among whom orthodox economic policy tendencies prevailed. They were always presented as being essential for dealing with an abnormal real situation; when things returned to normal they would be abandoned, and good normal doctrines would prevail once more. In addition, there was a project for the establishment of a Central Bank, which Prebisch drafted in 1931 but which the Executive did not dare to present to Congress because it was afraid it would be considered too interventionist and permanent, which proposed to regulate not only the inflationary tendencies in the upward phases of cycles but also (which was considered an unacceptably heterodox idea) the recessive tendencies in the downward phases (Prebisch, 1972).

Thus, he very quickly abandoned the Gold Standard and turned to heterodoxy, when he still believed that the crisis was merely a cyclic downturn; he no longer accepted that the liquidation of assets was an acceptable way out of the crisis, or that the automatic market mechanisms should be given full freedom to act. The rapidity of this change in his ideas raises the suspicion that he had already begun to doubt the validity of such convictions even before the crisis: indeed, he had already explicitly expressed his doubts about the efficacy of the market mechanisms when, years before the crisis, he supported State intervention in the meat market (Prebisch, 1927). Likewise, in the bill for the authorization of rediscounting operations in 1931, and very emphatically in 1932, he rejected the "liquidation" of assets as a way of putting the economy on a sounder footing and restoring growth: the State, of course, could not be liquidated, and he saw no advantage in



liquidating rural producers who could not pay off their loans because of the fall in the international prices for their products.

In his writings of those years, he returned to his old idea that the dynamics of cycles are affected by both external and internal factors; thus, he asserted that the problems Argentina was suffering were due both to monetary and fiscal excesses and to the external difficulties caused by the drop in export prices and the fall in capital inflows, as well as the country's weak monetary institutions. The proposal he put forward in mid-1932 was therefore to attack all those factors simultaneously through restrictive monetary and fiscal measures, exchange controls and foreign trade control measures, and a Central Bank which would put monetary institutions and policies in order and regulate cyclic fluctuations. At that time he still maintained that the crisis was merely a cyclic downturn, but he was beginning to suspect something worse: for many decades the evolution of the Argentine economy had been one of "growth only interrupted by depressions that were of short duration and low amplitude, in contrast with the severe features of the present recession" (Prebisch, 1932b, p. 86).

In 1933, however, he no longer had any doubt that the crisis was not just a cyclic downturn: between 1929 and 1933 agricultural commodity prices had gone down by almost half in pesos and by over two-thirds in gold; indeed, the prices in gold in 1933 were well below those prevailing in 1900. This reduction was much greater and longer-lasting than those which had occurred in cyclic downturns, and its impact was therefore broader and deeper, to the point of "..... violently upsetting the economic structure of the country" (Prebisch, 1933c, p. 135). Because of this, in order to pay the same amount of interest on its debt Argentina needed 200% more agricultural products in 1933 than in 1929 and, because of the deterioration in agricultural commodity prices compared with those of industrial products, Argentina needed 78% more of the former to buy a given amount of the latter in 1933 than in 1929.

This serious diagnosis was accompanied by a pessimistic forecast regarding the possibility of returning to the pre-crisis situation in the short term. This appraisal must have been considerably influenced by two events. First, when he took part in the organization of the 1932/1933 World Economic Conference he became aware of the enormous political, trade and financial difficulties hindering the evolution of the international economy, including the persistence of the problems connected with war debts, the obstacles

standing in the way of tariff reduction, the dislocation of exchange rates, and the protectionist and reserve-building policy followed by the United States. This latter issue, which was to be given considerable prominence in Prebisch (1949), was a source of special concern to him in view of the central position of that country in the international economy. Some of those problems (such as the war debts and protectionist tendencies) already existed before 1929, but the crisis made them worse and also created other new problems (Prebisch, 1933a). His pessimism must have been further heightened by the conditions that Argentina had to accept in its negotiations with Great Britain, which culminated in the 1933 Roca-Runciman agreement. Prebisch formed part of the Argentine negotiating team and knew at first hand the force with which Great Britain (the main buyer of Argentine products) took advantage of its economic power in order to regulate trade with Argentina in line with its own interests (Prebisch, 1933b).<sup>13</sup>

In such circumstances, three ideas must have come together in Prebisch's mind: i) full confirmation of his long-standing criticisms of the Argentine economy's external vulnerability as an agricultural commodity exporting and debtor country, along with the more recent idea of the deterioration of the terms of trade; ii) the conviction that the crisis was much broader and deeper than a mere cyclic downturn, and that it shook the very foundations of the economy; and iii) the improbability that Argentina would be able to return to the situation existing before the crisis, because of the problems affecting the international economy at both the multilateral and bilateral levels. Those ideas must have convinced him that it was necessary to make an even deeper search for new ways of bringing his country out of its present situation.

He had already become convinced that the automatic mechanisms of the Gold Standard were not appropriate to the Argentine situation, since they were procyclical and attacked the external imbalance only indirectly, through restrictive fiscal and monetary measures, which led to an economic and social cost which was unacceptable to him; instead, that imbalance should be tackled through direct measures designed to regulate the exchange market and foreign trade. This was an advance in his heterodox thinking, but it only

<sup>13</sup> The article by González and Pollock (1991) gives a very good analysis of the influence of these events on Prebisch's thinking –and state of mind.

referred to the manner –interventionist rather than automatic– of achieving balanced external accounts. A further decisive step was needed in terms of the application of active policies to bring the Argentine economy out of recession, and it was necessary to decide to what extent that called for the establishment of a new development pattern, now that it was clear to him that the primary export model would not be capable –at least for a long time to come– of playing the dynamic role that it had had before the crisis. In this aspect, Prebisch was influenced both by the ideas being formulated in those years in the industrial countries (especially the contribution of Keynes) and the policies being applied in them, especially in Great Britain and the United States. An analysis of this aspect is outside the scope of this article, however.<sup>14</sup>

He began to take this step with the National Economic Plan of Action which he prepared together with a number of colleagues in late 1933, with the explicit aim of “lightening the burden of the economic depression on the country” (Prebisch, 1934a, p. 146). After having put the monetary and fiscal situation in order, the Plan provided for a first set of measures to tackle the balance of payments deficit problem that Argentina suffered as an agricultural-exporting and debtor country, through devaluation and exchange and import controls. In defending these measures he explicitly and definitively broke with the Gold Standard system, since that only served to correct price and balance of payments upsets caused by an excessive increase in the money supply, but in 1933 no-one doubted that such upsets had not been caused by “excesses” or faults in the calculations of the economic agents, but rather by an unusually great and unforeseeable drop in international prices. Applying the Gold Standard mechanism, while ignoring the fundamental importance of external factors, would merely make the crisis still worse by causing an extraordinarily severe liquidation of assets.<sup>15</sup> He had already set forth these ideas earlier, but in this Plan it was noteworthy that, as well as seeking to balance the external sector, these measures were also designed to reactivate the economy; exchange and import controls would protect industrial activities from outside competition, and the devaluation would have a beneficial effect on rural producers. Without

devaluation, the domestic prices of agricultural products would drop in line with international prices, and producers would not be able to pay their debts contracted at higher price levels, thus causing enormous successive liquidations of assets; in contrast, devaluation would reduce the impact of the drop in international prices on those producers.

A second set of measures was designed to promote reactivation of industrial production directly through a recovery in domestic demand. He argued that the reduction in the purchasing power of the population had reduced economic activity and increased unemployment, giving rise to a situation which needed to be corrected by the government through a large-scale public works plan designed to reduce unemployment and increase the purchasing power and consumption of the population, thus stimulating the reactivation of domestic industrial production, which would be further protected by the inability to import goods from abroad. He noted that in recent years tariff protection and the higher cost of foreign exchange had favoured domestic consumption and production, giving rise to an extremely important process: “local industries ..... have managed to expand their production, while foreign trade has declined” (Prebisch, 1934b, p. 201). In short, “... it is very unlikely that the stimulus so desperately needed by the Argentine economy can come from outside; solutions must be sought within the country itself” (*Ibid.*, p. 144).

The Plan also has many other aspects worthy of interest, such as for example its attention to the redistributive effects of the economic policy measures on the different social groups, as already hinted in his early studies. This in turn leads the way to another issue of great importance: the social consequences of economic policies, for when redistributive effects are caused by the hidden hand of the market, as under the Gold Standard system, economists are not obliged to take complex ethical decisions, but when such effects are caused by their own interventions they have no alternative but to take them into account and analyse them carefully. Thus, for example, devaluation favours rural producers by improving the domestic prices of their products, which seemed fair to Prebisch because they had been one of the groups most seriously affected by the crisis. But this can encourage some of them to sell their products abroad at knockdown prices, thus adversely affecting the rest, so the government prevented this by setting up an institution to control this process (the National Cereals Board). Or other producers may try to derive excessive benefits by selling

<sup>14</sup> See, in this respect, the articles by Love (1994 and 1999), González and Pollock (1991), and Rodríguez (2001a and 2001b).

<sup>15</sup> His criticism of the Gold Standard appears in various studies of the time. See in particular Prebisch, 1934c.

the foreign exchange they obtain on the black market, so the government took steps to oblige them to change it on the official market. This shows that the Plan is important not only for its heterodoxy and its expansionary nature but also for its concern for the distributive effects of the measures taken.

How far did this Plan seek to reorient economic activity towards a development pattern in which industrial development played a decisive role, or was it only concerned with stimulating economic activity? Bearing in mind what we said earlier about the previous evolution of his ideas, there can be no doubt that the Plan was Prebisch's first answer to the question of how Argentina could cease to be an agricultural exporting debtor country: a question that Prebisch must have posed himself right from the start of his intellectual life, when he saw the problems that those problems brought with them. At that time he would have said that Argentina's situation as a debtor country could be overcome through a big domestic saving effort, but up to 1933 he had not written anything about how that country could overcome its dependence on agricultural exports. The idea of industrialization must have passed through his mind, however, for how otherwise could Argentina overcome that situation and raise its "degree of historical formation" to a level comparable with that of the important countries of the world? It would have been difficult to defend such ideas, as long as Argentina was registering high growth rates as an agricultural exporting country and the economic power was in the hands of an elite whose core consisted of great landowners. The situation changed in 1933, however, when it was clear that agricultural export activities had sunk into a deep crisis because of the serious drop in export prices, the deterioration of the terms of trade and the dislocation of international trade due to the crisis and United States protectionism, whereas industrialization had shown its capacity for increasing the supply of goods and improving employment and incomes.

Finally, some comments are called for on Prebisch's views in his early years about State intervention in the economy: a matter he never dealt with explicitly.<sup>16</sup> Above all, Prebisch was always a fervent defender of disciplined and austere economic processes and he rejected all "excesses", be they monetary, fiscal, or in the fields of external trade,

consumption or other areas. This attitude was always present in his thinking, right from the start of his personal and intellectual life, and is the reason why he always believed that countries must maintain well-ordered accounts, avoid conspicuous consumption, and base their growth on domestic saving, without resorting to the easy but spurious "solutions" of external indebtedness and inflation. At first, he believed that the free play of the market forces would be sufficient to achieve this, but between the late 1920s and the early 1930s he gradually realized that this was not the way to go, and he began to advocate State intervention. He had no doubt that it was necessary to guide and discipline the private economic actors: for example, he scornfully referred to landowners who were not capable of seeing where their real interests lay,<sup>17</sup> and in the decree serving as the basis for exchange controls he argues flatly that "the harmful anarchy prevailing in the market must be replaced with a centralized approach run by the most capable elements" (Prebisch, 1931b, p. 4). It was increasingly clear to him that the economic process must be regulated by an enlightened State elite capable of avoiding the pressures of powerful economic agents and also of governments themselves, which, as he showed in his first analyses on cycles, usually handle their economic affairs in an improvident, electoralist and often corrupt manner.

## 5. Conclusions

Prebisch's work on development began in 1921, when he became aware that the Argentine economy was highly vulnerable to the fluctuations caused by the industrial countries because of the position they occupied in the world economic system. This was the foundation-stone of the body of theories he built up over the years, which took its final shape in the centre-periphery scheme. As the most important exponent of Latin American structuralist thinking, he did not need to wait for the impact of the 1929 crisis in order to be aware of the intrinsically vulnerable and unequal nature of a development pattern whose functioning depended on foreign demand and capital and which was based on the concentration of land ownership; the crisis confirmed his diagnosis and made it urgently necessary

<sup>16</sup> With regard to ECLAC's thinking on the role of the State, see Gurrieri, 1987.

<sup>17</sup> "...the stock-raising crisis has shaken the great Argentine landowners out of their lethargy and may be a powerful element in turning their class instincts – mostly incoherent, disoriented and negative – into a clear awareness of their economic interests" (Prebisch, 1922b, p. 349).

to seek solutions, but it was not itself the prime cause of the problems. There is therefore a marked continuity in the evolution of Prebisch's ideas from his first youthful studies to the 1949 Report in which he presented his developmentalist "manifesto": those early studies already contain, to a greater or lesser extent, almost all the ideas he put forward when he joined ECLA, so it would be a mistake to overlook them as if they were merely another expression of neoclassical thinking.

Ever since 1921 Prebisch was concerned with the question of finding a less vulnerable and unequal way of organizing economic activity in Argentina. With regard to the dependence on external capital, his answer was immediate: much greater emphasis should be placed on domestic saving. The answers to the problem of dependence on external demand and the reduction of inequality were much more complicated, however, because they involved profound restructuring of the economy and came into conflict with the dominant interests. As already noted, he only returned to the question of inequality due to the concentration of ownership in the early 1960s, but he already gave a first response to the problem of external demand in the 1933 Plan, although he had probably been turning it over in his mind much earlier. What we can say for sure on the basis of his works is that in seeking new ways of reducing external vulnerability he had to abandon above all his support for the Gold Standard. This occurred when he became convinced that that standard was unsuitable because it subjected monetary and exchange policies to a criterion which took no account of the interests of the Argentine economy, since it expanded the cyclic fluctuations instead of reducing them and involved the application of restrictive monetary and fiscal measures which gave rise to high social costs. It was at this point that he proposed direct intervention on the exchange rate and foreign trade, and he began to apply measures in that direction when he took up a government post in 1931. Those measures not only helped to balance the balance of payments, however, but also helped to reactivate the economy, because they fostered domestic production, with beneficial effects on employment and income. In other

words they showed –if such a demonstration were needed– that industrialization should be an essential component of policies designed to reduce the dependence on external demand, so that in late 1933 he helped draft a Plan which combined control measures for the external sector with others expressly aimed at stimulating domestic supply and demand. This was his first consistent response on how to change the Argentine economy's situation of external vulnerability. The industrial development which took place in those years, however, revealed to him that industrialization also brings its own external vulnerability with it, so he insisted on the need to make such development compatible with the expansion of exports: a matter to which he devoted much attention in the 1949 Report.

Many other ideas put forward in that Report had already been present in his early works: the aggravation of external vulnerability through the deterioration in the terms of trade; the difficulties caused by the protectionist policies of the United States, and the error of accepting out of hand diagnoses and proposals prepared in the industrial countries, because they could well refer to different situations, so that economists must exercise a considerable degree of independent creation and critical judgement if they want to understand and successfully cope with the problems of their own national situations. He was also already convinced even as a young man that a combination of the market and State intervention was required in order to reorient the economy in the desired direction and promote its growth. As he was mistrustful of the political elites, he considered that such intervention should be carried out by an institution with a high degree of autonomy, staffed by technicians capable of disciplining and guiding the private and public agents in line with a technical and substantive rationale aimed at the benefit of the community as a whole. This perfectly expresses the way he then conceived the role of technicians in the decision-making process, and this is the line he took in ECLA and in the Central Bank of Argentina, which he helped to set up and of which he became General Manager in 1935.

*(Original: Spanish)*

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# Raúl Prebisch:

## *his years in government*

Roberto Cortés Conde\*

### 1. The early years

The Prebisch that most people remember nowadays was a distinguished figure in international circles, with only sporadic interventions (1955 and 1984) in the economic affairs of Argentina, but this Prebisch who lived outside Argentina in the second half of the twentieth century played an extremely important role when he was a young man in the design and implementation of policies that brought about notable changes in that country.

He had graduated from the Faculty of Economic Sciences in 1923, and twenty years later, when he was still only 42 years old, he was forced to put an end to his work as General Manager of the Central Bank of the Argentine Republic, after eight years in that post and after having occupied high posts in the government.

When he was still a student he translated the study that J.H. Williams presented at the seminars of the school.<sup>1</sup> That work, and through it Taussig's ideas on economic cycles and balance of payments adjustments with capital movements, gave him the idea of analysing the Argentine cycles and mechanisms not envisaged in current international trade theory.

In 1922 Alejandro Bunge put forward his name to occupy the post of Director of Statistics of the Sociedad Rural Argentina. There he headed a team which in 1928 published a yearbook with the fullest historico-statistical information on the country to date.

In that same year he was entrusted with the organization of an economic research department in the Banco de la Nación Argentina, where he was to carry out important work on the compilation of statistics and short-term economic analysis, published in the Bank's *Revista económica* (BNA, 1928).

When Argentina was faced with new problems in the 1930s, the theoretical and statistical knowledge thus acquired allowed him to meet a challenge to which few intellectuals of that country have been able to respond. The circumstances he had to live in: the end of one world, that of the belle époque, and the appearance of a new one, that of closed economies and nationalist reactions, were hard for anyone to understand.

It was necessary to adapt or construct theories to explain phenomena which were previously unknown and hence had never been studied before. His visit to Australia in the 1920s and his stay in the United States—including his friendship with Williams—helped him in this task and allowed him to keep abreast of the newest intellectual developments.

Under the influence of Williams' study on balance of payments adjustment mechanisms in a country with inconvertible paper money and the theories on economic cycles (Taussig, 1915; Hawtrey, 1919;

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<sup>1</sup> See Williams, 1969.

Kondratieff, 1946), he began to work out new interpretations on the characteristics of the Argentine cycle. Argentina had an economy which depended on its exports of cereals, and this gave it a seasonal nature and also made it very vulnerable, since it was affected both by weather conditions and by the big fluctuations in international markets. There was also a monetary system which further accentuated such fluctuations. The seasonal cycle –which had come to be called the Argentine cycle– meant that when the harvests were sold in the summer months there was an inflow of gold and the banks expanded their supply of credit, whereas in winter, when there were no export proceeds, there was a shrinkage in national income and the banks reduced their credit. This gave rise to the idea of taking counter-cyclical measures.

In 1921, while he was still a student in the school of Economic Sciences, Prebisch published his “Notas para la historia monetaria de la Argentina” (Prebisch, 1921), in which he went back all the way to colonial monetary antecedents, noting that it was paradoxical that in a colony producing silver there was a shortage of currency. It was not that there was a shortage of silver, he said, but that as the Mint received currency at a lower price than it had as a commodity, it hoarded it and only circulated bad money: the “macuquina”, a feeble currency which was considered to be of little value because of its low content of silver, or local substitutes. In his “Notas” he studied the experience of issuing banks and inconvertible paper currency, as well as the crises of 1876, 1885 and 1890, maintaining that they were the result of over-expansion of credit in the upward phases of the cycle, in which purchasing power was created through money issue, whereas this situation was reversed when a deficit appeared in the balance of payments and the money supply had to be reduced. In the last part of the article in question he dealt with the 1913 crisis and began to outline a theory on monetary disturbances in the phases of cycles with a Currency Board system: a theory which he later developed in the Central Bank, in that institution’s *Memoria* for 1938 (BCRA, 1939). He said in that respect that whereas in issuing banks the money issue is based on commercial credit, in a Currency Board system money can only be issued on the basis of the balance of payments surplus (gold reserves). He noted however that even under the latter system inflows of gold produce not only an increase in the money supply but also an increase in the reserves of the banks, which, because they have more reserves, likewise expand credit. Hence, in an upward phase of the cycle there is over-expansion of

credit (a procyclical tendency), whereas when the opposite takes place there is an outflow of gold, the reserves go down, and credit shrinks still further. This is what happened in the upward phase of the cycle in 1913, he said, causing a chain reaction and giving rise to generalized pessimism on the economic outlook which made the recession still worse through its effects on consumption and investment.

## 2. His years in government and in the Central Bank

The 1930s was a period of enormous difficulties, but also of new experiences in the formulation and implementation of economic policies, under the new roles taken on by the government.

The 1930 world crisis made it necessary for Argentina to place itself in a totally different international context and find answers to situations which were previously unknown.

In 1933 Prebisch had read the four articles by Keynes published in *The Times*, after which, he said, “I began to think about an expansionary policy”.<sup>2</sup> Later on, he was to play a leading part in disseminating Keynes’s ideas in Spanish (Prebisch, 1947).

After the enormous upsets in the international goods and capital markets during the period following the First World War, the rigidity of the Gold Standard had become obvious. Argentina had been one of the few countries which, following the lead of Great Britain, had returned to a Currency Board system in 1927, at the parity which had prevailed before the war. It may be noted that during the time that that system had been closed down, currency issue had continued under the rules of the Gold Standard. In 1914 a law had been adopted permitting the issue of money on the basis of the discounting of paper of the Banco de la Nación Argentina, provided that 40% of the reserves were kept in gold. This law had not been used, however. In 1929, after the collapse of the New York Stock Exchange, and fearing a run on the banks, the government decided to close down the Currency Board, but it did not prevent remittances abroad and, after the first devaluation, it tried to maintain an overvalued exchange rate for the peso by selling gold. After the 1930 revolution, and finding itself in a difficult situation because the outflow of gold to pay debts and imports continued and delays were building up in the delivery of foreign exchange, it decided –in line with the 1914 law– that the Currency Board would issue money on the basis of paper

<sup>2</sup> Quoted in Fernández López, 1996.



discounted by the Banco de la Nación Argentina. As Prebisch (who had been Under-Secretary of Finance up to 1932) noted, that measure did not yet represent a change from the orthodox policy with which the government aimed to face the crisis (i.e., reducing expenditure and increasing taxes), but was taken because it was urgently necessary to replenish the assets of the banking system, which had been exhausted with the outflow of gold. At all events, however, the Gold Standard system was made more flexible. Taxes were established on remittances and government expenditure was reduced by lowering the wages of public employees. Rather than because of the closing down of the Currency Board and the application of the 1914 law, 1932 was important because it was then that money was issued on the basis of public securities in order to finance the Treasury deficit and a new conception of the monetary system came into being.

In 1933, with the entry of Pinedo into the Cabinet as Minister of Finance and the return of Prebisch as Under-Secretary, measures were applied which formed part of a plan guided by a new conception of economic policy. At the request of ministers Pinedo and Duhau, certain economic measures were formulated which were reflected in the National Economic Plan of Action of November 1933.

In that year the peso was devalued, not only in order to balance the balance of payments but also in order to support the agricultural sector. There was, said Prebisch, a true redistribution of profits; it was not just a mere exchange rate measure but was combined with the purchase of the harvest surpluses which it had not been possible to sell, in order to give the population greater purchasing power. It also aimed to stimulate economic activity through public works programmes and aid for industry.

Exchange controls were also established, with two markets: one official, on which the foreign exchange corresponding to the official prices of regular exports was sold, and the other a free market on which the excess over the official prices and the income from non-traditional exports to neighbouring countries could be changed. Two exchange rates were established: a buying rate at 15 pesos per pound sterling, and a selling rate which was finally set at 17 pesos. Since at these rates the demand for foreign exchange was greater than the supply, foreign exchange was rationed through prior import licences granted according to criteria fixed by the government. As Prebisch said: "Now, for the first time, we are putting into effect a monetary and financial plan which is above the old traditional influences" (BCRA, 1986, p. 50).

It was the understanding of everyone that these measures were of an extraordinary nature, as were the situations they sought to correct, and that when the Central Bank was set up in 1935 and exchange controls were allowed to continue, there was nevertheless the intention of getting rid of the latter and returning to a free market. In the message accompanying the bill proposing the establishment of the Central Bank – noted Prebisch – it was clearly stated that the aim was to establish a bank which would maintain the stability of the currency and make it possible to return to normal in monetary matters, but only provided that the main nations of the world did the same and that international trade was restored. But "if a system of closed economies prevails" – added the message – "the country will have, in its Central Bank, the means for adapting its policies to this *de facto* situation, in defence of the national interests" (BCRA, 1986, p. 51). These measures were adopted, then, in response to the closure of the economies of the most highly developed countries.

### 3. The Central Bank

Prebisch was a member of the first commission responsible for drafting a project for a central bank, but this was rejected in favour of a project by Otto Niemeyer, who had already prepared a similar project for Brazil. The 1935 law, however, differed from the Niemeyer project and incorporated modifications which bore the stamp of Prebisch.

The creation of the Central Bank was designed to achieve monetary stability and reduce the disturbances of the economic cycle. Prebisch maintained that in view of the characteristics of the cycle in Argentina, the Central Bank should intervene to smooth out the fluctuations by using absorption instruments. He considered that rediscounting, in contrast, would play only a transitory role.

"Thus, although the Bank was along classical lines ... the actual situation would not allow it to act in that manner" and "the possibility of applying another type of policy" should be envisaged. Here, he reiterated the concepts which he had already put forward in the early 1930s in "La acción de emergencia en el problema monetario" (Prebisch, 1991, p. 51). He went on to say "The strict Gold Standard system had an intrinsic flaw: during the upward phase the banks' assets grow, and this leads them to lend more money, because of the natural competition among them, so that they create more purchasing power than would be warranted by

the balance of payments position. This creation of purchasing power expands the effects of the upward phase but makes necessary a more violent contraction in the downward phase. But this is not the case if, instead of creating money, the compulsory reserves of the banks are increased during the upward phase, this extra cash is collected and sterilized so that it cannot serve to expand credit, and it is then returned when the situation is reversed, in order to avoid a contraction" (*Ibid.*, p. 52).

Rediscounting would be used only in limited cases: when a harvest failed or exports went down and there was an outflow of hard money. In those circumstances, rediscounting was in order in order to take pressure off the economy and prevent a contraction in agricultural activity and all the other activities connected with it.

The first intervention by the Central Bank took place from 1935 to mid-1937, in the upward phase, and involved the creation of absorption certificates which made it possible to sterilize purchasing power (saving), as well as buying back part of the external debt in dollars. When it was observed, in mid-1937, that the cycle was turning round and a downward phase was beginning, the reserves were used to give back purchasing power to the public in order to prevent a recession from spreading. The idea was to soften the cyclic curve and this, said Prebisch, was the second stage in "our monetary ideas". Up to then, purchasing power was taken away in the upward phase and returned in the downward phase, but money was not created.

In the next intervention, during the early years of the Second World War, the authorities went much further. In view of the severe contraction in the early years of the war, when traditional markets disappeared, it was decided to try to give a more active role to the policy of regulating the means of payment, by creating purchasing power in order to promote industry and construction work; that is to say, it was decided to apply very active market policies in order to promote the development of the economy, but within a monetary circuit controlled through the exchange control system.

This idea had been at the centre of the proposal made by minister Pinedo in his 1940 economic reactivation plan (BCRA, 1986), which consisted of mobilizing the enormous amount of idle deposits invested in the short term in the financial system, so that through the intervention of the Central Bank—which would purchase those deposits—the commercial banks would be able to make long-term loans, primarily for promoting construction (which was the most dynamic engine of growth in Prebisch's view) and local

industry. This would have to be done with extreme caution, and only as long as there was not full employment of the factors of production, because otherwise it would lead to inflation.

These measures—said Prebisch—finally turned out to be unnecessary, because from 1941 on, with the entry of the United States into the war, exports increased, the supply of imports was reduced, and purchasing power rose within the country. This instrument was, however, to be used later in very different circumstances with highly inflationary consequences, which he criticized in his 1955 report to the Argentine government (BCRA, 1956).

#### 4. Conclusions

In his years in government, Prebisch played a leading part in the formulation of new ideas and economic policies which had a profound influence in following decades. Many of them were put forward in response to exceptional circumstances, and were to be abandoned if those circumstances disappeared. In the final analysis, they were responses to a world in which economies had closed and there were no international capital markets.

The starting point for these ideas was the conviction that the Gold Standard could avoid monetary crises, but not banking crises, which had serious consequences for the whole economy because of the pro-cyclical nature of bank credit. Prebisch proposed that compulsory reserves should be increased in the expansion phase and reduced in the contraction phase, and that a reserve fund should be established which would withdraw purchasing power from the public (through absorption certificates) and return it to them (by buying back those certificates) in the downward phase, while rediscounting should be only a transitory measure. In order for that purchasing power not to be diverted towards imports, there should be an exchange control system with selective exchange permits.

Although Prebisch does not actually say this in as many words, the idea was that counter-cyclical policies should be applied in the upward phase, when it is possible to build up reserves, for if it is not possible to restore purchasing power in the downward phase, this can only be expanded by creating money, which he does not recommend as it would produce inflation. All this, however—and this is an aspect which Prebisch does not mention because it seems so obvious—requires a thoroughly solvent and credible State.

In reality, this is rather similar to smoothing of taxes. But why use a monetary instrument instead of a fiscal one, then? In fact, fiscal instruments were not ruled out, since in the upward phase in 1935-1937 external debt was bought back with part of the surplus, but apparently it was politically easier to restrict credit by increasing the reserves in an upward phase than to increase taxes or reduce expenditure, when this had already been done earlier in order to balance the budget.

Finally, the last stage in what Prebisch called his thinking on economic management has to do with the reactivation plan prepared by minister Pinedo and the Central Bank policies designed to use the surplus of short-term deposits for long-term loans in order to promote construction and industrial activity. The Central Bank was to take those short-term deposits and then lend them to the banks on a long-term basis, the justification for that measure being the upsets caused by the war in agricultural production, which had no outlet for its goods, and the need to orient activities

toward the domestic market. The entry of the United States into the conflict in 1941 changed the situation, however, as exports of wool and hides to that country increased, while imports went down, thus balancing the balance of payments and, in Prebisch's view, making it unnecessary to apply the measure.

At all events, however, new policy instruments had now been created.

After Prebisch had been removed from the Central Bank, in 1943, that institution made repeated widespread use of rediscounting, with very adverse consequences for the economy, as he himself emphasized in his 1955 report to the Argentine government (BCRA, 1956). By then, after more than a decade in the government, his economic ideas had reached maturity, and since that time they have had an undeniable influence on numerous aspects of the economic thinking and history of Argentina.

(Original: Spanish)

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# Markets and the State

## *in the evolution of the*

# “Prebisch manifesto”

Edgar Dosman\*

### 1. Introduction

When Raúl Prebisch died in 1986 his ideas were out of fashion in Ronald Reagan's Washington and Latin American capitals, dismissed by most Western economists as *passé* –or even dangerously misguided in the new crusade for globalization. Only United Nations circles and a narrowing band of supporters insisted on his permanent contribution. It was as if his life had merely reflected the turbulence of the “short, violent century” (as Hobsbawm termed it); now that it was over, with the Cold War consigned to history, so too (it appeared) was Prebisch's legacy.<sup>1</sup>

Exactly the reverse has occurred. Prebisch's life and work retains a remarkable contemporary significance. Instead of diminishing, his stature as economist and policy-maker has grown, and the recognition of the magnitude of Prebisch's contribution continues to expand as previously unpublished sources and unpublished manuscripts are assembled by scholars. Prebisch, it turns out, wears very well. The

central theme which preoccupied him from the 1920s to the North-South Dialogue was the relationship between markets and the State; today globalization and its unpopular aspects (or “civilizing globalization” as some authors have termed it) remains the central challenge for both Latin America and most of humanity. For this reason, it is worth revisiting Prebisch's immense contribution –both the challenges he faced, and the concepts and policy tools he evolved through trial and error to meet the development challenges of Argentina, Latin America and the world.<sup>2</sup>

No person of his stature has been as neglected or misunderstood in the literature as Raúl Prebisch. This is not to claim that important contributions by senior scholars regarding individual segments of his life are unavailable; indeed a rich bibliography exists and continues to expand.<sup>3</sup> Instead, the obstacle which has

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<sup>1</sup> A special note of appreciation is extended to Doña Adelita Prebisch for giving me access to the Prebisch Papers in Santiago, Chile; for her permission to quote from these papers; and for her unlimited personal assistance in researching the life and work of Raúl Prebisch. I wish also to thank Eliana Prebisch and the Prebisch Foundation in Buenos Aires for their kind collaboration; Adolfo Gurrieri and David H. Pollock for their comments on the manuscript; and ECLAC in general for its cooperation over the years.

<sup>2</sup> For further references to the passions which Prebisch aroused, see Dosman and Pollock, 1993, pp. 11-43. For a telling example of the continuing vilification of Prebisch for allegedly misleading Third World leaders, see Crossette (1999): the ex-Premier of Singapore, Lee Kwan Yew, claimed to have read and heard out all the arguments of writers such as Argentine economist Raúl Prebisch and said they were rubbish, but that other leaders believed them because it was “emotionally satisfying”.

<sup>3</sup> The numerous works by Prebisch scholars include the exceptional contributions of Joseph L. Love, Carlos Mallorquín, Ronald Sprout, Octavio Rodríguez, Kathryn Sikkink, Cristobal Kay, Adolfo Gurrieri, Leopoldo Solís, Manuel Fernando López, and many others. For recent assessments see Ocampo (2001) and Rodrik (1997 and 2000).

handicapped Prebisch studies from the beginning has been the persistent inability to integrate the academic and policy dimensions of his life. There is an apparent dichotomy in don Raúl's life and work, with the mainstream historical record projecting a dual image, almost a split personality, between his Argentine and United Nations periods. There is first the international Raúl Prebisch of ECLA, UNCTAD and beyond – radical thinker and founder of structuralism; innovator and institution-builder; tireless fighter for justice in regional and global relations; the *bête noire* of Washington during the ECLA years; vibrant, elegant, with charisma and compassion – a true and rare leader from the moment in 1949 when he presented his Manifesto to ECLA's second conference in Havana. The "other" Prebisch, when he served the Argentine State, is associated with the Argentine oligarchy and Conservative Restoration between 1930-1943, also known as the "infamous decade". Indeed, he was a beneficiary of the September 6, 1930 military coup of General Uriburu which opened this period. He was appointed Under-Secretary of Finance at the age of 29, and his responsibilities continually expanded until 1943, culminating in his designing and running the Central Bank of Argentina as General Manager until his dismissal at the end of the Conservative Restoration.<sup>4</sup>

In reality, there is a fundamental unity to Prebisch's life and work – there is no split personality, dichotomy, or dual image – and the key to understanding his permanent legacy as a thinker lies in linking his Argentine and United Nations periods. The reasons why systematic biographical research has been limited for so long have been the complexity of don Raúl's life as both actor and thinker, on the one hand, and the exceptional turbulence afflicting Argentina and the global system during and after the Second World War on the other. Above all, there has been little attention to his years between his dismissal from office in October 1943 and his presentation of *The economic development of Latin America and its principal problems* at the ECLA conference in Havana in June 1949 (Prebisch, 1949). The Prebisch Papers, now available in Santiago, include a wealth of new material, including many previously unpublished manuscripts and items of correspondence, covering the whole period from his early years up to his time at ECLA, which document the progress of his thinking on markets and the State as he moved forward

from his dismissal in 1943 to the Havana "Manifesto" in 1949. The present paper offers a first step in this broader task of deepening the scholarly literature on the origins of the "ECLA Thesis".<sup>5</sup>

## 2. Inward-looking development (1943)

There can be no doubt that October 18, 1943, the day he was fired from the Central Bank, was the most painful experience of his life. The Central Bank had been a remarkable achievement, an adaptation of a Niemeyer model in such a way that it could play the role of a central agency in monetary and financial policy, growing in responsibilities and powers after 1935, while remaining autonomous from the political game as a mixed private-public sector enterprise. The manner in which he was sacked – paid only to the day, blackballed for other employment, with the university on strike and in disarray, and with the burden of being an honest man in a corrupt State – added to the sense of rupture. From being the busiest executive in Argentina, he had become an isolated intellectual, condemned to the sidelines in Mar del Plata to observe the post-war transformation of the international system under United States leadership, as well as the political and economic closing of Argentina under Peronism.

Prebisch decided to use this time to write a book on his experiences as General Manager of the Central Bank and also address Argentina's post-war challenges with recommendations on the actions required in order to prepare the country for a successful post-war transition. If he was no longer welcome inside the government, and if no-one else would give him a job, he could at least present his views to the public in a book. For fifteen years, beginning in 1928 in the Banco de la Nación Argentina and then in the Ministry of Finance and Central Bank, he had accumulated important insights in managing the world's leading emerging economy; however small a consolation, his forced resignation certainly gave him the luxury of spare time for reflection. He had managed large institutions without adequate time for academic research; especially since the outbreak of war in 1939 his work had been so overwhelmingly hectic that he was barely in the Faculty of Economics even to direct seminars. He had directed official publications such as the Central Bank *Annual Reports*, or ghost-written articles in *La Nación* where he was identified as "a senior government official," but he had been a practitioner

<sup>4</sup> Dosman and Pollock (1993), pp. 16-26. For more recent assessments see Dosman and Pollock (2001) and Lorenzutti (1996).

<sup>5</sup> See Toye and Toye (forthcoming) for a lucid and valuable contribution to this subject.

rather than a scholar –a technocrat in the governing establishment.<sup>6</sup> He was now free to think through the lessons of his experience since arriving in Buenos Aires as a student in 1918; essentially it meant integrating his personal experiences between 1928 and 1943 with his writings and lecture material in the Faculty. He knew he could offer an unmatched assessment of Argentina's response to the Great Depression and the successes and failures of policies evolved by trial and error during the 1930s. No detailed publication existed on the origins and workings of the Argentine Central Bank, and he knew that he could provide an unparalleled account of the role it had played as a central agency since its creation in 1935.

It was apparent, however, that the book he proposed to write, entitled "*La moneda y el ritmo de la actividad económica*" (*Money and the Rate of Economic Activity*), must go beyond the Central Bank experience to address theory as well as practice. By the time he completed his draft on December 13, Prebisch had decided on the need for innovation. "My long involvement with the practice of monetary policy over the last fifteen years," he noted, "has constantly persuaded me of the need to return to the theoretical foundations of the system to improve our understanding and management of concrete problems," and he considered that "a distinctive theoretical explanation" was required to understand and explain Argentina's position within the international economic system. Financial and monetary policy were of fundamental importance to Argentina; the Central Bank had been created because the alternatives had failed. It had initiated "a period of experiments and guesswork, successes and errors" from which "lessons for future policy could and should be extracted." But to be credible the book could not only look backward from past experience: it also had to look to the future. The challenges faced by Argentina in the Great Depression and the war would be followed by new problems after the peace; and solutions would be just as difficult to achieve. Traditional liberal economic theory offered Argentine governments an inadequate framework of analysis from which to draw the relevant policy prescriptions, and an alternative approach was therefore required in order to interpret Argentina's place and role in the international economic system.<sup>7</sup>

<sup>6</sup> The Prebisch Papers represent an indispensable source for this work, since much of the material in them is not included in the four-volume compilation *Raúl Prebisch: Obras 1919-1949* (Prebisch, 1991a).

<sup>7</sup> Raúl Prebisch, "La moneda y el ritmo de la actividad económica," unpublished manuscript, December 13, 1943, located in the

*Question 1: What were the national purposes of financial and monetary policy?* Prebisch saw three: avoiding a boom and bust cycle by controlling the violent ups-and-downs in agricultural prices and other foreign trade impacts on the economy; strengthening development and maintaining full employment; and stimulating the fastest possible rate of economic growth. There was no going back. Industrialization had unleashed national creativity, and growth must continue to harness that "enormous potential."

*Question 2: What should be the role of international trade?* Raúl underlined the need to restore an open trading system. "It is essential to avoid what happened after the First World War," he noted, when exports of the rest of the world to the United States were blocked, leading to a vicious circle of trade restrictions and controls, and the eventual breakdown of the world economy into "water-tight compartments" during the 1930s. Globalization, therefore, with a soundly-based multilateral trade and credit system, was a precondition for Argentine success after the war –but it was not enough. Harry Dexter White and John M. Keynes were preparing a Conference for July, 1944 to devise a post-war plan to revive trade and stabilize the international economy. White and Keynes's work was vital for all countries, including Argentina, Prebisch concluded, but Argentina's policies had to reflect its own needs within this evolving system.

*Question 3: Why must Argentine pursue industrialization?* Because neither the doctrine of comparative advantage, nor the workings of the business cycle, automatically work for emerging economies such as Argentina. Raúl concluded from his experience that the terms of trade for agricultural commodity producers like Argentina were in historical decline. He called it a "persistent fall in the international prices for our exports." But declining terms of trade only accentuated a deeper structural imbalance, or embedded equilibrium, in the international system. According to liberal Western economists, the market mechanism automatically benefited all countries, the large industrialized as well as the agricultural economies, and the business cycle regulated the periodic ebbs and flows in the international economy. He disagreed with this, however, arguing instead that the international economic system functioned in permanent disequilibrium because the business cycle operates with

Prebisch Papers. Subsequent quotations in the text are taken from this important document (Prebisch, 1943).

different rules for industrial and agricultural countries like Argentina, which have “such distinct characteristics in our economic life that their explanation requires an alternative theoretical approach.” Prebisch had already concluded in his 1921 “Anotaciones sobre nuestro medio circulante” (*Notes on the Money Supply*) (where he first used “centre” and “periphery,” a metaphor developed locally in the national debate on the concentration of wealth and power in the coastal metropolis of Buenos Aires, which drew wealth from the underpopulated pampas) that the business cycle in Argentina created an atypical boom and bust phenomenon because it lacked the self-correcting mechanisms characteristic of industrial economies (Prebisch, 1991b). Since then he had lived through the post-1918 crash, the boom of the 1920s, the Great Depression, the post-1934 recovery, and now the Second World War.

No country had aspired to trade and monetary orthodoxy more than Argentina in the illusive search for a restoration of “normalcy.” It had suspended the gold standard on August 20, 1914 for 30 days, believing that a return to convertibility was imminent—then again, and repeatedly again for 30 day intervals, until December 1927, when the gold standard was finally restored. After two disastrous years it was suspended again, and remained so in 1943. In 29 years the system hadn’t functioned “normally” at all, and in more than three-quarters of a century convertibility was in place for only 23 years.

*Question 4: Why promote development?* In practice, Argentina had been forced to abandon free trade and evolve the tools for an activist state led by the Central Bank. Now that the war was coming to an end, the Argentine State would have to retain that role because national development would not happen automatically. According to Prebisch, only an activist State could shield it from a permanent vulnerability relative to the industrial countries, with the primordial role of building on the type of calculated interventions devised by the Central Bank since 1935 to manage turbulence, and thereby ensuring that Argentina would remain a full partner rather than a marginal dependent country in the emerging global economy. A new period had opened because Argentina had to manage itself out of this problem or face marginalization. “To resist subordination of the national economy to foreign movements and contingencies, we must develop inward (“desarrollo hacia adentro”), strengthen our internal structure, and achieve autonomous functioning of our economy”.

Prebisch’s early views on free trade are well-documented. As late as 1927, in a polemic with Spanish visiting professor Luis Olariaga, he rejected protectionism with the argument that Argentina had benefited as much as the United States, Canada or Australia by specializing in commodity trade (Prebisch, 1991c). Nor is there a need to repeat the details of his gradual shift toward interventionism while Under-Secretary of Finance, with the National Recovery Plan of late 1933.<sup>8</sup> Simply stated, it was experience which changed Prebisch’s approach to markets. In practice, Argentina had been forced to abandon free trade and develop a more activist State in the first National Recovery Plan; the creation of the Central Bank in 1935 had in fact reduced Argentina’s vulnerability during depression and war by taming the business cycle. Major public works had created employment. Raúl was an intuitive economist rather than a typical academic pursuing scholarly debate via learned journals. In the balance between engagement and reflection, he had chosen public service in the 1920s, notwithstanding his commitment to economics and his tenure of a coveted Chair in the Faculty of Economic Sciences since 1925. Fundamentally a man of action, his theory-building derived as much from experience as scholarly research.

*Question 5: What should be the role of the State in promoting industrialization?* Prebisch called for “an intelligent regime,” or “smart State.” While the State must support industrialization, the economy as a whole must remain private sector-led in order to prosper. Excessive State intervention was therefore as damaging as a naive acceptance of the doctrine of comparative advantage. “Don’t stifle the private sector”, Prebisch warned. A healthy private sector and investment climate were essential for economic success and a wise investment strategy. Argentina required an active State, but within a judicious private-public sector partnership. “Monetary policy is little or no use if it suffocates private initiative and the spirit of enterprise, which absolutely require the profit motive and an overall climate of confidence.”

An example of an industry support initiative in 1941 was the Export Promotion Corporation (also called the Argentine Institute for the Promotion of Trade (IAPI), but quite different from Peron’s 1946 creation), with offices in the United States, for developing new and non-traditional export products to replace European products locked out by the German occupation. Managed by a private-sector board, it was ultimately

<sup>8</sup> The authoritative work is Love, 1994, pp. 393-601.



accountable to the Central Bank.<sup>9</sup> But the corollary of openness to the private sector was the latter's responsibility for remaining competitive. From the last Central Bank *Annual Report* prepared under Prebisch's direction, which dealt with the preparations for the post-war period, it is clear that his support for industrialization did not imply the wholesale protection of inefficient and uncompetitive businesses which had sprung up since the Depression.<sup>10</sup>

*Question 6: What about post-war policy?* In Prebisch's view the imperative post-war trade and industrialization policy required a judicious combination of import substitution and export promotion rather than blanket protectionism. "A policy of autarky is as absurd as free trade," Prebisch concluded, "with 'noxious' consequences... This possibility of increasing imports under an intelligent regime, and a policy of prudent monetary stimulation where indispensable, will favour intensive industrial development, with the natural effect of attracting immigration to other economic sectors, as in earlier days of economic and demographic growth." According to Prebisch, a competitive private sector after the war implied sanitizing the economy by building on the viable industrial sectors created during the war while eliminating the inefficient and uncompetitive industries which had emerged during the enforced protectionism of the World War. The same caution applied to State expenditures, which must remain prudent and non-inflationary. "There must be a reasonable equilibrium between the role of the State and the play of individual interests in economic life." Furthermore Prebisch warned against the politics of extremes. A balance had to be ensured between productivity and social policy to maintain growth, rather than engaging in excessive public expenditure. Inflation was a constant danger. The Argentine economy already had full employment and was in danger of overheating, and the government should

therefore resist political pressures for inflationary expenditures. Although Argentina had to improve conditions among the poor, Prebisch appealed for a social policy coordinated with national economic productivity in order to prevent deficits and inflation. "One must bear in mind that the common denominator of social policy is the increase in production. Without this a stable increase in the level of income of the masses cannot be sustained." Argentina could only maintain its high prestige if the government adopted the correct policy mix; domestic policy must encourage sustained growth because Argentina depended as much on the State as on industrial activity to shape the conditions for prosperity. Despite the many uncertainties, Prebisch forecast a positive future for Argentina. Obviously its prosperity was not automatically guaranteed by its relative success during the last decade, but Argentina had the policy tools needed to achieve stability and growth. Argentina's success in handling the Great Depression and the war experience had given it new confidence and international ranking; it had made great strides since 1930 and could look forward to the post-war era with confidence, rather than with fear, as a powerful young New World actor on the international scene.

*Question 7: What defines Prebisch's theoretical challenge?* Prebisch's approach promised a unique and prophetic blend of theoretical radicalism and Keynesian State activism, but within a banker's concern for sound money and the private sector. At the theoretical level, he challenged conventional Western liberal economists on holy ground by reversing the assumptions of equilibrium and comparative advantage in the international economy; since they had failed the empirical test he proposed developing a theoretical approach more in line with intuition, observation and Argentina's experience. But Prebisch was anything but a revolutionary critic of Western capitalism. He rejected communism, and was confident that Argentina could develop the tools it needed to meet the post-war challenge. Instead, Prebisch's book advocated an approach which could be called "civilizing globalization"; he felt that Argentina had no choice but to embrace globalization, strengthen trade links with its neighbours, recognize the decline of Britain, and accept that United States leadership was inevitable in the emerging international system. But he insisted that the Argentine State, private sector and society both could and should assume responsibility for policy choices to guarantee sustainable development.

<sup>9</sup> United States, Department of State, Memorandum from the United States Embassy in Argentina to Washington, November 29, 1940, which outlines the objectives and structure of the new IAPI, as well as Prebisch's discussions with Embassy and State Department officials. Under-Secretary of State Sumner Wells noted on January 7, 1941 (during Prebisch's extended visit to the United States capital) that the project "involves both policy and practical questions of some importance."

<sup>10</sup> This is also clear from the text Prebisch wrote for General Agustín P. Justo's Address to the British Chamber of Commerce on November 22, 1942 (Source: the Prebisch Papers).

### 3. Towards the "Manifesto"

One can only speculate on the impact of this book, had it been written and published. Prebisch's tantalizing outline in December 1943 regarding the decline in the global terms of trade; his hypothesis of structural disequilibrium in the international economic system and the projection of a new theoretical framework for development; his call for industrialization and an export mix going beyond commodities; and his notion of the "smart State" with administrative coherence to combine open markets with calculated interventions and deliberate processes, were of extraordinary scholarly promise. Already by 1943 Prebisch had proposed his conceptual leap forward that would challenge Western economists on their own ground. The manuscript is an essential reference point indicating his thinking in 1943 at the immediate close of his Central Bank career, demonstrating that he had elaborated his concept of "inward development" long before the formation of ECLAC, and that his theoretical development was more advanced than anticipated.

But his proposal was rejected by Argentine publishers, and he therefore had no option but to continue the project while teaching in the Faculty in order to make a living. He hoped to get it out quickly – friends like Robert Triffin were already asking for it in 1945 – but as it turned out, the Havana "manifesto" was still some distance away in 1943. Life in Buenos Aires was depressing for him as Peronism took hold in 1946 and he observed Argentina's growing isolation and cultural decline. He also had to act as a consultant in order to survive, and this also hampered his work, although his discovery of the wealth, beauty and potential of Latin America beyond the Southern Cone in his visits to Mexico, Colombia and Peru in 1944 and his subsequent travels in Paraguay, Venezuela, Guatemala and other countries were fundamental to the evolution of his regional vision. The lack of resources for research, and above all the problem of working in isolation without associates, also slowed down his work. On many occasions he envied scholars in North American and European universities who could devote themselves fully to their academic work.<sup>11</sup>

After 1946 it became increasingly difficult for Prebisch to continue teaching in the Faculty, and he

was finally forced out of the university on 15 November 1948 with his book project still incomplete.<sup>12</sup> After 1943 he had travelled and worked extensively throughout Latin America, but he had always resisted opportunities to move abroad to the United States or Mexico. Now he had to reconsider, and the options came down to heading ECLAC in Santiago as its first Executive Secretary, or taking up a senior position with the IMF in Washington. Of the two, Prebisch infinitely preferred the latter. Camille Gutt, the IMF Managing Director, accompanied by his deputy, Edward M. Bernstein, had visited Buenos Aires on November 25, ten days after Prebisch's departure from the university, and made an offer which Raúl accepted. An actual contract had not been signed, pending approval by the Fund's Executive Board, but Mr. Gutt had dismissed this as a formality. However a disturbing silence from Washington after this visit suggested problems, and Prebisch's humiliating and painful rejection by the IMF provided the essential personal backdrop for the emergence of the Havana "manifesto".

A first sign of internal opposition appeared early, on December 23, when Gutt cabled to announce that the terms of his appointment would have to be changed. "I have reviewed our recent talks with department heads. They feel that an adviser outside departmental lines is not feasible. Prepared to recommend appointment in Operations Department at proposed salary."<sup>13</sup> But Prebisch was assured that the change was simply to avoid setting a precedent within the Fund and that the offer would soon be confirmed. M. H. Parsons of the Operations Department told him that the delay in approval was merely technical – the January flu in Washington had decimated the Executive Board; he expected a meeting before the end of January. "We are looking forward to having you here and taking advantage of your great experience, particularly in our dealings with Latin America."<sup>14</sup>

<sup>11</sup> For example, in a letter to Eugenio Castillo dated 23 November 1948 (The Prebisch Papers, Correspondence), he described his situation in Argentina as "the thankless position of a solitary researcher".

<sup>12</sup> Prebisch eventually declined an offer in 1945, brokered by Robert Triffin, to visit Harvard and teach in the United States; both the Guggenheim and Rockefeller Foundations became involved, and Assistant Secretary of State Nelson Rockefeller noted that he was "very interested in Raúl Prebisch's proposed trip to Harvard...I am delighted to hear that plans are progressing and as soon as you have definite word, I would appreciate your letting me know when he is coming" (Memorandum, United States Department of State, February 9, 1945). Prebisch also turned down an offer of a senior appointment in the Bank of Mexico after the election of Perón in 1946.

<sup>13</sup> The Prebisch Papers: Correspondence, June Eckard to Raúl Prebisch, March 22, 1949.

<sup>14</sup> The Prebisch Papers: Correspondence, M.H. Parsons to Raúl Prebisch, January 19, 1949.

So, strongly reassured, Raúl and Adelita Prebisch continued preparations for their departure, with Urquidí and other friends combing the real estate market in and around the United States capital. Farewells were held, and Raúl prepared his lectures to be given in Mexico from February 16 on. Just before his departure Raúl received more good news from the IMF: Parsons suggested that they meet in Mexico during Prebisch's seminar at the National Autonomous University of Mexico (UNAM) to discuss a work plan. Executive Board approval was now imminent, he said. It was a busy month which augured well for the future, despite the emotional let-down of leaving Buenos Aires.<sup>15</sup> However, Adelita was confined to bed in Mar del Plata and unable to accompany him to Mexico when he left on February 15; on his arrival at the *Hotel Reforma* he cabled his affection.

But when Prebisch opened his seminar on February 16, it was clear that the hold-up of his much-discussed appointment at the IMF had little to do with illness on the Executive Board. Parsons failed to arrive; he heard nothing from Washington. To his mortification, rumours of United States Treasury opposition to his appointment became corridor gossip in Mexico. After the Mexican seminar ended, Prebisch decided to force the issue with the IMF and sent a cable to Gutt on March 6 demanding a definitive response. The Managing Director first procrastinated with a message asking for more time, but then confirmed that the Executive Board had indeed rejected his appointment. Parsons wrote a personal letter of apology on March 11. "We have behaved intolerably... I am not sure which is worse –to feel ashamed of oneself, or to feel ashamed of the organization for which one works. We shall pay heavily for our folly in losing your services and the prestige which you would have brought to the Fund in its relations with Latin America. I don't ask you to be tolerant with us because I think we have behaved intolerably, but I do ask that you pity us that we should add this kind of folly to what is already a heavy enough burden. Whom the gods wish to destroy they first make mad."<sup>16</sup> He signed it with "Keenest regrets." Raúl shared his disappointment by telephone with Adelita, who was now recovering. She said that she was happy not to go to Washington and have to deal with such dishonorable people. Some day, she predicted, the tables would be

turned.<sup>17</sup> Robert Triffin and other friends in Washington provided the inside story of his rejection by the IMF.<sup>18</sup> The issue had developed into an internal *cause célèbre* because the United States had reversed its position and now opposed his candidacy even though the Treasury had originally supported Prebisch. It was embarrassing and unpleasant; the Fund had sought him out in Buenos Aires, rather than the other way around, and so firm a commitment would never have been given had the United States not been on board. Moreover Prebisch was Latin America's best-known economist and central banker; there was no way the sudden rejection could be explained by questioning his competence. The fight over Prebisch in the Fund was therefore lengthy and bitter.

A complex set of factors lay behind Washington's refusal to accept his appointment in early 1949, and it had nothing to do with a rumor that old Washington hands remembered Raúl's toughness during the 1930's in bilateral negotiations with the United States and were getting back at him now for favouring Britain after the Roca-Runciman Treaty. Instead the United States decision reflected the new opening in US-Argentine diplomatic relations, Brazilian opposition to Prebisch's appointment, and the changing political climate in Washington. Perón vigorously opposed Prebisch for any influential position in the IMF, even though Argentina was not a member of the Fund; while he had agreed six months earlier to support him for ECLA (presumably to ease him out of Buenos Aires into a marginal position in Santiago), the Argentine President did not want a domestic opponent in a key position in Washington. Considering the deep-freeze in US-Argentine relations since Pearl Harbour, however, such expected opposition should not have concerned Washington –quite the reverse. The United States Embassy had campaigned openly against Perón in 1946, who later had denounced the Marshall Plan as a scourge and disaster for Argentina.<sup>19</sup> On January 19, 1949, however, Perón fired the economic team led by Miguel Miranda and Washington saw an opening to improve bilateral relations. A bilateral Joint Committee was established to review economic issues, including the potential opening of United States petroleum investment; Washington sought to restore its pre-war position in

<sup>15</sup> The Prebisch Papers: Correspondence, M.H. Parsons to Raúl Prebisch, February 10, 1949.

<sup>16</sup> The Prebisch Papers: Correspondence, M.H. Parsons to Raúl Prebisch, March 11, 1949.

<sup>17</sup> The Prebisch Papers: Correspondence, Adela Prebisch to Raúl Prebisch, March 13, and March 30, 1949.

<sup>18</sup> The Prebisch Papers: Correspondence, June Eckard to Raúl Prebisch, March 22, 1949.

<sup>19</sup> Lewis, 1990, pp. 191-192.

Argentina, then the most important market in Latin America, with assets in 1943 greater than all other countries except Cuba and Canada, and “now threatened by European expansion of bilateral trade and the dollar shortage.”<sup>20</sup> The Prebisch appointment was thus caught up in a bilateral diplomatic reorientation, with the State Department arguing that United States support for Prebisch in the IMF could preempt this promising development with Perón. Thrown out of the Central Bank by the Perón-backed military government in 1943 against United States protests, a man who had risked and lost his career for the allied cause and who had continued to work closely with the Federal Reserve after 1945 was thus sacrificed six years later on the altar of US-Perón rapprochement.

There was another, less tangible factor at play in the United States rejection of Prebisch. Raúl not only lacked the support of his country, but he was also vulnerable in Washington’s changing political climate, now unrecognizably different from the circumstances surrounding his exit from the Central Bank in 1943. He had worked with the United States Federal Reserve throughout Latin America, and still knew some of its officials such as David Grove, Chief of its Latin American Section in the Research Department. In those years he could also have picked his job among United States banks: the Chase Manhattan Bank referred to him as “almost a member of the family”; Joseph C. Ravensky commented in his retirement letter to Raúl in 1945 that “you are so at home in the Chase that you will not miss me much.”<sup>21</sup> But times had changed. Prebisch was no longer very well-known in Washington, and the friends who still regarded him highly, such as Triffin and Wallich, were increasingly out of step with the gathering Cold War ideology in the Beltway. They represented the war-time generosity and innovation of United States Latin American policy; a new and tougher approach rendered Prebisch an outsider in Truman’s Washington. The United States opening to Latin America terminated after 1945 and gave way to a different era in Washington. The many invitations from leading United States universities terminated abruptly; Triffin, Williams and Hansen gave way to Gottfried Haberler, Jacob Viner and the narrowest view of markets. While not yet hysteria, a groundswell of anti-

communism in the United States capital demanded the greatest care in choosing senior people for the IMF and World Bank; while no one could possibly argue that Prebisch was pro-communist, he was a Latin American who used terms such as “centre” and “periphery.” With the revival of orthodox economics organized principally around the concept of equilibrium and rejection of the need to correct the market mechanism, he stood out like a sore thumb: by recognizing the embedded imbalances in the system and proposing an active role for the State in the economy, he challenged the dominant post-war paradigm. Prebisch, in short, was not automatically “safe.” This new caution seeping into the IMF selection process was transmitted directly from the United States Treasury, but also internally by United States officials who followed the flag. E.M. Bernstein, for example, who had made the approach to Prebisch in Buenos Aires and whose support might have made the difference in Raúl’s approval, remained silent during the affair. Even Ravndahl, who might also have influenced the State Department, chose to stand aside. In the end the IMF was an inter-governmental organization led by the great powers, and its politics could not escape the changing ideological alignment of the Washington foreign policy community. Raúl had been used by Washington while he was powerful and to their advantage; now that he was weak he could be discarded and made a laughing-stock from one end of the Americas to the other without fear of retribution. Recently-hired Latins in the Fund could do nothing but watch the spectacle in frustration and anger.

Finally, Brazilian opposition to Prebisch fortified Washington’s determination to press its veto on Prebisch’s appointment, and the diplomatic weight of Brazil in South America also made this a factor of considerable importance in the region. In this case, however, the issue was not so much politics as envy. Although Octavio Bulhões had sent Raúl a congratulatory letter from the Ministry of Finance in Rio on February 5, he also convinced the Cabinet to veto the appointment at the level of the Fund’s Executive Board.<sup>22</sup> Eugenio Gudín, who genuinely respected and supported the Prebisch appointment, was away from Rio undergoing surgery in the United States and was therefore not in a position to prevent a betrayal. Confronted by the United States and Brazil, other members of the IMF Executive Board eventually fell into line.

<sup>20</sup> United States State Department (1949), Internal Memorandum 835.5151/7-149. For background see Escudé, 1981.

<sup>21</sup> The Prebisch Papers: Correspondence, Joseph C. Ravensky to Raúl Prebisch, December 28, 1945.

<sup>22</sup> The Prebisch Papers: Correspondence, Octavio Bulhões to Raúl Prebisch, February 11, 1949.

Rejection by the IMF on top of the end of his university career in Buenos Aires meant that Prebisch was down to his last chance: ECLA. He had been approached in late 1948 by the United Nations for the position of Executive Secretary, but had turned down the offer, and Gustavo Martínez-Cabañas had eventually been selected to begin work on January 1, 1949. Nevertheless ECLA persisted, offering Raúl a consultancy to help the new organization prepare for its Second Session in Havana, scheduled to open on May 26. The problem facing Martínez Cabañas and his deputy, Eugenio Castillo, was to fulfill ECLA's main task at its First Session in June, 1948 –namely, producing the first *Economic Survey of Latin America*: a huge task never before attempted– in less than one year, and with a brand new team in Santiago which lacked depth and experience. They pleaded with Prebisch for help, even for a leave of absence from the IMF (expecting that he would be in Washington); but Prebisch did not respond until the IMF debacle was evident, finally agreeing to a short-term consultancy for the duration of the Havana conference.<sup>23</sup>

In New York, David Owen and senior officials in the United Nations Department of Economic and Social Affairs were also increasingly anxious about the future of ECLA, realizing that they too could not afford a failure at Havana. The *Economic Survey* promised for Havana had to be presentable, and they hired Francisco Croire, another former employee in the Argentine Central Bank whom Raúl had sent to Harvard for graduate training, to head the Latin American section of the Stability and Development Section and provide a New York anchor for the *Economic Survey*. Arriving in December, 1948 he found that little had been done during the preceding six months and that the two staff members he inherited were of doubtful quality and acculturated to permanent paid holidays. United Nations morale and staff competence in New York contrasted badly with the old Central Bank in Buenos Aires, Croire sniffed.<sup>24</sup>

Croire poured out his concerns to Prebisch in a stream of long personal letters.<sup>25</sup> He discovered that the *Economic Survey* had taken on a heavy symbolic value for the United Nations system as a whole –or at least for Latin America within the United Nations. There was, he reported, a growing *Schadenfreude* among the skeptics in New York who doubted that Latin economists were competent enough to deliver unless supervised by United States and European superiors. Since the *Economic Survey* was the single most important work of ECOSOC relating to Latin America, it had therefore become a test of Latin American economists themselves. The *Economic Survey* was unique in that Latin Americans themselves were in charge; it was the first major international report on the region to be directed and written by Latin Americans rather than foreign consultants, for in the IMF or World Bank Latin Americans were members of teams led by senior North American or European economists. Croire and other Latin Americans like himself in New York therefore felt on trial; failure in Havana would confirm a New York perception that they were second-raters. This situation made Prebisch's role doubly important. New York would mobilize all available resources to pull together the individual components into an acceptable document, including sending headquarters staff to Santiago on short assignments. A great deal of data were being collected; a more realistic work-plan and *Economic Survey* outline were now accepted in Santiago. Other agencies such as the FAO and the IMF were being helpful, and the World Bank had just completed a study *The Pattern of Latin American Trade Payments with ERP Europe and the US*, which was helpful for ECLA's own report on "*Prospects for Trade Expansion*" being prepared for Havana. Dorfman and Alfonso Santa Cruz were working overtime on it; Louis Shapiro from New York Headquarters arrived in Santiago on December 17 to work with Regino Boti on regional foreign trade statistics. The problem, however, was overall leadership: although the *Economic Survey* had to be a team effort, one person, finally, had to draft a framework document laying out a theoretical approach and rationale. Croire was relieved by Prebisch's acceptance of this role; had he not agreed to write the report, the United Nations would have gone outside Latin America, probably to Sweden's Gunnar Myrdal, thereby demonstrating to the world the bankruptcy of

<sup>23</sup> United Nations, Correspondence: Eugenio Gudin to Harold Caustin, New York, July 13, 1948, reviewing the efforts to attract Prebisch, including Juan Perón's approval for the United Nations to approach him. Also in the Prebisch Papers, Correspondence: Eugenio Castillo to Raúl Prebisch, November 19, 1948 and February 5, 1949; Raúl Prebisch to Eugenio Castillo, January 10, 1949; and Martínez-Cabañas to Raúl Prebisch, February 3, 1949.

<sup>24</sup> The Prebisch Papers: Correspondence, Francisco Croire to Raúl Prebisch, December 24, 1948.

<sup>25</sup> The Prebisch Papers: Correspondence, Francisco Croire to Raúl Prebisch, February 28 and April 8, 1949.

Latin economists and spelling the certain demise of ECLA.<sup>26</sup>

Even more, Havana was unexpectedly emerging as an important meeting in US-Latin American relations. In part this reflected the old theme of dashed expectations of United States recognition and post-war cooperation. By 1949 and the beginning of Truman's second Administration, a sense of injustice was boiling up again as Washington's priorities focused on Europe and Asia. During the Second World War, Latin countries had sold their commodities to the United States at prices fixed by the OPA (Office of Price Administration), but they had been unable to convert their dollar earnings into goods during the war, with consequent inflation. Now they found that when United States goods were finally available for purchase, there were no price controls on these industrial exports, even though the prices for their own primary and agricultural products had declined.<sup>27</sup> With the end of the war, single-commodity countries such as Venezuela, Cuba, Chile and Bolivia faced an inevitable downturn in trade, and were on the verge of serious economic crisis. Yet the Truman Administration had failed to implement most of its war-time promises of economic partnership made during the war. Washington now opposed the creation of an Inter-American Development Bank, continued to postpone a much-heralded Inter-American Economic Conference, and rejected multilateral efforts to stabilize commodity prices. Worst of all, the United States Congress had killed the proposal for the ITO (International Trade Organization) put forward in 1948, also in Havana, placing an additional strain on US-Latin American relations. Conceived during the Second World War, Keynes had seen the ITO as the trade counterpart to the IMF and World Bank; its failure left Latin Americans disappointed and frustrated. The sequence of the Great Depression, the Second World War and the post-war challenge of adjustment to *Pax Americana* had created an incipient regionalism in Latin America—a consciousness of shared experiences, and even greater needs, carried by a new generation of better-trained and travelled professionals. Young Latins ached for recognition, for leadership and for definition

all in one; there was an opening for new ideas and change. *Does Latin America exist?* Mexican author Luis Alberto Sánchez had asked a few years earlier in the 1940s. Latin America was a region ready to be created, and this idea and opportunity built on perceived grievances to give the 1949 ECLA Conference in Havana a symbolic significance out of all proportion to the actual agenda of the meeting.<sup>28</sup>

The additional burden of evident ECLA, United Nations and Latin American anxiety and expectations added to Raúl's agony as he began his work in an upstairs office at the end of a corridor somewhat apart from the rest of the ECLA staff, pausing only for his daily lunch with Adelita in Providencia. He needed a breakthrough, but he felt flat—as flat as during his last lectures in the Faculty in 1948 and a set of seminars he had recently completed in Mexico. He now fully understood the cost of his years in the wilderness. When he left the Central Bank in 1943 and drafted his outline for “La moneda y el ritmo de la actividad económica” he had been well ahead of the pack in his theoretical development. His central concept of a structural rift in the international economy between industrial and agricultural countries in which market forces tended to accentuate inequalities had been novel and exciting. But that was more than five years ago. He had seemed on the verge of major innovation; so much had seemed possible, but he had not been able to deliver. He had certainly made progress; since 1945 he had grafted the centre-periphery terminology, first used in 1921, into his analysis to accent the dualism present in the international economy, and this was now a permanent fixture in his writing. Work on the business cycle had also advanced significantly. But the discipline was not standing still either, and younger economists were moving into development economics; the argument, for example, that agricultural exporters were at a disadvantage compared with industrialized exporters in international trade was becoming commonplace (Love, 1994). While no other scholar had yet presented an answer to Prebisch's hypothesis set out in “La moneda y el ritmo de la actividad económica” in 1943, it was only a matter of time before he would lose this race as well to scholars in Europe and North America.

Raúl felt close to a new synthesis, but the days went by in Santiago and his frustration grew as the Havana deadline approached. In early April he circulated some

<sup>26</sup> The Prebisch Papers: Correspondence, Francisco Croire to Raúl Prebisch, December 24, 1948. See also United Nations, Memorandum from W.R. Malinowski to Harold Caustin, November 12, 1948.

<sup>27</sup> United States State Department, “Latin American Policy Statement,” Memorandum from E. Miller to Louis J. Halle, November 14, 1950.

<sup>28</sup> The Prebisch Papers, Correspondence: Francisco Croire to Raúl Prebisch, February 24, 1949.

draft text to ECLA colleagues for comments. Furtado read the manuscript and was disappointed. The style was academic and defensive, dealing with familiar topics such as the declining United States import coefficient, capital controls, foreign trade, savings and inflation, and the importance of industrialization.<sup>29</sup> The paper seemed more a digest of his lectures in the Faculty and in Mexico than a policy document, and while it was enlivened by his "centre-periphery" terminology, his explanation for this lop-sided capitalism was not complete, and unlike his 1943 study "La moneda y el ritmo de la actividad económica" it apparently did not refer to declining terms of trade. Prebisch was clearly struggling as he faced the approaching deadline, aware that his work fell short of what he knew he could achieve.<sup>30</sup>

What happened next has been masterfully related by Furtado in his autobiography (Furtado, 1985, p. 60). While Prebisch struggled in Santiago, Croire in New York received a copy of a draft report which Dr. Hans Singer had written for the United Nations Sub-Commission on Economic Development entitled *Post-war Price Relations Between Under-developed and Industrialized Countries*.<sup>31</sup> Incredibly, Castillo had also received an advance copy of Singer's document as early as December 17 when United Nations statistician Louis Shapiro arrived from New York to work on the *Economic Survey*, but he had not shared it with Prebisch.<sup>32</sup> Croire noted a reluctance by senior staff to allow its circulation, because Singer's report challenged conventional wisdom and would therefore likely be rejected by the United Nations Sub-Commission, but he sent it immediately to Raúl in Mexico along with another IMF paper on foreign trade.

Prebisch had never met Singer, a German-born scholar who left Germany in 1933 and obtained a PhD

at Cambridge University. Recruited by David Owen to work in the Department of Economic and Social Affairs at the United Nations, he had arrived in New York in April 1947 on a two-year leave of absence from the University of Glasgow. He began his work in the trade section of the Department of Economic and Social Affairs with an interesting group of economists who quickly drew his attention to the terms of trade issue (Singer, 1984, pp. 275-311). Singer argued that historical statistics demonstrated a decline in the terms of trade of developing countries. "From the latter part of the nineteenth century to the eve of the Second World War, a period of over half a century, there was a secular downward trend in the prices of primary goods relative to the prices of manufactured goods" (Toye and Toye (forthcoming), p. 25). Such a decline provided an "added incentive towards industrialization" in developing countries, since they would otherwise lose resources for development relative to their industrialized counterparts (United Nations, 1949, pp. 16-17).

But Singer's paper was the stimulus Prebisch needed to escape his mounting frustration and fear of failure. In his 1943 draft "La moneda y el ritmo de la actividad económica", Raúl had already assumed a secular decline in the international terms of trade for agricultural countries, and both Kindleberger and Samuelson had written articles based on this hypothesis.<sup>33</sup> But Singer not only demonstrated it statistically within a rigorous historical study: he also articulated the ethical implications of declining terms of trade in the global economy, which created a divide between rich and poor countries. Prebisch therefore recognized a kindred spirit in the British economist; Singer's work not only corroborated his assumptions on trade, but also gave him the confidence to recast his work with a new structure and style.<sup>34</sup> Raúl's energy returned, and he began again, ensuring that all copies of his earlier text were collected and discarded. Then in three days and nights he wrote *The economic development of Latin America and its principal problems* (Prebisch, 1949), in which the laboured prose

<sup>29</sup> Both Furtado (1985) and Toye and Toye (forthcoming) are important sources of information on this episode. The author's extensive interview with Celso Furtado in 1990 provided additional insights for writing the present paper.

<sup>30</sup> Prebisch himself never referred in subsequent interviews to this transition towards the Santiago "manifiesto". Furtado (1985), Toye and Toye (forthcoming) and the present author's works note that early in 1949 there was an important turning point in don Raúl's work.

<sup>31</sup> Subsequently retitled as *Relative Prices of Exports and Imports of Under-Developed Countries* (United Nations, 1949).

<sup>32</sup> The Prebisch Papers, Correspondence: Gustavo Martínez Cabañas to Raúl Prebisch, March 5, 1949 and Francisco Croire to Raúl Prebisch, April 8, 1949. This matter is also discussed at length in Toye and Toye (forthcoming).

<sup>33</sup> Kindleberger (1943) and Samuelson (1948). The Prebisch Papers (particularly Prebisch's correspondence with Victor Urquidí, such as that of June 2, 1944, which takes up Kindleberger's work in detail) provide important insights into the evolution of Prebisch's reflections on emerging economic theories during the 1943-1949 period.

<sup>34</sup> Prebisch's life-long respect for Hans Singer never wavered during the long personal friendship subsequent to Singer's visit to Santiago in 1950. The feeling was entirely mutual.

of his earlier work disappeared in an essay which recalled the power and simplicity of Keynes. The new document may not have been scholarly, as defined by refereed journals; nor was it replete with mathematical formulas, explicit hypotheses or reams of footnotes. None of the individual components or his argument was entirely novel –it would be more correct, for example, to identify the terms of trade break-through as the “Prebisch-Singer Theory”– but the genius of Raúl’s “Manifesto” was that it moulded these disparate components into a unique and compelling synthesis. It succeeded in re-examining the determinants of economic activity in developing countries, and represented a key event which changed the vocabulary of international development and marked a new period in Latin America.

The 1949 “manifesto” began with an appeal to reason, paraphrasing Aristotle’s dictum that “the facts have not yet been sufficiently established. If ever they are, the credit must be given to observation rather than to theories, and to theories only in so far as they are confirmed by the observed facts.” Latin Americans must have the courage to confront their own reality to find solutions, and this meant subjecting inherited wisdom to the ultimate questions: Does it work? Who gains and loses? To understand is to be free and able to take control of one’s destiny, the *Manifesto* implied, and Prebisch articulated an unforgettable, if deceptively simple, framework to explain why the system was not working in the mutual interests of rich and poor nations, why the industrial countries reaped the major gains, and what had to be done to restore equality for Latin America in the international economy. The 1949 study *The economic development of Latin America and its principal problems* owed much to Prebisch’s 1943 study “La moneda y el ritmo de la actividad económica”. There is the same confident tone, the same stepping back from his data to highlight the key points, and the same assurance that the dilemma facing the countries of the region could be successfully overcome.

But the “manifesto” was different in its regional vision and call to action. The “center-periphery” conception of the world economy was much more explicitly focused on the dynamics and structure of global inequality. It began with the claim for a unified world economy in which all States, industrial and developing, were linked in a single system of exchange and affected by a common business cycle. Within this system, however, he counterposed the quite different roles of the rich industrial versus the developing agricultural countries: the latter produced primary

products for the industrial countries in return for manufactured goods, while the business cycle began in the core countries and spread to the periphery. Prebisch then argued that the distribution of benefits was unequal because the dynamics of foreign trade and the business cycle favoured the industrial countries. This was not due to the ill-will of governments, but rather the inherent functioning of the system: the fact that gains in productivity were greater in industrial than in primary goods could be documented by the declining terms of trade which he had assumed in 1943 and which Singer had now documented. This factor in turn was aggravated by the international trade cycle, in which the agricultural countries were more vulnerable than the core economies during recessions because organized labour in Europe or North America was strong enough to prevent an equivalent collapse of prices. The result of both factors –a secular decline in the terms of trade and business cycle vulnerability– explained the fundamental flaw of neo-classical trade theory, which assumed equal benefits for industrial and agricultural exporters and which was assumed to have the same validity in Latin America as in the United States or Britain. There was, in short, an inherent asymmetry in the system, understanding of which was a necessary step towards understanding Latin America’s insertion in the international economy and thereby designing a new approach appropriate to the region’s needs in the future.<sup>35</sup>

The attraction of the “manifesto” lay in its dual thrust: not only did it offer a powerful diagnosis, but it also contained a vision which promised agricultural countries a way out of their dilemma. To be peripheral was not necessarily to be dependent; just as in “La moneda y el ritmo de la actividad económica”, he proposed that industrialization, with due care to avoid inflation and distortions, offered Latin America the prospect of reversing the dynamic of unequal exchange which otherwise doomed it to constantly diminishing benefits in the global economy. Here was a non-revolutionary, non-communist prescription for change which all governments in the region, regardless of ideological orientation, could applaud. It was a call to action which Prebisch based directly on his experience in Argentina, where import substitution had already

<sup>35</sup> Within the vast literature on this subject, note the recent work of Love (1996); Rodríguez (1998); Gurrieri (1983); Mallorquín (1994) or Sprout (1992). All the articles in Iglesias, ed., (1994) are also useful. See also Spraos (1980) and Tanzi and Chu (1989).



advanced considerable even before 1914, and where the Central Bank had pursued precisely this role, to the point where industrial production equalled that of agriculture in the national economy by 1943. From a regional perspective, where most economies were less developed than Argentina, it was a truly bold departure. But once out of the bottle, his challenge to peripheral economies to move from commodity production to a more diversified economy proved durable and irresistible – so much so that today it is taken for granted to such an extent that the originality of the Prebisch “manifesto” has been obscured by its success.

The “manifesto” contained other elements which lurked below its extraordinarily elegant and flowing prose. For all its appeal to reason and measured arguments, there is an almost imperceptible but unmistakable undertone of indignation in the text. Development economics, Prebisch implied, meant taking a stand. The treatment he had just received in Washington may explain part of this tone, as well as the trade pessimism of 1949 in which the outlook for increasing Latin exports was gloomy. The United States – the region’s dominant supplier since the Second World War – had fallen into recession, with Latin America’s imports from it rising 168% while those from Western Europe fell by 15%. “Formerly, prior to the Great Depression, the Latin American countries developed outwardly, stimulated by the constant increase in exports. There is no reason to suppose, at least at present, that this will occur again to the same extent, except in very particular cases.”<sup>36</sup> Given this grim prospect, the international economic system was even less likely to stimulate development and technical progress in Latin America, and it was therefore urgent to get moving without delay.<sup>37</sup>

Prebisch’s report transformed the Havana meeting and created a sensation in the media throughout Latin America; instead of debating an important but dull *Economic Survey*, ECLA found itself with a great idea

and a potential cause. No one could possibly doubt that Prebisch had been the centerpiece of the Havana triumph, the great victor. Everyone, including he himself, realized that Havana had launched him as a regional personality, and a formal resolution of appreciation was unanimously approved on June 14 at the close of the conference. But in New York and Washington the reaction was different, and there was consternation among senior United Nations and United States officials who understood the power of the “manifesto”: Prebisch’s framework of structuralism offered a new approach to international development; he had spoken out in favour of an activist State and industrialization in a new language which challenged the old doctrine of comparative advantage. The notion that agricultural countries in Latin America could thrive in the future by remaining commodity producers was undermined, and all development experts – whether from the industrial or developing countries – knew that a new debate had been launched. The immediate and harsh reaction of mainstream economists, including Gottfried Haberler, Gerald Baldwin, Charles Kindleberger, and Gerald Meier, to *The economic development of Latin America and its principal problems* underlined the seriousness of Prebisch’s challenge to traditional economic theory.<sup>38</sup> Jacob Viner of Princeton University set the tone by dismissing the “manifesto” as a set of “malignant fantasies, distorted historical conjecture and simplistic hypotheses.” During his lectures in Brazil at the National University during July and August 1950, Viner’s arrogance astonished his audience as much as his advice: stay with free trade; don’t be wooed away from neoclassic verities by sirens promoting economic diversification; devote yourselves to agriculture and birth control.<sup>39</sup> Prebisch was a heretic – even a “grand heretic” – to be avoided at all costs. Other United States economists were less ideological, with criticisms of aspects ranging from the empirical data underpinning the Prebisch-Singer terms of trade theory, to the neglect of shipping costs, the impact of technological innovation, and so forth.<sup>40</sup>

<sup>36</sup> Prebisch (1949), pp. 9 and 37–38. The outlook for Latin American exports was gloomy in the United States and Europe as well as in Latin America itself. Moreover, the recession in the United States coincided with a transformation in US–Latin American–European trade relations between 1937 and 1949, over which period European exports to the region had fallen 15%, compared with a 168% increase for the United States, while Latin American exports to Europe had fallen by 39% and those to the United States had increased by 38%.

<sup>37</sup> Furtado (1985, pp. 60–61) underlined this point, noting that Prebisch had moved from a critique of economic theory to international “realities”.

<sup>38</sup> See Solis (1989) for a preliminary examination of the scholarly controversies surrounding the “Prebisch Thesis”.

<sup>39</sup> Prebisch was invited to Brazil for a lengthy visit, from August 19 to September 1, 1951, much of which was spent answering the criticisms Viner had made of Prebisch a year earlier, which had been published in the *Revista Brasileira de Economia* of the Getulio Vargas Foundation.

<sup>40</sup> “El Gran Heresiarcia” was the expression Furtado coined for Prebisch and ECLA at the height of his fame.

But Prebisch's critics missed the point. The "manifesto" was not a fully-developed theory of economic development, and Raúl made no claim in this direction. Indeed, the report repeatedly appeals for more research. It was not anti-trade ("The more active Latin America's foreign trade, the greater the possibilities of increasing productivity by means of intensive capital formation"). It was not anti-agriculture ("The industrialization of Latin America is not incompatible with the efficient development of primary production"). Nor was it blindly pro-industrialization (chapter VI of the report was entitled "The Limits of Industrialization" and said "Industrialization is not an end in itself, but is the only means at their disposal of obtaining a share of the benefits of technical progress and of progressively raising the standard of living of the masses").<sup>41</sup> Prebisch also believed in the market, but demanded answers to the question of "What else? What about the inequities and asymmetry in the system?". He challenged the market by itself as the great equalizer, and called for purposeful action to share the benefits of international trade. This was the cognitive leap which identified him as the father of development: he had presented a new paradigm of development within a fundamentally novel approach. Indeed the most serious –and resented– of Raúl's criticisms of neo-classical economists in American and European universities was their presumption of wisdom: "One of the conspicuous deficiencies of general economic theory, from the point of view of the periphery," he maintained, "is its false sense of universality". Viner (who once acknowledged that he was an "old-fashioned free trader") and his colleagues had no difficulty attacking the "manifesto" on specific points because it was not a fully-developed theory, and therefore vulnerable to academic criticism. But on the central issue of asymmetry, they could only fall back on the old "truths" –such as the fairness of the system if developing countries created a suitably hospitable business climate for investment.

#### 4. Conclusion: The essential Prebisch

It can be argued that Prebisch changed less than Washington and Argentina: between 1943 and 1949 the Cold War reversed policy in Washington, and Peronism transformed Argentina. The many criticisms of Prebisch –that he was a blind protectionist, or that he was anti-American, for example– obscure the record of his actual

life and work before 1943.<sup>42</sup> The ultimate irony is that he is often blamed for deforming Latin American development by advocating excessive import substitution. In fact the ethical imperative which drove him all his life derived from his boyhood years in Tucumán, where a handful of sugar barons maintained a colonial-style system of exploitation over migrant Indian labourers, because their power in the national capital could keep out cheaper Brazilian imports. Like his father, an immigrant from Saxony in Germany who married into a poorer branch of one of Argentina's most famous colonial families, he disliked the oligarchy and military; he was a charter member of Argentina's "golden generation," and he arrived in the capital committed to reform. His decision to study economics –at that time a new and non-prestigious discipline in Argentina promising few rewards– reflected a desire to understand markets to improve society in the original Adam Smith conception of the discipline. This same idealism infused his choice of a career in the Argentine public service when he recognized the modernization of the State as his future path, and he moved up quickly to become a leading technocrat by 1928. The autonomous Central Bank model he developed in 1935 was his crowning achievement in his Argentine years, capturing his vision of a modernizing elite in Argentina to oversee a coherent development process protected from political uncertainty –just as he built ECLA (and later UNCTAD) as instruments to champion equity in North-South relations. Ironically, after some 54 years, the World Bank's *World Development Report 1997* accepted Raúl's vision of a strong but "smart" State to correct market externalities, safeguard public goods, and seek competitive advantages instead of comparative advantages in trade.

In 1943, six years before the "manifesto", when Prebisch outlined his thoughts on the challenge facing Argentina, his ideas sound familiar in the current discourse on coping with globalization: especially the need to harness the market in the social interest by locating a compromise between the benefits of liberalization on the one hand and the political choices required to protect national values and public goods on the other. As we already noted, we would now view

<sup>41</sup> Prebisch, 1949, p. 52.

<sup>42</sup> See Prebisch, 1949, p. 11, for his assault on the "false universality" of general economic theory. The widespread notion that he was anti-American, which became prevalent in Washington during the 1950s, is entirely belied by his life and work. This issue is discussed at very considerable length in the author's forthcoming biography of don Raúl.

Prebisch's approach as "civilizing globalization" to ensure sustainable growth and social development. Some assumptions of the "manifesto" (such as the pessimism about exports) proved incorrect, but his enduring contribution does not lie in time-bound details. Rather its greatness lies in projecting a paradigm which restores the power factor to international economics and in demanding that theory be linked with experience in interpreting Latin America's peculiar regional insertion in the international economy. This vocation reflected

the constant interaction between the practitioner and the academic in his life, which by 1943 had abundantly demonstrated the false universality of neo-classical economic theory. The short and undistinguished trajectory of the Washington Consensus serves as a salutary reminder of ideological excess and the need for new approaches that reflect the contemporary Latin American context.

(Original: English)

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# The motive ideas *behind three* industrialization processes

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In its most orthodox version, neoclassical economic theory has occupied a leading place in Latin American economic policy discussions in recent years. According to this doctrine, the market mechanisms –if allowed to operate in complete freedom– allocate production resources in the most efficient manner possible. Any interference by State policy with this allocation will lead to loss of efficiency and a reduction in the growth rate of the economy compared with the optimum level that could be obtained through the free play of the market forces. The virtues of the main body of this economic theory for interpreting reality have been proved over more than two centuries. But this does not justify overlooking the serious limitations affecting the operation of the market or the differences observed in that operation in the different stages of countries' development. In the historical period in which they began their industrialization processes, the countries which are now developed applied policies of active State participation in combination with the free functioning of the market, and formulated theories which gave technical backing to those policies.

Although these facts have been studied and are well known in academic circles, very little reference is made to them in economic policy discussion in our region. I therefore propose in this essay to recall the ideas which

guided the evolution of two important economic policies: those of the United States and of Germany. Due to lack of space, I shall not deal with the case of Japan, which also applied policies in the last century which combined State and private action. The first two cases will be used in this essay as the background for analysing the ideas of Prebisch and ECLAC applied to the case of Latin America.

## 1. The case of the United States. Alexander Hamilton

These ideas on the industrialization of the United States were set forth by Alexander Hamilton in 1791 (see Hamilton, 1934). This author questioned the validity of the objections against policies for the promotion of manufactures and the assertion that –without government aid– industry would grow as quickly as the natural state of things and the interests of the community required. According to Hamilton, this assertion is not always true. Inertia and a tendency to imitate are reflected in fears about failing in new ventures, the obstacles inseparable from first experiments in competing with nations which have already perfected a particular branch of industry, and the artificial incentives with which foreign countries support their citizens (Hamilton, 1934).

Hamilton goes on to say that "Experience teaches ... that the simplest and most obvious improvements, in the most ordinary occupations, are adopted with hesitation, reluctance and by slow gradations. The

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spontaneous transition to new pursuits ... may be expected to be attended with proportionably greater difficulty. ... these changes would be likely to be more tardy than might consist with the interest either of individuals or of the Society ... and ... in many cases they would not happen. ... To produce the desirable changes, as early as may be expedient, may therefore require the incitement and patronage of government. The apprehension of failing in new attempts is perhaps a more serious impediment ... it is essential that [those embarking on such new ventures] should be made to see ... the prospect of such a degree of countenance and support from government, as may be capable of overcoming the obstacles, inseparable from first experiments". "The superiority antecedently enjoyed by nations, who have preoccupied and perfected a branch of industry, constitutes a more formidable obstacle ... to the introduction of the same branch into a country, in which it did not before exist. To maintain between the recent establishments of one country and the long matured establishments of another country, a competition upon equal terms, both as to quality and price, is in most cases impracticable ... without the extraordinary aid and protection of government". Thus, government aid for infant industry in a new country may be essential in order to offset inequalities of competition in the initial period.

Thanks to the reports by Hamilton and by some of his followers, such as H.B. Carey, who advocated these ideas in 1865, these concepts spread and strongly influenced the trade and industrial policy applied by the United States during its industrialization process (see Mill, 1987).

## 2. The case of Germany. Frederick List

The industrialization policy for Germany was set forth in similar, albeit broader, terms by Frederick List in the nineteenth century (List, 1856). List claims that, during the initial period of development of an industry in a new country, government aid for the infant industry may be essential in order to equalize the conditions of competition. He maintains "The protective system is the only means by which nations less advanced can be raised to the level of that nation which enjoys a supremacy in manufacturing industry. A monopoly not conferred by nature, but seized by being first on the ground; the protective system, regarded from this point of view, will be most effective promoter of universal association among nations, and consequently free trade" (List, 1856, p. 201). Although he recognizes that in the

beginning customs protection increases the price of manufactures, he maintains "that in course of time, in a nation capable of large industrial development, such articles can be produced at a cheaper rate than they can be imported from abroad" (List, 1856, p. 224). The initial sacrifice "is amply compensated by the acquisition of a productive power, which ensures not only a larger product of wealth in future, but also a greater industrial independence" (List, 1856, p. 224).

Citing Say, he accepts that the State may protect national industry provided that within a few years that industry can survive unaided, just like "... a shoemaker's apprentice, to whom a few years' teaching and support is accorded that he may learn his trade to live without further help from his parents" (List, 1856, p. 262).

List's proposals go further than those of Hamilton. He not only refers to the greater independence in industrial matters that this policy gives to a country, but also notes that the progress of industry in a predominantly agricultural country has more general consequences for development. It stimulates urban growth and has a positive influence on social and political development, on intellectual and cultural progress, and on creative capacity. Industrial development makes possible increased productivity throughout the economy and development of the means of transport.

He highlights the interdependence between industrial and agricultural development, noting that industrial development stimulates and diversifies demand for agricultural products (List, 1856, p. 295). During the process of industrial development, each new industry supports the development of others (List, 1856, p. 377). This assertion brings out the intersectoral and not merely individual nature of industrial policies.

List hints at the structural nature of the economic development process when he asserts that the development of manufacturing is only attained slowly and gradually. It takes a long time to improve equipment, production processes and distribution systems. It is easier to perfect and expand an existing enterprise than to start up a new one. Old industries, which have been developed over generations, can be promoted more easily than new ones. It is more difficult to make an enterprise progress when there have been few or no such enterprises in the country in the past, since in new enterprises the managers and workers have to be trained or brought in from outside, and the prospects are not promising enough to give capitalists the degree of confidence needed to ensure their participation. Over generations, it is possible to improve

the price, quality and quantity of the production (List, 1856, pp. 373-374).

These ideas open up a broader horizon than that of the industrial sector itself and are forerunners of later, technical proposals. The manufactures of a newly industrialized country, List says, "can be compared with a youth struggling with a fully grown man. The manufactures of the chief industrial and commercial power possess a thousand advantages over those of new or as yet not fully mature nations. They have ... skilful and experienced workmen in great numbers and at low wages, men of special skills and experience in management, ... financial institutions, ... transport facilities, ... efficient storage and distribution systems, ... a domestic market which provides them with support for conquering outside markets". In those conditions, it would be useless for a new country to trust exclusively in the natural evolution of the economy to develop an industry in free competition with the most highly developed nations (List, 1856, pp. 378-379). List, like Hamilton and other classical authors, considered that there must be limits on policies for the promotion and protection of industry: protection and support should not have excessive levels, should be kept in being only for a reasonable length of time, and should be applied to activities in which the country had the possibility of being competitive (List, 1856, pp. 390-393). Customs duties should be considered and applied only for the benefit of sectors which offered basic advantages for the country.

### 3. More general cases: John Stuart Mill and neoclassical theory

Mill acknowledged the legitimacy of industrialization policy by incorporating the infant industry argument into classical theory. His ideas (Mill, 1987) were based on the more pragmatic and limited version of Hamilton rather than that of List.<sup>1</sup>

Pages 922 and 923 of Mill (1987) contain the following well-known paragraph: "The only case in which, on mere principles of political economy, protecting duties can be defensible, is when they are imposed temporarily (especially in a young and rising nation) in hopes of naturalizing a foreign industry, in

itself perfectly suitable to the circumstances of the country. The superiority of one country over another in a branch of production, often arises only from having begun it sooner. There may be no inherent advantage on one part, or disadvantage on the other, but only a present superiority of acquired skill and experience. A country which has this skill and experience yet to acquire, may in other respects be better adapted to the production than those which were earlier in the field: and besides, it is a just remark of Mr. Rae, that nothing has a greater tendency to promote improvements in any branch of production, than its trial under a new set of conditions. But it cannot be expected that individuals should, at their own risk, or rather to their certain loss, introduce a new manufacture, and bear the burthen of carrying it on until the producers have been educated up to the level of those with whom the processes are traditional. A protecting duty, continued for a reasonable time, might sometimes be the least inconvenient mode in which the nation can tax itself for the support of such an experiment. But it is essential that the protection should be confined to cases in which there is good ground of assurance that the industry which it fosters will after a time be able to dispense with it" (Mill, 1987, pp. 922-923).

Neoclassical theory has refined the infant industry argument and clarified its validity. But at the same time it has helped to limit its application. It analyses the case of external economies, where the company making the investment does not capture all the resulting benefits, part of which may be diverted to other firms through the transfer of skilled labour, or through firms which supply the company which made the investment with non-tradeable goods, or through acquisition of its products (Corden, 1974, pp. 256-257). In these cases, it might be necessary to compensate that company for the benefits of the investment that it does not capture.

Neoclassical theory also takes account of the case where there are reciprocal external economies and none of the companies involved captures the total result of the investment (Corden, 1974, p. 260).

In the neoclassical school, there is some skepticism about the application of industrialization policies. Although the validity of the infant industry argument is usually accepted, it is considered that such policies are not the best alternative, but rather second- or third-best options. It is maintained that rather than applying active industrial policies it would be more efficient to improve the information available to entrepreneurs for taking their decisions or to try to improve the capital markets, leaving it to the market, free of all outside

<sup>1</sup> List showed himself to be a capable and far-sighted economist, but he advocated nationalist views which shocked other authors of his time, as described in the essay by G. A. Matile, who edited List's works.

interference, to allocate resources. This would give industrial policies less leeway than was allowed to them by the classical authors who influenced the industrialization processes of the United States and Germany.

Two main positions may be observed in the recent application of neoclassical theory to economic policy for the developing world in general and Latin America in particular:

On the one hand, there is the more orthodox point of view, which gives public policies a much-reduced role and leaves the allocation of production resources to the unfettered functioning of the market. It attaches decisive importance to maintaining fiscal and monetary balance, and advocates the reduction of the public sector to a minimum, the privatization of State activities, and deregulation. The supporters of this approach are openly hostile to active production development policies and attempts to change the economic structure, such as promotion of industry, policies designed to support technological progress, and trade policies based on protection and export promotion.

During the Reagan administration in the United States, this line of thinking, promoted by a supply-side economy, was very much in vogue. Even after the end of that administration, however, it has continued to enjoy strong support, especially among conservative groups, Latin America's private international creditors, and domestic sectors in Latin American countries associated with those financial circles. In the words of Feinberg (1990): "On one side are those who favor the restrictive Reaganite model: provide for national defense, set the appropriate macro conditions, and walk away".

On the other hand, there is also a less rigid neoclassical position which accepts some degree of active policies to promote industrial and technological development and support new exports. This position sets quite strict limits for such policies, however, both as regards the instruments used and the intensity with which they are applied in particular sectors, and also the length of time they are applied to each sector of production. Generally, though not always, it accepts one exception to the ideal of free trade, namely, infant industries, which may warrant substantial protection, but only on a temporary basis (Williamson, 1990, p. 15).

In another paragraph, Williamson refers to his own position on subsidies: "... for my taste, the hostility toward subsidies tends to be too general. I fully sympathize with the hostility toward indiscriminate subsidies, but I also believe that there are circumstances

in which carefully targeted subsidies can be a useful instrument ... for improving either resource allocation or income distribution" (Williamson, 1990, p. 12). Stiglitz (1998) also takes a broader view on economic policies which can be applied without distorting the operation of the markets.

#### **4. The case of Latin American industrialization: the Prebisch and ECLAC approach**

Prebisch and ECLAC also opted for an approach involving deliberate industrialization, with State participation, in support of the private sector. They took a broad-based approach which, although centering mainly on economic matters in its operational aspects, also covered social issues, especially for the interpretation of the process. Changes in economic structures, industrialization, agricultural development, international economic relations, saving and investment, employment and income distribution were other issues analysed extensively and in depth.

Prebisch had been brought up in the classical economic tradition, and in the first years of his professional life he was an orthodox economist. As he himself said: "I believed in the universal validity of the theories developed in the centres" (González and Pollock, 1991). As a young Under-Secretary of Finance of his country, in the early 1930s, he recommended the government to apply orthodox policies in monetary, fiscal, trade and exchange matters. Soon, however, his ideas began to change, as a result of his experience in government which began in that period and continued later in the Central Bank of the Argentine Republic. There were two main aspects of that change: i) he came to the conclusion that, in the light of the world crisis, the Argentine economy would not recover using orthodox policies, in view of the ongoing deterioration in exports, which contrasted with the tendency towards strong growth in import needs; and ii) the failure of the 1933 World Economic Conference and the fact that Keynes's ideas on international cooperation found almost no acceptance among the European countries convinced him that Argentina could not hope for a solution through the reactivation of world demand. The tough bilateral negotiations for the Roca-Runciman treaty with Great Britain clearly revealed to him the limits imposed by a high degree of dependence on the export of primary commodities to a few foreign markets (González and Pollock, 1991).

As a result of this experience, he became convinced that it was essential to change the country's structure



of production and of exports through industrialization, and that to secure this objective it was necessary to combine the play of the market forces with State action designed to promote and guide private sector action. Prebisch had become clearly aware of the profound repercussions on developing countries caused by crises originating in the developed countries, and knew that little could be done to avoid such crises.

His experience in Argentina served as the ground in which Prebisch's ideas initially germinated, to be subsequently developed in ECLAC and later still in the United Nations Conference on Trade and Development (UNCTAD).

According to Prebisch, the developing countries –which were on the periphery– specialized in the production of primary commodities. This resulted in an asymmetrical structure of their trade and financial relations with the developed countries. They exported low-technology goods and imported high-technology ones. Their exports were produced by unskilled labour, with a weak level of trade union organization, and the demand for them was marked by low income elasticity. As a result, this demand grew only sluggishly, and the exports provided low and unstable wages and profit margins. Their imports, in contrast, contained skilled, highly unionized labour, and their income elasticity was high, meaning higher wages and profit margins and faster growth for the supplier countries.

This asymmetrical structure of the external relations of the developing countries limited their growth potential, while their structural economic and social heterogeneity was reflected in unequal income distribution whose most evident –though not its only– features were poverty and marginality.

The cornerstone of the recommendations he made on the basis of this diagnosis was the industrialization process, which would make it possible to change the domestic production structure and external relations. This process could not be induced fast enough solely through the unaided effect of the free market forces, but required active public protection and promotion policies in the fields of trade, taxation and credit.

This policy varied with time, changing its emphasis according to the variations in the international economic situation and the development of industry in the region. In the post-war period, the markets of the developed countries were closed by high protectionist barriers, so that policy was aimed preferentially at the domestic market, through import substitution. Prebisch and ECLAC, however, considered that in view of the small size of that market import substitution meant

inefficiency, so they recommended integration among the Latin American countries in order to create bigger markets and greater competition, and ECLAC gave strong support to the Central American integration process, the Latin American Free Trade Association (LAFTA)/ Latin American Integration Association (ALADI) and the Andean Group. From the 1960s on, as the markets of the developed countries showed themselves to be somewhat more receptive to Latin American manufactures, ECLAC maintained a programme to provide technical support for policies to promote the export of manufactures.

There was also an ongoing evolution of the priority production sectors in the industrialization process, from sectors producing non-durable and durable consumer goods at the start, to intermediate and capital goods with greater requirements in terms of investment and technology later on. The production of consumer goods created the subsequent demand for intermediate and capital goods: a form of evolution endorsed by ECLAC studies on industrial sectors and policies.

In order for progress to be made in policies to support the production of manufactures, two complementary elements were required:

- i) A technology policy whereby the State provided support for the creative adaptation of outside technology to the special conditions of the Latin American countries and helped to speed up the innovation process. This increased efficiency, reduced costs, and improved the quality of the goods produced, so that they were better adapted to the demand on external markets. A project was carried out in collaboration with the Inter-American Development Bank (IDB) in this field.
- ii) As well as the efforts of the developing countries themselves, the export of manufactures required the active collaboration of the developed countries, which should open up their markets. One of the main objectives of Prebisch's work at UNCTAD –ably seconded by ECLAC in the Latin American area– was the creation of a generalized system of preferences, with unilateral opening of the markets of the developed countries in favour of the developing countries, through specific lists of goods that the developing countries were interested in exporting.

Although industrialization was the hub of the policies advocated by Prebisch and ECLAC, its success would call for the simultaneous application of other policies too.

Thus, an international cooperation policy was required, in order to secure a substantial increase in the

flow of medium- and long-term capital from the developed countries to the region. Domestic saving capable of being turned into foreign exchange was not sufficient to finance an acceptable growth rate, as was reflected in the saving and trade deficits. International cooperation was possible, thanks to the political climate prevailing at the end of World War II and the political competition between the capitalist developed countries and the socialist countries. The World Bank, which was set up soon after the war, was complemented with the establishment of the Inter-American Development Bank (IDB), in whose creation ECLAC played a leading role. Mechanisms were also established in the countries of the region to ensure that medium- and long-term capital of public origin was invested efficiently, with the highest possible yield in terms of its contribution to economic development and employment and with guaranteed payment capacity. These mechanisms operated efficaciously until the abundance of international funds created by the oil price rises from the 1970s on and the surplus savings being accumulated by the developed countries turned the shortage of international funds into a glut. This led to the slackening of the discipline which had prevailed up to then and encouraged unproductive or imprudent use of the funds, culminating in the 1980s in the Latin American external debt crisis.

It was also necessary to pay special attention to two interrelated social issues: income distribution and employment. Income distribution was a matter of growing concern for Prebisch and ECLAC from the 1950s on, unlike conventional theory, which paid little attention to this issue because it based its ideas on the principle that, in an equilibrium situation, redistribution could not improve one person's income without adversely affecting that of another person. ECLAC, however, considered that Latin American industrialization received substantial

support from the domestic market, so that better income distribution –quite apart from its importance for equity– was of great economic significance because it promoted the broadening of the domestic market and the incorporation into it of a high proportion of the previously marginalized population. With regard to employment –the other aspect of marginality– specific objectives and forms of development were proposed which would make it possible to progress towards the solution of structural unemployment and underemployment within a reasonable length of time.

Another two methodological aspects were given a great deal of attention by ECLAC: the investment projects manual, and planning – two technical instruments which were placed at the disposition of countries in order to help them to ensure the most efficient possible use of their resources. In the projects manual, a project preparation technique was described which increased projects' contributions to development and employment to the maximum, thus offering a means of relieving external constraints. This technique was very useful for submitting projects to financing bodies and evaluating their effects from the point of view of the entrepreneur and society. Planning, for its part, was put forward as a means for designing medium- and long-term policies and following up their implementation in order to ensure, as far as possible, that the structural changes pursued were effectively obtained. It aimed to secure coherence of the objectives proposed in development policies and compatibility of those policies with the restricted resources available, especially savings and foreign exchange. ECLAC therefore made the institutionalization of development planning one of the main objectives.

(Original: Spanish)

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# Technological change *and opportunities for* development as a *moving target*

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This article puts forward an interpretation of development as a process of accumulation of technological and social capabilities dependent upon taking advantage of successive and different windows of opportunity. These windows are determined from the core countries, through the technological revolutions which occur every half-century and the four phases of their deployment. The possibilities of progressing at each opportunity depend on the achievements made in the previous phase, on identifying the nature of the next one, understanding the techno-economic paradigm of the revolution in question, and being able to design and negotiate, in each case, a positive-sum strategy, taking account of the interests of the most powerful firms. On the basis of this interpretation, a summary review is made of the successive development strategies applied since the 1950s. The author then outlines the likely nature of the next phase and, applying the principles of the current techno-economic paradigm, explores some aspects of the institutional changes to be carried out.

# I

## Technological change and development

Technology is usually seen as a specialized field of development policy, with separate institutions. In this study, however, we maintain that, rather than being merely an element of development strategies, technology is a condition for their viability. The opportunities for development are a moving target. Any serious observer of the progress made in terms of development from the late 1950s to the late 1970s must acknowledge that the import substitution strategies applied by various countries resulted in gradual but significant advances. In the mid-1970s, when the combination of the industrial redeployment from the North with export promotion from the South showed and promised new and broader advances, there was hope that progress would be constant. With the failure and subsequent deterioration of the model based on protection and subsidies in most of the countries which tried to keep on applying it, the pendulum has swung to the other extreme, so that all the achievements previously made with that model are now denied. This has provided fertile ground for advocating the free market as the only way of achieving satisfactory results in terms of development, even though the efficacy of that policy has not yet been proven.

This article maintains that development opportunities arise and undergo changes as the successive technological revolutions are deployed in

the advanced countries. Technology and production equipment are only transferred voluntarily when they hold out the promise of mutual benefits. The import substitution strategies were successful because they represented a positive-sum game for the mature industries of the developed world, which were coming up against technological exhaustion and market saturation. With the eruption of the information revolution, however, these conditions radically changed and other viable options opened up.

Based on this interpretation, this article examines development strategies from a different angle, which can be especially useful as regards the challenges of the globalization process and the information era. Firstly, it analyses the evolution of technologies, in order to understand in what conditions development opportunities are created and to determine their nature. It then goes on to address the question of development as a way of learning to take advantage of these changing opportunities. This is illustrated through a review of the successive development models applied in the last 50 years and an examination of the challenges raised by the next stage of concentration of power in the world economy. Finally, some of the institutional requirements for coping with the new “flexible networks paradigm” are studied.

# II

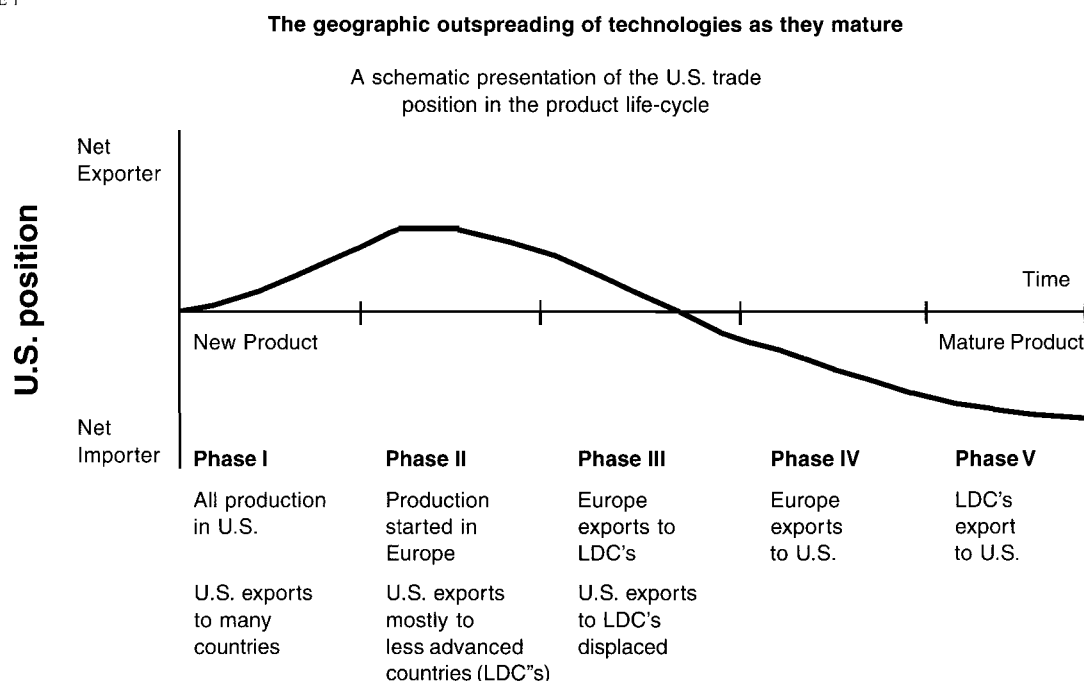
## The product cycle, development and changes in barriers to entry

The role played by imported technology as a mandatory stage on the road to industrialization is a fact that is known historically from the experience of the United

□ This study was originally prepared for UNCTAD X and was subsequently presented at the seminar on development theory at the dawn of the twenty-first century, organized by ECLAC in Santiago, Chile, to commemorate the centenary of the birth of Raúl Prebisch.

States and various European countries in the nineteenth century and the early twentieth. More recently, this role has been confirmed by the rapid transformation of Japan into a first-line country and the big advances made by the four “Asian tigers”. The success of these countries has undoubtedly been due to the absorption of technology from the most advanced countries and their own efforts to adopt, adapt, modify and master the

FIGURE 1



Source: Wells (1972), p. 15.

corresponding technical know-how (Freeman, 1987; Amsden, 1989). However, many more examples can be cited of countries which had little success in promoting their development over the same period, even though they apparently applied similar procedures for making use of imported technology. Furthermore, many countries and even whole regions –such as Africa and most of South America– seem to have lost much of the ground previously won (Mytelka, 1989; Katz (ed.), 1996).

The reasons for such different results are to be sought partly in the specific policies applied in each case and partly in the particular conditions of each country. At a deeper level, these reasons are connected with the nature of the windows of opportunity created by the technological evolution of the leading countries and the capacity for consciously or intuitively taking advantage of them. This makes it necessary to consult the abundant specialized literature on the ways in which technologies evolve and diffuse.

### 1. The product life cycle and the geographic propagation of technologies

One of the first attempts to analyse the technological possibilities of the developing countries was made by Hirsch (1965). By examining the behaviour of the traditional electronics industry in terms of the product

cycle, Hirsch showed how the advantages shift in favour of the less advanced countries when technologies approach maturity. Wells (1972) graphically summarized the process for the case of the United States, in his study of the literature on the product cycle (figure 1).

The migration of production, first from the country of origin to other advanced countries and later to less developed countries, revealed one of the processes behind the paradox observed by Leontief, whereby the exports of the United States had a higher labour content than its imports (Leontief, 1954). This situation, which was unexpected for the leading country in matters of technology, is related with the changing characteristics of evolving technologies. Technologies tend to make more intensive use of labour in their initial phases and to use relatively costly personnel with high levels of knowledge and qualifications.<sup>1</sup> When they approach maturity, however, they are using highly standardized, mechanized and automated processes.

When technologies mature, there are forces which push them out more and more towards the periphery, where, presumably, there are complementary forces that pull them in order to set development processes in

<sup>1</sup> See Hirsch (1965 and 1967), Vernon (1966) and, more recently, Von Tunzelmann and Anderson (1999).

motion. Although this observation applies above all to consumer goods and some basic capital goods, the range of products covered is wide enough to serve as a starting point for the analysis.

## 2. With mature technologies there can be no catching up<sup>2</sup>

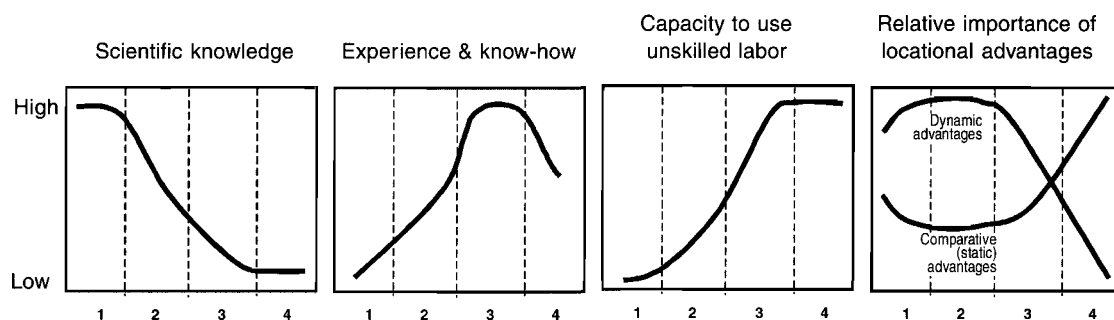
It is ironic that advantages are shifting in favour of capital-poor countries precisely when the production process is marked by more intensive use of capital. When this phase has been reached, tasks have become so routine –see phase 4 in figure 2–<sup>3</sup> that production

does not require much prior know-how or experienced managers, while the processes can use unskilled labour. As technology and markets reach maturity, the determining advantage is the comparative cost profile.

Can there be a catching-up process in development based on mature technologies? This is extremely unlikely, for various reasons. As shown in figure 3, mature technologies reach a point where they have only minimal potential for producing profits, face stagnant markets, and have almost no room left for improving productivity. Thus, generally speaking, using the maturity phase as a starting point is costly and is neither

FIGURE 2

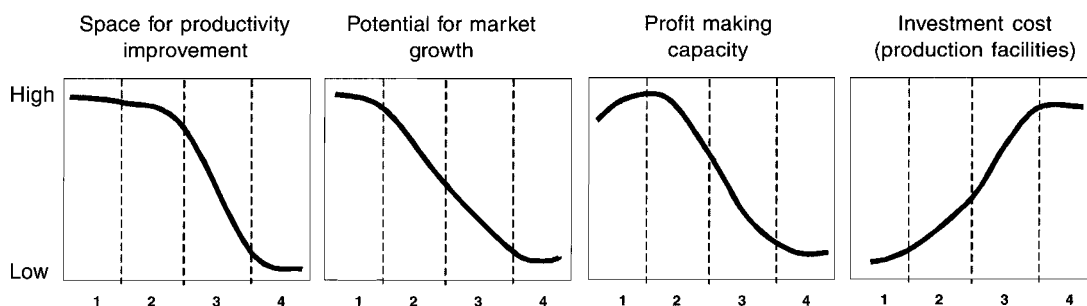
### Changing entry requirements as technologies evolve to maturity



Source: Based on Perez and Soete (1988) and Hirsch (1967).

FIGURE 3

### Changing potential of technologies as they evolve to maturity



Source: Based on Gerschenkron (1962), Cundiff and others (1973), Kotler (1980) and Dosi (1982).

<sup>2</sup> This section is based on Pérez and Soete (1988).

<sup>3</sup> It may be considered that phase 4 approximately covers phases IV and V in Wells's diagram (see figure 1).

very profitable nor very promising. Even so, it is probably the best starting point for creating a basic industrialization platform, generating learning capacity, and establishing the basic infrastructure and other externalities needed to back up a development effort.

However, catching-up supposes a dynamic development process, fuelled by local innovation and growing markets. This requires an entry as early as feasible. Surprisingly enough, apart from the mature phase of technologies, the other moment when weaker players confront surmountable barriers is not in phases two or three but rather in phase one. This happens to be the most promising entry point, because, as indicated in figure 3, potential profits are high, there is ample space for market and productivity growth and investment costs are relatively low. Even research and development investment, can often be lower than that of the original innovator.

It might be thought that only the enterprises of advanced countries can possess the high level of knowledge required in this phase (see figure 2). However, if the new products belong to the early phases of a technological revolution, the know-how involved tends to be in the public domain (available in universities, for example). An example of this is the recent case of Silicon Valley and its thousands of successful imitators all over the world. In these cases,

the prior experience required is not very great, and indeed, possessing it may even be a disadvantage, because technological revolutions impose new management models which make the previous ones obsolete.

The other restrictive factor is connected with the surrounding environment. Success in using new technologies depends on certain important complementary factors, such as dynamic advantages and different types of externalities, especially the physical, social and technological infrastructure or the existence of competent and demanding local clients. These elements may have been built-up before with mature technologies, or they can be acquired through intensive learning processes and investments in the improvement of the social and economic environment.

It would appear, then, that a strategy could be designed for accumulating technological and social capabilities through the use of mature technologies and then making use of that base for gaining access to new and dynamic technologies, but this possibility depends to a large extent on the specific opportunities created by the successive technological revolutions. A full understanding of the way technology evolved in the advanced countries could be useful for developing countries wanting to design viable strategies. This is the subject of the following section.

### III

## Technologies, systems, revolutions and paradigms

The evolution of technology is a complex process; technologies are interconnected in systems, and these, in turn, are intertwined and interdependent, both with each other and in relation to the physical, social and institutional environment.

Much of technological learning is gradual and incremental. However, there is no inevitable progression towards an ever more advanced and always unattainable frontier. There are important discontinuities which become windows through which latecomers can leap forward. These opportunities occur in the form of technological revolutions and involve sharp changes of direction in technological progress; they also provide the means for modernizing most activities at the cost of abandoning much of the management know-how

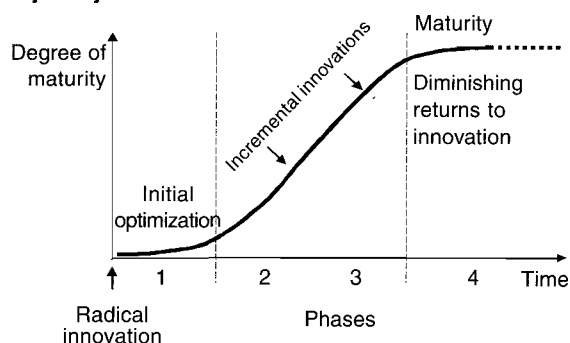
previously accumulated and part of the previous equipment, along with the related specialized knowledge. New technologies of a revolutionary nature open up new opportunities for learning and catching-up. The interaction of continuous and discontinuous technological changes explains why and how windows of opportunity for development vary with time.

### 1. Technological trajectories and the accumulation of experience

In spite of their specific differences, most technologies tend to follow a similar trajectory as regards the rate and direction of change and improvement, from initial innovation to maturity. This evolution more or less

FIGURE 4

### The evolution of a technology: A technological trajectory



**Source:** Based on Nelson and Winter (1977), Dosi (1982), Freeman and Pérez (1988), Wolf (1912), Abernathy and Utterback (1975), and other authors.

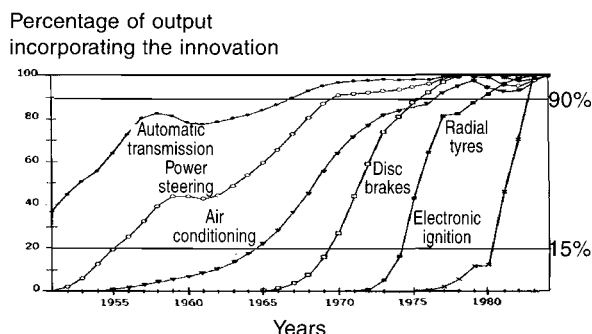
coincides with that of their markets: from introduction to saturation<sup>4</sup> (figure 4).

After a radical innovation gives rise to the appearance of a new product, capable of generating a new industry, there is an initial period of intensive innovation and optimization, until the product gains acceptance in the corresponding market segment. Interaction with the market soon determines the direction that improvements will take, and these often define a dominant design (Arthur, 1989; David, 1985). From that point on, as the markets grow, successive incremental innovations are made to improve the quality of the product, the productivity of the processes, and the producers' market position. This process culminates in maturity, when new investment in innovations begins to have diminishing returns. Depending on the importance of the product, the whole process can last a few years or a number of decades. In the latter case, the "improvements" usually take the form of successive models.

After the first innovations, the firms developing the technology acquire advantages, not only through patents but also –and perhaps more importantly– through the experience accumulated with product, process and markets. This tends to keep the corresponding general and specialized know-how in the

FIGURE 5

### Shortening of cycles of late innovations: Spread of successive technologies in the United States automobile industry



**Source:** Jutila and Jutila (1986), cited in Grübler (1990), p. 155.

hands of the producers and their suppliers, making it less and less accessible to new entrants. This experience also speeds up the adoption of innovations, so that the last ones are incorporated very rapidly and it is even more difficult for latecomers to catch up with the leaders (see figure 5, which illustrates this phenomenon, taking the example of the successive innovations in automobiles).

## 2. Technological systems and the creation of social capabilities

Technologies are not developed in isolation, but are connected with each other in systems, giving each other mutual support and taking advantage of experience, the development of suppliers, consumer education and other externalities created by their predecessors in the system (Freeman, Clark and Soete, 1982).

Technological systems evolve along similar lines to those of individual products (figure 4). New products represent incremental improvements in the system. In the first two phases there are many really important products with a long life cycle; afterwards, they tend to go down in number and importance, until the last ones are less significant and have a short life cycle (such as disk brakes and radial tires in figure 5).

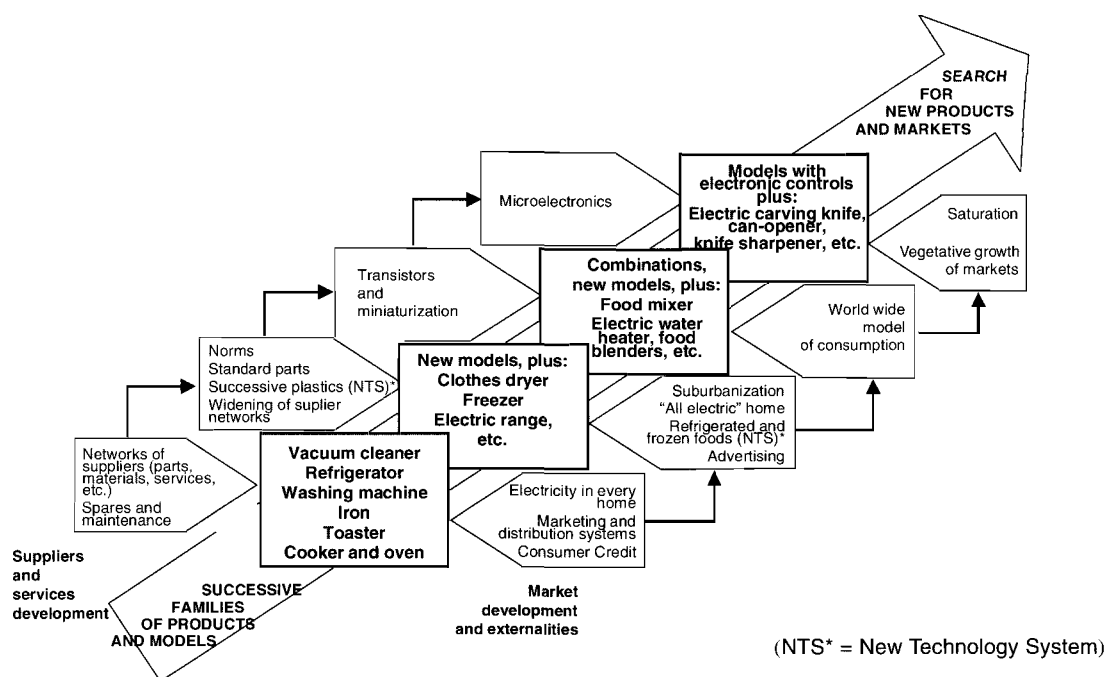
Figure 6 presents a stylized example of the technological system of household electrical appliances, beginning with refrigerators, washing machines and vacuum cleaners and later expanding to a series of new products and successive models of earlier products. Both tend to reach maturity more or less simultaneously, together with the introduction of the last minor

<sup>4</sup> Abernathy and Utterback (1975), Dosi (1982) and Sahal (1985). Among textbooks on business management, special mention may be made of Cundiff and others (1973) and Kotler (1980). An extensive summary is given in Coombs and others (1987) and Dosi (1988). A full interpretation of the relations between technology, the economy and policies is given in the classic work by Freeman (1974) on the economics of innovation and in the updated version by Freeman and Soete (1997).



FIGURE 6

## Co-evolution of a technological system and its environment: Household appliances



innovations of the system, such as electric can openers and carving knives. The figure also shows how the systems become established in particular territories, thanks to the extension of the network of suppliers of parts and services and the gradual establishment of regulatory frameworks and other institutional facilitators.

This growing interaction of “hard” and “soft” elements is one of the aspects that Abramovitz (1986) was referring to when he criticized the concept of development as the simple accumulation of capital and labour, stressing the need to acquire *social* capabilities. It is also related to the notion of national or regional systems of *innovation* formed by the interacting agents (Freeman, 1993; Lundvall, 1988 and 1992).

The need to form these complex networks of mutually supportive activities and institutions explains some of the limitations that development encounters when it is based on the transfer of mature technologies. It also gives support to the arguments of those who recommend building upon the traditions, local capacity and knowledge existing in each particular territory (Porter, 1991). Finally, it also shows the type of action needed to effectively support the survival of pioneering firms in developing countries.

### 3. Technological revolutions and the interconnection of systems<sup>5</sup>

Each technological revolution is a set of technology systems which gradually create the necessary conditions for the appearance of new systems, all following similar principles and obtaining benefits from the same externalities. Figures 7 and 8 illustrate two of these explosions of new technologies: the mass production revolution, with its successive systems, which crystallized around 1910 and reached maturity in the 1960s and 1970s, and the information revolution, which has been propagating since the 1970s.

The process of multiplication of innovations and technological systems, both up and downstream from the industries that form the core of each technological revolution, explains the enormous growth potential possessed by each of these constellations of new technologies. This process represents the opening up of a vast new territory for innovation, expansion and growth. The initial innovations correspond to the

<sup>5</sup> Freeman and Pérez (1988). An extended analysis of each of these revolutions, since the original Industrial Revolution in England, may be found in Freeman and Louçã (2001).

FIGURE 7

**The mass production revolution: A growing network of technological systems which spread out from 1910 on**

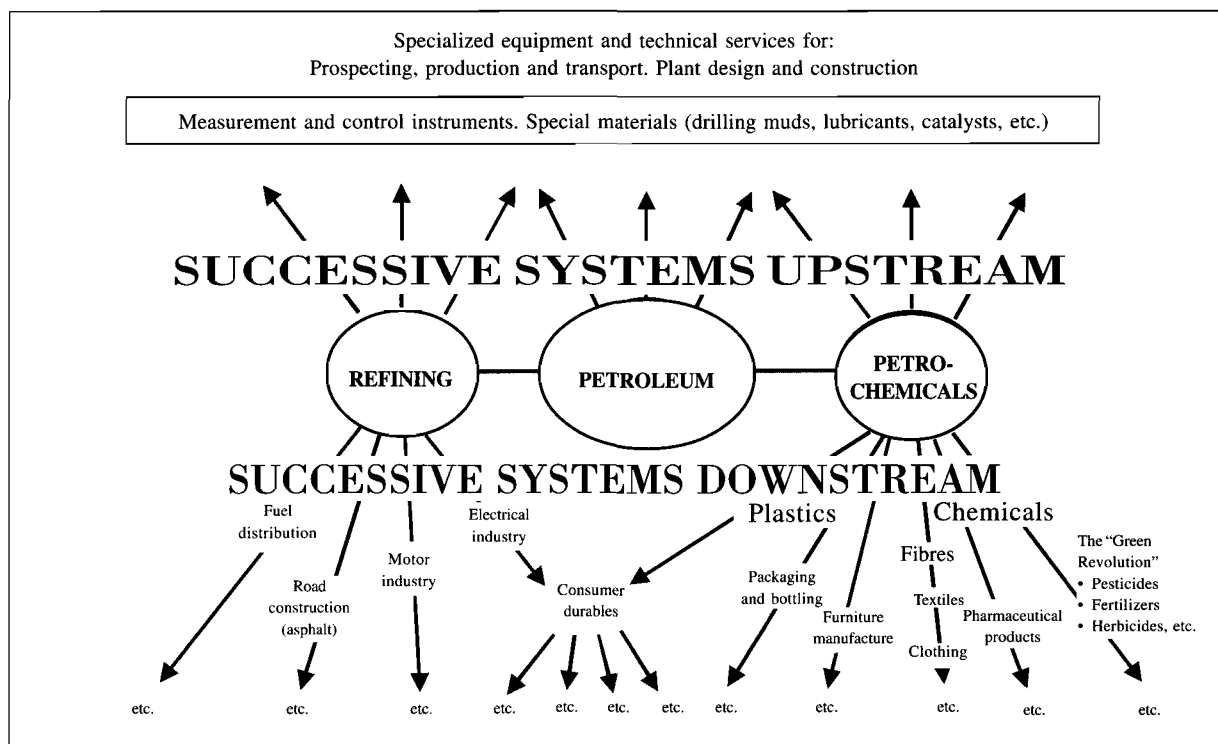
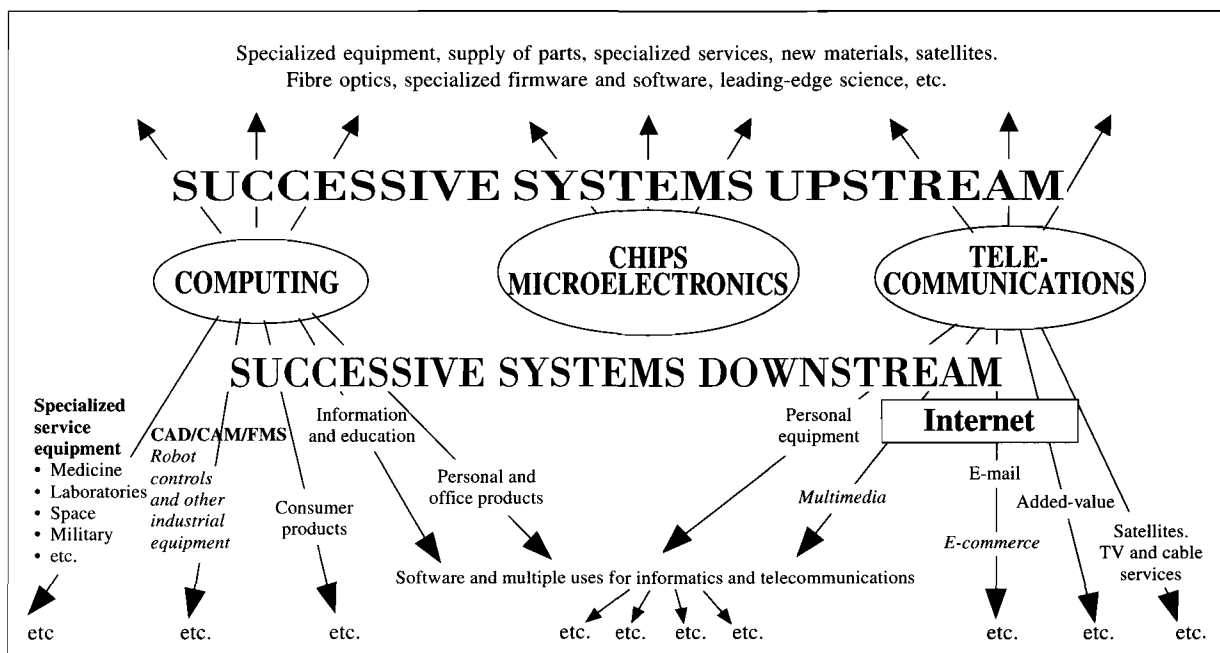


FIGURE 8

**The information revolution: A growing network of technological systems which spread out from 1970 on**



“discovery” of this territory, while the phase of maturity and exhaustion corresponds to its total “occupation”.

Figures 4 and 5, with a longer time scale, may also be interpreted as the life trajectory of a technological revolution. In this case, the incremental “improvements” would be the successive new technology systems. As in the previous cases, in the early period of growth many major systems make their appearance, but as the process advances towards maturity the new systems tend to be fewer and less significant.

#### **4. Techno-economic paradigms and the rejuvenation of all activities**

Existing mature industries neither remain unchanged nor passively coexist with the new industries. Each technological revolution brings generic and all-pervasive technologies, together with new organizational practices, which significantly increase the potential productivity of most existing activities. The principles on which this modernizing process is based are gradually incorporated into a best-practice model which we have called the “technological style” or “techno-economic paradigm”.<sup>6</sup> The result is the gradual rejuvenation of the whole productive structure, so that updated mature industries can again behave like new industries in terms of dynamism, productivity and profitability.

This process may explain the disappointment of those who, in the North-South Dialogue of the 1970s, cherished the hope of transferring mature industries to the developing world on a permanent basis. Since the 1980s, one industry after another has been modernized: even such a traditional activity as the clothing industry has been rejuvenated and placed on an innovative course, with segmented markets (Hoffman and Rush, 1988; Mytelka, 1991).

#### **5. Change of paradigm as a change in management common sense**

A techno-economic paradigm articulates the technical and organizational models to take the fullest advantage

of the potential of the corresponding technological revolution. Each paradigm provides a new set of “common sense” principles which serve to guide the decision-making of entrepreneurs, innovators, managers, administrators, engineers and investors towards the greatest efficiency and efficacy in both old and new activities. For those who had obtained satisfactory results with the previous paradigm, the process of adopting a new one may be devastating, for as well as demanding the abandonment of a body of experience acquired with great effort, it is as if the world had been turned upside down (Peters, 1989; Coriat, 1991).

Figure 9 shows how, with the transition from the mass production model to the flexible networks model, management criteria are changed in all fields, from product selection and design to organizational structures, forms of operation, and personnel relations.

Such phenomena as globalization and the tendency to political decentralization are also closely related with the change of paradigm, with the new possibilities it offers, and the most effective way of taking advantage of them. It may be considered that the Schumpeterian description of technological revolutions as processes of “creative destruction” is applicable not only to the economy but also to policies and institutions.<sup>7</sup>

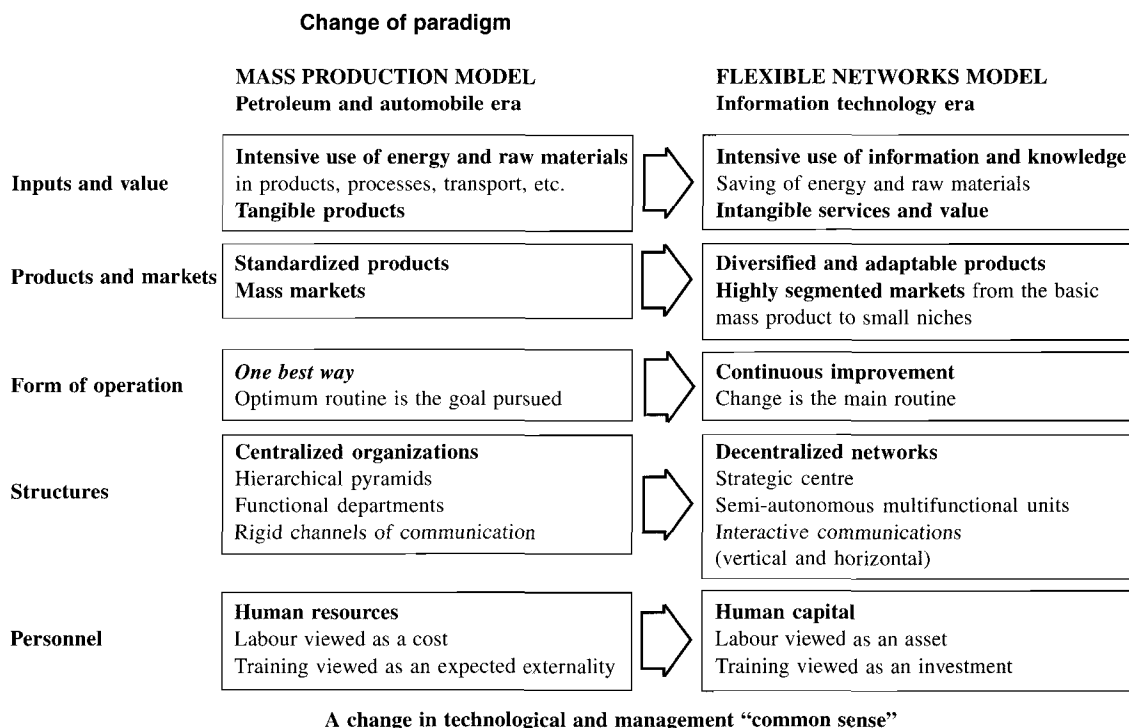
The process of change is not easy, and the transition to the new practices may take two or three decades. Finally, however, the new paradigm becomes accepted as general common sense and is considered the natural and normal way of doing things.

Newcomers or those who had not been successful with the previous paradigm can simply redirect their efforts towards learning the new practices, whereas the established leaders have to “unlearn” much of the old paradigm and adopt the new one. Much of the experience acquired and a considerable part of the investments made in the previous context become obsolete and have to be replaced. The renewal process is long and difficult, so the newcomers may have a certain advantage, which can be reinforced by early investment in the new infrastructure and the creation of suitable facilitating institutions.

<sup>6</sup> Pérez (1983 and 1986). The expression takes the notion of technological paradigm proposed by Dosi (1982) to describe the trajectories of individual technologies to construct a broader concept which defines a common trajectory or “meta-paradigm”.

<sup>7</sup> The enterprises of the developing world have had to go through a double transition, since they have also had to give up the protectionist model (see Pérez, 1996).

FIGURE 9



## IV

### Development as learning to take advantage of changing opportunities

The picture thus drawn in broad lines shows technological evolution as a process with periods of continuity and discontinuity deriving from the nature of competition in a capitalist system. At the microeconomic level, each radical innovation represents a discontinuity followed by continued evolution until the reduction in the possibilities of increasing productivity and profits gives rise to a search for other radical innovations. At the macrosystemic level, the successive technological revolutions irrupt in the economic system, bringing whole constellations of new products, technologies and industries. These fundamental discontinuities give rise to great surges of growth, initially in the core group of industrialized countries, where, in addition to the explosive expansion of the new industries, they also encompass and gradually rejuvenate most of the existing industries. At

the end of the process, when the whole set of industries is approaching maturity, the process spreads to the periphery, while in the core countries the next great surge is already irrupting.

The developing countries are thus pursuing a moving target which not only advances all the time but also changes direction approximately every half-century. If autarky is dismissed as an option, then development is a question of learning to play this game of constant shifts and variations, which is also a power game.

Could this be another version of dependency theory? It undoubtedly involves a notion of North-South and centre-periphery complementarity, yet at the same time it offers the possibility of breaking the vicious circle of underdevelopment by adopting suitable policies. Those who understand the game and play it

well could find a way of making a leap forward and catching-up. The real lessons taught by the Asian Tigers do not lie in replicable recipes but rather in understanding the specific dynamics that made development possible. For such an understanding we need to know why the most favourable conditions for advancing occur during the periods of paradigm shift.

### 1. Periods of change of paradigm as dual technological opportunities

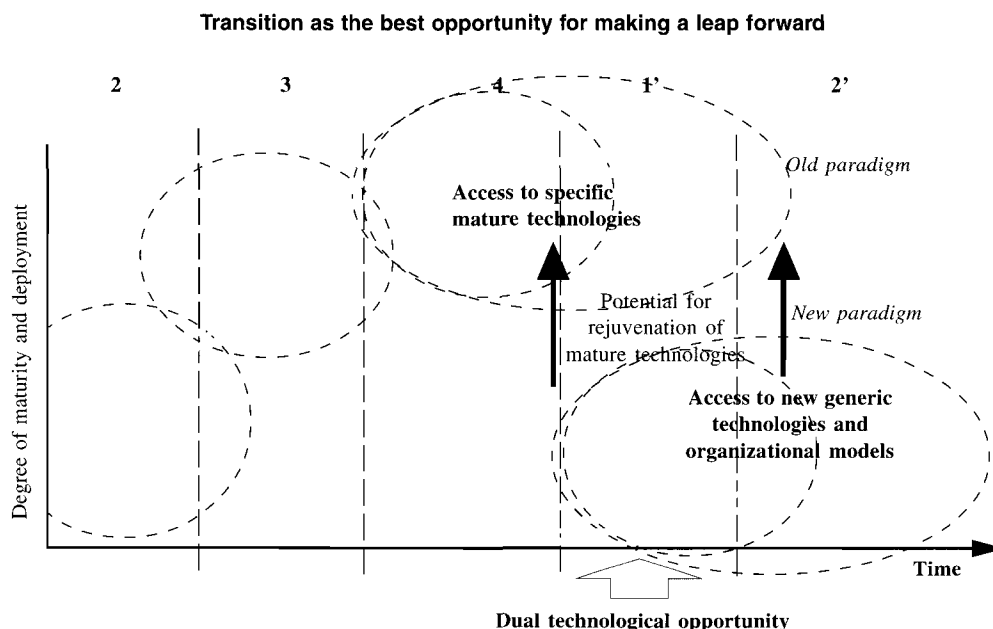
For a period of some 20 years or more, during the transition from one paradigm to another, old technologies co-exist with new ones. Most of the mature technologies of the previous paradigm are being outstretched in an attempt to overcome the limitations on productivity and market growth by spreading out geographically in order to survive. This takes place at the same time that the new technologies are expanding, flourishing and growing rapidly, with big profit margins. This situation characterized the 1960s and 1970s in the developed countries, giving rise to centrifugal trends in which the rich, modern and successful become richer, while the poor and weak become poorer. Paradoxically, however, it is in such periods, when social and economic conditions are at their worst, that the best opportunities appear.

During the transition between paradigms, the two main windows of opportunity open simultaneously: phase 1, that of the new technologies, and phase 4, that of the mature technologies (figure 10).

Although mature products can serve to provide growth for a certain length of time, they are not capable of driving a process of catching up, because their innovation potential is largely exhausted. During paradigm transitions, however, there is an excellent opportunity for making a leap forward. The new generic technologies and organizational principles can be applied in order to modernize and rejuvenate mature technologies (and even traditional technologies), as occurred, for example, in the automobile industry and other sectors in Japan, the shipbuilding and steel industries in South Korea, surgical instruments in Pakistan (Nadvi, 1999), and exports of fresh flowers from Colombia and fresh salmon from Chile.<sup>8</sup> During the transition, it is also possible to try to enter the new industries directly, as many firms in developing countries did in the case of microelectronic products and software. The problem is then how to pass successfully through phases 2 and 3. Many of the bright early stars disappeared in this attempt. Staying in the

<sup>8</sup> These and other examples are described in ECLAC (1990).

FIGURE 10



race requires growing support from the economic environment, constant innovation, capital-intensive investments and, probably, great maneuverability as regards markets and alliances. Memory chips in South Korea, hard drives in Singapore, and the Asian computer clones are examples of this type of success, although in very specific conditions in each case.

In this specific paradigm transition, a very strong third possibility appeared within the context of globalization. In contrast with how the industries of the mass production paradigm were deployed nationally first, before moving internationally, many industries in this paradigm have operated globally from phase one. This has opened up the possibility of participating in global networks in many roles and with varied arrangements (Hobday, 1995; Radošević, 1999). It has also allowed producing locally for export through global trading companies, either as single firms or by organizing cooperating clusters.<sup>9</sup>

## 2. "Dancing with wolves"<sup>10</sup> or the question of power structures

In order to fully understand the conditions of access to technology, it is necessary to consider the power structures. The changing nature of barriers to entry is closely related to the levels and forms of competition and concentration in the industry in question. The nature of each phase marks the behaviour of the firms involved and gradually modifies their main focus of attention and their interests.

Table 1 presents a stylized summary of the changing patterns of competition and power structures, which may typify evolving industries, their technologies and markets. It also indicates the "size" of the window of opportunity in each phase and the conditions that must be fulfilled by aspiring entrants, be they dependent (i.e., joining the strategy of owner firms) or acting autonomously as direct challengers in the market.

This stylized scheme cannot represent all cases, nor is it possible, in this brief article to examine all the variations and subtleties involved. The table can serve, however, as a frame of reference for making some important observations:

- i) Since there will always be products and industries passing through the different phases, it is necessary to be conscious and well-informed about the phase

of evolution of the specific technologies and about the patterns of competition prevailing in the various market segments, in order to be able to identify the interests of possible allies or competitors and assess their strengths. This process will also be useful for estimating the value of the assets and possibilities of one's own firm, in order to improve the decision-making process and the design of negotiating strategies.

- ii) It is also important to identify the current phase of deployment of the technological revolution. Since such revolutions involve the co-evolution of many different systems, during the first decades of their deployment there will be prevalence of important new technologies in phases 1 and 2, whereas in subsequent decades the technologies approaching maturity phases (3 and 4) will predominate, until they overlap with those of the next transition. Thus, the windows of opportunity of each technology are strongly marked by the broader context of the propagation of the paradigm. This affects the strategies of both businesses and countries.
- iii) Finally, the choice between dependent or autonomous entry is determined to a large extent by the conditions of the particular firm. It is also necessary to know the evolution of the power structures, in order to clearly identify the present and future interests of possible partners or competitors. The weaker the firm, the more important it is to learn to dance with powerful "wolves" (and even to distinguish among wolves and discover how to attract them).

Not all technologies are open to negotiation, of course. It may also happen that confrontation will be necessary in a zero-sum game. What must be avoided is to negotiate mutually beneficial agreements as though they were confrontations. It is ingenuous to think that through import substitution or export promotion policies governments were imposing conditions and restrictions on transnational corporations or obliging them to establish operations in the countries in question. In both cases, what was being negotiated in practice was a framework of regulations and incentives which solved the problems of both parties simultaneously. This indicates that, if the interests and needs of possible allies are clearly identified each time, the danger of aiming at the wrong target will be avoided, and negotiations will be based on a full awareness of the value of one's own competitive advantages.

<sup>9</sup> Schmitz and Knorringa (1999) and Schmitz and Nadvi (1999). See also IDS Collective Efficiency Research Project (2001).

<sup>10</sup> Used in a similar sense by Mytelka (1994).

TABLE 1

**Changes in patterns of competition and power structures  
as factors conditioning entry possibilities,  
according to phase of technological evolution**  
*Stylized summary*

	Phase in life cycle of product and its technology			
	1. Introduction	2. Early growth	3. Late Growth	4. Maturity
<b>Focus: competitive factors</b>	<i>Quality of product; the test of the market</i>	<i>Efficiency of production; access to market</i>	<i>Market scale and power</i>	<i>Lower costs</i>
<b>Competition and power</b>	<i>Many new competitors</i> Unpredictable results	Industry taking shape; firms growing and fighting for markets; <i>Emergence of leaders</i>	Tendency to concentration; <i>giant complex structures;</i> oligopolies, cartels, etc.	<i>Financial power.</i> Search for profitable new opportunities and ways of extending the life of the existing ones
<b>AUTONOMOUS ENTRY</b>				
<b>Size of window</b>	<b>Broad</b>	<b>Narrow</b>	<b>Very narrow</b>	<b>Widening</b>
<b>Basis for attempting autonomous entry</b>	<i>Knowledge:</i> capacity to imitate and innovate (without infringing patents) on local technical know how in order to create a specialized niche	<i>Knowledge plus experience</i> in process and market technology (importance of brands or privileged access to market)	<i>Experience, financial power and control of market</i>	<i>Comparative advantages</i> in terms of costs Learning capacity Capacity to copy
<b>Nature of autonomous entry (initiated by challengers)</b>	<i>Free competition to gain acceptance in the market</i> and perhaps to establish the dominant design; patents can be important here	<i>Aggressive competition</i> for growing, highly profitable markets Possible <i>alliances</i>	<i>Absorption or exclusion</i> of the weakest participants Possible <i>formation of cartels</i>	<i>Competition with other low-cost producers;</i> purchase (or copying) of mature technologies and know how or development of rejuvenatory innovations
<b>DEPENDENT ENTRY</b>				
<b>Size of window</b>	<b>Narrow</b>	<b>Very narrow</b>	<b>Widening</b>	<b>Very broad</b>
<b>Basis for negotiating dependent entry</b>	<i>Comparative or dynamic advantages;</i> <i>complementary assets</i>	<i>Attractive market</i> Competition as a <i>supplier</i> or advantageous access to resources or markets	<i>Large market</i> <i>Externalities</i> that already exist or can be created; other ways of promoting gains	<i>Comparative advantages</i> in terms of costs Access to <i>finance</i> <i>Learning capacity</i>
<b>Nature of entry on a dependent basis or in alliance with another firm (usually initiated by owner of the latter)</b>	<i>Alliances; negotiations on mutual benefits</i> of sharing complementary capacity and/or assets (in order to strengthen potential for competition)	<i>As a supplier or trade representative</i>	<i>As part of the structure</i> (as a supplier, producer, distributor or in any other capacity which serves the power strategy and expansion plans of the more powerful firm)	<i>Production contracts</i> or <i>joint ventures</i> of mutual benefit (transfer of mature technologies and market access)

Historically, processes of rapid growth and development ?whether catching up from behind or forging ahead to the front ranks? have been the fruit of well-managed technological development processes (Lall, 1992; Bell and Pavitt, 1993a; Reinert, 1994;

Freeman, 1994; Von Tunzelmann, 1995). Generally speaking, they have been based on playing successive positive-sum games with the most advanced actors and on being prepared to change the game as the context and the structures evolve.

## V

## Accumulated experience and future windows of opportunity

Looking back at the recent history of the developing world and the different strategies applied, we see that, consciously or intuitively, successive positive-sum games were established between the interests of the advanced country firms and those of the developing nations. Analysis of this experience could help to view the future with more soundly based criteria. As always happens with the lessons of history, however, a distinction must be made between recurrence and uniqueness. There are patterns of change which are repeated in each paradigm, but each of them is essentially unique and must be analysed in the light of its own peculiar characteristics.

### 1. Inventing and reinventing development strategies

The modern era of deliberate State intervention in the industrialization of Third World countries took shape clearly in the 1950s, when a growing number of mass production industries were in phase 3, trying to expand markets, seeking economies of scale, forming oligopolies, and opening international marketing outlets. *Import substitution industrialization*, subsidized by the State and protected by tariff barriers, was the positive-sum game that was established at that time. The international corporations multiplied their markets for final products by exporting much greater amounts of “unassembled” parts to their subsidiaries abroad, which in addition had higher profit margins. In the developing countries, for their part, although those factories only engaged in “screw-driver assembly” activities, they and the enterprises and organizations stimulated by their demand created a learning context for both management and workers. Their demand for construction services, highways, ports, transport, electricity, water and communications stimulated the modernization of the surrounding areas and the development of many complementary capabilities.

In the mid-1960s, some countries began to encounter the limits of the import substitution industrialization model, while in the advanced countries many products and industries were entering phase 4:

maturity and stagnation. *Technology transfer* and *export promotion* policies emerged as the new form of relations of mutual benefit. This process entailed the transfer of mature technologies to public and private enterprises, as well as the establishment of subsidiaries to produce goods for re-export, in areas with cheap labour. Already by the 1970s, the transnational corporations were engaged in the process of *industrial redeployment*, whereby they transferred a growing proportion of their production activities to developing countries, thus giving rise to a substantial flow of exports to the advanced countries. The “miracles” of Brazil and South Korea and the “export-processing zones” in many countries gave the impression that a *new international economic order* was arising. The North-South Dialogue was set up to negotiate the realization of those hopes.

At the beginning of the 1980s, however, the situation changed once again. Many of the products of the microelectronics revolution, which had irrupted in the early 1970s, were reaching phase 2. Furthermore, the Japanese had revitalized the automobile industry and their new organizational paradigm was radically transforming their competitors in the United States and Europe (Altshuler and others, 1984). Most of the old industries of the advanced countries reached the maturity stage in the midst of stagflation; export markets began to shrink, and the debt crisis broke out in the Third World. A new strategy needed to be designed.

Most of Latin America, however, failed to do so, and lived through the aptly designated “lost decade”. In contrast, the Four Tigers in Asia took a leap forward by capturing position after position in the rear end and at the edges of the markets of the fast growing revolutionary industries. They also rejuvenated mature technologies with modern practices and joined the networks of global firms as OEM suppliers of parts and components. The intense learning and the emphasis on human capital and on the active absorption of technology, which was behind these achievements, cannot be overstated (Amsden, 1989: Ch. 9; Bell and Pavitt, 1993b). It is in sharp contrast with the much



more passive “transfer of technology” practices still common in most Latin American and African countries, as well as in the rest of Asia, in that period.

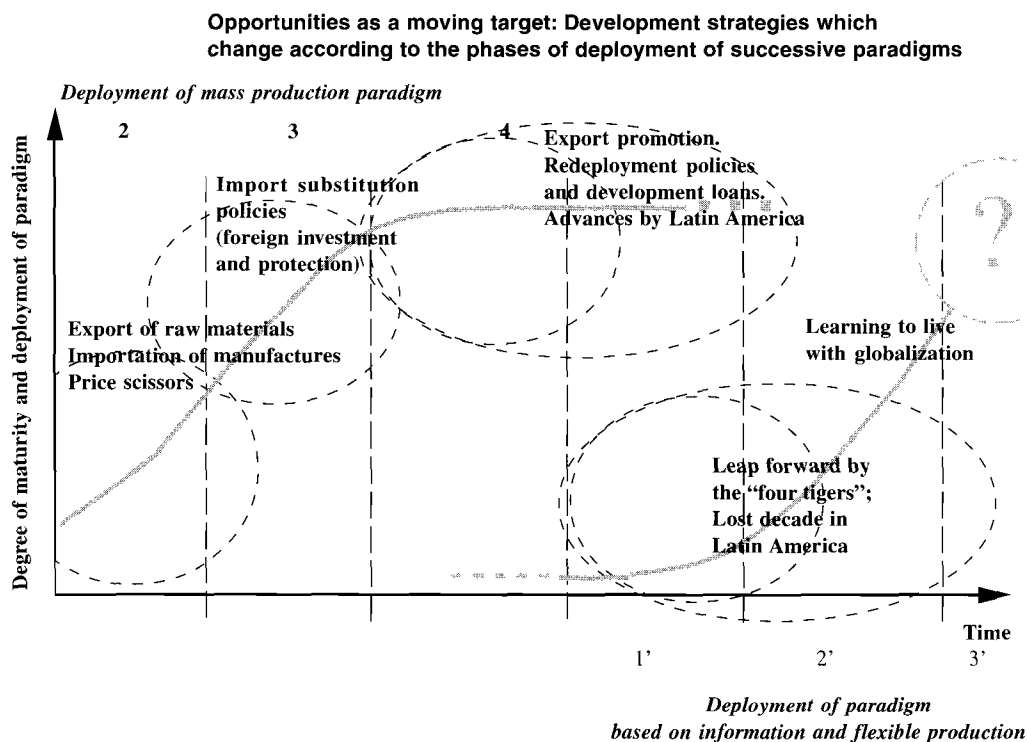
Figure 11 shows, from the 1950s to the present, how development strategies adapted to the opportunities created by the approaching maturity of one paradigm and the initial deployment of the next.

The 1990s was marked by the vigorous development of the new telecommunications infrastructure, by the structuring of the emerging industries and the modernization of the existing ones. As one new industry after another reached phase 2, the intense competition for market positions began. Since then, various possibilities have arisen for the enterprises of developing countries, due to a set of new phenomena such as: the emergence of global corporations and markets, the struggles to impose dominant designs and other standards, the establishment of complex networks of collaboration at the world level, the strengthening of the power of brand names in the market, the pursuit of both dynamic and static advantages in the geographical location of the various activities, the

interest in adapting products to particular market segments, the tendency towards outsourcing, and other related forms of behaviour. The quality and quantity of the opportunities deriving from all this have varied as a function of the conditions and disposition of the different economic agents and of the countries in which they operate.

Experimentation in the developing countries has been very diversified, both in terms of methods and of results: it extends from modern “maquiladoras” and OEM contracts to the practices followed by independent and highly competitive Asian firms and various types of joint ventures and alliances (Hobday, 1994). There has also been a big increase in interconnected local clusters in specific industries (such as software development in India), some of which have been successful on export markets. In this period, the four “Asian tigers” continued to progress, stimulating production in other Southeast Asian countries and China. Generally speaking, the countries and firms with successful strategies have displayed a capacity to learn to live in a globalized world.

FIGURE 11



Each of the successive strategies has had advantages and disadvantages, benefits and negative effects. Some countries have advanced with giant strides, while others have taken only small steps forward or have not advanced at all; some countries kept the ground gained, while others have fallen back. Some of the setbacks may have been due to having clung to policies which had ceased to be effective. It must be admitted that the general results are discouraging. This may lead to disenchantment or else to recognition of the great difficulty of narrowing the gap and the need for a better understanding of the nature of the problems and the opportunities.

## 2. Confronting the next stage

Sooner or later in this new century, the conditions will be created for the full deployment of the wealth-generating potential of the Information Age. The 1990s were years of experimentation in all areas: inside and outside global firms; in countries, regions, cities and localities; in the economy; in governments and other institutions, and in the different levels of society. Consequently, the “common sense” of the flexible networks paradigm has been widely disseminated and is becoming the normal way of seeing and doing things.

The dawn of the 21st century marks the transition to the third phase or period of late growth of the present paradigm.<sup>11</sup> Many industries are also reaching phase 3 in their trajectories, so they are seeking economies of scale and moving towards oligopolization in order to reduce the pressures of free competition. Agreements, mergers, takeovers and other arrangements are giving rise to the world-level concentration of many important industries into a few mega-enterprises or great global alliances.<sup>12</sup> Indeed, their growing power of intermediation, through their control of access to clients, could lead to a modern version of the old “trading companies”, based now on the power of information and telecommunications.<sup>13</sup> These gigantic enterprises

could become immense global “umbrellas” encompassing worldwide diversity in their field and covering all the segments of the market ?from the most specialized or luxury niches to the cheapest and most standardized products or services? buying and selling all over the planet and locating each activity where it enjoys the greatest advantages.

For the developing world, the next stage may be a very complex period of accommodation to the new emerging power structures. For enterprises, localities, regions and countries, finding out what positive-sum games are possible with these giants could define the nature of their next window of opportunity. Trying to create local or regional networks, either independently or in association with global networks, may still be possible when there are very specific local advantages. Countries and enterprises which have acquired technological, organizational, marketing and bargaining capabilities will of course be in a much better position either to find a favourable arrangement under the global “umbrellas” or to boldly establish themselves outside them. Cooperation among enterprises, regions or countries can increase the bargaining power of their leading actors and agents, both weak and strong.

The formulation of successful strategies therefore calls for a careful evaluation of the conditions and accumulated capacities of the country, region, enterprise or network in question, in order to take advantage of the *next* window of opportunity (not the window which is already closing), while at the same time recognizing, adopting and adapting the potential and features of the relevant paradigm. We will now look at some of the implications of these features.

<sup>11</sup> For a more complete analysis of the phases in the evolution of a paradigm and the role played by financial capital in the process, see Pérez, 2002.

<sup>12</sup> See Chesnais (1988 and 1992), Bressand (1990), Klepper and Kenneth (1994) and Castells (1997).

<sup>13</sup> See Bressand and Kalypso (eds.) (1989), and Kanellou (2000).

# VI

## Addressing development in the context of the present paradigm

Rapid growth of firms, localities or countries depends on the availability of a rich technological potential and a suitable form of organization for taking advantage of it. Whatever the starting point and the objective pursued, success in the present era will probably depend on how deeply the logic of the new paradigm is assimilated and how creatively it is adopted and adapted at all levels of society.

The old centralized pyramids of mass production effectively served firms and governments, universities, hospitals, and private and public organizations of all types. For over twenty years, however, modern firms –global or local– have been thoroughly restructuring their activities, having quickly understood the advantages of networks and of learning organizations.<sup>14</sup> The time has now come for governments to start experimenting in the same direction.

### 1. Technology at the core of development strategies

It is a generally recognized fact that the Japanese surge ahead to become the second largest economy in the world (and to remain in that position in spite of its crisis) involved exercises in technological foresight to collectively decide the road to follow, as well as intensive learning, training and innovative efforts (Peck and Goto, 1981; Irvine and Martin, 1985). The advance of the four “Asian tigers” from their initial position in the rear also involved a large-scale educational and learning effort (Ernst, Ganiatsos and Mytelka (eds.), 1998). Furthermore, the global enterprises which have been successful have reformulated their structures and practices to promote continuous learning and improvement. Knowledge management (Nonaka, 1995; Burton-Jones, 1999; Lamoreaux and others (eds.), 1999) is becoming a fundamental concern: enterprises not only organize regular training courses at all levels, but some have even created their own “universities” (Wiggenhorn, 1990).

In the case of the developing countries, it is an illusion to believe that significant advances are possible without equivalent efforts. There are no magic formulas for achieving development without mastering technology, in the simple sense of social, technical and economic know-how incorporated in people. This fact, which was fully recognized in the past, was lost from sight in the very special conditions of import substitution policies, which made it possible –for a time– for many countries to achieve extraordinary results in terms of growth, by investing in mature installations, equipment and technologies without having to make intensive learning and training efforts.

In this new paradigm, in particular, development of the capacity to take advantage of information and know-how for innovation is more important than ever. Perhaps the most relevant sense of the expression “knowledge society” (Castells, 1997; Mansell and Wehn (eds.), 1998) is the creation of conditions for all members of society to have access to information and make use of it. Consequently, strengthening the individual and social learning capabilities for wealth generation becomes a fundamental way of enhancing development potential.

For this to take place, technology must occupy a central and not just a peripheral place in development policies. In practice, this means adopting a different way of conceiving strategies and calls for a complete reformulation of the education and training systems as well as of science and technology policies.

In reforming education, it is essential to update and upgrade the technical contents of programmes and –perhaps even more importantly– to make radical changes in the methods, objectives and instruments of training in order to make them relevant for the future and compatible with the new forms of organization (Pérez, 1992 and 2000; ECLAC, 1992). This reform must induce students to take responsibility for their own training processes; it must place emphasis on “learning to learn” and “learning to change”; it must foster creative teamwork, teaching students to formulate problems and evaluate alternative solutions; it must find ways of providing access to computers and the Internet; and it must create the

<sup>14</sup> Nonaka (1994), Senge (1990) and Lundvall (1997); see also the website of the DRUID project (DRUID, 2001).

necessary conditions for giving students not so much the capacity to provide answers as the capacity to ask questions and process information.

These skills and aptitudes are becoming basic conditions for participating in the modern workplace, where firms are facing a constantly evolving environment that demands continuous improvement. They also allow persons and groups to become responsible for their own capacity to generate wealth, either as employees or as entrepreneurs, and they provide the organizational abilities needed to improve communities and organizations, either as group members or as leaders.

The other vital transformation concerns the "Science and Technology System", which was created in most developing countries as a set of government institutions responsible for technological development. Experience showed that very little use was made of these capabilities to incorporate innovations in the world of production. As most of the industries were using mature technologies, they had little capacity to absorb the results of the activities of these laboratory technologists. The consequent frustration experienced when trying to "build a bridge" between the universities and industry led most of the technological researchers to become adjuncts of the scientific community and to adopt its methods, time-scales, values and attitudes.

In the new context, it is necessary to act on two fronts: to make substantial investments in research for the future, and to re-connect the technological development effort with the direct and immediate improvement of production networks and the quality of life.

This transition from a "supply-push" science and technology system to an interactive network with producers has warranted the term "National System of Innovation (NSI)" (Freeman, 1987; Lundvall, 1988) which has been defined by Freeman as "the network of institutions in the public and private sectors whose activities and interactions initiate, import, modify and diffuse new technologies" (Freeman, 1995).

This starts out from the assumption that a national system of innovation is a social, not a governmental construction. It includes such elements as the environment in which innovation is stimulated and supported; the quality of the links between suppliers, producers and users; the education and training system; various public and private organizations facilitating technical change; and laws, regulations and even ideas and attitudes towards technology and change (Arocena, 1997).

## 2. Reinventing the "strong" State<sup>15</sup>

It should by now be clear that the market versus State debate is not adequate for dealing with the concrete problems discussed here. Both markets *and* State are needed, albeit redefined and combined in a new way. At all events, it will be gathered from the foregoing analysis that a successful development strategy for a lagging country will require, according to the logic of the current paradigm (and especially in the presence of global mega-firms), a high level of cooperation among firms and between them and the State at its various levels.

Although the magnitude and complexity of this task call for a strong State, the type of all-powerful State developed after World War II must be redefined and reinvented, probably along similar lines to those applied by modern global corporations.

No one could suggest that the central management of a giant corporation is weakened by decentralizing and giving high autonomy and decision-making power to its product, plant or market managers across the world. Computers and telecommunications have made it easier to exercise strong leadership over a vast and growing structure made up of semi-autonomous units following strategic guidelines. Thanks to interactive information channels, it is possible to monitor and control extremely complex networks which have flexible components and are highly differentiated.

Such networks could be imitated in the new configuration of a strong public sector which is needed. As in previous technological revolutions, once technology helps to define the optimum configuration of organizations, these can function effectively even without the technology. In turn, this prepares the terrain for the incorporation of modern technology when required.

The central national State can exercise its leadership by inducing the convergent actions of the various social actors towards a commonly agreed general direction of change. It can play a crucial role as intermediary between the growing global or supra-regional instances and the increasingly autonomous regional, local and even parish or community levels.

A process of "diffusion of power" is also taking place (Strange, 1996). Networks of private interests,

<sup>15</sup> See Reinert (1999), Wade (1990) and Osborne and Gaebler (1994).

the various components of civil society, global firms, the media, organized interest groups, non-governmental organizations (NGOs) and other entities are increasing the diversity of development agents and their interconnections, at both the national and global levels. The State must be capable of acting as a broker within the country and between the different supra-national and subnational levels, in order to promote and negotiate equitable opportunities for all. Taking on the role of consensus builder among the different actors, the State may be able to exercise more effective authority, as the foundation of real power to influence the course of events.

### 3. Think global, act local

The new seat of the proactive developmental state is, in our view, the *local* government. The old “central plan” idea of promoting a set of national industries to generate the wealth to fund social advance needs to be reconsidered. Obviously, in each country a set of important and competitive activities must develop, strongly connected to world markets and keeping up with the technological frontier, propelling growth and producing the necessary foreign exchange. But that is not enough. The time and the conditions have come to abandon the illusion of a “trickle down effect” and move towards the direct involvement of the whole population in wealth creating activities.

The characteristics of the present paradigm suggest that there will be a more integrated form of development in which the big, competitive industries trading on the world market will be complemented with the differentiated development of each part of the territory. This is possible by taking advantage of the new flexibility in terms of variety of products and competitive scales of production, of the power to increase the quality and efficiency of all sectors and activities (including artisan type activities) and –most important– the fact that all human beings can be given access to continuous learning processes in order to constantly improve their capabilities, their work and their environment.

Many examples can be cited of local governments identifying the production potential of their communities, promoting consensus and securing the participation of local and foreign firms, banks, the education system and other local and external agents in order to propel development projects (Tendler, 1997; Gabor, 1991; The Illinois Coalition, 1999). There are also local networks of

small and medium-sized firms collaborating in business and technological development to cover exports jointly (Nadvi and Schmitz (eds.), 1999). Authors who have studied the interaction that takes place within these clusters, or agglomerations of firms with related activities in the same locality, have suggested using the expression “local systems of innovation” (Cassiolato and Lastres (eds.), 1999), although in our view it would be more appropriate to call them “territorial networks of innovativeness”.

A highly successful experience has also been accumulated by specialized banks giving “micro-credits” to help men and women in urban and rural areas to set up income generating activities (Otero and Rhyne (eds.), 1994; Chaves and González, 1996). This is gradually breaking the myth that providing jobs is the only way to improve the quality of life of whole populations and favouring the idea of promoting multiple forms of individual or collective entrepreneurship. Addressing the plight of rural communities will also require abandoning the old pro-urban and pro-manufacturing biases (Fieldhouse, 1986, p. 152; Mytelka, 1989) and empowering local governments with the resources and the technical support to directly tackle the issue of improving the local levels of living. These “localized” activities can often connect as suppliers in the networks of global corporations or become part of the support network of the big exporting activities of the country.

### 4. Modernity and values

Naturally, the decisions involved are of a political nature, but the real options are not always clear. Historically, in each transition from one paradigm to another the current definitions of left and right become blurred. Each of the groups undergoes an internal division between those who cling to old ways of achieving their goals and those that embrace the potential of the new paradigm and gear it to their ends (figure 12).

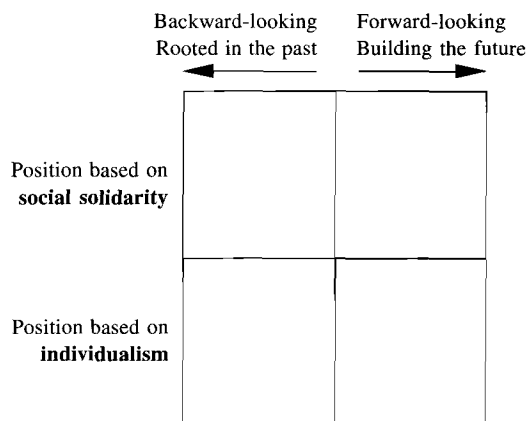
In the previous transition, between the two world wars, the social and homogenizing nature of the new mass production paradigm was so strong that even Nazism called itself “National Socialism”. Likewise, the role played by the centralized State was so important that after World War II even the most liberal nations adopted the model of State intervention in the economy in its entirety, following the ideas of Keynes,

which had met with so much resistance in the 1920s and 1930s. Unfortunately for those who are convinced of the need for social solidarity, however, neoliberalism is the only coherent programme that has adopted the present paradigm. Although there are thousands of isolated experiments in forward-looking practices such as participatory democracy and local consensus-building, no coherent experience or proposal has yet been put forward that could serve as a modern alternative to the pure market. Without it, in our view, there may be world growth, but there is probably little hope of a widespread surge in development.

(Original: Spanish)

FIGURE 12

**Political positions in the transition:  
A location matrix**



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# Sectoral regimes, *productivity* and international *competitiveness*

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This article seeks to analyse some mesoeconomic and microeconomic aspects related with productivity and international competitiveness in the context of the new Latin American economic model. These aspects go a long way towards explaining why those variables have not evolved satisfactorily in the different countries and sectors of activity, and why a strictly macroeconomic reading prevents a proper understanding of the changes which are taking place in society at the economic, technological and institutional levels, as well as impeding the identification of a public policy agenda which could help improve the implications of the process of change which is under way.

Within this process, new patterns of micro-economic behaviour have been taking shape in which imported capital goods and intermediate inputs have been displacing locally produced goods and the local technological efforts associated with their production. This has been giving rise to a new production organization model which is more closely linked with external sources of growth than in the past.

## I

## Introduction

In line with the principle of “appreciative theorizing” (Nelson, 1997), in several recent studies ECLAC has described various stylized features of the new model of social and production organization that has been taking shape in the countries of Latin America and the Caribbean after the structural reforms of the 1990s which were designed to improve competitiveness.<sup>1</sup>

It is noted in these studies that the transition from a paradigm of inward-looking development led by the State to another, more open and deregulated, paradigm –in which the “hidden hand” takes on a leading role and guides resource allocation– has been giving rise in the various countries of the region to the development of new patterns of production specialization and insertion in the world markets for goods and services. This has taken place in the context of a prolonged episode of Schumpeterian “creative destruction” in which one model of production organization and institutional and technological behaviour has been gradually displaced by another, through the joint and interdependent action of economic, technological and institutional forces. The interdependence of macroeconomic and microeconomic factors clearly occupies a central place in this situation. The macro economy –uncertain and subject to cyclical fluctuations largely due to the erratic behaviour of international capital markets– induces defensive forms of microeconomic behaviour which, in turn, feed the climate of feeble global dynamism, with improvements in productivity and international competitiveness which are lower than those registered in other parts of the world. This is what prevents the countries of the region from closing the relative productivity and income gap that separates them from the industrialized world. In a macro economy that is unable to overcome its high degree of uncertainty and risk, improvements in productivity at the microeconomic level are achieved more through the dismissal of workers from relatively “old” plants than through major programmes of investment and technological modernization. Strictly economic variables –such as the exchange rate, interest

rates, investment and real wages– interact with others of an institutional and technological nature –such as property rights, the greater or lesser degree of imperfection of factor markets, or the level of technological capability attained by the different countries– to give rise to a long-term growth process which is far from satisfactory.

The ECLAC studies also show that, in addition to being unsatisfactory in terms of growth rates and microeconomic efficiency, the new Latin American economic model does not exhibit any great achievement in terms of equity either. Indeed, it is characterized by profound structural heterogeneity which is in many respects more marked than during the years of import substitution industrialization. Some economic activities, regions, or even individual economic agents within each production sector have managed to adapt better –through imperfect access to factor markets, asymmetries of information or greater political lobbying power– to the new rules of the game, but others have not been able to do so. The former have cashed in on the new opportunities opened up by the change in the global system of incentives prevailing in society, whereas the situation of the latter has tended to deteriorate with time, and they have lost relative participation in the production structure or have even disappeared from it altogether. The process of structural change which is under way is also marked by a sharp increase in the degree of economic concentration and the consolidation of new monopoly positions in the production apparatus, within a context where the State has lost regulatory power and the capacity to intervene.

The present article aims to analyse various macroeconomic and microeconomic aspects relating to productivity and international competitiveness. We will argue that both these aspects play an important –and often forgotten– role in explaining why the latter variables have not evolved satisfactorily in the different countries and sectors of activity and why a strictly macroeconomic reading inhibits our capacity to understand the changes taking place in society at the production, technological and institutional levels, as well as preventing the identification of a public policy agenda which could help improve the implications of the transformation under way. If the diagnosis is

<sup>1</sup> Stallings and Peres (2000), *World Development* (2000), Katz (2000), Moguillansky and Bielschowsky (2000), Weller (2000), Ffrench-Davis (1999) and Ocampo (2001).

exclusively macroeconomic, we can hardly be surprised that the dominant agenda limits itself to recommending “more of the same”: i.e., further increasing trade openness, continuing to deregulate markets, and finishing off the privatization of everything which has not yet been privatized.

This article consists of four sections. After this introduction, section II compares the global performance of the region during the inward-looking growth stage (1940-1980) with the performance of the 1990s, when the Latin American countries opted for a growth strategy more open to outside competition, more deregulated and with less State participation in production activities. The overall regional pattern, however, does not describe the different national cases accurately, so after presenting the global panorama we move on to analyse the differences in performance

between individual countries and production activities, focusing in particular on indicators of labour productivity and revealed international competitiveness.

In section III we make a tentative simple effort at appreciative theorization on this process. Our reading of it is based on the Schumpeterian notion of “creative destruction”. We argue that sectoral technological and competitive regimes change through the “death” and “birth” of firms, through the arrival of new international actors, and through the *aggiornamento* of each production sector’s institutions,<sup>2</sup> technologies, and rules of behaviour. We are in the presence of a process of long-term structural transformation which economists are still far from fully understanding. Finally, section IV presents some concluding remarks on the processes analysed.

## II

### The present situation

#### 1. The overall picture

The numbers in table 1 explain the great scepticism currently prevailing about the effects of the reforms of the 1990s. The information is condensed into four specific dimensions: i) the behaviour of the macro economy, reflected in the rate of inflation of the region as a whole; ii) the performance of the external sector, summed up by the aggregate growth rates of imports and exports; iii) the functioning of the production structure, represented by the growth rates of the gross domestic product and labour productivity, and iv) equity, represented by an index of poor households as a proportion of total population.

The pattern of successes and failures is obvious. The region has made a lot of progress in handling macroeconomic policy. The rate of inflation, indicates that the performance of the Latin American economies improved considerably in the 1990s. The Latin American countries were also more open to trade than in previous decades. The growth rate of imports was higher than that of exports, however, suggesting that the region’s openness to trade was greater for imports than for exports. This suggests a certain degree of vulnerability in the external sector of the new Latin

American economic model, to which the governments of the region are now paying increasing attention.<sup>3</sup> We will return to this subject later in this article. At the same time, however, we must also bear in mind that the averages shown in the table are strongly influenced by Mexico, which managed to double total exports in the 1990s thanks to the rapid expansion of its in-bond

<sup>2</sup> The term “institutions” is used by economists rather ambiguously to refer both to agencies or entities –banks, universities, customs systems– and to norms of conduct or rules of behaviour. Thus, the patents system is an “institution”, as also is tariff protection. With regard to this debate, see David (1994).

<sup>3</sup> In a recent study on Brazilian exports, Miranda (2000) argues that it is not only urgent to increase exports but will probably also be urgent in the future to begin to substitute imports once again in sectors of production which make intensive use of imported intermediate inputs –such as capital goods, electronic products or pharmaceutical raw materials– and which are largely responsible for the big external trade deficits currently registered by a number of economies of the region. A similar debate is currently under way in Argentina. In many respects this recalls the old ECLAC debates of the 1950 on the chronic external constraints affecting many Latin American economies. We will return to this subject later in this article (see Miranda, 2000).

TABLE 1

**Global performance of Latin America during the import substitution industrialization period and the 1990s**  
(Percentages)

	1945-1980	1980-1990	1990-2000	2000
Annual rate of inflation	20	400	170.0	9.2
Growth rate of exports	2.1	4.4	9.4	11.1
Growth rate of imports	5.9	-0.8	12.8	12.3
Growth rate of GDP	5.6	1.2	3.3	4.3
Growth rate of per capita GDP	3.1	-1.8	1.6	2.2
Percentage of poor households	35	41	38	38

Source: ECLAC, 2000.

assembly industry, which supplies the United States market with television sets, video recorders, computers and vehicles.<sup>4</sup>

The growth and equity performance of the region, however, seems less satisfactory if we look at the indicators for production, labour productivity and percentage of "poor" households in total population, which do not on the whole display any long-term improvement, except in comparison with the "lost decade" of the 1980s.

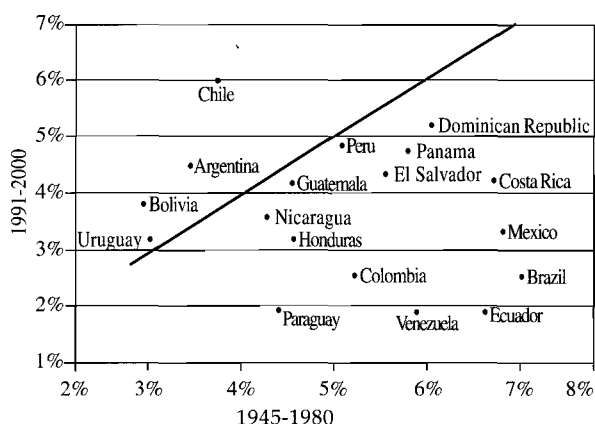
## 2. Differences between countries

There are very few countries in the region which grew faster during the 1990s than in their import substitution industrialization stage and which improved on their historical GDP growth rate. In fact, only Chile, Argentina, Bolivia and Uruguay did so (figure 1). In all the other countries their performance in the 1990s was clearly worse, especially in the case of the two largest economies of the region –Brazil and Mexico– which only recovered a higher growth rate towards the end of the decade, although such growth rate was still below that of the 1970s.

A similar pattern –big differences between the performance of individual countries– is seen when we

FIGURE 1

**Latin America: Average growth of gross domestic product, 1991-2000**



Source: ECLAC, 2000.

compare the indicators of revealed international competitiveness.

The aggregate information shows that the region as a whole has not significantly improved in terms of penetration of world markets. Thus, Latin America generated 5.57% of total world trade in 1985, and this figure had only risen to 5.67% by 1998. Even so, a few countries did manage to gain relatively larger shares of world trade flows during the period in question. This was especially so in the case of Mexico, whose share of total world imports rose from 1.55% to 2.24% between those years. To a much smaller extent, this was also the case of Argentina and Chile, which rose respectively from 0.37% and 0.23% of world imports in 1985 to 0.51% and 0.32% in 1998. Marginal increases were registered by Costa Rica, El Salvador, Guatemala, Honduras and the Dominican Republic, whose shares grew much less (table 2).

<sup>4</sup> Within only a few years Mexico has risen from US\$ 60 billion of exports to over US\$ 150 billion; a little less than half of this figure corresponds to in-bond assembly production for the United States market. This situation has currently given rise to a far-reaching debate among analysts of the Mexican model on the amount of local added value and the development of local engineering capacity attributable to the growth of the in-bond assembly industry (see Buitelaar, Padilla and Urrutia, 1999; Gerber, 2000; Dussel, 2000a; Cimoli, 2001).

TABLE 2

**Latin America and the Caribbean:  
Market share in world imports, 1985-1998**

Country	Market share		
	1985	1998	Difference
Argentina	0.37	0.51	0.14
Chile	0.23	0.32	0.09
Mexico	1.55	2.24	0.69
Costa Rica	0.07	0.10	0.03
El Salvador	0.04	0.05	0.01
Guatemala	0.06	0.08	0.02
Honduras	0.05	0.07	0.02
Dominican Republic	0.08	0.10	0.02
Bolivia	0.04	0.02	-0.02
Brazil	1.37	1.01	-0.36
Colombia	0.24	0.24	0.00
Ecuador	0.17	0.11	-0.06
Paraguay	0.03	0.03	0.00
Peru	0.17	0.12	-0.05
Uruguay	0.07	0.06	-0.01
Venezuela	0.66	0.41	-0.25
Nicaragua	0.02	0.02	0.00
Barbados	0.02	0.00	-0.02
Cuba	0.03	0.02	-0.01
Haiti	0.03	0.01	-0.02
Jamaica	0.04	0.04	0.00
Trinidad and Tobago	0.10	0.04	-0.06
Guyana	0.02	0.01	-0.01
Panama	0.10	0.05	-0.05
Suriname	0.02	0.01	-0.01

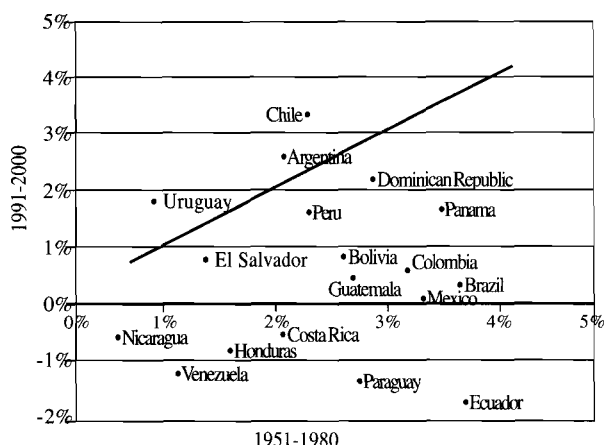
Source: CAN 2000 (Competitive analysis of nations, 2000 version): a computer programme prepared by the Industrial and Technological Development Unit, Division of Production, Productivity and Management, ECLAC.

In other words, regardless of whether we look at output and labour productivity statistics or at trade indicators which reflect revealed competitiveness, it is clear that at the aggregate level Latin America registered little improvement in the 1990s. Only a few countries of the region managed to improve on their previous performance. Furthermore, the two sets of data show that there is not always a good level of correlation between the two indicators. In the case of Mexico, for example, the success obtained in the field of revealed competitiveness contrasts sharply with its unsatisfactory showing in terms of labour productivity (figure 2). Export-led growth does not always seem to be as automatic as is often assumed in current debates on growth.

FIGURE 2

**Latin America: Labour productivity, 1951-1980**

(Average growth of gross domestic product per active worker)



Source: ECLAC, 2000.

### 3. Sectoral patterns of production specialization and world trade insertion: sectoral catching-up and lagging behind

Production and productivity statistics on the one hand and international trade figures on the other enable us to continue to progress in analysing and describing the restructuring of the production apparatus after the recent structural reforms. Our indicators clearly show that in the 1990s two main dominant production and trade specialization models became established in Latin America.

The first of these models is characteristic of the Southern Cone countries (Chile, Argentina, Brazil) and some Andean countries (Colombia and Peru), and shows a clear leaning towards activities that involve the processing of natural resources to produce industrial commodities such as vegetable oils, pulp and paper, iron and steel, fish meal, etc. From the point of view of the organization of production, these are industries that make intensive use of natural resources and produce goods in highly automated plants, using a great deal of capital and little labour. From the point of view of international trade, they are production sectors where world demand grows slowly and price- and income-elasticity are low. Finally, from the technological angle they may be described as mature industries where there are no great engineering efforts in the design of new products, although efforts are made to improve production processes and the organization of production (especially as regards transport, refrigeration, port operations, packaging, etc.).

The case of Mexico and a number of the smaller Central American countries is different. Here, the pattern of production specialization has gradually been moving towards greater relative participation of the assembly of electronic equipment, computers and clothing, mainly for the United States market. Some of these industries have operated under the maquila system, based almost entirely on imported intermediate inputs (Dussel, 2000b; Buitelaar, 1999). All of them make intensive use of unskilled labour. The Mexican assembly industry generated over a million new jobs in the 1990s. Using "state of the art" technology and sophisticated just-in-time supply logistics for parts and

components, as well as total quality techniques brought over almost integrally from the respective parent firms,<sup>5</sup> but paying wages which are only a fraction –not much than 10%– of those paid by developed countries, those assembly plants exclusively cater for the United States domestic market. Demand on that market grew very rapidly in the 1990s, and both product design (which is not done in the region) and brand names play an important role in a context of imperfectly competitive markets.

Table 3 shows that the relative weight of resource-processing industries and foodstuffs grew significantly in Argentina, Chile, Colombia and Peru between 1970

TABLE 3

**Latin America (six countries): Structure of industrial added value<sup>a</sup>**  
(Percentage composition)

Sectors <sup>b</sup>	Argentina				Brazil				Mexico			
	1970	1980	1990	1999	1970	1980	1990	1999	1970	1980	1990	1999
01	13.2	13.4	8.8	10.8	16.2	25.0	22.0	24.0	12.0	14.9	13.7	15.7
02	10.9	13.1	6.4	9.9	6.8	8.7	7.6	7.6	8.4	12.4	12.9	16.4
03	24.1	26.5	15.3	20.6	23.0	33.7	29.6	31.6	20.5	27.3	26.7	32.1
04	33.5	32.5	40.6	38.3	14.5	13.1	16.1	17.4	26.1	21.8	22.7	22.0
05	18.3	20.8	24.0	20.2	29.2	26.7	26.1	27.4	23.3	24.9	25.5	23.2
06	51.8	53.4	64.6	58.5	43.7	39.9	42.2	44.9	49.4	46.7	48.2	45.1
07	24.0	20.1	20.2	20.9	33.4	26.4	28.2	23.5	30.2	26.0	25.1	22.8
08	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sectors <sup>b</sup>	Chile				Colombia				Peru			
	1970	1980	1990	1999	1970	1980	1990	1999	1970	1980	1990	1999
01	15.9	10.4	10.8	11.9	12.3	11.1	9.7	9.7	5.7	9.9	6.2	4.7
02	7.7	3.4	2.3	1.9	3.0	4.2	3.6	6.3	6.5	8.6	5.3	0.9
03	23.6	13.8	13.1	13.8	15.3	15.3	13.2	16.0	12.1	18.5	11.5	5.6
04	24.4	33.9	33.5	36.2	31.3	32.7	32.6	33.1	34.1	25.6	31.7	26.8
05	21.0	23.7	25.8	24.9	18.9	20.1	24.1	22.3	19.4	25.0	26.0	31.1
06	45.4	57.5	59.4	61.2	50.2	52.7	56.7	55.3	53.5	50.7	57.7	57.8
07	31.0	28.7	27.5	25.0	34.5	32.0	30.1	28.7	34.4	30.8	30.8	36.6
08	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: PADI (Industrial Dynamics Analysis Programme): a computer programme prepared by the Industrial and Technological Development Unit, Division of Production, Productivity and Management, ECLAC.

<sup>a</sup> In all cases the petroleum refining sector (ISIC 353) has been excluded. In the case of Chile, industrial production of copper (ISIC 372) has also been excluded.

<sup>b</sup> The corresponding sectors are:

- 01 Sectors making intensive use of engineering services, except the motor industry (ISIC 381, 382, 383, 385).
- 02 Motor industry (ISIC 384).
- 03 Total for sectors making intensive use of engineering services (01 + 02).

04 Foodstuffs, beverages and tobacco (ISIC 311, 313, 314).

05 Other sectors making intensive use of natural resources (ISIC 331, 341, 351, 354, 355, 362, 369, 371, 372).

06 Total for sectors making intensive use of natural resources (04 + 05).

07 Sectors making intensive use of labour (ISIC 321, 322, 323, 324, 332, 342, 352, 356, 361, 390).

08 Total for manufacturing.

<sup>5</sup> On recent visits to plants in the Tijuana area it was noted that, while some assembly firms have in-plant engineering groups or departments for making process or organizational improvements, others –including nearby competitors– do not have them. This

obviously affects the comparative competitiveness of the firms. Sanyo and Samsung, for example, have very different strategies in this respect, although they are long-standing competitors in the United States television market.

and the end of the 1990s, and in Brazil during the 1980s and 1990s. The table also shows, however, that this was not the case in Mexico. The motor industry was a “winner” during the 1990s in Argentina and Brazil,<sup>6</sup> and from the 1970s on in Mexico. Industries producing wage goods such as footwear, textiles and furniture lost relative ground. That was also the case—particularly in

Argentina and even more so in Chile and Peru— with industries producing capital goods, agricultural equipment and other engineering-intensive activities.

Complementing the foregoing, but this time from the point of view of trade statistics, tables 4 and 5 show the different patterns of production and trade specialization established by Mexico and Argentina

TABLE 4

**Mexico: Aspects of its international competitiveness  
in world imports, 1985-1998**

	1985	1990	1995	1998
I. <i>Market share</i>	1.55	1.29	1.73	2.24
Natural resources <sup>a</sup>	3.59	2.38	2.05	2.26
Manufactures based on natural resources <sup>b</sup>	0.82	0.67	0.79	0.96
Manufactures not based on natural resources <sup>c</sup>	0.96	1.18	1.89	2.53
– Low technology <sup>d</sup>	0.59	0.82	1.41	2.12
– Medium technology <sup>e</sup>	0.98	1.33	2.22	2.81
– High technology <sup>f</sup>	1.33	1.27	1.77	2.44
Others <sup>g</sup>	1.31	1.51	1.82	2.25
II. <i>Structure of exports</i>	100	100	100	100
Natural resources <sup>a</sup>	53.5	29.3	15.8	12.4
Manufactures based on natural resources <sup>b</sup>	10.3	9.2	7.6	6.8
Manufactures not based on natural resources <sup>c</sup>	33.5	57.5	73.0	77.2
– Low technology <sup>d</sup>	5.4	10.6	13.6	15.7
– Medium technology <sup>e</sup>	18.1	32.0	40.0	38.9
– High technology <sup>f</sup>	10.0	15.0	19.4	22.7
Others <sup>g</sup>	2.6	3.9	3.6	3.6
III. <i>10 main exports, by relative shares</i>	58.8	48.1	46.5	46.0
781 Passenger motor cars	0.8	5.9	9.7	9.4
333 Petroleum oils, crude	42.0	19.3	9.3	7.3
773 Equipment for distributing electricity	2.4	4.4	4.8	4.8
761 Television receivers	0.5	2.4	3.5	4.0
764 Telecommunications equipment and parts thereof	3.3	3.0	3.7	3.8
752 Automatic data processing machines and units thereof	0.2	1.7	2.4	3.8
782 Motor vehicles for the transport of goods or materials	0.5	0.6	2.8	3.6
784 Motor vehicle parts and accessories	2.6	4.1	3.8	3.5
931 Special transactions and commodities not classified according to kind	2.1	3.4	3.2	3.3
713 Internal combustion piston engines and parts thereof	4.4	3.4	3.2	2.5

Source: CAN 2000 computer programme. The groups of goods are based on the Standard International Trade Classification (SITC Rev. 2).

<sup>a</sup> Contains 45 simply processed commodities, including concentrates.

<sup>b</sup> Contains 65 elements: 35 agricultural/forestry groups and 30 others (mainly metals—except iron and steel—, petroleum products, cement, glass, etc.).

<sup>c</sup> Contains 120 groups representing the sum of <sup>d</sup> + <sup>e</sup> + <sup>f</sup>.

<sup>d</sup> Contains 44 elements: 20 groups from the textiles and clothing division plus 24 others (paper products, glass, iron and steel, jewellery).

<sup>e</sup> Contains 58 elements: 5 groups from the motor industry, 22 from the processing industry and 31 from the engineering industry.

<sup>f</sup> Contains 18 elements: 11 groups from the electronics division plus 7 from pharmaceutical products, turbines, aircraft, instruments.

<sup>g</sup> Contains 9 groups of items not elsewhere classified (mostly from section 9).

<sup>6</sup> In Argentina and Brazil the percentage shares of the motor industry were a good deal greater in 1997 and 1998 than in 1999. In Argentina this share was 12.5% in 1998, while in Brazil it was 8.0% in 1997. The fall in domestic demand in those countries in

the later years of the 1990s was reflected in a marked increase in idle capacity in this sector, so that the data for 1999 in table 3 do not properly reflect the major investment effort made by the motor industry in the 1990s.

TABLE 5

**Argentina: Aspects of its international competitiveness  
in world imports, 1985-1998**

	1985	1990	1995	1998
I. <i>Market share</i>	0.37	0.36	0.44	0.51
Natural resources <sup>a</sup>	0.91	1.05	1.59	1.94
Manufactures based on natural resources <sup>b</sup>	0.47	0.55	0.64	0.69
Manufactures not based on natural resources <sup>c</sup>	0.12	0.15	0.18	0.23
– Low technology <sup>d</sup>	0.23	0.26	0.28	0.27
– Medium technology <sup>e</sup>	0.08	0.14	0.20	0.32
– High technology <sup>f</sup>	0.08	0.05	0.04	0.05
Others <sup>g</sup>	0.10	0.10	0.15	0.14
II. <i>Structure of exports</i>	100	100	100	100
Natural resources <sup>a</sup>	56.7	45.8	48.0	47.0
Manufactures based on natural resources <sup>b</sup>	24.8	26.9	24.0	21.6
Manufactures not based on natural resources <sup>c</sup>	17.7	26.4	26.8	30.4
– Low technology <sup>d</sup>	9.0	11.9	10.6	8.7
– Medium technology <sup>e</sup>	6.2	12.2	14.4	19.6
– High technology <sup>f</sup>	2.5	2.3	1.9	2.2
Others <sup>g</sup>	0.8	0.9	1.2	1.0
III. <i>10 main exports, by relative shares</i>	43.7	34.4	44.1	51.7
081 Feeding stuff for animals (not including unmilled cereals)	10.5	8.7	9.0	8.9
333 Petroleum oils, crude	0.7	1.2	8.8	7.9
423 Fixed vegetable oils	5.6	4.7	6.5	6.6
781 Passenger motor cars	0.2	0.3	2.2	6.1
041 Wheat (including spelt) and meslin, unmilled	5.2	3.0	2.2	5.1
044 Maize (corn), unmilled	7.1	2.1	3.6	5.0
611 Leather	4.8	4.1	4.0	3.4
334 Petroleum products, refined	4.9	4.1	2.5	3.2
782 Motor vehicles for the transport of goods or materials	0.1	0.1	1.4	2.8
011 Meat and edible meat offals, fresh, chilled or frozen	4.8	6.2	4.1	2.8

Source: CAN 2000 computer programme. The groups of goods are based on the Standard International Trade Classification (SITC Rev. 2).

<sup>a</sup> Contains 45 simply processed commodities, including concentrates.

<sup>b</sup> Contains 65 elements: 35 agricultural/forestry groups and 30 others (mainly metals –except iron and steel–, petroleum products, cement, glass, etc.).

<sup>c</sup> Contains 120 groups representing the sum of <sup>d</sup> + <sup>e</sup> + <sup>f</sup>.

<sup>d</sup> Contains 44 elements: 20 groups from the textiles and clothing division plus 24 others (paper products, glass, iron and steel, jewellery).

<sup>e</sup> Contains 58 elements: 5 groups from the motor industry, 22 from the processing industry and 31 from the engineering industry.

<sup>f</sup> Contains 18 elements: 11 groups from the electronics division plus 7 from pharmaceutical products, turbines, aircraft, instruments.

<sup>g</sup> Contains 9 groups of items not elsewhere classified (mostly from section 9).

over time. Mexico clearly subscribed to a model led by the exports of metal products and machinery sectors to the rapidly growing United States market. Argentina on the other hand –if we except its motor industry, which grew strongly within the framework of a highly subsidized policy– tended to concentrate on resource processing (industrial commodities).

In short, not only were there few countries of the region which were able to improve their international competitiveness in the 1990s, but those that did were only able to do so in a very limited number of

production activities. These comprised predominantly, on the one hand, assembly industries making intensive use of unskilled labour, and on the other, industries processing natural resources. The former quite accurately reflects the situation of Mexico and several of the smaller Central American countries, while the latter represent the case of southern countries such as Argentina, Chile, Brazil or Uruguay.

There was also an appreciable improvement in the productivity and international trade insertion of the motor industry –and in the case of Brazil of the aircraft



industry too—,<sup>7</sup> which received preferential treatment from the economic authorities.

Another fundamental feature of the process we are describing concerns the nature of the economic agents which have led the processes of change. In the maquila model, transnational enterprises predominate, and there are few large domestic conglomerates which have managed to incorporate themselves into the process as suppliers of parts or intermediate inputs (Mortimore and Peres, 2001; Garrido, 2000; Kulfas, 2000).<sup>8</sup> In the case of the growth model based on the processing of natural resources, in contrast, it is big local conglomerates which have played a leading role. In both scenarios, small and medium-sized locally owned enterprises, on the one hand, and the group of State firms, on the other, lost relative participation in recent years.<sup>9</sup> Once again, it is a question of dominant trends: examples can be found of transnational corporations which have specialized in the processing of natural resources and of countries where small and medium sized enterprises as a whole have not significantly lost (or have even marginally improved) their share in GDP (Peres and Stumpo, 2000).

#### 4. The relative productivity gap

Let us begin by looking at the aggregate performance of the manufacturing sector of various countries of the region in comparison with that of the United States in the period 1970-1998 and in various sub-periods of this two-decade-long global stretch of time.

Before embarking on the analysis of the indicators contained in table 6 it is important to keep in mind that the United States economy, which is used here as a benchmark for evaluating the evolution of the labour

productivity of the Latin American countries, grew faster in the 1990s than its historical rate.

The figures in table 6 show that between 1970 and 1998 no country of the region reached growth rates of industrial labour productivity which were higher than those of the United States manufacturing sector.<sup>10</sup> Consequently, not only was the disparity quite large in absolute terms to begin with but we also found a long-term tendency towards a widening of the productivity gap.

It may be seen from table 7 that all the countries under examination show lower levels of relative productivity in 1998 (compared with the United States) than in 1970. Here too, however, there are differences between countries: the relative loss of ground was clearly smaller in the case of Brazil and, above all, Argentina. These two countries (together with Uruguay up to 1996) are the only ones which showed a clear tendency to narrow the productivity gap during the 1990s. As already noted, however, even in these cases the growth in relative productivity was not enough to regain the values of the early 1970s and to make up for the serious loss of ground suffered in this respect in the 1980s. It should also be noted that—at least in Argentina—the reduction in the relative productivity gap in the 1990s was due essentially to the restructuring of enterprises and the closure of less competitive firms rather than to a generalized trend towards new investments in industry.

This suggests that the structural reforms favouring competitiveness induced a certain amount of transformation of the production structure, but did not succeed in bringing labour productivity in manufacturing closer to that of the corresponding sector in the United States.

Figure 3 shows that the reduction in the relative labour productivity gap has tended to be greater in the motor industry (which received preferential treatment from the economic authorities in all the countries considered) and in the industrial sectors processing natural resources, especially those producing pulp and paper, chemical and petrochemical products and non-ferrous metals (i.e., the branches identified in the figure as “Other N.R.”).

In contrast to the above, the industrial activities making heavy use of unskilled labour and catering for the local markets, producing footwear, clothing,

<sup>7</sup> In this respect, it is worth analysing in detail the case of Embraer, which is currently the leading Brazilian exporter of manufactures, has gone through various stages of evolution in its links with the Brazilian public sector, has given evidence of a notable long-term process of accumulation of its own technological capabilities which has served as the basis for its present export success (see Goldstein, 2000).

<sup>8</sup> An interesting debate is currently under way on the degree to which the great Mexican economic groups have managed to enter the first “ring” of suppliers of Mexican automobile assembly firms: something which does not seem to have been accomplished by local auto parts suppliers in Argentina or Brazil, where takeovers of such firms by big transnational corporations have become a byword in recent years (see Brown, 2000).

<sup>9</sup> The available figures show a wide variety of situations among the different countries, however (see Peres and Stumpo, 2000).

<sup>10</sup> The country which came closest to this was Argentina, with an average annual growth rate of 3.7%, as compared with 3.9% in the United States.

TABLE 6

**Production, employment and labour productivity  
in Latin American manufacturing, 1970-1990 and 1990-1998**  
(Annual average growth rates)

	Production		Employment		Productivity	
	1970-1990	1990-1998	1970-1990	1990-1998	1970-1990	1990-1998
Argentina	-0.3	5.2	-2.3	-2.5	2.0	7.9
Bolivia	2.1	3.9	2.6	4.1	-0.5	-0.1
Brazil	4.4	0.1	3.2	-5.9	1.2	6.4
Chile	1.8	4.8	0.4	0.3	1.4	4.4
Colombia	3.6	1.5	1.8	-1.8	1.8	3.3
Costa Rica	4.8	4.2	8.0	1.8	-2.9	2.0
Ecuador	4.5	4.0	4.4	2.9	0.1	2.7
El Salvador	-0.3	5.8	-1.8	...	1.8	...
Honduras	4.6	4.2	4.9	...	-0.4	...
Mexico	4.1	3.7	2.1	1.0	1.9	2.7
Panama	1.6	4.7	2.6	0.5	-1.0	4.2
Peru	0.7	4.4	3.1	2.0	-2.4	3.1
Uruguay	1.1	0.7	3.0	-8.0	-1.8	8.2
Venezuela	3.5	2.7	3.8	-1.0	-0.3	4.8
United States	3.5	4.3	-0.2	-0.2	3.7	4.5

Source: The PADI computer programme.

TABLE 7

**Latin America: Relative labour productivity of industry  
compared with the United States manufacturing sector**

	1970	1980	1990	1998
Argentina	50.2	46.6	36.4	46.9
Brazil	35.4	28.3	21.7	25.0
Chile	46.2	42.2	29.5	29.3
Colombia	40.1	30.7	27.3	24.8
Costa Rica <sup>a</sup>	—	—	15.0	13.8
Jamaica <sup>a</sup>	28.0	16.5	9.3	8.8
Mexico	28.7	25.5	20.3	17.6
Peru <sup>b</sup>	40.4	30.0	1.9	11.4
Uruguay <sup>c</sup>	43.0	21.7	1.7	17.3

Source: The PADI computer programme.

<sup>a</sup> Data up to 1992. <sup>b</sup> Data up to 1996. <sup>c</sup> Data up to 1995.

furniture, etc., turned in a poorer relative performance and were unable to withstand the competition of China. A particularly poor performance was registered by the activities making intensive use of engineering services and engaging in research and development activities (capital goods, the electronics industry, scientific instruments). These activities faced a massive increase in imports, facilitated by the greater external trade openness, and have clearly lost ground with respect to the international technological frontier.

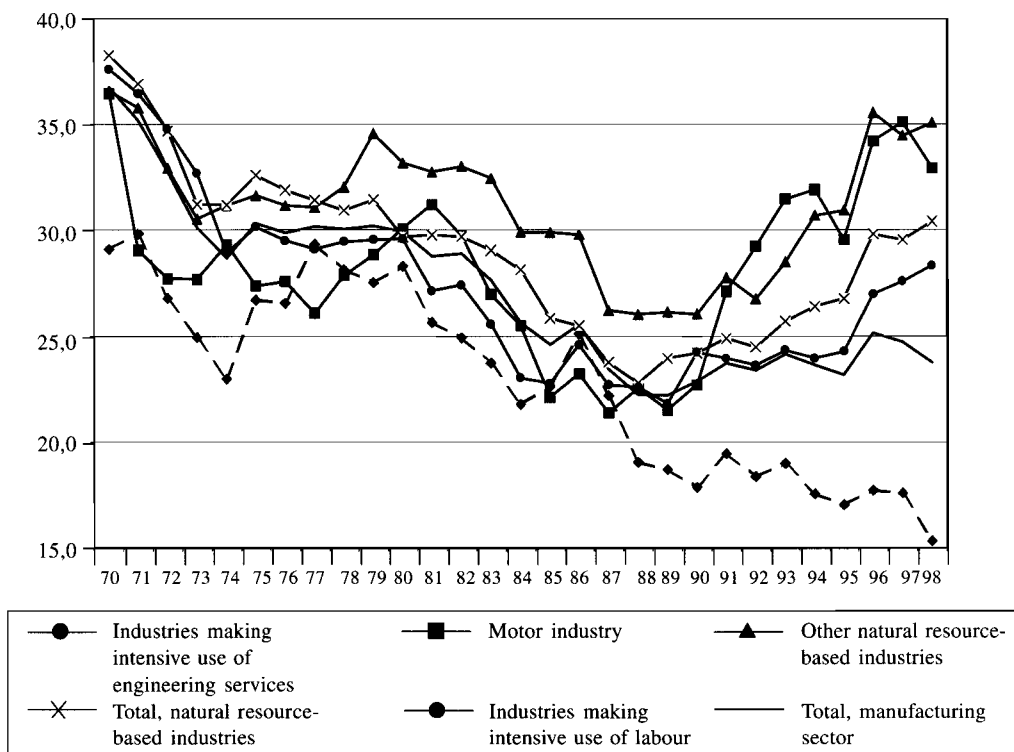
In other words, what happened as regards the relative labour productivity gap in the 1990s confirms

that the “winning” sectors, i.e., those which managed to come somewhat closer to the international productivity frontier, were those which were favoured by industrial policy, which benefitted from intra-regional trade agreements, or which fitted in with the pattern of “natural” comparative advantages of the region. These three manufacturing categories currently make up the new production specialization pattern of the various Latin American countries. In contrast, the industries making intensive use of technological know-how and spending money on research and development have clearly lagged behind, as so also have, to a lesser extent, the industries making intensive use of labour to produce wage goods for the domestic market. While the latter industries have more and more difficulty in competing with imports from labour-surplus countries, the former have the same problem with imports from technologically more mature economies.

To sum up, the sectors which are doing better in relative terms are: i) the industrial sectors which have received preferential treatment from economic authorities; ii) assembly industries producing for the United States market; and iii) industries processing natural resources and enjoying static comparative advantages. In contrast, those which have lost relative ground internationally are: i) industrial branches making intensive use of knowledge, and ii) those making intensive use of unskilled labour producing wage goods for the domestic market, which in the

FIGURE 3

**Relative labour productivity gap compared  
with United States manufacturing sector**



Source: The PADI computer programme.

present circumstances can hardly face the competition from Chinese firms.

What types of firms tend to predominate in the “winning” and “losing” sectors? Local subsidiaries of foreign corporations and big locally owned conglomerates predominate in the first group, while small and medium-sized family-owned firms are typical members of the “losing” set.

Figure 3 shows another fact of considerable interest: only the motor industry is now closer to the international technological frontier than it was twenty years earlier, in the early 1980s. This enables us to gain an idea of the enormous amount of ground the region lost through the debt crisis and subsequently throughout the 1980s. If we also take into account the crucial role played by industrial policy in the revitalization of the motor industry, we cannot fail to be struck by the dubious capacity of conventional market mechanisms to further the growth of the sectors with the greatest content of technological knowledge and domestic added value.

This is a serious conclusion to reach, to be sure, because it questions much of the conventional wisdom of the more orthodox sectors of our profession. Nevertheless, we believe that the results set forth here give a fairly credible picture of what has happened in the industrial sector of Latin America in recent years, and they will undoubtedly be useful when considering public policy matters, as we will do later in this article.

The results presented so far also clearly show that there are great differences among industries and types of enterprises in terms of their pattern of adaptation to the new rules of the game. It is precisely this observation which suggests that we should progress to the meso-economic and microeconomic aspects of the present structural transformation if we wish to understand more fully what has happened in recent years in Latin America. The transition to a more open and deregulated industrial organization model has been accompanied by many changes in what we have called here the technological and institutional “regimes” of each activity.

### III

## Meso-economic and microeconomic aspects of the structural change process

### 1. The empirical evidence

In almost all sectors of production, firms which could not adapt to the new rules have disappeared, new firms have entered the market, bringing with them new technologies (products, processes and organization of work), and there have been changes –sometimes of a radical nature– in the institutional and regulatory framework in which the sector operates (changes in patent law, property rights over natural resources, fiscal treatment, etc.). At the same time, the degree of economic concentration has increased and in each market the competition from foreign firms has also become stronger. Firms have reduced their degree of vertical integration and have moved towards just-in-time production organization techniques, interacting in a very different way with the international environment.

All this suggests that in each field of production a new production organization model has emerged, i.e., a new way of creating economic surplus and distributing it among the different economic agents and also between the local economy and the foreign sector. This is exactly what economic globalization means; that the different sectoral technological and competitive regimes become more closely linked with external forces.

Let us take as an example the steel industry –ISIC 371 (iron and steel)–, in which Argentina, Colombia and Brazil are clearly coming closer to the international technological frontier, while Chile and Mexico are also doing well, though rather less spectacularly. In other words, all the countries studied here managed to improve their position relative to the United States in this field during the period under examination. To what was this due? The failure of the United States in the iron and steel field throughout the 1980s was undoubtedly very serious and is well documented in the literature of the 1970s and 1980s, highlighting the enormous difficulty experienced by the United States steel companies in keeping up with the rate of innovation of their European or South Korean competitors. This obviously cannot be the whole explanation for what happened, however. What we are

interested in analysing here are the changes that took place within Latin American countries.

Let us take the case of Argentina, for example. We know that the Argentine steel industry underwent a major restructuring process –including the privatization of a large State-owned steelworks– during the 1980s and 1990s. This process involved: i) “births” and “deaths” of enterprises; ii) changes in the institutional fabric of the sector; and iii) the transnationalization of the industry or, in other words, its generalized orientation towards the external sector not only in terms of imports and exports but also in terms of foreign direct investment and its gradual insertion in the community of international “global players”. All this was reflected in a period of profound structural changes and the gradual construction of a new competitive regime which is certainly very different from that prevailing during the import substitution industrialization period.

Of the 59 industrial steelworks that Argentina had in 1975, only 26 were still operating in the 1990s. The State-owned plant –Somisa S.A.– had been acquired, partially dismantled and rehabilitated by Techint S.A., one of the two large locally-owned conglomerates that currently control the industry. In a rapid internationalization programme, that same group had also acquired Tamsa in Mexico and Sidor in Venezuela, as well as other firms, while at the same time it formed strategic alliances with big European steelmaking groups in order to gain control of the State-owned steelworks privatized by the Italian government. In other words, in spite of the vicissitudes of the Argentine macroeconomic picture and the fall in investment suffered by that country in the 1980s, Techint S.A. carried through a major internationalization process in the 1980s and set itself up as a “global player” on the world scene, with diversified activities all over the world in the steel industry in general and in the production of seamless tubes in particular.

As well as the “birth” and “death” of enterprises and the changes in market structure and performance –including the privatization of a State-owned steelworks and the total disappearance of the State as an important agent in this market– changes were also taking place

in the institutional structure, in the mechanisms for the training of skilled human resources, and in the creation of new technological knowledge within the industry, along with a marked change in the pattern of comparative advantages and of insertion in world trade. Techint S.A. made progress in the establishment of a world-class research and development infrastructure, acquired railways and ports, began to participate in energy production, and was gradually building up a new business management model which was younger and more professionalized than that which had previously characterized the sector. As it grew, it quite naturally became linked with the exterior more than with the domestic environment. As it became a global player it gradually left behind its past as an import substitution firm and steadily took on characteristics of present-day capitalism. Its former image belonged to the international climate of the post-war years, while its new image belongs to the competitive world of globalization.

This completes our description of the example of the steel industry, which we now intend to use as the basis for an exercise in "appreciative theorization". Generalizing on the basis of this case, we can say that all forms of productive activity may be seen as an aggregate of firms (public and private), regulatory agencies, and rules and standards of behaviour which, together, define a "competitive and technological regime", unique and particular in many respects, which is different from that prevailing in other sectors of production. This regime fits in with the global pattern of incentives prevailing in society, but it also depends on the specificities that each production sector has developed over time and, ultimately, on the nature of the individual actors participating in it. Comparative advantages and forms of globalization do not only reflect relative prices but also institutional factors, business strategies and the technological changes that the international production frontier undergoes exogenously. Among the institutions involved are the banks and financial agents which provide resources to finance the long-term investment programmes of the sector. There are also the universities and technical schools responsible for training the human capital required by industry, the engineering firms which support the technical management of enterprises, customs services, ports, and firms that supply energy and transport services. In one way or another, each of these links conditions the day-to-day operation of the sector. This "collection" of actors "stores up" a whole range of technological know-how, legal frameworks and

rules of behaviour which determine the greater or lesser degree of efficiency attained by the sector at any given moment in time. When we say that competitiveness is systemic, this is exactly what we mean: in order to be efficient, a production sector must operate in a context which is efficient globally.

The recent structural reforms have affected the systemic competitiveness of the whole structure of production through the changes they have brought about in the structure and performance of the multiple sectoral regimes and in their linkages with domestic and external institutional, economic and technological forces. Each line of production, including its firms, its technological know-how, its institutional framework and its degree of internationalization, tends to change as a function of the changes in the global system of incentives prevailing in society. Only a proper understanding of the way this takes in each sectoral and national context will enable us to understand the new forms of operation of Latin American capitalism of recent years.

## 2. The forces behind changes in sectoral regimes

### a) *"Birth" and "death" of enterprises*

A first important topic related with the impact that the structural reforms have had on almost all types of production activities is that of the death and disappearance of enterprises, on the one hand, and the entry of new firms into the market on the other. Thus, when the economy is opened up to outside competition some firms are forced to leave the market because they are unable to adapt to the new rules of the game, while new firms may enter the market in their place. Such births and deaths may take place at very different points in time, that is to say, in very different phases of each sector's adaptation to the new rules. An important role is played in this respect both by the relations between micro and macro variables and by the changes which take place simultaneously, but independently of each other, in the institutional environment of each sector. A macro economy with a high degree of uncertainty does not stimulate the creation of new industrial plants. A procyclical institutional situation, on the other hand –for example, one that favours long-term investment through suitable reorganization of the capital market– can help to foster the installation of new production capacity.

We can see from table 8 that the Argentine steelworks which have disappeared have mostly been

TABLE 8

**Argentina: Structural change, “births” and “deaths of companies in the steel industry, 1975-1992**

	1975	1980	1985	1990	1992
<i>Integrated firms</i>	Alt. Horn. Zapla Somisa	Alt. Horn. Zapla Somisa Acindar Siderca	Alt. Horn. Zapla Somisa Acindar Siderca	Alt. Horn. Zapla Somisa Acindar Siderca	Aceros Zapla Aceros Paraná Acindar Siderca
<i>Total</i>	2	4	4	4	4
<i>Semi-integrated firms</i>	Aceros Bragado Aceros Ohler Acinda Cura Brothers Gurmendi La Cantábrica Mairimi&Sinai Santa Rosa Siderca Tamet	Aceros Bragado Gurmendi La Cantábrica Santa Rosa Tamet	Aceros Bragado Tamet	Aceros Bragado Tamet	Aceros Bragado
<i>Total</i>	10	5	2	2	1
<i>Total rolling mills</i>	47	38	36	33	21
<i>Total, whole industry</i>	59	47	42	39	26

Source: Azpiazu and Basualdo (1997).

small and medium-sized non-integrated enterprises, and they have mostly disappeared in the early stages of the country's macroeconomic adjustment process.<sup>11</sup> In contrast, the “births” seem to take place in later stages of the cycle, when the macro economy entered on a stage of stabilization and business expectations once again favoured longer-term investment processes and technological modernization programmes.

Apart from the question of the point in time at which the births and deaths of enterprises take place, we can also see that the process has a clear impact on the average size of the plants in the industry, on labour productivity, and on the index of economic concentration prevailing in the activity. This is shown in stylized form in figure 4. The vertical axis measures

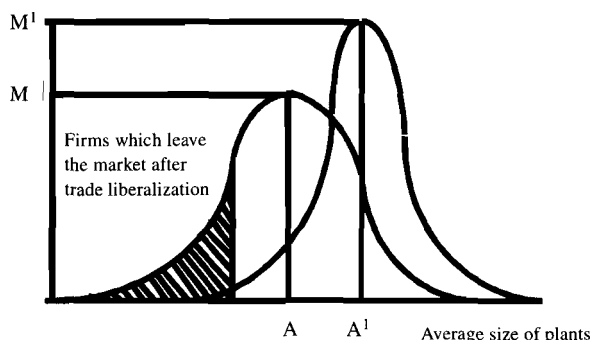
the average productivity of the branch, while the horizontal axis shows the average size of the plants. The first distribution describes the situation of the industry before the opening of the economy, while the second one represents the industry after trade liberalization has taken place.

We note that the improvements in average productivity are due both to the deaths –which we may assume to correspond to the smaller and more inefficient enterprises of the sector– and to the births, which we may assume to be associated with the entry into the market of new firms of larger average size which bring with them production and organizational technologies much closer to the international “state of the art”.

The sectoral restructuring process we have been describing is associated with an increase in the degree of economic concentration, but also probably with a reduction in the index of relative heterogeneity among plants within the sector. The increase in economic concentration in the sector should not necessarily be seen as an indication that the degree of monopoly is increasing, however. It should be remembered that, along with the restructuring of the sector, the opening up of the economy is increasing the disciplinary effect

<sup>11</sup> The weakness of local anti-monopoly legislation may be viewed as part of the institutional situation in which the restructuring of this industry takes place. Techint S.A. bought and then closed down several of the small and medium-sized steelworks which disappeared from the market in the 1980s. An institutional situation which was firmer as far as the protection of competition was concerned would assuredly have given rise to a different type of restructuring of the sector from that which finally occurred in this branch of production.

FIGURE 4

**Births and deaths of enterprises and average productivity of a branch of production**

$M$  = Average productivity of sector before trade liberalization efforts  
 $M'$  = Average productivity of sector after trade liberalization

Source: Prepared by the author.

of outside competition on local firms, making it harder for them to capture monopoly rents. This effect will undoubtedly differ a great deal between branches of activity, however, depending on the greater or lesser role, in each case, that brand names, patent rights and other such “institutions” play in strengthening the capacity of firms to differentiate their products from imported ones. An extreme example of this is the case of the pharmaceutical industry, where consumers display various forms of “loyalty” to brand names and imperfect information of the consumer is a proverbial feature of the industrial organization model of the sector. This has enabled pharmaceutical entrepreneurs to capture monopoly rents even in the context of trade liberalization (Katz, 1998). This obviously does not apply, however, to less differentiated products which are more in the nature of “commodities”.

b) *Rejuvenation of the stock of machinery and equipment and displacement of local engineering services*

The fact that imported capital goods have become cheaper because of greater trade openness has favoured their use instead of locally-made machinery and equipment, and the same thing has happened with respect to local engineering services, which were previously used in-plant to extend the life cycle of the available equipment. In other words, the structural reforms designed to increase competitiveness have led on the one hand to a certain degree of rejuvenation of the machinery and equipment available in industry, and

on the other to the gradual externalization of the sources of technological progress underlying the increases in productivity.

The privatization of public enterprises has operated in the same direction in recent years –i.e., lowering the average age of the stock of capital goods and facilitating the expulsion of skilled labour (as for example in the telecommunications or energy sectors). In a number of countries of the region, there has even been a tendency in these sectors to close down the engineering and project design departments which State enterprises had created during the import substitution years. A similar process seems to be taking place in many local subsidiaries of big transnational groups, which in recent years have started to operate in real time, working “on line” with their respective headquarters. Many of them have radically changed their past forms of production organization and technological behaviour. It now seems less necessary to them to adapt technology to the local environment as they did in the past; the proportion of imported inputs used in production has increased and there has been a transition towards a strategy of almost total assimilation of the range of products manufactured locally with those of the parent firm.<sup>12</sup>

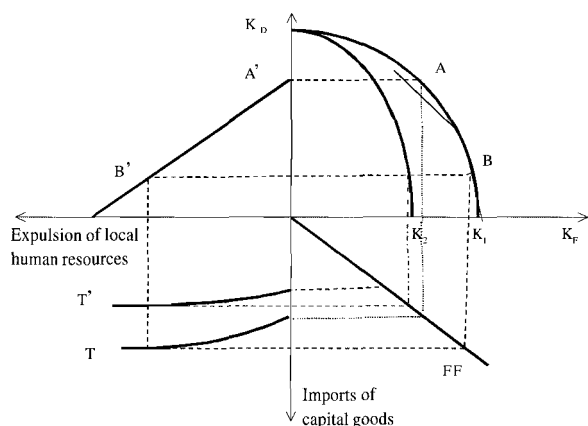
In all these cases we are faced with the paradox that while progress is being made towards product designs and production technologies which are closer to the world technological frontier, at the same time there is a growing trend towards the assembly of imported components, with less domestic value added.

In a recent study, Cimoli and Katz (2001) illustrate this phenomenon through a model which is summarized in figure 5. In quadrant 1 we have a transformation function with two production factors: domestic capital (KD) and foreign capital (KF). The curves in this quadrant show the various combinations of machinery and equipment, of local and imported origin, that firms can choose at different relative prices. The relation between the use of foreign capital and the expulsion of human resources observed in the plants is shown in quadrant 2. Quadrant 4 describes the relation between the use of foreign capital and imports. Curve FF represents a neutral response to prices on international markets. A movement towards the abscissa will restrict imports of capital goods. If the curve moves in the opposite direction, however, there will be more incentives for the importation of such goods.

<sup>12</sup> The motor industry is a typical case in this respect (see Katz, 1998).

FIGURE 5

**Lowering of cost of imported capital goods  
and obsolescence of local human capital**



Source: Cimoli and Katz (2001).

A fall in the relative price of imported capital goods compared with locally-made ones (as a result, for example, of a reduction in import tariffs) will cause a movement from A to B. In general, using more machines means that less labour will be needed, but as the imported equipment “embodies” some of the skills of local skilled labour, its importation will also mean that fewer skilled human resources are needed in-plant. Furthermore, some maintenance efforts which were previously made in order to extend the life cycle of the machinery also become unnecessary because of the greater accessibility and lower price of imported equipment. It makes less sense than before to maintain engineering departments of the size previously considered to correspond with the scale and level of activity of the plants, so that many of them are simply eliminated. Curve T in quadrant 3 represents the solution of the model: greater imports of capital goods due to the reduction in their relative prices leads to the expulsion of human capital.

The figure also shows a situation in which the foreign capital incorporates a much better “vintage” of technology, causing the curve in quadrant 1 to shift towards the root. This means that the same level of production can be achieved with fewer (imported) machines than before. If more machinery is imported than is needed to manufacture the original amount of output, the displacement of skilled labour from the plant will result even larger. Curve T will shift to T',

indicating that the same amount of expulsion of human resources can be achieved with fewer imports of machines. If output increases with respect to the initial output, the “destruction” of local human capital will be even greater.

In an open economy the life cycle of machinery tends to be shorter, the rate of obsolescence higher and the replacement of equipment faster than in an economy which is less open, where importing machinery is more expensive and more difficult (because of non-tariff restrictions). This brings in an important new phenomenon: as the production of technological know-how does not constitute part of the local comparative advantages, firms will increasingly resort to the importation of technological knowledge “embodied” in new equipment, instead of using locally-produced machinery and engineering services. In these circumstances, it will be more difficult to build up local technological capacity, and this situation becomes even worse when, because of the privatization of State enterprises and the gradual transition to internationally integrated systems of production in large MNCs, engineering and project planning activities tend to be transferred to the head offices of the parent firms. In the new pattern of production specialization resulting from mergers or from the privatization of public companies, the local firms tend to concentrate on tasks involving less local added value. They choose to operate closer to assembly activities or the primary processing of natural resources than to engage in processes with a higher local added value (Cimoli and Katz, 2001).

This phenomenon also has implications for the trade balance, as we see in section d below.

On the other hand, just as there is some evidence of forces associated with the sectoral restructuring process described above which can destroy domestic technological capacity, there is also evidence that that process leads to the appearance of new activities (for example, production services such as packaging, development of computer programmes, real-time transport and distribution services, international marketing, etc.) which involve a gradual transition and competitive regime closer to the international “state of the art”.

In short, sectoral restructuring is intimately associated with a process of creative destruction of both the physical and human capital linked with a given sectoral regime.



### c) *The restructuring of institutions*

The process described above has a clear parallel in the institutional sphere, where different forms of partial approximation to the model of production organization of the developed countries may also be noticed. The strengthening of property rights in the field of natural resources (some countries have even incorporated these rights in their Constitutions), the deregulation of many markets (capital and labour markets, for example), stronger intellectual property rights, and the assurance by law that foreign capital will receive the same treatment as domestic capital all form part of a broad network of new institutions which represents a gradual process of “levelling the playing field”, as this is sometimes called today.

The changes in the international agenda in this respect began to take shape in the mid-1980s and were connected on the one hand with the 1984 United States Trade and Tariff Act and on the other with the initiation in 1986 of the multilateral negotiations on intellectual property rights, which finally resulted in the TRIPS (Trade-Related aspects of International Property Rights) agreement of the Uruguay Round of GATT, signed in Marrakesh in 1994.<sup>13</sup> It was precisely from that time onward that the process of institutional convergence towards the new set of disciplines (TRIPS, TRIMS (Trade-Related Investment Measures) and GATS (General Agreement on Trade in Services) began to gather pace. In a recent study, Sercovich holds that the commitment to institutional convergence is undeniable. Of the 109 developing countries and transitional economies which have undergone pro-competitive reforms since the 1980s, 75 did so from 1989 onwards. Furthermore, 107 of the 134 members of the WTO are developing or transitional economies, while 28—including China, the Russian Federation and Taiwan—are actively negotiating their entry under special conditions. The TRIMS agreement provides that by 2002 the developing countries must abolish all restrictions on foreign investment which affect, among other things, export subsidies and local content requirements (Sercovich, 1999).

In short, the restructuring of the sectoral technological and competitive regimes we have been describing involves not only a complex episode of changes in the structure and performance of each sector of production—through births and deaths of enterprises, increases in the degree of economic concentration, etc.—but also profound changes in the institutional and regulatory environment in which each activity operates.

### d) *Linkages with the external sector*

The changes in the global incentives regime prevailing in society also cause the relationship with external forces and linkages to change in a dramatic way.

In view of the changes in relative prices that take place in the economy as a result of trade liberalization, the greater degree of vertical disintegration now observed in production processes and the increasingly important role played by MNCs operating under integrated international production systems, it may be expected that many inputs that were previously made locally (or subcontracted to local firms) are now imported. In order to import them it becomes necessary to export more. In other words, it would seem reasonable to expect that the new technological and competitive regimes will give rise to a greater orientation towards the exterior in terms of both imports and exports. It also seems reasonable to expect that there will be big differences in the way each industry restructures its pattern of linkages with the exterior. We know, for example, that industrial sectors which make intensive use of technological knowledge and research—such as the pharmaceutical, electronics or capital goods sectors—have found it more efficient, when tariff protection was reduced, to go back to buying intermediate inputs and raw materials from their respective parent firms instead of continuing to produce them locally. We also know that in order to be able to import those intermediate inputs many firms have been obliged to export (or have been pressed to do so by the economic authorities, as in the case of the motor industry).

<sup>13</sup> The “Statement of Views of the European, Japanese and United States Business Communities” issued in June 1988 as a preparatory base of GATT on intellectual property rights says: Inappropriate and ineffective protection of intellectual property rights has given rise to serious distortions in international trade ..... [those] rights form the basis for international competitiveness .....”. Much of the explanation for the changes which have taken place in the international agenda during those years may be found in the political

lobbying carried out in Washington by the United States pharmaceutical industry, whose international competitiveness was seriously affected by the weakness of patent legislation in countries such as Argentina, Brazil or India. See in this respect Olson (1991) and, with regard to pharmaceutical matters in general and the erosion of the United States’ comparative advantages because of the slower rate of innovation of its pharmaceutical industry in the 1970s, see Katz (1974).

In other words, the change in the production organization model (vertical disintegration), the tendency to operate under the form of integrated international production systems, tariff reductions, government pressures or contraction in domestic demand have caused the new technological and competitive regimes to be “naturally” more linked with the exterior than before. This brings with it the possibility that those regimes may involve foreign exchange deficits, i.e., that they may generate deficits on their external trade balances. This gives rise to an important new issue of micro-macro coordination: a global trade balance seems increasingly difficult to sustain under present circumstances.

The following tables show that this is actually taking place, though some countries seem to be more affected than others by these new trends.

The evidence shows that the transition to more open sectoral regimes has been much stronger in Mexico than in the other countries. The role of the North American Free Trade Agreement and the pressure that may be expected from operating in increasingly close integration with the world's largest economy –which also kept up a rapid growth rate throughout almost the whole of the decade– undoubtedly explain the big increase in both the import and export coefficients in

the case of Mexico, especially after the devaluation in late 1994. We can also see that, although both indexes increased considerably, the new sectoral regimes in Mexico were more oriented towards exports than imports, which represents a major difference with the cases of Argentina, Brazil or Colombia.

This explains (table 10) why Mexico achieved a positive trade balance in the manufacturing sector from 1991 on. In contrast, although MERCOSUR has given rise to considerable increases in intra-regional trade, its impact on the degree of external openness of the new sectoral competitive regimes of Argentina, Brazil or Colombia has been significantly less than in the case of Mexico and there has been a stronger orientation towards imports, reflected in significant trade balance deficits. As our reasoning earlier shows, this deficit has been particularly marked in those industries making intensive use of technological and engineering services and research and development, i.e., those manufacturing capital goods, electronic goods and pharmaceutical inputs. As we argued earlier, in all these cases the new sectoral regimes have tended to cause a disproportionate increase in their demand for imports. Their revealed competitiveness has clearly fallen further behind after trade liberalization.

The data show a clear deterioration in the trade balance during the 1990s, except for Mexico. Brazil

TABLE 9

**Latin America (five countries): Export and import coefficients of the manufacturing sector**

	1970	1980	1990	1998	1999
<b>Argentina</b>					
Export coefficient	7.6	6.0	16.0	17.1	16.8
Import coefficient	10.3	11.3	6.8	30.7	27.6
<b>Brazil</b>					
Export coefficient	7.3	9.1	7.7	10.2	13.6
Import coefficient	8.4	7.1	4.8	13.0	15.3
<b>Mexico</b>					
Export coefficient	3.4	2.9	9.5	42.0	51.7
Import coefficient	9.7	15.1	17.8	45.2	49.4
<b>Chile</b>					
Export coefficient	3.2	10.2	13.2	15.8	17.5
Import coefficient	21.0	30.1	34.3	44.0	35.8
<b>Colombia</b>					
Export coefficient	2.9	6.6	10.1	13.8	
Import coefficient	22.9	22.4	24.0	42.4	

Source: The PADI computer programme.

TABLE 10

**Latin America (five countries): Trade balance of the manufacturing sector as a whole and the sectors making intensive use of technology**

Countries	Trade balance				
	1970	1980	1990	1998	1999
<b>Argentina</b>					
Sectors making intensive use of technology	-519.89	-4 214.3	-649.82	-13 050.1	-10 357.00
<i>Manufacturing sector as a whole</i>	-382.4	-4 237.21	4 592.41	-13 107.8	-9 431.69
<b>Brazil</b>					
Sectors making intensive use of technology	-1 051.16	-2 136.85	-947.89	-15 855.5	-12 194.50
<i>Manufacturing sector as a whole</i>	-291.13	3 478.45	9 252.51	-10 918.3	-4 607.14
<b>Mexico</b>					
Sectors making intensive use of technology	-1 201.92	-8 237.65	-6 800.07	5 894.14	22 143.48
<i>Manufacturing sector as a whole</i>	-1 404.33	-13 193.1	-11 912.3	-7 929.67	6 327.72
<b>Chile</b>					
Sectors making intensive use of technology	-437.74	-1 804.3	-3 272.27	-7 664.89	-5 188.14
<i>Manufacturing sector as a whole</i>	-643.29	-2 357.18	-3 439.62	-9 470.48	-5 790.67
<b>Colombia</b>					
Sectors making intensive use of technology	-419.61	-1 793.25	-2 205.66	-6 105.21	-3 876.11
<i>Manufacturing sector as a whole</i>	-677.89	-2 626.78	-2 810.82	-8 912.3	-5 403.23

Source: The PADI computer programme.

TABLE 11

**Latin America (five countries): Import coefficients**

Sectors <sup>a</sup>	Argentina					Brazil				Mexico			
	1970	1980	1990	1998	1999	1970	1980	1990	1999	1970	1980	1990	1999
0.1	28.3	33.3	21.4	126.0	112.8	22.9	13.6	10.1	36.6	26.1	32.3	42.9	105.5
02	5.3	11.7	6.1	43.7	33.3	11.8	9.3	3.6	22.2	25.2	25.6	23.3	32.7
03	17.8	23.5	14.8	77.0	65.5	19.0	12.3	8.0	31.6	25.8	29.8	34.2	72.7
04	0.8	1.6	0.4	3.2	3.0	1.5	1.8	2.2	3.0	1.4	5.5	7.4	7.3
05	23.9	14.9	10.6	28.8	27.0	12.3	9.6	5.5	14.3	10.7	19.0	17.5	52.9
06	10.0	6.9	5.0	13.7	12.9	6.7	6.7	4.1	8.9	5.1	11.7	12.1	26.4
07	3.8	7.5	4.0	26.4	27.4	2.2	1.7	2.1	9.2	4.0	4.5	9.4	43.0
08	10.3	11.3	6.8	30.7	27.6	8.4	7.1	4.8	15.3	9.7	15.1	17.8	49.4
Sectors <sup>a</sup>	Chile					Colombia							
	1970	1980	1990	1998	1999	1970	1980	1990	1998				
01	65.9	102.3	151.3	187.0	157.3	79.0	82.2	97.9	158.3				
02	47.5	133.4	151.7	211.0	142.6	112.4	64.1	44.2	98.7				
03	59.6	111.8	151.4	192.3	154.3	88.8	75.6	76.9	136.2				
04	6.7	10.4	3.8	7.2	6.7	2.5	4.7	2.5	8.8				
05	20.9	24.3	32.4	33.6	28.1	40.4	36.8	42.1	56.9				
06	12.9	15.7	15.4	18.1	15.4	15.5	16.4	18.6	27.5				
07	6.8	17.4	16.3	34.2	33.0	6.3	5.8	6.5	20.6				
08	21.0	30.1	34.3	44.0	35.8	22.9	22.4	24.0	42.4				

Source: The PADI computer programme.

<sup>a</sup> The corresponding sectors are:

- 01 Sectors making intensive use of engineering services, except the motor industry (ISIC 381, 382, 383, 385).
- 02 Motor industry (ISIC 384).
- 03 Total for sectors making intensive use of engineering services (01 + 02).
- 04 Foodstuffs, beverages and tobacco (ISIC 311, 313, 314).
- 05 Other sectors making intensive use of natural resources (ISIC 331, 341, 351, 354, 355, 362, 369, 371, 372).
- 06 Total for sectors making intensive use of natural resources (04 + 05).
- 07 Sectors making intensive use of labour (ISIC 321, 322, 323, 324, 332, 342, 352, 356, 361, 390).
- 08 Total for manufacturing.

and Argentina went from surpluses to deficits, which grew up to 1997-1998. After the latter year the external sector shows improvements but this due to a drastic fall in the demand for imports (in Argentina, Chile and Colombia) and to devaluation of the local currency. In these four countries imports went down in 1999 compared with the previous year (the declines in nominal values were 19% for Argentina, 17% for Brazil, 25% for Chile and 28% for Colombia), while exports also went down in nominal values in the case of Argentina, Brazil and Colombia and increased slightly in the case of Chile.

## IV

### Conclusions

The transition from an inward-oriented, State-led development model to another model which is more open to trade and deregulated –in which the “hidden hand” of markets plays a leading role in guiding resource allocation– has given rise in the different countries of the region to new patterns of production specialization and insertion in world markets for goods and services. This has taken place in the context of a Schumpeterian episode of “creative destruction” in which one model of social organization of production and institutional and technological behaviour was gradually displaced by another one, through the joint and interdependent action of economic, technological and institutional forces.

In previous pages we have shown that big changes have effectively been taking place in the pattern of production specialization and the form of insertion in world trade, so that two new “dominant” models have taken shape in the region as a whole. On the one hand, there is the “maquila” or assembly-based model, centered in Mexico and various small Central American countries, while on the other there is the model based on the processing of natural resources, which characterizes Argentina, Brazil, Chile and Uruguay, and various Andean countries such as Colombia and Peru.

Obviously, in order to understand the details of this process of change we must leave the macro sphere and descend to the mesoeconomic and microeconomic levels, since it is there that the changes in the dominant production organization model have taken place. There

In Mexico, the trade balance situation is different as a result of the strong increase in exports, which more than offset the also considerable rise in imports.

A more disaggregated analysis of the import coefficients (table 11) shows their impressive increase in the 1990s, which was concentrated primarily in the sectors producing capital goods and consumer durables (electronic goods, computer-related products and household appliances. The fall in domestic demand in the late 1990s reduced these coefficients in 1999 and thus lowered the trade deficit in Argentina, Chile, Colombia and Brazil. The improvement in Mexico’s trade balance was due rather to an increase in that country’s export capacity.

have been changes in the relative participation of different types of firms – local subsidiaries of transnational groups, locally-owned conglomerates, and small and medium-sized family owned enterprises – as well as in the sources of economic growth of each type of production activity. New patterns of microeconomic behaviour have also been growing up in which imported capital goods and intermediate inputs have been displacing both their local production and the local technological efforts associated with their creation. A new production model has thus been taking shape which is more closely linked with the exterior than in the past.

Export-led growth does not seem to be as automatic as is sometimes assumed in the current debates, however. Our data clearly show that the process of growth and economic restructuring of the 1990s is raising a number of new and quite complex problems which, if not solved, can seriously compromise the growth prospects of the countries of the region.

It should be emphasized in this respect that not only were there very few countries in the region which have managed to improve their international competitiveness in the 1990s, but also this has only happened in a few production activities. These were mostly maquila industries making intensive use of unskilled labour and oriented basically to the United States market, or industries processing natural resources.

This is reflected in the weak relative performance labour productivity has exhibited as compared with the

United States: although almost all the countries registered a substantial increase in labour productivity in manufacturing in absolute terms in the 1990s, only in a very few cases (basically Argentina and Brazil) was that increase greater than in the United States and –what was worse– in no case did it recover the absolute levels of relative productivity of the early 1970s.

These weaknesses of the new economic model are clearly reflected in the trade deficits, which are mostly due to the technologically more complex activities. Moreover, these deficits tend to increase in the upswing of the cycle and tend to go down in periods of sharp recession.

The complexity of these problems leads to the conclusion that a great deal remains to be done in terms of economic policy. A number of countries of the region have begun to perceive this, and in recent years they have been abandoning strictly orthodox rules in order to begin exploring a new agenda of public actions through which to improve their long-term productivity and competitive performance.

On the basis of the above diagnosis, we suggest that important areas for future government involvement are: i) regulatory environments and consumer protection; ii) competition policies; iii) measures to promote production and technological development, and iv) interventions aiming at “constructing” synergies and externalities at the local levels. In each of these four spheres there are obvious “market failures”, asymmetries of information, exploitation of dominant market positions by MNCs and other such “anomalies” that would justify the design and implementation of institutional measures aimed at constructing markets and knowledge-based dynamic comparative advantages that would favour a more efficient (and equitable) transition to open and competitive economies. Each of these topics would, of course, demand extensive analysis which is beyond the scope of this study to undertake.

(Original: Spanish)

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# Participation by the *poor in the* fruits of growth

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The influence of economic growth on numerous aspects of the economy and society is a frequently recurring topic among economists, especially at present, when profound economic and social transformations are under way in most of the countries of the region, while simultaneously there is an awareness that there are great shortcomings in terms of income distribution and that a high percentage of the population is in a state of poverty. A strong desire therefore exists to determine the capacity of economic growth to cope with those problems. This article begins by placing the issue in a conceptual and Latin American context and then going on to analyse it in the light of abundant statistical evidence. In particular, the assertion made in a recent study that “growth is good for the poor” is subjected to analysis and testing in the Latin American context.

# I

## Introduction

This article seeks to analyse the evolution of the income of the poor groups of Latin American society during the 1980s and 1990s. Such an analysis can be addressed from two perspectives. The first is to determine what proportion of the lowest-income households are above absolute levels corresponding to the indigence and poverty lines. The second is to analyse the share of such households in the total income of all households. Fundamentally, we will

concentrate here on the second approach, since the first one has been extensively covered in various issues of the *Social Panorama of Latin America*, published by ECLAC.

This second approach has been used recently in the study of a large set of countries made by Dollar and Kraay (2000). Here, we will review the situation of Latin America to see how far the conclusions of that study are applicable to the region.

# II

## Growth and poverty: a brief conceptual analysis

A brief conceptual analysis would appear to be in order here, in order to place this matter in the broader context that it requires.

The econometric study included in the study by Dollar and Kraay establishes a direct relation between growth and the share of the poor groups in total income, thus suggesting that growth is the determining factor. Moreover, when the relation is established over a lengthy period of time (over 20 years), the impression may be gained that that effect displays a certain homogeneity over time.

ECLAC has always recognized and stressed the importance of economic growth when addressing social problems. Indeed, in its studies it coined the term “dynamic insufficiency” to express the difficulty or impossibility of absorbing the labour force in productive jobs when growth rates are low. At the same time, however, it also emphasized some other aspects which are complementary and essential for the analysis. Thus, for example, it used the term “styles of development” to express the possibilities of achieving similar growth rates through changes in production of different natures, the aim being to achieve greater sustainability over time, greater economic dynamism and, above all, differentiated consumption structures and broader social dissemination of the fruits of economic growth.

Emphasis has also been placed in other documents on the existence of degrees of freedom, within a given form of development, to apply different types of economic policies.<sup>1</sup> Another important example of the possibility of influencing income distribution for a given growth rate is the idea of changing the size and destination of social spending.

It should also be recalled that in the 1980s and 1990s intensive reform processes were carried out in the Latin American region with the aim of changing the prevailing forms of development. Analysing the changes which the new forms of development can cause in the social dissemination of growth is therefore a matter of the greatest importance, and it has in fact been extensively explored in various issues of the *Social Panorama of Latin America*. Such an analysis involves studying the relation between growth and the income of the poor, separating the analysis into different periods when necessary. Indeed, the study by Dollar and Kraay begins with quotations from critics and defenders of the new form of development which is being installed today in the majority of Latin American countries. Its critics accuse this new form of having harmful effects on the poor, and one of the main objectives of the study

<sup>1</sup> See, for example, Calcagno and Sáinz (1992).



in question is precisely to show that this is not so. The fundamental variable chosen to show this is the proportion of income growth captured by the poor deciles.

In view of this, it seems important, before taking up the question of the amount of income captured by the poor deciles, to review some aspects which represent degrees of freedom with respect to growth within a given form of development. Thus, for example, low-income households faced with difficult situations in terms of income sometimes manage to increase the number of employed members and generate extra income by providing services which are not customary in less critical situations, while the government may be able to change the structure of public expenditure in order to increase the proportion of social spending in it and focus it on the neediest sectors. It must be borne in mind that although much of this spending is usually destined for education and health, with effects that are observed in the medium and long term, a significant portion of it has more immediate effects, as for example in the case of increases in pensions for the poor groups, monetary transfers for subsistence purposes, and increases in the number of jobs and rates of pay of the lowest-level public employees.

At the same time, the economic changes under way can also lead to changes in relative prices which have an impact on absolute poverty. These changes are not independent of the different types of policies considered acceptable within the form of development adopted. Thus, for example, exchange rate policies have varied from one country to another and from one period to

another and have had unequal effects on the evolution of relative prices, especially those affecting the consumption of the lower-income groups, such as their consumption of food. They also usually have an unequal effect on the evolution on the production of the various sectors and hence also on the level and structure of employment and on wages.

None of these factors evolve linearly with income. For a given form of development, however, there can be no doubt that higher economic growth does have positive effects on employment, income and the possibilities of expanding public expenditure.

Analysis of the evolution of economic growth and of some of the above-mentioned factors during the 1990s shows that in different countries there are different relations between economic growth and the reduction of poverty. In order to illustrate these differences, we will henceforth take the figures for the three Latin American countries which have registered reductions of over ten percentage points in the number of households in a state of poverty: Brazil, Chile and Panama (table 1). The first thing that attracts our attention is that the per capita annual growth rates of these three countries differ considerably (between 1% and 5%). Although the fall in poverty in Chile was more marked than in Brazil and Panama, the respective falls are by no means proportional to the growth rates. Moreover, there are appreciable differences between the transfer policies of the three countries, both in rural and urban areas. Thus, transfers increased significantly in Brazil, especially in rural areas, and they also increased in Panama, but they changed little in Chile.

TABLE 1

**Brazil, Chile and Panama: Indicators of growth and poverty, 1991-1997**

	Brazil		Chile		Panama	
Total poverty reduction	From 41.4 to 29.9	11%	From 33.3 to 17.8	15%	From 36.2 to 24.2	12%
Reduction in urban poverty	10%		16%		13%	
Reduction in rural poverty	19%		11%		10%	
Per capita annual growth	90-99	0.95%	90-98	5.36%	91-99	2.40%
Proportion of transfers in the income of poor urban households	1990	11.1%	1990	12.4%	1991	12.7%
	1996	15.1%	1996	12.6%	1997	17.5%
Proportion of transfers in the income of poor rural households	1990	8.6%	1990	12.8%	1991	19.7%
	1996	24.8%	1996	15.8%	1997	23.0%
Occupational density around the poverty line	1990	0.45	1990	0.31	1991	0.30
	1996	0.49	1996	0.34	1997	0.34

Another factor which is relatively independent of the economic growth rate is that comprising demographic changes and migrations. Within a given country, a given growth rate –but of different geographical origin– can give rise to different types of migrations which affect the incomes of different social groups likewise differently. If the incidence of poverty in rural and urban areas differs significantly, and if the urban areas have some capacity to absorb labour

productively, then migrations will tend to reduce the national coefficient of poverty, other conditions of the urban and rural coefficients being equal. Extreme conditions of recession or political crisis can also give rise to international migrations. In this latter case, the relation between growth and poverty takes on special features which are further accentuated if, in the medium term, those who have emigrated begin to send back remittances.

### III

## Economic growth and the income of the poor in Latin America in the 1980s and 1990s

It has already been noted that poverty is influenced by factors which depend to different degrees on economic growth and which give rise to differences in the effects that a given economic growth rate can have on poverty, and it has also been noted that the effect of these factors varies from one country to another. We will now examine the empirical evidence available in Latin America on the evolution of economic growth and the income of poor households: especially the information on the percentage of total household income actually received by poor households.

This article deals with what happened in the 1980s and 1990s in a group of 17 countries. In view of the fact that the percentages of absolute poverty in most of those countries (especially those with the largest economies and populations) range between 10% and 40% and that income distribution studies generally cover the income of the poorest 40% of the population, we will present here data on the percentages of total income received by the poorest 10%, 20%, 30% and 40% of households. Moreover, since the nature and evolution of urban poverty differ considerably from rural poverty, the two types will be examined separately.

In Latin America, the 1980s and the 1990s showed opposite signs in terms of economic growth: the 1980s was a period of recession, whereas for many countries the 1990s was a decade of growth and recovery. In most countries, these variations in income in the two decades took place in substantially different macroeconomic, institutional and hence structural contexts. This is why it is important to study the two periods separately. Moreover, there is a qualitative difference between

investigating how far the slowdown in the economy affected the poor and studying the evolution of their income in a period of positive growth.

In the 1990s most of the countries studied had a very low level of per capita growth. Nevertheless, there were changes –sometimes appreciable– in their poverty situations, so that it would appear that other factors as well as economic growth must be taken into account in order to explain the differences in the evolution of poverty in different Latin American countries.

Details of the shares of the 10%, 20%, 30% and 40% poorest households in total income are given in table 2. Information on the 1980s and 1990s is available for about half of the 17 countries studied, and data on the evolution of rural and urban income are available for most of them. These results will be examined below, first of all analysing the information given in the table and then using econometric instruments.

It will be seen from the table that there is a sharp contrast between the 1980s and the 1990s and that there are significant differences between rural and urban areas. Thus, in all the countries for which information is available on the evolution of urban income distribution in the 1980s (between 1980 and 1990), except for Uruguay and the city of Asunción in Paraguay, households in the deciles studied here, which contain the bulk of the poor population, lost shares in total household income, often significantly. Indeed, in many cases the loss up to the second or third decile was 1% or more of total income, and in some particular cases the loss up to the third or fourth decile was 3% or more. Moreover, in those countries this trend was

TABLE 2

**Latin America (15 countries): Per capita income distribution of households, 1980-1999<sup>a</sup>**  
(Percentages)

Country	Year	Share of 10% poorest in total income		Share of 20% poorest in total income		Share of 30% poorest in total income		Share of 40% poorest in total income	
		Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
		(Percentages)							
Argentina (Greater Buenos Aires)	1980	2.71	-	6.60	-	11.39	-	17.23	-
	1990	2.29	-	6.15	-	10.31	-	14.88	-
	1999	2.31	-	6.02	-	10.45	-	15.85	-
(Urban areas)	1994	2.19	-	5.17	-	-	-	-	-
	1999	2.42	-	6.09	-	10.26	-	15.35	-
Bolivia <sup>b</sup> (17 urban centres) (Urban)	1989	0.72	-	3.43	-	7.37	-	12.05	-
	1992	1.52	-	4.51	-	8.53	-	13.29	-
	1997	1.55	0.85	4.64	2.87	8.60	6.02	13.64	9.77
	1999	1.64	0.50	5.09	1.69	9.53	3.82	15.22	6.86
Brazil	1979	1.30	1.86	3.91	5.79	7.52	10.76	11.79	16.59
	1990	1.14	1.88	3.29	5.16	6.33	9.04	10.27	14.51
	1999	1.13	1.52	3.45	4.54	6.58	8.50	10.57	13.74
Chile <sup>c</sup>	1987	1.57	2.69	4.35	6.86	8.05	11.95	12.60	17.67
	1990	1.72	1.75	4.69	4.93	8.64	8.95	13.41	13.80
	1998	1.68	2.44	4.63	6.38	8.52	11.17	13.31	16.88
Colombia	1991	2.01	0.98	5.57	3.73	10.33	7.64	15.99	12.25
	1999	1.20	0.91	4.00	3.89	7.66	8.20	12.35	13.98
Costa Rica	1981	2.25	2.17	6.71	5.95	12.11	10.71	18.82	17.18
	1990	1.60	1.18	5.71	5.17	11.02	10.77	17.82	17.59
	1999	1.71	1.32	5.55	4.70	10.32	9.57	16.15	15.78
Ecuador	1990	2.05	-	5.87	-	10.88	-	17.14	-
	1999	1.45	-	4.73	-	9.04	-	14.12	-
El Salvador	1995	2.13	1.27	6.20	4.89	11.37	10.32	17.34	16.97
	1997	2.13	2.87	6.12	7.06	11.21	12.69	17.81	19.38
Guatemala	1989	1.02	1.20	3.66	4.39	7.39	8.77	12.10	14.41
	1998	2.05	2.21	5.45	5.50	9.45	9.85	14.69	15.22
Honduras	1990	1.46	1.42	3.93	4.25	7.38	8.35	12.81	13.13
	1999	1.49	1.25	4.50	4.42	8.93	9.03	14.63	14.31
Mexico <sup>d</sup>	1984	3.15	2.94	7.80	7.80	13.67	13.78	20.11	20.25
	1989	2.47	2.71	6.20	7.04	10.96	12.35	16.25	18.68
	1998	2.77	3.00	6.74	7.46	11.65	12.46	17.22	17.95
Panama	1979	1.17	2.82	4.68	6.64	9.52	11.73	15.48	17.85
	1991	1.06	1.89	3.86	5.38	8.01	9.67	13.30	14.96
	1999	1.57	2.33	4.75	6.02	8.96	10.86	14.19	16.24
Paraguay (Asunción)	1986	2.39	-	6.35	-	11.25	-	17.39	-
	1990	2.59	-	7.05	-	12.48	-	18.94	-
	1999	2.92	-	7.03	-	11.93	-	18.64	-
Uruguay	1981	2.72	-	6.78	-	11.87	-	17.68	-
	1990	3.49	-	8.18	-	13.82	-	20.11	-
	1999	3.60	-	8.73	-	14.81	-	21.59	-
Venezuela <sup>e</sup>	1981	2.54	3.05	6.97	7.69	13.09	13.67	20.20	20.75
	1990	2.00	2.74	5.67	7.10	10.87	13.17	16.77	19.83
	1999	1.19	-	4.42	-	8.97	-	14.55	-

Source: ECLAC, on the basis of special tabulations of household surveys of the respective countries.

<sup>a</sup> Calculated on the basis of the distribution by deciles of per capita household income.

<sup>b</sup> The 1989 survey covers the eight departmental capitals and El Alto. This survey also includes eight cities representing altogether 8.2% of the total.

<sup>c</sup> Calculations based on the national socioeconomic profile surveys (CASEN) for 1987, 1990, 1994, 1996 and 1998. Estimates in line with new figures from the household income and expenditure account provided by the Ministry of Planning and Cooperation (MIDEPLAN).

<sup>d</sup> Data from national household income and expenditure surveys (ENIG).

<sup>e</sup> As from 1997, the census sample design no longer permits a rural-urban breakdown. The figures therefore correspond to the total for the whole country.

observed not only for the group of households below the poverty line but for all households without exception in the poorest 10%, 20%, 30% and 40% of households.

It should be recalled that Latin America is noted for its poor income distribution, and therefore the amounts received by these low-income households are extremely small. Thus, in urban areas the poorest decile receives only between 1% and 2.5% of the total income in the great majority of the countries, while the poorest 40% of households receive between 10% and 20%. This helps to place in its proper context the seriousness of, for example, losing three percentage points in a period of recession, as occurred in some countries in the case of the poorest 30% and 40% of households. It also helps to weigh the question of whether it can be considered a success for the poor when they merely maintain their share in total household income.

In urban areas of Brazil, Guatemala, Mexico and Panama, the 1990s witnessed a partial recovery of the ground lost in the 1980s, but in Ecuador and Venezuela the situation continued to deteriorate. In Argentina the situation of the poorest 20% of households remained unchanged or suffered a slight deterioration, but there was a partial recovery at the level of the poorest 30% and 40%. In Costa Rica the situation of most of the poorest 40% of households deteriorated. It may thus be seen that in these countries there was marked asymmetry between the size of the losses in the 1980s and the magnitude of the recovery – if any – in the 1990s. This would appear to show that in many cases the poor were receiving smaller percentages of total income at the end of the 1990s than at the beginning of the 1980s.

Information for Chile is only available for the 1990s, when the percentage share of the poor remained unchanged in a context of rapid growth of per capita GDP, so that the elasticity was very close to 1.

When analysing the situation in rural areas, it should be remembered that the evolution of the income of dwellers in such areas is not as closely associated with global economic growth as in urban areas and also that in rural areas internal and international migrations may have had different effects. In order to avoid possible distortions, the percentage shares used have been calculated with respect to the total income of rural households.

Among the few countries for which information is available on rural areas for the 1980s, the share of the poorer sectors went down in Brazil, Mexico, Panama and Venezuela, while it remained unchanged in Costa Rica. This occurred even though the per capita income of rural households as a whole did not go down in

Panama and remained unchanged in Brazil. If the analysis is extended beyond the households with a per capita income close to the poverty line, it is noted that in the first four countries the decline affected all of the first four deciles, except in the case of the first decile in Brazil, whose share remained unchanged. In Costa Rica, where households under the third decile maintained their share, there was a decline in the shares of those under the second decile but an increase in the share of the fourth decile.

The figures for rural income distribution in the 1990s show that there was a decline in the shares of all deciles in Brazil and of most deciles in Costa Rica, whereas the shares of the first three deciles recovered in Mexico and the same occurred in the case of all four deciles in Panama, all this taking place in the context of an increase in the average income of rural households as a whole. Among the countries for which figures are only available for the 1990s, there was a significant improvement in the shares of all deciles in Chile, Guatemala and Honduras and in those of the second to fourth deciles in Colombia.

On the basis of these same figures, a broad econometric study was carried out, covering both rural and urban households in the 1980s and 1990s. Basically, two types of regressions were prepared. The first one was effected by studying the relation between the per capita income of the 10%, 20%, 30% and 40% poorest urban and rural households and the corresponding per capita income of all households, both measured in terms of the respective poverty lines.<sup>2</sup> The second regression was carried out by studying the annual rate of variation of the average per capita income of households in the poorest 10%, 20%, 30% and 40%, as a function of the annual growth rate of the average per capita income of all households. Both rates were deduced from consecutive observations for each country. In both cases the regressions were estimated for rural and urban areas.

The cases considered are those included in table 2, adding the available intermediate years. Obviously, the number of observations is a good deal larger for the first type of relations than for the second.

The specifications used for these types of relations were of the following type:

$$\text{LOG ING}_i = a + b \text{ LOG ING} + \varepsilon \quad [1]$$

$$\text{TING}_i = c + d \text{ TING} + \varepsilon \quad [2]$$

<sup>2</sup> The data for each year are expressed in current prices, so that the shares are not affected by the poverty lines. When the data for different years are placed together, however, the poverty lines act as deflators.

where

$ING_i$  = per capita income of households  $i$  in which  $i = 10\%, 20\%, 30\%$  and  $40\%$ .

$ING$  = per capita income of all households.

$TING_i$  = annual growth rate of per capita income of households  $i$  in which  $i = 10\%, 20\%, 30\%$  and  $40\%$ .

$TING$  = annual growth rate of per capita income of all households.

Equations [1] and [2] were estimated separately for the urban and rural sectors.

These relations make it possible to analyse the main subject raised in the study by Dollar and Kraay, namely, the changes in the share of the poor in total household income when the latter varies. As may easily be understood, as the first type of relations place different countries and years together, they reflect both the effect of differences in income between countries and that of the evolution of income over time within a country, and this makes it more difficult to interpret the results.

It has repeatedly been shown in many studies, especially those by ECLAC, that the relation between the level of income and the quality of income distribution is neither simple nor, much less, linear. The second type of relation (using rates) is conceptually sounder, since all the observations refer to growth rates within a country and are measured in a homogeneous dimension which does not incorporate differences in income between countries.

It should be noted that, unlike in Dollar and Kraay (2000), it was not necessary here to estimate data on the basis of assumptions, as the information was available from the ECLAC data base. Among the available household surveys it was possible to select those measuring income in the 1980s and 1990s for 17 countries. The income was edited in all cases using additional information, especially from national accounts. It was also possible to present rural and urban areas separately and to refer the shares of groups of households to the total income of the corresponding urban and rural households, without needing to refer to the total income of the whole economy.

The equations of type 1 were estimated for the 1980s and 1990s and for both decades together. Because of the nature of each observation, it is not known whether the point corresponding to it refers to a period of growth or recession. If we separate the 1980s and 1990s, however, we know that periods of recession predominated in the former, while the opposite was the case in the latter. Because of the smaller amount of

observations and the fact that working with rates clearly indicates whether each observation corresponds to growth or recession, the regressions for the equations of type 2 were only made for the two decades taken together.

The results of the regressions for the type 1 equations were generally good or acceptable; those for the type 2 equations were not of such good quality for urban areas and were of poor quality for rural areas.

Table 3 gives the values of the coefficient  $b$ , which represents an estimate of the income elasticity of the different groups of households with respect to total income, both for the 1980s and the 1990s. In addition, in order to be able to compare these results with those of other studies which simultaneously include the data for all the years available, estimates are included for both decades together.

All the estimates of coefficient  $b$  were statistically significant at the 1% level. When the results for urban areas for the 1980s and 1990s together are analysed, the elasticities (combining inter-temporal and inter-country effects) for the poorest 10%, 20%, 30% and 40% of households range between 1.00 and 1.10. It is worth noting that the value estimated for the 20% poorest households (1.03) is close to the elasticity obtained by Dollar and Kraay (2000).

In the case of Latin America, however, when the 1980s and 1990s are examined separately it is seen that the elasticities for the period of income recession (the 1980s) are between 1.20 and 1.42, so that it may be concluded, in so far as the regression includes both the

TABLE 3  
**Latin America (17 countries): Elasticities of income of poor households with respect to total income<sup>a</sup>**  
(Coefficient  $b$ )

	1980-1989		1990-1999		1980-1999	
	$b$	$t$	$b$	$t$	$b$	$t$
<b>Urban areas</b>						
INGU 10/INGU	1.42	5.03	1.03	10.00	1.10	10.02
INGU 20/INGU	1.27	6.06	0.98	11.31	1.03	12.75
INGU 30/INGU	1.26	7.20	0.96	13.93	1.01	15.37
INGU 40/INGU	1.21	7.64	0.95	15.31	1.00	16.86
<b>Rural areas</b>						
INGR 10/INGR	1.36	5.65	1.31	7.49	1.34	8.45
INGR 20/INGR	1.21	8.59	1.28	9.38	1.28	10.61
INGR 30/INGR	1.07	6.70	1.18	9.74	1.19	11.30
INGR 40/INGR	1.15	9.67	1.17	11.46	1.17	13.16

<sup>a</sup> INGU: urban income; INGR: rural income.

variations between countries and within each country, that the economic downturn was extremely unfavourable for the poor. When we look at the 1990s, we see that the respective elasticities are between 0.95 and 1.03, so that, in general terms, during economic growth this group continued to receive shares similar to those registered after the losses of the 1980s.

This separate treatment of the 1980s and 1990s leads to a conclusion which is the opposite to that deduced if they are considered together. Thus, it might be concluded from analysis of the two decades together that growth is neutral for the income shares of the poor groups. When they are analysed separately, however, this confirms what was said in ECLAC's studies: namely, that there is a marked asymmetry between periods of recession and those of growth. In the former, income distribution becomes even worse for the poor, while in the latter it displays rigidity.

At all events, caution is called for in drawing conclusions from these elasticities, because as already noted, combining cross-temporal and cross-country observations can lead to conclusions which are not applicable to any country in particular. Moreover, this result does not coincide with the country study made earlier.

It would appear to be more interesting to study the second type of relations, which, as already noted, do not suffer from the problem of the different income levels of the countries. Analysis of the results of these estimates raises econometric problems, however, since only coefficient *d* (the angular coefficient) is statistically significant. This coefficient shows that the relation between the growth rates for urban areas is always significantly less than 1. As may be seen from table 4, the values of *d* for the different groups of households range between 0.76 and 0.86. This means that for the 1980s and the 1990s taken together, the growth rate of the income of the lowest-income households is in all cases between 15% and 25% less than that of total household income.

TABLE 4

**Latin America (17 countries): Growth rate of income of poor urban households compared with growth rate of total income, 1980-1999**  
(Coefficient *d*)

TINGU 10/TINGU	0.805
TINGU 20/TINGU	0.763
TINGU 30/TINGU	0.855
TINGU 40/TINGU	0.830

This result is contrary to the findings of Dollar and Kraay (2000), and it makes it clear that in urban areas the growth in the per capita income of the lowest-income deciles was significantly lower than that of the per capita income of all households taken together. This finding should not come as a surprise to analysts of Latin American income distribution in the 1980s and 1990s.

For the countries for which figures are available on the 1980s and 1990s (Argentina, Brazil, Costa Rica, Mexico, Panama, Uruguay and Venezuela), the annual growth rates of per capita income were calculated for urban households as a whole and for the poorest 10%, 20%, 30% and 40% among them (table 5).

The results show that in Argentina total income virtually stagnated and the growth rates for the various groups ranged between -1.5% and -2%. In Venezuela, where total income suffered declines of -2.5% per year, the incomes of the different groups went down by between -4% and -6%. In the cases of Brazil, Costa Rica, Mexico, Panama and Uruguay, where total household income grew by between 0.8% per year in Uruguay and 1.9% per year in Panama, the income growth of practically all the lower-income groups was lower than this, except in Uruguay and in the case of the poorest 10% and 20% in Panama. The long-term evidence (covering over 14 years in the cases studied) thus fits in perfectly with the results of the regression.

TABLE 5

**Latin America (seven countries): Household per capita income, 1980-1999**  
(Growth rates in percentages)

		Total	Poorest 10%	Poorest 20%	Poorest 30%	Poorest 40%
Argentina	1980-1999	0.02	-2.04	-1.83	-1.65	-1.50
Brazil	1979-1999	1.27	0.34	0.34	0.45	0.48
Costa Rica	1981-1999	0.88	-0.20	0.10	0.03	0.05
Mexico	1984-1998	1.04	0.06	-0.17	-0.26	-0.35
Panama	1979-1999	1.87	2.97	2.15	1.84	1.69
Uruguay	1981-1999	0.78	1.29	1.64	1.22	1.19
Venezuela	1981-1999	-2.54	-6.21	-4.88	-4.41	-4.13

## IV

### Interpretation of the econometric results

The analysis presented in the foregoing pages warrants some reflections on the use of econometrics in the study of these matters. The study by Dollar and Kraay repeatedly tests the hypothesis that the value of 1 cannot be ruled out for the income-elasticity of the amounts received by the poorest deciles and for the value of the coefficient linking the income growth rates of the poorest deciles to total income. This means asserting that, in the light of the evidence from the sample studied, it cannot be dismissed with a sufficient degree of confidence that a value of 1 is a possible figure for the population of the sample.

It might be asked what need there would be to test hypothesis 1 in the case of a Latin American analyst working with the data with which this regression has been prepared, in which the significance of the total population with respect to the sample is by no means clear. Indeed, on the basis of the available data there can be no doubt that in the great majority of the Latin American countries the poor deciles did worse in terms of income than the total universe of households, both in the 1980s and the 1990s. It could be argued that in some cases the recovery in the 1990s corresponded to a rigid form of evolution of income distribution which

could back up the hypothesis of a coefficient with a value of 1. However, for a number of countries which went through crises in the 1990s this hypothesis does not seem to have much point. Moreover, nothing indicates that there could be any substantive interpretation of this hypothesis applicable to the 1980s and 1990s as a whole.

If the hypothesis of a particular value for the coefficient  $d$  is put to the test, the results obtained on the basis of the available data would indicate –with a coefficient of confidence of 95%– that acceptable values (i.e., values that could not be rejected) which could be taken as probable “certain” values of the population parameter would be those coming within the following ranges for the four urban equations studied:

Equation for the poorest 10%:	0.40 to 1.22
Equation for the poorest 20%:	0.51 to 1.01
Equation for the poorest 30%:	0.64 to 1.08
Equation for the poorest 40%:	0.63 to 1.03

Consequently, an analyst who used econometrics in this way in order to prove that 0.75 is a feasible value for the respective population parameter could accept the hypothesis just as easily as for the value 1.

## V

### Conclusions

Latin America's per capita GDP went down in the 1980s and grew only slowly in the 1990s. The question that arises with respect to the 1980s is therefore whether this decline in GDP adversely affected the income of the poor more, equally or less than the income of the other strata. The answer is that in the great majority of countries it affected the poor more. The slight recovery of growth in the 1990s only enabled the poor to recoup part of their losses, and even in the country with the highest growth rate distribution was rigid, so that the poor strata only managed to maintain their previous share. This illustrates the Latin American asymmetry

between crises and periods of growth: concentration of income in the former and rigidity in the latter. Another aspect worthy of attention is the very small proportion of total income received by the poorer groups, so that it is doubtful whether merely maintaining their share of total income is “good” for them, unless they simply resign themselves to this situation. Finally, it has been shown that in the 1980s and 1990s, for the majority of countries for which information is available, which account for the bulk of the region's population, the incomes of the poorest 10%, 20%, 30% and 40% of households grew significantly

less than total household income. With regard to the total group of countries for which information is available, whether for the 1980s or the 1990s, an econometric study shows that the relation between the

income growth rates of the urban deciles studied and total household income was between 0.76 and 0.85.

*(Original: Spanish)*

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# **Seduced and abandoned:** *the social isolation* **of the urban poor**

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This article examines the effects that some recent changes in the social structure of the early-developing Latin American countries have had on the social isolation of the urban poor.

These changes mainly concern the labour markets and some opportunity structures which are the source for the formation of human resources and social capital. It is argued here that, as a result of these changes, the links of the urban poor with the labour market have been weakened and their areas for informal socialization with persons of other social classes have been made smaller, thus leading to their progressive isolation. The article also analyses the reduction of opportunities for accumulating individual and collective social capital and civic capital and examines the particular characteristics assumed by the processes of residential segregation in the big cities of the countries studied.

## I

## Introduction

Most of the public policies carried out in the countries of the region in order to improve the well-being of the urban poor have neglected the problems of their integration into society and have acted as though merely improving their living conditions would enable them to establish (or restore) significant links with the rest of the community. It is only in recent years, as the worsening of the problems of social segmentation which have accompanied the application of the new growth models has become evident, that the discourse of academics and social policy-makers has begun to reflect a concern for the problems of social isolation of the urban poor and the mechanisms that further and support such situations, over and above consideration of their economic constraints and specific needs. Thus, the incorporation into the specialized vocabulary of such notions as exclusion, disaffiliation, disvalidation, fragmentation and the like reveals the concern over the growing proportion of the population which, as well as being linked with the labour market in a precarious and unstable way, is increasingly isolated from the mainstream<sup>1</sup> of society. Whatever the term used for it, this phenomenon implies fragile –or in extreme cases non-existent– links between the urban poor and persons and institutions who guide their own actions by the norms and values prevailing in society at a given moment in time.

One virtue of these approaches is that they incorporate the social structure as an explicit element of the conceptual framework within which they interpret

the phenomena of poverty. The location of the poor within this structure varies not only according to the size of the gaps separating them from other social categories in the labour market, but also according to the degree of segmentation in terms of the quality of all kinds of services and the degree of residential segregation. These considerations make it possible to broaden the field of understanding poverty phenomena beyond schemes that see them merely as a result of the ups and downs of the economy or of the stock of resources of households and their capacity for mobilizing them efficiently, and at the same time they open up expectations about the possibility of formulating policies to deal with those phenomena in a more integral manner than in the past.

In the following pages we will put forward some hypotheses about the nature and determinants of the social isolation of the urban poor, in the hope that the results of their testing will help to make anti-poverty programmes more effective. It goes without saying that, since there has as yet been very little research on these matters in the countries of the region, most of those hypotheses are still at an embryonic stage.<sup>2</sup>

Among the factors that most powerfully affect the changes taking place in urban poverty in the region are the changes which are occurring in the labour markets. Under the influence of the processes of de-industrialization, reduction of the size of the State sector and the rapid incorporation of technological innovations in some areas of activity, the proportion of stable, protected jobs is going down, the income gap between skilled and unskilled workers is widening, and the problems of unemployment and underemployment are getting worse, particularly for the unskilled sector of the labour force.<sup>3</sup> Unless there are policies specifically designed to prevent this from happening, the widening

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<sup>1</sup> The expression "mainstream" refers to that sector of society whose aspirations for social integration and mobility are directed through institutional channels and whose behaviour and expectations are in keeping with the prevailing norms and values. The word "prevailing" usually has the connotation not only of the power and prestige of this sector, and hence their capacity for spreading norms, values and models of behaviour, but also their numerical weight in society.

<sup>2</sup> Some results of studies made in Argentina and Uruguay may be found in Kaztman (1997), Kaztman (ed.) (1999), and Kaztman and others (1998).

<sup>3</sup> These connections must not be interpreted in an automatic manner, of course, since different States display different dispositions and capacities –usually reflecting collective values deeply rooted in their institutional systems– to take measures to soften the impact of the economic changes on poverty and inequality. Even so, it cannot be denied that the evidence built up in the developed

of the income gaps between segments of the urban population will further increase the social distances between the poor and the non-poor.

There are, of course, many explanations for the way disparities in income become social disparities. Perhaps the simplest of these is that which holds that, as favoured households depart from the average level of income of the population, their propensity to acquire in the market services of better quality than the collective average increases. When this form of behaviour extends to basic services such as transport, education, public safety, health and recreational services, at least three important changes take place in the social structure, which heighten the mechanisms causing the social isolation of the urban poor. Firstly, there is a reduction in the areas for informal socialization between different classes provided by the fact of using the same services. Second, there is also a reduction in the domain of common problems faced by households in their daily life. Third, public services lose the important support they previously enjoyed through the interest of the middle strata (where those with "voice" are concentrated) in keeping up the quality of the services they use. This gives rise to a vicious circle of growing differences in quality between public and private services which tends to lead to a further deterioration in the position of the poor compared with the rest of society.

Differences in income and in the degree of job protection and stability are also reflected in the location of the different classes in the urban territory. Thus, as we shall see later, one of the most obvious expressions of the reduction in the areas of informal interaction between the different socioeconomic strata is the progressive polarization of the social composition of neighbourhoods.

The result of these processes is growing social isolation of the urban poor from the mainstream of society. This isolation becomes a serious obstacle to the accumulation of the assets needed in order to cease to be poor, so that socially isolated urban poverty is a copybook example of social exclusion.

In the following sections we will examine some of the most important processes which are currently joining together to produce the three changes in the social structure referred to above, namely, the increase in the proportion of the economically active population with only precarious and unstable links with the labour market; the progressive reduction in the public areas that enable informal contacts to be made between the classes on an equal footing, and the growing concentration of the poor in segregated areas of the urban territory. The first of these processes is connected with the increasingly precarious and unstable nature of the labour markets; the second, with the segmentation of services (especially education), and the third, with residential segregation. Box 1 summarizes the main working hypotheses regarding each of these processes.

In order to simplify the presentation, box 1 does not mention other basic services, but health, transport, public safety and areas of collective recreation and leisure, as well as others, all represent areas of interaction, with their own specific mechanisms of integration and segmentation. Each in their own way, these go to make up the structure of opportunities on which the assets of the poor depend, and thus help to define the place of the poor in the social structure of the city.

We will now comment in greater detail on the nature, determinants and consequences of segmentation in the fields of employment, education and residence.<sup>4</sup>

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countries tends to indicate that the different types of welfare arrangements, while admittedly softening the impact of globalization on the households with the fewest social assets, are not sufficient to alter the general direction of the trends. As Esping-Andersen (1999) points out, maintaining more equitable types of income distribution is usually effected at the cost of high rates of unemployment, while in cases where unemployment rates are low, inequality is usually higher. These observations make one suspect that the tension between equity and full employment may be an inherent phenomenon in the application of the new style of economic growth.

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<sup>4</sup> The terms "differentiation", "segmentation" and "segregation" are used in different parts of this article, so it is worth clarifying at this point the exact meaning assigned to each of them. The first term simply refers to differences between the attributes of two or more social categories. The second means that there are not only such differences, but also barriers to movement from one category to another, while the third term means that there are not only such differences and barriers, but also a desire by the members of one or another category to maintain or raise the barriers separating them.

## Box 1

POSSIBLE INCIDENCE OF DIFFERENT TYPES OF SEGMENTATION OF THE SOCIAL STRUCTURE ON THE FORMATION OF ASSETS WHICH COULD RELIEVE TENDENCIES TOWARDS THE ISOLATION OF THE URBAN POOR

Type of segmentation	Individual social capital	Collective social capital	Civic capital
In the area of employment	Reduces the probability of having networks of information and contacts which facilitate the search for work.	The separation of the places of employment which hire those who have "voice" reduces the strength of the labour institutions and demands of the urban poor.	Work ceases to act as the main link that gives a feeling of belonging to society. The acquisition of rights as a citizen is affected. Feelings of citizenship are weakened because the poor do not share the problems and fate of mainstream workers.
In the area of education	There is a weakening of: i) the formation of feelings of reciprocity and solidarity; ii) the possibility that those who have more will be aware of the merits of those who have less and will form links of loyalty with them; iii) the possibility of incorporating middle-class habits and attitudes regarding mobility, through education.	There is a decline in the participation by the parents of middle-class students in public education and their influence on maintaining the quality of such services is reduced.	There are fewer opportunities for poor students to experience belonging to a community where they have the same rights and obligations, similar problems and similar rewards for merit as their peers from other classes.
In areas of residence	Less information and fewer contacts. Less normative efficiency. Less exposure to role models.	Danger of decline of neighbourhood institutions for lack of leadership.	Weakening of feeling of citizenship because of not sharing neighbourhood problems with other classes; danger of formation of marginal subcultures.

## II

### Labour segmentation

For the purpose of the analysis which we are about to make, it is worth bearing in mind the observations summarized in box 1 on certain aspects of the stock of assets of the urban poor which could be affected by the changes taking place in the labour market which have an incidence on their degree of social isolation or integration:

- i) Individual social capital: the workplace is a prime place for building up networks of friends, through which resources are received in the form of contacts, information and facilities for gaining access to various kinds of services.
- ii) Citizenship in both its subjective and objective aspects: this too is a prime area for generating

subjective elements in this respect by sharing problems, consolidating identities, bolstering self-esteem and building a common destiny. It is also an area of prime importance, however, for acquiring objective rights of citizenship through labour-related gains such as the expansion and improvement of the social benefits usually associated with the role of a wage worker.

- iii) Collective social capital: stable participation in an establishment with workers of different levels of skills increases the opportunities of the less-skilled workers for gaining access to institutions which will efficiently defend their interests as workers and preserve the rights they have already gained.

One of the central features of the present economic restructuring process is that the minimum levels of skills demanded for participation in the formal labour market are rising in line with the ever-faster rates of technological innovation and the need for world-level productivity and competitiveness. This usually means a drastic devaluation of the skills that workers have managed to acquire in the workplace and an equally drastic reduction in their possibilities of participating in the formal market and in the kind of employment where the type of assets referred to can be accumulated. At the same time, intensive processes of de-industrialization and reduction of the size of the State sector take place, with a consequent reduction in the proportion of stable and protected jobs and a corresponding increase in the services sector, especially personal and consumer services. As the distribution of income and skills in the services sector is more polarized than in industry, however, the massive transfer of labour from one sector to the other is linked with an increase in inequality in terms of income and working conditions.<sup>5</sup> Moreover, many personal and consumer services activities may be viewed as extensions of housework, so that they offer very little room for increasing productivity. As Esping-Andersen (1999) argues, citing Baumol (1967), these two characteristics expose these activities to the danger of cost disease, thus making them intrinsically precarious and unstable.

In order to appreciate how important these processes are for Latin American workers, it is sufficient to bear two facts in mind. The first is that the present tendency towards more precarious employment is to be observed in societies which have moved from the predominance of interactions governed by "mechanical solidarity" to the predominance of "organic solidarity" (Durkheim, 1964). This means that with the greater division of labour, and under the effect of the need for interdependence generated by the processes of differentiation and specialization, the main mechanism for integration in society was shifting from the primary institutions (the family and the community, for the most part) to the world of work, thus giving grounds for

hoping that, as in the early-industrialized nations, work would become the main means for integration into society and for the formation of identity and self-esteem.

This promise seems to have been losing validity, however, for the growing mass of population which, in the new global economic context, is not able to establish a sufficiently stable and protected relation with the labour market to serve as a basis for social integration processes. For these groups, work ceases to be the main activity on which the rational construction of everyday life is based. There is a weakening of the role of work as a shaper of identities and a generator of forms of solidarity in the working community and the institutions deriving from it, and, in so far as the reduction of stable forms of participation in the market and the weakening of the related organizations close off important sources of the construction of rights, it also loses relevance as a promoter of citizenship.

The second fact connected with the effects of more precarious and unstable employment on the living conditions of the urban poor has to do with the type of welfare system prevailing in the region.<sup>6</sup> Although none of the countries of Latin America have systems of social benefits of such a level of coverage, quality and organization that they could be described as "welfare systems" in the sense assigned to them by Esping-Andersen (1990 and 1999), the embryonic systems which have been established in the region have followed patterns which are closer to the "conservative" model followed in continental Europe, with emphasis on the procurement of rights through work, than to the "social-democratic" model of the Scandinavian countries, based on the idea of universal rights of citizenship, or the liberal model of the Anglo-Saxon countries, with its focus on the provision of safety nets for the poor and marginal sectors. In this sense, the institutions of the region responsible for the socialization of risks are poorly prepared for protecting a population with only precarious and unstable links with the labour market.

The State undoubtedly has a vital part to play in determining the effects of economic restructuring on labour segmentation. A guaranteed social wage reduces the urge to accept unattractive types of work such as unskilled jobs in the services sector. Public employment programmes make possible the temporary absorption of workers displaced by technological progress in jobs

<sup>5</sup> A very extensive debate is in progress on the effects of de-industrialization on inequality (see, for example, Sassen (1999), Mollenkopf and Castells (1991), Hamnett (1998), and Musterd and Ostendorf, eds. (1998)). One of the main features of this debate is that little consideration is given to the processes which could be influencing the increase in income inequality and which are connected, *inter alia*, with changes in tax systems, social benefits, unemployment, household structure or the age structure of the population. The question of action by the State is a central issue in this critical analysis.

<sup>6</sup> By "welfare system" we mean the more or less organized arrangements for protection against social risks provided by the institutions of the State, the market, the family and the community (Esping-Andersen, 1999).

related with the functioning of different services. Changes in the tax system can activate potential sources of employment. In general terms, the State can measure out and balance the coverage and size of the resources it transfers to the social groups most affected by the economic reforms, making them more or less gradual and displaying a greater or lesser intention to limit their concentrative effects. Taking these factors into consideration helps in understanding the differences that exist between developed countries with different

welfare systems in terms of changes in income distribution and the relative weight of informal activities. It must be borne in mind, however, that even studies that lay stress on the differences between such systems recognize that, under the pressures arising from both the need to improve productivity and the changes taking place in demographic structures, there are signs of a retrenchment in social security coverage even in countries which had distinguished themselves by their advances in this field.<sup>7</sup>

### III

## Segmentation in education

The increasingly vital role of knowledge as a means for the progress of nations confirms the importance traditionally attached to education as the main means of social mobility and a key area for the social integration of the new generations. This role has repeatedly been stressed in the declarations of Presidential summit meetings in recent years, where the top public policy makers have agreed that equity in the first years of life must form part of the central core of values of the models guiding development in Latin America and that concentration of the resources of educational systems on children from homes of low social and cultural level is one of the most efficient ways of breaking the mechanisms responsible for the reproduction of poverty and social segmentation.

It seems paradoxical, however, that at the same time that they are enouncing these principles many societies of the region are going through an unparalleled process of stratification of their educational circuits.<sup>8</sup> It seems obvious that the educational system can hardly be qualified to help in lifting the social burden of poverty and inequality and offsetting the growing segmentation of employment if it is segmented itself. This is

undoubtedly one of the main problems of the present social dilemma in many Latin American countries.

In order to gain a better understanding of the importance of the social composition of places of education for the integration of the new generations, we need only consider the fact that –apart from the periods of compulsory military service, in the few countries where such conscription exists and really is universal– there are very few institutions that all citizens must pass through and which give persons of different social origins an opportunity to interact with each other for a lengthy period of time on a footing other than that of employment contracts or the commercial exchange of goods and services. Thus, the educational system is the main –and often the only– institutional area which can act as a melting pot, through its potential for generating contexts in which poor children and adolescents have the possibility of maintaining a daily relationship with their peers from other strata and developing with them common codes and links of solidarity and affection on an equal footing.

If the rich go to colleges for the rich, the middle class go to colleges for the middle class and the poor go to schools for the poor, it seems obvious that there is little the educational system can do to promote social integration and obviate marginality, whatever efforts it may make to improve the educational opportunities of those with less resources.<sup>9</sup> It is therefore important not

<sup>7</sup> With regard to the case of France, see White (1998); for Germany, Friedrichs (1998); for Belgium, Kestellot (1998) and for Sweden, Borgegard, Anderson and Hjort (1998).

<sup>8</sup> So much so that in many countries of the region the awareness of such stratification causes many parents to go through a stage of great anxiety when they try to get their three or four year old children into certain kindergartens (where the infant candidates even have to take an entrance examination) because this will subsequently enable them to continue in an educational circuit made up of schools and colleges with high-quality teachers and equipment, which will in turn open the doors of the best universities for them.

<sup>9</sup> When considering these problems, it should be borne in mind that the distinction between paid and free and between public and private establishments does not cover all the forms that educational segmentation can take. Both the quality of these services and the social homogeneity of those attending them may be and usually

only to stress the contribution that the educational system makes to equity through greater equality of access but also its contribution to social integration by creating conditions that facilitate interaction between non-equals on terms of equality.

Going on now to consider the summary picture given in box 1, it can be said that the educational system can make an important contribution to equity in the distribution of social capital assets, by facilitating the establishment of student networks of heterogeneous social composition. For poor students, these networks are stores of reciprocity, confidence and loyalties which can be activated when the time comes to enter the labour market, through the mobilization of the "credits" accumulated with their more influential peers when they were studying together and the direct knowledge that the latter have of their merits (Flap and Graaf, 1986). Believing that merit alone will aid in social mobility is a fallacy that only comes true in exceptional circumstances. It is social contacts that help to exploit the full potential of human capital and, since they give a reasonable degree of certainty that it will be possible to obtain suitable employment, this provides a motive for continuing to invest in the development of such capital.

Likewise, in view of the impact usually caused by the exodus from the public educational system of the

middle-class elements who have "voice", any initiative which prevents an increase in educational segmentation will, on the one hand, make an indirect contribution to the collective social capital of poor students, by reducing or halting the deterioration of that system compared with the private system, while on the other hand it will aid in the early development of feelings of citizenship among poor students, based on their participation on an equal footing in an educational community shared with their peers from better-off households, which will give rise to shared identities and goals, positive attitudes of recognition of others as holders of rights, and feelings of moral obligation extending to their companions of different social, religious, ethnic or national origin. In other words, the contribution of a person's schooldays to his formation as a citizen will be all the richer when the social composition of the student community of each school is closer to that of the national community as a whole. In contrast, when there is greater segmentation among educational establishments, this will increase the likelihood that the members of a given social stratum will only come face to face with the members of other strata in the labour market, where relations are governed by the hierarchical patterns typical of the organization of the world of work.

## IV

### Residential segregation

Residential segregation refers to the process whereby the population of cities tend to congregate in socially homogeneous areas. Among the most important factors considered to influence this process are the degree of urbanization and the degree of poverty in urban areas, the degree of concentration of income distribution, the

nature of the pattern of social distances typical of each society, and the homogeneity or heterogeneity of the ethnic, religious or nationality-related composition of the urban population.

are accompanied by the effects of the processes of residential segregation, so that the fact that better-off children may attend a public school is no guarantee that the educational system is carrying out its social integration function. Some politico-administrative arrangements may have the same effect, as in the case of some counties in the United States where the financial autonomy of the municipalities seems to completely neutralize the objective of integration (Massey, 1996), since if those that do not belong to a prosperous community cannot make use of its public services the results in terms of the segregation of society may be similar to those that would occur if those services were private.

Many analysts of the situation existing in this respect in the United States, and also in the big European urban centres, have drawn attention to the concentration of the poor in certain neighbourhoods which have an unprecedented concentration of material deprivation that contrasts strikingly with the equally unprecedented spatial concentration of rich households in other neighbourhoods. In the opinion of these analysts, the relative weight of the population affected and the seriousness of the consequences of this situation on their opportunities of integrating into society and on the general health of the fabric of society are such that the residential segregation affecting the urban poor should

be given priority attention by those responsible for formulating social policies (Massey, 1996; Wilson, 1997, and Wilson (ed.), 1993).

Although they only deal with a clearly insufficient range of determinants, the efforts which have been made to measure residential segregation, basically in terms of the urbanization of poverty and the increase in urban density (Massey, 1996) are useful for bringing out the importance and historical singularity of the concentration of the poor in the cities as a necessary condition for setting in motion the mechanisms that may eventually lead to their social isolation. A further contribution they make is that they provide a simple explanation for the formation of subcultures which depart from the mainstream of society. According to the theory of Fischer (1975), such subcultures arise naturally from the spatial concentration of categories of people who share similar characteristics, and the mere fact of greater intra-group accessibility favours the formation of normative patterns that reflect those common features.<sup>10</sup>

### 1. A typology of lower-class urban neighbourhoods

Of course, it may be argued that the lower strata of the big cities have always tended to congregate in neighbourhoods that are different from the rest because of the average socioeconomic level of their inhabitants as well as a set of special features associated with the patterns of interaction that exist within the neighbourhood and between it and the rest of the city: a set of features which, although this might be an exaggeration in many cases, could indicate the presence of a subculture. If this is so, it might be asked why it is that social isolation, unlike other examples of spatial concentration of lower-class urban strata, is now presented as a central characteristic of the new cases of residential segregation of the urban poor.

In order to facilitate the search for answers to this question, box 2 presents a typology of lower-class urban neighbourhoods, defined in very broad terms. The types of neighbourhoods were ordered according to the hypothetical degree of openness to individual or

collective mobility prevailing at the time when these neighbourhoods were growing up. As will readily be gathered from this box, it is based on the assumption that a knowledge of the changes taking place in the structures of opportunities which are most important for unskilled and semi-skilled workers is essential in order to understand the different kinds of poor urban neighbourhoods.

Before going on to examine each of the cells in box 2, however, readers should be aware of its limitations in at least two important respects. Firstly, this scheme stems from consideration of the history of urban changes in the Southern Cone countries, and while it will probably also be useful for interpreting the urban social morphology of big cities in other countries of the region with similar characteristics, it is doubtful whether it would be applicable to Latin American societies with situations of cultural heterogeneity due to strong ethnic differences. In such cases, the legitimacy of the pretended social superiority of the middle and upper classes does not appear to be openly questioned, and the social distances are so firmly established that they are unaffected by proximity or daily interaction between people of different classes (perhaps the most archetypal example is that of the castes in India). In these countries, the problem of segmentation in the areas of interaction controlled by the different institutional orders takes second place to the main challenge faced by the urban poor: that of coming closer to gaining access to full citizenship and legitimizing their desire to become integrated into society on equal terms.

A second limitation on the scheme presented is that it does not take account either of neighbourhoods made up largely or entirely of ethnic or religious minorities or households with the same territorial origin. The *distinguishing feature of these neighbourhoods is that their inhabitants have voluntarily decided to settle in them*. They may have various reasons for this: in order to restore networks, preserve customs or maintain common norms, values and cultural identities; to defend themselves against attacks by other social groups; to lay the foundations for business projects in which community social capital is a very valuable resource; or to organize under more favourable conditions collective actions to improve the common infrastructure or even to pursue longer-term political objectives. It is worth noting that in these cases residential segregation may be a deliberately sought instrumental resource (Boal, 1998, p. 97), a prior condition for forming a community, or a result of this (Castles, 1998).

<sup>10</sup> In the case of urban ghettos, as Crane (1989) holds in his study on dropping out from school and adolescent motherhood in Chicago, what probably happens is that certain threshold levels of poverty density are passed, after which the patterns that build up around the conductal correlates of prolonged experiences of critical deprivation begin to operate as the dominant framework that guides action.



## Box 2

TYPOLOGY OF LOWER-CLASS URBAN NEIGHBOURHOODS ACCORDING TO THE OPPORTUNITIES  
FOR MOBILITY PREVAILING WHEN THEY WERE BEING FORMED

COLLECTIVE	Individual	
	Favourable	Unfavourable
Favourable	Heterogeneous lower-class neighbourhoods (3)	Traditional working-class neighbourhoods (2)
Unfavourable	Neighbourhoods inhabited by recent migrants (1)	Urban ghettos (4)

a) *Neighbourhoods made up of recent migrants (cell 1)*

Following the Second World War, the growth of this kind of neighbourhood in many cities of the region was closely linked with the rate of massive transfers of rural dwellers, who mostly settled on the outskirts of large urban centres.

The situation in these neighbourhoods differs in various respects from that of the poor living in the present urban ghettos of the region. Firstly, many of these migrants voluntarily chose to live on the outskirts of the cities, close to relatives or friends of similar migratory origin. Second, most of these people were attracted by the possibilities for social mobility offered by the city. Achieving the status of a city dweller meant, among other things, gaining access to services and social benefits which did not exist where they came from. Third, the period in time when these migrations took place permitted them to cherish hopes of sustained progress, for the expansion of the machinery of the State—together with the expansion of public services— and the activation of the economy that accompanied the import substitution process in the two decades following the Second World War gave rise to a labour absorption capacity that extended to unskilled workers too. Moreover, when they compared their new situation with their previous way of life many migrants found that their efforts were well rewarded, thus giving rise to a climate of optimism and confidence in future progress. Both the actors themselves and most analysts of these processes basically perceived the passage through these areas on the outskirts of the cities as an intermediate stage in the process of full assimilation into the cities.<sup>11</sup>

b) *Traditional working-class neighbourhoods (cell 2)*

This category refers to neighbourhoods where a substantial proportion of the residents work in the same type of establishments, such as factories, mines or transport undertakings. In many Latin American cities, neighbourhoods of this type grew up around shipyards, meat packing plants, railway workshops or different types of industrial establishments. Their distinctive characteristic was a relatively strong sense of class, and the socialization that took place in the neighbourhood

<sup>11</sup> This quick sketch does not do justice, of course, to the variety of situations associated with urban settlements of rural migrants in the various countries of the region. A wide-ranging and fruitful debate took place in the late 1960s on this subject among such experts as Roger Vekemans, José Nun, Fernando Henrique Cardoso, Aníbal Quijano and Gino Germani. A good summary of the controversy raised from different perspectives on the nature of these phenomena may be found in the special issue on urban marginality of the *Revista latinoamericana de sociología* (1969). It is interesting to note that this situation is not very different from that which arose in connection with the processes of massive rural-urban migration in the United States in the 1920s, while there were similar tendencies in the European countries after the Second World War (see Esping-Andersen, 1999). Some studies were already arguing that the social problems affecting those settling in the poorest neighbourhoods of the cities were due to temporary circumstances which would disappear on the road to progress (Park and Burgess, 1925). However, even the situation of the highly segregated urban ghettos of the 1950s in the United States was radically different from the present situations, since the great majority of the unskilled workers in them had jobs, and this represented a central experience in their lives. The present residential segregation, in contrast, occurs in the context of a sharp decline in the employment opportunities and relative wages of unskilled workers (see Wilson, 1996a, p.54).

tended to strengthen the social microcosm that grew up around the inhabitants' work.<sup>12</sup>

This robust sense of class was the result of various factors. Firstly, there was the stability of the inhabitants' insertion in the same working environment and the size of the establishments where they worked.<sup>13</sup> Second, there was the existence of utopias generating images which highlighted the importance of the workers' role in the construction of a richer, more equitable and more integrated new society. Third, there was the accumulation of labour benefits through collective efforts and the parallel advances in the acquisition of rights as citizens. Fourth, there was the importance and strength of the workers' institutions, and fifth there was the hope of progress through industrial growth. In these circumstances, the attitudes and values emerging from the labour community had a strong influence in forming the patterns governing the relations among the residents of workers' neighbourhoods, and in turn the socialization among residents and their participation in neighbourhood institutions provided positive feedback for these attitudes and values.

c) *Heterogeneous lower-class neighbourhoods (cell 3)*

This cell contains the neighbourhoods established in urban contexts that favoured individual and collective mobility. This phenomenon only occurred in some of the big cities of Latin America, and its relative weight was directly related with the age and depth of the industrialization and urbanization processes. The inhabitants of these neighbourhoods included industrial workers with steady jobs, other persons who had become independent by setting up workshops or small businesses, workers in various kinds of personal services, and office workers and teachers, all of whom kept up daily informal contacts in which they were basically classed as good or bad neighbours and as decent or not so decent persons, and in which other

distinctions connected with the socioeconomic situation of each household were of little importance. Although many of these households were close to poverty, as a whole they had sufficient purchasing power to stimulate the establishment of a large number of micro-enterprises (whose owners also lived in the neighbourhood) which provided a wide range of services such as all kinds of shops, hairdressing saloons, cinemas, bars and repair workshops.

d) *Urban ghettos (cell 4)*

Cell 4 mainly reflects the results of the processes of residential segregation, which have basically operated since the 1980s in Latin America, in a context which displays considerable differences from the processes which marked the formation of the neighbourhoods made up of new workers (internal migrants) and old-established workers in the cities. The factors prevailing in this context are the processes of de-industrialization and reduction of the size of the State –i.e., the weakening of two of the most important sources of non-precarious urban employment–, the rapid shrinkage of employment opportunities for unskilled or semi-skilled workers, and the rapid rise in the minimum qualifications required for entry into the labour market. Instead of attraction to the cities, there is expulsion to their outskirts, and instead of stimuli provided by the possibility of new employment opportunities, a growing proportion of the active population feel that there is little hope of finding a stable place in the production structure. Unlike the migrants from rural areas, who favourably compared their new situation with that which they had left behind, many of the present urban poor are already imbued with expectations of full citizenship in terms of social, civil and political rights, including legitimate aspirations of sharing in the lifestyles prevailing among other residents of the cities. Instead of expectations of upward mobility, the feelings which now prevail are those of inevitable downward mobility or at least the impossibility of progressing. The negative effects of all these processes on the well-being of the urban poor and their possibilities of social integration are further aggravated by the perverse combination of two other phenomena: the central point for the formation of identity shifts from the world of work to the world of consumption, while the gulf between the material and the symbolic participation of these strata grows ever wider.

This historically unprecedented spatial concentration of people who have their own aspirations

<sup>12</sup> A study made in Chile around 1960 deals with the ways in which the characteristics of the working environment and the community of residence mutually strengthen each other. The populations studied in this case were those of the coal miners of Lota, an isolated and economically depressed area, and the steelworkers of Huachipato (Di Tella and others, 1966).

<sup>13</sup> Lipset, Trow and Coleman (1962), in their study on the International Typographical Union, found that there was a relation between the size of the establishment and the strength of the links established: links that in turn involved a wide range of values, attitudes and activities outside the context in which the interaction originated.

regarding urban life but are suffering from serious material privation and have few hopes of making any significant achievements through employment gives rise to strong feelings of relative privation. In these circumstances, the new urban ghettos provide fertile soil for the most disruptive elements associated with poverty. The households which have sufficient resources to get away from these neighbourhoods do so, leaving behind them a residual population which lives in increasingly precarious conditions and is further and further removed from the kind of people who have the minimum features needed in order to be successful in present-day society.

The spatial concentration of people with these characteristics increases the precarious situation of the group in various ways. Firstly, interaction with neighbours is limited to contact with people whose skills, habits and lifestyles do not hold out any promise of successful results according to the prevailing criteria of society. Second, the neighbourhood networks available are of little use for obtaining work or information about opportunities for work or training. Third, the labour instability itself gives rise to difficulties in maintaining the basic neighbourhood institutions and adequate levels of organization and informal social control. Fourth, the children and young people lack contacts with successful role models of mainstream society and opportunities for exposure to such models. Lastly, situations of persistent unemployment increase the predisposition to explore illicit sources of income. Even if the local community rejects these forms of behaviour in principle, in practice the shared experience of the hardships caused by the daily struggle to survive in these conditions gives rise, because of a deeper understanding of its causes, to a more tolerant attitude to such deviations from the norm, and the gradual accumulation of these adaptive responses progressively causes the norms and codes prevailing in these neighbourhoods to depart from those of the rest of the city, thus accentuating the neighbourhood's social isolation.

## **2. Rises, falls and changes**

A close look at the social composition of neighbourhoods at any given moment will very

probably reveal the existence, alongside other types of communities, of neighbourhoods whose composition comes close to one of the types described above, thus forming a scenario which reflects the spatial projection of the heterogeneity of poverty. What differs in each case is the relative weight of each category, since their growth depends on different combinations of forms of development, degrees of urbanization and types of welfare systems. Each neighbourhood changes its composition at a different rate, but in an ongoing manner, as a result of the households that leave and others that arrive and the economic units that disappear and the new ones that are set up in the area, so that in each period a snapshot of any neighbourhood with a few years of existence behind it would reveal traces of different stages in its formation, of the way the territory was ordered and occupied, of the types of families that predominated, of economic activities that no longer exist or are on the way out, and of successive configurations of social structures that dominated socialization in their time and put their stamp on it.

In short, at least three working hypotheses may be derived from the foregoing discussion, and their verification could make possible some interesting advances in our understanding of the processes of residential segregation and their connection with social isolation. The first hypothesis is that the heterogeneity of poverty is projected into the urban space, so that there is a tendency among poor households to group together according to the nature of their stocks of assets. The second, which is the underlying assumption throughout the foregoing analysis, is that the new economic and social setting creates conditions that favour the growth of neighbourhoods whose characteristics come very close to those of an urban ghetto: i.e., neighbourhoods where people stay because they do not have the resources to go elsewhere and are joined by people who have had to leave other areas of the city, while those who are in a position to do so move out. The third hypothesis is that the households in such neighbourhoods display the highest levels of social isolation: i.e., the weakest links with the market, with the various State services, and with those segments of the urban population whose behaviour is guided by mainstream patterns of norms and values.

## V

## Segmentation and social isolation

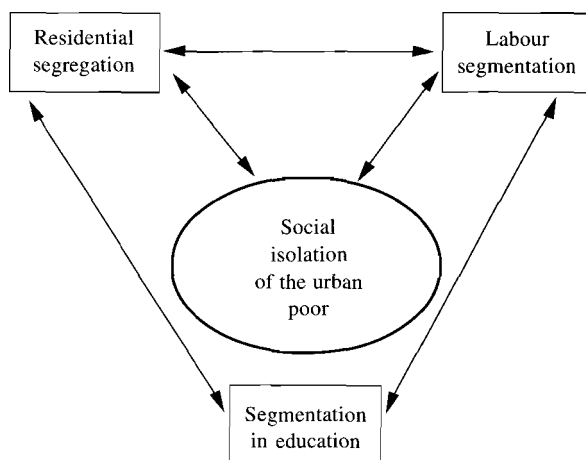
Although such an assertion must be verified in each specific case, it is very likely that, as shown in figure 1, the three types of segmentation referred to above strengthen each other in terms of the progressive isolation of the urban poor. Thus, the increase in the disparities in income and working conditions due to the current way the economy functions will tend to be reflected in the segmentation of services and polarization of the distribution of classes in the urban space, while the subcultural formations which usually accompany the consolidation of the residential segregation of the poor will in turn strengthen the processes of differentiation of income and segmentation of services. As the disparities between socially homogeneous neighbourhoods grow deeper, they will be reflected in differences in the quality of the infrastructure in the areas of services, education, health, transport, public security and recreational and leisure facilities, all of which will increase the social isolation of the urban poor and reduce their possibilities of finding a stable rather than a precarious place in the labour market.

In spite of this hypothetical interdependence between the degrees of segmentation in the above-mentioned potential areas of interaction, however, the study of each of them separately has at least two advantages. The first is precisely the fact of presenting these supposed relations of interdependence as hypotheses, thus furthering the identification of the mechanisms behind the propagation of the segmentation effects from one area to another. The second is the fact of causing the deployment of the whole range of instruments available to the State for dealing with the problems of integration of the urban poor, which would provide a variety of alternatives for impeding these transmission mechanisms so as to reduce, slow down or offset segmentation in the other areas.

Thus, depending on the nature of the national socio-cultural matrices and the conceptions of citizenship guiding the State's actions, even if there is an increase in the segmentation and precariousness of the labour market, policies can be adopted to reduce its impact on differences in income and prevent those disparities from being reflected at the territorial level

FIGURE 1

**Social isolation of the urban poor and the different types of social segmentation**



Assets affected:

- Individual social capital.
- Collective social capital.
- Civic capital.

in residential segregation. The State can also incentivate or disincentivate universality in the use of basic services such as transport, public security, health and education by making greater or lesser efforts to maintain their quality and by leaving the possibility of acquiring those services on the market more or less subject to the free play of supply and demand: options which have obvious implications for the likelihood of loss of interest in them by the middle and upper classes. This seems to have been the position taken by some social-democratic welfare regimes. In the case of Sweden, for example, some authors consider that although the growing social and economic polarization between neighbourhoods, which began to show itself in the early 1990s, has weakened the spaces for interaction among the classes, its effects on the social isolation of the poor seem to have been effectively offset by a Welfare State which, although plagued by financial problems, continues to maintain generalized coverage of services which provide suitable levels of protection and security for all social classes (see Borgegard, Anderson and Hjort, 1998).

## VI

### Some mechanisms which help to further heighten the social isolation of the poor

#### 1. The growing independence of the effects of marginal subcultures on the behaviour of the isolated urban poor

Whatever their causes, once concentrations of poor people involuntarily isolated from the mainstream of society spring up, this creates fertile ground for the emergence and perpetuation of marginal subcultures, since the reactions aroused in the rest of society by the forms of conduct guided and governed by those subcultures promote and heighten the social isolation of the urban poor.

There are many examples of the operation of such vicious circles of expanded reproduction of social isolation, and most of them were activated once public opinion branded the neighbourhoods in question as spaces where the “dangerous classes” congregate. Let us merely mention three of the best-known examples of this: i) their inhabitants—especially the younger ones—are usually victims of “statistical discrimination”, whereby simply hearing where they live is enough to make some employers reject their job applications; ii) households which are in a position to do so move to other areas, thus depriving the neighbourhood of possible role models and of people with “voice” who could have helped to transmit the normative patterns of mainstream society and provide useful contacts and information for obtaining jobs and/or access to services; and iii) people avoid entering such neighbourhoods, thus reducing the frequency with which some new residents are able to keep in contact with their friends and relations who live in other areas of the city (see Zaffaroni, 1999).

Marginal subcultures are made up of a wide range of patterns of conduct and norms that gradually build up around an awareness of the adversities shared by a population with serious material wants and precarious living conditions, of the barriers to social mobility, and of the need to find common bases on which to build or rebuild their self-esteem, which has been seriously damaged by the experience of exclusion. As already noted, the lack of stable formal employment slowly but surely causes the world of work to lose its role as a

central referent for the organization of daily life, for the provision of discipline and regularity, and for the coherent formation of expectations and the gradual achievement of goals, while the progressive isolation tends increasingly to reduce the clarity of the signals (if any) from mainstream society which point the way for unskilled persons to obtain decent living conditions. All this gradually increases the receptivity of the isolated urban poor to other normative proposals that arise in their immediate environment, some of which include guidelines that do not reject the idea of using illegal means to attain the elusive goals in terms of consumption, while the social isolation inhibits the effectiveness of possible initiatives that could counter these tendencies by appealing to the norms and values of mainstream society.

If we go a little deeper into the consequences of these processes, it can be argued that isolation helps to deplete the stock of assets of the poor inasmuch as it affects their capacity to accumulate social capital. There are at least three reasons for this. Firstly, isolation reduces the opportunities for mobilizing for one's own benefit the goodwill of persons who are in a position to provide work or information and contacts on employment opportunities, training facilities and strategies for making better use of the existing services, while the resources circulating internally within segregated neighbourhoods tend to be superfluous and ineffective. Secondly, there is less exposure to role models—that is to say, individuals who, because they have attained a good standard of living through their determination, talent and discipline, can serve as positive examples of the association between effort and achievement—and this reduces the attractiveness of the legitimate channels of social mobility as ways of satisfying the consumption aspirations of the poor. Thirdly, there is a reduction in the opportunities for sharing with other classes the kind of everyday experiences which nurture and preserve a belief in a common collective destiny and which are the basis for feelings of citizenship. The idea that one has the same rights and enjoys the same benefits of the universal principle of equality and freedom in social life may

seem a futile fiction when every day one is acutely aware of one's remoteness from mainstream society.

The marginal subcultures which spring up among the urban poor must therefore be considered as something different from what Lewis called "the culture of poverty", which may be summarized as meaning a legacy of values and norms whose knowledge helps to understand the persistence of poverty. Instead, the emphasis in this case should rather be on the idea that marginal subcultures are a reaction to structural conditioning factors deriving from the functioning of the market, the State and society: that is to say, that they are one of the results of the progressive buildup of adaptive responses to a mass of negative factors that go to make up a precarious and segregated environment.

From the point of view of those interested in devising ways out of these situations, the most important question is that of the capacity of these subcultures to keep on influencing the behaviour of young people after the main causes which gave rise to them have disappeared. In other words, how far will a significant improvement in economic activity make it possible to bring into the market unskilled young people who are currently trapped in a subculture which does not believe that there is a link between effort and achievements through work.

William J. Wilson is optimistic with regard to this situation in the United States, and considers that a change in employment opportunities could wipe out the effect of the immediate social environment. However, one should not underestimate the burden of the structural chains which transmit those effects from one generation to the next and which would appear to reduce the stock of assets with which poor people living in segregated neighbourhoods could face the challenge of taking advantage of possible new employment opportunities.

In an exhaustive review of the United States literature on the effects of neighbourhoods on a number of types of behaviour considered to present risks, Jencks and Mayer (1990) found abundant evidence of the effects of segregated and homogeneously poor neighbourhood contexts on educational performance, on types of behaviour associated with addiction and crime, and on adolescent motherhood. Furthermore, in a study recently carried out in Montevideo, the author of the present article tested the effect of the social composition of the neighbourhood on educational performance, adolescent motherhood, and the success of young people in the labour market, as measured by their hourly wages. The results of that study tend to

confirm the importance of the degree of homogeneity of the social composition of the neighbourhood as a determining factor in the emergence of high-risk forms of behaviour and in the level of achievements in the world of work. The risk component in the types of behaviour analysed lies precisely in their capacity to act as barriers to the accumulation of the assets needed in order to take advantage of the opportunities that may present themselves in the market, in society and in the State (Kaztman, coord., 1999).

## 2. The desertion of public spaces by the globalized middle classes

Societies may be distinguished by the type of distributive rules embodied in their basic structures (market, property rights, the State, etc.). Those rules, which profoundly affect the living conditions of the population, are reflected in individual attitudes of greater or lesser toleration of inequality. These institutional forms, together with their corresponding mental attitudes, are vital elements of the socio-cultural matrix characterizing each society.

The notion of tolerance of inequality helps to understand the stability of some indicators of equity or inequity.<sup>14</sup> These are "underground" structures which, when the indicators of inequality rise by amounts that exceed tolerable levels, spring into action to set off actions of solidarity which tend to restore the balance. These actions may range from electoral support or initiatives designed to protect the weakest and maintain the quality of services of universal coverage to a willingness to pay taxes to finance redistributive measures.<sup>15</sup>

<sup>14</sup> In a study which compares data on income distribution in different countries and different periods it is claimed that income inequality is relatively stable over countries and time, unlike the behaviour of GDP growth rates, which change rapidly and are not at all persistent (Li, Squire and Zou, 1998).

<sup>15</sup> Barry (1998, p. 23) argues that the willingness to pay high taxes not only makes it possible to raise the quality of collective services but at the same time reduces the resources available to the higher-income groups for the private acquisition of services, thus discouraging their desertion from public spaces. Of course, the contribution by the middle and upper classes to the maintenance of public spaces which make possible interaction between the classes is not motivated solely by their aversion to inequality. It is also due to their fear of the negative effects which usually accompany deterioration in the quality of life of the masses and of the public services they can use. Among those effects are political instability, a decline in the legitimacy of institutions –and consequent difficulty on the part of the elites in mobilizing collective support for proposed changes– and, increasingly, the effects of public insecurity on their quality of life.

Aversion to inequality derives from the degree of sympathy of the better-off classes for those who have less and from a feeling of moral obligation to them. These mental contents lose their vigour if they are not periodically renewed through informal contacts between persons of different socio-economic situation, and the more intense and frequent such interaction is, the stronger they will be. The area where these encounters take place is the public space (transport, public squares, schools and hospitals, football grounds, bars, beaches, mass events, the street, etc.). Both residential segregation and the segmentation of services reduce these spaces, thus weakening the structural base for that capacity for sympathy and sense of moral obligation and thereby affecting the levels of toleration of inequality and making the homeostatic mechanisms less effective.<sup>16</sup>

High levels of refusal to tolerate inequality also operate as mechanisms that cause the middle and upper

classes to control their consumption themselves, especially in the case of those types of consumption which cause irritating and highly visible differences compared with the other classes. These mechanisms come into conflict with the expectations aroused by exposure –inevitable in globalization processes– to the lifestyles of their peers in the developed countries. In so far as the resources needed to satisfy these new consumption aspirations compete with those needed to satisfy the demands of the poor, a widening gap between the consumption patterns of the different classes will be accompanied by loss of interest on the part of the well-off classes in the situation and fate of the less-privileged sectors.<sup>17</sup>

Social solidarity mechanisms are usually not seriously affected by the isolation of a small sector of society which, because of its wealth, has always used private sources of services, but rifts in the social fabric begin to be obvious when a substantial proportion of the middle classes stops using public services.

## VII

### Final remarks

“Seduced and abandoned”, the metaphor contained in the title of this document, seeks to highlight one of the special features of present-day urban poverty in many countries of the region: the growing proportion of households which, after having incorporated expectations of achieving full citizenship through work and developed consumption aspirations typical of today’s society, witness the progressive weakening of their links with the means of obtaining the resources that would enable them to attain those goals. They have been seduced by a modern society in which they can only participate symbolically, since they cannot overcome by their own means the obstacles standing in the way of the corresponding material participation.

The approach taken here to the analysis of the nature and determinants of these phenomena, which might be termed a “structural” approach, differs from other ways of analysing urban poverty because it lays stress on the location of these categories within the social structure of the cities: i.e., on the existence and

quality of the links established with the structure of opportunities controlled by the State, the market and other institutional elements of society. From this standpoint, it is important to know the manner of operation of the areas of interaction which can act as a source of the assets needed for social interaction in each historical stage, of the relations that are formed among these areas, and also of the behaviour of other social actors, especially the logic underlying the decisions taken by the middle classes to either foster and promote public spaces and services or on the contrary to abandon them (Hirschman’s “voice” and “exit”).

I have devoted particular attention to discussion of the problems of residential segregation, partly because I think this is a dimension which has been neglected in the social agenda, and partly also because I believe that neighbourhoods with a high proportion

<sup>16</sup> These are a set of self-regulation phenomena which maintain relative stability in the properties and composition of the internal environment of an organism.

<sup>17</sup> In small and culturally very homogeneous countries, there is a climate of social nearness which tends to inhibit excessive growth of the gap between the elites and the rest of society, since in these cases the community has a greater capacity for expressing its disapproval of those who stray too far from the habits and lifestyles of the majority.

of households suffering from material wants and frustrated aspirations provide fertile ground for the appearance of high-risk types of behaviour and marginal subcultures whose emergence raises further barriers –which can often only be overcome with difficulty or at a very high cost for society as a whole– to the accumulation of needed assets and thus strengthens the tendencies towards the social isolation of the urban poor.

Since this approach is as yet only at an embryonic stage, the main suggestions made in this stage are of a largely theoretical nature. Thus, if we acknowledge that the study of the problems of residential segregation and the segmentation of services is a promising way of advancing in our understanding of the barriers to social equity, it can be concluded that there are various areas which warrant closer study and that several of the hypotheses put forward in this document need to be tested. Even so, the progress made so far indicates that a set of general guidelines can be proposed for improving public policies designed to deal with the root causes of the production and reproduction of urban poverty.

Firstly, it can be said that, whatever the form assumed by residential segregation in the cities, its consequences for the isolation of the urban poor seem to be sufficiently important to assert that those responsible for territorial planning should not leave that process to market forces impelled essentially by real estate considerations, in which case the income inequalities prevailing in the cities would tend to split up the urban space into neighbourhoods inhabited solely by people of the same class, where the spatial polarization of classes would act to permanently cement inequalities and thus prevent any subsequent return to more equitable situations.

In this respect, in order to identify the best practices to follow it would be desirable to make a detailed study of the actions taken in countries which have given priority to these problems on their social agendas, especially those countries with social-democratic welfare regimes which have shown themselves to have the most effective social integration policies. In Sweden, for example, even though there has been an increase in the indices of income concentration the effects this has had on residential segregation have been minimized by government policies aimed at mixing together different types of households in integrated apartment buildings. Similar results have been obtained through initiatives designed to equalize the rents for dwellings which are of the same level but are located in different neighbourhoods (Borgegard, Anderson and Hjort,

1998). Generally speaking, policies designed to de-mercantilize housing through rent subsidies or by facilitating ownership by lower-income sectors, along with other initiatives aimed at securing greater housing integration, can legitimately be considered an integral part of welfare policies (Murie, 1998). It should be borne in mind that the State can also withdraw from this area too or, as in the cases of Chile or South Africa, apply policies deliberately designed to promote residential segregation (Christopher, 1998; Portes, 1989).

Pressures to reduce the fiscal deficit and balance the public finances, associated with efforts to improve competitiveness, can also constraint the options open to the State for halting or offsetting processes of residential segregation. The pursuit of financial balance and the consequent need to maximize the use of public resources incline the State to concentrate its low-cost dwelling construction efforts in the cheapest urban or peripheral land or to legalize the unauthorized occupation of land by poor people trying to solve their housing problems who set up makeshift settlements and then press for their official recognition.

The slowness with which the decay of the multi-class spaces for informal socialization becomes evident in the cities means that the consequences of this process for social integration are often not noticed by citizens at large, and in any case the effects of these spaces as an integration factor and as sources for the renovation of the reserves of selflessness, solidarity and rejection of inequality are usually underestimated. In this respect, as Caldeira (1996) points out, although the idea of a city open to all, like the notion of citizenship, is never completely fulfilled, it nevertheless acts as an ideal that legitimizes the demands of excluded groups for incorporation.

The aim of strengthening social integration in the cities through the promotion of multi-class public spaces might also seem to be beyond the possibilities of State policies, partly because the resources needed for it are usually competing with those required for other priority items on the social agenda for poverty relief. This perception is certainly in keeping with the realities of many of the big cities of the region, where residential segregation, the segmentation of services and the abandonment by the middle class of public places for multi-class informal socialization is so advanced that the possibilities of halting or offsetting these processes in the short or medium term may seem quite unrealistic. Even so, these circumstances should stimulate rather than discourage such action, since the



alternative is the progressive worsening of exclusion, with unforeseeable consequences for the social order and civilized coexistence. Indeed, those consequences break out sooner or later, sometimes in a violent, anomic and unexpected manner, through the socially disruptive correlates of poverty marginalized by the buildup of privations and progressive isolation from the mainstream patterns of society. The response of the middle classes is to stay away from the public places and services used by the "dangerous classes", whose forms of behaviour, cultivated in isolation and generalized precariousness, seem outlandish and abnormal to the other classes. This desertion by the middle classes merely heightens the deterioration of public spaces, thus further narrowing the field of experiences that can stimulate empathy with the less privileged sectors and feelings of moral obligation towards them, ultimately raising the threshold of toleration of inequality. Familiarity with the experience accumulated regarding the consequences of neglecting these problems in the big cities can be particularly useful when designing preventive measures for intermediate-sized cities.

As already noted earlier in this article, policies to promote the use of public spaces, measures to prevent the segmentation of basic services and actions in the field of town planning are among the many ways in

which it would be possible to promote multi-class socialization and offset the powerful tendencies towards a retreat into private worlds and isolation of the different classes. In many of these fields, what is needed is not so much specific policies as the incorporation of an approach into sectoral programmes which gives preference to all the initiatives that could foster more frequent and better-quality interaction between people who are not otherwise equal.

There are a number of examples of successful actions in this respect which could provide a very valuable information base for countries which are about to face these problems. There are many social integration initiatives which have been carried out in the cities of North America and Europe which, either through actions specifically designed for this purpose or as approaches kept in mind in the formulation of sectoral policies, affect town planning measures, the selection of beneficiaries for subsidized housing projects, defence of the quality of public services, and the promotion of spaces to encourage informal contacts between different classes. Careful study of these initiatives would make it possible to select those best fitted to the resources and special characteristics of each society.

(Original: Spanish)

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# Employment *in Latin America:* cornerstone *of social policy*

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This article analyses labour market trends in Latin America and the Caribbean during the 1990s and suggests that employment should form the basis of a social policy strategy for the region. It begins with an analysis of the expectations generated with respect to the labour market by the reform process carried out in the region, after which it presents an overview of what has actually happened in terms of rates of participation, generation of employment, unemployment and wages, also suggesting some reasons why the reality was below expectations. It then goes on to examine a new hypothesis on the different performances of the labour markets in the more northerly countries of the region and those of the south. Finally, on the basis of data which bear out that hypothesis, it formulates policy recommendations on specific measures for both areas and describes policies that could be applicable to the region as a whole.

# I

## Introduction

In order to be effective, social policy programmes must be based on an employment generation strategy, which is the fundamental link between economic development and social development. From the economic standpoint, the labour force is one of the main factors of production, and its importance is increasing all the time, because human capital is a key element for the growth of the economy and of productivity, while from the social point of view employment is the main source of income for most Latin American households. Unless there are enough jobs that provide at least the minimum resources for maintaining workers and their families, social policies will be swamped by the need to satisfy the basic needs of the population and will therefore be unable to fulfill their proper function, as a complement to the labour market, of improving the level of education and training of present and potential workers and providing a safety net for those who are not able to work. This is the fundamental principle on which the analysis given in this article is based.

Our study focuses on the 1990s, when most of the countries had already adopted the new market-based economic model. The reforms underlying this model raised great expectations as regards the generation of employment and its consequent positive effects on equity. Section II reviews these expectations and analyses the reasons why the results obtained so far have been disappointing. Section III traces the evolution of the labour markets of the region in the light of a number of indicators, namely, participation rates, total and sectoral employment generation, job creation by size

of firm, and the results of all these factors for unemployment rates. It also gives information on wages and the wage gap between skilled and unskilled workers, which represent important links between the behaviour of the labour market and income distribution. The analysis confirms that in the 1990s there were serious problems in the field of labour because of the sluggish generation of employment and the increase in unemployment. Average wages rose, but so too did the wage gap between skilled and unskilled workers.

Section IV examines a recent hypothesis that there is a substantial difference between employment generation in the more northerly countries and those of the south. Specifically, it suggests that the demand for labour in manufacturing in Mexico and Central America is higher than in the countries of the southern part of the region, where capital-intensive industries processing natural resources have predominated. The available information bears out this hypothesis. Employment – particularly industrial employment – has indeed risen more rapidly in the northern countries, partly because of the dynamism of production but also because the elasticities of employment were higher in Mexico and Central America.

On the basis of that analysis, section V puts forward a number of policy recommendations for improving the employment situation in this decade which is just beginning and also analyses the relation between employment and other social policies and the synergies between them.

# II

## The reforms and employment: expectations and reality

Over the last ten or fifteen years, the economic policy applied in Latin America and the Caribbean has undergone the biggest changes since the Second World War. Through the application of a series of structural reforms, a growing number of countries have ceased

to be closed economies dominated by the State and have become market-oriented economies open to the rest of the world. These reforms include import liberalization processes, domestic and international financial liberalization, privatization processes and

labour reforms, although in this latter field most of the changes have been *de facto* rather than *de jure*.<sup>1</sup>

There were great expectations about the results of the reforms, mostly based on studies dating back to the late 1970s and early 1980s.<sup>2</sup> These laid special stress on raising growth rates by reorienting the structure of production away from the domestic market (what was known as import substitution industrialization, or the ISI model) towards production for export. It was assumed that this turnaround would be reflected in greater efficiency at the microeconomic level, better utilization of economies of scale, and smoothing-down of the stop-go cycles caused by foreign exchange constraints.

These studies also maintained that elimination of the distortions caused by the import substitution model would generate more employment, especially for unskilled workers. Among the mechanisms supposedly linking the reforms with increased employment, the main emphasis was placed on more efficient resource distribution which, by permitting more dynamic growth, would generate more jobs, even if the elasticity of employment remained unchanged. It was also assumed that the elasticity of employment would be more favourable due to the changes in the investment pattern and the structure of production. As Latin America's comparative advantages were based on unskilled labour, it was forecast that when the supposed bias in favour of capital was eliminated, investment in general and the technologies now chosen would become more labour-intensive. The greater emphasis on exports would also generate more jobs, because it was believed that production for export was more labour-intensive than in the case of products that competed with imports. This conclusion coincided with the analysis by sectors, according to which the new trade strategy would particularly favour agricultural activities and light industry. Lastly, it was claimed that reducing the high cost of hiring workers would give rise to more jobs.

In addition to the benefits for employment, it was expected that its expansion would help to improve the manifestly inequitable form of income distribution characteristic of Latin America.<sup>3</sup> The most obvious link in this respect would be the generation of new jobs for unskilled workers. In so far as many of these jobs would be created in rural areas, they would help to reduce poverty in its main focal points. It was also expected that the greater demand for unskilled labour would have a positive effect on the relative wages of people who already had jobs. In other words, wage differences between skilled and unskilled workers would be reduced, thus improving income distribution. It was also considered that most likely the difference between profits and wages would be narrowed; there were some indications that protection had raised the former at the expense of the latter. Finally, as the role of the State in production was reduced, this would free resources that could be assigned to social expenditure to help the poorest groups.

A second set of studies has appeared in recent years which analyses whether the benefits expected from these reforms have been fulfilled or not. These studies display a surprising degree of consensus: in general, they conclude that growth in the 1990s was quite modest, although it was obviously better than in the "lost decade" of the 1980s. Furthermore, most of the empirical studies conclude that the reforms had a negative impact on the generation of employment and perhaps also on equity. The data indicate that in the 1990s the growth rate of employment was lower than in the second half of the 1980s; unemployment increased; there was a proliferation of informal-sector employment, and the rise in real wages favoured above all skilled workers. There is less agreement on the impact of the reforms on equity: some authors consider that they have had a negative effect on income distribution, while others maintain that there is no

<sup>1</sup> The situation with regard to the labour reforms has been the subject of some controversy. The IDB (1997) maintains that the reforms have been few in number, but Weller (2000a, chapter 7) considers that there have been important changes, although they have often not been incorporated in the legislation.

<sup>2</sup> Among the earliest studies advocating structural reforms were those made by Anne Krueger (Krueger, 1978; Krueger and others (eds.), 1981, and Krueger (ed.), 1982 and 1983) for the National Bureau of Economic Research. The fact that this author was Chief Economist at the World Bank in the early 1980s meant that her opinions carried weight even outside academic circles.

<sup>3</sup> Although there is no doubt that the advocates of the reforms believed that they would favour employment, there is not so much agreement as to whether they explicitly aimed to improve income distribution. Balassa and others (1986, pp. 93-94) clearly did so, as did Krueger (ed.), 1983, pp. 186-187. Williamson, however, expressly excluded the improvement of income distribution from the Washington Consensus measures, saying that in the Reagan/Bush years Washington was not interested in the subject (Williamson, 1990, pp. 413-414, and 1993, p. 1329). Perhaps the best summing-up is Bulmer-Thomas's conclusion that reducing poverty and improving income distribution were not among the main objectives of the new economic model (Bulmer-Thomas, ed., 1997, p. 310).

relation between the two. None of the studies find that the expected positive effects have been achieved in reality.<sup>4</sup>

There are various reasons for this discrepancy between expectations and reality, especially in respect of employment. Above all, the fact that growth rates in the 1990s were lower than expected means that the growth rates of employment were lower too. Forms of investment and growth by sectors show that the least

dynamic sectors and enterprises were those making intensive use of labour, which reduced the possibilities of employment growth still further. In many cases rates of participation were higher, and this made it even more difficult to combat unemployment. Lastly, the hypothesis that Latin America's comparative advantages lay in unskilled labour proved to be wrong on the whole, although it may have been true for part of the region.

### III

## Evolution of the labour market in the region

In the 1990s, the evolution of the labour market in Latin America was affected by the reforms and by the long-term trends of the economies. In order to enlarge on the diagnosis made in the previous section we will first of all examine the labour supply variables, as reflected in rates of participation, and we will analyse the variation in the demand for labour, as reflected in the total and sectoral generation of employment and the creation of jobs according to size of firm. The evolution of unemployment would be the result of the pressures of supply and demand. The data on wages focus in particular on global trends and on the wage gap between skilled and unskilled workers.

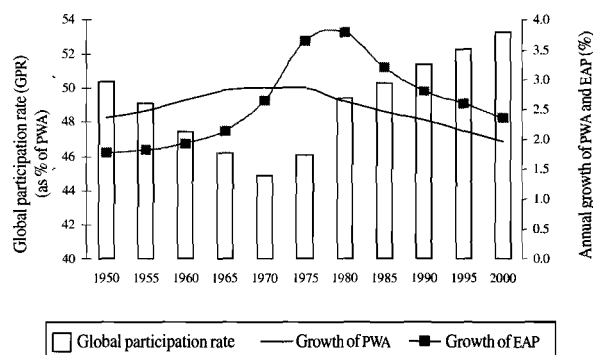
Specialists agree that long-term trends in employment are determined by the evolution of the supply of labour. Variations in the economically active population (EAP) may be explained by changes in the size of the population of working age and the extent to which that population decides to participate in the labour market (the global participation rate). In Latin

America the last two variables have evolved differently in the period following the war. On the one hand, as the demographic transition has progressed the annual growth rate of the population of working age has gone down, thus easing the pressure on the labour market, but on the other hand the degree of participation in the labour force has continued to rise as a result of both long-term processes and transitory fluctuations, especially the greater participation of women. At the same time, urbanization, development of the educational system and the increase in the coverage of social security systems have tended to reduce participation rates, since people have entered the labour force later and retired from it earlier. Since the 1970s, the tendency towards a reduction of the population of working age has had a stronger impact than the reduction in participation rates. Thus, in the 1990s the participation rate for the region as a whole rose by 0.2 percentage points per year, following the trend of the previous decade. Figure 1 combines the effects of demographic changes and variation of the participation rate in order to show their impact on the growth of the economically active population, which went down from 2.9% per year in the 1980s to 2.5% in the 1990s.<sup>5</sup>

<sup>4</sup> We have taken part in a large multi-year project designed to evaluate the effects of the reforms. See in this respect Stallings and Peres (2000), Weller (2000a) and Morley (2000). Other important sources are Edwards (1995), Bulmer-Thomas (ed., 1997), IDB (1996), Lora and Barrera (1997), Fernández Arias and Montiel (1997), Londoño and Székely (1997), Burki and Perry (1997) and Berry (ed., 1998). Some sources which deal specifically with the question of employment are Tardanico and Menjívar (eds., 1997), Funkhouser and Pérez Sáinz (1998), Lora and Olivera (1998), Weeks (1999), and various issues of the ILO's annual publication *Panorama Laboral de América Latina y el Caribe*. A review of this bibliography may be found in Tuman (2000).

<sup>5</sup> The complex interaction of factors related with supply and demand is reflected in short-term fluctuations around the long-term trend. Thus, for example, the increase in unemployment tends to raise the growth rate of the global participation rate, since households try to make up for the loss of income by sending more of their members out to work. With time, however, the persistence of a high rate of unemployment may cause people who lose all hope of finding work to withdraw from the labour market, thus reducing the participation rate.

FIGURE 1  
Variations in the labour supply, 1950-2000<sup>a</sup>



Source: Weller (2000, p. 45).

<sup>a</sup> Based on the weighted average for 20 Latin American countries.

The strong correlation between the supply of labour and total generation of employment makes it more difficult to analyse the demand for labour and its possible links with the changes produced by the reforms. In order to minimize this problem, we have focused on its evolution among wage-earners, since this category is more closely linked with the demand for labour. Table 1 shows the differences between total employment and the number of wage-earners, as well as their variation over time, with figures for economic growth by decades since the war, the generation of total employment and employment of wage-earners, and the corresponding elasticities. Leaving aside the 1980s, which were clearly atypical,<sup>6</sup> the elasticities

in the 1990s were not much different from those registered between 1950 and 1980. In so far as the effects of the reforms were felt in the 1990s, it may be deduced that, at this level of aggregation, they did not affect either positively or negatively the quantitative relation between GDP growth and the generation of employment. What the table does bring out with respect to the past decade is rather that growth rates were lower and influenced the more sluggish generation of employment, especially of wage-earners.

As may be seen from table 2, employment trends showed great differences at the sectoral level in the last decade. Some of these are due to long-standing processes. Thus, in the 1990s there was a further increase in the long-term trend towards a decline in employment in agriculture and growth in employment in the services sector. At the same time, the strong expansion in employment in manufacturing, which had ceased at the beginning of the 1980s only to resume again at the end of that decade, seems to have come to an end. The reforms accentuated many of these trends.

Between 1990 and 1999, employment in agriculture went down at an average rate of 0.4% per year because the demand for labour by the most dynamic activities, generally export agriculture, was not sufficient to offset the loss of jobs in the less dynamic activities, especially peasant agriculture. The reforms contributed to this process in several ways. The reduction in tariffs stimulated outside competition, while at the same time subsidized credit was eliminated, and as the prices of agricultural machinery went down employers replaced labour with equipment.

TABLE 1

**Employment: Growth and elasticities, 1950-1999<sup>a</sup>**  
(Weighted annual average)

Period	GDP growth	Employment growth	Employment/ GDP elasticity	Growth of wage labour	Wage labour/ GDP elasticity
1950-59	5.1	1.9	0.4	2.5	0.5
1960-69	5.7	2.3	0.4	2.7	0.5
1970-79	5.6	3.8	0.7	4.7	0.8
1980-89	1.2	2.9	2.6	2.4	2.0
1990-99	3.2	2.2	0.7	2.0	0.6
1950-99	4.2	2.6	0.6	2.9	0.7

Source: Weller (2000b).

<sup>a</sup> From the 1950s to the 1970s, employment growth corresponds to the increase in the labour force. From the 1950s to the 1980s, the figures cover 20 countries; in the 1990s they cover 17.

<sup>6</sup> The particularly high elasticities of the 1980s were due to the increase in the supply of labour at a time when growth was very

sluggish, although the economically active population grew more slowly than in the 1970s.

In the 1990s, employment in the manufacturing sector increased in Latin America as a whole by only 1.2% per year. The data for employment in medium-sized and large firms show that two processes were taking place simultaneously at the subsectoral level. On the one hand, the subsectors making intensive use of labour lost ground compared with those which were more capital-intensive. In the 1990s, labour-intensive manufacturing activities such as textiles, clothing and leather products and footwear kept on losing ground, while natural resource-based products, which require large inputs of capital per unit of output, maintained the shares they had won in the 1970s and 1980s. At the same time, in many subsectors the incorporation of new technologies was reflected in the reduction of personnel or the generation of a smaller number of new jobs, even in sectors where there was a big increase in output, such as the motor industry.

The greatest dynamism was displayed by services, which accounted for 90% of the net generation of new jobs (table 2, second column). This sector is very heterogeneous, but broadly speaking it consists of two main groups of activities. The first of these –commerce, restaurants and hotels, and social, community and personal services– accounted for 67% of the total number of jobs generated in the region. The second –financial services, insurance, real estate and business services– grew even faster, as also did basic services (electricity, gas and water, plus transport, storage and communications). Because of its small share in total employment, however, this latter sector only accounted for 23% of new jobs.

The economic reforms played an important role in the growth in employment in the services sector, as well as in the polarization that took place in it. Although in most of the countries the privatization of electricity and telecommunications services led to a large number of dismissals, there was also a process of modernization and expansion, which explains why there was nevertheless some generation of employment. Greater trade openness caused an expansion of import- and export-related services, while financial liberalization led to the establishment of new financial services and generated employment. Finally, the pressures for the reduction of costs encouraged the outsourcing of services previously carried out by manufacturing firms themselves, which explains part of the strong growth of business services. At the same time, however, there was an increase in the number of unskilled jobs in the services sector, which were the main source of employment for people who could not find work in other sectors.

TABLE 2  
**Employment growth by sectors, 1990-1999<sup>a</sup>**  
(Percentages)

Sector	Employment growth	Contribution to total
Agriculture	-0.4	-4.3
Manufacturing	1.2	8.3
Construction	2.8	8.0
Commerce, restaurants and hotels	4.0	32.7
Electricity, gas and water and transport, storage and communications	4.4	10.9
Financial services, insurance, real estate and business services	6.0	12.3
Social, community and personal services	2.7	34.8
Others	-2.3	-2.7
<i>Total</i>	2.2	100.0

Source: Calculations prepared by the authors on the basis of official country statistics.

<sup>a</sup> Weighted average for 17 countries.

There were differences not only between sectors but also, and especially, in the generation of employment by size of firm. According to data from the International Labour Organisation (ILO), the main increase in the number of private-sector wage-earners in the 1990s was in micro-enterprises (units with less than six workers) and small enterprises (between six and twenty workers). Thus, between 1990 and 1998 employment in those groups increased by 3.7%, compared with 2.3% in medium-sized and large enterprises and only 0.7% in the public sector (table 3).

The ILO's concept of the informal sector, which has been widely used in studies on employment, covers micro-enterprises and various categories of non-wage employment (excepting the owners of enterprises).<sup>7</sup> Although the definition is based on the level of productivity of enterprises, in practice this sector is measured by a proxy variable grouping together micro-enterprises, own-account workers, domestic servants and unpaid family members. As shown by table 3, if this definition is used some 60% of the jobs generated in the region correspond to the informal sector. This concept of the informal sector assumes that this type of employment is of low quality because of its deficient working conditions, its low levels of remuneration and

<sup>7</sup> For an analysis of the informal sector as seen by the ILO, see Mezzera (1990).



TABLE 3

**Urban employment growth, by size  
of enterprises, 1990-1998<sup>a</sup>**  
(Percentages)

Sector	Annual employment growth rate	Contribution to growth:	
		Total	Formal/informal
<i>Total</i>	2.9	100.0	
Informal sector	3.9	61.0	100.0
Own-account workers	3.6	29.0	48.0
Domestic service	5.2	11.0	18.0
Micro-enterprises <sup>b</sup>	3.8	21.0	34.0
Formal sector	2.1	3.9	100.0
Public sector	0.7		
Private enterprises	2.6	39.0	100.0
Small enterprises <sup>c</sup>	3.6	9.5	25.0
Medium-sized enterprises <sup>d</sup>	2.2	12.7	32.0
Large enterprises <sup>c</sup>	2.4	16.8	43.0

Source: ILO (1999a, p. 47).

<sup>a</sup> Weighted average for 12 countries.

<sup>b</sup> Less than 6 workers.

<sup>c</sup> 6-20 workers.

<sup>d</sup> 21-100 workers.

<sup>e</sup> Over 100 workers.

productivity, and its lack of legal and social equity. This is not completely true, of course, because there is good-quality employment among some own-account workers and micro-enterprises, but the concept continues to be used because of the lack of information on the exact characteristics of these occupations and the assumption that in practice most of the jobs are indeed of a precarious nature.

Even more precarious is the situation of the unemployed, whose number has increased in Latin America even though GDP growth was higher in the 1990s than in the 1980s. In the period from 1980 to 1990 unemployment averaged 6.6%, whereas between 1991 and 2000 it rose to 7.2%.<sup>8</sup> Table 4 shows that the generalized decline in GDP growth in South America in the late 1990s raised unemployment to record figures for the region, even exceeding the levels reached during the debt crisis of the early 1980s. The increase in unemployment was particularly marked in Argentina, Colombia, Uruguay and Venezuela, which came to register two-digit levels in 1999.

The other term in the labour market equation is remuneration. During the 1990s, average real wages in the Latin American formal sector as a whole improved or at least held their own. In Argentina,

Mexico, Nicaragua, Peru and Venezuela, however, wages were lower in 2000 than in 1980 (table 5). Real wages were quite unstable in many countries, and in some cases –Bolivia, Colombia and Costa Rica– they went down in the early 1980s but later rose again. In Mexico and Peru the opposite trend was observed, with an initial increase followed by falls which, in the case of Mexico, were clearly the result of the 1994-1995 financial crisis. Chile was the only country in which there were steady rises throughout the decade.

If economic theory is right, there should be a compensatory relation between wages and the volume of employment generated, but this does not seem to have been the case in the 1990s, for although there was a fairly general rise in wages the behaviour of employment and unemployment varied considerably from one country to another.<sup>9</sup> This might be explained by the fact that the labour markets of the region are not in balance, but in order to be able to analyse the phenomenon properly we would need better information than that currently available. Sectoral data are particularly important in this respect, since the labour markets of Latin America are usually highly segmented both by sectors and by other characteristics.

<sup>8</sup> These figures represent the weighted average for 17 countries. Taking the simple average, the increase was from 8.3% to 8.6%.

<sup>9</sup> The econometric analysis given in Weller (2000a, chapters 4 and 5) gives a negative correlation between employment generation and real wages, but the coefficient is not significant.

TABLE 4

**Unemployment rates, 1980-2000**  
(Percentages)

	1980-90	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 <sup>a</sup>
Latin America	6.6	5.7	6.1	6.2	6.3	7.2	7.7	7.3	7.9	8.7	8.4
Argentina <sup>b</sup>	5.5	6.5	7.0	9.6	11.5	17.5	17.2	14.9	12.9	14.3	15.1
Bolivia <sup>b</sup>	7.8	5.8	5.4	5.8	3.1	3.6	3.8	4.4	6.1	8.0	7.6
Brazil <sup>b</sup>	5.3	4.8	5.8	5.4	5.1	4.6	5.4	5.7	7.6	7.6	7.1
Chile <sup>c</sup>	11.9	8.2	6.7	6.5	7.8	7.4	6.4	6.1	6.4	9.8	9.2
Colombia <sup>b,d</sup>	11.2	10.2	10.2	8.6	8.9	8.8	11.2	12.4	15.3	19.4	20.2
Costa Rica <sup>b</sup>	6.8	6.0	4.3	4.0	4.3	5.7	6.6	5.9	5.4	6.2	5.3
El Salvador <sup>b</sup>	9.3	7.9	8.2	8.1	7.0	7.0	7.5	7.5	7.6	6.9	6.7
Guatemala <sup>c</sup>	8.0	4.2	1.6	2.6	3.5	3.9	5.2	5.1	3.8	...	...
Honduras <sup>b</sup>	9.7	7.4	6.0	7.0	4.0	5.6	6.5	5.8	5.2	5.3	...
Mexico <sup>b</sup>	4.3	2.7	2.8	3.4	3.7	6.2	5.5	3.7	3.2	2.5	2.2
Nicaragua <sup>c</sup>	5.3	11.5	14.4	17.8	17.1	16.9	16.0	14.3	13.2	10.7	9.8
Panama <sup>b,d</sup>	14.5	19.3	17.5	15.6	16.0	16.6	16.9	15.5	15.2	14.0	15.2
Paraguay <sup>b</sup>	5.6	5.1	5.3	5.1	4.4	5.3	8.2	7.1	6.6	9.4	8.6
Peru <sup>b</sup>	7.4	5.9	9.4	9.9	8.8	8.2	8.0	9.2	8.5	9.2	8.5
Dominican Republic <sup>c,d</sup>	...	19.6	20.3	19.9	16.0	15.8	16.5	15.9	14.3	13.8	13.9
Uruguay <sup>b</sup>	8.9	8.9	9.0	8.3	9.2	10.3	11.9	11.5	10.1	11.3	13.6
Venezuela <sup>c</sup>	9.3	9.5	7.8	6.6	8.7	10.3	11.8	11.4	11.3	14.9	13.9

Source: ECLAC, on the basis of official country sources.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Urban areas.

<sup>c</sup> Nationwide total.

<sup>d</sup> Includes concealed unemployment.

TABLE 5

**Average real wage in formal sector, 1980-2000**  
(1990 = 100)

	1980	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 <sup>a</sup>
Argentina <sup>b</sup>	128.8	99.1	100.4	101.7	100.4	101.1	100.0	99.9	99.3	99.0	100.1	101.6
Bolivia <sup>c</sup>	57.6	87.6	82.1	85.5	91.2	98.5	100.0	100.5	106.6	110.1	117.0	118.0
Brazil <sup>d</sup>	94.6	104.4	88.9	87.0	95.5	96.3	100.0	107.9	110.7	110.8	105.9	104.8
Chile <sup>e</sup>	77.2	80.9	84.9	88.7	91.8	96.1	100.0	104.1	106.6	109.5	112.1	113.7
Colombia <sup>f</sup>	80.7	94.9	92.4	93.5	97.9	98.8	100.0	101.5	104.2	102.8	105.9	110.0
Costa Rica <sup>g</sup>	104.0	89.8	85.6	89.2	98.3	102.0	100.0	97.9	98.7	104.3	109.2	110.1
Ecuador <sup>h</sup>	88.3	65.4	68.4	74.2	83.5	90.9	100.0	105.4	103.0	98.9	90.7	86.4
Guatemala <sup>g</sup>	88.7	77.1	72.1	82.9	88.8	89.3	100.0	109.7	112.7	116.8	123.5	128.2
Mexico <sup>b</sup>	113.1	88.1	93.8	100.7	109.7	114.9	100.0	90.1	89.1	91.5	92.4	98.0
Nicaragua <sup>i</sup>	390.8	81.8	84.5	100.5	93.3	98.2	100.0	97.9	97.7	104.9	109.6	111.3
Paraguay <sup>j</sup>	89.5	87.7	91.8	90.9	91.7	93.0	100.0	103.1	102.6	100.7	98.6	99.9
Peru <sup>k</sup>	265.0	85.7	98.7	95.2	94.4	109.2	100.0	95.2	94.5	92.7	90.7	91.8
Uruguay	99.5	91.7	95.2	97.3	102.0	102.9	100.0	100.6	100.8	102.7	104.3	102.9
Venezuela <sup>l</sup>	302.4	138.1	130.1	136.5	124.4	104.8	100.0	76.7	96.3	101.5	96.8	90.5

Source: ECLAC, on the basis of official country figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Manufacturing.

<sup>c</sup> Private sector in La Paz. The figure in the 1980 column actually corresponds to 1985.

<sup>d</sup> Workers covered by the social and labour legislation in six metropolitan areas; 1980 average for Rio de Janeiro and São Paulo.

<sup>e</sup> Up to April 1993, the figures are for non-agricultural wage-earners. From May 1993, the general index of hourly wages is used.

<sup>f</sup> Workers in manufacturing.

<sup>g</sup> Average declared wages of workers covered by the social security system.

<sup>h</sup> Non-agricultural enterprises with 10 or more workers. The figure in the 1980 column actually corresponds to 1985.

<sup>i</sup> Average wage. Does not include remuneration in kind or other benefits.

<sup>j</sup> Asunción.

<sup>k</sup> Private-sector workers in Lima.

<sup>l</sup> Non-manual and manual workers; second half of each year. The figure in the 1980 column actually corresponds to 1982.

TABLE 6

**Wage differences by level of education in the 1990s<sup>a</sup>**  
(Percentages)

Country and period covered	University graduates, compared with average level of remuneration		University graduates, compared with remuneration of persons with 7-9 years' schooling	
	First year <sup>b</sup>	Last year <sup>b</sup>	First year <sup>b</sup>	Last year <sup>b</sup>
Argentina (1991-1997)	164.3	169.6	218.3	227.9
Bolivia (1989-1996)	235.0	292.9	251.8	506.4
Brazil (1992-1997)	380.2	383.5	553.2	553.3
Chile (1990-1996)	231.6	247.9	366.1	448.6
Colombia (1988-1995)	222.2	261.6	276.7	327.2
Costa Rica (1990-1996)	285.0	273.2	323.1	316.7
Mexico (1991-1997)	182.1	232.1	160.1	302.2
Peru (1991-1997)	220.7	275.0	321.0	403.1
Mean	226.9	267.4	298.9	365.2

Source: Weller (2000a, p. 167).

<sup>a</sup> Coefficient of average wages of specified groups.

<sup>b</sup> First and last years of the period shown for each country.

Apart from the question of average wages, it is also important to examine what happened with the different categories of workers. The studies indicate that the wage gap is a key link between the labour market and income distribution.<sup>10</sup> It is a question of studying the divergence, if any, between the wage trends for skilled and unskilled workers. This can be done in various ways, but the most common is based on the level of education and training. Table 6 compares two versions of a wage gap based on level of education in eight countries in the 1990s: the first shows the difference between the wages of university-trained professionals and workers of the average level of the sample, while the second shows the difference between the wages of university graduates and workers with seven to nine years' schooling (equivalent to full basic education or a little more, depending on the educational structure of each country). In most of the cases, the second method gave a larger difference. The increase in the size of the gap over the period studied was quite marked in most cases, although it was small in the case of Argentina and insignificant in that of Brazil; only in Costa Rica did the gap grow smaller.

Another way of studying wage differences is to compare the results for manual and non-manual workers. Data are available for a number of countries

in this respect, including Chile, Colombia, Costa Rica, Mexico and Peru. In almost all cases the results display a pattern similar to that obtained in comparisons by level of education: non-manual workers received bigger pay increases than manual workers, except in Costa Rica.<sup>11</sup> Finally, there is a difference between the remuneration of workers in large enterprises and those in small ones: the wages of the latter have risen more slowly than those of the former (Weller, 2000a, p. 181). Although it is more difficult to interpret, this third difference may also include some elements characteristic of differences in skill levels.

The widening of the wage gap between workers with different levels of qualifications is in contradiction to what the reforms were supposed to achieve. Theoretical analysis would appear to indicate that this phenomenon is due mainly to the fact that the relative prices tend to favour capital, which is cheaper than labour, and this variation in relative prices will cause labour to be replaced with capital, so that there will be a higher capital-labour ratio. According to the data collected by Morley for nine countries, however, the actual trends in relative prices have not followed a trajectory in keeping with this ratio. In the 1990s, the ratio rose in Brazil, Costa Rica, Chile and Mexico but it went down in Argentina,

<sup>10</sup> Bulmer-Thomas (ed., 1997), ECLAC (1997), IDB (1998) and Morley (2000).

<sup>11</sup> García-Huidobro (1999), Ramírez and Núñez (1999), Montiel (1999), López (1999), and Saavedra and Díaz (1999).

Bolivia and Peru and remained almost unchanged in Colombia and Jamaica (Morley, 2000, pp. 99-102).

If the widening of the wage gap is not explained by relative prices, then it may be due to the restructuring of enterprises. If there is more outsourcing of services, for example, this could stimulate the employment of more highly qualified workers within the firm, whereas the less-skilled occupations such as those in the fields of catering, cleaning and security would be carried out by outside personnel. This could explain the increase in the wage gap between small and large enterprises observed in the 1990s.<sup>12</sup> Another explanatory factor is

the expansion of tertiary activities, which generally make more intensive use of skilled labour, and the reduction in the weight of the primary and secondary sectors, which use less-skilled labour. Even more important were the processes of improvement within the services sector, especially in the case of social and community services and financial and business services. Finally, it is possible that in some countries the waning power of the trade unions may also have played a part, since the less-skilled workers were gradually remaining outside them, while minimum wage policies have often caused the minimum wage to lag behind average wage levels.

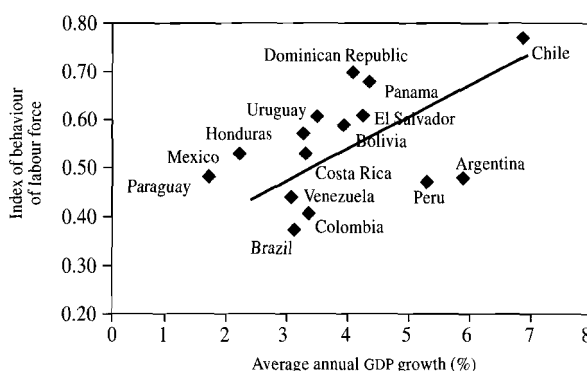
## IV

### Divergences between the countries in the north and south of the region

Although employment trends in Latin America and the Caribbean as a whole reflected serious problems in the 1990s, the tables in the preceding section show clear differences between countries. To a certain extent, these differences correspond to the economic results obtained by each country, since those which registered the highest growth rates were generally the same ones which had better performance in the labour market. Figure 2 shows the relation between GDP growth rates and an index of labour market performance for 15 Latin American countries between 1990 and 1998.<sup>13</sup> Generally speaking, the countries which grew most strongly had better results in terms of employment, unemployment and wages.

Chile was the country with the highest economic growth rate, and this had a positive influence on the four labour variables, so that it was the country with the best performance in the labour market. In contrast, the worst result was that of Brazil, whose annual growth rate was next to last in the group. In that country, employment contracted severely, which was reflected

FIGURE 2  
Economic growth and behaviour  
of the labour market, 1990-1998



Source: Prepared by the authors.

in growing unemployment, even though the supply of labour diminished. Argentina was an exception to the rule, because in spite of its high economic growth rate there was no improvement in the labour situation. Although wage labour increased, the global employment rate went down – particularly after the Mexican financial crisis – and in the late 1990s unemployment rates, boosted by the increase in the labour supply, were far above those registered at the beginning of the decade.

It has also been suggested that another phenomenon may have an influence. In the view of

<sup>12</sup> Although of course specialized services are also procured outside the enterprise.

<sup>13</sup> The index is an average of four sub-indexes which sum up the countries' performance as regards unemployment, real wages, employment generation and increase in wage labour compared with total employment growth (as an indicator of demand). The best and worst results for each variable were given values of 1 and 0 points, respectively.

TABLE 7

**Characteristics of exports  
to the OECD countries, 1980-1996<sup>a,b</sup>**

	Growing share of market (%)	Decreasing share of market (%)
Dynamic products	<p>“Rising stars”</p> <p>Dominican Republic (76.0)</p> <p>Mexico (71.8)</p> <p>Honduras (62.3)</p> <p>El Salvador (54.5)</p> <p>Costa Rica (46.1)</p> <p>Guatemala (42.5)</p>	<p>“Lost opportunities”</p> <p>Haiti (68.2)</p>
Non-dynamic products	<p>“Waning stars”</p> <p>Paraguay (71.6)</p> <p>Venezuela (62.0)</p> <p>Ecuador (58.6)</p> <p>Chile (54.9)</p> <p>Uruguay (52.9)</p> <p>Argentina (48.2)</p> <p>Colombia (44.4)</p> <p>Bolivia (43.0)</p> <p>Brazil (37.7)</p>	<p>“Loss of competitiveness”</p> <p>Suriname (64.5)</p> <p>Nicaragua (48.8)</p> <p>Guyana (47.3)</p> <p>Peru (46.0)</p> <p>Panama (44.7)</p>

Source: ECLAC (2001b, p. 135).

<sup>a</sup> The countries were placed in the quadrants corresponding to over 40% of the total value of their exports of goods to the OECD countries.

<sup>b</sup> The figures in brackets correspond to the percentage of sales of the products referred to in the quadrant with respect to their total exports to OECD countries.

ECLAC, a structural difference is beginning to appear in the region: the situation of the countries in the northern part (Mexico, Central America and possibly the Caribbean) is linked with the United States economy through the manufacture of traditional industrial products (especially textiles) and goods with a higher technological content (electronic articles and motor vehicles). In the smaller countries of the north, these links have been strengthened through the effect of the in-bond assembly industries, but in Mexico the production links are more varied. In South America, in contrast, the main source of economic stimulation comes from the processing of natural resource-based products which are exported to Europe and other markets. Among such products are steel, petrochemical products, pulp and paper and prepared foodstuffs. Other industrial products are exported to the subregional market, especially MERCOSUR.<sup>14</sup>

Another difference is noted when the types of goods produced in the northern and southern countries are classified according to the buoyancy of their participation in the world market: exports of the products of the northern countries are more dynamic

than those of the south. This difference can be seen by using a computer programme developed by ECLAC which classifies the countries in four groups according to their export results: countries whose main exports enjoy growing market access in dynamic sectors (“rising stars”); countries which are increasing their exports, but in lagging sectors (“waning stars”); countries which are losing their shares in dynamic sectors (“lost opportunities”), and countries which are losing their shares even in lagging sectors (“loss of competitiveness”). Table 7 classifies the countries of Latin America and the Caribbean according to these characteristics, showing that the group made up of Mexico and the Central American countries is mainly in the “rising stars” quadrant, whereas the South American countries are mostly in the “waning stars” category.

For the purposes of the present study, another important aspect of this apparent dichotomy is that the in-bond assembly industry is highly labour-intensive, whereas the industries based on the processing of natural resources are more capital-intensive. This difference as regards the proportions of the factors of production used has clear repercussions on the generation of employment. The available data are

<sup>14</sup> ECLAC (2000, vol. 1, chapter 3); see also Katz (2000).

quantitatively and qualitatively limited, so that the following analysis can only be viewed as a first approximation.

Table 8 gives some basic information on the relative behaviour of the northern and southern countries. Although both groups share some common features, especially the predominance of services as a source of employment, there are two obvious differences. In the northern countries, global employment growth was almost twice that of the southern countries (3.6% versus 1.9%). Furthermore, at the sectoral level, employment growth in the former was more vigorous or at least its decline was less marked. These differences have to do with the positive correlation between the increase in the number of jobs and the growth of the labour supply: i.e., the fact that the growth rate of the working-age population was higher in the first group of countries. The second difference emerging from the table is connected with the demand for labour: employment in the manufacturing sector in the northern countries grew at an average rate of 4.3% per year, i.e., faster than total employment, and it represented 13% of all the jobs created. In the southern countries, in contrast, employment in the manufacturing sector *declined* by an average of 0.1% per year.

Not all the countries evolved in this manner, however. In the southern hemisphere, for example, employment generation grew rapidly in Bolivia and Paraguay both in terms of total employment and employment in the manufacturing sector, although these jobs were of an own-account nature rather than jobs as wage-earners. Among the northern countries, Costa Rica did not do as well as its neighbours in terms of employment generation. Nevertheless, the differences between the two groups of countries are undoubtedly significant and raise important problems for the countries of the south, where in five of the nine nations (Argentina, Brazil, Colombia, Peru and Uruguay) there was a net loss of industrial jobs and in the majority of the countries the global employment trends were definitely unsatisfactory, even in quantitative terms.

Another difference between the northern and southern countries in terms of employment generation concerns the type of employment generated. Table 9 classifies total employment generated in five categories: wage-earners, own-account workers, domestic servants, unpaid family workers, and others.<sup>15</sup> In the northern

countries, the category which grew fastest was that of wage-earners, with an average annual rate of 4.2%, and it represented two-thirds of all the new jobs generated. In the southern countries, in contrast, wage labour only grew by 1.8% per year and accounted for less than half of the new jobs. The alternative was own-account employment, which grew more strongly in the south than in the north (4.0% versus 3.6%), although total employment increased more rapidly in the north. As a proportion of the total number of new jobs generated, own-account employment represented 27% in the north compared with 37% in the south. The differences with regard to the proportion of wage-earning employment are due to the differences in the demand for labour, which grew more rapidly in the north.

The differences regarding the demand for labour make it advisable to review the relation between the growth of GDP and that of employment. Figure 2 shows that the behaviour of the labour market was positively correlated with GDP growth rates. However, the results obtained by the southern countries as a whole were less satisfactory than might be expected from the level of GDP growth, so that in figure 2 most, although not all, of those countries are below the regression line, whereas all the northern countries are above it.

Another way of analysing the relation between growth and employment generation in the various countries and subregions is to calculate the employment elasticity. Table 10 shows the situation in the region in this respect in the 1990s, which backs up the hypothesis of a structural difference between north and south. Whereas the mean elasticity for the 15 countries as a whole is 0.79 (which means that for every increase by one percentage point in the product there is an increase of 0.79% in employment), the figure for the southern countries is 0.52, compared with 0.83 for the northern countries. This indicates that in the latter growth was more labour-intensive, thus helping to generate more jobs than might have been expected from the faster growth in the 1990s.

The significance of these elasticities must be interpreted with caution, however. As may be seen from the table, some of these are very high, both in northern and southern countries. In Bolivia, Honduras, Paraguay and Venezuela the elasticities exceed 1.00. Except partially in the case of Bolivia, these were situations in which supply pressures exceeded the capacity of the economy to generate jobs, in a context of low GDP growth rates. As a consequence, employment was "created" through own-account work and other informal-sector activities, not because the economic models favoured intensive use of labour.

<sup>15</sup> It should be noted that tables 8 and 9 give different totals for some countries because the information sources were different and so were the periods covered.

TABLE 8

**Growth of employment and contribution to that growth by individual sectors,<sup>a</sup> 1990-1999**  
(Percentages)

Country and period	Agriculture	Manufacturing	Construction	Commerce <sup>b</sup>	Basic services <sup>c</sup>	Financial services <sup>d</sup>	Social services <sup>e</sup>	Others	Total
Argentina	...	-3.1	1.0	0.3	4.0	4.9	3.0	...	1.4
1991-1999	...	-46.6	5.5	4.7	36.5	37.1	62.9	...	100.0
Bolivia	...	8.8	10.2	9.9	7.2	12.8	-0.3	-7.0	5.4
1990-1997	...	29.4	14.7	47.5	11.8	9.1	-1.5	-7.4	100.0
Brazil	-0.9	-0.2	2.4	2.8	3.0	5.6	2.6	-1.4	1.3
1992-1999	-18.0	-1.6	11.5	26.8	8.4	14.0	62.4	-3.6	100.0
Chile	-1.5	0.4	3.1	3.0	3.0	7.7	2.5	-3.4	1.9
1990-1999	-12.9	3.2	11.4	29.4	12.8	24.1	35.7	-3.5	100.0
Colombia	-0.5	-1.4	0.7	2.1	2.3	5.0	2.8	-6.6	1.1
1991-1999	-11.8	-17.4	3.0	40.7	12.1	18.7	61.0	-6.2	100.0
Costa Rica	-0.3	1.2	2.5	6.0	5.9	7.6	3.0	0.0	2.8
1990-1999	-2.6	7.4	5.9	38.6	12.5	11.1	27.0	0.0	100.0
El Salvador	-2.3	5.0	7.2	9.1	6.0	21.0	3.4	7.1	3.9
1992-1999	-8.1	10.7	4.4	23.0	3.2	5.4	8.0	0.1	100.0
Honduras	2.5	7.3	4.9	7.8	3.6	10.9	5.2	-2.7	4.9
1990-1999	19.9	22.3	4.9	29.5	2.0	3.7	17.9	-0.2	100.0
Mexico	0.0	5.1	1.8	4.3	5.1	5.6	3.8	-0.6	3.1
1991-1999	0.2	28.8	3.4	26.4	7.5	6.0	28.1	-0.4	100.0
Panama	-1.6	3.7	15.4	5.6	4.0	9.7	3.1	12.2	3.7
1991-1999	-9.6	9.6	20.8	32.4	9.0	13.6	23.4	0.8	100.0
Paraguay	2.8	4.9	0.5	10.4	7.8	...	8.4	-32.7	5.2
1992-1999	17.6	11.7	0.6	35.3	6.5	...	37.2	-8.9	100.0
Peru	...	-0.1	7.4	5.7	10.8	12.3	0.2	...	3.8
1990-1997	...	-0.6	9.9	44.1	16.5	16.5	1.7	...	100.0
Dominican Rep.	1.6	3.1	14.4	6.3	6.0	-5.4	1.1	-17.0	3.5
1991-1999	8.9	15.6	19.5	42.7	12.1	-2.9	7.6	-3.6	100.0
Uruguay	...	-4.0	1.8	0.4	1.0	2.9	-0.7	1.1	-0.5
1990-1999	...	-138.3	23.7	12.2	12.0	29.6	-29.6	11.5	100.0
Venezuela	1.0	2.0	3.9	6.0	4.2	2.3	3.4	-0.8	3.5
1990-1999	3.2	8.4	8.5	39.8	8.8	3.8	27.7	-0.2	100.0
Latin America	-0.3	1.2	2.8	4.0	4.4	6.0	2.8	-2.1	2.2
(weighted average)	-4.1	8.3	7.8	32.7	10.8	12.3	34.8	-2.4	100.0
Latin America	-0.1	1.6	2.8	5.8	4.1	6.6	3.0	-1.1	3.5
(mean)	-1.2	9.6	5.9	32.4	8.8	8.6	33.4	-0.3	100.0
Northern countries	-0.1	4.3	6.0	6.1	5.5	8.6	3.3	-0.3	3.6
(mean)	-1.2	13.2	5.4	30.9	8.2	5.7	27.6	-0.1	100.0
Southern countries	-0.5	-0.1	3.1	5.7	4.2	6.7	3.3	-3.4	1.9
(mean)	-11.8	-0.6	9.9	35.3	12.1	17.6	48.3	-3.5	100.0

Source: Calculations prepared by the authors on the basis of official country statistics.

<sup>a</sup> The first line for each country refers to the annual growth of employment in the period shown; the second line indicates the contribution of each sector to the total employment generated in that period. The data are nationwide totals except in the cases of Argentina (urban areas), Bolivia (capitals of departments and El Alto) and Peru (Metropolitan Lima). It should be noted that for Latin America and the northern and southern countries the rows do not add up to the total because they represent the means for the columns.

<sup>b</sup> Including hotels and restaurants.

<sup>c</sup> Electricity, gas and water and transport, storage and communications.

<sup>d</sup> Includes insurance, business services and real estate.

<sup>e</sup> Includes community and personal services.

TABLE 9

**Growth of employment and contribution to  
that growth by categories of employment in the 1990s<sup>a</sup>**  
(Percentages)

Country and period	Wage earners	Own-account workers	Domestic service	Unpaid family members	Others	Total
Argentina	1.8	-1.0	2.3	...	0.9	1.1
1991-1997	100.7	-20.0	14.7		4.5	100.0
Bolivia	4.7	5.5	-2.9	11.6	16.1	5.5
1990-1997	41.4	34.7	-2.8	12.3	14.4	100.0
Brazil	1.1	1.5	3.8	-1.9	3.1	1.2
1992-1997	49.0	34.2	22.5	-15.7	10.0	100.0
Chile	3.3	2.4	-0.6	-1.9	0.2	2.5
1990-1997	84.1	22.4	-1.4	-15.7	0.3	100.0
Colombia	1.1	4.0	0.1	-7.5	-1.4	1.4
1991-1997	43.8	92.3	0.2	-31.3	-5.0	100.0
Costa Rica	2.7	2.8	2.8	-4.4	7.8	2.7
1990-1997	64.6	20.0	4.4	-6.7	17.7	100.0
El Salvador	5.8	3.1	3.5	-1.9	-4.4	3.4
1992-1997	83.6	26.3	4.4	-5.1	-9.2	100.0
Honduras	4.4	4.9	4.2	3.8	15.8	4.8
1990-1997	40.6	38.1	3.5	9.9	7.9	100.0
Mexico	4.0	4.0	8.4	3.0	-5.9	3.4
1991-1997	62.7	28.2	9.1	11.3	-11.2	100.0
Panama	5.0	5.0	4.0	-2.3	-13.1	4.0
1991-1997	70.8	36.6	5.8	-2.4	-10.7	100.0
Paraguay	2.9	6.3	8.5	20.4	11.5	6.3
1992-1997/98	19.6	37.2	8.9	25.5	8.8	100.0
Peru	1.7	5.3	1.7	...	...	3.8
1991-1997	18.4	81.0	0.6			100.0
Dominican Republic	3.6	0.8	...	8.0	-2.0	1.9
1991-1996	79.3	14.5		12.7	-6.4	100.0
Uruguay	0.8	1.6	...	-0.3	-2.0	0.8
1991-1997	77.0	37.8		-0.5	-14.3	100.0
Venezuela	2.7	8.2	...	-10.0	0.2	3.8
1990-1997	46.8	57.5		-4.6	0.3	100.0
Latin America (weighted average)	2.2	2.2	3.0	3.8	0.2	2.2
	52.7	38.2	9.1	-0.4	0.4	100.0
Latin America (mean)	2.7	4.0	3.2	-1.9	0.2	3.4
	62.1	34.7	3.5	-1.5	0.3	100.0
Northern countries (mean)	4.2	3.6	4.0	0.6	-3.2	3.4
	67.7	27.5	4.4	3.7	-7.8	100.0
Southern countries (mean)	1.8	4.0	1.7	-1.9	0.6	2.5
	46.8	37.2	0.2	-2.6	2.4	100.0

Source: Calculations prepared by the authors on the basis of official country statistics.

<sup>a</sup> The first line for each country refers to the annual growth of employment in the period shown; the second line indicates the contribution of each sector to the total employment generated in that period. The data are nationwide totals except in the cases of Argentina (urban areas), Bolivia (capitals of departments and El Alto) and Peru (Metropolitan Lima). It should be noted that for Latin America and the northern and southern countries the rows do not add up to the total because they represent the means for the columns.



TABLE 10  
GDP growth rates and  
employment/GDP elasticity in the 1990s

Country	GDP growth rate	Employment/GDP elasticity <sup>a</sup>
Argentina	4.7	0.30
Bolivia	4.0	1.35
Brazil	2.5	0.52
Chile	6.2	0.31
Colombia	2.6	0.42
Costa Rica	5.2	0.54
El Salvador	4.5	0.87
Honduras	3.0	1.63
Mexico	3.2	0.97
Panama	4.7	0.79
Paraguay	2.1	2.48
Peru	4.6	0.83
Dominican Republic	5.0	0.70
Uruguay	5.0	-0.17
Venezuela	2.0	1.75
Latin America (mean)	4.5	0.79
Northern countries (mean)	4.6	0.83
Southern countries (mean)	2.9	0.52

Source: ECLAC (2000a, p. 66).

<sup>a</sup> The elasticity was calculated by dividing the growth rate of employment by the growth rate of GDP.

As already noted, the behaviour of the manufacturing sector is the main factor explaining the difference in terms of employment creation between the northern and southern countries, and the assembly industry plays an important part in this, which explains the disparities within industry as a whole. Table 11 shows the importance that the assembly industry has had. In reality, during the 1990s it was the only form of manufacturing that registered employment growth worthy of mention.<sup>16</sup> In some countries, especially Mexico and the Dominican Republic, there were already a considerable number

TABLE 11

**Employment in the assembly industry, 1990-1999**

Country	Employment in assembly industries (thousands)			Employment in assembly industries as a percentage of employment in manufacturing (1999)	
	1990	1996	1999	Total	Formal
Costa Rica	33	48	...	25 <sup>a</sup>	36 <sup>a</sup>
El Salvador	2	38	45	11	...
Guatemala	45	62	...	...	48 <sup>a</sup>
Haiti	...	20	...	...	...
Honduras	18	76	120	32	...
Mexico	446	779	1197	16	28
Nicaragua	0	8	20	16	36
Dominican Republic	130	164	191	37	...

Source: Calculations by the authors on the basis of official country statistics.

<sup>a</sup> 1996.

<sup>16</sup> See ECLAC (1997, p. 93, and 2001a, chapter 3).

of jobs in such firms at the beginning of the 1990s, but the main increase took place during the decade. In 1999, jobs in the assembly industry represented between 10% and 40% of total employment in manufacturing in the sample of northern countries shown in the table, while they represented up to 48% of total formal-sector employment. As they depend on exports to the United States, the buoyancy of the United States market in recent years was decisive for the development of this industry; it remains to be seen how they will fare when circumstances are less favourable.

The big growth in employment in the assembly industries does not mean that the traditional industries of the northern countries have escaped the heavy impact of trade openness and modernization on employment suffered by the manufacturing sector in the southern countries. In Mexico, just as in Argentina and Brazil, the increase in imports affected labour-intensive industries such as textiles and leather products, and between 1990 and 2000 the number of jobs in non-assembly industries went down by over 10%, with a slight recovery from 1997 on.<sup>17</sup> In view of these common trends, the increase in manufacturing employment in the northern countries and its contraction in those of the south may be attributed mainly to the presence of the assembly industries in the former.

The assembly industries have often been accused of not complying with basic labour standards such as the right of association, of having substandard working conditions and of not making a significant contribution to economic and social development.<sup>18</sup> The sector includes very different types of enterprises, however, and it is hard to generalize.

<sup>17</sup> Weller (2000a, chapter 5) and ECLAC (2001a, chapter 3).

<sup>18</sup> See for example ILO (1996, pp. 34-35). For a more detailed analysis of the assembly industry, including both its advantages and disadvantages, see Buitelaar, Padilla and Urrutia (1999) and Buitelaar and Padilla (2000).

# V

## Policy recommendations

There are still substantial problems in Latin America in terms of economic development, investments and productivity, but progress was made during the 1990s in these respects compared with the 1980s. The problems related with employment and equity grew worse, however: employment generation was sluggish, the quality of jobs deteriorated, and inequality probably increased. Consequently, governments must devise policies expressly aimed at solving these problems. The data we have presented here on the differences between employment generation in the north and south of the region indicate that such policies must to some extent be adapted to the characteristics of each country.<sup>19</sup>

For the region as a whole, however, policies must bear in mind in general that measures to speed up growth must form an integral part of any strategy designed to promote employment generation. In order to reduce unemployment and inequality, growth rates must be high and stable. The nature of the growth obtained is also important. The new development model applied in Latin America entrusts the private sector with the task of leading investment, but governments can offer incentives so that growth will be based on more intensive use of labour. This is why the creation of infrastructure is important: it has the dual advantage of increasing the competitiveness of the country and also generating a considerable number of jobs. Concessions, as an extension of the privatization process, are a useful means of achieving this.

As regards the northern countries, the assembly industry offers great potential for improving the labour market situation both quantitatively and qualitatively. Substantial differences may already be observed among assembly firms in terms of technology, human capital requirements, compliance with labour legislation and other aspects, indicating that they are capable of developing with positive consequences for employment.

Recognition of this potential would help to overcome the futile confrontation between those who criticize the shortcomings of many assembly industries in terms of working conditions and the supporters of these enterprises, who insist that most of the people working in them have no satisfactory employment alternatives. As the jobs offered by the assembly industry correspond to the formal sector, they most probably offer some advantages compared with informal-sector activities, but they are often characterized by their deficient working conditions and refusal to allow workers to join trade unions. By combining outside pressures on the enterprises to comply with basic standards, such as the obligation to apply codes of conduct and the adoption of seals of social quality, with internal measures to guarantee the right to join trade unions and the fulfillment of labour legislation, it would be possible to improve working conditions without jeopardizing the competitiveness of the enterprises.

The assembly sector could also be improved through reforms which gradually change the basis of its competitive advantages from low factor costs to the greater use of knowledge: a trend which can already be observed in some production networks, especially in the U.S./Mexico border zone and in Costa Rica. Another improvement could be to integrate the assembly industry more tightly into the production structure of the country by creating links with small and medium-sized enterprises. This would undoubtedly require not only legal reforms but also an improvement in the competitiveness of domestic producers.

In the South American countries, the assembly industry is not so important as the need to give support to small enterprises so as to complement the capital-intensive production structure that prevails at present. In devising employment policies for these units, a distinction must be drawn between small and medium-sized enterprises and micro-enterprises. The former generally have some economic potential, so that the problem is to increase their competitiveness, but although this is also true of some micro-enterprises, many of them operate more as survival strategies than as firms which have any significant business

<sup>19</sup> This section is based on Stallings and Peres (2000, chapter 7) and Altenburg, Qualmann and Weller (2001). For other proposals for policies to improve the employment situation, see IDB (1996), Edwards and Lustig (eds., 1997) and Tokman and Martínez (1999).

capacity for improving working conditions. In the longer term, then, the workers in the great majority of these units need to be given more education and training so that they can find better employment opportunities in other sectors of the economy.

In other parts of the world, two methods have been used to improve the situation of small enterprises and could serve as useful examples for the governments of Latin America. The first is the formation of groups of enterprises engaged in the same line of activity, in order to reduce the cost of services for small enterprises. Among the most successful of these groups are those which have been set up in northern Italy. Credit operations are particularly costly when it is necessary to negotiate with a number of small firms, and the use of a system of collective loans has proved to be viable in this respect, even in the case of micro-enterprises (examples are the Banco del Sol in Bolivia and the Grameen Bank in Bangladesh). The same method has given good results in the case of small agricultural producers too. The formation of groups can be useful not only for credit but also for reducing the cost of other inputs and marketing.

The second method of tackling the need to create productive jobs is for small and medium-sized firms to establish links with larger companies as suppliers. It is in the interest of the larger firms to help increase the competitiveness of their small suppliers in this way, especially in the fields of information, technology, training and finance. In a number of Asian countries, including Japan, such relations with suppliers have markedly improved the viability of small firms, even though at times of crisis the latter tend to be the losers. A variant of this approach is the contract production model, whereby a foreign marketing firm buys the products of firms that manufacture them to its specifications. There are a number of such agreements in Latin America, some of them more successful than others.

Some labour experts have proposed that the labour market should be made even more flexible.<sup>20</sup> In our opinion, the labour markets are already much more flexible than is generally believed. We are also concerned at the possibility of introducing radical reforms with dubious consequences both for new jobs and for the quality of the existing ones. It would be

very undesirable to apply an across-the-board solution in view of the marked differences among the labour markets of the region.

Instead of centering their attention exclusively on making the labour markets more flexible, the authorities should rather seek ways of making them operate better. At all events, if a government did decide to press ahead with flexibilization it would also have to provide access to an unemployment insurance scheme and, in order to facilitate the transition from one job to another, cease to make benefits conditional on length of service in a given firm. Another way of improving the operation of the labour markets would be to provide workers and firms with more information in order to reduce the period spent looking for work and the resulting temporary unemployment. As these measures would not eliminate structural unemployment, they would have to be combined with the employment generation policies mentioned earlier.

Initiatives for stimulating employment are not a substitute for the other social policies but rather a complement to them. There are two kinds of complementarity, which overlap with each other. One is to increase the capacity of the labour force to adapt to the new demands of the labour market, especially now that the region is participating more fully in the world economy; in this respect, education and training are of fundamental importance, although health and housing are also important. The other is based on the establishment of safety nets to aid the most vulnerable groups: i.e., those who do not have access to the labour market or whose income is not sufficient to allow them to maintain their families. Both types of initiatives require an increase in social expenditure.

After the contraction in social expenditure which took place during the crisis of the 1980s, all the countries increased it in the following decade, some of them by a substantial proportion.<sup>21</sup> The resources for this increase come from one or more of the following three sources: faster GDP growth, an increase in public spending as a percentage of GDP, or an increase in the proportion of total public spending represented by social expenditure. Countries where social expenditure accounts for only a small proportion of GDP should increase that proportion in order to expand their social services; the others will probably

<sup>20</sup> See, for example, Guasch (1996), Burki and Perry (1997), Márquez and Pagés (1998) and Heckman and Pagés (2000).

<sup>21</sup> See ECLAC (1999, chapter 4).

have to resort to one of the other two mechanisms. Several countries, however, are approaching the maximum politically viable level of social spending as a proportion of total public expenditure. In these circumstances, they have three possibilities: to make more efficient use of the existing resources, to increase total public expenditure, for which they would have to increase total revenue, or to expand the participation of the private sector. All these options present problems, and the question of which of them is most advisable will vary according to the country, depending on its circumstances and the preferences of its society as a whole.

It will not be much good increasing and improving social expenditure if it is subsequently reduced when there is a crisis. This is what happened in the 1980s, and as social expenditure has a markedly pro-cyclical tendency there is always a danger of future reductions. Governments must take care to ensure that social expenditure is protected at times of crisis. The long-term social losses resulting from crises are often never recovered. Children who drop out of school may never return to it, workers who lose their jobs may lose experience of incalculable value if they have difficulty in finding work again, and families who lose their homes may have problems for many years afterwards. The most likely thing is that those who benefit from subsequent reactivation of the economy will not be the same people who were adversely affected by the crisis.

The social services must give priority to improving and expanding access to education. Spending on education has the double advantage

that it contributes both to competitiveness and greater equality, albeit in the relatively long term. Many of the problems of income distribution and productivity suffered by Latin America are due to its large supply of unskilled labour, which is the result of many years of shortcomings in education. It is of the utmost importance to overcome this legacy of educational insufficiency. This matter has been extensively analysed, but there are still numerous controversies and problems regarding the manner of achieving this goal. In the case of basic education, the main thing is to improve its quality; in secondary education, what is needed is to expand its coverage and access to it. With regard to higher education, it is necessary to improve access and ensure proper selection of the areas of specialization. A substantial increase in the number of people entering the labour market with full secondary education would help to solve both the economic and the social problems of the region.

In short, it is urgently necessary for the Latin American and Caribbean countries to take steps to solve their problems in respect of employment, which is the main link between economic and social development. Employment problems are also a danger to democracy in the region, as a number of cases have shown. The solutions must be multi-faceted. In the area of economics, they involve an increase in growth rates and hence also in investment, while at the social level they will demand special efforts in education. This alone is not enough, however, since it is also a question of applying policies designed to promote employment and devoting special attention to the problems of small and even micro-enterprises.

(Original: Spanish)

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# Trade in *transgenic products:* a review of the *international debate*

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Transgenic products have a number of contradictory aspects.

On the one hand, the genetic manipulation of plants makes it possible to develop both products which contain insecticidal toxins and can thus permit a reduction in the use of pesticides that may harm the environment, as well as foodstuffs with contents of vitamins and proteins that can improve the social indicators of the developing countries. On the other hand, however, questions have been raised about the possible effects of transgenic products on biosafety and biodiversity and the potential danger involved in consuming them, and the various actors participating in the debate on these products have widely different positions on their commercialization. The process of negotiation and subsequent approval of the Biosafety Protocol and the controversies over acceptance of the safety first principle or over the rules of the World Trade Organization (WTO) for restricting the production and commercialization of transgenics have shown up the great divergences that exist among governments.

# I

## Introduction

### 1. Background

New biotechnological research with economic applications has been taking place for several decades now. The rapid progress of biotechnology ("the genetic revolution") is often compared with the "green revolution" of the 1960s and 1970s. The new biotechnology<sup>1</sup> has a direct relation with biosafety and biodiversity, both of which are important tools for enabling a country to achieve economical and efficient agricultural development.

Genetic engineering techniques play a fundamental role in the progress of agricultural biotechnology and have a particularly strong impact on the inputs used in agriculture and food production. Manipulation of the existing genes allows agroindustrial enterprises to develop new varieties of crops and processed foodstuffs with a smaller consumption of energy or chemical inputs.

The use of agricultural biotechnology has given rise to great expectations, but also to uncertainty over possible risks. There is concern over its possible repercussions on human health and the environment. Even though there is no evidence so far that biotechnology makes foodstuffs any less innocuous, there is continuing mistrust in society about consuming products subjected to such techniques.

The Convention on Biological Diversity defines biotechnology as "any technological application that uses biological systems, living organisms, or derivatives thereof, to make or modify products or processes for specific use". This definition covers a whole range of techniques used in agriculture and the food industry, such as DNA<sup>2</sup> and reproductive techniques and gene manipulation and transfer. Through their application it is possible to modify foodstuffs more quickly and precisely.

Genetic engineering techniques make it possible to alter the inherited characteristics of living organisms such as animals or plants. The individual genes are extracted from the genome of one organism and

introduced into that of another, so that moving the genes also moves their features and characteristics and new substances or functions are produced. The resulting organism has a new combination of genes which is not found in nature and cannot be attained by natural means. The use of these techniques makes it possible to increase or block the amount of proteins produced by an organism which, for example, does not produce them or whose production it is desired to inhibit (OECD, 1999a).

Another application of biotechnology is the use of techniques to recombine DNA. Scientists can isolate the genes of different organisms, different species or a single species and divide or join them and add or transfer genetic material between different varieties deliberately and at will. This technique has a well-defined capacity for intervention. As the DNA is part of the nucleus of cells, the genetic information is transferred between unrelated organisms to produce a new one. Thus, with the existing technology hereditary information can cross the barriers between species (OECD, 1999a and 1999b; Grace, 1997).

Through the breaking down of biological barriers and crosses between species, transgenic foodstuffs or organisms are obtained. The new organisms with the desired genetic characteristics are a crop variety which is identical to the traditional one but now incorporates new genetic information.

### 2. The issues and actors in the international debate

#### a) *The issues*

Biotechnological applications are designed to help satisfy the growing food needs of the world's population. At the same time, however, scientists and entrepreneurs warn that scientific progress, while offering benefits to society, also presents risks and challenges of an ethical, environmental and health-related nature.

Ethical, because it is within their territories that the indigenous communities of some developing countries possess the ownership and knowledge of the genetic resources found there. These countries and communities are not taken into account, however, when

<sup>1</sup> Hereinafter, "biotechnology" will be used in the sense of the modern or new biotechnology.

<sup>2</sup> The nucleic acid chain containing the genetic material governing the development of cells and organisms.



the enterprises that possess the relevant technology share out the resulting benefits. The use of biotechnology cannot be viewed solely from the scientific standpoint, because when scientists intervene they produce genetic combinations that may transgress the laws of nature.

Environmental, because agricultural biotechnological applications raise possible risks of reducing biodiversity and affecting the biological balance. Crops - plants and organisms - can be reduced to a state of complete uniformity from the genetic standpoint. Expanding the area devoted to a single type of crop reduces the overall variety of crops and contributes to the loss of genetic diversity, especially in rural areas. There may also be a risk of developing wild species which are resistant to insecticides or to diseases and thus unbalancing the ecosystem.

Lastly, the fear that the consumption of transgenic foodstuffs may be dangerous to health is due to the fact that there is no convincing scientific evidence that such foodstuffs really are harmless. The risks involved include the transfer of toxins or allergenic compounds from one species to another, the creation of new toxins, or the appearance of unexpected allergic reactions. This is one of the ever-present issues in the present debate. The short length of time that has passed since the introduction of these products makes it difficult to deal with this problem, because of the insufficient evidence available for determining whether transgenic foodstuffs are a danger to human health or not.

The use of transgenic organisms in agricultural production has revealed improvements in some of the original characteristics, such as greater resistance to certain pesticides or herbicides and to diseases or pests (viruses, fungi, insects and parasites). Crops are now better adapted to environmental conditions - such as frosts, droughts and poor soils - which were unfavourable when using traditional techniques; they have a higher content of nutrients, vitamins, minerals or proteins; their fat content is lower; the flavour, colour or texture of foodstuffs is better, and they are easier to prepare and store.

One of the contributions of genetic modification is that it can introduce elements designed to lower the risk of infection and reduce the use of chemical products for pest control. Some experts note, however, that this resistance can also represent a threat to biological diversity, because farmers will tend to cultivate genetically uniform plant varieties or the conservation and/or use of traditional crops will be adversely affected.

Another unfavourable result is the spread in the earth of micro-organisms which can give rise to biochemical changes and affect the balance of the ecosystem. There is also the negative impact of transgenic crops on the conservation of neighbouring traditional crops, by pollinating them with genetically modified elements and passing these on to future generations of the crops. Furthermore, while biotechnology has developed new and more powerful pesticides and weedkillers which destroy pests and weeds and prevent them from affecting crop productivity, they may also endanger other plants which are desirable for conserving biodiversity (Brañes and Rey, 1999).

At the same time, the cultivation of transgenic crops can cause socio-economic changes in less developed countries by displacing labour from one of its principal economic activities. In those countries, an important source of employment is the cultivation of staple crops such as maize, and the displacement of the labour force employed in this can endanger the livelihood of a considerable part of the population.

#### b) *The actors*

The participants in the international debate include governments, biotechnology enterprises, scientists, non-governmental organizations, farmers, consumers and environmentalists; some of them are more critical than others of the application of the new techniques. These groups are not homogeneous and display differences both among them and within the groups themselves.

There are two main currents of opinion, with opposing arguments, in the debates on the use of biotechnology. One of them, which supports the new biotechnology, is made up in particular of producers and distributors; the other group, which rejects this technology, is mainly made up of consumers and environmentalists.

Those in favour of the continued progress of the biotechnology industry emphasize that the greater output will allow consumers to obtain food at lower prices because of the lower production costs, the reduced use of production inputs and chemicals, the higher yields, and the availability of more environmentally favourable production techniques. The application of biotechnology to crops, they claim, has given these greater resistance to pests, diseases and adverse environmental conditions.

The biotechnology industry is run mainly by a small group of transnational corporations, mostly

located in industrialized countries. These enterprises develop and market products and processes and are concerned with achieving efficient production and making a profit. The high cost of biotechnological innovation means that the world seed, fertilizer and pesticide market is concentrated in only a few enterprises, which, in their campaigns in favour of transgenic products, lay great stress on the fact that only small amounts of their inputs are needed in agricultural production. The transnationals do not, however, publicize the fact that they themselves are the main producers of such agricultural inputs: they control 60% of the pesticide market and 100% of the transgenic seed market.

Distributors also gain from the advance of biotechnology, since perishable transgenic foodstuffs can be stored longer without deterioration.

Scientists do not take a united stance. They are divided between those who defend the harmlessness of transgenic foods, on the grounds that so far they have not caused any major accidents in the areas of health and the environment, and those who consider that such foods involve potential risks. As public opinion is highly sensitive to biotechnological matters, scientists must redouble their research efforts in order to arrive at an objective and impartial evaluation of their effects.

Those members of the scientific community who are in favour of biotechnology consider that the use of the new genetic techniques is an advance and that, if they are properly used, they could benefit countries by improving their crop yields, saving costs on inputs, or improving production by increasing the content of nutrients in foodstuffs. They also consider that facilitating access to markets would help developing producer countries to reduce their dependence on imported staple foods, thus enabling them to combat famines in depressed areas.

Consumers are not very well organized and, unlike the scientists, they have only confusing information on the risks and benefits of transgenic foods for health. The information they receive is incomplete, since the producing companies do not always publicize the transgenic origin of their products, thus further increasing the degree of uncertainty. They consider that they have the right to receive innocuous and good-

quality foodstuffs and to know what inputs were used in their production. They demand transparency, education and true, adequate and timely information on the benefits and risks for their health. They do not always believe that the results of scientific studies are true. They are very reluctant to accept agricultural products that damage the environment. They claim that regulations are either non-existent or inappropriate, and they demand more participation from the governments responsible for regulating the production and marketing of the new products.

Advances in biotechnology help to create new foodstuffs of agricultural and agroindustrial origin, and since these are aimed at society as a whole, greater attention should be paid to consumers' complaints. Society demands that governments should detect and appraise possible health risks before allowing transgenic foodstuffs to be placed on the market.

Environmentalists are generally against the production of these foods because they consider that they represent risks for the environment and biodiversity and not enough studies have been made of the possible dangers. This group is also joined in this attitude by the non-governmental organizations, which take an active part in these debates.

The debates stress the need to carry out more careful studies of the effects that the application of genetic engineering techniques may have on human health, on the environment and on agriculture, and they emphasize that the task is how to produce more and provide real benefits to society.

The studies on the effects of incorporating biotechnological applications in the agricultural environment have centered mainly on the developed countries, especially the United States and the Western European countries. The differing interpretations on the harmlessness of transgenic products which have emerged in the developed world, however, have given rise to concerns which have spread to the developing countries in advance. With the appearance of the first transgenic products, some governments have shown more concern than others, regulating transgenic crops in experimental fields and providing information to ensure that there are no risks even before the modified products are placed on the market.

## II

### Production and commercialization of transgenic foodstuffs

#### 1. World production

The surprisingly rapid growth in the area planted with transgenic crops faces agricultural producers with an enormous challenge. According to James (2000), the total area planted with such crops in the world increased from 1.7 million to nearly 40 million hectares between 1996 and 1999. The 44% increase between 1998 and 1999 was accounted for mainly by four industrialized and four developing countries.<sup>3</sup> The total area planted with transgenic crops in the United States came to 29 million hectares in 1999: i.e., almost 80% of the world total (table 1).

In the year 2000 this area increased once again, but more slowly. The 11% increase over the previous year was equivalent to 4.3 million hectares, of which 3.6 million (84%) corresponded to developing countries, with the remaining 0.7 million (16%) being accounted for by industrialized countries. Between 1996 and 2000, the area planted with such crops increased by a factor of 25 and the number of countries involved rose from 6 to 13. Today, these crops have spread to Australia, China, India, Malaysia and Thailand.

The United States, Canada and Argentina accounted for 98% of the total area planted with transgenic seeds in the year 2000. In that year, 100% of the area planted with such crops corresponded to soya beans, maize, cotton and canola. Of the 273 million hectares devoted to these four products in the world, 16% corresponded to modified crops (table 2).

In 2000, there were 26 million hectares of modified soya in the world: 58% of the total area planted with transgenic seeds and 19% more than in the previous year. Thus, of the 72 million hectares of soya planted in the world, 34% corresponded to the modified variety.

Between 1999 and 2000 the total area planted with modified maize in the world went down from 11.1 million hectares to 10.3 million, so that of the 140 million hectares planted with maize in the world, 7% corresponded to the transgenic variety. The reductions

<sup>3</sup> South Africa, Argentina, Australia, Canada, Spain, the United States, France and Mexico.

TABLE 1

**Selected countries: Area of transgenic crops, by country,<sup>a</sup> 1997-2000**  
(Millions of hectares)

	1997	1999	2000	2000/1999 (%)
United States	8.1	28.7	30.3	6
Argentina	1.4	6.7	10.0	49
Canada	1.3	4.0	3.0	-25
Australia	0.1	0.1	0.2	100
Mexico	0.1	0.1	< 0.1	0.0
Europe	...	...	...	...
<i>Total</i>	<i>11.0</i>	<i>39.9</i>	<i>44.2</i>	<i>11.0</i>

Source: Agrodigital, 11-05-99, Bioinfo Centre, <http://www.biotechknowledge.com>; reference 2781.

<sup>a</sup> Excluding China. Inclusion of China would increase the total area for 1997 to 12.8 million hectares.

TABLE 2

**World: Area of transgenic crops, 1996-2000**  
(Millions of hectares)

Crops	1996	%	1999	%	2000	%
Tomatoes	0.1	4	...	...	...	...
Potatoes	...	...	0.1	...	...	...
Soya	0.5	18	21.6	54	25.8	58
Maize	0.3	10	11.1	28	10.3	23
Tobacco	1	35	...	...	...	...
Cotton	0.8	28	3.7	9	5.3	12
Canola	0.1	5	...	...	2.8	6
<i>Total</i>	<i>2.8</i>	<i>100</i>	<i>39.9</i>	<i>100</i>	<i>44.2</i>	<i>100</i>

Source: James, 2000.

in the United States and Canada were partly offset by increases in Argentina and South Africa. In the year 2000, the United States Environmental Protection Agency (EPA) warned growers of modified maize that they must reserve between 20% and 50% of their cultivated area for traditional products in order to help stop the increase in transgenic crops.

Cotton has an important place among transgenic crops: between 1999 and 2000 it increased by 1.6

million hectares (43%). Of the 34 million hectares planted with cotton in the world, 16% correspond to transgenic cotton. The increases observed are mainly due to the larger areas planted in the United States (55% and 72% in 1999 and 2000 respectively). China also increased its area of this crop, but only moderately (10%); it was followed by Mexico, Australia, Argentina and South Africa.

China was one of the first countries to produce transgenic crops. It began in 1992, and this activity has come to occupy an important place in the country. In 1999 it planted some 750,000 hectares of such crops (mostly cotton), and it is estimated that in 2000 the total area came to 1.2 million hectares.

The situation in Europe is different, and the areas planted with transgenic crops are only small. Spain is an importer of transgenic products, especially modified maize, and it has the largest experimental plantations of genetically modified products in Europe, with over 20 experimental stations. In 1999 it was the leading producer of modified maize, with 10,000 hectares planted with this crop (0.02% of the world total). In the year 2000 the total area planted with transgenic crops went down in Europe, but two new producers entered the scene: Romania with soya and potatoes, and Bulgaria with maize.

In recent years the European Union has approved only a few experimental plantations, and only for a limited number of transgenic crops. The small number of authorizations granted by the EU, compared with the number granted by the United States, Canada and some Latin American countries, is putting the European authorities under pressure. In 1999 the United States approved 35 modified crops and the EU countries only nine, while Japan alone authorized seven.

Early in 2001, the European Parliament approved the unification of the different national regulations and authorized the fixing of deadlines and labelling standards, which suggests that it intends to put an end to the moratorium on the marketing of modified agricultural products. This new attitude could begin to bring the positions of the European countries closer to that of the United States.

## 2. Production in Latin America

The area planted with transgenic crops in the developing countries increased by 14% in 1997, 18% in 1999 and 24% in 2000. In the latter year, a quarter of the total world area planted with such crops corresponded to the developing countries (10.7 million hectares).

Between 1999 and 2000, the area of transgenic crops in the developing countries increased from 7.1 to 10.7 million hectares (51%), the countries which contributed most to this increase being China and Argentina, with 0.5 million and 10 million hectares respectively.

In 1998 there were two outstanding developing producers of transgenic crops: Argentina, with 15% of the total area, and Mexico, with nearly 1%. Argentina has the largest area of transgenic crops in Latin America and is the second largest producer of them at the world level, with 4.3 million hectares out of a world total of 28 million in 1998.

Soya accounts for the largest number of hectares of transgenic crops, and Argentina is the third largest producer of transgenic soya in the world. Over the last five years the area devoted to this crop has grown by 29%, while over the last ten years it has doubled, reaching 7.4 million hectares in the year 2000. Of the 4.2 million hectares by which world production of transgenic soya increased in that year, 2.7 million corresponded to Argentina and 1.5 million to the United States; in 2000 the total area planted with soya was 9.6 million hectares in Argentina and 30.2 million in the United States.

The cultivation of modified maize, for its part, increased from 5% to 20% between 1999 and 2000 in Argentina, and this growth, together with that registered in South Africa, partly offset the decline in the United States and Canada.

Mexico has one of the highest levels of biodiversity in the world, and its protection is a priority matter. It has authorized some 150 applications to release genetic organisms in fields, greenhouses and laboratories, of which 33 corresponded to maize, 28 to cotton, 15 to tomatoes, 13 to soya and 3 to wheat, among other species.

In Brazil, biotechnology is applied especially in agriculture. That country is the second largest producer of soya in the world, with an output of 30.5 million tons in the 1998-1999 period. Brazil has great biodiversity, and the government seeks to protect it by limiting or prohibiting modified crops until environmental impact studies are carried out. At the end of 2000, however, the situation seemed about to be reversed with the Ministry of Agriculture's announcement that it would permit the production of those crops for which there was a demand.

In Chile there are nearly 5,000 hectares of transgenic seed plantations, mostly run by foreign firms. Land is available for their reproduction, and there is a

possibility of increasing exports of such seeds in coming seasons. The country has been importing genetically modified seeds of maize, soya, sugar beet, canola and tomatoes since 1992 but only for reproduction and export, since their local sale is not yet allowed (Manzur, 1999). The production of transgenic foods for local consumption is not allowed, but such foods are imported without any knowledge of the origin of the inputs they contain. A high percentage of the imports of foodstuffs containing soya and maize come from Argentina and the United States, without any indication of whether they contain manipulated genes.

Uruguay and Paraguay take a cautious stance in this respect. In 2001 the Ministry of Stockraising, Agriculture and Fisheries of Uruguay authorized the experimental planting of transgenic products, but not their sale. In Paraguay, consideration is being given to an application to allow Argentina and the United States to introduce transgenic soya and maize seeds, but so far the country is considered to be free of transgenics (The Biotechnology Knowledge Center, 1999a and 1999b).

Costa Rica has a rich diversity of biological resources and uses biotechnological means to conserve them. It is estimated to possess 5% of the biodiversity existing in the entire world (Brañes and Rey, 1999). The use of pesticides on banana, coffee and rice plantations trebled between 1993 and 1996, causing health problems for workers and contamination of land, water and animals.

### 3. Trade

Between 1995 and 1998, world sales of transgenic crops soared from US\$ 84 million to nearly US\$ 2.3 billion, and in 1999 they amounted to US\$ 3 billion (Krattiger, 1999), while they are expected to reach US\$ 20 billion by 2010 (James, 1999). The most important market is for seeds, followed by microbiological agricultural inputs. There is a growing trade in new types of fruit and vegetables marketed directly by the companies that develop them (Jaffé and Infante, 1996).

Authorizations for the marketing of transgenic products include such items as soya, canola, cotton and potatoes. The countries which market the largest quantities of modified foods are the United States, Canada and Australia, together with some Latin American countries such as Argentina and Mexico. The

marketing of such products has got off to a slow start in Europe, where the sale of only 18 transgenic products has been authorized between 1992 and 1998.

The United States leads the way in the use of genetic engineering in the production of modified soya, maize, wheat and cotton for export. It accounts for nearly 90% of the world trade in transgenic soya and maize. In transgenic soya alone it exports 40% to Europe. It exported some 9 million tons of modified and unmodified soya in 1998 (*The Economist*, 1999).

United States exports of modified maize to the European Union went down from 2.7 million tons in 1995/96 to only 100,000 tons in 1997/98 because of the mistrust of EU consumers over possible effects on health.

Japan imports transgenic foods, mainly from the United States. It currently imports 29 varieties of seven crops: maize, soya, colza, potatoes, cotton, tomatoes and sugar beet (Programa Chile Sustentable, 1999).

Free trade is menaced by national regulations such as production and import controls, limitations on access or sales, or direct prohibitions of entry into markets. There is an ever-present danger that food safety regulations will be adopted in response to the pressures of consumers and defenders of the environment.

The increase in opposition to the consumption of transgenic foods has affected the destinations of Argentina's soya exports. In 1999, 40% of the seeds and some 60% of soya pellets went to Europe, but since then they have gone to countries where consumers are not opposed to the consumption of such foods, such as India, China and some Latin American countries.

Other Latin American countries have expressed a desire for well-defined guidelines on trade in foodstuffs obtained through biogenetic applications, because they are aware that they have an asset – biodiversity – which they want to conserve. They are also producers of various organic products (fruit and vegetables) which have a better chance of acceptance than transgenics.

It is not expected that the production and marketing of transgenic foods can be stopped. On the contrary, some new ones will come on the market soon, now with incorporated vaccines. This could endanger the foreign exchange income from exports of traditional foods if developing countries, including some from Latin America, replace some products with others that are similar but are obtained through *in vitro* techniques using transgenic organisms.

### III

## The Protocol on Biosafety and the WTO rules

### 1. The Protocol on Biosafety

#### a) *Background*

From the very beginning the application of biotechnology to agricultural crops and foodstuffs has given rise to a debate on their impact on agriculture, the environment and human health. It is therefore not surprising that the scientific, socioeconomic and environmental issues connected with biological and biotechnological resources come up frequently in the main forums of negotiation.

Environmental concerns were expressed at the Earth Summit (Rio de Janeiro, 1992) and were given concrete form in the Rio Declaration on Environment and Development, in Agenda 21, and in the Convention on Biological Diversity (CBD). The negotiations on the Protocol on Biological Diversity began in 1996, and six meetings have been held, the first at Aarhus, Denmark, and the latest, in February 2000, at Montreal, Canada.

The CBD lays down that the countries must consider the form and need for a Protocol to regulate procedures regarding the transfer, handling and use of transgenic organisms which could have harmful effects on biodiversity and its components. The aim was to create an international juridical framework for the application of measures to ensure complete safety or at least minimal risks so that this technological advance will not affect biodiversity, already threatened today by over-exploitation of resources and degradation of ecosystems, through the danger of homogenizing crops.

The European Union countries have defined standards, domestic laws and EU-wide laws concerning human health and the environment. They included in them regulations on agricultural production, and within them rules on transgenic foods, whether for experimental purposes or commercialization, in order to avoid negative repercussions on themselves and other States.

At the same time, the difficulty of harmonizing the different national interests, regardless of whether countries are EU members or not, has meant that biodiversity has ceased to be the common property of the human race and has become instead the property of States, which have now been given responsibility for

preserving it. As a result, it was decided that States also had territorial responsibilities in regulating their domestic standards.

In 1999 the Ministers of the Environment of the EU tried to check the spread of transgenic organisms and adopted a "policy declaration" which was seen as a *de facto* moratorium on new crops and authorizations for their commercialization, to remain in force until research findings were more conclusive. This decision causes conflicts with the United States and with companies producing transgenic foods, and could give rise to complaints to the WTO.

By including the safety-first principle in the Protocol, the European Union can block the sowing of seeds containing modified genes or prohibit their importation on the grounds of doubts or lack of sufficient information. The Ministers of France, Greece, Italy, Denmark and Luxembourg defend the moratorium on the introduction of new crops. Countries with a more favourable attitude to the marketing of such products are Germany, Spain, the Netherlands and the United Kingdom, although Germany and Spain, which have only incipient markets in this respect, did not oppose the moratorium. Moreover, some countries do not wish to lose the chance of doing business with the main vendors of biotechnology and its products, nor do they wish to face possible sanctions applied by the WTO.

In the United States, in order to put a transgenic agricultural food product on the market it is necessary to comply with procedures laid down by three Federal agencies: the U.S. Department of Agriculture, the Food and Drugs Administration, and the Environmental Protection Agency. Responsibility in health matters lies with the National Institute of Health and a division of the Department of Agriculture which supervises food safety.

Some of the developing countries are in favour of regulating trade in transgenic foods on the grounds that little is known about their effects on health and the environment. They are worried that in the future dependence on imported biotechnology will be added to their already high degree of subordination to foreign scientific knowledge and outside management of new technology. Acceptance of an international law

regulating cross-border trade could avoid their land being used as testing grounds for such crops and thus obviate possible environmental risks.

#### b) *Positions and negotiations in the debate*

The negotiations in Cartagena and Montreal were difficult, and countries with diametrically opposed positions had to give way in their demands in order for the Protocol on Biosafety to be adopted. The discussions were continued in other international forums with different actors, including representatives of consumers and environmentalists.

Biotechnology has raised the value of genetic resources and made it advisable to establish international regulatory frameworks. The Convention on Biological Diversity called upon States to consider the possible forms of an international instrument to regulate the use of the new techniques. The Protocol on Biosafety, which is an international instrument, only covers the cross-border movement of products and asks its signatory States to complement it with national legislation.

The difficulties in arriving at a consensus caused the countries to form groups according to their interests and opinions. Five such negotiating groups were formed: i) the Miami Group, made up of the United States, Canada, Australia, Argentina, Uruguay and Chile; ii) the European Union countries; iii) the Compromise Group; iv) countries with a high level of biodiversity, such as Switzerland, Norway, New Zealand, Mexico, Japan and South Korea; and v) the Like-Minded Group, made up of developing countries such as China and countries from Africa, Asia, Latin America and the Caribbean, excepting those already mentioned earlier.

The negotiations began with matters connected with biodiversity and the safety of human health and the environment and continued with the evaluation of risks in the handling, use and transport of transgenic products, socioeconomic implications, responsibility for damage or accidents, institutional capacity, and the exchange of information. With time, trade-related aspects were also dealt with, such as cross-border movements, the safety-first principle, labelling, and the relation with other international agreements, especially with the WTO in the Sanitary and Phytosanitary Measures (SPM) and Technical Barriers to Trade (TBT) agreements.

In the position of the EU countries and a number of developing countries, the Protocol on Biosafety was

linked with agreements on the environment. It was feared that controls on transgenic foods would become a dead letter and that trade-related measures would take precedence over environmental and sanitary measures, so the members of this group sought to balance environmental measures with trade-related measures and make the former complementary to those of the WTO.

The European Union countries considered that it was necessary to weigh risks under the safety-first principle on the basis of scientifically proven evidence. That principle, which is not regulated by international law, does not allow the circulation of foodstuffs unless it is known for certain that they do not have any adverse effects on health or the environment. The countries which are in favour of international rules reject the importation of transgenic foodstuffs unless they have passed the risk evaluation tests carried out by national and EU authorities. The European Commission does not permit unilateral prohibition of a crop unless there is new evidence that it is harmful.

The members of the European Union have striven to achieve a common position and set of rules on modified organisms, as they have been obliged to regulate the liberation of such organisms (for sale, experiments or trade) in their territories. The stricter European rules, compared with the absence of suitable legislation in other markets, has led EU companies with biotechnological interests to experiment in unregulated markets, or else in their own markets, but with prior authorization. The differing opinions of governments on the effects of the different national standards of food safety make it difficult to advance in the negotiations.

In the year 2000, the European Commission did an about-turn in its position on the moratorium existing since 1998 on authorizations for new transgenic products: it now admits that such a moratorium is an illegal and unjustified measure which must be lifted, and it plans to adopt some new proposals, but in return for medium- or long-term licences the biotechnology companies must accept stricter rules which include risk evaluation, labelling and closer controls over trade.

The Miami Group countries prevented the approval of a regulatory framework which would prevent the free trading of transgenic foodstuffs and derivatives thereof.<sup>4</sup> The Group was worried that the safety-first principle could be used as a legal barrier to trade even when there

<sup>4</sup> As it has not ratified the Convention on Biological Diversity, the United States does not have voting rights in the negotiations on the Protocol.

was no sound scientific evidence to back it up. The Group was also reluctant to include labelling in the Protocol, although this is an essential element in the safety-first approach to commercialization. The United States position is that only those transgenic foods which are substantially different from traditional ones warrant regulation. Otherwise, they say, the European Union could take advantage of the situation to demand that all modified foods are labelled to show the genetic origin of the product: the WTO trade regime should therefore prevail over the Protocol on Biosafety (Kerr, 1999).

The negotiations to define rules on trade in transgenic foodstuffs failed at the Cartagena meeting in 1999. Some countries feared that the WTO rules would come into conflict with those of the Protocol, since they saw that the environmentalist group was not fully familiar with the international trade rules. If the Protocol were accepted, the international movement of transgenic foodstuffs could be limited for human, plant or animal health reasons or for alleged damage to the environment. That should not be allowed to create barriers to agricultural trade or to weaken the Sanitary and Phytosanitary Measures Agreement.

Early in the year 2000, the Miami Group prevented other governments from demanding prior authorization for imports for re-export. The negotiations ground to a halt, and a year later, at Montreal, the Miami Group and the European Union gave way on their initial positions and assumed a compromise position. 135 States voted in favour of the Protocol, which, when ratified, will be added to other environmental treaties for regulating trade.

### c) *The Protocol and its significance*

A distinction may usefully be made between two cases of introduction of transgenic organisms into the environment: one is their incorporation into cultivation (seeds, for example), while the other is their incorporation into the processing and consumption of human or animal food (grains, for example). This distinction will make it easier to understand certain aspects of some of the principles included in the Protocol.

This lays down that each country can adopt its own regulations on transgenic foodstuffs, and those regulations may be more demanding than those of the Protocol itself, but they must be notified to the other countries. In order to share that information, the Advance Informed Agreement (AIA) mechanism was set up and forms a key element of the Protocol.

The AIA is merely a prior control before authorization is given for human consumption of modified foods in importing countries: i.e., it is a notification between countries. This Agreement requires an authorization from the importing country before the first cross-border movement of the transgenic organism in question. This allows information to be obtained about countries which reject transgenic foods. The application of the AIA also makes possible an evaluation of risks and possible adverse effects and, if the latter are present, denial of access based on scientific evidence, in order to avoid unjustified trade barriers.

The AIA makes possible restrictions on the trading but not on the cultivation of transgenics. As from 2002, exports –mainly made by the United States, Canada and Argentina– must obtain a prior permit from the importing country and notify it to a United Nations regulatory body.

This is where the first responsibility of the exporting country arises, which must notify its intention to export the goods, and that of the importing country, which must develop and announce its regulations. The exporter can opt between a national regulatory system consistent with the Protocol or a system regulated by the Protocol itself. The AIA allows the importing country to veto the application even if scientific evidence is submitted by the exporting country (Cosbey and Burgiel, 2000).

In the case of transgenic organisms destined for processing and consumption, the AIA is not mandatory. Through its risk evaluation the importer can request additional information, accept access with or without conditions, prohibit entry or extend the time limit for the entry of the modified organism. Although the AIA does not cover agroindustrial products whose production processes have involved some transgenic organism, this is a consumer and environmental protection element when solid scientific evidence is lacking.

The Protocol includes the safety-first principle, in order to protect the environment from the reduction of biodiversity and to protect the health of consumers. Regulation of cross-border movements of transgenic agricultural foodstuffs obviates environment and health risks. Other biosafety aspects must be covered by national laws.

The safety-first principle is a government option for rejecting access without being penalized at the international level. It allows the country to receive the information on use and safety required when transgenic organisms are introduced into the environment and requires notification among the countries when



applying the AIA. It also allows the application of restrictions and the requirement for guarantees for trade in transgenics on the grounds of insufficient scientific evidence and the assumption that there may be a risk to biodiversity or human health.

The safety-first principle was achieved through the mutual support existing between environmental and trade instruments, without the former being subordinated to multilateral trade agreements. Biological diversity and food safety do not prevail over the WTO rules, and vice versa. The Cartagena Protocol is based on the safety-first principle and the WTO rules on scientific evidence.

The Protocol must not affect the rights and obligations of governments under other international agreements (of the WTO or any other nature). With regard to trade, it does not mean any change in the rights and obligations entered into under an international agreement, including the SPM and TBT agreements. The controls on trade in transgenic products permitted under the safety-first principle reverse the burden of proof, in that stricter controls can be applied if there is no certain scientific proof that the products are free of risk.

When an activity is begun it must be shown that its effects are harmless to the environment; otherwise, those effects are subject to controls and can lead the country concerned to impose higher standards than those provided for in other international agreements, as a sovereign right. The European Commission considers that every member of the WTO has the right to establish the level of protection it sees fit, especially as regards the environment and human health. The United States, however, rejects the view that the European Union's safety-first principle should be accepted as a legitimate trade barrier, arguing that the question must be settled by having recourse to science, which is not yet capable of assuring that transgenic products will be safe in the future.

## 2. The WTO rules

One of the functions of the WTO is to settle trade disputes among its members. With regard to the safety of modified foodstuffs, it offers some principles that can be used when countries are faced with different interpretations of how to protect consumers.

Although the members of the WTO have not given it a mandate to develop food safety standards, it does have rules to prevent members from using unnecessary and unjustified trade barriers. These rules are to be found in the SPM, TBT and Trade-related Intellectual

Property agreements and in the exceptions to GATT, article XX b) and g).<sup>5</sup>

Under article XX of GATT, countries have the right to establish their own environmental and food safety rules. Measures adopted under this right, however, must be consistent with the principles of GATT: absence of discrimination between nations and national treatment once an import enters the national market. In the case of a biotechnological product, however, some actors argue that the production process is an important element also. If the rules on trade include production processes, using the exceptions in article XX of GATT, the justification for the latter should be scientifically proved, otherwise an amendment to that article would be needed (ECLAC, 1998).

There is no commitment in the WTO regulating trade in transgenic products, nor are there any international rules governing their trade according to their method of production. The rules on international trade deal with trade in goods and not the production process, unless the latter affects safety and endangers the natural resource in question or human and animal health.

There are arguments both for and against the desirability of amending article XX of GATT to permit the application of trade measures to production processes. This is a point which will have to be discussed and settled in future negotiations, as also the question of whether the Protocol should include only transgenic micro-organisms or should also cover production processes which use biotechnological techniques in some part of the production chain.

National regulations can lead to discrepancies among the parties. Those countries which consider that a product obtained by traditional production methods and one obtained through the use of biotechnology are basically similar insist that the WTO agreements are adequate for settling differences. Those which consider that they are different products because the production process is different, however, complain of the lack of regulation of trade in biotechnological products.

The idea of annexing the Protocol to the WTO agreements was defended by the Miami Group, which respects the agreements of that organization. The Group proposes that differences on trade in transgenic products should be settled within the WTO, not through special agreements. This matter is down for discussion at the next round of negotiations of the organization (WTO, 1999).

<sup>5</sup> This allows governments to adopt trade measures which are necessary in order to protect human, animal or plant health and to ensure the conservation of exhaustible natural resources.

Other countries use the safety-first principle to justify protectionist measures. The European Union has asked the WTO to clarify the use of that principle and to extend its application to the whole framework of the organization. It argues that transgenic products represent a new technology which justifies the use of the principle, because the prevention of possible risks and the preservation of the environment should come above trade liberalization. Crops incorporating modified genes are seen by the EU members as a potential source of danger.

So far, the WTO has condemned the European Union's prohibition of the importation of meat treated with hormones, the Australian ban on Pacific salmon, and Japan's requirement that a variety of fruit should be subjected to tests because there is no scientific evidence that its consumption is harmless. These two factors—solid scientific evidence or, in its absence, the application of the safety-first principle—cause tensions in the trade negotiations.

New restrictions on trade can cause friction with the multilateral trade system. According to the WTO, the SPM and TBT agreements provide the necessary basic guidelines for negotiating regulations on trade and labelling, but when these agreements were signed, in 1994, the question of transgenic products was not under negotiation. The two agreements in question seek to regulate trade restrictions arising from the indiscriminate use of technical measures to safeguard human health, the environment and national interests, as well as to harmonize national food quality standards.

a) *The Agreement on Sanitary and Phytosanitary Measures (SPM)*

This Agreement, signed at the Uruguay Round, regulates the application of sanitary and phytosanitary measures. It applies to all measures for the protection of human health that could directly or indirectly affect international trade. It refers to regulations on the harmlessness of foodstuffs and allows governments to impose temporary internal and international measures if such harmlessness and the sanitary control of animals and plants are not assured.

The SPM Agreement allows governments to regulate trade by applying national measures which are stricter than international standards. In order to do so they must scientifically prove that the international standards provide less sanitary protection and must carry out a risk evaluation; otherwise, there could be a flood of sanitary and phytosanitary measures which would impede trade flows (WTO, 1996).

There are important differences between the SPM Agreement and the Protocol on Biosafety. One difference is in respect of risk. The Agreement recognizes that a level of risk exists, but does not stipulate what constitutes a risk, and it promotes systematic risk evaluations, but does not say how to manage them; in order to apply the proper level of risk governments review similar cases in other countries. In contrast, the Protocol indicates what a risk is and how to manage it, and in the absence of a scientific basis it allows the use of the safety-first principle for prohibiting or restricting an import.

The SPM Agreement allows the adoption of provisional measures when the scientific evidence is insufficient, whereas the safety-first principle is relatively more restrictive for consumers. The Protocol permits the importer to request the exporter to carry out a risk evaluation in order to take decisions, whereas the Agreement determines in advance what constitutes a risk and how to calculate it (Cosbey and Burgiel, 2000).

On the basis of new scientific information, the Protocol permits importers to review and change a decision on the cross-border movement of transgenic products, whereas the measures of the SPM agreement are more ambiguous. Under the WTO, the rules do not judge whether there is suitable scientific evidence or what constitutes the best evidence in respect of a transgenic foodstuff. At the request of the WTO itself, this function has been transferred to the Codex Alimentarius Commission, which is trying to formulate general rules on the harmlessness of foodstuffs, to control biotechnological foodstuffs and to develop voluntary international food standards to be submitted to governments for their acceptance and use in the application of the SPM and TBT Agreements.

The rules prepared by the Codex Alimentarius Commission should make it possible to judge whether national rules inhibit international trade flows. If the national regulations are not fully justified in accordance with the international rules of the Codex, the dispute must be settled by the WTO.

b) *Agreement on Technical Barriers to Trade (TBT)*

The TBT Agreement incorporates the technical rules of national standards and regulations, regulates food quality requirements and obligations not covered by the Agreement, and includes technical prescriptions resulting from measures on food safety, inspection and labelling.

In accordance with the rights and obligations laid down in the TBT Agreement, countries can impose

technical standards with legitimate intentions, provided that the requisites thus demanded do not constitute barriers to cross-border trade which are more restrictive than is necessary in order to comply with the objectives pursued. Among the contributions of the Agreement are the establishment of international principles for the elimination of unjustified trade barriers, avoidance of the creation of new obstacles, provision of elements for the development of international standards, and the possibility of raising national standards to international levels.

The Agreement does not give a clear and precise definition of the meaning of international standards for transgenic foods, nor does it provide for the equitable distribution of national needs. The scant information available means that the standards only reflect the measures of a few countries. The Protocol on Biosafety should give a precise definition of standards at both the national and international levels.

The Codex Alimentarius Commission is considering the advisability of adopting an international standard for the labelling of transgenic foods, based on substantial equivalence: i.e., whether a transgenic organism is substantially equivalent to the original foodstuff. The labelling requirements would seek to ensure that the chosen standards support the right of consumers to be informed and given a free choice, to know what a foodstuff contains, and to be informed of the inputs used in the production process. However, this would require that the life cycle of the foodstuff be kept constantly in view, which is no easy task. Moreover, even if it were possible to follow up every stage of the production process, not all countries would be in a position to comply with that requirement.

The United States FDA does not support special labelling and argues that, if there is no scientific certainty that the incorporation of a transgenic product alters the composition of a foodstuff and represents a danger to health, special labelling should not be obligatory. It does not reject voluntary labelling, but it does not wish to establish a compulsory distinction between a transgenic and an original foodstuff unless there is a substantial difference between them. In some countries, trade problems have arisen due to domestic pressures to use labels as a condition for access to the market.

The Protocol does not aim to physically separate genetically modified products from the rest. The differences over labelling have been partly solved

because the United States has yielded to the European Union's pressures that labelling should be compulsory. This is just the starting point for the reconciliation of interests and the beginning of a new stage in the negotiations. Compulsory labelling is also a matter of concern for Brazil and Argentina. The Canadian Government is analysing whether it should introduce new regulations in this respect, since its position is similar to that of the United States. In Japan, special labelling has been obligatory since April 2000.

The European Commission does not consider special labelling to be necessary, but the European Parliament does demand complete information in order to differentiate between products and considers that more drastic measures should be taken to regulate transgenic crops. Some countries of the European Union, in contrast, give priority attention to biotechnology, the introduction of new transgenic foods on the market, the storage and shelf life of products, or a responsible approach to food safety.

The main exports of transgenic products from the United States to EU countries consist of wheat, cotton and soya: precisely those products over which there are differences. For the United States, these do not raise any health risks. However, some European companies have stopped using them as inputs in their production processes because they are afraid they may contain modified organisms.

European environmentalists continue to fear that in the long run there will be negative effects on the environment. They argue that consumers are being deprived of information on potential risks and consider that governments should require all transgenic foods to be specially labelled. They claim that the rejection of compulsory labelling by some biotechnology industries shows that they have no confidence in their own products.

Generally speaking, national and international legislation on the control of transgenic organisms is still sparse. Demands to the government by consumer groups and non-governmental organizations for sure and effective control of the foodstuffs offered on the market are stronger in many developed countries than in the developing countries. In this respect, there are proposals for the establishment of a governmental body with suitable technical and economic capacity for reviewing food imports and verifying the truth of the information printed on their packages.

## V

**Final considerations**

Modern biotechnology should be seen as a complement to and not a substitute for traditional agricultural techniques. Its use involves human intervention to move genes between different species. The current uncertainty about consuming a transgenic foodstuff or a hybrid –which is also the result of genetic modification, but within the same species– applies to the former but not to the latter.

Biotechnology is simply a tool for solving some agricultural problems. Its possible environmental, sanitary and socioeconomic risks have caused concern within society. The risks to human health are more generally shared and similar among countries, but the environmental risks need to be studied case by case because the effects of applying this new tool –both positive and negative– vary from one situation to another.

These techniques offer possible solutions for current problems such as developing agriculture and the food industry and satisfying the nutritional needs of a growing population. This can be achieved, at least in part, if a new generation of food crops incorporating new characteristics and providing advantages over traditional similar foods can be successfully introduced.

In order to decide whether it is beneficial or not to put a transgenic foodstuff on the market, it is necessary to provide the public with more information on the advantages and biological safety of consuming it. Active participation by consumers in the corresponding debates and their guidance with information that can be readily understood by them would reduce uncertainty in this respect, but the lack of finance for establishing the necessary information networks makes communication difficult, especially in the developing countries.

The absence of rules on biotechnological foods in international trade gave rise to a series of rounds of negotiations which finally ended when the countries with opposing positions gave way. The approval of the Protocol on Biosafety showed that when the parties gave way on their positions trade interests were balanced with environmental concerns.

The Protocol requires countries to adopt domestic legislation, develop a juridical framework applicable to biotechnology, evaluate the risks of adaptation, determine the level of protection desired, and ensure the existence of national institutions capable of

carrying out the relevant tasks. The dynamic development of science, the national standards and regulations established and the level of risk involved, however, make it necessary for the institutions to formulate new regulations and make constant revisions of existing ones in order to supplement and expand the rules designed to ensure the safety of consumers.

The developing countries also need capacity for adaptation, implementation, dissemination and innovation in a sector which is accessible but of high technology. They therefore need research institutions which will not only fulfill their own objectives but will also carry out the function of bringing investors and creators of technology closer to consumers.

Biotechnological development benefits producers, directly satisfies consumers' needs and involves both benefits and risks for the agricultural sector. In order to attain food security, however, it would be desirable for the developing countries, and especially their resource-poor farmers, to derive more benefits from advances in biotechnology, to have greater access to sources of genetic resources and public finance, and to receive the fruits of a better dialogue between the public and private sectors (FAO, 2000).

The confidence of consumers in the institutions which recommend standards is increasingly important for the decisions they take. Lack of transparency and clarity of the rules adopted and delays in taking suitable measures to deal with problems as they arise are elements that militate against this.

The different views regarding transgenic products are a source of concern. For the United States, only the final product and not the production process can be the subject of regulation; for the European Union, in contrast, both the final product and the production process should be subject to regulation. The tendency to regulate the production process is a source of dispute, since such regulation is not accepted by the WTO.

The SPM and TBT Agreements provide lines along which countries can guide their regulations on the basis of science and settle their differences at the bilateral level, avoiding the need to bring them before the WTO. They also make it possible to harmonize the different national regulatory systems and labelling requirements,

but they do not provide a solution if the conflict is based on ethical considerations, without scientific evidence to justify demanding special labels. This may make necessary the revision of both agreements and lead to further negotiations in the WTO.

The approval of the Protocol does not eliminate the possibility of future problems, but it does indicate that the arguments for and against the use of the new techniques are gradually beginning to draw closer to each other. Steps have begun to be taken towards convergence between the different positions which, on the one hand, promise more plentiful food and, on the other, fear the possible effects of the consumption of transgenic products on health and the environment. This does not mean that the debate is over, however, since some countries consider that the Protocol is insufficient and want to continue research in order to achieve safer trade in biotechnological products.

The question of new agricultural products is under discussion in international forums and repeatedly turns up in negotiations. The trade disputes over labelling and the different national regulations do nothing to reduce the uncertainty. Labels do not say what genes are incorporated in products; the uncertainty over the risks involved in the consumption of modified products will very likely continue, and it will be necessary to negotiate over what information should be included in order to give greater transparency. The uncertainty over the consumption of such products could be reduced if

the wording of labels is precise, free of any form of manipulation, simple and balanced.

An element which helps to keep the debate alive is the fact that the Latin American countries possess great biodiversity, which currently provides large profits that go mainly into the pockets of the transnational corporations, without the countries of the region receiving the share that corresponds to them for giving access to the genetic inputs in question. The question of sharing out the profits has not been settled, and it does not seem that an easy solution can be reached in the short term. So far, the arguments usually stress the concerns of the countries that make the greatest use of biotechnology, neglecting the concerns and interests of the developing countries.

Finally, it cannot be concluded *a priori* that a foodstuff should be classed as harmful or beneficial, good or bad, deleterious or harmless simply because it is transgenic. Every new foodstuff must be subjected to exhaustive analysis before it is placed on the market. It is essential that the risks and benefits of each of the transgenic organisms involved and their repercussions on national ecosystems should be dispassionately evaluated and the conclusions passed on to society. This will pave the way for further progress in the creation of transgenic foods which are healthy and environmentally friendly.

(Original: Spanish)

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# Static and dynamic *impacts of MERCOSUR:* the case of the *pharmaceutical sector*

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This article analyses the impact of MERCOSUR on the pharmaceutical sector. It concludes, among other things, that the sector suffered strong impacts, both static and dynamic, as a result of the integration process. From the static point of view, it may be observed that integration has given rise to a marked increase in intrazonal trade, which reflects the existence of a substantial trade creation process in MERCOSUR. From the dynamic point of view, the outstanding aspect is the increasing interest in regaining a place in the markets of Argentina and Brazil shown by transnational corporations since the integration process. This process, together with the changes in the regulations on medical patents, has given rise to big changes in the strategies and positions of laboratories of domestic origin.

# I

## Introduction

Not only is the evaluation of the benefits of integration processes a difficult task, as also is the appraisal of their costs, but moreover there is no consensus as to how to carry it out.

Most economic studies consider that the static effects in terms of creation or diversion of trade are the fundamental variable for such evaluation. However, these effects leave out the potential dynamic benefits that may be derived from the integration process, such as the development of technological change, of learning processes, of production specialization, etc. These dynamic effects are those which provide the most convincing arguments in favour of integration processes, as compared with arguments in favour of the unilateral opening of the economy. The problem arises, however, with regard to the difficulties in measuring these benefits, since they cannot be determined solely on the basis of analyses of growth rates or of the behaviour of regional trade flows.

These difficulties point to the need for methods of working at a more disaggregated level, which would make it possible to identify processes that could not be detected at the global level. In order to do this, we analysed the changes which took place within each sector of production,<sup>1</sup> in order to determine the effects on the levels and forms of organization of production, business strategies, levels of technological modernity, the regional dynamics of the sector, etc. This type of analysis calls, as far as possible, for the isolation of the effects of integration processes from the effects of the other changes which are taking place in the economies of the area (processes of greater openness, privatization, etc.). This provides us with suitable elements for determining what kind of national or community policies could be applied in the future in order to make MERCOSUR a dynamic element in production development.

In line with this methodological approach, in the present article we will analyse the impact of MERCOSUR

on the pharmaceutical sector.<sup>2</sup> This is a very interesting sector from the point of view of analysing the effects of regional integration because of its strategic importance, the fact that it has registered growing intra-zonal and extra-zonal trade flows, and the profound changes it is undergoing both at the world level and within the countries making up the MERCOSUR zone. Thus, the cost and way of financing the population's access to medicines is and always has been a source of considerable concern for governments, while the level of technological innovation and dynamic efficiency attained by the sector can be an important factor in its insertion in regional and world markets.

Anticipating the findings set forth later in this article, it may be noted that the sector has suffered strong static and dynamic impacts as a result of the integration process. Firstly, the integration of the MERCOSUR area has given rise to a marked increase in intra-area trade: as imports from outside the area have also increased but production levels have grown much less, it may be inferred that a considerable trade creation process has taken place in MERCOSUR. The dynamic impacts are due to different causes, including the growing interest displayed by transnational corporations, in the light of the integration process, in strengthening their positions in the Argentine and Brazilian markets because of the greater possibilities of expanding intra-company trade.

The pharmaceutical sector displays an increasing degree of internationalization, and at the world level it is dominated by a handful of companies whose efforts in the field of competition are based on the ongoing introduction of new products through scientific and technological research as well as on heavy expenditure on marketing and publicity for their existing products. Indeed, within the region the proprietary ethical drugs

<sup>1</sup> This is because each sector is affected very differently, either because of its previous situation as regards competitiveness, the possibilities of taking advantage of latent demand in other markets, or the special ways in which differences between the levels of regulation of partner countries affect the sector.

<sup>2</sup> The pharmaceutical sector forms part of a chain of production which begins with the discovery of a molecule or active principle and culminates in the industrial production of pharmaceuticals. These two stages make up the "pharmaceutical industry", which is part of what is generally known as the "fine chemicals industry". The pharmaceutical industry proper, which will be analysed in this article, comprises the production and marketing of pharmaceutical specialities or medicines.



segment is clearly dominated by the big transnational corporations.<sup>3</sup> These corporations act very dynamically as regards the location of their plants and their national specialization patterns.

In the case of generic products, capacity for innovation and marketing expenditure play only a secondary role: price competition is the key factor, and this makes it necessary to pay more attention to process technologies and economies of scale.

In most of the countries, in addition to the transnationals there are also local-capital firms which produce pharmaceutical specialties. These firms use generic drugs, which cost less than the corresponding patented drugs, as their inputs, and they carry out hardly any research activities, although they do spend a certain amount on product development. They compete with each other and with the subsidiaries of the big transnationals on the basis of price and marketing costs, and the brand name and corporate image are

fundamental elements of competition. In the case of ethical products, the marketing effort is aimed at the medical profession, because it is the doctors who prescribe one or another specific medicine for their patients. In the case of products which are sold freely to the public, the competition is based on the brand name, promoted through intensive mass publicity.

The intrinsic nature of the products of this industry, which are intended for public health purposes, as well as the importance of scientific and technological research activities, make this a highly regulated sector.<sup>4</sup>

First of all, we will look at the asymmetries in regulations between Argentina and Brazil (section II) and the performance of the sector in the individual MERCOSUR countries (section III), concluding with an appraisal of the static and dynamic effects of the integration process, as identified from statistical analysis and field studies in Brazil, Uruguay and Argentina<sup>5</sup> (section IV).

## II

### Policy asymmetries in MERCOSUR

The policy asymmetries in MERCOSUR may be observed in two fields: in the global policies for the promotion of investment, production, innovation and exports, and in the differences in the regulatory framework specifically affecting the pharmaceutical sector.

During the import substitution industrialization phase, the MERCOSUR countries, and especially Argentina and Brazil, developed a wide range of promotion instruments which combined high rates of trade protection with special investment promotion regimes and, later, export promotion measures. Towards the end of the 1980s, the MERCOSUR countries embarked on a reform process aimed at economic liberalization and at the elimination of the State promotion and

regulation machinery, including the pharmaceutical sector.

In the case of Brazil, however, various investment incentives adopted by the federal and state governments remain in force. The latter enjoy fiscal powers which are even broader than those of the provinces in Argentina, so that they have considerable possibilities for granting fiscal incentives in the form of the reduction or financing of the goods and services turnover tax in order to attract new investments. State incentives are often also granted for labour training and development of infrastructure.

<sup>3</sup> Medicines for human consumption are divided into *ethical* and *non-ethical* drugs. The first group comprises all those medicines which are sold exclusively on a doctor's prescription, and they may be further divided into generic and proprietary medicines. Generic medicines are those whose patents have run out, so that they can now be freely manufactured. Proprietary medicines, in contrast (in countries which accept the corresponding rules), can only be manufactured by the patent-holders or under licence from the latter, so they generally cost more. Non-ethical drugs are those which can be acquired without a doctor's prescription.

<sup>4</sup> The provisions on patents adopted in 1994 in the agreements on Trade-Related Intellectual Property aspects of the General Agreement on Tariffs and Trade (GATT) oblige countries, once they come into force, to provide patent protection for pharmaceutical products and the corresponding production processes. Although the developing countries were given a five-year period of grace, these agreements are having a profound impact on countries which did not recognize patents in this respect and had managed to develop industries based on imitative development efforts by local firms (such as India and Argentina).

<sup>5</sup> The field studies consisted of standardized interviews with representatives of about 15 firms in each of the countries and the main trade associations of the sector.

In Uruguay, the structural reforms have been more gradual (there has been practically no privatization of public enterprises), although the process of unilateral trade openness did advance during the 1990s (Laens, Lorenzo and Osimani, 1993; Torrello and Noya, 1992).

Since the early 1990s, however, new policy instruments have been appearing which are designed to promote technological development and business restructuring, such as the Argentine Technological Fund (FONTAR), aimed at the promotion of technological innovation, and a variety of export incentives, such as temporary admission and export drawbacks, which have been used by most of the Argentine laboratories interviewed.

As part of the general tendencies to rationalize and reduce public intervention in industrial policy matters, substantial changes were made in all the MERCOSUR countries in the policies on regulation of the pharmaceutical sector, which was subject up to the late 1980s to severe restrictions in terms of price formation mechanisms and external suppliers. In the 1990s, in both Argentina and Brazil, a number of deregulatory measures were taken, beginning with the elimination of maximum price controls, although there are still substantial differences in regulations between the two countries in two fields: the registration of medicines and patent law.

With regard to the registration of medicines, Argentina has eased the rules in this respect in order to facilitate the importation of medicines as a means of fomenting competition with local products. To this end, in 1992 it set up the special register for authorized medicines.<sup>6</sup> In Brazil, in contrast, the mechanism for the registration of medicines is much more restrictive, since it requires the submission of samples for analysis and a number of tests considered necessary by the health authorities. These requirements impose serious limitations on Brazilian imports of medicines from the MERCOSUR countries and oblige companies in those countries to establish agreements with Brazilian firms which have products that are already registered with the health authorities (De Queiroz, 1993).

<sup>6</sup> In that year, automatic registration was decreed for all medicinal specialties already circulating in the country, as well as for those which were authorized in the domestic markets of a number of countries considered to be of "high levels of sanitary supervision", a list of which is given in annex I of the decree in question. At the same time, a maximum deadline of 120 days was established for the authorization and registration of products similar to those already registered in the country, either for domestic production or for importation from countries listed in annex II.

With regard to the new patent legislation, this does not have retroactive effect in Argentina: i.e., it does not affect products which circulated in that country or were covered by patents granted in other countries prior to 1995 (when the new regulations came into effect). Moreover, new inventions of pharmaceutical products are not patentable in Argentina until five years after the publication of the law (Challú and Lewis, 1996). After that date, the patent-holders will enjoy a monopoly of their use for 20 years, provided that they are indeed effectively used, since when a patent is not used, the authorities are empowered to grant exploitation rights to third parties. "Exploitation" or "use" is considered to be the proper distribution and marketing of the product covered by the patent in question, whether through domestic production or importation.<sup>7</sup>

In Brazil, the patents law has been in force since it officially came into effect (May 1996) and it likewise provides that the use must be "effective", but unlike the Argentine law it considers that use or exploitation can only mean supply of the domestic market through the domestic manufacture of finished products. This means that if a firm wants to enjoy monopoly rights to use its invention, it must manufacture the product in Brazil. This requirement for domestic production has already given rise to an application for a panel by the United States, that is to say, an application for the case to be decided within the World Trade Organization (WTO).<sup>8</sup>

These differences between Argentina and Brazil with respect to patents law may turn out to be of decisive importance in the strategies adopted by pharmaceutical firms, encouraging them to operate plants in Brazil, since supplying a product from that country can give a patent-holder monopoly rights in both countries (as Argentina considers importation equivalent to use),

<sup>7</sup> Towards the beginning of 2000, when the payment of pharmaceutical patents was to come into force in Argentina, there was a heated debate in that country as to whether the requirement of "exploitation" or "use" of patents should involve domestic production of the medicine in question, as in Brazil.

<sup>8</sup> Brazil, in turn, has just denounced the fact that the United States makes a similar stipulation for a number of medicines, and it recently won a vote in the Human Rights Commission (by 53 votes to 1) which condemned the abuse of patent rights by some pharmaceutical companies. Furthermore, under international pressure, a number of such companies have recently abandoned an action against South Africa for the use of basic drugs needed to treat AIDS. All this means that the discussion on patents law may take a new turn in the future (Watal and Mathai, 1995).

whereas if a firm sets up a factory in Argentina it may be obliged to grant a licence to manufacture the product in Brazil. Moreover, the difference between the dates of entry into effect of the two laws (with regard to pharmaceutical products) may operate in the same direction during the transitional period in Argentina, in the case of the establishment of plants to use companies' own inventions. In this case, production in Brazil at least ensures monopoly rights in that country, whereas production in Argentina does not ensure this in either country.

Another aspect worthy of note is that in both countries there have been attempts to promote sales through generic medicines, but there is still a long way to go in this respect. In Argentina, it was decreed that lists of the trade names of medicines should be prepared, grouped together according to their generic names, and doctors were obliged to use the latter names when

writing prescriptions, but this obligation proved hard to enforce, and in a later decree doctors were left free to write prescriptions as they saw fit. In Brazil, it was decreed in February 1999 that all medicines sold under brand names must clearly show on their packages the name of their active principles.<sup>9</sup>

Furthermore, within the process of harmonization of rules which is taking place in MERCOSUR, progress has been made in the rules on inspection of the quality of medicines, good manufacturing practices for them, inspection of manufacturing plants and guidelines therefor, and the training of inspectors. This harmonization process makes it possible to advance towards mutual recognition of the government agencies of both countries responsible for authorizing the sale of medicinal specialities in the respective domestic markets, and has also aided in the exchange and upgrading of know-how.

### III

## Recent evolution of the pharmaceutical sector in MERCOSUR

### 1. Structure and recent performance

The pharmaceutical sector of the different MERCOSUR countries displays some common structural features.

Firstly, there is a clear division between transnational and national laboratories. In Argentina and Uruguay, the turnover of the sector is divided more or less equally between the two types, but in Brazil the ratio is 75% to 25% in favour of the transnationals.<sup>10</sup> The differences in ownership are also reflected in different types of microeconomic behaviour: the national laboratories generally do not carry out scientific and technological research and survive by copying medicines developed abroad, whereas the transnational laboratories apply in the local market the innovations made in world-level research centres. In both cases the active principles are mostly imported.

<sup>9</sup> In order to further this process, the Brazilian Health Supervision Agency was given 90 days to establish the criteria for determining the therapeutic equivalence of generic medicines and the exceptions to this rule when expressly requested by the prescribing physician.

<sup>10</sup> In the case of Uruguay, the category "national laboratories" also includes those of a binational or multi-Latin American nature.

Secondly, although the pharmaceutical market as a whole is not very concentrated (the ten main firms account for no more than 40% of total sales in Argentina and Brazil), within each therapeutic speciality the level of concentration is markedly greater.<sup>11</sup> Promotion (largely through salesmen visiting doctors) and brand names are the main forms of competition, with competition on price only playing an important role in direct sale to public health systems (hospitals, etc.).

There are considerable differences between the various MERCOSUR countries as regards the size of firms. Thus, in Brazil over 50% of the turnover is accounted for by big laboratories with over 500 employees, whereas in Uruguay most of the firms are small, and up to 1997 there was only one laboratory with more than 100 employees.

The demand structure also seems to differ significantly in the three countries studied. In Brazil, this structure is made up of almost a thousand

<sup>11</sup> In the case of Brazil, for example, the share of the leading laboratory comes to 91% for the generic medicine paracetamol, 58% for amoxycillin, and 93% for dipirone.

TABLE 1

**Production and apparent consumption of pharmaceutical products in Argentina, Brazil and Uruguay**  
(Millions of current dollars)

Year	Argentina			Brazil			Uruguay		
	Production	Trade balance (exports- imports)	Apparent consumption	Production	Trade balance (exports- imports)	Apparent consumption	Production	Trade balance (exports- imports)	Apparent consumption
1988	1 197	-29	1 226	...	...	...	...	...	...
1989	927	-24	951	7 565	-62	7 606	...	...	...
1990	1 441	-21	1 462	10 973	-157	11 276	...	...	...
1991	2 087	-45	2 132	8 769	-159	9 090	146	-14	160
1992	2 468	-107	2 575	9 767	-117	10 009	147	-26	173
1993	3 005	-135	3 140	12 058	-176	12 476	185	-41	236
1994	3 427	-235	3 662	14 338	-339	14 993	183	-50	233
1995	3 396	-204	3 600	17 040	-406	17 964	193	-57	250
1996	3 423	-221	3 644	17 540	-701	18 575	201	-75	276
1997	3 606	-234	3 840	19 700	-1 170	20 905	...	...	...
1998	...	...	...	20 313	...	21 643	...	...	...

Source: Argentina: on sales, Cámara Argentina de Especialidades Medicinales (CAEME); on external trade, Instituto Nacional de Estadísticas y Censos (INDEC). Brazil: on production and apparent consumption, Fundação Comércio Exterior (FUNCEX) (production data include perfumery and toiletry sector); on the trade balance, data prepared by the authors on the basis of data from the INTAL database. Uruguay: Uruguayan report with data from the Instituto Nacional de Estadística (INE).

distributors and 46,000 pharmacies. The distributors operate at the regional level, and only in recent years have they begun to operate at the national level. In Argentina, in contrast, the distribution of medicines is concentrated in three big firms in which the most important laboratories play an active part. These distributors have also moved into the level of the retail pharmacies, thus increasing still further the degree of concentration.

The apparent production and consumption of pharmaceutical products, measured in current dollars, displays an upward long-term trend, especially in Argentina and Brazil, as may be seen from table 1. In 1996 the output of the three countries studied amounted to US\$ 21 billion in current terms, of which Brazil accounted for 82%, Argentina for 17% and Uruguay for the remaining 1%.<sup>12</sup>

However, the increases in production levels in current dollars reflect not only changes in physical output but also in the real exchange rate and the price levels of pharmaceutical products. If these increases

are measured at constant prices, the picture undergoes a radical change: only the Brazilian pharmaceutical industry registers an increase in the physical volume of production during the 1990s. This growth took place after the introduction of the Plano Real and amounted to 23.6% between 1994 and 1998 (which is still a long way from the 42% increase in output in constant dollars registered over the same period). In the case of Argentina, unit sales shrank by around 10% between 1991 and 1997, so that the whole of the increase in production in current dollars was due to the big increase in the average prices of the industry's production (Ministry of Economic Affairs of the Province of Buenos Aires, 1997).

This indicates that, in spite of the tariff reduction process which took place in the 1990s, the MERCOSUR pharmaceutical industry registered a sharp recovery in its relative prices during that decade.

## 2. Evolution of trade in pharmaceutical products during the 1990s

### a) Total exports and imports

MERCOSUR external trade in pharmaceutical products grew strongly in the 1990s, with imports growing more

<sup>12</sup> It should be noted that the production figures for Brazil also include the perfumery and toiletry sector, so that Brazil's share in the total MERCOSUR pharmaceutical market is somewhat overestimated.

TABLE 2

**MERCOSUR exports of pharmaceutical products**

	1990	1991	1992	1993	1994	1995	1996
<i>Thousands of dollars</i>							
Argentina	21 569	44 556	48 258	73 656	91 357	131 303	179 058
Brazil	43 884	50 652	66 129	62 332	83 174	111 164	131 178
Uruguay	6 091	14 142	14 119	12 116	13 460	23 636	21 597
Paraguay	156	452	1 328	2 004	3 689	2 987	4 293
MERCOSUR	71 700	109 802	129 834	150 108	191 680	269 090	336 126
<i>Percentages</i>							
Argentina	30	41	37	49	48	49	53
Brazil	61	46	51	42	43	41	39
Uruguay	8.5	13	11	8	7	9	6
Paraguay	0.5	0	1	1	2	1	1
MERCOSUR	100	100	100	100	100	100	100

Source: Prepared by the authors on the basis of data from the INTAL database.

TABLE 3

**MERCOSUR imports of pharmaceutical products**

	1990	1991	1992	1993	1994	1995	1996
<i>Thousands of dollars</i>							
Argentina	42 322	89 601	155 955	207 999	362 362	335 596	400 896
Brazil	200 903	209 423	183 126	238 692	422 086	517 319	832 378
Uruguay	21 310	27 397	36 676	43 460	54 740	66 659	79 763
Paraguay	11 499	18 962	23 545	29 038	50 954	38 913	45 184
MERCOSUR	276 034	345 383	399 302	519 189	854 142	958 487	1 358 221
<i>Percentages</i>							
Argentina	15	26	39	40	38	35	30
Brazil	73	61	46	46	49	54	61
Uruguay	8	8	9	8	6	7	6
Paraguay	4	5	6	6	6	4	3
MERCOSUR	100	100	100	100	100	100	100

Source: Prepared by the authors on the basis of data from the INTAL database.

than exports (tables 2 and 3).<sup>13</sup> As a result, the trade deficit of the pharmaceutical sector widened from US\$ 204.3 million in 1990 to US\$ 1,022.1 million in 1996 (table 4).

Within this overall situation, the shares of the different MERCOSUR countries are not in line with their

relative sizes both as regards exports and gross values of production, as Argentina and Uruguay account for relatively high proportions of total exports, whereas Brazil's share is relatively small for the country's size. In this sense, Argentina figures as the main exporter of the area, with 53% of its exports in 1996, while Brazil

<sup>13</sup> It should be noted that the primary data are taken from publications of the official statistical bodies of the countries. This gives rise to problems of reliability and consistency of the external trade figures. Thus, for example, exports FOB from Argentina to Brazil in 1989 (as declared by Argentina) came to US\$ 186,000, whereas imports CIF by Brazil from Argentina in the same year (as

declared by Brazil) came to US\$ 1.8 million, and Uruguay's exports FOB to Brazil in 1996 (as declared by Uruguay) came to US\$ 10.1 million, whereas the CIF value declared by Brazil came to US\$ 20 million. Generally speaking, there are big discrepancies between the FOB and CIF values declared by trading partners in intrazonal trade, and these differences are not always in the expected direction.

TABLE 4

**MERCOSUR trade balance for pharmaceutical products**  
(Thousands of dollars)

	1990	1991	1992	1993	1994	1995	1996
Argentina	-20 753	-45 045	-107 697	-134 343	-235 005	-204 293	-221 838
Brazil	-157 019	-158 771	-116 997	-176 360	-338 912	-406 155	-701 200
Uruguay	-15 219	-13 255	-22 557	-31 344	-41 280	-43 023	-58 166
Paraguay	-11 343	-18 510	-22 217	-27 034	-47 265	-35 926	-40 891
MERCOSUR	-204 334	-235 581	-269 468	-369 081	-662 462	-689 397	-1 022 095

Source: Prepared by the authors on the basis of data from the INTAL database.

TABLE 5

**Export coefficients**  
(Percentages)

	Brazil	Argentina	Uruguay
1991	1	2	10
1992	1	2	10
1993	1	2	7
1994	1	3	7
1995	1	4	12
1996	1	5	11
1997	3	7	...

Source: Data on production: country reports for Argentina, Brazil and Uruguay. Data on trade: prepared by the authors on the basis of data from the INTAL database, except for Brazil in 1997, which was taken from the corresponding country report.

is the main importer, with 61% of the area's imports in that year.

As regards the degree of trade openness of the sector, it should be noted that the pharmaceutical industry of the MERCOSUR countries has been and continues to be aimed basically at the domestic market, as witness the low export coefficients (table 5). Nevertheless, in the 1990s exports grew faster than output, especially in Argentina.

The coefficients of openness to imports are slightly higher than the export coefficients, but even so (except in the case of Uruguay) the import penetration of pharmaceutical products continues to be relatively low. If the supply of raw materials for the industry (pharmaceutical chemicals) were taken into account, however, those coefficients would be substantially higher.

In the geographical pattern of external trade in pharmaceutical products in MERCOSUR, there is a marked difference between exports and imports. Exports to the zone account for a growing share of the

total, as those destined for the rest of the world grow substantially slower and are mostly to developing countries, especially of Latin America (table 6).

Imports, in contrast (table 7), show that although the share of MERCOSUR member countries has grown in recent years, in 1996 imports from Brazil and Argentina only came to 10% or 12% of the total, indicating that the bulk of imports continue to come from the developed countries (the United States and Europe).

*b) Index of revealed comparative advantages*

In the 1990s the MERCOSUR countries were affected to a greater or lesser extent by marked macroeconomic fluctuations which had a heavy impact both on their global trade balances and on those corresponding to specific sectors of production. For this reason, in this article we will use the index of revealed comparative advantages<sup>14</sup> (also called the index of contribution to the total balance), as a way of separating within the sectoral balances the effects of changes in the global trade balances.

Table 8 shows that in the pharmaceutical sector MERCOSUR has a revealed comparative disadvantage with the rest of the world which grew more pronounced during the 1990s. This means that the normalized trade deficit of the sector (discounting the effect of global trade deficits or surpluses) has increased in relation to the total volume of trade of the area. It may be deduced from this that there have been structural changes in the

<sup>14</sup> The index of revealed comparative advantages is constructed by deducting from the sectoral trade balance a theoretical value representing the sector's share in the global trade balance. This share is expressed in thousandths of total trade, and its value may vary between -500 and +500 (corresponding to complete specialization). The formula for this indicator is:  $VCR = ((X_i - M_i) - (X_i + M_i)/(X + M) * (X - M)) * 1000 / (X + M)$ .

TABLE 6

**Destination of exports by Argentina, Brazil and Uruguay**  
(Percentages)

Destination/year		1990	1991	1992	1993	1994	1995	1996
Argentina	MERCOSUR	44	41	48	49	56	53	61
	Rest of world	56	59	52	51	44	47	39
Brazil	MERCOSUR	8	14	20	22	27	37	41
	Rest of world	92	86	80	78	73	63	59
Uruguay	MERCOSUR	28	70	55	58	56	70	58
	Rest of world	72	30	45	42	44	30	42

Source: Prepared by the authors on the basis of data from the INTAL database.

TABLE 7

**Origin of imports by Argentina, Brazil and Uruguay**  
(Percentages)

Destination/year		1990	1991	1992	1993	1994	1995	1996
Argentina	MERCOSUR	1	4	6	6	5	12	12
	Rest of world	99	96	94	94	95	88	88
Brazil	MERCOSUR	1	5	6	5	6	8	10
	Rest of world	99	95	94	95	94	92	90
Uruguay	MERCOSUR	28	40	36	38	42	41	42
	Rest of world	72	60	64	62	58	59	58

Source: Prepared by the authors on the basis of data from the INTAL database.

TABLE 8

**Index of revealed comparative advantages in the MERCOSUR pharmaceutical sector**  
(Thousandths of total trade)

	1990	1991	1992	1993	1994	1995	1996
Argentina	-3.22	-3.44	-3.20	-3.36	-4.56	-5.23	-4.68
Brazil	-3.99	-4.01	-3.28	-3.46	-4.93	-4.02	-6.42
Uruguay	-5.71	-4.35	-5.35	-5.47	-6.88	-5.91	-7.31
Paraguay	-4.68	-6.62	-7.65	-7.47	-7.72	-3.60	-4.61
MERCOSUR	-3.99	-4.05	-3.83	-4.03	-5.36	-4.45	-5.90

Source: Prepared by the authors on the basis of data from the INTAL database.

pattern of trade which are not exclusively due to the change in macroeconomic conditions that took place in the 1990s.

This overall behaviour of the pharmaceutical sector corresponds more or less closely to the individual cases of the MERCOSUR countries. In all of them, exports and imports expanded at a rapid rate and the sectoral trade deficit and revealed comparative disadvantage have tended to grow worse.

### 3. Intrazonal trade in MERCOSUR

As a result of the regional integration process, intrazonal trade has grown even faster than trade outside the area. Thus, during the period studied, intrazonal exports grew by 1,110%, from US\$ 14.6 million in 1990 to US\$ 176.7 million in 1996 (tables 9 and 10).

In intrazonal exports, it may be seen that Argentina's leading position in exports is even more

TABLE 9

## Intra-MERCOSUR exports of pharmaceutical products

	1990	1991	1992	1993	1994	1995	1996
<i>Thousands of dollars</i>							
Argentina	9 553	18 138	23 025	36 170	50 836	69 056	108 584
Brazil	3 385	7 038	13 343	13 390	22 197	41 280	53 735
Uruguay	1 692	9 927	7 814	7 040	7 502	16 642	12 614
Paraguay	16	281	684	1 187	2 515	828	1 772
MERCOSUR	14 646	35 384	44 866	57 787	83 050	127 806	176 705
<i>Percentages</i>							
Argentina	65	51	51	63	61	54	61
Brazil	23	20	30	23	27	32	30
Uruguay	12	28	17	12	9	13	7
Paraguay	0	1	2	2	3	1	1
MERCOSUR	100	100	100	100	100	100	100

Source: Prepared by the authors on the basis of data from the INTAL database.

TABLE 10

## Intra-MERCOSUR imports of pharmaceutical products

	1990	1991	1992	1993	1994	1995	1996
<i>Thousands of dollars</i>							
Argentina	626	3 315	9 809	12 484	17 426	39 648	48 915
Brazil	2 310	9 582	10 244	12 313	24 227	42 765	79 435
Uruguay	6 056	10 882	13 207	16 586	22 793	27 176	33 659
Paraguay	6 460	10 099	12 370	16 870	19 434	22 554	29 169
MERCOSUR	15 452	33 878	45 630	58 253	83 880	132 143	191 178
<i>Percentages</i>							
Argentina	4	10	21	21	21	30	26
Brazil	15	28	22	21	29	32	42
Uruguay	39	32	29	28	27	21	18
Paraguay	42	30	27	29	23	17	15
MERCOSUR	100	100	100	100	100	100	100

Source: Prepared by the authors on the basis of data from the INTAL database.

pronounced than in exports to the world as a whole (indicating greater dependence by Argentina on the area market). On the import side, it may be seen that Uruguay and Paraguay have much greater relative weight (i.e., both of them purchase a relatively greater proportion of their imports from other MERCOSUR countries).

This behaviour of the trade flows gives rise to an intrazonal trade pattern in which Argentina increasingly figures as the only country with a trade surplus, whereas Uruguay, Paraguay and, since 1994, Brazil have deficits (table 11).

The faster growth of intrazonal exports compared with those to the rest of the world reflects

a general trend in the trade of MERCOSUR's trading partners. The zonal orientation index<sup>15</sup> (table 12) shows that, in the cases of Argentina and Brazil, pharmaceutical exports register a zonal orientation which is substantially greater than 1. In other words,

<sup>15</sup> The zonal orientation index compares the relative importance of the zonal market for the sector's exports with its importance for the country's total exports. The indicator ranges from zero to infinity. A value of 1 suggests that there is no zonal orientation. The corresponding formula is:

$$IOR_i = X_{ij}/X_i/X_j/X.$$



TABLE 11

**Intra-MERCOSUR trade balance for pharmaceutical products**  
(Thousands of dollars)

	1990	1991	1992	1993	1994	1995	1996
Argentina	8 927	14 823	13 216	23 686	33 410	29 408	59 669
Brazil	1 075	-2 544	3 099	1 077	-2 030	-1 485	-25 700
Uruguay	-4 364	955	-5 393	-9 546	-15 291	-10 534	-21 045
Paraguay	-6 444	-9 818	-11 686	-15 683	-16 919	-21 726	-27 397

Source: Prepared by the authors on the basis of data from the INTAL database.

TABLE 12

**Zonal orientation index in the pharmaceutical sector**

	1990	1991	1992	1993	1994	1995	1996
Argentina	4.56	3.47	3.88	2.47	2.88	2.33	3.09
Brazil	1.90	2.05	1.96	1.78	2.31	3.87	3.84
Uruguay	0.72	4.29	2.49	2.00	1.43	2.68	1.52
Paraguay	0.17	3.03	1.77	2.21	3.00	0.29	0.41

Source: Prepared by the authors on the basis of data from the INTAL database.

the pharmaceutical exports of Argentina<sup>16</sup> and Brazil depend on intrazonal markets relatively more than the total exports of each of those countries. In Brazil,

however, that zonal orientation displays an upward trend during the decade, whereas in Argentina the trend is downward.

## IV

### Static and dynamic effects of trade openness, integration and changes in regulations on the pharmaceutical sector

The pharmaceutical industry is going through a process of profound change, both at the zonal and the international level. The enterprises in this sector have had to adapt to new ways of carrying out their scientific and technological research processes, new systems of regulation (based fundamentally on trade liberalization

<sup>16</sup> The fact that there is a positive zonal orientation in the case of Argentina is due to the fact that most of that country's primary-sector exports go to the "rest of the world". If, instead of taking total exports as our reference point, we used exports of manufactures, the opposite result would be obtained, because pharmaceutical exports depend more on the zonal market than primary exports, but less than the average for manufactures.

and the elimination of price controls), new market signals, and new patterns of relations with public and private bodies. In other words, the regional integration process (through MERCOSUR) has coincided with other structural changes that have taken place in the area. This faces us with the methodological difficulty of identifying which of the aspects of the process of change in the sector which we discussed earlier can be attributed to the effects of regional integration and which are due rather to the impact of the other phenomena mentioned. In the following sections we will try to answer this question with regard to both static and dynamic effects.

## 1. Analysis of the static effects

Static analyses of integration and openness processes are generally aimed at determining to what extent those processes reduce the static distortions induced by trade protection. Such analyses tend to center on the behaviour of imports and the extent to which they displace inefficient domestic production, but they also involve the evaluation of domestic price trends and their effect on the well-being of consumers.

From that view of the behaviour of trade, there can be no doubt that both trade openness and regional integration have generated static benefits in the area. The total imports of the three countries studied have increased, proportionately, much more than their respective levels of apparent consumption. This has markedly increased the sectoral imbalance of the area with the rest of the world and raised its import coefficients (although these continue to be relatively low). There has consequently been a gradual decline in the index of revealed comparative advantages of the zone compared with the rest of the world, affecting each of the four countries of the area more or less equally.

At the same time, the integration process has made possible a notable increase in intrazonal trade. Both imports and exports are over ten times greater than they were at the end of the 1980s. The fact that imports from outside the area have also increased, while levels of production have grown much less, gives grounds for assuming that there has been a considerable process of creation of trade in the area.

The trade pattern of the area shows us that the bulk of its imports continue to come from the developed countries, while the increase in the latter's exports to MERCOSUR have turned it into their main export destination.

The increase in the area's exports has been led by Argentina, which has consolidated its position as export leader of MERCOSUR and continues to be the only country with a positive sectoral balance. In spite of the strong progress made by Brazil as a market for Argentina's exports, however, this mainly benefits the transnational corporations operating in the sector, since the exports of the local-capital firms go rather to the Uruguayan and Paraguayan markets.<sup>17</sup> This is attributed by Argentine firms to the regulatory asymmetries between Argentina and Brazil and the fact that in order to export to Brazil it is necessary to make heavy

investments to win a place for their brands in that market.

In Brazil, too, the transnational corporations occupy a leading place in exports. There, out of the ten main enterprises exporting to MERCOSUR (which account for some 70% of total exports), eight are transnationals and two are in the "unclassified" category, while none of the main national laboratories figure among the largest exporters to the area. The transnational corporations also figure among the main MERCOSUR importers of products. A number of transnational corporations act both as importers and exporters of pharmaceutical products, reflecting an intra-industry specialization strategy.

The intrazonal trade structure would appear to reflect a specialization pattern marked by the export of bulk medicines and the importation of retail medicines by Uruguay, while there is intra-industry specialization between Argentina and Brazil in retail medicines (with a high proportion of antibiotics, hormones and enzymes, anti-inflammatories, etc.).

To sum up, the increase in tariff preferences in MERCOSUR has clearly given rise to faster growth of intrazonal exports than of exports to the rest of the world: a process in which the transnational corporations have been the clear leaders. This has also been accompanied by an upward trend in imports from the rest of the world, however, though this gives no grounds for inferring the existence of diversion of trade and has led to a slight decline in the index of intra-industry trade and an erratic tendency in the zonal orientation index during the decade.

The local-capital enterprises of all the countries studied complain that there are asymmetries in the regulations which make it difficult to take advantage of the existing comparative advantages or that there is a danger of excessive penetration by imports. The Argentine enterprises claim that the restrictions on access to the registration of medicines in Brazil mean that only the transnational corporations can benefit from the expansion of exports to that country. The problem is that local-capital Argentine firms must undergo stringent quality controls of their plants and products, which limits the entry of their products into the neighbouring country. Brazilian firms, for their part, claim that health control rules are looser in Argentina because there are fewer requirements as regards the licensing and quality control of medicines, and this affects the competitiveness of Brazilian products. Another static effect of the greater trade openness in Argentina and Brazil has been a sharp increase in

<sup>17</sup> And also to other Latin American countries, especially those where the local-capital laboratories have plants of their own.

imports of pharmaceutical products, which has helped to bring down the production costs of the pharmaceutical industry considerably.

It is interesting to note that the apparent positive static effects of the behaviour of trade flows are in sharp contrast with the behaviour of domestic prices, since the domestic prices of medicines in the three countries studied kept on rising throughout the 1990s.

In the case of Argentina, in particular, unit sales stagnated (and even went down slightly, depending on the years compared), whereas average prices in dollars registered a constant increase which amounted to 100% between 1991 and 1997 and 240% if 1988 is taken as the starting point (data from CAEME). This means that consumers have been seriously prejudiced by the effects of the various changes that have taken place in the sector. This trend towards higher prices is compounded by some special characteristics of the health market, such as the differentiation between those who decide the expenditure that must be made – the doctors – and those who have to pay it, or the existence of more or less generalized health insurance arrangements. These characteristics tend to give rise to excessive use of medicines and an inability to negotiate over their prices by those who have to foot the bill (fundamentally the consumers).

## 2. Dynamic effects of the integration process

As we saw in section III, the pharmaceutical sector of the area is going through a far-reaching process of change. This is giving rise to big changes in the ways of developing, manufacturing and marketing medicines, through modifications in the forms of conduct and strategies of the companies and institutions of the sector. As we shall see below, the strategies differ considerably, depending on whether they involve local-capital firms or subsidiaries of transnational corporations.

How far has the integration process influenced these changes? Both in Argentina and in Brazil, companies have attached less importance to integration as a catalyst of change than to changes in the regulations (maximum prices, trade openness, the law on patents) and macroeconomic stabilization. We will now describe some of the areas where the integration process might have been expected to have dynamic positive effects.

### a) *The pressures of competition and conversion of the sector*

As we already noted, neither the integration process nor greater openness have so far given rise to greater

pressure through competition on the domestic prices of the MERCOSUR countries. This may be attributed to the market structure of the sector, in which medicinal specialities generally have captive markets due to the brand name (thanks to powerful promotional campaigns) and in some cases strong concentration of distribution is also taking place. Moreover, in many cases the importation of medicines is controlled by the producer laboratories themselves, so that the capacity of imports to discipline prices is severely limited.

Although no competitive pressure on domestic prices has been observed in the area, however, there are clear signs of a new situation in terms of competition due to the important changes that have been made in the regulations, especially as regards patent law. The changes caused by this new situation are so profound that there is reason to doubt the viability of the local-capital laboratories, especially the smaller ones.

The entry into force of the regulations on patents narrows the production horizons of local firms, since it limits their possibilities of participating in the production of the new products which are coming onto the market and which are usually the most profitable ones.

In view of this situation, the options open to local firms are to seek agreements with the transnational corporations, concentrate increasingly on the market for generic drugs, or simply sell their plants.

The strategies of the larger firms seem to be increasingly aimed at securing new kinds of strategic alliances with the transnational corporations which would allow them to gain early access to production licences through joint marketing agreements or to act as local distributors of the molecules and active principles developed by those corporations abroad.

In order to improve their bargaining capacity with foreign companies, one of the strategies which is being increasingly used by the local laboratories of various countries is to strengthen their marketing structures and build up the prestige of their brands and the level of confidence in them.

Greater participation in the market for generic products is not an obvious solution for Argentine companies. When an attempt was made there to impose legislation to promote the use of those products, it was seriously questioned by various sectors of the industry. Since generic products require a modern industry and high scales of production in order to keep costs down, they have been developed to a greater extent in Brazil, because of the large size of the local market.

This situation suggests that the tendency towards increased participation by foreign companies in the

markets of Brazil and Argentina will be further strengthened in the future. The integration process has increased the interest of the transnational corporations in strengthening their position in those markets. MERCOSUR offers them greater possibilities for expanding intra-firm trade, because of the regional tariff liberalization, the geographical proximity of the markets, and the prospects that in the future a high level of harmonization of regulations will be achieved among the member countries. The most common strategy adopted by those firms in Argentina, and especially in Brazil, is to revitalize their production facilities, acquire existing plants, and establish new distribution and marketing networks.

In Uruguay, however, the opposite is taking place, for the transnational corporations established in that country are tending to give up local production and sell only imported medicines, particularly from Argentina. Some of the plants closed down by those companies have been or are being bought by local firms or "multilatinas": i.e., Latin American companies which have operations in that country and in some other MERCOSUR nation (Laens and Terra, 1998).

The repositioning of the transnational corporations in Argentina and Brazil is taking place by various means: some of them acquired companies which previously belonged to local interests (Bristol-Myers bought Argentia in Argentina) or merged with them (Hanssen with Cilag Farma in Argentina; Merck, Sharp and Dohme with Ache in Brazil), while some firms which had lost dynamism during the 1980s recovered their positions by rehabilitating and improving their existing factories (Rhodia Farma in Brazil). Finally, some firms opened new laboratories or embarked on expansion projects involving the construction of pharmaceutical plants (Bayer in Argentina; Glaxo Wellcome and Pfizer in Brazil). This restructuring process has also included the transfer of production plants from one country to another, such as the closure of plants in Uruguay and also in Argentina (Alcon) for their relocation to Brazil.

Thus, except in Uruguay, over the last few years market shares by capital origin have been changing in the area in favour of the transnational laboratories. The latter, however, show little or no interest in expanding their capacity for the production of active principles or pharmaceutical raw materials. Indeed, after the trade openness process a number of transnational corporations gave up producing active principles and opted for a policy of managed intra-firm imports. National firms too have been replacing the local

production of active principles with imports.<sup>18</sup> This process, which has enabled the laboratories to obtain a reduction in the cost of their raw materials, has considerably increased the trade deficit of the pharmaceutical industry of the area.

*b) Production specialization and reduction of the range of products*

The MERCOSUR integration process is accentuating a trend arising from the globalization strategies of the transnational corporations, which allow them to make use of the advantages developed by the countries in locating their different lines of medicines among them. This enables them to reduce their range of products and increase the production specialization of their various subsidiaries, thus favouring a big increase in intra-firm trading relations. As a result of this process, for example, Glaxo has made its Argentine plants specialize in antibiotics and its Brazilian ones in tablets and creams, while Roche produces vitamins in its Argentine plants and imports injectable products from Brazil.

In the case of local-capital firms, the Argentine laboratories interviewed are using two mechanisms in order to reduce their product range. On the one hand, they are reducing the amount of products they place on the market, thus enabling them to concentrate their research and marketing efforts. On the other hand, a number of firms have established supply agreements with other national firms for the mutual supply of different types of products which they then sell under their own brands, because of the need to increase their competitiveness (through economies of scale), as well as for health reasons (one laboratory cannot produce different lines of medicines).

The local-capital laboratories of Uruguay are also reducing their product ranges, giving up the production of certain lines, which they have begun to import from Argentina, and specializing in others in order to take advantage of economies of scale and brands which are common to both countries. In the case of Brazil, it is the transnational laboratories which can benefit by relocating their production activities among the MERCOSUR countries.

<sup>18</sup> This is not the case in Uruguay, which has not developed the production of active principles, so that the pharmaceutical firms of that country, which no longer see the area as a source of supply of raw materials, are calling for a reduction on the common external tariff levied on them.

c) *Export strategies and regional business alliances*

As already noted, MERCOSUR has favoured trade relations among transnational corporations in the area, giving rise to the expansion of intra-firm trade. Only in a few cases has there been an increase in trade between Argentina and Brazil due to the exports of local firms. The Argentine firms claim that this is very difficult because of the restrictions on the certification of products in the Brazilian register and the need to make heavy investments in marketing. In this respect, the impact of area integration on strategic export-based development has been felt above all in the case of exports to the smaller countries of the area. This is particularly noteworthy in the case of locally-owned enterprises which have plants in Argentina and Brazil, such as Elea, Bagó and Raffo. Some of the local firms interviewed say that such exports to MERCOSUR have enabled them to carry out a learning process with regard to export activities.

According to the transnational corporations located in Brazil which were interviewed, MERCOSUR has not significantly altered their behaviour in the markets of the area because their business strategies are based to a much larger extent on their relations with their head offices. Brazilian local-capital firms, however, display defensive strategies with respect to MERCOSUR, which they attribute to the fact that they consider it a market with little growth potential, but which may in fact be connected with their lower competitiveness compared with the Argentine plants.

The restrictions referred to by the local-capital firms of the MERCOSUR countries mean that in order to expand their trade in the area they need a local partner in one of the other countries of the bloc. So far, practically no trade or production agreements have been made between local-capital firms of Argentina and Brazil. From the point of view of the Argentine firms, the possibilities of association are limited because of the relative weakness of the Brazilian firms, while the latter, as already noted, take a defensive stance which they attribute to the unfavourable asymmetry of the regulations.

In both countries, however, there have been trade agreements led by companies which have made technological advances of their own.<sup>19</sup>

<sup>19</sup> In Brazil, the Macrobiológica company (which has made advances in the production of active principles) signed a trade agreement with an Argentine firm to sell raw materials to the latter, while in Argentina the Bio Sidus company (which has made advances of its own in the field of biotechnology) has also made a

d) *Development of technological capacity, capture of certain market niches, and strengthening of marketing structures*

The fundamental research of the transnational corporations is concentrated outside the region. While innovation is part of the world strategy for those companies, at the local level it seems to be directed more towards organizational changes, especially in business management and marketing.

Some local-capital Argentine laboratories are carrying out applied research, and for this purpose they have signed collaboration agreements with universities and research centres, aided by the loans made by the Fondo Tecnológico Argentino. In a few cases, these agreements have enabled them, as already noted earlier, to make technological advances of their own, especially in the field of biotechnological products. The levels of investment in scientific and technological research are low, however, and it is not possible to advance beyond a certain point because of the high cost of securing registration in the countries of the north.

Other local-capital Argentine firms are carrying out product differentiation processes with regard to both the characteristics of medicines and their packaging. In other cases, they have tended to engage in production for certain market niches, such as natural plant-based medicinal products, which are not patentable. The impression which emerges from the interviews, however, is that, because of their lower level of scientific and technological maturity, except in a few cases the local-capital firms have opted to give up their previous in-house scientific and technological research efforts.

The strategies of the Argentine and Brazilian local-capital firms appear to be highly conditioned by the economic openness process and the patents law, which imposes limitations regarding the launching of new products which will come into effect immediately (for Brazilian firms) or in the near future (for Argentine companies). This augurs future setbacks in their respective domestic market shares.

e) *Some pending issues in the integration process*

It may be concluded from this study that the MERCOSUR integration process in the pharmaceutical products sector is still at a very incipient stage, in that the

trade agreement with a Brazilian firm, in open competition with transnational corporations, which has made it the fifth largest exporter of pharmaceutical products to Brazil and enabled it to increase its shares of both the Brazilian and the Latin American markets.

liberalization of trade in this field among the countries of the area is still far from being sufficient to form an integrated market. Among the tasks which are still outstanding in order to achieve this objective and strengthen the development of dynamic comparative advantages over third countries, mention may be made of the following:

- i) *Elimination of asymmetries in regulations.* This involves a broad range of policies and actions of the national public health bodies, such as harmonization of the rules on product licensing and the certification of bio-equivalent products, the health standards needed for the importation of medicines, regulations on the marketing of generic products, etc. It also includes the harmonization of policies which are the responsibility of other public bodies, such as those on patent law and policies on competition in the marketing of products.
- ii) *Promotion of technological cooperation agreements in order to further the area's development in this field.* An example of action taken in this field is the Argentine-Brazilian Biotechnology Agreement (CABIO), adopted in 1986. Indeed, a number of studies suggest that priority should be given to the technological efforts of the countries of the periphery in the areas of biotechnology and fine chemicals, since they cover a wide field and could be applied

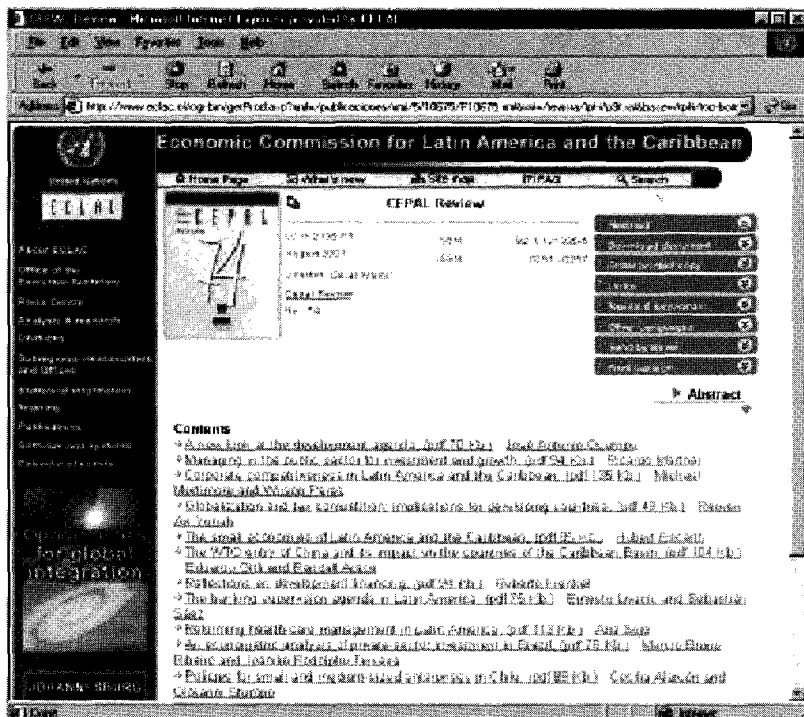
in a relatively short space of time. CABIO registered only limited success, but this does not mean that strategies to promote technological agreements at the zonal level should be abandoned. The present study bears witness to the different performance in terms of trade and business dynamism displayed by firms which have made technological innovations of their own.

- iii) *Reduction of the obstacles to competition represented by captive brand-name markets, through a faster transition towards the consumption of generic products (Katz, 1997).* This process is making most progress in Brazil. At the national level, it will make it possible to advance in the deregulation of the pharmaceutical products market, while minimizing the negative impact of this process on the well-being of consumers. At the zonal level, it will increase the capacity of local-capital laboratories to compete in their countries' markets. One of the most serious problems in this connection is the lack of information of doctors and consumers regarding the quality of generic products. Coordination among the countries of the area could help to increase their capabilities both as regards past experience and legislation to facilitate this transition and as regards all aspects of the certification of bio-equivalent products.

(Original: Spanish)

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## Recent ECLAC publications

### Periodical publications

**Economic Survey of Latin America and the Caribbean 2000-2001** (LC/G.2139-P), United Nations publication, Sales No. E.01.II.G.2, ECLAC, Santiago, Chile, October 2001, 312 pages.

This is the fifty-third edition in this series, and incorporates new changes in presentation, designed to expand the coverage of the analysis of the region and make the document easier to read.

The *Survey* is once again published in a single volume, Part One of which describes the main aspects of the regional economy, while Part Two analyses the recent economic situation of the countries of Latin America and the Caribbean. The statistical appendix is in electronic form, thus facilitating the processing of the data contained in it.

Part One of the *Survey*, which covers the regional economy as a whole, has a new and more compact structure, beginning with a chapter dealing with the situation in the first half of 2001 and the prospects for the year as a whole. The analysis of various specific aspects of the regional economy in 2000 consists of three chapters on macroeconomic policies and reforms, the performance of the domestic economy, and the external sector.

Part Two contains analyses of the economic performance of the 20 countries of Latin America and the English-speaking Caribbean during 2000 and early 2001. The country reports include tables and figures on the main economic indicators.

The Statistical Appendix, which is supplied on CD-ROM, includes over 400 tables providing ready access to data for recent years and permits the creation of spreadsheets in order to facilitate data processing. It also includes the full text and figures of the *Survey* in electronic format.

**Social Panorama of Latin America 2000-2001** (LC/G.2138-P), United Nations publication, Sales No. E.01.II.G.141, ECLAC, Santiago, Chile, October 2001, 330 pages.

The 2000-2001 edition of the *Social Panorama of Latin America* provides new poverty estimates for the countries of the region based on household surveys conducted around 1999, together with recent statistics on income distribution, employment and unemployment. It also examines the levels of public expenditure allocated to the social sectors, the situation of Latin American households, and the main public policies aimed at them.

Chapter I presents an analysis of trends in poverty and extreme poverty during recent years and an assessment of the progress made by the Latin American countries in reducing poverty. Some of the basic features of the profile of poor households are described, and the feasibility of halving the incidence of extreme poverty in the region –and thus meeting the target set for 2015 at the Millennium Summit– is discussed.

A number of indicators are used in Chapter II to analyse the situation in the various countries as regards their degree of

inequality of income distribution and recent trends in that respect. The point is made that, although many countries succeeded in expanding their economies and raising their levels of social spending considerably during the 1990s, Latin America has not managed to alter its characteristically high degree of income concentration to any substantial extent.

Chapter III deals with employment and unemployment trends. For the first time, in this edition aggregate data are provided for the Latin American countries as a whole in order to highlight the main trends in relation to labour supply and demand, the segmentation of the labour market, and the evolution and characteristics of the rising open unemployment rates being observed in many countries.

Chapter IV offers an assessment of trends in public social expenditure. The factors that contributed to the major increase in per capita social spending seen during the 1990s are discussed, and changes in spending levels during upturns and downturns in economic growth are examined. Information is given on trends in public social expenditure in individual sectors (education, health, social security and housing) and on their impact in terms of income distribution.

The fifth and final chapter deals with the social agenda. Quantitative data are furnished on changes in the structure of Latin American families, with emphasis on the relations between that structure, demographic changes and women's participation in the labour market, and the social institutions responsible for designing and implementing family-related policies, and their links with other public policies, are discussed.

This edition of the *Social Panorama* includes a statistical appendix with 48 tables on indicators relating to a wide range of social phenomena.

### Other publications

**El espacio regional. Hacia la consolidación de los asentamientos humanos en América Latina y el Caribe** (The regional living space. Towards the consolidation of human settlements in Latin America and the Caribbean) (LC/G.2116/Rev.1-P), "Libros de la CEPAL" series, No. 60, United Nations publication, Sales No. S.01.II.G.68, ECLAC/HABITAT, Santiago, Chile, May 2001, 160 pages.

This document was designed to serve as an input for the work of the Latin American and Caribbean Regional Conference (held at Santiago, Chile, from 25 to 27 October 2000), which was a preparatory meeting for the special session of the General Assembly for the general discussion and evaluation of the Habitat Agenda.

The document reviews various aspects of the territorial, urban and housing situation in Latin America and the Caribbean, in order to determine the main challenges faced by the region in its efforts to consolidate the regional environment as a space for encounter and the complementation of national and local interests and efforts in the field of human settlements. The various social, economic, environmental, political and institutional processes taking place in the countries are analysed, and the challenges involved in the development of the existing potential are identified in each case.

First of all, the recent evolution of the urbanization process in Latin America and the Caribbean is considered: a process which has been and continues to be a powerful force in shaping the regional space. The way the social processes are expressed in the region is then examined, as well as the measures needed in order

to make that space an effective area for social integration. The importance now being assumed by economic forces in shaping the regional space is then determined, and the challenges raised by the need to achieve more balanced management of those processes in the near future are identified. The aspects that must be given urgent attention in order to improve the quality of life of the population, especially in the cities, are identified from the environmental standpoint, and it is emphasized that the need to support the formation of citizenship in a continent which is bolstering its democratic values calls for other tasks that must be carried out in the regional space.

In order to achieve and maintain effective and balanced development in Latin America and the Caribbean, habitat policies must reconcile and integrate the many challenges that emerge when the regional space is reviewed from each of the foregoing standpoints and they must coordinate joint action in order to gain the fullest benefit from the efforts to construct that space. The document therefore concludes with a list of proposed measures for consolidating the regional space through joint efforts by the countries which make it up.

**Apertura económica y (des)encadenamientos productivos. Reflexiones sobre el complejo lácteo en América Latina** (Economic openness and production (de)linkages. Some reflections on the dairy industry in Latin America) (LC/G.2122-P), "Libros de la CEPAL" series, No. 61, United Nations publication, Sales No. S.01.II.G.23, ECLAC, Santiago, Chile, July 2001, 396 pages.

This book has two main purposes: it presents some reflections and empirical analyses on the production complexes that operate in connection with primary milk production in various countries, but also, and precisely on the basis of those empirical studies, it seeks to make some contributions to the debate which is currently under way on the economic development of the region, local and rural development, and the links formed or destroyed between the various agents through the processes of liberalization, greater openness and globalization which have been taking place in the region during the last 15 years.

There is a contrast here between two approaches: one which is closer to the ideal proposed as a goal for the development of Latin America, namely, the formation of "mature" production complexes as a road to balanced and equitable economic growth, and another, less optimistic, approach which considers that the region seems to be drawing further and further away from that ideal.

The truth is that there has been a process of formation of production chains, but at the same time, in contrast with what was expected, many links have been broken, especially in the case of small and medium-sized agents, whether they be producers or enterprises. At the same time, a number of negative features of the region seem to be getting worse, such as the imbalance in the geographical location of production activities, concentration of ownership, and the transfer of firms into foreign hands. This seems to bring into question the path that development is following in the region. We are thus faced with a question of fundamental importance: are these changes inevitable, or, while preserving the positive elements which seem indispensable for competitiveness, can we reorient these changes in such a way that the region will follow a path leading to greater social equity and better spatial distribution?

These contrasting views are set forth in parts I and II of the book. Part I outlines a development strategy based on the creation

and promotion of production complexes for the exploration, harvesting, processing and marketing of the natural resources of the region. Part II, which takes a more skeptical attitude, claims that many production linkages, some of them essential for endogenous development, are disappearing rather than being strengthened. Finally, part III of the book studies the dairy industries of five countries of the region (Argentina, Chile, Colombia, Mexico and Uruguay), ending, by way of contrast, with a description of a mature and long-standing production complex, that of the Netherlands. These studies analyse, among other things, the various elements making up such complexes, namely, the primary production units, the processing industry, the distribution firms, the suppliers of inputs and equipment, and financial or research institutions, with emphasis on the different types of agents involved, the relations they form with each other, their sources of information, their manners of learning, and their forms of association.

**América Latina y el Caribe: Series regionales y oficiales de cuentas nacionales 1950-1998** (Latin America and the Caribbean: Regional and official national accounts series 1950-1998) (LC/G.2090-P), "Cuadernos Estadísticos de la CEPAL" series, No. 27, United Nations publication, Sales No. S.01.II.G.96, ECLAC, Santiago, Chile, June 2001, 128 pages.

This Cuaderno contains national accounts series at constant prices. It is divided into four parts and an appendix and also includes a diskette with information for each year. The introduction contains a foreword and a methodological description of the contents.

Part I gives a brief descriptive summary of the System of National Accounts at constant prices, in four chapters: chapter 1 gives a general overview of the system, chapter 2 deals with the classes of index numbers, chapter 3 with the reference periods of the indices of prices and volumes, and chapter 4 with the general methods of calculation of national accounts series.

Part II contains the summary tables for Latin America and the Caribbean, expressed in millions of dollars at constant prices, by sectors of economic activity and types of expenditure in the gross domestic product, at market prices. For the Latin American countries they also include indicators on the product, per capita income, and related variables. For the Caribbean countries they give summaries of their contribution to the regional gross domestic product. The tables by branches of activity cover a total of 32 countries, while the tables by types of expenditure and indicators cover 19 countries. Statistical tables are given with data by decades for the period from 1950 to 1990 and annual data from 1995 on.

Part III contains tables on the gross domestic product by branches of activity and types of expenditure for 33 Latin American and Caribbean countries, in national currency at constant prices, with the national accounts series officially published by the respective governments.

The appendix provides the tools for installing and using the diskette with historical series which accompanies the Cuaderno.

The diskette contains the complete year by year series in Excel format, in compressed form ("zip" format), plus the installation procedure which allows users to gain access to all the tables of the publication. It also contains the complete text in MS-Word format, for greater ease of use.

**Dirección del comercio exterior de América Latina, según la clasificación central de productos provisional de las Naciones Unidas** (Directions of external trade of Latin America, according

to the United Nations Provisional Central Product Classification) (LC/G.2091-P), "Cuadernos Estadísticos de la CEPAL" series, No. 28, United Nations publication, Sales No. S.01.II.G.97, ECLAC, Santiago, Chile, August 2001, 517 pages.

In this Cuaderno the Economic Commission for Latin America and the Caribbean presents an application of the United Nations Provisional Central Product Classification (CPC), which was approved in February 1989 and published for use by member States and specialized agencies in 1990. This classification is designed to provide an international framework for the comparison of different types of statistics on goods, services and assets. This means that it can be used to prepare industrial statistics and national accounts

and statistics on prices, external trade (including trade in services) and the balance of payments.

The statistics given here are on the external trade in transportable goods by each of the member countries of the Latin American Integration Association (ALADI), the Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA), and both groups together, under the heading of "Latin America". For most of the countries and Latin America as a whole, the period covered is from 1990 to 1999. Over this period, the trade flows of each of the countries and of Latin America as a whole, and their structure, are analysed according to the direction of trade, in line with the broadest categories provided for in the CPC.



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**SUMARIO DEL Nº 186**  
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#### Rescate

**SOSTENEMOS LA LUCHA, LA ALEGRÍA Y LA ESPERANZA**

Patricia Walsh

**CARTA ABIERTA A LA DICTADURA**

Rodolfo Walsh

#### Debate

**MEDIDAS ECONÓMICAS: GANADORES Y PERDEDORES. OPCIONES**

Claudio Katz - Diego Herrero - Juan Carlos Junio

#### Opiniones

**DÍA DEL PETRÓLEO ARGENTINO**  
**¿CELEBRACIÓN O VELATORIO?**

Adolfo Dorfman

#### Análisis

**TRANSFERENCIAS DE RECURSOS DURANTE LA PRESIDENCIA DUHALDE**

Eduardo Basualdo - Claudio Lozano - Martín Schorr

#### Anticipo

**ALCA: NEOLIBERALISMO Y NUEVO PACTO COLONIAL**

Enrique Arceo

#### Comentario

**EL FETICHISMO DEL CAPITAL-DINERO:**  
**DEBATE CHESNAIS-HUSSON**

Alberto R. Bonnet

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Susana Formento

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Norma Giarracca y colaboradores

Flora Losada

**ESTRATEGIAS DE DESARROLLO Y TRANSFORMACIÓN ESTATAL -**

Víctor Ramiro Fernández

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**Luis A. Rivas** *Impuestos de tasa fija y composición del gasto público. Algunas consecuencias para el crecimiento a largo plazo*

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Índice

Nº 12

- **Presentación**
- **Enfoques interregionales sobre la globalización: Las experiencias de Asia del Este y de América Latina**  
*Juan José Ramírez Bonilla*
- **Intersecciones complejas: Los lazos comerciales entre Asia del Este y América Latina en el marco de recientes desarrollos multilaterales, regionales y subregionales**  
*Robert Scollay*
- **Comparación de las canastas exportadoras de América Latina y Asia**  
*Patricio Meller y Gabriela Contreras*
- **Liberalización e integración regional: La estrategia filipina hacia la competitividad global**  
*Myrna S. Austria*
- **Flujos comerciales entre la Comunidad Andina y Asia Pacífico: Tendencias recientes e implicancias para una nueva fase de cooperación**  
*Fernando González-Vigil y Carlos Kuriyama Shishido*
- **Integración económica en Asia Pacífico: Experiencias y nuevas iniciativas**  
*Akio Hosono*

## NOTAS Y COMENTARIOS

- **Las relaciones económicas de América Latina con China: Fundamentos y perspectivas**  
*Hernán Gutiérrez B.*

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Nº 116

## SUMARIO

- ¿PUEDEN MEJORAR SU PAA LOS ALUMNOS DE  
ESCASOS RECURSOS? EVIDENCIA EXPERIMENTAL 5  
*Javier Núñez E.*  
*Isabel Millán V.*

- SIMULACIÓN DE CIT EN LA PESQUERÍA DEL  
JUREL EN CHILE 27  
*Hugo Salgado C.*  
*Bernardo Aliaga R.*

- INFLUENCIA DE LAS TARJETAS DE DÉBITO  
SOBRE LA DEMANDA DE EFECTIVO 51  
*Juan Carlos Pérez Velasco Pavón*

- CAMBIOS ESTRUCTURALES E INTEGRACIÓN.  
DISCUSIÓN Y ANÁLISIS DEL MERCADO  
ACCIONARIO CHILENO 95  
*Fernando Lefort*  
*Eduardo Walker*

## NOTAS TÉCNICAS

- UN MODELO INTEGRADO DE DEPREDACIÓN  
Y COLUSIÓN 123  
*Germán Coloma*

- AJUSTE ESTACIONAL E INTEGRACIÓN EN  
VARIABLES MACROECONÓMICAS 135  
*Raimundo Soto*

## PRECIO SUSCRIPCIÓN ANUAL 2002 (CUATRIMESTRAL)

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**Fausto Hernández Trillo** MANEJO DE RIESGOS  
FINANCIEROS EN ENTIDADES  
FEDERATIVAS DE MÉXICO

**Michel Bauer** GERENCIA PÚBLICA,  
y **Catherine Laval** GERENCIA PRIVADA

**Luis Montaña Hirose** ESTRATEGIAS EMPRESARIALES  
DE MODERNIZACIÓN FRENTE  
AL PROCESO DE  
GLOBALIZACIÓN ECONÓMICA.  
EL CASO DE MÉXICO

**Marc Uhalde** LAS TRANSFORMACIONES  
SOCIALES DE LA EMPRESA  
FRANCESA EN LOS AÑOS 1980-  
1990: LOS "MUNDOS SOCIALES  
DE LA EMPRESA"

**Rafael Tamayo Flores** LOS NEXOS TEÓRICOS DE LA  
POLÍTICA DE DESARROLLO  
INDUSTRIAL REGIONAL EN  
MÉXICO

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EN EL CAMPO POLÍTICO. EL  
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## ARTÍCULOS

**Martín Puchet** *Presencia en revistas  
académicas de los  
artículos sobre la  
economía mexicana y  
productividad de los  
economistas académicos  
de México*

**Alejandro  
Rodríguez-Arana** *Optimal Growth and  
Disinflation under  
Incomplete Credit Markets*

**Kurt Unger** *La organización  
industrial, productividad  
y estrategias  
empresariales en México*

**Rigoberto Ariel Yépez** *The Secondary Market for  
Capacity in Natural Gas  
Transportation*

**José Carlos Ramírez  
y John Goddard** *Aprendizaje con informa-  
ción incompleta en  
modelos de consumo con  
múltiples atributos*

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### TEMAS

La democracia mediática y las  
bases del sistema republicano  
*Gustavo Ferrari Wolfenson y  
Constanza Mazzina*\_\_\_\_\_

La influencia de los medios sobre  
la actitud ante la política  
*Jens Wolling*\_\_\_\_\_

Congreso y prensa. Relaciones  
institucionales y representación  
social  
*Carlos Álvarez Teijeiro, Hugo  
Alconada, Luciano H. Elizalde,  
Damián Fernández Pedemonte y  
Fernando Ruiz*\_\_\_\_\_

Periodismo e información judicial  
en Argentina  
*Miguel Rodríguez Villafañe*\_\_\_\_\_

Alianzas peligrosas. Padrinos y  
ahijados de la información  
*Marco Fidel Yukumá*\_\_\_\_\_

El buen periodismo: Las contra-  
dicciones irresueltas del periodis-  
mo de investigación  
*Silvio Waisbord*\_\_\_\_\_

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Año 3 Número 4/5 septiembre 2000-abril 2001

**DOSSIER: CULTURA Y DERECHOS DE LOS PUEBLOS INDÍGENAS**  
**Pueblos indígenas. Del etnocidio a la vindicación**  
por Jorge Fuentes Morúa

**San Andrés Sacam ch'en de los Pobres (Larráinzar). Cinco años entrados en seis**  
**Los acuerdos de San Andrés Sacamch'en de los Pobres, síntesis de un largo**  
**proceso de los movimientos indígenas.**  
por Jorge Fuentes Morúa

**Volver el rostro. Crisis política en los municipios indígenas**  
**La autonomía de los pueblos es una manera de fortalecer sus identidades y**  
**garantizar la convivencia entre todos.**  
por Adriana López Monjardín

**Etnicidad y democracia. Tendencias electorales en los municipios**  
**indígenas de Chiapas**  
**Hacia un cambio cultural más profundo de la sociedad chiapaneca que**  
**puede iniciarse con la transparencia de los procesos electorales, pero que**  
**va más allá de ellos.**  
por María Eugenia Valdés Vega

**La liturgia del diálogo. Foros de consulta sobre cultura y derechos indígenas**  
**Los pueblos indígenas no deben esperar gran cosa de quienes buscan re-**  
**presentarlos, sino contar con su propia voz.**  
por Víctor Zúñiga

**Poder y etnicidad. Relaciones interétnicas en la Guatemala liberal**  
**Un examen de la dinámica interétnica en el marco de la institucionalidad en**  
**Chimaltenango (1871-1944).**  
por Edgar Esquit

**De la nación-Estado a la nación multicultural. Una reflexión histórica y crítica**  
**Por una revisión de sus implicaciones para poder adaptarlas a realidades**  
**tan complejas y dinámicas como la guatemalteca.**  
por Santiago Bastos

**Pensar la interculturalidad. El contexto de la nación guatemalteca de posviolencia**  
**Un concepto que representa el proyecto hegemónico en el debate de la**  
**construcción de la nación multicultural de posguerra.**  
por Manuela Camus

### TEORÍA

**Memoria indígena. Un nuevo enfoque sobre la reconstrucción del pasado**  
**El pasado, antes que conocimiento especulativo, fue memoria práctica de lo**  
**vivido y lo heredado.**  
por Enrique Florescano Mayet

### ÁMBITO

**Polos opuestos. Nuevo León y Chiapas**  
**La globalización económica profundiza la polarización social y regional.**  
por Esthela Gutiérrez Garza

**Entre la crisis y la pared. Zapatismo y renovación de la izquierda latinoamericana**  
**La experiencia de renovación que ha heredado la izquierda latinoamericana.**  
por Leandro Alexis Vergara Camus

### MEMORIA VIVA

**La vergüenza del olvido. Diálogo con Rigoberta Menchú Tum**  
**Esthela Gutiérrez entrevista a la destacada Premio Nobel de la Paz.**

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## IN THIS ISSUE OF THE REVIEW TRIBUTE TO RAÚL PREBISCH

<b>Foreword</b>	<b>7</b>
<i>Oscar Altimir</i>	
<b>Raúl Prebisch on ECLAC's achievements and deficiencies: an unpublished interview</b>	<b>9</b>
<i>David Pollock, Daniel Kerner and Joseph Love</i>	
<b>Raúl Prebisch and the development agenda at the dawn of the twenty-first century</b>	<b>23</b>
<i>José Antonio Ocampo</i>	
<b>Prebisch: the continuing validity of his basic ideas</b>	<b>39</b>
<i>Octavio Rodríguez</i>	
<b>The return of "vulnerability" and Raul Prebisch's early thinking on the "Argentine business cycle"</b>	<b>51</b>
<i>Arturo O'Connell</i>	
<b>The ideas of young Prebisch</b>	<b>67</b>
<i>Adolfo Gurrieri</i>	
<b>Raúl Prebisch: his years in government</b>	<b>81</b>
<i>Roberto Cortés Conde</i>	
<b>Markets and the State in the evolution of the "Prebisch manifesto"</b>	<b>87</b>
<i>Edgar Dosman</i>	
<b>The motive ideas behind three industrialization processes</b>	<b>103</b>
<i>Norberto González</i>	

## ARTICLES

<b>Technological change and opportunities for development as a moving target</b>	<b>109</b>
<i>Carlota Pérez</i>	
<b>Sectoral regimes, productivity and international competitiveness</b>	<b>131</b>
<i>Jorge Katz and Giovanni Stumpo</i>	
<b>Participation by the poor in the fruits of growth</b>	<b>153</b>
<i>Mario La Fuente and Pedro Sáinz</i>	
<b>Seduced and abandoned: the social isolation of the urban poor</b>	<b>163</b>
<i>Rubén Kazzman</i>	
<b>Employment in Latin America: cornerstone of social policy</b>	<b>181</b>
<i>Barbara Stallings and Jürgen Weller</i>	
<b>Trade in transgenic products: a review of the international debate</b>	<b>201</b>
<i>María Angélica Larach</i>	
<b>Static and dynamic impacts of MERCOSUR: the case of the pharmaceutical sector</b>	<b>217</b>
<i>Marta Bekerman and Pablo Sirlin</i>	
<b>Recent ECLAC publications</b>	<b>235</b>

