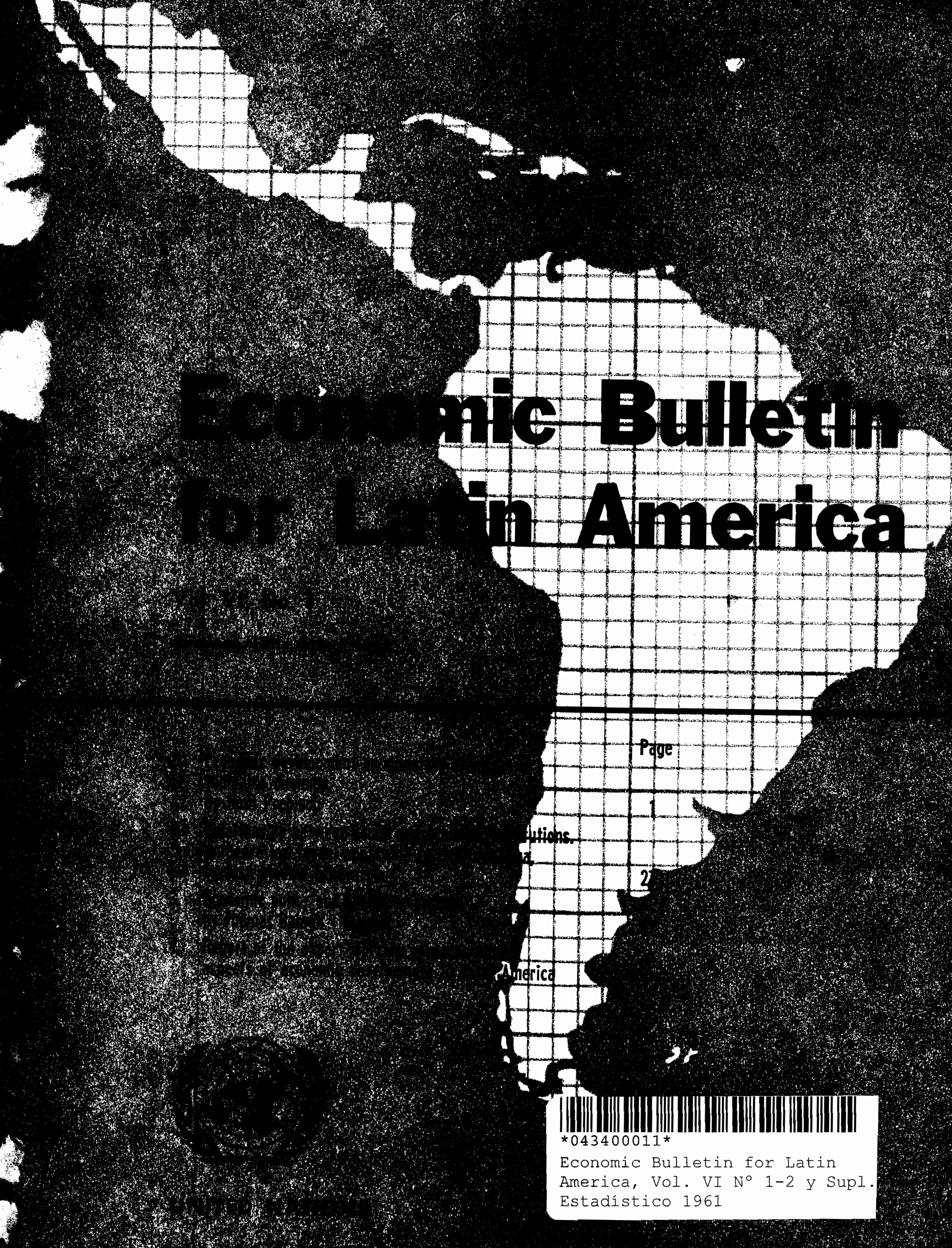


Economic Bulletin for Latin America

Page

1

The *Economic Bulletin for Latin America,* published by the Secretariat of the Economic Commission for Latin America, appears twice yearly. The essential purpose of this periodical is to provide a résumé of the economic situation of the region designed to supplement and bring up to date the information published in the Commission's annual economic surveys. Apart from this summary, which is to appear in every issue, special articles on different subjects related to the economy of Latin America are also included.

The ECLA Secretariat assumes entire responsibility for the *Bulletin.* Its content —intended for the information both of public officials and of the general reader— was not submitted to the Commission's member Governments before publication.

EXPLANATION OF SYMBOLS

Three dots (...) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A minus sign (—300) indicates a deficit or a decrease.

A space is used to separate thousands and millions (3 123 425).

A stroke (/) indicates a crop year or a fiscal year, e.g., 1954/55.

An asterisk (*) is used to indicate partially or totally estimated figures.

"Tons" and "dollars" are metric tons and United States dollars, respectively, unless otherwise stated.

Minor discrepancies in totals and percentages are due to rounding.

Price of Vol. VI, No. 1 of the *Economic Bulletin for Latin America*
U.S. $ 0.75; 5/- sterling; Sw. fr. 3.00
(or equivalent in other currencies)

The *Bulletin* may be purchased from any United Nations sales agent (see back cover) in national currency

Subscriptions should be placed either with these agents or with:

Sales and Circulation Section
United Nations
New York
U.S.A.

Sales Section
European Office of the United Nations
Palais des Nations
Geneva, Switzerland

ECONOMIC BULLETIN FOR LATIN AMERICA

Published by the secretariat of the

ECONOMIC COMMISSION FOR LATIN AMERICA

Vol. VI, No. 1, March 1961

UNITED NATIONS

ECONOMIC DEVELOPMENT OR MONETARY STABILITY: THE FALSE DILEMMA

by *Raúl Prebisch*

I. INTRODUCTION AND SUMMARY

1. Inflation and monetary orthodoxy

The economists of ECLA are often thought of as having a certain leaning towards inflation, as being prompted by the belief that this phenomenon is inevitable in the economic development of Latin America. Nothing could be further from our thoughts. This erroneous interpretation arises perhaps partly from the fact that the problem of inflation has not yet been systematically dealt with in our studies. An attempt to do so is now being made and, pending its conclusion, I have thought it convenient to avail myself of the opportunity offered by the Sixth Meeting of the Central Banks[1] to present a few ideas arising from my own observations and from our extensive discussions on this subject within our organization. They are my personal opinions and do not necessarily reflect the views of my colleagues. Happily there is no monolithic thinking in ECLA, either in this or in any other aspect of our intellectual activities.

Two facts largely explain why our thinking is wrongly judged. We reject the theory, which is so current, that inflation is caused solely by the financial disorder and lack of monetary restraint of the Latin American countries, not because we deny the existence of these patent aberrations but because there are extremely powerful structural factors in Latin America which lead to inflation and against which monetary policy is powerless. This is the first fact.

The second is the critical position we have adopted towards certain measures aimed at monetary stabilization. We all agree that a supreme effort must be made to arrest inflation and to achieve stability on sound bases. But we are seriously worried about achieving this at the expense of a decline in over-all income, of its stagnation or of a slowing-down in its rate of development.

Those who profess this type of anti-inflationary policy — both those who suggest it from outside and those who live in the midst of this harsh and hazardous reality of Latin America — sometimes entertain the esoteric notion that sin can be redeemed by sacrifice. The evil of inflation must be atoned for by retrenchment. But very often the conventional punishment is not visited upon those who unleashed inflation or who thrived on it, but on the broad masses of the people who were suffering its consequences.

The general mistake persists of considering inflation as a purely monetary phenomenon to be combated as such. Inflation cannot be explained as something divorced from the economic and social maladjustments and stresses to which the economic development of our countries gives rise. Nor can serious thought be given to an autonomous anti-inflationary policy, as if only monetary considerations were involved; it must be an integral part of development policy.

Economic development calls for constant changes in the form of production, in the economic and social structure and in patterns of income distribution. Failure to make these changes in time or to undertake them partially and incompletely leads to these maladjustments and stresses which release the ever-latent and extremely powerful inflationary forces in the Latin American economy.

This should not be construed as meaning that inflation is inevitable in our countries. Far from it. To avoid inflation, however, there must be a rational and far-sighted policy of economic development and social betterment, in other words, an essentially new approach in which an answer other than inflation is sought to these maladjustments and stresses arising from development.

This is not a merely technical problem; it is essentially a political one in which the paramount task for us economists is to clarify and to persuade. We have often seen politicians who, imbued with the genuine desire to improve the measurable well-being of the masses, frequently succumb to the corrosive illusion of inflation. Have we offered them any other alternative? Have we come to them with a coherent and feasible set of principles which would have enabled them to escape from the dilemma of choosing

[1] The present article was the subject of a very partial and incomplete oral statement made at the aforementioned meeting, held in Guatemala in 1960, to which I was kindly invited by the authorities of its Central Bank. It is offered here in a considerably amplified version in which some of the obvious gaps in the original presentation have been filled.

between inflation and an over-simplified and perplexing monetary orthodoxy? We Latin American economists are indebted to the politicians of our countries. I should like, by the present contribution, to requite them as far as it befits me to do so.

The object of these pages is to demonstrate that there is a solution to the problem of monetary stabilization that is different from the one so often recommended by the orthodox school. Before going into this any further, however, the structural factors usually leading to inflation should be examined. Perhaps a general picture should be presented here which will allow us, from the very outset, to grasp the nature and trend of our argument, even at the risk of indulging later in possible repetitions.

2. The why and wherefore of the dilemma

It is common knowledge that the economic development of a peripheral country is very closely linked to the course that its exports follow. On the one hand, the rate of growth of its exports sets a limit to spontaneous economic development. On the other hand, continuous fluctuation in this rate contribute to serious internal instability. When there is a cyclic increase in exports, income in the aggregate expands with relative ease, and this calls for a volume of imports easily paid for by exports. But when exports fall off, these imports cannot be maintained and, as a result, neither can the level of income formerly attained. Under an orthodox system of monetary stability, the external and internal disequilibrium thus produced necessarily leads to a contraction of economic activity, and the balance tends to be restored at a lower income level.

This contraction usually arouses the ever-latent inflationary forces lurking within the Latin American economy, that is, if they are not already at work. Recourse is then had to the expansion of credit and this, while counteracting the downward trend of income, also impedes the readjustment of imports and, consequently, restoration of the internal balance.

Disequilibrium is one of the factors which renders it very difficult for our countries to apply an anti-cyclic policy that does not compromise monetary stability. Hence, the solution does not lie in counteracting the effects of contraction but in *preventing them* by means of effective structural changes. The purpose of these changes is twofold: to allow the rate of development to exceed the limit imposed by exports; and, at the same time, to keep internal activity operating at the highest level of employment without being affected by export fluctuations.

Structural rather than cyclic measures should be resorted to in order to overcome the external vulnerability of our economies, although some anti-cyclic measures are also helpful as a complement to the structural solutions.

Another — and perhaps the most significant — factor hampering an anticyclic policy is the inadequacy of savings, which becomes more acute when exports decline. Any attempt then made to maintain the level of investment previously achieved is usually one of the chief causes of the inflationary expansion of credit.

The savings coefficient is relatively low in our countries, not only because average *per capita* income is also low but, in addition, because of the form in which this income is distributed and the prevailing patterns of consumption. An increase in this coefficient calls for work on distribution and consumption — in other words, on the social structure — and, at the same time, for a change in the structure of production and imports so that the increased savings can be converted into capital goods. In order to do this and to facilitate a rise in the savings coefficient to a level which would accelerate the rate of economic development, an additional contribution in the form of international funds is usually needed.

Resistance to these structural changes, which are essential to a rise in the savings coefficient, often leads to inflation in our countries. Inflation not only makes it possible to raise the level of public and private expenditure and investment but, by swelling the profits of entrepreneurs and, through them, of other high-income groups, it also causes them to increase their consumption, generally on a much higher scale than that of investments. It is therefore a socially costly and regressive method of raising the savings coefficient.

Since the inadequacy of savings becomes more acute during the period of contraction, it is extremely difficult, if not impossible, for monetary leaders to oppose an expansion of credit to cover expenditure and investments which tend to shrink. It sould not be concluded, however, that this type of inflation of expenditure and investments — different from inflation of costs — is attributable solely to the structural vulnerability of the economy. The effects of inflationary forces are usually also felt in periods of prosperity, when increased economic activity stimulates expenditure and creates new investment opportunities.

These forces tend to burst forth whenever a marked change takes place. When the change is favourable, however, inflationary expansion cannot be attributed to vulnerability of the economy — as it can when the change is unfavourable — but to the weakness of the central banks to arrest these inflationary forces; indeed they may well be operating within the banks themselves.

It is therefore an expression of the aforementioned lack of financial and monetary restraint which, while it may not explain our inflationary phenomena in all their great complexity, is nevertheless a very important element thereof.

The simple orthodox formula of credit containment — perfectly correct when rising exports stimulate domestic activity — completely ignores the phenomena of structural vulnerability and, once the decline sets in, irremissibly exposes the economy to the inflationary forces.

All this relates to the inflation of expenditure and investments, where the inflationary pressure of demand first causes prices to rise and then brings about an increase in wages and salaries in order — very rightly — to restore the real income of the workers. This is the traditional type of inflation in our countries, although there are new aspects to structural vulnerability.

However, inflationary phenomena of another type emerge as the process of development continues. Either because of the form in which the structural changes required by development are carried out, or because they are undertaken only partially or inadequately, regressive movements come into operation in income distribution. Efforts to compensate for their effects lead to higher wages and salaries and their inevitable impact on prices.

There are three main elements in these regressive movements which derive from economic development itself: the cost of import substitution; the higher cost of agricultural products; and the rise in taxes and duties which affect mass consumption in one way or another.

Import substitution policy, while reflecting an inevitable structural change, has been carried out with very serious flaws. Very often considerations of economic feasibility have not been given their due, and it was not until recently that an attempt was made to break the confining bonds of national markets by means of the gradual economic integration of our countries. First and foremost, this policy has been applied in a discriminatory way, without promoting a corresponding expansion in exports, and thus it has been carried farther than it might have been under other circumstances.

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

This is particularly true of the productivity of the land and it constitutes one of the chief obstacles to economic development. Antiquated systems of land tenure have contributed to the relative rise in the cost of food in some Latin American countries as demand increased with population growth.

If to this is added the greater cost of some elements or inputs of agricultural production as a result of substitution policy and agricultural wage increases arising from higher productivity in other branches of the economy, an answer may be found to the question why in some countries costs and prices relative to agricultural production have risen with a marked effect on mass consumption.

To raise wages and salaries is a very understandable reaction. However, it fails to solve the problem either in the present or in the previous case; it is merely reflected in the aforementioned inflationary spiral. Nor does the solution lie in the policy of credit containment; if central banks do not increase the amount of currency in circulation when salaries and wages rise, they cause a contraction in economic activity. Hence, the contraction may be due not only to the external vulnerability of the economy but also to the endeavour to use monetary instruments to ideal with the consequences of its structural flaws.

In the case of an inflation of expenditure and investments, and not of costs, the inflationary rise in prices likewise involves a corresponding readjustment of salaries and wages. Unlike the previous case, however, this increase is not inflationary but is the corrective of an inflationary phenomenon. Nevertheless, what happens very often is that the entrepreneurs, instead of absorbing it at the expense of their inflation-swollen profits, resort to credit expansion and transfer it to prices, thus generating the inflationary spiral.

Inflation is asymmetrical in so far as its distributive effects are concerned. It is used by entrepreneurs to modify distribution to their advantage and to the detriment chiefly of the workers. Yet it does not help the latter to achieve the opposite effect but, at best, to restore their earlier share, if the credit system is handled fairly and firmly.

Hence, inflation is not an effective means of redistributing income from the point of view of the broad masses. In those cases where positive results are achieved at the expense of social groups other than the entrepreneurs, there is no doubt that taxation, if judiciously applied, is a more efficacious and less disruptive method. In fact, taxation is the income redistribution instrument *par excellence,* and the Latin American masses must learn to wield their growing political power so that it can be used for economic and social purposes. Likewise they must learn to wield their trade union power — already very substantial in some countries — to effect sizable increases in productivity and thus raise their real income, instead of wasting their energy on securing salary and wage increases which are soon cancelled out by the inflationary spiral. What is needed, therefore, is a salary and wage policy which leads to this goal and at the same time ensures the growing participation of the broad masses in the process of national capital formation.

All these considerations allow us to approach the problem of inflation in our countries in all its vast complexity. In actual fact, it merges with the problem of development. There is inflation because the economy is structurally vulnerable, because there are regressive income distribution factors, because there are not enough savings to expedite investment within a given economic and social structure. The resulting maladjustments and tensions encourage latent inflationary forces to burst forth. By means of regular and intensive economic development the maximum resistance can be offered to these inflationary forces and the policy of monetary stability can thus be upheld on sound bases — which do no exist today — as an integral part of economic development policy.

II. STRUCTURAL VULNERABILITY OF THE ECONOMY AND INFLATIONARY FORCES

1. Growth and vulnerability

(a) *Structural character of the solution*

This section attempts to explain how the growth of income at a more rapid rate than exports permit, and continual fluctuation of exports, release inflationary forces that upset monetary stability in Latin American countries.

The solution of this problem is fundamental because it calls for structural changes that will allow the economy to grow beyond the limit imposed by exports, while at the same time giving it the strength it must have to prevent, rather than correct, the internal consequences of these export fluctuations.

In the absence of such structural changes there will inevitably arise the dilemma of choosing between a policy of monetary stability that subordinates economic development to the tempo and fluctuation of exports, on the one hand, and an attempt to counterbalance the effects of these factors through inflation on the other. In our countries, a corrective policy of a compensatory nature is difficult to apply for reasons that will be explained in due course.

I shall begin by explaining the nature of the structural phenomenon, summarizing briefly what we have been expounding for some time in ECLA.

(b) *Exports as a factor limiting growth*

The growth of exports places an upper limit on the rate of development in a peripheral country. This limit is set by the intensity with which the demand for imports expands with the growth of *per capita* income. A simple example will serve to illustrate this point. Let us suppose that primary exports grow at an annual rate of 2 per cent *per capita. Per capita* income can rise at the same rate only if the demand for imports also increases at 2 per cent, that is, if the income elasticity is 1. But if imports expand at a higher rate, it will not be possible for *per capita* income to rise spontaneously at the same rate as exports. If imports tend to expand by 1.50 for each 1 per cent of increase in *per capita* income, the latter cannot rise by as much as 2 per cent, since in that case the demand for imports would go up by 3 per cent, thus exceeding the rate of 2 per cent at which exports increase. Obviously an external imbalance of this kind could not continue for long.[2] If development is to be accompanied by external balance, the annual growth of *per capita* income must not exceed 1.33 since this rate, given the income elasticity of demand for imports, will result in a growth of 2 per cent in imports, that is, the same rate as for exports.

Consequently, if *per capita* income is to rise more rapidly, import substitution is essential. In the example given above, an annual *per capita* import substitution rate of 1 per cent is required if income is to grow by 2 per cent. A 3-per cent rise in income would require an expansion of 4.5 per cent in import demand, of which 2.5 per cent would have to be met from domestic production in order to maintain this rate of growth in conjunction with dynamic equilibrium.

The rate of growth of exports in Latin American countries has in fact generally been much lower than that in the above illustration, and in some cases exports have declined instead of grown. Hence the great proportions which the substitution process has had to assume.

This disparity in the trends of external trade is a consequence of the well-known fact that, as *per capita* income grows, the demand for industrial goods tends to expand more rapidly than the demand for primary commodities. Peripheral countries import the former and export the latter, whereas the position of the major industrial countries is exactly the reverse. In the industrial countries, import substitution can in no way be justified on the grounds of growth; if it takes place for other reasons, income-elasticity of demand for primary commodities tends to become weaker still, with the result that the peripheral countries which export those commodities have to intensify their substitution policy in order to maintain the same rate of income growth.

It follows from the above arguments that, even with the same population increase, a peripheral country cannot attain the same rate of spontaneous growth as the industrial centres with which it trades, because of differences of elasticity, which are generally rendered even greater by the protectionist policies applied by these centres. Hence import substitution (and the development of industrial exports to the centres) is a *sine qua non* for rectifying these differences. Since the peripheral countries of Latin America have a much more rapid population growth than the industrial centres, the process has to be proportionately more vigorous.

The substitution process has to be steadily maintained so long as income continues to grow more than exports, even when the coefficient of elasticity of demand for imports is not constant, as was assumed for the sake of simplification in the illustrative example. This depends on the rate of growth of *per capita* income, on the changes in import demand arising from technical developments and consumer preferences, on changes in the composition of imports caused by substitution policy, and on the cost of the substitutions.

(c) *Improvisation of substitution policy*

If there were in practice a regular and constant increase in exports, it would be comparatively easy to determine the extent of the substitution effort required annually. Unfortunately this is not so, since exports are subject to a continuous undulating movement which makes the systematic application of this policy difficult.

When exports increase comparatively rapidly during the favourable phase of this cyclical movement, the domestic economy can obtain all the imports required for its development and there is no apparent need for substitution. All is well so long as exports continue to rise or are maintained at a high level and provided that a prudent monetary policy has been pursued. This latter aspect will be dealt with below. But as soon as exports fall off, the country finds that its income in the aggregate has grown to such an extent that the volume of imports required is higher than what can be paid for by its declining exports. An import substitution policy therefore has to be improvised. It is generally applied not as a prudent measure that anticipates the demands of development, but as a step imposed by critical circumstances when external disequilibrium has already occurred.

The frequent result of this has been that considerations of economic feasibility and of anti-cyclic flexibility are left out of account. Moreover, the inescapable need to protect substitution activities, and the various extreme forms which such protection usually assumes, create conditions unfavourable to export development, and thus increase the tendency to disequilibrium. All this points to the need for a review of substitution policy.

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

How can substitutions be planned in advance? How can the pressure of future events be forestalled? This is a problem to which the secretariat of ECLA has long been devoting attention, and it was with this in mind that the first attempts at analysis and projections of economic development were made. I believe that sufficient progress has been made to enable us to determine the requirements of an import substitution policy; consequently, I shall not dwell on this point, which is beyond the scope of the present article, despite its intrinsic interest.

(d) *The economic feasibility of import substitution*

Much less progress has been made in elucidating the problem of the economic feasibility of substitution activities. Generally speaking, it has been tackled in the light of considerations of circumstance rather than on the basis of a selective criterion. When external disequilibrium arises, the reaction often is to restrict imports of finished consumer goods by measures which, albeit unintentionally, involve the promotion of substitution production, regardless of the type of goods concerned.

The laudable aim of thus facilitating imports essential

[2] In the interest of simplification a balance of payments consisting only of imports and exports is assumed; at this juncture it would be pointless to include other balance-of-payments components.

to economic activity at the expense of finished consumer goods has led to increasing rigidity in the composition of imports, with serious consequences for some countries. These consequences may also fall to the lot of other countries if a rational and far-sighted substitution policy is not followed.

What has happened is that the structure of imports has become so distorted that they are limited to raw materials, intermediate goods vital to the maintenance of economic activity and a few capital goods, together with essential items for direct consumption. As a result, any subsequent appreciable contraction in the capacity to import has a depressive effect on the economy because it becomes difficult to obtain these essential and urgently needed goods from abroad. It remains a paradox that industrialization, instead of helping greatly to soften the internal impact of external fluctuations, is bringing us to a new and unknown type of external vulnerability.

All this is of great importance not only for the proper functioning of monetary policy but also for economic development policy itself, and consequently it is essential to formulate a substitution policy whereby the requirements of economic feasibility and the aim of endowing the economy with the strongest possible structural resistance to external fluctuations are combined.

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

Discrimination against exports

Obviously the development of new exports, in addition to traditional lines, would help considerably to achieve this aim. This brings us to the other fundamental error: an asymmetrical development policy. The need for import substitution and for consequent protection of substitution activities has been unavoidable. But there has been a failure to boost exports to the same extent. There has been discrimination in favour of industrial substitution and against exports, mainly industrial exports. The ideal policy would have been to promote exports in order to place them on an equal footing again with substitution activities, which does not necessarily mean equal incentives.

This aspect is sufficiently important to merit examination; in a nutshell, it is the following. Limitation of external demand for primary exports makes it necessary to devote part of the *increase* in the factors of production to substitution activities. As their productivity is lower than in the industrial centres, they need to be given a certain subsidy in the form of tariff protection. Yet there would be possibilities of using a smaller subsidy to develop new industrial export activities, whereby a greater quantity of industrial goods could be obtained through trade than those that could be manufactured by substitution production.

By subsidizing substitution production rather than production intended for *new* exports (industrial or primary), export opportunities have been lost which, had they been properly used, would have reduced the scope of substitution policy or made more rapid economic growth possible.

This is admittedly a problem for which there is no simple practical solution, but it is unquestionably true that the lack of subsidy policy, especially for new exports and, even more, the negative subsidy that monetary overvaluation sometimes constitutes, have caused the Latin American countries to miss export opportunities to the detriment of their economic development.

However, it should be recalled that some countries, conscious of this need to encourage exports, have resorted to multiple rates of exchange. It is open to question whether this is the best formula. At all events, multiple rates of echange have been rejected by the school of monetary orthodoxy, without the application in their stead of any rational subsidy policy, which, it might be added, might come up against other forms of doctrinaire opposition. All these questions should be thoroughly debated, and it is to be hoped that, when countries review their policies of economic co-operation with Latin America, this subject will receive the attention it deserves.

I should now explain why I referred to new exports and not to exports already established. In this connexion, there is one thing that is self-evident: if external demand makes it possible to employ the whole of the increase in the active population and other factors of production on customary exports, it would be absurd to embark on substitution activities that would yield a lower net product. This is, in essence, the classic argument of an essentially static character.

However, it can happen that, by increasing exports beyond a certain point, prices fall both for the increment and for those that already existed, and the resultant net product is often lower than what could be obtained by substitution activities, and may even be negative. This is the basic argument in favour of protection in countries in the course of development, whose exports have a much lower income-elasticity of demand in the rest of the world than industrial imports have in the Latin American countries.

2. The internal impact of external fluctuations

(a) *The internal cyclic rise*

In the preceding section it was explained how, when exports underwent a cyclic decline, the economy's over-all income — as a result of its previous growth — required a volume of imports larger than exports permitted. Thus income would have to contract until the consequent reduction of imports restored the export-import balance. This is the requirement of an orthodox policy of monetary stability.

Thus, through successive expansions and contractions, the spontaneous growth of the internal economy follows the tempo imposed by exports, if no substitution policy has been followed. The country is then faced with the dilemma, referred to above, of choosing between monetary stability, which requires domestic activity to contract until over-all income has been reduced to a level consistent with exports, and inflationary credit expansion to counteract the contraction in the economy to the detriment of monetary stability. Before analysing this question, however, it is advisable to consider the course followed by the internal economy during this undulating movement of exports.

This movement is generally accompanied by a change in the terms of trade, which improve during the ascending phase and deteriorate when exports decline, with a consequent change in the profits and other returns from this branch of production. Thus there is heavier demand for goods and services in internal activities and production increases, both because of a greater use of productive capacity and because that capacity is expanded by new investment.

Entrepreneurs in internal activities also get a higher return on these new investments, because of the fall in costs that accompanies the better utilization of capacity and because of the rise in domestic prices. The extent to which this occurs depends mainly on the form and methods adopted for limiting imports in order to protect domestic production. If this is done by customs duties that merely compensate for differences in productivity between domestic and foreign output, without providing any excessive margin of profit for the entrepreneur, the rise in domestic prices tends to be moderate, since foreign competition makes itself felt instantly. If, on the other hand, the protective margin is large, or if imports are limited by bans or direct restrictive measures, domestic prices may rise considerably, even without the stimulus of an inflationary credit expansion.

However this may be, the general rise in profits facilitates further investment, with a consequent increase in employment, although generally not at the expense of consumer activities. Employment shows an upward trend in both forms of activity, but more especially in investment activities, because of the growth of the active population. Public investment and expenditure also tend to increase, as a result of higher tax returns, especially when these are closely linked with foreign trade.

When the over-all income of the economy is thus expanded, there tends to be a stronger general upward movement in the growth rate of imports — that is, there is a cyclic increase in their coefficient — owing to changes in income distribution in favour of entrepreneurs and other social groups high on the income distribution scale.

In this ascending phase, easy credit and new opportunities for expenditure and investment stimulate the expansion of credit beyond the point required by the increment in business activity. This expansion tends to speed up utilization of the economy's idle capacity, and to broaden it, so that imports proceed at a brisker pace. In general terms, it can be stated that inflationary credit expansion tends to increase imports to a corresponding extent.

(b) *The cyclic decline*

A decline in exports and a deterioration in the terms of trade naturally lead to phenomena of an opposite kind. Firstly, over-all demand falls off as a result of contracting demand in the export sector; this, coupled with the decrease in revenue, discourages investment, thereby opening the way to reduced employment in export activities with further depressive effects on over-all employment, income and imports.

The State, of course, suffers from the same depressive effects as a result of falling tax revenue; and the endeavour to maintain the level of its expenditure and investments generally leads to a deficit with its inevitable inflationary effects. These effects tend to relieve the contraction of the economy and to give private investment further encouragement, and for this purpose recourse is usually also had to credit expansion which leads to further compensatory effects on over-all economic activity.

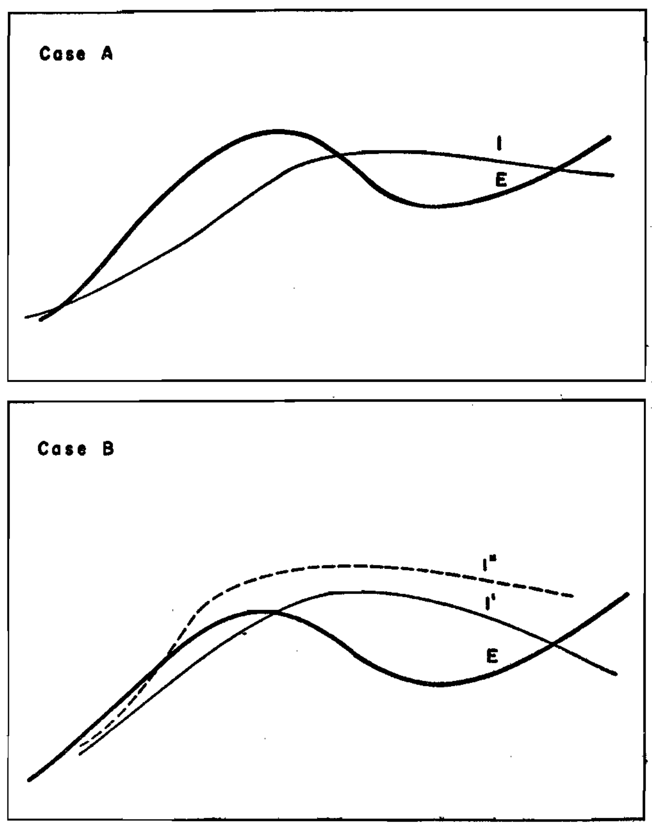
However, if the impact of a contraction in exports on over-all income is counteracted in this way, the decline in imports is prevented or attenuated, thereby intensifying external disequilibrium. The continuation of such a policy makes monetary depreciation inevitable.

(c) *The import lag*

In order the better to understand the nature and magnitude of this external disequilibrium, attention must be given to the way in which a growth in exports entails an increase in imports as part of the undulating movement. This phenomenon could be explained in the following way (see the figure). Curve E represents exports and curve I imports. When there is no inflationary pressure, curve I always drops below curve E, but while, during the upward swing, this lag indicates a surplus of exports over imports and accordingly an accumulation of foreign currency, during the downward swing the exact opposite occurs, because the previously accumulated foreign currency reserves are used up. These reserves will not be completely exhausted if exports stop declining at a level higher than their starting point, which is customary in their growth process.

If inflationary pressure makes itself felt — i.e., if part of public or private investment is financed with bank credit instead of genuine savings — imports will tend to rise with greater rapidity (I′) and approach or even exceed exports during the upward phase (I″). At all events, inflationary investments — or inflationary expenditure covered by bank credit — by accentuating the growth of imports will tend to bring about external disequilibrium proportionate to the magnitude of such investments. For these reasons, monetary reserves tend to shrink more than they otherwise would; and if inflationary pressure is very strong, monetary reserves may not only lose all the ground they have gained but may even fall below their previous level. This phenomenon usually occurs

THE LAG OF IMPORTS IN THE EXPORT CYCLE



in an acute form during the downward swing when inflationary pressure originating in the previous phase, added to the pressure that continues to develop later, intensify the external disequilibrium characteristic of this phase of the cycle.

(d) *Compensatory effects of inflation*

The decline in exports is evidenced both by the inadequacy of internal demand and by excess demand for imports until the contraction in income re-establishes external equilibrium. Thus, if exports decrease by 1,000 and the import coefficient is 0.20 — we shall suppose it to be constant for purposes of simplification — the first impact of the reduction will be a fall of 800 in internal demand and of only 200 in imports, compared with the drop of 1,000 in exports.

The fall in internal demand will bring over-all income down with it until the latter is sufficiently low to bring about a decrease in imports to the same extent as exports. On the basis of the foregoing example, this will occur when over-all income falls to 5,000.

The credit expansion which usually occurs then is not always a spontaneous consequence of economic contraction, for it is sometimes the expression of an anti-cyclic policy. At all events, expansion tends to correct the inadequacy of demand. At the same time, however, it wards off a decline in imports and thus runs counter to the re-establishment of external equilibrium. In our example, an expansion of 1,000 will offset the fall in exports and the gap of 800 in internal demand. But imports will fail to decline and external disequilibrium will be equivalent to the amount of the drop in exports. Naturally, disequilibrium leads to monetary devaluation which, in its turn, tends to bring about external equilibrium by restricting imports and promoting exports.

But this policy of an inflationary nature has very serious defects, since its positive effects depend essentially on the regressive redistribution of income. In fact, devaluation leads to price rises — if this has not already occurred — with the resultant redistribution of income in favour of entrepreneurs and high-income groups in general.

Such income redistribution generates certain changes in the composition of demand: it reduces the demand of the broad masses and boosts that of the high-income groups. Apart from its social effects, this would have no adverse effect on the total volume of internal demand if the investment coefficients of demand of the broad masses and of the high-income groups were the same. But this does not happen in practice; the coefficient of the latter is usually higher.

Thus a new problem arises. An understanding of the import coefficient is essential to correct external disequilibrium. But, as the demand for imports of the high-income groups tends to remain at the same level or to rise, depending on the intensity of inflationary pressure, it necessarily makes itself felt on the rest of the imports. The very decrease in consumption suffered by the mass of the population has depressive effects on internal activity and thereby facilitates the regressive readjustment of imports.

As a result, the inflationary redistribution produces two opposite effects. By expanding investment, it tends to maintain internal economic activity at a level higher than is justified by exports. At the same time, however, the incentive that the relevant imports offer to the forces favoured by the redistribution tends to limit the scope of this process.

It is therefore not strange that intensive credit inflation may be accompanied by inadequate use of productive capacity or may result in a slow rate of income growth, if no direct measures are taken to modify the composition of imports.

(e) *Possibilities of an anti-cyclic policy*

Inflationary expansion is far from being a satisfactory anti-cyclic instrument. Would it be possible to pursue a policy of expansion without inflationary consequences? Can a deficit fiscal policy possibly be used in our countries to counteract external contraction without inflation ensuing?

It should be remembered that, even if inflationary credit expansion counterbalances the inadequacy of internal demand, such expansion constitutes an obstacle to the re-establishment of external equilibrium by preventing a readjustment of imports. An apparently simple problem thus arises: to divert excess demand for imports towards internal demand to compensate in a non-inflationary way for the shortage resulting from the fall in exports. In practice, however, such an operation involves serious difficulties. Let us examine the chief of these.

For it to be possible to divert the surplus demand for imports, it is essential that there should be an easily reducible margin. The most favourable case is when this margin consists of articles, imports of which can be cut or abolished without lowering the level of employment nor affecting mass consumption unfavourably.

Let us suppose that the articles concerned are for the high-income groups. Part of the surplus demand can be absorbed by import taxes. These taxes must be high enough to divert the rest of surplus demand towards the internal market. This diversion will be converted into inflationary pressure of demand to the extent that there is no idle capacity in the economy. And the only way to avoid this is by absorbing this remaining demand by new taxes of an internal nature.

In this way all the surplus demand — except that part which has been covered by the aforesaid idle capacity and the resultant rise in employment — will have been collected by the State in the form of taxes. The resources accumulated in this way enable the State to cover the investments which formerly were made in an inflationary manner and thereby to ensure employment for that part of the labour force which was not absorbed by fuller utilization of the available capacity to which reference was made.

In a nutshell, the operation consists essentially in shifting surplus demand for imports to internal demand for the factors occupied in investment activities. This is, however, a simple case. Let us now examine the complications, first those arising from the composition of the reducible margin and then those resulting from the inadequacy of that margin.

Let us suppose that, in order to restore external equilibrium, the imports for the high-income groups are insufficient and that it is essential to resort to imports that form a direct part of mass consumption. To carry out an operation similar to the previous one would be tantamount to placing a direct burden on such consumption; and if this burden is eschewed, inflationary pressure will emerge which will, in any event, make prices rise in the same way as if the burden had been applied. In both cases there is the danger of setting off the spiral already referred to. There is no alternative but to obtain financial aid from international sources to cover investments to an extent equivalent to the inflationary pressure. And this is even more cogent if the reducible margin is insufficient or if resources are lacking to cover all the imports essential to the maintenance of the level of economic activity. The only solution is international aid.

Careful examination of the problem reveals that the policy we are considering consists of maintaining the volume of investment which was previously made in an inflationary way, but covering it with savings provided by taxes and with international financial assistance. Such international aid is essential when imports vital to mass consumption or economic activity cannot be reduced. It is conceivable that a higher level of internal savings might be achieved which would cover all investment, but this would not solve the problem because the lack of resources for essential imports would make it necessary to restrict mass consumption or lower the level of economic activity which would also have unfavourable effects for the population at large.

This is not, however, all. Covering essential imports in this way is a temporary device until structural transformations are introduced to restore dynamic external equilibrium on firm rather than precarious bases. It is therefore essential to invest capital in local industries that will replace imports and in export activities. In so far as the absence of internal savings or the extent or composition of the reducible margin does not leave room for corresponding imports of capital goods, international financial assistance will also be required.

All that I have just said follows a logical line of reasoning. In practice, however, it would run into two serious difficulties. Firstly, a greater internal savings effort through taxes or the floating of loans is required when a drop in exports has already weakened saving capacity. Secondly, resort is had to international aid as a normal part of an anti-cyclic policy. Let us dwell on this aspect for a moment.

(f) *International financial assistance*

The difficulty does not reside solely in the deep-rooted reluctance of international credit institutions to cover internal investments which, as we shall attempt to demonstrate below, would seem to have no very serious basis, but also in a consideration far more deserving of attention. The amount of international assistance which a country requires must correspond to the rate of growth which it wishes to maintain or attain and to the savings effort which it can make. But if considerations connected with anti-cyclic policy enter into the picture, the amount of international resources required could easily be exaggerated.

Again, a compensatory policy might require a type of internal investment — public works and construction, for example — which would exceed the level proper to a rational distribution of available resources among the various investment requirements. In other words, as a result of this type of anti-cyclic policy excessive resources might be used for such investments to the detriment, to cite one example, of the production or importation of machinery and equipment.

International financial assistance can be justified as a means of supplementing the scant savings in our countries but not as a normal part of anti-cyclic policy to cover the imports required for the maintenance of economic activity. The solution does not lie there, but in a far-sighted policy of import substitution that anticipates the cyclic decline of exports so as to obviate — or at least mitigate — its consequences on the internal economy.

These considerations are relevant to anti-cyclic policy but not to means for stemming inflation. Contributions from national resources to cover external disequilibrium while the above-mentioned measures are being taken to deal with it fundamentally are usually a *sine qua non*. We shall return to this later.[3]

3. Structural equilibrium

(a) *Currency devaluation as an agent of structural equilibrium*

Are direct measures likely to be necessary to deal effectively with structural disequilibrium or is devaluation sufficient? The school of monetary orthodoxy usually advocates devaluation in all cases, whether the phenomenon is basically structural or merely a temporary departure from structural equilibrium. Neither the nature nor the effects of devaluation are the same in the two cases.

A departure from structural equilibrium usually occurs in our countries in the event of currency overvaluation. A rise in internal prices unaccompanied by a similar movement in export and import prices leads to disequilibrium by encouraging the former and discouraging the latter. This disparity may originate in inflationary pressure on prices or in upward movement of wages and salaries to a figure unjustified by the level of productivity.

So long as there are no obstacles to an increase in imports, the rise in internal prices will be confined to those goods and services which are not linked to external trade, so that external disequilibrium is merely a direct consequence of inflationary pressure. If direct restrictive measures are applied to lessen or correct disequilibrium, the rise in prices will spread to the whole economy and occasion a readjustment in salaries and wages.

Such a readjustment will make the cost of exports go up without their prices rising owing to monetary overvaluation; and likewise it will affect those branches of production that compete with imports of articles which, for one reason or another, are free of restriction. The damage which exports and the other afore-mentioned branches of production suffer makes devaluation indispensable if competitive conditions are to be re-established and the flow of external trade is to be restored on a balanced basis. The same occurs when the increase in prices is caused by a rise in wages and salaries unjustified by productivity.

The case is very different when disequilibrium results from growth of income beyond the level justified by exports. This is structural disequilibrium which happens when exports fall off as we saw earlier. If, in order to maintain or raise the level of internal activity, recourse is had to credit expansion with resulting devaluation, this will tend to re-establish equilibrium even though accompanied by the regressive effects mentioned earlier.

Now, in this case, devaluation acts in a different way. The prices of exports and imports rise and, as costs are not adjusted simultaneously, an extraordinary margin of profit is generated which, while encouraging traditional exports and promoting the development of new lines, brings into being hitherto non-existent import substitu-

[3] See section V of this article.

tion activities and offers an incentive to those that are already in operation.

But, as wages and salaries mount, these effects gradually diminish; and, in order to keep productive activity at the higher level achieved, it becomes necessary either to resort to further devaluation or to take steps to place direct restrictions on imports or subsidize specific exports.

It might be argued that the rise in remuneration need not keep pace with devaluation, since competition will prevent prices from moving up except in the case of new activities which may have cost more to develop. It is possible to think along these lines, although practices restricting competition frequently combine to push up prices to the extent permitted by the greater margin of protection afforded by devaluation.

When this fact sooner or later entails an adjustment in wages and salaries correlative to devaluation, the latter loses its effectiveness. In other words, devaluation acts in this case solely as a stabilizing factor so long as it has regressive effects on income distribution.

It is true that import prices may be prevented from rising — except for imports to be replaced by nationally-produced items — if devaluation is accompanied by a proportional cut in customs duties for all existing industries, so as to avoid double protection. The protection provided by tariffs would thus be wholly or partly replaced by the protection resulting from devaluation. Consequently, the rise in prices would be confined to items produced by the new substitution activities, whose cost is higher than that of the articles previously imported.

An adjustment in wages and salaries, which is justifiable when there are extraordinary profits, would not be an adequate solution in this case, since there would be no such profits, and would lead to an inflationary spiral. Other measures should therefore be adopted to prevent the rise in prices from affecting the consumption of the population at large.

From the point of view of exports, the incentive given by devaluation to traditional items might bring about a deterioration in the terms of trade, if one country's products constituted a substantial proportion of the international supply. Steps would then have to be taken to restrict exports, either by taxes and duties which would absorb all — or part — of the extraordinary profit, or by direct controls. The incentive to devaluation would thus be confined to new exports.

Measures of this kind imply deliberate intervention in the economy and lessen the prestige which devaluation normally enjoys as an automatic method of restoring equilibrium "by allowing money to find its own level". Moreover, such action is very seldom taken, because the amount of devaluation is usually determined by the particular effect that it is desired to produce.

The question is therefore one of economic policy and the advantages and disadvantages of such a method have to be compared in practice with those of other measures such as direct export subsidies, import substitution and protective tariffs.

(b) *The gold standard and structural equilibrium*

Those who uphold the theory of monetary orthodoxy usually fail to see the problem of Latin American structural equilibrium as clearly as they might, despite the constant prompting of a reality which they usually prefer to ignore. They have inherited the fundamental principles of the gold standard and apply them to the policy of monetary stability. The adherents of the classic theory did not notice the structural problem, nor had they any reason to notice it in the golden age of the gold standard under British hegemony.

The operation of the gold standard did not jeopardize in any way the structural equilibrium of the world economy, since the British centre, with its individual structure, had found in the peripheral countries and the dynamic centres a structural adaptability which facilitated the movement of gold in either direction. It is not surprising, therefore, that equilibrium was believed to be inherent in the operation of the gold standard. But, at the end of the last century and early 1900's the main dynamic centre began to feel the consequences of certain structural changes in the rest of the world which were accompanied by constant signs of instability. I refer in particular to the repercussions of the rapid process taking place in the other dynamic centres (e.g. Germany) and of protectionism, and to certain monetary procedures that tended to keep gold in the leading countries.

One result of this was of great importance: the British centre began to lose its knack of drawing back the gold that it sent out. Clear proof of the perplexity and distress which this caused the monetary authorities is to be found in Sir John Clapham's book on the Bank of England, the first written by an author with access to that institution's confidential files. An interpretation of those structural phenomena was, of course, still very premature in those days. But ideas were beginning to emerge for mitigating the consequences of the centrifugal tendency of gold. Thus, long before Keynes and earlier than the First World War, it was already thought desirable for the holdings of the world's central banks to be concentrated in the British centre.

It is not surprising therefore that fairly similar events now occurring in the main dynamic centre which superseded the British centre after the First World War should be reflected in measures whose objectives are basically analogous. It is undeniable that the new dynamic centre has operated in structural conditions very different from those that prevailed in earlier times and which made it very difficult for the gold standard to operate. These conditions became much less favourable when, during the great world depression, the dynamic centre reduced its import coefficient while continuous increases in productivity and technical innovations stimulated the expansiveness of its exports. It was impossible for the gold standard — monetary stability — to be maintained, and in the rest of the world, the other dynamic centres and peripheral countries were obliged to adapt their structure to the structural changes in the focal dynamic centre.

The process of adaptation had lasted nearly a quarter of a century, and, as soon as it was completed, contrary phenomena affecting the main dynamic centre and posing a grave problem have emerged in the other dynamic centres. These other centres either have to liberalize their policy as regards imports from the rest of the world, including the principal dynamic centre, without prejudice to other measures of readjustment, or, by *force majeure,* they will be instrumental in inducing the principal centre to seek equilibrium to the detriment of international trade.

Our countries could not fail to take an interest in the solving of this problem since the more active development of world trade, by enhancing their export and import opportunities, is a factor of prime importance for the acceleration of their economic growth.

1. The structural solution to the problem

(a) *Maximum employment and imports*

The following are the salient conclusions reached in the foregoing section: given the structural vulnerability of the economy, monetary stability is usually incompatible with the maintenance of economic activity when exports decline; stability leads to a contraction of the economy and any measures taken to remedy the contraction are generally conducive to inflation, or, if this has already begun, give it greater momentum.

It is, of course, possible to devise an anti-cyclic policy that is not inflationary, but it would call for a greater savings effort precisely when the requisite capacity has been reduced by the drop in exports. It would also be necessary for international credit institutions to have a clear concept of the nature of anti-cyclic policy. It is not surprising, therefore, that circumstances lead to inflation.

If inflation has any positive effects, they are attributable to its regressive influence on income distribution. Hence, it is far from being a recommendable policy.

Apart from the measures of international co-operation which may be taken to reduce the scope of external fluctuations, the solution to the problem is structural in nature.

The ideal solution would be to make the internal structure of the economy strong enough to divert the effects of such fluctuations outwards so that internal economic activities could progress without periodic interruptions. What has to be done to come closer to that goal? One simple fact in particular should be borne in mind. If the aggregate income of the internal economy tends to shrink when exports decline, this is because exports are not yet sufficient to satisfy the import demand corresponding to that level of income. In other words, the import coefficient is too high for income to continue to increase at the maximum level of employment, despite the drop in exports.

It is therefore indispensable to reduce the coefficient by changing the composition of imports and transforming the production structure radically enough to ensure that the factors of production are employed to the maximum in internal economic activity when exports — and consequently the capacity to import — are at the lowest point of the cycle. Once this aim has been achieved, and exports begin to climb again, the corresponding increase in income will swell aggregate demand. But in view of the fact that the economy is operating at the maximum level of employment, any surplus demand relative to the domestic product will tend to be met by stepping up imports.

(b) *The pressure of demand and imports*

What imports will tend to increase in this way? In order to answer this question, imports should be divided into the following categories, according to the possible scale of their cyclic fluctuations: (*i*) the raw materials and intermediate goods that are essential for maintaining economic activity at the maximum level of employment, whether it consists of the production of consumer goods and services or of capital goods; (*ii*) the end consumer goods needed to satisfy the regular demand of the wage- or salary-earning active population, as well as of the remainder of the population with fixed incomes; and (*iii*) the consumer or capital goods required to satisfy the demand of the variable-income groups, chiefly entrepreneurs.

If the top level of employment has been achieved when exports are at their nadir, there is no reason whatsoever for imports in the first category to increase when exports take a fresh upward turn; instead they will simply follow a normal course of growth in accordance with the development of internal activity. Nor is there any reason why demand for imports of final consumer goods in the second category should be cyclic, since, if economic activity were to continue developing at a steady pace, there would be no fluctuations in wages and salaries and fixed incomes, except in the export sector. On the contrary, the repercussions of external fluctuations would tend to focus on demand for imports of consumer and capital goods falling into the third category.

This does not mean that when a cyclic increase takes place in entrepreneurs' profits, the entrepreneurs would be likely to devote the whole amount to importing these goods. There would merely be an upsurge in demand for certain goods, whether domestically-produced or imported. But as internal activity cannot expand cyclically, and maintain its normal rate of growth, the heavier demand would tend to be satisfied by the cyclic increase in such imports.

As a result, the only imports subject to the undulating movement would be those that satisfy the demand of groups whose income fluctuates cyclically. These imports would go up as the cycle rose and decline as it fell. Thus, the fluctuation in exports would be rapidly reflected in imports but would not affect the regular growth of internal activity.

This is the purpose of the structural changes referred to earlier. From this standpoint, the import coefficient could be divided into two: on the one hand, the coefficient that corresponds to the imports in the first and second categories which are not subject to cyclic fluctuations; and, on the other, the coefficient for imports in the third category, which is highly sensitive to fluctuations in exports.

The composition of the two coefficients would not only depend on the nature of demand, but also on economic policy decisions with respect to the articles that would still have to be imported and those that should be replaced by domestic products. But both coefficients would have to decline uninterruptedly while the growth of income exceeded the rate imposed by exports — one steadily, and the other in accordance with the fluctuations of the cycle.

(c) *Formulation of a substitution policy in advance*

The structural changes required to lower the two import coefficients need not wait until an import surplus occurs; on the contrary, they must be planned in advance in keeping with the development requirements anticipated. In other words, it is essential to anticipate the forthcoming drop in exports while they are still in their upward phase and to begin the process of import substitution, so that when decline is imminent the economy is prepared to resist it and to continue its course without setbacks.

It is clear that these forecasts involve a number of very important conjectures. Past experience has shown that everything that goes up has to come down again. But there is no way of telling when the descent is likely to take place or how substantial it will be. Hence, the structural changes may be excessive in some instances and insufficient in others. For this reason they should be combined with measures for ensuring flexibility. If they are excessive, the substitution process should be slowed down and, in the meantime, the resulting surplus of exports should be used to build up monetary reserves. If the changes are insufficient, the reducible margin of imports should be brought into play to restore dynamic equilibrium in both the balance of payments and the internal economy, and, if this is not enough, international resources should be drawn upon.

In the present case, it is perfectly justifiable to resort to international assistance, not, as explained before, as a normal part of a compensatory policy, but as an emergency measure when the inadequacy of the substitution policy or an unusually steep drop in exports have made it necessary to call on such resources to help restore the balance.

2. Supplementary anti-cyclic measures

(a) *The cyclic variation in certain imports*

It has just been seen that the fundamental solution to the problem of external vulnerability is structural in nature. This does not mean that the possibility of certain supplementary anti-cyclic measures should be discounted. First of all, it ought to be asked whether the rise and fall of imports, in which the fluctuation of exports is reflected, would be spontaneous or would need other measures. If the economy succeeds in developing at the maximum level of employment of the factors of production, no such measure would seem to be required, since the pressure of additional demand would be enough to send imports up once productive capacity had been exceeded. There will, of course, always be a certain measure of idle capacity in the economy, not because domestic demand is insufficient but because, in a developing economy, its eventual expansion should always be anticipated. In such a case, the increase in demand will lead to the utilization of idle capacity and will be gradually transformed into imports as income circulates. But when the limits of capacity are approaching, imports will expand at an increasingly rapid pace and an ever-larger proportion — and eventually all — of the additional pressure of demand will be reflected in heavier imports.

In any case, the cyclic increment in demand will tend to push prices up. The intensity with which it does so depends, apart from the elasticity allowed by available capacity, on the margin of protection that exists for the production of import substitution goods. If the margin is fairly small and only offsets differences in costs, the rise in prices will soon be checked by the increase in imports.

This margin also conditions the downward trend of imports when internal demand is reduced by a fall in exports. A slight cut in internal prices will, if import prices remain steady, divert the impact of the fall in demand towards the latter instead of towards internal activities.

In the absence of such flexibility, it would be indispensable to establish a variable duty, which could be lowered or abolished during the upward phase of the cycle in order to stimulate imports, and raised during the downward phase in order to reduce them more rapidly with a view to safeguarding domestic production.

(b) *Promotion of cyclic imports of capital goods*

There is another case in which a variable duty might be established on both imports and production for import substitution, but for different reasons. The problem is the following. The fluctuation in profits in the export sectors is one of the prime factors behind the movement of imports. Any increment in these profits automatically tends to expand investment and consequently imports of capital goods; however, it also tends to increase consumption of capital goods, particularly those with a high income-elasticity of demand and, as the pressure cannot find a local outlet, it will turn towards imports.

This is where a flexible duty would enable the increment in external resources to be put to better use for expanding investment. It is conceivable that the upswing in demand for capital goods might be absorbed by means of a duty applied equally to imports and to domestic production. Of course, there is no reason why a rise in the price of these goods should effect the level of living of the population at large.

In order to achieve the purpose in mind, the resources thus obtained by the State would have to be used for importing capital goods, either for the activities of the State itself or for the private sector, if such resources are devoted to strengthening the lending capacity of the economic development institutions.

When exports begin to decline, the correlative reduction in the duty and the consequent drop in the price of goods would stabilize effective demand for such goods without leading to a shrinkage in imports or internal production. Applied in this way to goods with a high income-elasticity of demand, a flexible duty would enable capital investment to be expanded at the expense of the consumption increment in the high income groups. I refer to the cyclic increment and not to the regular growth of consumption in the course of economic development. Many different solutions undoubtedly exist as to the amount of duty, depending on the extent to which it is desired to influence consumption so as to boost investment. But whatever they may be, all the solutions should have one element in common: the State should not use the special revenue from the flexible duty to add to the number of employees in the current public administration or to increase its investment, since the subsequent lack of these same resources would bring unemployment in its train.

Apart from the effect of such resources on the investment coefficient, their employment to import capital goods would lessen internal instability. This would also be lessened if the State were to use the aforesaid resources to buy abroad the consumer goods it requires to continue its activity, or to expand internal demand for these goods, thereby indirectly causing a rise in imports. But in this way, a favourable opportunity for raising the rate of capital formation would be lost.

The same considerations are applicable in the event that the State taxes exports directly and thus participates in the cyclic increment of the economy's aggregate income. By allotting resources to the importation of capital goods, for its own investment or for that of the private sector, the State could ward off an inflationary deficit when exports declined, and at the same time raise the coefficient of capital formation. It is essential for the State to pursue an anti-cycle policy if the economy is to develop at a steady pace with the maximum employment of its productive forces.

This means that to reduce the vulnerability of the economy to external fluctuations, the State must also introduce structural reforms with respect to its expenditure. A clear distinction should be made between current administrative expenses and internal investments. The latter must grow steadily at a rate imposed, on the one hand, by considerations of economic and social policy and, on the other, by imports of capital goods. Current administrative expenses should be paid for out of resources made available by the steady growth of the domestic economy, whereas imports of capital goods should reflect the variable rate of exports.

(c) *Investments to absorb cyclic unemployment in export activities*

Let us consider another aspect, of this problem. We have spoken so far of the fluctuation in entrepreneurs' profits. When the trend is upward, profits in export activities are the first to rise; the resultant expansion of internal demand then forces up prices and profits of entrepreneurs in the other branches of the economy. If the economy operates at a maximum level of employment within a steady growth process, the rise in prices will be limited by the brisk flow of imports, except in respect of services for high-income groups for which imports offer no competition.

If the margin of protection is high, or if direct or prohibitive restrictions are imposed so as to discourage imports, price rises will obviously not be kept within these bounds. This is an additional argument in favour of also introducing into these aspects a number of reforms designed to ensure the smoothest possible functioning of the economic system.

In any event, and all other conditions being equal, the fluctuation of entrepreneurs' profits in the rest of the economy will not be as marked under maximum employment conditions as when the economy is subject, as it is to day, to the impact of external fluctuations. These cause internal activity to go through a succession of expansions and contractions, with profits rising and falling not only because of price movements but also because of the changes that take place in the utilization of the productive capacity.

If external fluctuations were only reflected in entrepreneurs' profits, the measures to counteract external vulnerability would be confined to those we have just explained. However, they are also reflected in changes in the level of employment in export activities, although these changes are usually smaller in scope than the movement of prices and profits. Anti-cyclic measures are thus complicated and further preventive measures must therefore be taken.

What can these measures be? That is the problem. Unemployment in export activities is not structural but cyclic. It is, in other words, temporary. Hence, the unemployed cannot be permanently shifted to other activities but must be temporarily absorbed. They should therefore be employed in internal investment and this means that savings must be brought into play if the inflationary consequences of that action are to be avoided. However, these savings cannot be achieved at the expense of internal consumption; otherwise we should be creating one phenomenon — that of insufficient demand — in order to correct another. By avoiding insufficient demand in export activities, we would be creating insufficient demand in the rest of the economy. That is why the cost of these investments must be covered at the expense of imports rather than by saving on the consumption of domestic goods.

In fact, what is required is a mass of savings which would grow steadily as the economy developed. These savings would be used to import capital goods when exports were on the rise and for internal investment when exports fell off. In the latter case, the savings achieved at the expense of imports would be converted into consumption by those for whom the investments had provided employment, thus filling the gap in demand caused by falling employment in export activities.

(d) *Investment flexibility*

Investment flexibility is an essential component of anti-cyclic policy, not only with respect to the investments just mentioned but also to investments in general.

We shall attempt to explain this point in outline. Careful examination reveals that, from the anti-cyclic point of view, investments consist of two parts: one that fluctuates and another that grows steadily as the economy develops. The fluctuating part consists of imports of those capital goods in which the movement of exports is reflected. The steady growth part is represented by the remainder of capital goods imports, which are not subject to cyclic changes, and by the entire range of internal investments.

If internal economic activity grows steadily with the maximum level of employment, it might well be assumed that a steadily-growing rate of savings can be maintained. To these stable savings of internal origin, intended for steady growth investments, must be added the fluctuating savings of external origin in the export activities, intended for the fluctuating part of capital goods imports. However, this does not fully solve our problem. Internal investments are closely linked to capital goods imports. Thus, the installation of imported machinery and equipment requires large-scale investment in industrial plants. This close link is a factor of internal instability, because construction activities would be left exposed to these imports. For this reason, in this case too, internal investment requires a measure of flexibility. In our countries, the State usually has the machinery with which to do this. It must merely use them in such a way as not to cause sharp fluctuations in construction activities. A compensatory type of movement is required. When the cycle of industrial construction — in the broadest sense of the term — increases cyclically, other forms of construction should be curtailed. Through its own public works and low-cost housing construction, on the one hand, and the mortgage credit system, on the other, the State is in a position to introduce this anti-cyclical element, without prejudice to possible recourse to taxation if necessary. In other words, anti-cyclic considerations should play a very important role in the long-range planning of all these investments, which is essential to the steady growth of the economy.

(e) *Nature of anti-cyclic measures*

Before going on to the other aspects of this vast problem which we are considering, let us now sum up the major conclusions deriving from our earlier discussion. We have sought to show, in the first place, that the basic solution to external vulnerability lies in structural measures. The structure of the economy must be changed so that internal economic activity — in spite of the alternatives offered by the international economy — may grow steadily at a maximum level of employment.

The internal economy thus loses its vulnerability and acquires the resistance necessary to ensure that export fluctuations are promptly reflected in imports whose movements do not affect internal activity.

We have also shown that enforcement of a simple anti-cyclic policy would be difficult without these structural changes. However, if these changes are effected, additional anti-cyclic measures are required for the following purposes:

(a) to assist the movement of imports subject to cyclic fluctuations by means of a flexible tax;

(b) to increase cyclic imports of capital goods at the expense of consumer goods imports by means of a different tax which would be combined with the tax mentioned above;

(c) to earmark the fluctuating part of the State's revenue — closely linked to foreign trade — for capital goods imports;

(d) to absorb cyclic unemployment in export activities by means of the funds that were used, during the upward phase of the cycle, for capital goods imports additional to those just mentioned;

(e) to change the composition of construction activities to compensate for cyclic movements deriving from capital goods imports.

Emphasis has been placed on the importance of a structural solution because the problem of applying an anti-cyclic policy to correct external instability has often been viewed as something unrelated to the problem of economic growth, as if fluctuation were not a characteristic feature of our growth pattern. I myself have on earlier occasions advocated an anti-cyclic policy unrelated to structural considerations and bear some responsibility for its application in one of the Latin American countries. To sum up, demand has to be dealt with in its rising phase by the public sale of bonds designed to absorb savings. By thus curtailing demand, and not using savings to import capital goods, the savings are available as monetary reserves. When the declining phase begins, the monetary authorities buy back these bonds on the market and thus restore the purchasing power previously withdrawn. The effect of the contraction of demand is thus mitigated, as was its expansion earlier, without entailing any inflationary consequences because of the use of the monetary reserves previously accumulated.

While this idea is right from the anti-cyclic point of view, it leaves aside the essential problems, which are structural in nature. But, for the sake of an anti-cyclic policy savings are accumulated in the form of monetary reserves in countries which do not have enough savings to expedite their growth. It is not only a question of the accumulation, which is obviously temporary, but of the need to make use of the relative abundance of funds in order to introduce those structural changes which, apart from preventing a contraction of the economy when exports fall off, allow the economy to continue to grow at the maximum level of employment.

It is true that, at the time when these ideas emerged in our countries, we were all still very much under the strong influence of the great world depression; and we were therefore mainly concerned with economic stability. Since then, however, we have gained experience which changes essential for ensuring steady economic growth in a régime of monetary stability.

IV. REGRESSIVE FACTORS IN INCOME DISTRIBUTION AND INFLATION

1. The reaction against regressive movements

Economic development policy, as we have said, means a deliberate attempt to act on the forces of the economy in order to expedite its growth, not for the sake of growth itself but as a means of ensuring a steady improvement in the living standard of the lower — and middle — income groups and their progressive participation in the distribution of the over all income.

This movement is usually interrupted by regressive factors which tend to lessen their share in income distribution. Certain structural phenomena implicit in economic development raise prices and naturally produce reactions in the mass of consumers that tend to restore the real value of their wages and salaries. Similar reactions occur when taxes are levied on the broad masses in order to cover the cost of social benefits or of increased State expenditure, or when some groups succeed in restricting competition and thus are able to raise the prices of their goods and services. In either case, the original price increments, followed by these defensive reactions, set off the inflationary spiral of prices and wages; and the monetary instrument, originally unaffected by this phenomenon, is compelled to go along with it by expanding credit in order to avoid a contraction of economic activity. In such cases, the monetary instrument is a simple passive element in the inflationary process.

This reaction against these regressive effects on income distribution is easily explained. An increase in wages and salaries does not provide the answer, for it merely sets off the inflationary spiral or accelerates it if it is already in motion, or, worse still, when an increase in wages and salaries is not simply a reaction aimed at correcting a regressive effect but an attempt to secure progressive redistribution effects. Inflation is not the proper way to achieve this.

This case therefore differs from those in which the monetary instrument assumes an active role either because the State uses it, instead of resorting to taxation, when there is no contraction of the economy, for the purpose of maintaining or increasing consumption or investment, or when private groups wield their economic or political power to achieve the same end. The resulting price rise derives from the monetary instrument and not from factors outside the purview of the central banks. The defensive reactions aimed at correcting this regressive movement in distribution have no reason to set the inflationary spiral in motion; it is then for these banks to use credit facilities in order to compel the entrepreneurs to absorb the wage and salary increments by means of their inflation-swollen profits. This section will be devoted to an examination of these phenomena.

There are three main structural or functional factors implicit in price increases: *(a)* the cost of import substitution; (*b*) the higher cost of agricultural commodities; (*c*) the movement in the terms of trade.

(a) *The cost of import substitution*

Production designed to replace imports is generally more costly than importing. Such is the price of industrialization. If all the productive factors of our countries could be channelled into exports without raising their cost or substantially reducing their prices, there would be no need to industrialize. But the reality of the matter is different.

This process implies an increase in costs with respect to the imports that were obtained in exchange for exports. Why then is industrialization advocated as a means of raising the standard of living of the masses? The answer is very simple. Even if *per capita* output is smaller in industry than in exports, it is much higher than in the rest of the activities into which modern production techniques have barely penetrated. This is typical of agriculture for internal consumption, of cottage industries, and of that vast range of unspecified personal services which are one of the features of under-development. Thus, a shifting of manpower from these relatively unproductive activities into industry and other more highly productive activities, at a rate commensurate with the growth of the active population, represents a net increase in the average *per capita* product for the economy as a whole.

The higher cost of substitution is thus absorbed in the over-all economy. There would otherwise not have been any improvement in real income *per capita*. Yet, some groups of workers suffer while others benefit. Adversely affected are those already employed in industry or other activities with a relatively high rate of productivity which absorb the labour force. They have to pay higher prices for products which are no longer imported but are manufactured by national industries. Of course, the productivity of these adversely affected groups has also increased and, to the extent that this is so, the effects of the dearer prices are lessened or overcome. If these conflicting phenomena occurred gradually and steadily, the phenomenon might be much less noticeable than it is in actual fact. This phenomenon also occurs — perhaps more acutely — among groups of workers remaining in jobs of low productivity.

We thus come to the second explanation referred to earlier. Import substitution does not take place gradually; it is particularly intensive in periods when shrinking exports call for measures to correct external disequilibrium. During the upward phase, the rise in average *per capita* income could be expedited because, thanks to heavier exports, it was unnecessary to resort to import substitution. The opposite occurs during the downward phase. Average income falls and import substitution becomes a matter of obvious necessity and has to be undertaken rapidly instead of progressively.

A few figures may help to make this clear. Let us assume that the import coefficient was 17 per cent before the rise in exports and that it is then pushed up to 20 per cent by the export boom, as usually happens. During the downward phase the coefficient must be reduced not to the previous level of 17 per cent but to an even lower figure, say 16 or 15 per cent, in order to cope with the income growth that has occurred in the meantime.

It thus becomes necessary to curtail imports by an amount equivalent to 4 or 5 per cent of the income figure within a relatively short period of time. Some imports will drop spontaneously, but taxes or restrictions will have to be applied to the rest in order to achieve external equilibrium and, at the same time, to mitigate the effects of reduced exports on internal activity. This leads to internal price increases even before the substitution process, with its higher costs, takes effect.

If this process were carried out gradually, as we have suggested, and the cyclic rise in the import coefficient affected only those goods which have no impact on the level of living of the broad masses, the higher cost of substitution activities could also be absorbed gradually. But this is not what happens, and the increase in costs occurs precisely when *per capita* income declines or when its growth is arrested or slowed down. Its impact is therefore much greater than it would otherwise be.

All this is greatly simplified because the actual phenomenon is more complicated. A few qualifications are therefore called for. In the first place, the impact of the rise in real costs resulting from the substitution process on the rate of income growth does not depend only on the higher cost itself but also on the difference in the product per actively employed person as between the export and substitution sectors. Moreover, the larger the difference between *per capita* income growth and *per capita* export growth, the greater the impact because of the more pressing need for substitution. The impact is strongest when imports decline instead of rising and when there is a very wide gap in *per capita* product as between exports and substitution activities.

Apart from its inflationary effect, this impact could severely hamper income growth if the greater productivity in existing activities is largely absorbed by the higher cost of the substitution process. This is not a mere academic exercise, but a practical possibility which ought to command our attention in connexion with Latin American development.

Let us review the reasons for which the cost of substitution is exorbitant: (*a*) substitution has had to be improvised in critical situations when no reasonable criterion of economic feasibility has been applied; (*b*) the smallness of national markets makes it necessary to incur exorbitant costs of substitution; (*c*) the substitution process has assumed excessive proportions because of the failure to establish parity of conditions as between substitution and export activities.

The fact that a radical change of policy is required to deal with this does not mean that nothing can be done in the meantime to counteract the increase in cost. If the new substitution activities are protected by subsidies instead of customs tariffs, a rise in the cost of activities which in one way or another affect the level of living of the broad masses can be prevented. The impact varies according to the items for which substitution is undertaken. If they are consumer items for the high-income groups, we need only concern ourselves with considerations of economic feasibility in substitution activities. But if these items affect the level of living of the community at large, recourse to subsidies would ensure that the social cost of economic development is defrayed by the groups which can better afford to absorb it.

This is a purely anti-inflationary measure calculated to correct these effects rather than to avoid them. To avoid them entirely or at least to mitigate them radical measures must be taken, as we said earlier, to reduce the scope of the substitution process and to enhance its economic feasibility. That is why the common market is of decisive importance.

(b) *The relative increase in the cost of agricultural commodities*

Some Latin American countries are familiar with certain phenomena which raise the cost of domestically-produced agricultural commodities. Their effect on mass consumption seems to have been an important factor in inflating costs in such cases. The root of the problem clearly lies in the antiquated land tenure system prevalent in many of our countries. But this is only one aspect of the problem, very important though it may be. There are other factors which tend to add to the cost of agricultural production; they help to push up prices or to discourage production when the price rises are checked without an attempt to get to the root of the problem. This is a subject that has been discussed at length in our countries but so far the facts have not been fully recognized. We shall, at this juncture, venture a few remarks aimed at explaining the nature of the problem and its relationship with other inflationary phenomena.

Apart from the causes deriving from the land tenure system, there are two important factors which add to the cost of agricultural commodities: (*a*) the cost of import substitution, to which we have just referred; and (*b*) the slower rate of increase of agricultural productivity compared with that of the rest of the economy.

Jorge Ahumada has given a lucid explanation of this first factor.[4] If the prices of machinery, fertilizers and insecticides and other inputs in agricultural production rise in the substitution process, the increase is reflected in the cost of production.[5]

As to the other factor, productivity, when this shows a general increase, the tendency is for wages and salaries to rise, rather than for prices to fall as has happened in capitalist development. But if agricultural productivity has not risen, or has risen less, the extension of wage increases to agricultural production results in higher costs reflected in higher prices.

The land-tenure system prevailing in many Latin American countries often impedes productivity by seriously obstructing the introduction of advanced techniques. Except in a few cases, there has been no decisive governmental action for vigorously promoting the use of modern techniques, and there is not much point in attacking the land-tenure problem if such action is not forthcoming.

In some cases this situation has taken an even more serious turn, especially when an attempt is made to control price rises, caused by higher agricultural production costs, by means which have harmed producers, because of the form in which they were applied, without being of any real benefit to the consumer in the long run.

Attempts have also been made to mitigate or avoid price rises in certain agricultural commodities by facilitating imports. For this purpose the substitution policy has often had to be extended to high-cost industries when it would have been better to promote agricultural production by introducing advanced techniques on an adequate scale.

All this relates to production for domestic consumption. Cost increases attributable to higher-cost inputs or labour also occur in production for export and, if the increase is not absorbed by greater productivity, he following dilemma arises: either exports are discouraged and production is limited to the relatively better land and stopped on marginal land, or recourse is had to monetary devaluation in order to restore a proper relationship between prices and production costs for agricultural products and also for other items for export.

(c) *Terms of trade and effects of devaluation*

This dilemma becomes even more serious when rising costs coincide with a deterioration in the terms of trade. This does not usually happen by chance; the deterioration makes the need for import substitution more pressing, with its inevitable effects on internal costs. The perplexity of those caught between the two horns of this dilemma is easy to understand. If they avoid monetary devaluation, they discourage exports and weaken the rate of economic growth if they accept devaluation, they raise the price of mass consumption goods. In either case there is no avoiding a regressive effect on income distribution, although in the first case the effect is not as immediate and obvious as in the second.

The worst feature is that devaluation leaves income from land unaffected, or even pushes it up; in other words, it tends to perpetuate an outmoded form of tenure. This is because there are two aspects to the problem: first, the unavoidable necessity of compensating for the high cost of inputs and wages so that agricultural production can continue; and, second, since the same, or a larger, area of land is used for this purpose, the tendency is for income from land to be maintained or increased, if the heavier demand for agricultural commodities cannot be met by increases in productivity.

This does not mean that the problem is insoluble, although it is if there is unwillingness to go to its very roots. Here we are faced with another disturbing feature of the doctrine of the free play of economic forces, as it is usually interpreted in the Latin American countries. Naturally devaluation, in the case under consideration, is not always a consequence of this free play, but rather a deliberate measure taken to attain a specific end. Once this has been attained, the free play doctrine is usually an excuse for not going any further, for not attempting to find a radical solution; why do so, if the free play of economic forces will solve the problem of production spontaneously, once the incentive to private enterprise has been restored?

What is really needed is strong governmental action, not only to promote the introduction of advanced techniques but also for the precise purpose of establishing a land tenure system that will make possible and encourage such progress. There are extreme cases where direct land redistribution measures are required, and others where taxation can be an effective instrument for promoting better land utilization. I refer to the tax based on the potential capacity of the soil, which compels the transfer of land that is not being properly worked. Clearly if this tax is not applied progressively, according to the potential capacity of the holdings, the inefficient use of the soil inherent in this outmoded system of land tenure will be remedied, which is in itself a step of considerable importance, but the discrepancies of distribution will persist and can only be changed by the effective use of income tax.

[4] *Inflation in Latin America. Notes for a working hypothesis* (awaiting publication).

[5] The rise in the cost of living that occurs when the higher substitution cost of other goods is not absorbed by greater productivity leads to wage increments, adding yet another factor to the increase of agricultural costs. However, as the same process takes place in other sectors, there is no relative rise in the cost of agricultural commodities which merely participate in a general process.

2. The inflationary spiral

We now come to another aspect of the subject. Price rises resulting from the higher cost of import substitution, relative increases in the prices of agricultural commodities, and higher prices caused by devaluation aimed at correcting cost increments and lower prices for exportable production, are all symptoms of problems whose radical solution calls for the changes in production systems, economic structure and distribution patterns repeatedly referred to in this paper. In the absence of such changes, the inflationary spiral is usually regarded as the easiest way out, through reluctance to resort to taxation as a method of distributing more fairly the burden that these maladjustments involve and of ensuring that they are not borne solely by the mass of the people.

There is a great difference between the spiral that originates in rising costs and that initiated by an inflationary increase in demand. In both cases the spiral is a means of spreading inflation, but whereas in the first case the central banks are powerless to check it, they can do so in the second case if they take firm and determined action.

Inflationary demand leads to bigger profits, and a policy of tighter credit can oblige entrepreneurs to use these profits to absorb wage increases, while at the same time further inflationary expansion in demand is prevented. As higher costs, on the other hand, are not accompanied by extra profits, generally the chances of absorbing them are poor, and they are necessarily reflected in prices. If the central banks attempt to prevent this by tighter credit, they only succeed in depressing economic activity without interrupting the inflationary spiral, which, on the contrary, continues unchecked, to the dismay of those who have always regarded the orthodox formula of retrenchment as the infallible method of bringing about a fall in prices and the end of inflation.

The cases of higher costs and prices just considered are of internal origin. There are other cases in which the situation derives from external factors: increases in import and export prices. As is common knowledge, the movement is concurrent in each case, but not equal in magnitude; when there is a rise, export prices usually climb more; and when there is a fall, import prices drop more rapidly than export prices. An increase in import prices naturally always affects mass consumption goods, whereas rises in export prices have this effect only when the products concerned are important items in domestic consumption.

In these cases, too, the inflationary spiral is not the solution. Consequently, other steps are required to counteract the internal effects of these movements. Some propose a flexible policy of multiple exchange rates so designed that foreign currency prices move in the opposite direction to import and export prices. This method, while technically correct, is difficult to apply, because it means introducing practices conducive to instability which weaken the position of the central banks when it comes to protecting monetary stability in other circumstances. Furthermore, the periodic changes in the exchange rates give rise to speculative activities which can seriously hamper the execution of this policy. The same purpose could be achieved by flexible export duties the revenue from which could be used to subsidize imports, especially those that have an appreciable effect on mass consumption.

I am fully aware that this means resorting to discriminatory practices that have fallen into disrepute in Latin America. Consequently I believe that it is better to reject these partial compensatory methods in favour of more general measures.

This relates especially to those cases where exportable items are important for domestic consumption. A flexible duty on such goods would have the advantage of reducing the fluctuation of domestic prices, but it would put those articles on an unfavourable footing in relation to goods that carry little weight so far as domestic consumption is concerned.

3. Other cases of cost inflation

The cost increases thus far considered are attributable to the partial or inadequate way in which the changes in production systems and in the economic or social structure are carried out, or result from the actual operation of the economic system. Let us now consider other cases where such increases are a result of practices that restrict competition or of methods of taxation.

Practices restricting competition are common in Latin America. In industry they have been greatly encouraged by extreme forms of protectionism and certain types of import control. They also occur in trade, especially in staple items the distribution of which is often inefficient. Apart from their unfavourable effect on the utilization of the country's factors of production, these restrictive practices have regressive effects on income distribution and consequently encourage inflationary reactions.

Restrictive labour practices have similar effects. I am not referring to practices that impede greater productivity and are governed by deeper-rooted factors that can be counteracted only by a rapid rate of growth and manpower absorption, but to practices that, by severely restricting access to certain occupations, make possible higher wages than those paid in other occupations for the same level of skill and training. When this happens in activities that hold a key position in the economy, the resulting rise in costs is general and consequently becomes an inflationary factor.

With respect to taxes, increases in taxes on mass consumption goods usually have inflationary consequences. These taxes usually constitute a major contribution to total tax revenue for two main reasons: first, the regressive character of the tax system, which does not tax consumption by the higher-income brackets sufficiently or permits a considerable degree of tax evasion; second, the narrow tax basis which, precisely because of the low level of development, makes it necessary to include taxes on mass consumption goods.

Often this fact is not taken into account when disproportionate increases are made in governmental expenditure or in social transfers. These expenditures and social transfers can play a very important part in income redistribution. If the higher-income groups are taxed to provide more extensive and better education, public health services and other social benefits, the aim of income redistribution is attained. If, on the other hand, recourse is had instead to taxes affecting the masses, or if such taxes are resorted to once the higher-income groups are already being taxed beyond a reasonable limit, the result is merely that certain forms of consumption of goods are replaced by other forms of consumption of services provided by the State. This social policy requires careful consideration to be given to the relative advantages and disadvantages, which in practice are generally ignored.

The most notorious example is that of the social services in certain countries, which often cost over 50 per cent of total wages and salaries. This high proportion is due partly to the nature of the social benefits provided, such as retirement pensions at an early age, and partly to high administrative costs. To pay for these services, taxes are levied on entrepreneurs or workers that generally cannot be absorbed by the former's profits. They are then shifted to prices, thus encouraging the inflationary spiral.

From this standpoint and from others, social policy in Latin America is not usually the outcome of any rational plan. But there is a further point to consider: taxes that fall on the masses also contribute to excessive increases in Government expediture, both on general administration and on military items, which absorb such a high proportion of the budgets of some countries. Consequently, in such cases the State plays an important part in inflating costs, as it does in inflating expenditure and investment.

4. Controlled inflation

It is now appropriate to consider efforts to avoid the effects of inflation on prices. I shall not deal with those measures of control or rationing that are adopted in highly critical situations, when inflation is more or less inevitable or very difficult to avoid, as in time of war or when exports decline disastrously; I refer to those measures to which Latin American Governments have often had to resort to control the effects of an inflation that they could well have avoided or lessened if they had been willing to go to the roots of the problem.

One such anti-inflation measure, perhaps the most important and the most disruptive is monetary overvaluation, as explained in section III. The desire to avoid an increase in the cost of imports with its consequent impact on mass consumption leads to the stabilization of the exchange rate while there is an inflationary rise in internal prices, or to the establishment of rates favourable to certain imports.

Naturally this policy cannot be maintained indefinitely. Latin American experience shows that sooner or later this maladjustment has to be set right by currency devaluation and a consequent rise in prices. If these rises are followed by wage increases, the spiral is set in motion irrevocably, or, if it is already in operation, it is intensified and subsequently further devaluation becomes necessary.

In some cases currency overvaluation has been resorted to not only to soften the impact of inflationary price increases, but also to shift to wages the favourable effect of the improvement in the terms of trade. All is well so long as this improvement is maintained, but when the opposite trend begins, the loss of real income is so great that it becomes very difficult to check the spiral.

The problem is still more serious when the terms of trade continue to deteriorate beyond their level prior to the improvement. To continue resorting to currency devaluation in this situation means that the real income of export activities is restored at the expense of the real income of the workers, that is, the latter are made to bear the brunt of the deterioration in the terms of trade.

A phenomenon of this nature makes it all the more imperative to introduce changes in production systems and in the economic and social structure. How far is the aim of maintaining or raising the real income of export activities conducive to such changes? It may well be that it would hamper or prevent them. It must also be asked whether in such cases the general incentive of improved prices operates satisfactorily, or whether it is necessary to resort to special incentives aimed at achieving as rapidly as possible increments in productivity through which the unfavourable impact of the deterioration in the terms of trade can be absorbed. However, this device of using special incentives to cope with certain structural problems is not part of the doctrine of the free play of economic forces, invoked to justify a devaluation that undoubtedly arises usually not from these forces but from certain designs for the regressive distribution of income.

Another important method of controlling the effects of inflation has been not to allow the prices of public services or of certain goods produced by the State to be adjusted in line with the rise in costs, taking higher productivity into account. The result has been to deprive enterprises of the funds required for capital replacement, and, what is more, it has often left them with a chronic deficit, thus intensifying the inflationary process. Moreover, when these enterprises are in private hands, there is a complete absence of incentive to expand productive capacity. In some countries, this has constituted a serious structural obstacle to economic development. Hence it is clear that, in certain cases, inflation is not merely the outcome of structural factors but can become an active agent in bringing about structural maladjustments.

Lastly, I would like to say a very few words about the use of price control to counteract the consequences of inflation. Currency overvaluation and the stabilization of public service rates and of rents have proved effective means, although extremely disruptive of shifting real income to offset or overcome the regressive effects of inflation on income distribution. Price control, on the other hand, has proved ineffective in Latin American experience. In most cases it has been no more than a psychological expedient that has upset production and trade without producing any redistributive effect.

V. The depressive effects of orthodox anti-inflationary policy

1. Three possible cases of contraction

The foregoing considerations will help us elucidate a problem of great current importance. Since inflation, despite the serious disturbances that it involves, has certain positive effects, there is reason to ask whether the mere execution of a policy of monetary stability with a view to checking inflation does not involve the loss of those positive factors and lead to contraction of the economy, stagnation and a slackening of the pace of development. Is this the price that must be paid to check inflation and achieve monetary stability? One cannot overstress the importance of these questions and the urgent need to discuss this problem which is giving rise to so much controversy in Latin America.

There is in fact no real reason why anti-inflationary policy should necessarily lead to contraction, except in the extreme case where basic services are insufficient to maintain the level of economic activity. A contraction in economic activity is the result of the type of anti-inflationary policy adopted rather than the inescapable result of checking the inflationary process. There are three main cases in which such a policy could bring about a constriction of economic activity: (*a*) when there is restriction of investment or inflationary expenditure without simultaneous measures to offset their effects; (*b*) when an attempt is made to neutralize the effects of the public deficit by a deflationary policy in the private sector of the economy; and (*c*) when rates of remuneration are stabilized at a level so low that the effective demand of the workers cannot absorb the production intended for them.

(a) *The contraction of inflationary investment, taxation and international assistance*

As was mentioned earlier, inflation in Latin America, whatever the extent to which structural factors are involved, usually entails inflationary expansion of credit brought on by a surplus of investment in relation to the actual resources available.

In examining the first case, let us begin by recalling the expansive effect of inflationary investment (or expenditure) on the economy. The effect is similar to a rise in exports. The corresponding heavier internal demand stimulates use of the economy's idle capacity and encourages new expansive investment. Inflationary investment tends this way to increase employment and over-all income, although at the same time it brings external disequilibrium in its train since higher income leads to more imports.

Herein lies the radical difference from the expansive effect of an increase in exports: the circle is simply closed with a rise in imports, while in inflationary investment the circle remains open in the form of external disequilibrium. Similarly, the circle remains open when, at a time of declining exports, inflationary investment is made which tends to maintain employment and income, with resulting external disequilibrium. In both cases inflationary investments allow a level of investment higher than is justified by exports given the coefficient of imports.

To check inflation it is essential to restrict the credit behind these inflationary investments. But if this step is not accompanied by other measures of a compensatory nature, income will shrink in the same way as it expanded previously as a result of inflationary investment. Contraction then leads to a cut in imports and the re-establishment of external equilibrium.

The essence of the orthodox formula for monetary stabilization is therefore to squeeze income until imports decline to a level coverable by exports. The advocates of this policy make no secret of the fact that a temporary sacrifice must be made for the good of the economy.

Once this orthodox view has been established as an irrefutable dogma, no search is made for other types of anti-inflationary policy consistent with the requirements of economic development. Some countries have suffered very greatly from having pursued such a policy out of conviction or as a result of circumstances. Some other non-orthodox formula for monetary stabilization is therefore urgently needed.

The essential idea behind the formula must be to close the open circle without bringing about a contraction in income. In section II an explanation was given of what such an operation consisted of: surplus demand for imports must be eliminated and diverted internally to maintain the demand for the factors of production employed in investment activities in a non-inflationary way.

Likewise it was stated that taxation — combined with internal loans — was the most suitable means for achieving this purpose. A reducible margin is, however, necessary in imports; the margin must be such that its use will affect neither economic activity nor mass consumption. In the absence of such a margin, international assistance alone could avert the damage. That, however, means using such resources for internal investment.

The fundamental error of the orthodox anti-inflationary policy resides in exactly these two points. Use has been had neither of taxation nor of timely international assistance. These two operations should have been combined with restriction of credit for inflationary investments.

Such investments need not be reduced but rather progressively financed from taxation and international resources as restrictions on inflationary credit are progressively imposed. A cut in investment would be understandable if these were excessive from the point of view of economic development. This case is not, however, to be found in Latin America. Yet this does not mean that there is no reason to change the composition of investments in order to align them more closely with economic development needs, with particular emphasis on the re-establishment of external equilibrium.

In addition, credit restrictions are usually applied without a savings effort having first been made. This is left until later when income has already fallen, bringing the capacity to save down with it.

All this is a result of the prevalence of the dogmatic concept of monetary policy. Credit is restricted without application of such other measures as will tend to maintain and develop economic activity without creating external disequilibrium, in the hope that once inflation has been eliminated and monetary stability achieved, spontaneous forces in the economy will first bring about recovery and later growth.

This oversimplified approach to anti-inflationary policy may well be inspired by static reasoning which takes no account of the dynamics of Latin American growth. In the industrial centres the idea of spontaneous economic recovery is conceivable because their external trade trends are usually contrary to ours. The nature of their imports is such that demand for them tends to increase more slowly than income. In our countries, on the other hand, the opposite phenomenon occurs. In the industrialized countries, therefore, there is no need to introduce the structural changes which growth in Latin America requires.

Likewise, in the industrialized countries a relatively slight contraction in income is usually sufficient to enable exports, given their composition, to increase at the expense of internal consumption; while in the Latin American countries the proportion of exportable goods which are consumed internally is not usually high. Accordingly, no effects of comparable magnitude can be expected. With the growth of exports from the industrial centres combined with a decline in imports, the stimulus which an export surplus gives to internal economic activity may lead to spontaneous recovery.

I do not maintain that an orthodox policy would be advisable in the industrialized countries to slow down the process of inflationary expenditure or investment, but it would at least have a rational basis which is entirely lacking in our countries. Credit restriction, however, if really forcefully applied can also lead to an export surplus in our countries by violently squeezing income. And such a surplus would not be long in stimulating economic recovery if the credit restrictions associated with an anti-inflationary policy are simultaneously lightened. But, in climbing further, income would reach a point beyond which it would not be possible to go without causing external disequilibrium, unless in the meantime the structural readjustments already referred to had already been introduced. Why not therefore introduce them before initiating the contraction process and when the savings capacity of the economy to achieve them is greater?

From whatever angle the problem is viewed, no justification could be found for this contractionist anti-inflationary policy. Perhaps the only positive argument in its favour is that, once external equilibrium and monetary stability have been achieved, foreign private capital will be given the necessary confidence to invest. There can, however, be no doubt that private capital would be still more strongly attracted if the rehabilitation were achieved while the level of economic activity was maintained, as the incentives to invest would be greater.

Clearly, an anti-inflationary policy of the type we are advocating requires foreign financial assistance as an element simultaneous — and not subsequent — to a tighter credit policy. But it is very unlikely that foreign private capital will be forthcoming at such a time and to the required extent: it will be more likely to await the success of the said policy. Accordingly, in the first stage of the stabilization policy external contributions can come only from international credit institutions. If these credit institutions adopted the same wait-and-see attitude as private capital before affording their help, this policy would be deprived of one of its essential conditions for success.

To what extent could internal investments continue to be covered by contributions from international sources? The reply to this question is part of a broader problem than the struggle against inflation and is considered in section VI. Here a few brief remarks will suffice. If the amount of inflationary investment which it is sought to finance with actual resources is higher than a country can meet out of an investment programme using national and international resources, this means that employment in internal investment activities is excessive and a shift of manpower to consumer activities is required. Viewed from another angle, the labour force which is thus transferred from investment activities will not consume what others have ceased consuming as a result of saving but will have to make its own contribution to producing consumption. Such an increase in consumption in its turn requires a corresponding increase in imports; and, to avoid a further surplus of imports, a greater advance than before will have to be made in the import substitution policy — or in the encouragement of exports —, with a resulting expansion of investment in the relevant sectors. Once this aim has been achieved, investments will not have to be repeated — as the matter was one of provisional readjustment — and it will be necessary only to continue making those investments required to ensure regular economic growth at a tempo compatible with the rate of capital formation that available resources allow.

(b) *Compensation for inflation of fiscal origin by the contraction of economic activity in the private sector*

It was stated above that contraction of the economy brought on by tighter credit led to a decline in the capacity to save. This is not, however, all that has to be said: fiscal resources will also diminish, leading to a deficit or aggravating the already existing deficit. In addition, it is no easy task to eliminate a deficit particularly when tightening of the economy has reduced fiscal resources.

This usually leads to another of the errors of anti-inflationary policy: the belief that the inflationary effects of a deficit in the State investment budget can be counteracted by tighter credit in the private sector depriving enterprises of resources for their circulating capital.

If a firm line is taken, there is no reason whatever why it should not be possible to avoid a rise in prices which inflation of fiscal origin would otherwise involve. But this is achieved at the expense of a contraction in the economy. To avoid such a situation, it is essential that the private sector should continue to have available the same amount of credit as previously, for if prices rise as a result of inflationary pressure of fiscal origin, profits will also rise and this makes it possible to meet the increased requirements for circulating capital. But if enterprises have a smaller amount of credit available, they will be obliged to reduce their level of activity in a deflationary movement which will neutralize the inflationary pressure of fiscal origin.

The effects of tighter credit in the private sector of the economy are aggravated when restriction is applied not through quantitative credit regulation but through an increase in interest rates. This increase is usually considerable and it renders the position of enterprises even more difficult by raising operating costs while demand declines. Furthermore, a rise in interest rates is accentuated in some cases by a certain strange procedure of limiting imports by means of prior compulsory deposits which absorb enormous sums of money. It should be asked in passing: why not do this by means of flexible taxes and duties? Such taxes and duties would have the advantage of providing the State with additional resources to counteract inflation instead of increasing bank gains and the profits of private money-lenders.

(c) *Depressive effects of the inadequate readjustment of wages and salaries*

Another of the measures essential to achieving monetary stability without detriment to economic activity is the stabilization of wages and salaries. The point at which this is done is not without importance. Sufficient readjustment must be made to compensate the workers for the rise in prices brought on by *inflationary demand.* I wish to emphasize this expression because this case must be distinguished from those others in which the price rise results from higher costs. The rise in prices brought on by inflationary demand or by devaluation exceeding the increase in costs augments the profits of enterprises, and it is thus possible to restore the previous level of real wages without a further rise in prices by the use of a policy of tighter credit, provided that inflation has been attacked simultaneously on other fronts.

In the wage-prices spiral, the relationship between the real amount of wages and prices and entrepreneurs' profits fluctuates continually. When a large-scale increase occurs, real wages may rise not only at the expense of profits but also of inventories of goods, as prices do not adjust themselves immediately to the new costs. But as the process develops, the level of real wages goes down again and profits rise. In addition, entrepreneurs seek to reconstitute their inventories and this contributes to pushing up prices higher than the rise in costs would justify.

If wages were then to be stabilized, their real level would be lower than the average level resulting from these fluctuations and, if there were no further adjustments, the activities providing the workers with goods and services would suffer a decline in demand which would swiftly bring about a contraction in that sector. Similarly, with a drop in entrepreneurs' profits, the activities satisfying their demand would also be involved in the contraction.

How far will this movement induced by the inadequate readjustment of wages go? There is a force which tends to arrest it. The fall in prices and profits tends to lead to a further increase in real wages which will continue until demand by the workers can absorb the entire output. That is the moment at which the process of contraction stops, but at a level of activity lower than had previously been reached. Will activity remain at that level or will it tend to recover spontaneously? In the case under consideration — in which no other depressive factors come into play — spontaneous recovery will occur since, with the contraction of economic activity, imports will fall off and the surplus of exports will have the stimulating effects already referred to. But was it really necessary to go through this process of contraction and recovery when it could have been avoided by choosing the right point at which to stabilize wages?

Attention should be called to one aspect of this phenomenon. We have just seen that contraction is checked when the fall in profits ensures absorption of all the goods and services intended to satisfy the demand of workers. What sometimes happens, however, is that prices are prevented from dropping by restrictive practices in which enterprises engage in order to regulate prices. If this is the case, the longer this readjustment is delayed or the more it is obstructed, the more severe the contraction will be in activities which produce for the workers. One cannot say whether or not this will result in a sharper import drop because, since there is less of a decline in entrepreneurs' profits than in the previous case, it may well be that the larger share of imports in the demand of entrepreneurs which will not result in the spontaneous generation of the destined to meet the demand of employees and workers, which will not result in the spontaneous generation of the recovery movement.

2. Combination of various measures in anti-inflationary policy

In short, anti-inflationary policy calls for the combination of a series of measures if it is to be compatible with the exigencies of economic development. The first would be to channel surplus import demand into the domestic market, and the second to replace inflationary investment or expenditure by investments covered by savings before credit restrictions are applied. If the reducible margin of imports or the savings potential is inadequate, contributions in the form of international funds must be resorted to *at the same time* and not afterwards. Devaluation is essential if internal costs have climbed more than the international prices of commodities, but it should not be applied to bring about changes in the structure of production and the composition of imports unless other measures are adopted as well.

This will not suffice to arrest the spiral if wages are not stabilized at a level which would absorb entrepreneurs' inflation-swollen profits because inadequate readjustment would have depressive effects, as would an attempt to tighten credit in order to counteract wage increases provoked by rising costs.

I am referring to immediate measures to arrest the process of inflation. But more will have to be done. An anti-inflation policy must be the starting point of an economic development policy which, by effectively attacking the structural factors of inflation, will strengthen the position of the central banks against the inflationary forces continually threatening the stability of the currency.

VI. INADEQUATE SAVINGS AND INFLATION

1. Consumption patterns and inadequate savings

In another part of this article we have stated that, although the phenomenon of contraction usually caused an inflationary reaction, it would be a serious mistake to attribute inflation of expenditure and investment merely to the structural vulnerability of the economy. The importance of monetary and financial policy has been demonstrated on more than one occasion in the experience of the Latin American countries. There is no mechanical relationship between structural vulnerability and inflation or the intensity with which it develops. In equally difficult situations, inflation has been avoided or eased where persons responsible for that policy have displayed, in addition to ability and wisdom, a firmness of purpose and a depth of conviction without which it would have been impossible to resist the pressure of inflationary forces. If these human qualities are lacking, monetary stability will be constantly threatened, however weak the structural factors conspiring against it.

For all these reasons, great caution should be exercised in approaching the argument that inflation is usually the result of inadequate savings. In many of our countries, the high-income groups have a relatively low savings coefficient because of prevailing consumption patterns in which to the superfluousness and ostentation of the past is added the incitement of new consumer items of the more developed countries.

In such circumstances, it cannot be denied that reluctance to save usually leads to inflation, not because opportunities for saving are lacking, but because there are no effective means of exploiting these opportunities. Inflation, for its part, aggravates this state of affairs since it destroys the savings habit where it already existed or was beginning to develop among the broad masses, and renders extremely difficult, if not impossible, any attempt to instil it.

As has been shown elsewhere, inflation is far from recommendable as a compensatory policy. But it is understandable that, in face of a contraction in economic activity the central banks should be induced to yield to the pressure of inflationary forces. Such a proceeding can hardly be condoned, however, when, at the height of a boom in economic activity under the aegis of a developing export trade, credit expansion is advocated to supply the lack of saving, or when recourse is had to inflationary expedients to speed up the rate of economic growth.

I unhesitatingly uphold the belief that much might be done to change consumption and saving patterns, especially among the higher income groups in Latin America, by means of tax reform. Not only the system of taxation itself calls for improvement, but also the current methods of tax collection, particularly in respect of income tax, where evasion is common and the sums thus lost to public revenue are considerable.

In the first connexion, the reform needed is the abolition or at any rate the reduction of the tax on that proportion of income which is invested either by enterprises or by individuals; conversely, the part used for consumption should be subject to a *reasonably* progressive tax. I underline the modifying adverb because in some countries — especially those where inflation has been intensive — progressive rates have soared so high that they have given rise to all sorts of manoeuvres to evade payment of the tax. Apart from this, there are other effective means of discouraging certain forms of consumption of durable goods — luxury building, for example — which militate against saving or against its application in the best interests of society.

Unfortunately, serious studies on the possibilities of amplifying the tax instrument in order to boost investment have not as yet been undertaken in Latin America. Moreover, the situation is far from uniform. In some countries the tax burden could be increased without difficulty, since the proportion of aggregate income to which it corresponds is relatively small, and, in addition, the capacity of the higher income groups to raise the investment coefficient by more substantial saving is strikingly obvious. In others, the proportion of income represented by taxes is so high that the possibility of increasing them is non-existent, or very slight, and only the growth of aggregate income could gradually solve the problem.

The trouble is that in the second group the heavy incidence of taxation is usually accompanied by an expansion not of the State's productive investment but of its current expenditure — and not of precisely those aspects of the latter which, like education and public health services, contribute to economic development and the improvement of social conditions. This has helped to weaken the savings potential and, in consequence, the rate of growth.

It is thus understandable that the idea of using the tax instrument to augment State investment has few adherents in the countries where this procedure has been tried out, not so much for doctrinary reasons as in consequence of their own experience. But there is no justification for such an attitude when the aim, as indicated above, is to use the tax instrument to stimulate private investment. It might be objected that the total abolition of taxation on the latter would lead to an even more inequitable distribution of capital than already exists. This effect could be offset, however, by means of an inheritance tax.

In any event, there is little sign that Latin American countries where inflationary expenditure or investment is prevalent are making a serious and tenacious effort to use taxation as a means of incentive to greater capital formation. Much less is there any evidence of a long-term plan to stimulate capital formation on the part of the masses as one aspect of an income redistribution policy. The inflationary response to the problem of inadequate saving has been the easiest way out.

2. The dual role of international resources

How far would it be possible to achieve by means of such an effort, in a relatively short space of time, an appreciable improvement in the investment coefficient in order to expedite economic growth? Here, as was said before, there is room only for conjectural estimates. But it is highly doubtful whether, even if efficacious incentives to save more were applied, an adequate rate of development could be achieved, especially in view of the magnitude of unsatisfied investment requirements in a large number of the Latin American countries.

From this standpoint, the co-operation of international resources might help to supply the needs in question and to bring about the reforms in the pattern of production and the structure of the economy which are indispensable requisites for the acceleration of development.[6] An attack on these and other strategic points might in most cases secure a relatively rapid increase in *per capita* income, which would enable the national savings coefficient to be raised in a certain number of years.

This raising of the coefficient will not be an automatic process. Habits of saving and consumption are not easily altered, and recourse to the tax system and to other measures and incentives will be necessary. This again is an aspect which has not been carefully studied in the Latin American countries, although it is of decisive importance in economic development policy. For if the savings coefficient were not to rise as *per capita* income increases with the co-operation of international resources, the limit of absorption of such resources might easily be reached without the achievement of what seems to me vital both from the standpoint of development and on other grounds: namely, the creation of the capacity to maintain a high capital formation coefficient on the basis of the region's own resources.

Once this aim has been fulfilled, further international contributions will no longer be indispensable, as they usually are at present — although they may still be desirable — especially if the position of the national entrepreneur has meanwhile been successfully strengthened.

Besides playing this role — in itself highly important — of helping the Latin American countries to raise their own savings coefficient, international resources must be channelled towards the attainment of another objective, since the problem lies not only in achieving an appreciable increment in savings, but also in the possibility of allocating that increment to imports of capital goods. If the consumer expenditure for which the income concerned was formerly used had an import content much smaller than that of the investment in which the new saving is reflected, as is usually the case, an external disequilibrium would be registered even in the total absence of inflation. The application of international resources to imports of capital goods for substitution industries or export activities, besides other investments, would permit the creation of the necessary margin for the increase in national savings to be switched to capital goods imports. All this, of course, with due regard to the possibilities for domestic production of such goods.

3. Bank financing of circulating capital

I am unwilling to bring these remarks to a close without touching on two points that claim attention, since their neglect often reinforces inflationary trends. One concerns investment in circulating capital and the other the obli-

[6] This is not the place for discussion of an exceedingly important aspect of the question — the need for a substantial proportion of these resources to be devoted to strengthening private enterprise in the Latin American countries themselves, as I have long been advocating.

gation to finance the internal part of investment with national savings.

As regards the former, even those who insist on the absolute necessity of covering fixed capital investment with domestic or foreign savings consider the expansion of credit by the banking system admissible as a means of meeting the increase in the circulating capital requirements of entrepreneurs which economic growth involves. If the banking system can draw upon a correlative increase in savings deposits, no inflationary consequences will ensue. But if this is not so, or if the increment in the deposits in question is absorbed by the financing of fixed capital investment, such consequences are inevitable.

This fact acquires greater significance when the increase in circulating capital relates to activities in which the production process is relatively lengthy. A typical case in point is that of agricultural and particularly livestock production. It is a mistake to suppose that in such circumstances credit expansion is not inflationary because its purpose is to increase production. Expansion stimulates demand immediately, whereas the growth of supply is a more or less long-term process, in the course of which the inflationary pressure of the aforesaid additional demand will meanwhile be developing.

Hence the need for the banking system to have at its disposal genuine savings with which to meet requirements in respect of both circulating capital and the financing of fixed capital, especially in the case of banks operating in connexion with agricultural production.

4. The stipulation that domestic investment be from internal sources

The other point relates to the international credit institutions' stipulation that the proportion of investment which is effected within the country itself must be covered by domestic savings, international resources being earmarked solely for imports of capital goods. The difficulties encountered by the entrepreneur or the State in complying with this requirement customarily lead to the inflationary expansion of credit.

What is at fault is not only the lack of an ample capital market by means of which sectors with a deficit could avail themselves of the surplus savings of other sectors, but, first and foremost, the limitations of the savings coefficient itself. This is one of the reasons why over-all development programming should include a programme for investment. Briefly, such a programme must determine the volume of investment required to attain a specific rate of growth, establish the potential extent of internal savings (given adequate incentives) and, lastly, assess the amount of international resources that must be regarded as indispensable.

At the same time, the stipulations under discussion are explicable in the light of possible misgivings as to what might happen if certain investments were entirely financed with external resources. A country might well neglect to make the necessary effort to utilize its own sources of savings; or the availability of the outside contribution might mean that sums which could otherwise have been used for capital formation were diverted towards consumer expenditure. It has already been explained that the essential objective of such international contributions is precisely that of helping a country to raise its own savings coefficient; and if the resources in question lead it to forgo the measures required to this end, they will have proved self-defeating.

Undeniably, experience in Latin America in general affords grounds for such apprehensions. The solution lies, however, not in the restrictive attitude referred to, but in the programming of investment. For this purpose an analysis must be made of the immediate prospects of increasing internal saving and of those likely to be opened up as the rate of growth of *per capita* income rises. This done, the amount of international resources needed to supplement internal saving can be determined. Of course, the gradual inflow of such resources depends not only upon the satisfactory quality of the individual projects presented, but also on the progressive implementation of the basic measures which are the mainstays of the programme, and which include those designed to raise the savings coefficient.

Once the amount of international resources has been established, it does not matter if in the case of certain investments these resources are used to cover some proportion of the expenditure effected within the country, and in others only to defray the value of capital goods imports, or, in the remainder, an amount less than the value of those goods. The essential point is that investment as a whole be effected in accordance with the programme, and that, when the country has made its savings effort, a bigger international contribution than was originally contemplated be not needed.

Yet again, the contribution of international resources to aggregate investment may conceivably suffice to cover more than a given country's total imports of machinery and equipment. I do not think this has been typical of Latin America's experience, since the funds contributed generally fall far short of the amount represented by such imports; but it might happen in the course of some countries, development, especially if, thanks to the common market, intensive expansion of the machinery and equipment industries takes place. In reality, there would be no economic reason why international contributions should not exceed the cost of the imports in question and finance, in addition, the purchase of domestically-produced capital goods. I cannot help wondering whether the restrictive position so often noted in this respect does not smack of commercialism, or may not be a survival of the old-fashioned belief that the production of capital goods is the prerogative of the great industrial countries alone.

The question is fundamentally one of economic expediency and of the availability of savings. If it is more economic to substitute domestic production for imports of certain machinery and equipment rather than for those of particular consumer goods, because the costs differences between the domestic manufactures and the corresponding imported articles are smaller, there seems to be no reason why international resources should not be applied to finance internal purchases instead of imports of capital goods, if domestic savings are not available for the purpose. Total purchases of such goods remain the same in both cases; the difference lies in the fact that less machinery and equipment and more consumer goods are imported in the former than in the latter instance, because this happens to be the more economic solution.

And supposing the consumer goods thus imported were non-essential or luxury articles? Here the issue should not be confused, as it so often is. Undoubtedly, in critical periods when a country lacks foreign exchange for essential goods, such imports would be unjustifiable. But this is not the point; the problem under discussion is that of steady economic development by means of a programme which determines, on the basis of economic criteria, what must be produced at home and what must be imported. As regards non-essential or luxury goods, the important decision incumbent upon economic and social policy relates to how far such consumption should be restricted by means of taxation, with due regard to capital formation requirements and the redistributive aims of a given programme. Once this vital question has been settled, it is immaterial whether these goods are imported or domestically produced, so long as the course chosen is adopted on its economic merits.

Another objection which might be adduced is that the country concerned would be importing consumer goods — whether non-essential or luxury articles or not — while factors of production were available to manufacture them. There are no grounds for confining this argument to consumer goods. If factors of production are available, and still more if idle capacity exists in the economy, the proper solution is to utilize them, for which purpose, as has been explained elsewhere, import substitution will have to be accelerated in so far as exports cannot be expanded.

If, as may well happen, economic development is accompanied by maximum utilization of factors, there is no need for concern as to whether international resources are applied to imports of consumer goods, provided, it must be reiterated, that the substitution policy pursued is based on considerations of economic expediency. The essential point is that all investment be covered with genuine savings, either internal or external, and that the amount of the international contribution be correctly related to the country's external payments capacity and its future evolution as a result of the structural transformations which the implementation of the development programme entails.

VII. A POLICY OF MONETARY STABILITY COMPATIBLE WITH ECONOMIC DEVELOPMENT

1. Dynamic nature of the inflationary process

Steady and intensive economic development calls for a series of reforms in the pattern of production, in economic and social structure and in income distribution. These reforms will enable the economy to grow faster than primary exports and to cushion the internal impact of fluctuations in these latter, while at the same time removing local obstacles to development. If such reforms are effected only in part, or inadequately, or not at all, maladjustments and tensions arise which call into play or stimulate the inflationary forces latent in the Latin American economy. This is the contention sustained in the foregoing pages.

Rightly considered, it is *change* in economic conditions that favours the action of these inflationary forces. If an energetic economic development policy were to promote the steady growth of the economy, if *per capita* income were to increase persistently enough and on a satisfactory scale, without the fluctuations registered at present, and if income distribution were modified not regressively but progressively — if all this were carried out with a reasonable degree of efficacy — the maximum degree of resistance to the action of inflationary forces would be ensured, whereby to maintain monetary stability.

There are also cases, not so much of resistance to inflationary forces, as of weakness on the part of these forces themselves. In reality, it is not usually difficult to maintain monetary stability in situations of relative economic and social stagnation based on an out-dated system of land tenure and income distribution, with little social mobility. But sooner or later social pressures emerge to militate against this precarious equilibrium, spurring on inflationary forces which quickly put an end to monetary stability.

These forces are not always associated with adverse circumstances. They are also intimately allied to prosperity. A favourable change in economic conditions opens up new opportunities for consumption or investment which, when they exceed the genuine resources available, precipitate inflationary expansion.

True, inflation is not a purely economic phenomenon, and a thorough understanding of its nature and significance calls for sociological research of a kind in which Latin America is behind the times. If the stagnation or slow progress of the economy provokes those social pressures which degenerate into inflation in default of an enlightened development policy, rapid growth also brings about conditions favourable to the increased mobility of dynamic elements, to changes in the existing social complex, likely to stimulate the action of inflationary forces.

New social groups force their way into politics and economic affairs — in close combination — and resort to inflation to establish and consolidate their power, altering income distribution in their own favour. History has afforded examples of other highly efficacious ways of redistributing income, among them that concentration of land ownership which is still widely prevalent in the Latin American countries. But inflation perhaps outdoes them all in its flexibility and the far-reaching scope of its consequences.

Thus, inflation is a manifestation of economic and social change, an essentially dynamic phenomenon. Consequently, campaigns to prevent or combat it cannot be waged through autonomous monetary measures, but must form part of a vast and deliberate effort to channel economic and social forces towards the attainment of clearly-defined objectives.

2. Orthodoxy and the free play of economic forces

Hence the irremediable fallacy of the orthodox position. It heedlessly ignores the phenomena of economic development. Whether a Latin American country is enjoying a boom or suffering a slump in its exports, whether it is growing at a rapid rate or barely developing at all, the formula is the same; inflationary forces must be combated by means of a firm credit restriction policy and certain other expedients which, as a general rule, do not venture beyond the monetary sphere.

But does this mean that orthodox monetary policy is indifferent to a country's economic development? Does it set up monetary stability as a primary objective, for the sake of which such development must be curbed or smothered? This would be an unjust assumption. The difficulty is not lack of interest in economic development, but a concept that is perhaps even more serious: the implicit negation of the need for a development policy, of the need for reforms in the pattern of production, in economic and social structure and in income distribution — of the need, that is, for a conscious and deliberate endeavour to influence economic and social forces.

Deliberate action of this kind is unnecessary because economic development is a spontaneous phenomenon. Herein lies the basic error — in the belief or the supposition that, once monetary stability is assured and the economy relieved of any kind of State intervention, the free interaction of its forces will suffice to bring about maximum efficiency in the utilization of the factors of production.

The orthodox application of anti-inflationary policy generally implies economic contraction and social distress; it is the present price that must be paid for a welfare shortly to be enjoyed, the indispensable sacrifice whereby to earn the remission of our economic sins and the grace of foreign private capital. Emanating at times from profound conviction, and at others from the impression that without it external contributions to help control inflation will be unobtainable, a policy of this type demands qualities of energy and firmness which — however admirable in themselves — end by foundering amid the tensions, antagonisms and resistances of every kind which the contraction or relative stagnation of the economy brings in its train.

All this is much to be regretted, for such qualities are highly necessary in any campaign against inflationary forces. But monetary policy should not be expected to yield results which it cannot produce alone. It is impossible to combat inflation or prevent its reappearance by purely monetary measures; they must be incorporated in the framework of an energetic economic development policy which ensures the structural equilibrium of the economy. Only then can monetary policy be required to give what it is capable of achieving, namely, stability, an essential requisite for economic development, but not the only one.

Structural equilibrium is not static, but dynamic; that is, it must perpetually adapt itself to the new demands of economic development. In the Latin American countries this means a continuous transformation of the structure of production and the composition of imports so that the rate of growth of the economy may exceed that of exports. These changes cannot result from the spontaneous interaction of economic forces, but must be the outcome of measures which forestall the claims of future events. Nor should they be the consequence of successive devaluations of the currency; this is a fantastic theory, which purports to show that if the exchange rate is left to find its own level through the machinery of free interplay, the readjustments referred to will be achieved without the necessity of deliberate action.

In this whole field there is a deplorable confusion, resulting from the static reasoning on which the orthodox conception of monetary matters is based, and which fails to reckon with the dynamic process of development. Of course, the main objective of a sound monetary policy — to which I unconditionally subscribe — is to stabilize the external equilibrium of the economy; not, however, its structural equilibrium, but the deviations from this which take place in the course of the operation of the economy.

Structural equilibrium is not a matter for monetary policy, nor is the remedying of external vulnerability. For such purposes structural reforms are indispensable, and without them the risk of inflation will continue to be very great. A tax policy planned to provide incentives to investment, and measures which actively promote capital formation on the part of the broad masses of the population, will give monetary and financial leaders a more stable base from which to operate against the inflationary expansion of credit.

Nevertheless, this concerns only one aspect of inflation. Not all inflationary pressures originate in credit. The inflation of costs must also be guarded against. It is expedient to do so by means of measures which equitably distribute the social burden of heavier costs. But the fundamental solution lies in changes in the pattern of production which will obviate such increased costs or permit their absorption.

3. Inflation as an instrument of redistribution

Redistributive aims never have been and never will be efficaciously achieved through inflation. In the course of history, inflation has shown itself to be an effective instrument of regressive redistribution in favour of the higher-income groups. But it has not proved an instrument of progressive redistribution in favour of the masses, since the credit system makes sure that the burden of illusory wage increases, or of social security contributions that cannot possibly be absorbed by productivity instruments or entrepreneurial profits, is shifted back on to their own shoulders.

It is readily understandable, however, that pressure for the amelioration of social conditions should have become a persistent inflationary factor in some of the Latin American countries. The inflationary spiral usually constitutes a psychological safety-valve when the contraction of income, its slow growth, or maladjustments in its distribution, militate against any lasting upward trend in the level of living of the population.

I refer, of course, to the use of the inflationary instrument to achieve social improvements, which must not be confused with the protection of workers against the rise in prices and profits generated by inflationary expansion. This defensive posture is not inflationary, but a corrective to the effects of inflation.

That wage increases higher than can be absorbed by profits or productivity infallibly culminate in the inflationary spiral is an incontrovertible truth. But it must not be supposed that as a preventive step the stabilization of wages — however high the level chosen — constitutes a basic solution to the problem. It is impossible to stop the clock at the present moment, since the stabilization of wages also implies the stabilization of the existing disparities in income distribution. And an anti-inflationary programme which does not set resolutely to work to correct these irregularities lacks economic efficacy and social significance, while incurring a very serious risk of a relapse into inflation.

4. Income redistribution and capital accumulation

This problem of redistribution assumes new characteristics in the Latin American countries. In the capitalist evolution of the great industrial centres capital accumulation preceded redistribution. In our countries the two operations have to be performed simultaneously. Hence the need to seek new formulae by means of which the broad masses of the population can play an active part in national capital formation as redistribution policy makes progress.

Those who believe that inflation is the readiest expedient for the satisfaction of popular aspirations in the direction of income redistribution are falling into an error whose political projections are incalculable. And the same is true, at the opposite extreme, of those who advocate inflation as an instrument of saving.

The solution of the problem of inadequate saving is not to be found in inflation, but in a rational combination of measures to increase thrift within the framework of a development policy. The consumer expenditure of the higher-income groups must be restricted. But this is not enough. The inflationary solution of restricting mass consumption cannot be perpetuated, however, firstly because present levels are unsatisfactory as they stand, and secondly because such inflationary restriction of consumption is effected by transferring the margin of saving to the entrepreneurs, and only a fraction of it — not as a rule a very large one — is used for capital formation. Moreover, a proportion of the latter represents investment stimulated by the increase in demand on the part of the higher-income groups resulting from this transfer of real income in their favour.

Within a socially acceptable programme to raise the investment coefficient, the capacity for saving of the bulk of the population is at present very limited. Here too the solution is dynamic in character: namely, to increase *per capita* income through the co-operation of international resources and the more efficient utilization of the factors of production, and to apply the income increment in such a way that investment increases more rapidly than consumption.

The masses in Latin America must be assigned their share in the basic task of capital formation. But their intervention in this process must not be passive, deriving from the spoliative effects of inflation, but conscious and deliberate. They must be allotted an active role in the formulation and application of development programmes and a clear and effective responsibility in respect of internal capital formation.

That inflation may have dynamic effects is undeniable. It mitigates the intensity of a contraction of the economy, and, in favourable circumstances, allows the investment coefficient and therefore the rate of development to increase. What is more, in certain cases, the transfer of income is effected not so much at the direct expense of popular consumption, as by diverting towards the higher-income groups a considerable part of the increment in productivity or of the effect of an improvement in the terms of trade. But this is not a typical phenomenon, and furthermore implies a regressive redistribution of income which is inadmissible from the social standpoint. Moreover, as the workers gradually develop their capacity for self-defence, the efficacy of inflation as an instrument of capital formation diminishes or disappears, and the distortions it causes are accentuated.

Neither inflation, nor orthodoxy. The time has come to formulate a monetary policy which meets the requirements of an economic development policy, which fits into its framework perfectly. Orthodoxy, owing to the dogmatic complacency with which it is administered, owing to the uncompromising finality with which it is generally presented to our countries, acts as a severe brake on the effort to devise this new form of monetary policy. I greatly fear that its continued application will increasingly strengthen the notion that economic development and monetary stability are incompatible concepts.

And that they certainly are not. If dynamic equilibrium is ensured by means of the reform of the economic and social structure, a firm foundation will have been laid for a policy of monetary stability, which is, moreover, indispensable to the steady development of the economy. Once structural equilibrium has been established by virtue of an energetic development policy, monetary policy can efficaciously discharge its proper function of correcting deviations therefrom; and the instruments of monetary orthodoxy may then be very useful — although not all-sufficing — in restoring external and internal equilibrium.

Doubts are sometimes expressed as to the possibility of putting a rational development policy into practice because of our countries' lack of political maturity and the want of understanding on the part of the masses. And the idea of popular capital formation is repudiated as impracticable. Perhaps some misgivings are entertained lest all these advances may prove incompatible with the conservation of certain economic and social complexes.

But it must not be imagined that inflation is an alternative. If the system under which we live cannot develop without it, inflation will be an alternative that leads nowhere. For it corrodes the economy and dangerously disrupts society. Impossible, then, to deny the rationality of inflation as an instrument, not to infuse the system with dynamic vigour, but to sweep it inexorably onward to disintegration.

RELATIONSHIPS BETWEEN SOCIAL AND ECONOMIC INSTITUTIONS: A THEORETICAL MODEL APPLICABLE TO LATIN AMERICA

by *José Medina Echavarría**

I. GENERAL QUESTIONS OF THEORY

Questions of methodology and principle are apt to seem irritating digressions which serve only to put off the moment of grappling directly with the problems that really matter. The number of people interested in them is therefore small, and they should always be broached with discretion. Nevertheless, they are indispensable if the problems concerned are to be approached with the maximum degree of lucidity; in order, that is, to ascertain on the one hand what may sensibly be asked, and on the other what may be expected of the reply. The subject of this paper, as set forth in the title, involves two questions, two tacit assumptions, to which some preliminary consideration must be given. It alludes, in the first place, to the possibilities of constructing a model of the economic and social development of the Latin American countries, which will also show, or take into account, reciprocal connexions between the various institutions. And secondly, it appears to attribute the responsibility for such a work of construction to the specialized knowledge or the particular point of view implicit in sociology. These two problems may consequently be formulated as follows: What contribution to development activities may be expected from sociological analysis? What is the real meaning of the word "model"?

The more general questions relating to the role of the sociologist in development activities have been discussed in some detail elsewhere, and there is consequently no point in reverting to them here. It should be recalled, however, that the scope of that role varies according to the extent of the intellectual responsibility assigned to sociology. The sociologist may be regarded as a mere collaborator, within certain limits, in the more essential tasks of the economist; a specific field may be conceded to him in given sectors of research and doctrine; or, lastly, it may be admitted that his work is capable of carrying him to the farthest bounds of critico-cultural thought and that he may therefore help to determine the general — including the political — direction of economic development.

What is of interest here and now, however, is to envisage the question of the value of sociology in development activities from a different angle. On the one hand, the relations of sociology to practical action must be considered, and, on the other, the links between theoretical construction and empirical research — in so far, of course, as they are strictly relevant to the topic in hand.

There would be no reason to pose the first of the questions indicated above if sociological activities were simply confined to the academic sphere of theoretical analysis. But nowadays, not always without attendant risks, a huge and more or less lay public expects of sociology immediate practical applications similar to those required of other social sciences, and particularly of economics. In these demands, moreover, bodies of every kind, both public and private, have a voice. The ground must therefore be meticulously cleared and the various claims hitherto put forward for sociology in its relation to praxis must be pointed out. Obviously, only a cursory glance at them is possible here.

One view of the relationship referred to — still quite commonly held today — is that the sociologist's work implies a total appraisal of the society in which he lives and with which he deals; an appraisal, therefore, which is necessarily based on a particular ideological moment or a certain conception of the universe and, in the upshot, suggests a complete remodelling of the society in question in one direction or another, either left or right.

A second position makes a less sweeping but no less ambitious claim. The ideological moment postulated by the foregoing attitude is now replaced by one of a strictly scientific character. Sociology is conceived as a functional branch of study from which, as from others of the same kind, definite guidelines for practical conduct can be deduced. The praxis derived from sociological analysis does not aim at the reform or total metamorphosis of the structure of society, but the exertion of an efficacious influence on one or other of its components, perhaps in accordance with predetermined objectives. In this sense the accent is laid on the "operative" significance of sociology, which aims at offering, like other sciences, a whole set of precision instruments. How far sociology has attained such a degree of maturity is not a matter for discussion here and at any rate must be left as a moot question.

Lastly, a third attitude represents theory and praxis as less closely dovetailed; for it postulates, not the formulation of scientifically accurate — although limited — predictions like those based on knowledge of the natural sciences, but the "understanding" of a social situation of a historical character. Consequently, it aims at a type of analysis which will reveal the structure of that situation and its dynamic trends, projecting, as far ahead as possible, the various probabilities inherent in it. Here the "diagnostic" value of sociology comes to the fore. The diagnosis once made, the choice between the possible alternatives is left to the responsibilities of action and the influence of other points of view. It is important to state that this is the position adopted in the present study.

Another point worth establishing equally clearly, although it may seem to be only incidental, is that bearing on current relationships between theory and empirical research. There is a strong possibility that — as might perhaps be demonstrated at more leisure — a relative

* Although the author is a member of the staff of the Division of Social Affairs of the Economic Commission for Latin America, the opinions expressed in the present study are entirely personal and are not necessarily shared by the Organization to which he belongs.

consensus of opinion already exists with respect to general theoretical positions in the sociology of economic development. At least a certain number of working hypotheses are available which so far have retained their validity. This in no way implies that the careful formulation of general theory on the one hand, and, on the other, the discovery and refinement of the most suitable conceptual categories and instruments, have lost all their interest and importance.

Where Latin America is concerned, it seems patent that the greatest lacunae and shortcomings are to be found not so much in the theoretical field as in the practical contributions of empirical research. Such research, apart from the knowledge which it may represent *per se*, serves to confirm or disprove hypotheses which are almost universally accepted but which have their origin in other social environments. There are consequently grounds for the assertion that in the present phase of study of the social aspects of economic development, the centre of attention is being and must be shifted to the garnering of this basic empirical research. Indeed, it must be recognized that the most elementary empirical descriptions are still lacking for a considerable number of problems.

This need once acknowledged, some of the attendant dangers and difficulties must likewise be frankly faced. Only a hurried sketch of them can be given here. It is common knowledge that the greatest difficulties lie in the shortage and at times the total absence of competent personnel, in the deficiency of instrumental and financial resources, and in the very small number of centres or organizations capable of coordinating these.

The dangers, on the other hand, arise partly from the enthusiastic reception given to so-called "scientific research" today. And they consist above all in what might be termed an emulatory zeal, unnecessarily perfectionist, which may have a most unfortunate effect not only on the results achieved but even on the mere approach to much of the research undertaken. A precise and systematic order of priorities for such research is of course an urgent need, but no less important is a clear awareness of the limits within which it will have to be conducted. Given the situation in Latin America, the research required is not the kind that aspires to scale the highest peaks of scientific attainment, but the sort that offers modestly enough, upon occasion, the first steps towards knowledge of reality.

Always and everywhere the progress of social science, and particularly of sociology, has centred around some topics which at different times were absorbing the attention not only of scientists and politicians but also of the general public. In Latin America the "topic of economic development" has this crucial significance at the present time. It must therefore be explicitly enunciated, so that in relation to it — as a focal point of theoretical convergence and orientation — not only economic problems proper may be analysed, but also all such social, political, educational and other questions as are closely associated with these.

II. THE "IDEAL TYPE" OF DEVELOPMENT IN THE HISTORY OF WESTERN CIVILIZATION

1. Weber and the social conditions of the liberal economy

There are two customary methods of approach to the construction of an economic development model: recourse is had either to the historian or to the economist. Perhaps the most profitable procedure would be to keep both viewpoints constantly in mind, but the models and texts in which such a merger is to be found are very few. Consequently there is nothing surprising in the frequency with which, in our time, inspiration and instruction are sought in the pages of Max Weber. Indeed, if events in the economic development of the Western world are to be grasped in their historical perspective — if, therefore, the "ideal type" of this development's course is to be traced — a thorough initial acquaintance with the German sociologist's interpretation is a *sine qua non*. Nevertheless, although at the present moment his theories are continually being invoked, the twofold contribution which his work represents is not always clearly shown. For if, on the one hand, it is the most convincing attempt so far made to interpret the origin and the formation of the modern Western economy, it perhaps also offers, on the other hand, the most nearly perfect construction of the "model" or paradigm of a liberal-capitalist social structure. These two aspects are worth recalling briefly and in turn.

Weber's schematic outline of the historical origin of capitalism — of the modern industrial system — is, of course, an endeavour to reply to an incisive question as to what is the most significant idiosyncrasy of Western culture. That is, it attempts to discover why in Europe capitalism has grown up only with the special features that are today accepted as typical of its industrial form, although previously, and in other parts of the world, it displayed different characteristics. According to the diluted textbook version, the religious ethic of Protestantism — and of Calvinism in particular — would seem to be in some sort the cause of modern capitalism. It would be irrelevant to the present study to do so much as suggest the over-simplified nature of this popularized version; or to comment, even allusively, upon the controversy unleashed by the authentic Weberian thesis. It is self-evident — and should any doubt be felt, a rapid glance at his *General Economic History* would suffice to remove it — that Weber was aware of all the complexity of the problem and in no wise disregarded the external factors which helped to foster the growth of European capitalism.

But for the purposes of the present study all but two essential elements can be dismissed. The first relates to the formation of what at a later stage in this paper will be termed a general "economic attitude"; the second bears on the conditions which made it possible for this economic attitude to be effectively developed. In the words of Weber, the appearance of a specific professional ethos, or, if more modern psychological terminology is preferred, the habit of work of the industrial society, had first to be accounted for. How was that rational, temperate and disciplined attitude formed which was to be the psychological mainstay of modern economic life? How did "economic rationality" come into being, and what is its relation to the over-all process of rationalization of the whole of Western culture? The answer is well-known. But it must not be forgotten that in this connexion the influence of Protestantism — exerted through the religious ethic whose sustenance consisted in special solutions to the problem of salvation — served only to accentuate, or at any rate fully develop, permanent trends in Western culture, concurrently manifested in various fields, and particularly in that of science, which had its origin precisely in Catholic countries.

It is because Weber's work has not been viewed as a whole that due attention has never been devoted to the second of the above-mentioned elements. For, given the formation of the modern professional ethos and the habit of work which it involves — of specific economic commitment, to use the current term — how was this economic rationality able to develop and function effectively? The reply — not so oft-repeated or popularized as the previous answer — is to be found in the history of law and administration in the Western world, the origins of which — political, professional and ideological — are largely independent of all economic conditionality. Without the security afforded by the juridical systems of the Continent or by that of common law, without the predictability of future prospects guaranteed by professional "bureaucracy", it would never have been possible to calculate expectations and rely on their stability to the extent demanded by economic rationality, the more temperate attitudes of work and discipline could never have been brought to social maturity. In the light of this unique historical experience, the course of events observable in very dissimilar economic systems or traceable to widely different historical processes leads up, notwithstanding these divergencies, to the same question: how, in the case of such systems and processes, did the necessary "economic rationality" come into being, and how has it been maintained? In Japan, for example, or in the Soviet Union? How can it take shape in the less developed countries?

But, as was stated previously, the significance of Weber's contribution lies in the fact that it offers not only an intelligible interpretation (it makes no other claim) of the original conformation of modern industrialism, but also an equally brilliant formulation of the paradigm — as it would be called today — of the "social conditions" of the "liberal economy". Thus, in the study of contemporary literature dealing with the subject the conceptual elements of the paradigm in question are continually encountered. Given that the fundamental idea on which it is based is that of "formal rationality", its most concentrated expression might be as follows: the social premises of the "liberal economy" are those which permit and establish the exercise of such rationality. In principle, the premises in question can be reduced to those governing the following three fields: the market, property and labour relations, and the political organization of the economy.

An economic system operates in accordance with the requirements of the idea of formal rationality when, in the first place, on the basis of a specific effective demand there is open competition among autonomous bodies and meticulous calculation of capital; when, secondly, property relations are characterized by the enterprise's complete appropriation of the physical means of production, and labour relations are governed by the formally free contract; and when, thirdly, the concomitant of all this is a State which confines itself to maintaining rational monetary, legal and administrative systems, and in every other respect leaves the economic life of the country to the spontaneous interaction of its own forces. In other words, the formal rationality of the economy is reflected most faithfully in the calculation of capital, which in turn entails — and here some of the conditions indicated reappear — absolute freedom of the market, disciplinary stability in the enterprise and constant relations with respect to appropriations. These elements of the Weberian paradigm are the same that are to be found, implicit or explicit, in one combination or another and with merely terminological differences, in recent literature dealing with the social aspects of development (Parsons, Lewis). And from this schema orientations for economic and social policy can be and, moreover, usually are derived.

2. The historical invalidation of the Weberian paradigm

Nevertheless, while the paradigm referred to unquestionably constitutes the most highly-perfected expression of a sociological interpretation of the social conditions of the liberal economy, or, in other words, while it remains of value in this connexion as a theoretical contribution, there can be little doubt that it no longer fully depicts the present situation of the more mature industrial societies. To express this in another way, everything that has hitherto taken place in the real evolution of the Western economies during the last few decades implies, in the last analysis, at least the partial invalidation of the paradigm in question. Hence it would seem desirable to consider both the intrinsic significance of this invalidation and what it represents for countries in the process of development. The changes that have come about in the social conditions of liberal capitalism as a whole are of widely varying kinds, and it would be necessary to examine these conditions one by one, following the list given above. But perhaps for the time being it may suffice to say that the invalidation under discussion has consisted essentially in the discarding — to a greater or lesser extent — of the principle of formal rationality and in its replacement, wholly or in part, by principles of material or functional rationality.

It is a well-known fact that economic changes have consisted first in the deterioration of absolutely free market relations, or, to use the contemporary formula, "perfect" competition; secondly, in the modifying of labour relations, still theoretically established by free contract, but in practice no longer conforming to the disciplinary situation typical of the early industrial enterprise, as a result of either the action of collective organizations or the influence of informal trends towards the stabilization or appropriation of jobs; and, above all, in the ubiquitous tendency of the State to abandon its strictly neutral position *vis-à-vis* economic affairs and intervene on a larger or smaller scale in their regulation or in economic activity itself.

In countries that have reached a more advanced stage of economic maturity, these changes have been accompanied by sweeping transformations of the social structure which it is impossible to examine in detail, but which in their extreme form are reflected in the evening-up of levels of income and living, and the mitigation—not, of course, the elimination — of class conflicts. The process thus reviewed, which has been summed up, in accordance with Weberian usage, in the apparently cryptic phrase relating to the substitution of material rationality for the formal rationality once prevalent, is described today in the most diverse terminology and from differing points of view both by sociologists and by economists and political theorists. Some see it from the market standpoint, as the transition from "perfect" to "imperfect" competition in its various forms. Others endeavour to identify the distinguishing mark of the altered social structure; the predominance of "organization", for example. Lastly, yet others expound or formulate the theory of the "welfare State" and the problems — both constitutional and administrative — which it brings in its train.

From the angle which concerns us at present — that of the countries in process of development — the decisive fact which it is important to establish is that the real image, the effective model which such countries have before them today and on which their attention is primarily concentrated — a manifestation of the famous "demonstration effect" — is not the one condensed in the historic paradigm, but the one which is the living product of its transformation. Consequently, the orientations derived from the classic schema and from time to time proposed for these countries contradict their own authentic experience of the contemporary world. In this connexion, the responsibility of current thought (of which some expressions exist) is not so much to recapitulate with academic insistence — innocent enough if it were not sometimes dangerous — the distinguishing features of the Weberian paradigm, as if they were still applicable to the conditions of the contemporary economic world, but rather to construct a new "model" of the social conditions which really enable capitalism to continue in its present form.

The contradiction between the theoretical image and the image presented by life becomes still more complicated in countries in process of development because of the existence of the Soviet "model", which, of course, is based on premises quite different from the traditional postulates, both as regards the type of rational "effectiveness" of its agents and with respect to the political and social conditions of its organization.

III. THE CONCEPT OF THE MODEL IN CURRENT THOUGHT

1. History and theory of the model

The foregoing paragraphs contained an inaccuracy which must now be rectified as a point of departure for this new section. In the adoption of Weber's interpretation of the origins of capitalism, the terminology used was applied with a looseness which the author himself would not have allowed. The word "model" and "paradigm" were used to designate what in Max Weber's own methodological theory is accurately defined as "ideal type". We are thus confronted with a problem, apparently minor but serious enough in the present state of social science. It consists in the perennial coining of new terms, the attaching of new meanings to those already known, and, in general, the deterioration suffered, through the vagaries of intellectual fashion, by concepts which ought always to be used with strict precision.

This is what is happening now in the case of the term "model", which is applied with the most widely varying meanings in each and all of the several branches of social science; economics, sociology, psychology, political science, etc. The story of this term's evolution in our time has yet to be written, and all that would seem appropriate for the moment is to indicate its broad outlines, which lie between the two extremes of an interpretation that takes full account of all historical facts and a strictly mathematical conception of the model in question.

While a more detailed investigation is impossible here and now, the origin of the use of the "model" may be attributed to the "ideal type" concept in Max Weber's methodology, which in turn has its own sources of inspiration. In Weber, the ideal type as an interpretative construction has a precise significance definable as the accentuation or exaggeration of certain features of a specific real phenomenon in order to facilitate a better understanding of it. The ideal type thus constructed is only a heuristic instrument to check whether the picture presented by reality approximates to the synthesis built up in the concept with the maximum degree of logic, or is remote from it. An essential requisite, however, is that it should be formulated on the basis of the data empirically supplied by the facts of history themselves. But without prejudice to this historical content, a subsequent position has endeavoured to eliminate all that may be considered factitious in the Weberian methodology relating to the "ideal type", by putting forward the construction of "real types". This position is best represented in the models formulated by Eucken and by the group of contemporary French economists who adopt the theory of economic systems and structures.

An entirely different significance attaches to the model in other lines of modern economic thought. The best-known examples, and particularly the models offered by economic development theory, are actually, by their nature or by their logical make-up, quantified theories, or, strictly speaking, series of quantified hypotheses. Lastly, the model sometimes appears in social science with the same character as in the physico-mathematical branches of study, that is, aiming at a formalization of isomorphic relationships. This cursory reference to the most important types of models presented by contemporary social science suffices to give a fairly exact idea of the relation between the economic model and the social model in the theory of economic development.

Since the model most common in economic theory constitutes, as pointed out above, a quantified theory or a quantified set of hypotheses, the possibility of measurement is an essential premise of such quantification, which must, as is always the case in all economic theory, be susceptible of expression in terms of causal relationships. This is not the moment to appraise either the validity or the methodological scope of the economic model thus conceived, nor to determine whether it is fully acceptable in respect of its theoretical claims or only for its instrumental value, and what are the limitations to which its construction is subject. Only in relation to the functioning of the model is the critical viewpoint of the sociologist relevant.

What is important here is to examine how far it is or is not possible to expand the content of this economic model by the insertion of specific variables of a social character. The application of the model to sociological questions may have in some instances, and does have for the time being, a purely metaphorical value, a case in point being the recent tendency to use, both in sociology and in political science, the terminology and schema of the economic input-output analysis. But, as is generally true of these transpositions based on analogy, such an application is not without its hazards, if it leads to the mistaken idea that, in the different branches of study referred to, propositions of exactly the same degree of precision are encountered. The metaphorical use in question — that is, the transfer of the economic model as a quantified theory from the measurable field of economic phenomena to those of other social sciences, more complicated and less measurable — clearly reveals the weak points in this and other similar attempts. The intellectual output stimulated by the problems of economic development includes Rostow's theory, which was, of course, an endeavour to incorporate social variables in the economic model; but the "propensities" in which he tries to embody these social variables — for example, the so-called propensity to procreation, or the propensity to innovation, or the propensity to material improvement — cannot be equated to the strictly economic variables in respect of their quantitative precision. It has therefore been rightly said that, if they are of little use from the economic standpoint, their application is not satisfactory from the sociological angle either.

Rostow's essay very clearly locates the fallacy in the application of the strictly economic model to social factors; what makes it of questionable value is, on the one hand, the complexity and the multiplicity of such factors or variables, and, on the other, the difficulty with which they lend themselves to the necessary quantification. Perhaps quantified hypotheses may one day be constructed with variables of widely differing kinds, but for the time being it does not seem feasible, nor is there any possibility of acting operatively through the causal chain between one set of variables and another.

What is more, even in the case of models of a different nature, such as those of a strictly inductive kind constructed on the basis of historico-statistical analysis, the degree of interdependence of the phenomena correlated cannot be exactly defined, but must be recognized as varying and as contingent upon non-economic factors, for example, the social structure, the political set-up or the cultural environment concerned. This is a point made by Kuznets.

This reference suffices to introduce the question of how far it is possible for the sociologist to construct models comparable with those of a strictly economic nature as regards their exact causal significance. Undoubtedly, he could construct a similar model if he had at his disposal a complete and fully tested functional theory of society.

It is common knowledge that in recent years the endeavour to formulate such a theory has played a predominant part in sociology; and valuable findings have certainly been obtained, although it must be acknowledged that their significance is only instrumental or heuristic.

But the functional theory as such (that is, as an attempt to formulate the system of institutional components of a society) is weak in the very point that is of most importance here and now, namely, as regards the exact knowledge — the predictability — of the relations of interdependence and equilibrium between these elements. The sociologist could construct the desired model, analogous in nature to the economic model, if he had available a system of precise hypotheses on the mechanisms which make the above-mentioned relations of interdependence possible and on those which, it is asserted, are calculated to produce equilibrium relations likewise. In such circumstances, the variables integrated in the model could be treated as authentic "functions", so that accurate prediction would be feasible and, in consequence, practical action could be based on any one of them.

It must be confessed, however, although with no controversial intent, that for the moment such knowledge is not available, and that the conceptual precision sometimes displayed by sociological theories of a functional character is attributable to an underlying tautology.

Full validity of the "model" in its pure mathematical forms is found only where it is possible to express exactly in one specific idiom what was formulated in another, an outstanding example being analytical geometry. But such point-by-point equivalence of the elements of two distinct provinces — i.e., complete isomorphism — is unlikely to exist among different social institutions. Nevertheless, the methodological attraction of this scientific ideal may sometimes be implicitly apparent, as in the case of the precise categorial parallelism in some of Parson's schemas. Of course, in such instances, where no more than juggling with concepts is involved, the equivalences of the institutional components, and therefore their reciprocal action and influence, certainly do function.

The foregoing purely allusive considerations are not intended as a criticism of functionalism, as it is called (a criticism which could better be levelled from other points of view), but merely as an indication of how dubious is the claim that the sociologist can offer "functional" models in the field of economic development equivalent to those handled by the economist, that is, of similar operative reliability. To avoid misunderstanding, it should be noted that not only the greatest sociologists but all students of social science have been and are functionalists in the broad sense of the term, for they have always conceived society as a dynamic whole, made up of various interconnected parts — institutions, social forces, groups, trends, etc. — changes in each of which affect the contexture both of the remainder and of the whole. This conception is the starting-point of every attempt at a historical understanding of social reality and the premise on which any type or model is based. The only thing that varies is the degree of exactitude envisaged.

2. The social components of the economic model

Within this endeavour to interpret society as a complex of institutions and structures, the fundamental distinctions which are nowadays reiterated when the social aspects of economic development are analysed have likewise an immediate link with Weber, in the shape of his basic differentiation between economic and "economically relevant" institutions. It is true that those pages of his *Wirtschaft und Gesellschaft (Economics and Society)* in which this distinction is drawn deal not with institutions but with economic communities; but they of course apply to both. Economic communities proper are those which develop an activity, of that type — to obtain profit or to cover their needs — as an end in itself, a primary objective. On the other hand, "economically relevant" communities are those whose special activity, while not themselves economic, may represent a "causal moment" in the process of an economic activity. Outstanding among these are the communities which regulate the economy. As has just been pointed out, these distinctions are still valid if the concept of institutions is substituted for that of communities. In the pages referred to, Weber attacks, precisely as a historical prejudice, the "functional connexion" of the economy with other social structures, if by this is understood an "unequivocal" reciprocal conditionality. But at the same time it is significant that in those very pages should be postulated the value of such functionalism in a more moderate form. Indeed, it can be asserted in principle that an "elective affinity" exists between specific economic structures and certain social structures, or, in other words, that it is possible to say how far they are mutually "suited or unsuited", and how and in what degree they favour, hamper or exclude one another. This position, which, in the last analysis, is the classic attitude in sociological tradition, may seem to some inadequate. Within its limits, however, it enables diagnosis to steer a fairly accurate course, in complex historical situations, between the two extremes of exaggerated faith in the value of absolute prediction — scientific and quantifiable — and the discouragement provoked by mere groping in the dark.

Although not always dovetailed in the same way, the distinctions referred to constitute the groundwork of every type or model of economic development from the viewpoint of the sociologist. They are necessarily found, therefore, in one guise or another, in subsequent thought; and this is true of one of the most subtle and satisfactory of recent expositions — that of W. E. Moore. A very rapid reminder may therefore be given of the distinction between first-order requirements and second-order requirements, parallel to the differentiation between economic institutions and economically relevant institutions, which he draws in dealing with the institutional pattern. While it is true that alongside this latter Moore places the pattern constituted by organization and a preliminary formulation of the pattern of motivations and attitudes, the point of interest here is that, with reference to institutions, among first-order requirements he specifies property, manpower, and terms of trade or market relations, and among second-order requirements the political system, science and technique, and modes of stratification. That is, the author's fidelity to the traditional schema is shown in the subordinate and regulatory character he assigns to the poltical system; and this raises a question as to the universality of the schema, in view of the possibility — which has materialized in history — that the system in question may have a different role and significance. Nevertheless, the schema is valid for the Western tradition, even within its possible variants.

At this point — and merely by way of illustration, since no claim whatever is made to exhaust the topic — it is worthwhile to point out that the latest literature on the subject includes other schemas, in which, however, the same elements still come into play. A case in point is that of the group of French economists who stress the significance of the concepts of social structure and social systems for economic theory. In this connexion, among the structures making up economic systems — apart from those of a demographic, physical and strictly economic nature —, André Marchal devotes considerable attention to those which he terms *"structures d'encadrement"*, i.e., those of a social and psychological character. These comprise "institutional structures" (whether *institutions-choses* or *institutions-groupes),* social structures and mental or psychological structures. The list is enough to underline the general agreement existing today on this point. Under the heading of *institutions-choses* — a somewhat infelicitous term derived from the traditions of French institutionalism — he considers the right of property and the contract, and under that of *institutions-groupes,* the State and the trade unions. Among the social structures, in their turn, he notes social morphology, relations among the various groups and social mobility. And among mental structures he deals, *inter alia,* with the attitude to work, the spirit of adventure and of competition and the worship of material progress.

The dynamic element assigned to motives in Moore's analysis is represented in Marchal's theory by what he describes as "autonomous forces", which comprise technical advances, population and the movement of ideas. However, these propositions formulated by Marchal only acquire their full significance within the broader theory of economic systems and their special plasticity and dynamism. Wide horizons are thus opened up for sociological analysis from the very outset.

In pursuance of the declared aim of formulating a model of economic development, allusion may lastly be made to the articulation contained in S. Klatt's recent book, of which the theoretical pretensions are considerable. Klatt's model distinguishes between what he terms the "regulatory" and the "dynamic" elements in the industrial process. The active regulatory elements include social groups — above all the State — and the so-called social forces, i.e., religion, law and education. Among the dynamic elements or "impulses" are population growth, technical progress and entrepreneurial activity, whether public or private.

Klatt's schema is an outstanding example of the current attempts to incorporate the most important social aspects or factors in a model of economic growth, or, more accurately, of industrial development. But, as in the case of other models, of a strictly economic character, these factors soon cease to play any decisive part in the analyses presented in the book.

It is worthwhile to recall that in some historico-economic models of development a social content is more often than not implicit. This is true of the broad outlines of the theories of Clark and Fourastié, which assume a varying social structure in the main phases of development; and also of the historical categories of Rostow's five phases of economic development, in each of which socio-political conditions of a different nature are presumed to exist.

IV. OUTLINE OF SOCIAL FACTORS OF STRATEGIC IMPORTANCE IN ECONOMIC DEVELOPMENT

Had unlimited time and space been available, the immediate task in hand would have consisted in applying the basic schema sketched out above — in any of its possible articulations — to Latin America's social reality, so that the "model" of the conditions for the region's development might here and now be brought down from the abstract plane to the concrete situation in which it is destined to function. But even the least ambitious essay of such a kind would be too long for the present occasion. On the other hand, there seems little point in replacing it by a summary of the main questions relating to the social aspects of development at the theoretical level, since several studies of this nature have already been made.

Fortunately, the angle from which the present paper is written and the intellectual motivation behind it allow the work to be confined to a few central points. For what is of interest here is the possibility of indicating certain factors or elements of strategic value, upon which action can be brought to bear in one way or another so as to accelerate the development process. The elements or factors concerned are those that various authors single out, as was seen in the preceding section, for their dynamic character.

Again, plenty of arguments could be adduced to support the contention that economic sociology — a branch of study which still remains to be systematized — must be built up, in the last analysis, on the basis of three elements: property, labour and enterprise. In the following paragraphs, however, property is excluded for two reasons. First, its characteristics must be taken for granted as a known premise in the case of the Western-type economies, and its study would entail in addition an examination of the whole pattern of the present-day juridical system. And secondly, from the sociological standpoint only one thing really matters — the clear definition and the stability of powers of transfer, whatever the existing forms of tenure. Obviously, in the case of many of the Latin American countries, the defective organization of land tenure has to be reckoned with as the most serious obstacle to dynamic development. But this is a special topic which is outside the scope of the present paper. The problem of the structural changes required is universally recognized, although the measures proposed for its solution may differ.

1. General economic commitment

There is in addition a basic component of economic sociology which is of decisive strategic significance, and which was touched upon in passing earlier in this paper. It might be called, for want of a better term, general economic commitment. The entire economic history of the Western world can be traced in the slow and laborious formation of this economic commitment or attitude; and the most urgent of the development problems of the least advanced countries derive, or have in the past derived, from the need to create, shape or stimulate it. The meaning of the term is really twofold; it comprises both economic aspirations and a personal and collective sense of responsibility.

The greatest handicap of our time may very well lie in the fact that basic economic creeds are very far from homogeneous. Everywhere there is an expansion of economic aspirations that merges with the broadening of horizons which every sweeping historical metamorphosis brings in its train; on every hand there is the same desire to raise the level of living, the same eagerness to improve consumer capacity, which in the view of many is merely the result of that oft-cited phenomenon, the "demonstration effect". But this broadening of horizons and this desire to satisfy more ample needs is in no way based on any "economic creed" shared equally by all, the lettered and the unlettered alike. In the history of economic development in Europe, on the other hand, the economic creed of the man in the street consciously or unconsciously coincided with the scientific ideas of the economist. A completely accurate picture of the state of "effervescence" or confusion in economic creeds at the present moment could be obtained, if research were available on the position of the younger generation of today — as the economist Raúl Prebisch has observed — or on that of the intellectuals, in both of which it is dramatically reflected.

The most striking internal contradiction in these creeds consists firstly in the fact that the desire for an improvement in the level of living or in consumer capacity may be unaccompanied by the parallel impulse to make the necessary effort to obtain it; and secondly — although perhaps this is merely one facet of the preceding anomaly — in that individual aspirations to this intensification of enjoyment are not kept in reasonable check by the necessary sense of individual and collective responsibility. In essence, as should be well-known, economic development in any circumstances is possible solely at the cost of sacrifices on the part of a considerable proportion of the population, which can be channelled in only two ways — indirectly, through profit, under one system, or directly, through the tax burden imposed by the State, under the opposite type of régime. But in both cases, the sacrifice involved remains humanly and socially similar, whatever the yardstick by which it is measured. The vacillations that characterize the creeds of our time have their origin in the concealment of this basic fact, and in the consequent difficulty of deciding in favour of one or other of the possible formulae from motives dictated by the interests of the nation. What is the state of the creeds in question in Latin America? What should be done to stimulate and spread the satisfactory formation of the required economic attitude in the countries of the region?

Granted that democratic systems continue to prevail, they offer the possibility of energetic action in this field. To begin with — and this will not be the last time that it figures in the present paper — their educational system affords the most flexible instrument for continuous and efficacious action. But, in addition, the State can avail itself of the so-called "mass means of communication", provided that tact is used to forestall the negative reactions that endless harping on any form of propaganda is liable to provoke. And together with the State, other social forces such as the press, political parties and trade unions can operate in the same direction.

In the long run, however, all such action will fall short of its objective unless society provides the real model worthy of imitation in the conduct of its leading groups. It is doubtful whether a highly-developed industrial society — stimulated by the steady expansion of consumption — can be compatible with ascetic principles. But unquestionably all industrial societies have demanded in the early phases of their expansion — by whatever method this was achieved — a strong tincture of asceticism in their leading economic or political *élite*. In more than one part of the world at the present time the sluggishness or bewilderment of the masses is attributable to the absence of the necessary exemplary conduct in the ruling minority. Its presence may be decisive in face of the dilemma represented by the choice between the two possible ways of accepting the inevitable sacrifice — indirectly, through the profits of private enterprise, or directly, through the State taxation system under the control of a political group. The first formula can be attractive only if the ruling minority, which temporarily reaps the benefit of the efforts of the rest of the community, is the first to act with a proper sense of responsibility; to state it in economic terms, if profit is the visible instrument of rapid capital formation and not the unethical means of ostentatious expenditure.

Given the background of a favourable economic attitude — whether energetic or weak — not only the growth but the mere continuity and persistence of economic activity depends, whatever the systems in which it is incorporated, on two capacities not always easy to qualify: the capacity for execution or achievement — that is, the capacity for work in the broadest sense of the term — and the capacity for direction or initiative, hitherto designated by the ambiguous word "enterprise".

2. Work capacity

The following are the three commonly recognized sociological problems relating to labour, manpower or — to use the most abstract term — work capacity: (a) that of diligence or impulse to effort, with the attributes which shape it and which make it possible to speak of the morality or ethos of labour; (b) that of adaptation to new work techniques; and (c) that of the social responsibility of labour as an expression of the consciousness of its own function in society as a whole. In the cursory and allusive notes which are all that the nature of the present paper permits, only the following reminder can be offered: nothing could have been slower or more difficult than the formation of the impulse to work in the active population — which nowadays seems so hardworking — in the more advanced economies. Leisurely in the West, volcanic in the Soviet world, the process has consisted in the imposition of a discipline invariably opposed to instinctive tendencies; but in the more mature countries its triumph is reflected in a radical change in incentives, from the inhuman physiological stimulus of hunger to the socialized motive of aspiration towards a gradual improvement in levels of living.

The story of the worker's adaptation to his occupational environment, on the other hand, has been shorter, although at times no less dramatic. It has comprised not only the adaptation of man to machine (the first thing that comes to mind), but the much more complicated adjustment of the industrial worker to the social and psychological conditions imposed by modern industry in its three special dimensions — space, time and hierarchy. Nowadays, in the more advanced countries, this process of adjustment does not in principle present insuperable difficulties, although conflicts still exist and new problems emerge — that of leisure, for example — discussion of which would be irrelevant here.

Lastly, as regards the participation of labour in the whole social pattern and the awareness of responsibility which derives therefrom, its history may concisely be said to merge with that of labour organization. The worker participates in one way or another, through his own associations, in the economic organization and political destiny of all mature industrial societies.

What is the situation of Latin America in this respect? How can this strategic factor be properly handled within the region? It is perhaps impossible to answer such questions with due accuracy, because certain essential research, the nature of which was defined elsewhere, is generally lacking. But the partial knowledge available, and what might be described as an impressionist picture of the problem, may warrant the following assertions: (a) the economic history of Latin America is itself the best proof that the impulse to work exists in the region, since otherwise it could never have happened; (b) in addition, the formation of that impulse — not yet complete — has followed much the same course as in the various European countries, where it took just as long, and similar difficulties were encountered; (c) it is questionable whether the vestiges of archaism surviving in the region — the least developed indigenous groups — are an absolutely negative factor in the formation of the impulse to work, and there are many grounds for believing that they will make rapid progress when the requisite economic incentives and the equally necessary educational stimuli are provided; (d) there does not seem to be any congenital and essential impediment to the worker's adaptation to technique or his acceptance of the disciplines of industrial organization, obvious though it is that Latin America's most serious problem in this connexion is the deficiency or shortage of skilled labour; (e) on the other hand, it may well be that at present the greatest defect in the field under discussion is the very limited participation of labour in national life, imputable to political influences which have prevented the satisfactory formation of workers' organizations. It is by no means surprising that the trade unions and associations are usually characterized by a much more marked concern for claiming rights than for participation and joint responsibility. In all these aspects action can be taken which will help to speed up development, besides furthering other objectives relating solely to humanity and social justice. How this can be done is the subject of another special paper.

3. Entrepreneurial capacity

The statement that economic development has everywhere been the work of enterprise does not involve any form of determinism, nor does it imply eulogy or defence; still less does it signify unconditional subscription to the Schumpeterian school of thought. Since the word enterprise is ambiguous, the phrase just cited either means scarcely anything at all or simply enunciates a principle of formal cultural sociology. In one sense it is tantamount to saying that economic progress is the result of economic innovation or creation; but in another it indicates the role played in the economic field by a type of human being that in other realms of culture may be represented by the prophet or the great scientist, for example. Here again it is impossible to do more than recall certain essential elements. The first and most important of these, to which allusion has already been made, is the historical significance of the entrepreneur, if this term is understood to mean, without further specification, the man of action and innovator in the economic sphere. Equally well known is the historical evolution of the enterprise, that is, the process of change determining the successive appearance of various types of economic action and of the different underlying ideologies which have provided the necessary justification for each. Lastly, a point which can barely be touched upon here is that in the last few decades a new type of economic agent is beginning to emerge — both in planned economies and in the more mature economies of a mixed character — who for want of a recognized term may for the moment be called a "public manager".

Despite the insistence with which for some years now attention has been drawn to the need for research on Latin American enterprise, there is still a lack of the historical and contemporary monographs that would be needed for any strictly competent discussion of its modes of activity and its ideological and social justifications. But, as in the case of the labour factor, it seems that a short series of statements can at least be formulated here as hypotheses:

(a) In most of the Latin American countries the nineteenth century offers evidence of the existence of efficient and farsighted entrepreneurs, while during the last few decades and in the more advanced countries of the region the presence of thriving complexes of entrepreneurial capacity is undeniable;

(b) Nevertheless, in the majority of these countries commercial enterprise has prevailed over that of a strictly industrial nature, and, above all, the political or conjunctural type of entrepreneur has predominated, thanks to the vicissitudes of power;

(c) In several countries the entrepreneurial type described above as a "public manager" may be said to have made its appearance, though without having taken very definite shape as yet.

To sum up, whatever the angle of approach, it would seem certain that one of the keys to Latin America's economic future lies in the possibility of the timely emergence of an appropriate complex of public and private economic agents, capable of creating the "poles of development" — to use the French terminology — upon which the region's destiny depends. How is this strategic factor to be manipulated? How is enterprise, in the sense of the capacity for innovation and organization, to be stimulated? There are only two possible methods, aptly brought out by a contemporary psychologist, whose theory of the achievement motive need not be discussed here. One is the rigid imposition on the whole society of orientations based on the psychological prerequisites for enterprise, as under the Soviet system; the other is the "professionalization" of economic action, of management, which is now in its initial stages in the Western world. In the second instance, it is incumbent upon the university spirit to achieve the desired objective, with the assistance, of course, of the experience acquired in entrepreneurial circles. This applies both to the private entrepreneur and to the public manager in process of formation.

As regards the latter, however, it is impossible, in the case of the less advanced countries, where the middle classes are so small, to ignore the difficulty of balancing the distribution of their limited human resources so that the flow of energies required in the field of private enterprise is not diverted into public activities.

4. Social mobility

It often happens in essays like the present that some sort of indication of the strategic elements mentioned above — economic attitudes and entrepreneurial and work capacities — is followed by discussion of the so-called social mobility. But it is doubtful whether this element can be placed on the same level as the others, or, in other words, assigned equal significance as a strategic factor. In the last few years mobility studies have been in vogue, and a great deal of research has been conducted and publicized. But an examination of such studies as a whole — setting aside their intrinsic value — reveals the dubious character of repeated assertions as to the relations between economic development and social mobility. It used to be affirmed that social mobility was — as attested by the history of the industrial countries — an indispensable "condition" of economic development; and, consequently, that one of the most efficacious ways of accelerating the latter was to seek some means of speeding up mobility. The studies referred to above, however, suggest a series of doubts with respect to the usual ideas on the subject. In the first place, the suspicion arises that mobility studies of the customary type, like the so-called stratification studies, do no more than describe, by means of the relevant indices, the same phenomenon as is represented by the development already achieved. That is, social mobility and economic development are simply the obverse and reverse of a single reality, a fact which theoretically — not in its empirico-descriptive value — involves a tautological element. Secondly, as Aron has rightly observed, it is doubtful whether the findings of such mobility analyses are in themselves capable of revealing the existence of an independent sociological factor. Inter-generational analyses, the son's move to a position better than his father's — from manual to non-manual work in particular — only reflect the redistribution of manpower as a result of development. Over against this gross mobility, the operative concept of net mobility would have to be obtained in order to discover the existence of factors independent of those of an economic character. Thirdly, there is nowadays a tendency to revert to the idea that social mobility has always existed, in all types of society, and that its conformation has been similar in all of these. Fourthly, doubt has been cast upon the extant belief that there is greater social mobility in the United States than in European countries. And, fifthly, certain research has undermined the conviction that mobility could be influenced with the desired efficacy through the educational system. It must be placed on record, however, that the foregoing results are contradicted by the findings of other research.

The upshot of all this would seem to be that social mobility cannot be thought of as a strategic factor in itself, and deeper probing is needful to find the true dynamic elements. Similarly, from the point of view of economic development, *ex post facto* studies — merely descriptive of what has taken place — are of less interest than projections of the new functions, occupations and social roles which must be contemplated, given certain economic targets.

Nevertheless, despite these reserves, the educational system is still of instrumental value as a means of promoting increased mobility. For it is education, in the last analysis, that sets the level of aspiration and forms the capacities required for moving up in the social scale; and these are two unquestionably dynamic elements.

The frequency with which attention has been drawn in this section of the present study to the value of education — in its various forms — as an indispensable instrument for exerting influence on the various social factors which play a strategic part in development, confirms how vitally important it is for Latin America, and for all countries at whatever stage of development, to grapple energetically with the problem of the new responsibilities of education in industrial societies.

V. THE BASIC EXTERNAL ELEMENT IN THE ECONOMIC MODEL

None of these possible methods of conditioning the social factors of strategic significance in the economic development process can be successfully adopted without a clearly-defined expansion programme as a basis. Needless to say, such a programme and such measures call for the presence of a specific agent; or, in other words, there is obviously no point in attempting to identify the social elements of a dynamic character on which it is desirable or necessary to bring action to bear, unless at the same time consideration is given to the problem of how and by whom that action is to be taken.

In the face of these questions, there is no evading another which is in itself of basic importance, and which relates to the nature of the political power that is the necessary vehicle of all the above-mentioned activities. Consequently, in the "ideal type" of development which the historical conjuncture assigns to the Latin American countries, it is impossible to omit the decisive role of State action and the political processes by which it is constituted. Whether the model concerned is strictly economic or is of a broader character, incorporating this or that component of the social pattern, its external support, the conditions which will permit its materialization, are to be found in the structure of political power and the nature of its relations with economic organization. Consequently, emphasis on the role of the State in the work of economic development in Latin America is neither the expression of a temperamental bias, nor academic verbiage, nor a fleeting symptom of ideological contagion.

1. Economic and political rationality

At the theoretical level — which is not only admissible but seems inevitable in a study of this type — the starting-point of every train of thought takes the inevitably abstract form of the relations between economic rationality and political rationality; that is, how and in what measure political and economic systems are necessary to each other or mutually incompatible by virtue of the nature and degree of their rationality. This approach involves two possibly debatable premises: (a) that economic activity always embodies a maximum of rationality; and (b) that in any event political activity is capable of approximating to the degree of rationality demanded by the economy.

These assumptions seem less problematic if two things are borne in mind. Firstly, in historical reality it is idle to look for pure systems; all that can be found are specific régimes, full of imperfections, strained by the pressure of contradictory trends, and representing the ideal design of a system only to a more or less limited extent. Secondly, parallelism between political and economic systems does not imply a permanent and constant equivalence between their elements, such as will at any given moment justify the assertion that to a specific political mode another specific economic mode necessarily "corresponds". Rather is it a matter of "elective affinities", as was previously insinuated in Weber's phrase. These affinities or kinships are compatible with the most striking experiences of recent years, which confirm the plastic character of political and social structures and the fact that one and the same system may vary considerably according to time and place.

Once these reservations have been disposed of, it is time to return to the point of departure. Thus, pursuant to the relation as originally postulated, it may be possible to formulate certain hypotheses which are confirmed, as it is thought, by the evolution of history itself. In this context, it may be at least plausibly stated that what corresponded in the sphere of politics to the moment of the liberal economy, characterized by the prevalence of formal rationality, was the predominance of the typical "representative democracy", which in many parts of the world was able to function efficaciously and without setbacks throughout the nineteenth century. During this phase the economy was left to the spontaneous action of its own forces, the maintenance of the formal mechanisms it required, and particularly of the juridical and administrative pattern upon which the security and predictability of its operation depended, constituting the only field in which the State intervened. It would be out of place here to go into details which in any case are well known, but some allusion to what parliament then represented in the political process of that type of State is indispensable. Its strictly representative character, its nature as a forum for national "discussion" and as the supreme organ of defence of the juridico-political safeguards afforded by the constitution, corresponded to a society in which individual action predominated in every walk of life, and first and foremost in its economic aspects. It has rightly been remarked in this connexion that social structure and the structure of the market came to be one and the same thing. The two kinds of rationality could therefore be linked up in a relatively simple fashion, namely, by the subordination of political reason to economic reason, which was governed solely by the mechanism of its formal principles.

But with the beginning of the new century signs of the radical change which had taken place in all these conditions began to appear. In the more advanced industrial countries the State abandoned its traditional position of neutrality and began to intervene in economic and social life, impelled by three fundamental needs: (a) that of tackling the problems presented by the international conjuncture which daily became more serious and complicated; (b) that of taking into account the changes in the internal structure of the various economies; and (c) that of implementing a social policy, within a society whose traditional structure had also undergone modification. This is not of course the place to follow up each of these trends in detail, but it does seem appropriate to review some of their most characteristic manifestations. On the economic side, there was the emergence of the various forms of market based on imperfect competition, whose mainstay was the large-scale organization that was superseding the small individual enterprise. On the social side, there was the formation of powerful groups of interests — the workers' organizations to begin with — which were in conflict with one another. And on the political side, there was the increased importance of the executive in face of a substantial internal change in parliamentary life. Obviously, it is not easy to sum up the whole of this metamorphosis in a single phrase. For some it represents the transition from liberal-representative democracy to the radical-equalitarian democracy of the party State. For others it is the history of the formation of the modern welfare State. It is also reflected in the formula of the so-called pluralist democracy, which is perhaps the most expressive in relation to the sociological perspective of the present study, since social structure in the more advanced industrial countries is in fact a complex of groups and "organizations" which cover almost the whole field of human activities. In a society of this type the State necessarily assumes the role of arbiter between the conflicting interests, and endeavours to strike a balance between their several claims. Thus, the political counterpart of the mixed phase of the economy is the group or pluralist democracy, so that the relation between the two forms of rationality — political and economic — must be the result of persevering effort to devise a temporary compromise in every case. In this context rationality assumes a "functional" rather than a formal character.

To depart for a moment from the consideration of Western tradition, totalitarian planning presents a new and naturally a very different mode of effecting the connexion between political and economic rationality, which has unquestionably operated with success. It is a paradox of history that the system which proclaims as its doctrinal premise the decisive supremacy of the economic factor as the prime mover of change, in practice stands for the paramount importance of the political factor; thus, just as in the representative liberal economy the pre-eminence of formal rationality in the realm of economics was a guarantee of its concurrent exercise in the political field, conversely, in strictly totalitarian systems it is the predominance of rationality in politics that safeguards the possibilities of its achievement in the economic sphere.

The sole aim of the foregoing concise summary has been to lead up to the conclusion that optimum or maximum levels in the necessary correlation of political and economic rationality have been attained, in the course of history, only in one or other of the ways indicated above. Once the materialization of the liberal economy in its pure form is recognized to be unlikely in present circumstances, if not impossible, at the theoretical level only two systems nowadays permit an approximation to equilibrium between political and economic rationality — namely, either the pluralist democracy of the totalitarian State.

A similar conclusion can also be reached from the opposite direction, by way of the identification of those forms of political activity which make the necessary parallelism between the two kinds of rationality difficult or impossible, or, in other words, which are irrational from the standpoint of economic development. These are, on the one hand, traditional authoritarianism and, on the other, "popular dictatorships" or "democratic Caesarism" (the terminology is loosely used), which are characterized by the absence of strictly rationalized ideologies and political machinery.

The typical attitude of traditional authoritarianism seems to be neglect of development problems, or, at best, the imposition of some kind of restraint on development when its socio-political consequences jeopardize the duration of the authoritarian régime. Where "democratic Caesarism" prevails, interest in economic development may be and usually is displayed, but it is generally reflected in irrational spurts of activity. As such systems lack the rigid discipline existing in totalitarian régimes, they are exposed to the risk not only of ideological confusion but also of constant disruption of their administrative machinery. Where political trends of this type appear, economic development is deprived of continuity, and at best its achievement is attended by sharp and erratic fluctuations.

What has so far been expounded in unduly abstract and consequently not very attractive terms might perhaps be formulated in more graphic and expressive language; but a search for precedents in the politico-scientific literature of our time might prove disappointing, as few of the most recent examples will suffice to suggest. A group of students of political systems in the less developed countries — mainly those of Asia and Africa — proposes the following three basic models: the mobilization system, the consociational system and the system of modernizing autocracy. These are difficult terms enough; and no less complicated a problem of expression confronts another team which is attempting to apply the categories of the sociological theory of social action to the analysis of political processes, and use them for the study of the situation of new and old countries in process of development. The discussion of the advantages and drawbacks of all this terminological innovation must be left, however, for a more opportune occasion.

Nevertheless, whatever the terminology employed — newly coined or traditional — the gist of the problem is always the same: to achieve the necessary cohesion between economic activity and the political process. It is not possible to desire — still less to attain — incompatible objectives, or to use instruments unfitted to the ends proposed. Always the same, too, are the scope and limitations of scientific analysis placed at the service of practical action; it can show the compatibility of the targets chosen, the suitability of the means selected for their attainment and the predictable repercussions of the objectives pursued, in so far as for one reason or another they might prove to be adverse or negative.

As regards economic development, the essence of all these considerations is to be found in the statement, none the less true for being trite, that in present circumstances it cannot be achieved without a clearly-formulated programme functioning within an appropriate political framework. The greatest differences among the Latin American countries are not to be found so much in the economic field as in their social infrastructure and in the political processes which this permits. It may be contended, however, that the more advanced of them are already in a position to make their economic expansion feasible within a "pluralist democracy", although not in exactly the same way as the more advanced countries of Europe or North America. Thanks to the influence of their common background of Western tradition, the shape of the "welfare State" is discernible in their political patterns too, but here it is important to lay strong emphasis upon the differences between the welfare state in the mature and in the less developed industrial countries, to which Myrdal has rightly called attention. In the former the functions of State intervention are principally arbitration and equalization; in the latter they must be, first and foremost, orientation and programming.

2. Political effects of development

The present topic would not be fully covered if another question of interest — that is, the political effects of economic development — were not touched upon, although as hurriedly as its predecessors. The problems of stagnation and poverty are too obvious to require discussion here.

At the present time, application of the techniques of what is known as electoral sociology has enabled a few research workers to trace correlations between the degree of economic maturity and the degree of politicial maturity, within Western traditions and ideals, be it understood. Such correlations seem to show that, in the more advanced countries, democracy functions with "relative" stability by virtue of the elimination, or rather the moderation, of political fanaticism. Thus, the correlations in question are sometimes ingenuous to a fault, and may be the object of severe criticism, but in the long run it is undeniable that they correctly reflect visible results of the historical process. These results have certainly not been achieved overnight, and are the sequel to an arduous tale of struggle and conflict; but the fact remains that today, in economically more advanced economies, the changes in social structure deriving from their increased wealth have eased — not eliminated — the most serious social tensions, and that consequently politics can be reduced to joining issue on restricted and objective questions (particularly in the economic field), on which more often than not a provisional compromise can be reached. In economies which are less wealthy and are in process of development, however, it seems almost impossible to prevent the emergence, as a result of that development itself — and especially during phases when its pace is accelerated — of maladjustments in the social structure which are favourable to the creation of such mass situations as may lead to some type of political fanaticism. Situations of this kind derive from one or other of the following causes. Firstly, they may result from the sudden uprooting of a large number of people — mainly of rural origin — who are involved in an industrial and an urban growth (the two do not necessarily coincide) too rapid to allow them to adapt themselves easily to the new conditions. Secondly, they may arise out of inequalities between various sectors of national life, serious disequilibria between advanced and less developed areas, or other similar phenomena within the various industries. And thirdly, they may spring from a process typical of wealthy countries — the rapid rise into "consumer society" of large population groups lacking the necessary "moral reserves" to make them moderate in their pleasures and desires.

VI. THE ORIGINS AND PARADOXES OF LATIN AMERICAN HISTORY

From the foregoing pages the basic elements for the construction of a model of Latin American development have gradually emerged. The image which takes shape is that of a task which of course is not and cannot be easy, since it calls for parallel effort in the economic and social fields, subject in both cases to one and the same clearly-formulated programme, and moreover, requires that an attempt be made to maintain a balanced relationship between State authority and social spontaneity. But it is the task that is imposed by the confluence of Latin America's whole history and the world conjuncture of our time.

Every sociological consideration culminates in — if it does not precede — the study of the universal complex from the focal point of an individual history, and upon this depends, in the last issue, the significance of any given analysis, however intrinsically important it may seem. But it would be unwise to tackle such a subject here, and all that seems advisable is to sketch a few rapid notes relating to the interpretation of history, which may serve to impart some overall significance to all that has been said hitherto.

The socio-economic history of Latin America still remains to be traced in complete and satisfactory fashion. And the reasons for this, moreover, are well known. One is the fact that this branch of history is slow to awaken interest as compared with the traditional study of the purely political aspects of the subject. The second is that it acquires a fragmentary character in the history of the various individual countries, which breaks up the overall picture of the great movements that were similar throughout the region. But unless this background of common history is kept well in mind, a thorough understanding of development problems at the present time is equally impossible for those intimately concerned and for outsiders.

The basic fact which is forgotten or disregarded by both these groups — not always to a greater extent by the latter than by the former — is that Latin America, if it is to be given that name, is in its own right a fragment of the civilization and of the physical entity of the Occident, although, without foregoing this kinship, it has retained more or less up to the present time the same somewhat marginal features in relation to the older metropolitan countries. The distinctive marks of this special characteristic are not of interest here; but where a good deal of stress must be laid is on the fact that *vis-à-vis* those older countries the cultural and political history of Latin America is outstanding for two features belonging essentially to the complex from which it springs: (a) for having been a "new land", so that its life has been that of a "colonial culture"; and (b) for having forged its independence under the banner of the purest and loftiest liberalism.

It is hard to say which of these distinctive marks has exercised the more decisive influence on the region's subsequent history, and they are too complex both in themselves and in their effects for a study of them to be attempted here. But the second is of singular interest, since it is the source of the first great basic paradox of Latin American history. For many decades this liberal mentality persisted in patent contradiction to the real social structure — agrarian in type — inherited from the days of the Viceroys. From the contemporary standpoint, the survival of these liberal aspirations, still intact, imparts an almost anecdotal quality to the unhappy reality of dictatorships and military coups.

It is because the history of the nineteenth century has mainly been envisaged as a vague whole and viewed from the more depressing angles that the colossal effort made by most countries in its second half is buried in such unjust oblivion. At the present time, the widespread predominance of the idea of under-development, which tends to relegate to the same category all the countries composing the so-called "third world", has produced — to use the picturesque popular formula derived from the demonstration effect of science — a shyness and inferiority complex whose importance transcends that of an academic subject in cultural sociology. On the one hand, it blinds judgment to the proper worth of the considerable effort made in all fields during the last fifty years. On the other, it has an unnecessarily damping effect on the spirits of the new generations, whose business it is to bring to fruition, in different circumstances, the seed mainly sown by their predecessors.

Two things above all are lost sight of in this unfair appraisal of the immediate past. In the first place, it is generally forgotten that in most countries there were members of the ruling minorities who in their own time did achieve a sound political and economic vision of the existing reality, and who were able to create in unfavourable conditions, and against all odds, the "economic infrastructure" of which the benefits are reaped today, and on the basis of which the necessary fresh start can be made on more advantageous terms. The fact that, broadly speaking, these ruling minorities lacked the feeling for a well-timed exit to leave the stage clear for new actors, and thereby justified the subsequent attack on their "oligarchic domination", ought not to preclude acknowledgement of their economic achievements and their sometimes undeniable political capacity.

Neither, in the second place, is the proper importance attached to the radical social transformation which took place during the years under discussion, or to the appearance, in the most important group of Latin American countries, of new social strata with a strong upward impetus, which — with the inevitable differences between them — range from the middle classes to the organized proletariat, and which in some cases are only awaiting the necessary political framework for their complete incorporation into national life. Apart from this, it is a commonplace — correct in the present instance — that all the difficulties of the last few years have been no more than an expression of the conflict of these new strata with the established "oligarchies".

The second great paradox of Latin American history — unquestionably a corollary to the one just described — is that the historical and international conjuncture is nowadays the greatest obstacle to the complete materialization of that "liberal structure" which was the goal of the region's most tenacious aspiration throughout the past century. Given the continuance of its life in a historical void, with plenty of time ahead, Latin America could "now" bring to maturity the liberal society of the old type. But in the age of "collectivity", and in face of the need for rapid adaptation entailed by the speed of world processes, the old textbook prescriptions sound like ineffective patter. The challenge offered by existing circumstances to Latin America's creative capacity — to keep alive and efficiently incorporate the impulse of its "outworn" liberal traditions in the age of organization — is somewhat formidable, but in the last analysis is matched by the region's own history.

The third great paradox in the history of Latin America is its pressing need to achieve integrations at the supranational level when the national integration of many of its countries is only just beginning to be completed and perfected.

In reality, the history of the disunited States of America likewise remains to be written from this point of view. From the Independence onwards, and against the homogeneous background of the complex from which Latin America developed — that is, of its essential features — each and all of the countries of the region have had to effect their national integration by means of exceptionally slow processes, whose final episodes (sometimes revolutionary and sometimes paradoxical) are belatedly taking place in our own century. And there can be no doubt as to the existence of marked disequilibria between the countries in question. There is no need to go into details. What matters is to point out how it is in this same century, when the integration of the individual countries has only just taken shape, that, in response to the demands of the world situation, economics and technology are opening up the way to a new integration of a different and supranatural type, well within the limits set by the region's common historical inheritance and the undying ideals of Bolivar. The approach to the supranatural integration of virtually new-born nations and its initiation in our time have already been exemplified in the work in progress in Central America, and in a number of countries' acceptance of the immediate common market targets, a first manifestation of which is the recent creation of the Free-Trade Area through the Montevideo Treaty.

The pattern constituted by these few essential general features of the history of Latin America, while giving their ultimate global significance to all the partial aspects of the work of economic development — so cursorily glanced at here — cannot be manipulated to any practical effect unless at the same time the whole range of differences is borne in mind. For this purpose a prerequisite is a carefully-prepared typology of the socio-economic reality of the various Latin American countries, which will presumably have to be revised from time to time in accordance with changes in the relevant indices.

ECONOMIC POLICY AND THE PRICE SYSTEM

by *Thomas Balogh**
Fellow, Balliol College, Oxford

1. THE IDEAL

1. Much of the current discussion of economic policy in Latin America, and even more of particular measures or institutional arrangements such as the proposed Latin American common market or Latin American payments union, is couched in terms which suggest that the main, if not the sole, vital problem of these countries is the restoration of the "free" play of the price mechanism and the elimination of inflation. Thus economic restoration is viewed exclusively as aiming at the removal of artificial interferences with the working of the price mechanism.[1] There seems to be no recognition that an acceleration of growth and optimal progress might, in the circumstances confronting these countries, demand positive, systematic and discriminatory policies.

2. It is clear that the underlying and implicit hypothesis is that most, if not all, of the distortions in the economic system, at any rate in Latin America, are the *result* and not the *cause* of inflation. The inference is that, with the elimination of inflation these distortions would also disappear, or any rate that there will be such a net reduction of distortion that it would enable, indeed, an optimal increase in the rate of growth. The implicit character of the hypothesis dispenses with the need to demonstrate whether the rather stringent conditions, in which this view might be valid, do in fact exist in the circumstances to which it is being applied.

3. Thus the question is left altogether unanswered whether the relative price system, once inflation is eliminated, can be expected to revert to something corresponding to the ideal pattern on the basis of which that would be, so it is claimed, an optimal allocation of resources and, therefore, also an optimal rate of growth. Nor is it clear whether measures of monetary stabilization are themselves thought to have any impact on relative prices, other than restoring their "natural" level.

Hence it would seem useful to recall the assumptions on the basis of which such claims were originally put forward, assumptions which are apparently forgotten when the conclusions are applied to current economic issues:

(*a*) Firstly, there must be full employment — or at any rate a speedy and automatic elimination of unemployment and underemployment. Unemployment and underemployment vitiate the working of the price mechanism. Short-term private money costs will no longer be proportionate to long-run social costs, and thus a necessary condition of optimal resource allocation through "free" market forces will not be fulfilled. The social cost of employing labour will fall below its wage.

(*b*) In the second place — and this seems to have been altogether disregarded in the recent discussions — the distribution of income must be desirable or at least politically tolerable. Alternatively, taxation measures which would correct the income distribution brought about by the "free" play of the market must not interfere with the efficiency of factor allocation. Otherwise alternative policies, even though these interfere with the "free" play of the market, e.g. direct quantitative regulations, might nevertheless produce an economically more efficient solution.

(*c*) In the third place, consumers' tastes must be independently determined, i.e. must not be influenced by the policies chosen. If, for example, a liberalization measure leads to a significant change in demand patterns, there is no way of ascertaining whether the net welfare effect of the measure, even if it were to increase national net income estimated conventionally on the basis of the prices prevailing at some point of time would be favourable or not.

(*d*) Both product markets and factor markets must be perfectly competitive. Factor remuneration must, in particular, be equalized on the basis of its marginal production. If monopoly or oligopoly permeates the economy, it must not vary in severity; otherwise the less monopolistic products and factors would be relatively too cheap.[2] In addition, the taxation measures which would have to be taken to correct the maldistribution of income due to monopoly must not interfere with the allocative efficiency of the system more than direct controls would.

(*e*) The capital market, in particular, must function in accordance with the assumptions of the model, i.e. allocating capital at negligible cost among projects according to their relative profitability (see paragraph (*c*) above). Projects must be of a marginal, small nature not affecting the structure of the economy substantially; and there must be a significant response, both of savings and investment, to changes in the rate of interest.

(*f*) There must be no considerable divergence between, on the one hand, private money costs and returns and, on the other, social real costs and returns. In particular, investment projects must be marginal (not "lumpy") and should not significantly affect the returns of other investment projects (external economies). Cumulative

* The views expressed in this article are those of the author and may not coincide with those of the secretariat of the Economic Commission for Latin America.

[1] See the memorandum on payments systems submitted by the International Monetary Fund to the Meeting of Governmental Representatives of Central Banks, held at Montevideo, which is reproduced in the *Revista de Ciências Econômicas*, No. 2, São Paulo, June 1960.

[2] R. F. Kahn, "Some Notes on Ideal Output", *Economic Journal*, March 1935, pp. 1-35.

movements — favourable or unfavourable — diverging from the original position must also be ruled out.

4. A further complication arises with the introduction of international economic relations into the simple model, on which the monetary diagnosis of the "distortions" and "inefficiency" of the economic system is based. In an open economy with foreign trade relations, the rules of the "free" market would apply only if the terms of trade were independent of the policy pursued. But most countries in Latin America are specialized exporters, the demand for whose produce is not infinitely elastic. Thus, as will be seen, any liberalization of imports would, in fact, tend to result in a worsening of the terms of trade and therefore a fall in real income. Since Latin America is relatively poor, such "monopolistic doctoring of the terms of trade" as would be implied by a restriction of imports can hardly be rejected on welfare grounds.[3]

5. In other words, the efficient operation of the price mechanism is dependent on the full social (income-distribution) and, from the point of view of the market, economic integration of the economy. In this article an attempt will be made to show that these conditions for the successful working of a market economy are not fulfilled in the economic framework of countries at the stage of development reached in Latin America. Factor and produce markets are both fragmented, and there is not even a tendency towards equalization of factor remuneration. In addition, given the great difference in the degree of imperfections, the monetary measures enforcing stability might, because they can only operate through the creation of increased unemployment, further undermine the validity of the assumptions on which they are based. More will be said about this in subsequent sections.

6. Moreover, monetary measures ought not to distort relative prices and thus factor allocation: the maintenance of complete integration needed for the assumed optimal functioning of the price system is compatible only with measures which are neutral in this respect, i.e. those which have a diffused, general way of operation and do not impinge with different severity on different sectors of the system. This is generally accepted by the critics of direct controls who base their attacks on direct regulation on the fact that they have severe directional or sectoral effects and thus disrupt the harmony of the system. It is not so generally realized that monetary measures, unless they act on marginal demand for capital through a rise in the cost of borrowing, might equally have such strong directional effects. They will impinge on construction and possibly the consumption of durable goods. They will act by rationing borrowers rather than by discouraging borrowing: the impact of interest as a cost element has become extremely weak as a result of the need for speedy depreciation and of modern direct taxation. Thus, restrictive monetary measures might also cause new distortions, even in a well-integrated system, rather than remedy distortions caused by previous monetary unbalance. It is at least unlikely that the directional effects would just happen to coincide with and offset the existing disequilibria.

7. Monetary policy will impinge on projects which are vulnerable to the pressure it generates. Apart from the creation of unemployment, certain prices and incomes will come under specially severe pressure, and the sectoral differences will be further accentuated in a way that harms the most vulnerable parts of the economy. Within these sectors, the restriction will be most effective against those least able to defend themselves by monopolistic practices. In an under-developed area, where there is strong monopoly market power, this means that the sector of labour least able to protect itself, i.e. unskilled workers, will be most affected. The general upward pressure on wage and prices in the rest of the economy need not be — and historically was not — affected sufficiently to stop upward pressures immediately. The fragmentation of the economy, combined with the tenor of monetary policy, results in stability having to be purchased at the cost of significant unemployment, because the degree of employment and investment compatible with stability in the most monopolistically protected sector will *ipso facto* mean much more severe pressure and unemployment elsewhere. These phenomena, which are apparent even in the United States and United Kingdom, assume much greater importance in less developed areas with a social and economic structure akin to those of the Latin American countries. Under these particular circumstances, monetary restriction, instead of restoring a perfect price system, is likely to increase the degree of monopoly and sectoral unbalance. This problem will be examined in detail in the penultimate section of this article.

8. It should not be concluded that policies involving direct Government intervention and control exercised in a milieu of limited administrative capacity, under intense and conflicting pressures from political power-groups, might not seriously aggravate economic unbalance. If such measures are intended to check incipient inflationary pressure and are applied without sufficient vigour or scope, it is only too likely that new disequilibria and bottlenecks will be created, hampering a policy of balanced development and stability. This does mean, however, that monolithic explanations of the problems of underdeveloped areas, especially of a demand-inflationary character, and a therapy based on them must be severely scrutinized as being *a priori* suspect of illicit simplification and exaggeration. Relations between economic factors are seldom reversible or symmetrical.

[3] Even though the alternative, an equivalent free grant from the fully developed countries, if available, might be preferable.

II. THE REALITY

1. Industrialized countries

9. It should be noted that views similar to those mentioned at the beginning of this paper were freely expressed both in the United States and in the United Kingdom immediately after the war, when war-time controls were felt to be increasingly irksome and inefficient. Inflationary pressure was regarded as primarily responsible for creating bottlenecks and distortions which, in their turn, would slow down economic progress. It was hoped that the return to the "free" play of the price system, and especially recourse to monetary policy as the main or sole control, would accelerate growth by restoring efficiency in factor allocation.[4] Given the highly integrated

[4] This tendency reached its European zenith perhaps in the

nature of the social and economic structure of both the United States and the United Kingdom, this diagnosis might well have seemed plausible.

10. In the period following 1952, these views were borne out in practice. Such controls as still remained in being in the United States were abolished, and the emphasis in managing the economy was also shifted from fiscal measures to monetary policy. In the monetary field, the doctrine of "bills only"[5] further restricted the authorities' freedom of movement. In the United Kingdom the development was similar.

11. Sufficient experience has since been gained to formulate conclusions, which are more than tentative, regarding these original claims. It is fortunate that, in the report of the Radcliffe Committee[6] and in the Staff Report of the Joint Economic Committee of the United States Congress,[7] the mature reflections of people who, especially in the case of the Radcliffe Committee, were initially at least sympathethic to the claims of the so-called monetary school are set forth.

12. The verdict in both countries has been unanimously unfavourable to these contentions. Monetary policy was discovered to have no less directional effects than other, more direct measures. Even in the integrated and fully industrialized countries, the return to monetary controls has slowed down growth, increased the average level of unemployment, and resulted in further structural unbalance due to the uneven incidence of these controls. This was the outcome of the repeated discouragement of investment caused by money. On the other hand, these controls were unable to stop the rise in prices, which during a large part of this period could not be explained by an excess of demand pressure or by an insufficient supply. Both reports conclude that only a coherent complex of policies, with due regard to sectoral unbalance, could enable the market system to work efficiently. In particular, the exercise of the market power of large-scale industry and the wage demands of trade unions would somehow have to be made compatible with stability, if the economy were to maintain steady expansion without an inflationary rise in prices. Fiscal policy would have to be assigned a more powerful role than of late in solving the problem of maintaining short-run stability; and, in the longer run, budget surpluses would be needed to make resources available for increased investment. The importance for stability of an accelerated increase in productivity, in modern conditions, has at least been fully accepted.

2. Under-developed areas

13. In brief, there is growing scepticism about the effectiveness of the combination of a mere negative decontrol and of restrictive monetary policy to restore the efficient allocation of resources. But this scepticism does not as yet seem to have made much of an impression in authoritative circles in Latin America. Just as the turn towards decontrol, non-discrimination and a unified, free foreign exchange régime was subject to a certain delay, disillusion with these measures seems also to lag behind.

14. Even in highly developed communities, socially and economically integrated sectoral problems tend to defeat what might not unfairly be called the "negative liberalizing approach", as a means of restoring the efficient working of the economic system through the "free" price mechanism. In under-developed countries, the failure of this approach is immensely aggravated by the inherent defects of that mechanism.

15. These defects are due, in the first place, to large-scale unemployment, especially in agriculture. In the second place, they are the consequence of the deep-rooted lack of integration between the various important sectors of the economic structure, parts of which are only imperfectly linked with the market — or money — economy. Within each of the sectors of the economy, there are faults no less deep in the markets both for productive factors and for products. All this is aggravated by extreme differences in monopolistic market power, and perhaps also in the capacity for exerting political pressure. Thus there is neither mobility nor even a semblance of unified markets.

16. Consequently short-run money costs and prices fail to express long-run relative social opportunity costs, even more than they fail to do this in better integrated and more perfectly competitive economies (i.e., leaving aside the problem of external economies which are not taken into account in either system). As this failure is more far-reaching in certain sectors than in others, the present short-cut recommendation to restore the "free" play of *existing* market forces would not promote or even permit an efficient allocation of scarce resources. It might well perpetuate and further aggravate their present inappropriate use. In particular, since the problem of unbalance between agriculture and industry is grave, it would leave labour in what is, taking the long-run social view of classical comparative costs, an inferior employment.

17. It should be noted that, in the case of economies at an early stage of their development, the failure of current money prices to reflect the immense potentiality of external economies both of production and of consumption is far more detrimental to welfare than in richer countries.[8] The "lumpy" character of investment makes itself much more felt at a low absolute level of accumulated capital, and the reduction of costs with the increase in the scope of markets might be of a dramatic nature in poor countries.

18. Hence, attempts to single out some factor, mostly the monetary one, for a monolithic global explanation of the failure of greater progress seem entirely unjustified. If we are looking for the reasons why, in some cases, accelerated development has not been achieved, why it has not been, in others, compatible with monetary stability, we must investigate the sectoral structure of the economy and the precise relations of these sectors to one another from the point of view of allocative and accumulative efficiency. In this way the historical uniqueness of each case can be recognized, while some restricted general features of the

first report of the Cohen Council (Council on Prices, Productivity and Incomes) and the Report of the Experts Committee appointed by the Council of OEEC (OEEC, Information Division, A(52), Paris, 18 June 1952). In the United States, the various declarations of M. Martin, Chairman of the Board of Governors of the Federal Reserve System, can be regarded as the most confident statement of this case. (See his testimony to the Joint Economic Committee of Congress in 1959.)

[5] I.e. the refusal of the Federal Reserve System to operate in the long-term market.

[6] *Report of the Committee on the working of the monetary system*, London, 1959.

[7] *Staff Report on Employment, Growth and Price Levels*, Washington, December 1959.

[8] Mr. Streeten and I have adduced reasons why external economies are of much greater importance even in rich systems than is usually assumed. (See "Foreign or domestic investment", *Bulletin of the Institute of Statistics*, Oxford, 1960.)

mechanism of instability can be established. The precise nature of this mechanism in fully developed countries will obviously differ from that in under-developed areas, even though some common factors might be discovered. The same monetary and fiscal policy gives very different results in countries with different basic structures (e.g., even as between the United States or the United Kingdom and the Federal Republic of Germany, and far more so as between one of them and either Argentina or Chile). From this analysis, one might hope to gain some insight into the conditions needed to ensure accelerated growth while maintaining stability. Short-cut recommendations are not likely to succeed.

19. Special features of Latin America include its rapid population growth, its dependence on exports, in the main rather unfavourably placed, its singular social structures and its distorted productive patterns (to some extent the result of these factors and also of the direct foreign investments which were made in the pre-1929 era, and of the relative failure of many exports after 1929). These features will obviously influence, if not determine, the character of the problem of how to make the price mechanism work in such a way as to achieve optimal growth. This article will try to demonstrate that this cannot be expected to result automatically from monetary disinflation combined with fiscal retrenchment.

3. The defective integration of the economy

20. Professor Williams, in his celebrated article,[9] pointed to the imperfect domestic mobility of labour as a serious limitation on the applicability of the classical analysis, since this analysis assumed perfect domestic equalization of factor incomes through mobility, in contrast to absolute immobility of productive factors assumed in international economic relations. Imperfection in labour mobility exists in a more severe and dangerous form in under-developed countries.

21. The theoretical problems arising out of the harsh division of poor countries into, on the one hand, an utterly miserable subsistance sector, raked by unemployment and underemployment, and on the other, a market economy, formed by towns, plantations and mines, have been fully treated and need not be analysed here in detail. What concerns this article is the faulty allocation of resources due to the bias against industrial employment in the "free" price system,[10] which can only be offset by protecting domestic industry. It is only one of the rigidities in factor markets, even if it is a notable one. While in some countries, where agriculture still absorbs over 60 per cent of the population or even as much as 85 per cent (especially in Asia and possibly northern Latin America), this is the vital flaw in the price system. In some countries of southern Latin America, while important, this is not the most disturbing defect.

22. As a rough approximation the economy of most under-developed areas, especially in Latin America, might be conceived as being divided into four parts:

(*a*) *The fully developed, mostly foreign-owned, sector* mainly producing minerals or agricultural produce for export and often with an extremely high output per head, relying for capital and technical knowledge on foreign markets and resources;

(*b*) *Traditional agriculture,* not seldom monoculture, producing cash crops for markets rather than representing a self-sustained subsistence economy, of low output per head and usually showing extreme inequality in the distribution of land ownership;

(*c*) *Domestic industry,* under heavy protection against foreign competition and sometimes in a consciously created position of monopoly, confronted with a fragmented labour market in which the skilled workers in a number of trades form strong unions, while unskilled workers partly drawn from agriculture are virtually unprotected, except by laws which are often not effectively enforced;

(*d*) *Services,* especially distribution, banking and finance, again in a closely-knit structure of monopoly or oligopoly. Transport and public utilities are often State enterprises working at heavy losses and, if privately owned, at times controlled with prices at a lower level than the general level of profits would seem to justify. Thus these sectors tend to become bottlenecks, at times severe.

23. This fractioning of the economic structure produces two equally unfavourable results. It leads, in the first place, to an unsuitable, considerably suboptimal, allocation of factors; and, in the second place, it renders the system inelastic, and incapable of responding to economic stimuli considered "normal" in more highly developed countries.

(a) *Unsuitable allocation and factor prices*

24. (*i*) *The problem of agricultural labour.* The real consumption of individual members of a peasant family is determined by the earnings of the family as a whole. It is, even in Latin America with its relatively rich endowment of land relative to labour, likely to be higher than the productivity of the marginal member of the family which approaches zero and might possibly be negative. In contrast, urban wages are high because of the much higher cost of urban existence and partly because of trade-union pressure. Thus the expansion of the industry is impeded by its higher money costs, even though from a national point of view a faster absorption of agricultural labour would raise productivity. There is a fatal discontinuity in the structure of costs between agriculture and small handicrafts, on the one hand, and large-scale enterprise, on the other. Even in countries like Japan with a large and energetic entrepreneurial *élite* this is a severe handicap to expansion. Its paralysing effect in some countries of Latin America is increased by the absence of an industrial leadership which could begin to bridge it. The mercantile tradition of the urban areas and the large monopoly profits which can be obtained from trading constitute further obstacles to industrial expansion.[11] Employment in various industries, especially trade, is far higher in Latin America than would be justified by the average national productivity. In Argentina, Chile, Venezuela and Cuba, it was between three quarters and nine tenths of the United States ratio (see table 1). The consequences of this are discussed below.

25. In those countries of Latin America in which industrial development started as a result of the two world wars,

---

[9] *Economic Journal,* 1928.

[10] This problem is examined in T. Balogh, "Welfare and Freer Trade", *Economic Journal,* 1951. In Latin America, especially in Brazil, Chile and Argentina, this initial bias of the "free" system has been offset — and in some cases much more than offset — by protection and the promotion of monopoly in industry. In the plantation economies, still based on the export of products of the traditional agricultural sector, this problem persists.

[11] The rise of large-scale foreign enterprises encouraged the emergence of this mercantile stratum by enabling the governing *élite* to buy foreign luxuries without an organic development of the domestic productive power.

Table 1

LATIN AMERICA: EMPLOYMENT BY MAJOR DIVISION OF ECONOMIC ACTIVITY, 1957[a]

Country	Primary	Secondary	Tertiary
United States			
Thousands of persons .	7 031	19 590	31 263[b]
Percentage	12.0	33.7	54.3[b]
Argentina			
Thousands of persons .	1 784	2 036	3 891
Percentage	23.1	26.4	50.5
Brazil			
Thousands of persons .	11 145	3 678	4 366
Percentage	58.1	19.2	22.7
Chile			
Thousands of persons .	875	618	1 064
Percentage	34.2	24.2	41.6
Mexico			
Thousands of persons .	5 712	1 533	2 903
Percentage	56.1	15.3	28.6
Venezuela			
Thousands of persons .	831	426	952
Percentage	37.6	19.3	43.1
Cuba			
Thousands of persons .	870	496	925
Percentage	38.0	21.7	40.3
Colombia			
Thousands of persons .	2 299	838	1 160
Percentage	35.5	19.5	27.0
Peru			
Thousands of persons .	1 976	577	759
Percentage	59.7	17.4	22.9

SOURCES: Latin American countries: ECLA, on the basis of official statistics. United States: ILO, *Yearbook of Labour Statistics*, 1959.

[a] Excluding the armed services. In the case of some Latin American countries, the figures exclude miscellaneous categories (e.g. "activity not specified").

[b] Excluding domestic servants.

only comprehensive protection was able to shift agricultural workers into industrial employment. Unfortunately the process was neither carefully thought out nor consciously managed. Thus it took place mainly during foreign exchange crises when import substitution became imperative and at the same time difficult to achieve. Whenever the pressure ceased, the relief was not used for a systematic development of industry. Hence, the real income of agricultural workers, already miserably low, tended to be degraded further by increases in industrial prices.

26. It is unlikely that the situation of the peasant can be much improved without securing, either through land taxation or through agricultural reform, a decisive improvement in the distribution of land ownership. It is also essential to improve production techniques and, in particular, to decrease the seasonal character of agricultural work: the peak sowing and harvest requirements will otherwise prevent a shift of a large portion of the working force before the reforms, capital accumulation and mechanization of agriculture have succeeded in changing the system of rural organization, which will take a considerable time.

27. In the short run, rural public works might be the best way to tackle the problem. Such rural works might also encourage co-operative organization and, by injecting additional incomes, accelerate rural reorganization. They could, in addition, help to create the substructural investments needed for increased output and reduced seasonal strain on manpower.[12]

28. (*ii*) *The problem of non-rural labour.* The scantiness of budgetary means for education, attributable partly to insufficient and regressive tax-structures and partly to the high proportion of unproductive expenditure on administration and defence, has left even the non-rural labour divided into sharply differing groups of utterly different education, technical skill and capacity for organizing themselves. Thus the difference between salaries and wages, and even between incomes of different sectors, is extreme, reflecting unequal bargaining and political power. This necessarily distorts the international comparative cost position of the country. In conjunction with monopolistic or oligopolistic dominance, a rather strong deterrent to expansion is introduced because of the likely use of the market power of industries to increase profit margins and because of the wage demands of certain privileged sections of fully employed labour. However justified these may seem to be from a human point of view, they cannot help further reducing the prospect of proper integration of the economic system as well as of sound industrial development. The assumption of proportionality between social and private costs is quite illegitimate in poor under-developed areas.

29. (*iii*) *The problem of the unsuitable capital substructure.* A further influence militating against a balanced growth of the economy and impeding a shift from primary production, even though relative social opportunity costs would demand a progressive shift, is the consequence of the character of much of the present substructure and social investment. The evolution of this capital structure has historically been dominated by the distorted system of costs and prices favouring primary exports and the import of manufactures, which it in turn exaggerates.

Thus the *transport* system, especially the railways, has primarily been built for exports and imports rather than to encourage balanced development. Nor, as the case of the United States eloquently proves, can a domestically oriented transport system be built up on the basis of direct profits. Its contruction needs to take into account, as was done in the United States through land grants to the railway companies, the external diffused benefits and profits which accrue to others as a result of the investment. The so-called "external" economies must be included when deciding on development policies.[13]

In the same way, the *banking systems* in under-developed countries grew up in the nineteenth century in response to the effective demand of the highly developed areas for the reliable and efficient supply of food and raw materials. These requirements could best be satisfied by ensuring the stability of the monetary unit and by developing a sound banking organization which would at all times be safe. The former was achieved by tying the currency to gold; the latter by establishing branches of banks with head offices in leading financial centres and leaving them free to choose their assets. Liquid assets of impeccable security were not easily available in under-developed areas. Their

[12] See T. Balogh, "Linked Public Works", in *Política*, Caracas, 1960; and FAO, *Interim Report of the Mediterranean Survey*, Rome, 1957.

[13] This has been generally accepted so far as road development is concerned. It is still ignored in the discussions on railway development.

Governments were not encouraged to borrow at short term. The large expatriate companies financed themselves out of profits or by share issues in the financial markets of the highly developed areas. Thus the banks operating in under-developed areas kept a large part of their assets abroad on the plea that suitable domestic investment media for their reserves did not exist. As regards the rest of their assets, they typically restricted their lending to liquid or self-liquidating projects. In practice this meant the financing of exports and imports.

30. The banking system in under-developed areas thus became a potent influence helping to perpetuate the existing production patterns in these areas, however uneconomic they were on the basis of the long-run social comparative costs of the classical analysis. It cheapened the financing of exports and imports and drew capital away from the poor areas by providing an easy and safe way of investment in bank deposits which were mainly invested in securities of the large international financial centres.[14] Thus even the scant savings which originated in the under-developed areas tended to flow towards the highly organized financial markets of the rich countries, and the cost of domestic loans for industrial development in the poor areas tended to cost more in so far as the financing of industrial investment was left to the moneylender. While foreign trade was financed on the basis of world rates of interest of between, say, 3 to 8 per cent per annum, industrial investment had to be undertaken on the basis of rates of between 12 and 48 per cent per annum. The divergence between the comparative social and private cost was further widened.

31. All this contrasts sharply with the beginnings of banking in the United Kingdom and United States in the eighteenth and nineteenth centuries, when the local bankers provided the financial basis of the industrial and agricultural revolution by undertaking local commitments, often incurring great risks. Their influence and activity deserve study in poor under-developed areas and will provide pointers to banking reform.

32. As regards the contemporary scene, the organization of strong Central Banks, capable of taking an active initiative in stimulating the diversification of the country through investment in industry and related social substructure capital might, for instance, serve the same purpose. An example of such institutional structure which successfully stood the test of time was the Australian Commonwealth Bank in its orginal form.[15] Its command over a large part of savings, through its control of the Federal Savings Bank, ensured financial means for the financing of development and gave it the possibility, by keeping savings liquid, of putting pressure on the banking system, where open market operations would have been out of question, in the absence of any developed large-scale capital market. Through its trading bank department, finance could be channelled towards domestic development at reasonable rates of interest. Its rural and industrial development divisions provided judicious help to desirable long-term development and thus counterbalanced the bias in this lop-sided framework of the price mechanism against balanced growth. Banking reform, reducing monopoly and oligopoly, is one of the most urgent tasks if the optimal working of the price mechanism is to be assured.

(b) *The problem of the inelasticity of the productive structure*

33. (*i*) *The rigidity of agriculture.* Victory in the mortal battle for development in Asia, and perhaps even in large parts of Africa and Latin America, will go to those who succeed in mobilizing the idle or underemployed rural labour force. No doubt the process of growth will imply much more than rural mobilization. But even in countries where agriculture no longer supports an overwhelming portion of the total population, the mobilization of rural manpower for rural growth and the establishment of a flexible food base is of decisive importance, especially in view of the accelerating population growth in many of these countries. Only a decisive increase in agricultural production and productivity can provide the supplies of food needed for better standards of living in conjunction with industrialization, without an intolerable burden on the balance of payments.

34. At present the conventional working of the market mechanism is often impeded in considerable parts of the agricultural sector because of the inequality of the distribution of land an inappropriate land tenure systems. It would be far from accurate to say that the owners of large and tiny estates (the latifundia and minifundia) are not actuated by rational or economic motives. It would be more appropriate to assert that their motivations differ considerably from what is assumed in the instantaneous profit maximization model of perfect competition (which has become highly inaccurate also in the fully industrialized areas largely dominated by oligopolies). The owners of the vast feudal landholdings which characterize certain parts of Latin America have no interest in improving the land, or even in maximizing output in the short run. They are interested in a maximization of their income over time, with the constraints of being able to maintain the most effective supervision of the work of their labourers and of incurring as little effort and risk, both economic and political, as possible. Thus in a large part of Latin America as well as of the Afro-Eurasian area, there is a heavy concentration on crops or animals needing relatively little care and enabling the holder to absent himself for the maximum of time. Moreover, modern techniques would necessitate education, and education might encourage change. The aversion to change thus contributes to the continuance of out-moded production techniques.

35. The inequality in the distribution of land, which permits the landlord to be sure of a large income, also reduces the marginal utility of increments in terms of effort. Thus the traditional assumptions about the working of the system, assumptions on which important policy recommendations are based, are undoubtedly vitiated.

36. The minifundia, on the other hand lack both the capital and, what is more important, the knowledge to react in the conventional way to price changes. They often are subject to the power of merchants and money-lenders, whose reaction to improvements might well be to increase their charges. Thus the interest of the small farmer — and also of sharecroppers — in improvements is much reduced, if not entirely eliminated.

37. A further and hardly less important problem arises

[14] The fact that there was no capital market in the less developed areas strengthened the force of this argument. But the fact that the banks operating there did not have to keep at least a prescribed part of these funds in the country prevented the development of a capital market. So the under-developed area, poor in capital resources, did not fully benefit even from its own and admittedly scant savings.

[15] The recent separation of central banking from its other functions can no longer hamper Australian economic development.

in this context which is likely to vitiate further the working of the price-system. In traditional agriculture the monetary inputs, apart from being governed by average rather than marginal productivity, are relatively low. The opportunity cost of crops grown on land let on a sharecropping basis approaches zero: the income becomes pure rent. Thus, irrespective of the superior alternative possible use of manpower in industry, its use for agricultural products, including exports, remains possible. A large part of the proceeds serve to buy the supplies and services which the rich desire, to a considerable extent imported luxury items and travel. With the increase of population, and often merely on account of monopoly market power, the share of the crop which can be exacted for rent increases. Thus the impulse to higher production is further decreased. The market mechanism certainly does not, and cannot, force landlords to alter the productive structure by eliminating the inefficient.

38. The situation differs only slightly in cases where the owner works his land through managers or stewards. The need for supervision remains. Money inputs, are, as before, not high enough to compel productivity improvements. A large part of the wage is in terms of land use or its produce. And productive inputs bought for cash — such as machinery, fertilizers etc. — are kept traditionally at a minimum.

39. Two influences have raised land values above all relation to the yield of other forms of assets: one is that land ownership is a social status symbol; secondly, land is bought as a guarantee against possible monetary instability because of century-long experience of steady appreciation of land values. The artificial prices for land prevent its better distribution and, together with the existing monopolistic conditions in the financial markets, militate against commercial agriculture.

40. These are additional reasons why the traditional system of land tenure, in its inequality, prevents the full mobilization of resources. The consequence is an extreme rigidity in the agricultural framework and output. In a number of countries of Latin America, landowners have shown an elastic response to price stimuli. In Mexico, Brazil and in a number of countries in Central America and northern South America, latifundia owners and a newly emerging class of often smaller-scale agricultural enterpreneurs have achieved considerable successes in increasing output and adapting it to changes in demand.

41. In some countries, moreover, of which Brazil is perhaps the most important, there still exist large tracts of free land, which might be thought to limit the inequality in the distribution of income by providing alternative opportunities for tenants and landless labourers. Yet, for reasons which are not altogether clear, and which merit further detailed research, even the existence of free land has not, in contrast to the experience of the United States in the nineteenth century, set a limit to the inequality of income.

42. Thus the double handicap to industrial development deriving from the poverty of the rural population, which has been discussed in the previous section, remains even in these countries. An additional problem is created by the fact that the supply of certain protective foodstuffs, e.g. fruits and vegetables, is held back by difficulty in securing a more equitable distribution of land.

43. This difficulty is much enhanced by the defective organization of marketing, which is only partly attributable to those deficiencies in the organization of domestic transport, to which allusion has already been made. When grading is inefficient and the middleman is able, partly because of his power as a moneylender, to exact an undue share of the price paid by consumers, the response of production to changes in demand will be imperfect and sluggish. The establishment of marketing organization giving security from abrupt price fluctuation and enabling producers to obtain credit at reasonable rates might therefore help in increasing the elasticity of supply.

44. It should be noted that land-reform in the sense of a simple redistribution might not be able to achieve full mobilization of agricultural resources, even though it might be beneficial from the point of view of income distribution and social balance. It might even lead to a fall in production, given the fact that on the sharecropping estates there would be hardly any change in traditional methods of production and on the others the change might not be much greater. On the other hand, land reform might well cause the landowner to farm his remaining holdings more effectively, especially if he receives compensation or credit. The total effect will depend on the circumstances in which the land reform is carried out.

45. If pressure for land reform is not extreme, a progressive land tax, based not on actual but on potential yield and accompanied by suitable taxes on water resources might, in the short run, produce more favourable results, in the sense of increasing the elasticity of agricultural supplies. Such tax reform must be accompanied by the establishment of an effective agrarian credit system, both for *long-term credit*, enabling the acquisition by cultivators of the land entering the market, and supervised medium- and short-term credit to help create economically sound cultivation. The provision of extension services, supplemented by the introduction of improved seeds and fertilizers and advice on the effective use of water, are further conditions for sucesss. The rigidity of the agricultural structure might also be loosened, as already mentioned, by undertaking rural public works in conjuction with these reforms.[16] The increase of rural incomes will put pressure on landowners, thereby speeding the sale of uneconomic units and spurring them to adopt better productive methods.

46. Should land reform be enacted, the same institutional changes will be required, but extending over far larger areas, since the change in ownership will be far wider spread. One possible method of effectively infusing into the countryside new technical knowledge might be the formation of co-operatives, to which the surrendered land would be, in the first instance, entrusted. This would enable the scarce expert knowledge to be used in improving growing practices, introducing better seeds, adequate fertilization and the organization of irrigation (all of which might be severely impeded, or indeed made impossible, by a fragmentation of land ownership). Support for these co-operatives for the farmers might be secured by having them undertake rural public works. Thus the formation of co-operatives can be fostered while, at the same time, the capital structure needed for more intensive cultivation (e.g. dams, access roads, canals, etc.) is built up and incomes are raised in rural areas.

47. In different countries the solutions that will prove politically acceptable and technically efficient will vary. A pragmatic approach is therefore essential, always keeping in mind, however, that the aim is to restore or maintain

[16] See paragraph 26 above.

the growth and elasticity of production, while achieving a less uneven distribution of ownership and income.

48. Finally, it should be added that, in the absence of large-scale reorganization, piecemeal attempts at improvement might not merely be ineffective but might actually do more harm than good. Thus, irrigation without drainage in a number of areas would poison the soil by salting. The provision of fertilizers without water and drainage might result in a total failure of crops through burning, although some crops might survive without fertilization even under the same conditions. The peasants' resistance to new techniques is therefore not as irrational as it is often thought to be.

49. (*ii*) *Non-agricultural rigidity.* The classical mechanism of readjustment is, of course, based on the existence of a large area of marginal choices imperceptibly merging into each other. "Marginal" in this sense means divisible and small, not *grosso modo* choices between ways of life or modes of production.

50. The existence of such marginal choices, even in these cases — increasing in importance — where the technical rigidities do not rule them out altogether, presupposes that the organic growth of the industrial structure has already been achieved and that the increased mobility of labour and capital has led to an equalization of factor remuneration. As a picture of the conditions in under-developed areas this could not be further from reality. In these areas, individual projects usually bring about large-scale changes. The whole development process is violently changing the relations of the various factors of production to each other. And the external economies of any one investment decision, in the sense of changing the markets and supply conditions of *other* firms, are always relatively significant. The price mechanism is thus inherently incapable of assuring an optimal allocation unless it is assisted and modified by conscious and discriminating measures, which can either consist of physical controls or be financial in character, i.e., taxes and subsidies.

51. (*iii*) *The highly developed foreign export sector.* A number of Latin American countries possess a fully developed foreign export sector which is an enclave, a State within the State, and which has no organic relationship with the rest of the economy though indirectly feeding it (and altering its pattern). The capital needs of this sector are met from foreign sources at rates of return which are independent from the domestic ones.[17] The marginal productivity there is not related to the marginal productivity of the other sectors and will often be far higher than the average productivity of the metropolitan area which controls it. Transport facilities and energy provision have traditionally been shaped by its needs and help to perpetuate its superiority.

52. The very superiority of its productivity has certain important consequences. If the relative taxability of the developed foreign sector has obvious political and economic advantages, dependence on it implies the danger of not having any effective alternative on hand should any unfavourable development slow down or reverse the rise of exports.[18] Even stationary foreign exchange receipts from the fully developed export sector involve, *ceteris paribus,* an appreciable fall in real income per head from this source, if the population is growing as fast as it is in most Latin American countries.

53. The fact that Government revenue is only too often dependent on taxing the exports of the developed foreign export sector, while domestic vested interests, even when successful in the export field, effectively prevent the imposition of a corresponding tax burden, enhances the importance of this factor. So long as the exports of the developed foreign sector rise, and with them Government revenues, the elasticity of the economy is safeguarded. Indeed from an important point of view, an increase in import capacity is likely to have more pervasively favourable effects than an increase in domestic physical productivity: it permits much greater flexibility in satisfying demand.

54. Thus the continued expansion of the markets of the foreign sector has a significance for smooth economic growth which cannot be over-emphasized. Any actual switch from that sector would involve, as table 2 shows, a very sharp decline in productivity.[19] Even a failure to grow at least at the rate of the increase in population

[17] Though the yield paid might not be lower. There are often political risks, and the monopoly power of the large mining enterprises secures them high returns, making them disinclined to undertake projects on the basis of lower ones.

[18] The great plantation economies are not very different in their relation to the rest of the system.

[19] The dependence on exports is enhanced if virtually free imports prevent the development of domestic industry while the service sector handling imports expands.

Table 2

LATIN AMERICA: TOTAL AND *PER CAPITA* OUTPUT IN SELECTED COUNTRIES, 1957

	Argentina	*Brazil*	*Colombia*	*Chile*	*Peru*	*Venezuela*	*Mexico*	*United States*
	TOTAL OUTPUT (*millions of dollars at 1950 prices*)							
Agriculture	1 863	3 988	1 059	363	447	422	1 712	20 859
Mining	132	52	117	125	89	1 939	356	6 135
Industry and construction	3 345	3 996	874	439	340	666	1 801	139 878
Services	6 011	7 080	1 262	1 351	731	3 113	4 315	240 492
Total	11 351	15 116	3 312	3 378	1 607	6 140	8 184	407 364
	OUTPUT PER HEAD OF THOSE EMPLOYED (*dollars at 1950 prices*)							
Agriculture	1 066	361	467	480	231	510	305	3 352
Mining	3 568	464	3 900	1 050	2 342	34 018	3 747	7 583
Industry and construction	1 643	1 086	1 043	710	589	1 563	1 160	7 140
Services	1 545	1 622	1 088	1 270	963	3 259	1 486	7 571
Total	1 472	788	711	891	485	2 698	805	6 977

SOURCES: Latin American countries: ECLA, on the basis of official statistics. United States: United Nations, *Yearbook of National Accounts Statistics,* 1959-60; and ILO, *Yearbook of Labour Statistics,* 1958.

might result in a fall of average national productivity, because the small numbers employed by the sector are offset by its high contribution.

55. This threat to productivity is the more acute because of the exaggerated size of the mercantile sector. This is one of the consequences of the high productivity in the foreign developed sector. Partly because the contribution to Government revenue is relatively much higher than would be normally supplied by the domestic sectors, a foreign sector which does not employ many people itself can indirectly maintain a large ancillary establishment. The distribution of employment in a number of Latin American countries between primary, secondary and tertiary industries is more akin to that in countries of the productivity level of the United States than to that in other areas of the same average income as Latin America (see again table 1).

56. Thus the availability of goods becomes unduly dependent on export capacity. Shifts to industrial employment are seriously impeded by the monopolistic character of trade, by the lack of training, etc. The outlets in trade for entrepreneurs are so remunerative, with profits being increased by disproportionately low ancillary costs, e.g., those of transport and banking, that there is little inducement for them to enter productive industry. The impediment to industrialization implicit in the nature of the agricultural sector, which has already been discussed, is further enhanced by the indirect consequences of the existence of a highly developed foreign sector. This must not blind us to the importance of the financial contribution which the fully developed foreign export sector has made to the standards of living in Latin America. Government expenditure and national income would be far lower in their absence. The point to be made is that its existence renders *conscious* action to achieve a *balanced* development of domestic industry even more necessary than would be the case if that development had been impeded only by the distortion of classical comparative costs because of the defective framework of agriculture.

57. (*iv*) *The traditional agricultural export sector.* In contrast to the mainly foreign mining and plantation enclaves, traditional agriculture is also divided in most countries between a domestic sector (often self-sufficient) and one which is mainly devoted to exports. As a rule, the export sector, based on the whole on large or medium land holdings, has a higher-than-average productivity but is not intrinsically in a position of superiority to industry. It is in those countries where foreign mining and plantation ventures do not play an important role that the shift from agriculture to industry is most impeded by the distortion of classic comparative advantages. At the same time there would be no loss of real income implied in a shift towards industry. The importance of traditional exports in this case is derived from its command over foreign exchange which is needed to pay for capital equipment that has to be imported. The importance of the terms of trade is evident in this case too: the less favourable these are, the greater the justification for a shift to industry, but the less the ability to do so.

58. (*v*) *The terms of trade and industrial development.* The importance of this ineluctable fact is much enhanced by the uncertain prospects of primary exports, both those produced by the fully developed foreign export sector and by traditional agriculture and mining. After wars, especially after such a devastating one as the Second World War, economists usually foresee an increase in the relative price of primary commodities, i.e., worsening terms of trade for manufactures. This is strictly in accordance with the classical model of static balance, which assumes that the cost of production rises as demand and production increase. This model, of course underlies the defence of free trade and is attractive because it supplies determinate, inapplicable policy recommendations.[20]

59. After the last war these predictions seemed more nearly borne out than in earlier periods. The improvement in primary commodity prices encouraged the hope that the consequential increases in production and income might produce a sufficient basis for sustained growth,[21] especially if judiciously supported by foreign aid. It also deeply influenced thought on the strategy of economic development.[22]

60. With the end of the boom consequent upon the hostilities in Korea, the post-war trend abruptly changed. The terms of trade of the manufacturing countries improved by some 30 per cent. It was perhaps even more ominous that the further rise in the relative prices of manufactured goods in the 1957-58 recession was not fully reversed in the subsequent recovery; thus the deterioration cannot be entirely attributed to short-term and reversible fluctuations in demand. And the vital question arises whether and how far a further worsening should be taken into account in determining the strategy of development. The matter is of the utmost importance. Any deterioration of the terms of trade necessitates an acceleration of import substitution. If a further worsening of the terms of trade is expected in future this would demand a completely different, far more domestically-oriented investment programme. Preoccupation with the terms of trade far from being economic hypochondria, or a consequence of the inability to effect adjustment, is thus the first stage towards a systematic policy of adjustment.

61. This is not the context for a lengthy analysis of the actual export prospects of Latin America. There is, of course, no natural law governing these matters. The terms of trade of primary commodities against manufactures will be determined by the relative demand and supply, and these, as has been learnt in the last ten years or so, can change with astonishing violence. They are especially influenced by the market structure of the two types of products.

62. There is little doubt that the rate of economic expansion in relation to productive capacity in the rich industrial part of the world has been, and will remain, the main determinant of the outlook for the products of primary-producing countries. A slowing-down of growth represents the gravest danger to the poor areas. Time has vindicated the results of ECLA's earlier investigations to the effect that the rate of progress of Latin America's foreign market is not encouraging.[23] It is also probable

[20] See C. Clark, *Economics of 1960*, New York, Macmillan, 1942.

[21] Not all writers share this expectation. See, for example, Raúl Prebisch, ECLA, *The Economic Development of Latin America and its Principal Problems* (E/CN.12/89/Rev.1), United Nations publication, (sales No.:1950.II.G.2); *Economic Survey of Latin America, 1949* (E/CN.12/82), United Nations publication, (sales No.:1950.II.G.1); and H. W. Singer, "The Distribution of Gains between Investing and Borrowing Countries", *American Economic Review, Proceedings*, 1950, p. 478.

[22] Under-developed countries, such as those of Latin America, have been periodically advised not to industrialize, even in recent years (see, for example, F. Benham and H. A. Holley, *The Economy of Latin America*, Royal Institute of International Affairs).

[23] The increase in population and the growing exports of manufactures in exchange for import of primary commodities by ra-

that, apart from reasons which cannot be considered as unsound, such as better diets, advertising and innovation are likely to change the pattern of demand to the further disadvantage of goods with a relatively high content of primary commodities. Thus the general tendency of the demand for these commodities to grow more slowly than income will be reinforced.

63. The nature of the process of development seems, for the moment at any rate, strongly biased against primary commodities. The relationship between them and manufactured goods is likely to be affected by the fact that the former are sold on organized world markets while the latter are supplied directly by the producers. Primary producers may be organized or constitute an oligopoly, as is the case among the great base-metal producing firms and petroleum companies, or regulated by Governments, as is the case with sugar and coffee. Nevertheless, the existence of free markets on a world-wide scale seems to destabilize prices of primary commodities relative to those of manufactures.

64. This greater sensitivity of primary commodity prices to downward pressure is enhanced in the case of those products which are grown by small, weak and remote producers, especially if marketing is manipulated by middlemen. Even when the market is not controlled in this way, the inability of the producers to store and carry stocks will tend to lower the prices they are likely to obtain. When producers are indebted to middlemen, this increases their vulnerability. It would be foolish to assume that this pressure on primary commodities will continue indefinitely. All that is claimed is that, in the present state of the development of the world economy, the possibility of a worsening of the terms of trade of primary producers can be appreciable. This deterioration can occur both when the prices of manufacture are likely to rise before those of primary commodities, and also in those periods when the Governments in the developed countries try to control the rise in prices by restrictive monetary measures. The relative sensitivity of primary commodity markets tells against those products unless special countervailing measures are taken. Such measures are difficult to administer.[24]

65. In addition to these factors which are quasi-short-term, but likely to remain persistent, the poor areas have been beset with rather more structural handicaps, mainly in the biased character of technical advance and growth. The emergence of substitute materials and the reduction of waste through technical progress have played an important role in this respect. More important still was the rapid technical advance in agricultural production in the highly developed areas of the world, surpassing even improvement in industrial productivity. There is no need to enlarge on this theme here. Reference can again be made to earlier ECLA investigations.

66. (*vi*) *Domestic protected industry*. The difficulties and dangers to living standards arising out of even a relative decline in the fully developed foreign export sector are enhanced by the problem caused by the ubiquitous excesses of monopoly. The nature of the vicious circle of poverty and lack of investment represent a commonplace in development economics. Most under-developed areas lack sufficiently wide markets for the establishment of competitive industry. The fact that they are latecomers, together with the scarcity of skilled labour and the well-organized character of such as exists, further impedes the rise of numerous units capable of facing import competition. The mercantile character of such capitalist classes as exist, and their proneness to tight organization, often implicit, completes the picture. Thus there can be no doubt that the rise in prices and profits can be avoided and the establishment of uneconomically small units prevented.

67. Import substitution will involve a real loss in income if it is an alternative to a further rise in the production and foreign sales of the fully developed foreign export sector, because that sector is more productive and it enables supplies to be purchased from the most highly efficient foreign sources. This loss can be offset by the increase in the general level of productivity. If, then, the periods of buoyant export markets are used for a planned increase of investment in import substitution[25] rather than for increases in current outlays, both public and private, the effects of the worsening in the terms of trade could have been easily handled.[26]

68. This has not happened. In consequence, acute problems arise especially for countries interested in mineral exports. In this field, the domestic market is limited and manpower cannot easily be switched. In the case of traditional agriculture, the productivity differences are not large between exports and production for internal consumption and alternative domestic uses for land might be easier to find. The danger in this case is that the increase in internal consumption during a foreign slump might prove politically irreversible, or at least difficult to reverse.

69. But, as has been seen, the relative cost of industrial production prevents such an orderly process of unprotected import substitution. When the balance of foreign payments is favourable, an active anti-monopoly policy would permit foreign imports in cases where the protected industries try to abuse their privilege. In periods of such relative affluence, import controls are generally relaxed and investment in import substitution is not specially encouraged.

70. In the absence of conscious planning and the encouragement during favourable times of import substitution, the process is likely to take place in periods of crisis, owing to either the failure of foreign supplies (e.g., as a result of wars) or to balance-of-payments difficulties and heavy political pressure. Thus it will be difficult to prevent the emergence of unnecessarily large profit margins as a result of the exploitation of newly-created monopoly power. It is not improbable that the degree of protection granted might be far greater than necessary merely to implement the changed structure of comparative costs through a suitable modification in the relationships be-

---

pidly growing industrial countries, such as the Federal Republic of Germany, Japan and the Soviet Union, might easily reverse the trend.

[24] In addition, the poorer areas are menaced by the so-called "whip-lash" effect. Large corporations operating in both the metropolitan territory and elsewhere might be forced by political pressure to cut production abroad rather than at home (e.g. the Canadian experience). Protective measures of the metropolitan area (e.g. the Venezuelan experience with United States oil quotas) have the same effect.

[25] An alternative would be to accumulate international reserves to be used for the continuation of imports during slumps. Given the non-homogeneity of social returns in the various sectors and the low returns of foreign reserves, this of course would probably cost a serious reduction in income over time.

[26] A policy of employment stabilization would, of course, have to have further elements to take care of the countercyclical effects of domestic investment in import substitutes.

tween money costs and prices. If so, the loss in real income attendant on the shift from imports to home production might be accompanied by a parallel redistribution of income from the lower to the higher income classes, i.e. from real wages to profits, as the result of an all-round increase in the degree of monopoly.

71. Thus the relative prices of manufactures express social opportunity costs as little as do those of agriculture. They are expressions of relative monopoly power and the bargaining power of the respective unions. The hindrance to industrialization caused by the distortion factor markets in agriculture is further accentuated. A downward rigidity is imparted to manufacturing prices, further increasing sectoral unbalance and disjointedness.

72. It is quite possible that an appreciable part of such investment as is managed will be frustrated by monopolistic influence keeping output low and prices high. In this way a large excess capacity would be created. The inelasticity of the supply of manufactures is joined to that of agriculture. Since a large-scale substitution of domestic manufactures for imports will involve not merely a loss of real income but special pressure on non-profit incomes, the conditions are created in which strong unions can press for wage increases. The fractioning of the factor market will then be further aggravated. Thus monopoly power can transmit a cost-inflationary spiral.

73. A similar influence might be exercised by the interaction of supply rigidities in agriculture and industry. Insufficient expansion in agricultural output, at a time when population and industrial production are rising, can prove particularly pernicious in the cases of goods with fairly high income elasticity and low price elasticity. If agricultural output as a whole does not respond to price stimuli, the tug-of-war between an archaic agricultural sector and a monopolistic industrial one would by itself seem sufficient to start a reciprocating and self-sustaining inflationary spiral.

74. The fragmentation of the domestic factor and product markets, and their inferiority relative to both the fully developed foreign export sector and to analogous industries in developed foreign countries prevents an orderly process of development, because the degree of inferiority will vary from industry to industry. Discriminating measures are therefore needed, selected so as to promote a maximum increase in productivity.

75. The broadening of the protected domestic market, e.g. by the organization of a common market or a free-trade area in Latin America might, in this respect, have a decisively favourable influence in the long run. It would increase the scale of profitable production and the scope for specialization. Thus it might go far to offset the handicap at present suffered by Latin American industries because of their inadequate scale of operation. Unless these industries accord each other such discriminatory preferential treatment, the likelihood is small of each being able to increase productivity towards the level of their fully developed foreign export sectors. In that case a much longer and more painful process of industrial development will be needed.

76. A further complication, necessitating discrimination, arises from the fact that industrial development within the region is uneven. Thus the promotion of a common market could involve the less industrialized countries, whose intra-regional exports consist mostly of traditional agricultural exports, at some loss. They would buy rather more expensive industrial products from other countries in the region by comparison with the prices charged by traditional sources of supply. One remedy might be an export subsidy. While such subsidization might take different forms, it must be on a discriminating basis. Administratively its easiest form would be through multiple exchange rates.

77. These considerations show clearly that the development which would result from a negative reliance on the free interplay of market forces would fail to promote optimal allocation of resources and thus achieve optimal growth. The operation of the price system needs to be modified by conscious and discriminating measures.

78. Given the fragmentation of the product and labour markets, and the varying degree of monopoly, comprehensive measures aiming at an over-all balance between monetary demand and supply need not, and probably will not, be effective in ensuring stability. Sectoral unbalance, added to monopolistic rigidity, might be the explanation of inflationary pressures. Monetary, global factors under these circumstances might *respond to*, rather than *cause*, unbalance. No significant conclusions can be drawn from purely monetary analysis, however tempting that may be because of the relative abundance of monetary statistics. Thus, in order to ensure stability by global means, sufficient pressure has to be exercised to restrain the least stable and most monopolistic sectors. This would seem to imply heavy unemployment or underemployment in the more elastic or defenceless sectors. The consequent overall discouragement is unlikely to promote growth.

79. The system is inherently so rigid that it becomes unstable and prone to cost-inflationary pressure. Both cyclical instability and the long-run weakness of export markets constitute a severe strain on such a framework. Given the fact that the rigidities of the system vary in degree, and that the sectoral unbalance might be of complex nature and also differ in extent, global measures, especially monetary restraint, are most unlikely to have a diffuse and neutral effect. Their directional effects might be strong and cannot conceivably be such as neatly to offset precisely the divergence of sectoral resources from an efficient allocation of scarce productive factors. Decontrol and monetary restraint are most inappropriate policies if the normal classical working of the economic system is to be achieved. Any attempt, for instance to force countries to liberalize imports as the price for financial help is likely to harm the long-run prospects of their reaching a situation in which the price system can justifiably be expected to function satisfactorily.

80. Thus the social cost in terms of loss of real income, both through the misallocation of resources and through the defective working of the free-price system in Latin American conditions, will be appreciable. The unfavourable social effects are much aggravated by the fact that they might and probably will fall with particular force on a relatively restricted sector, while the reaction of the monopolistic sectors would be by way of restriction rather than by reductions of price through cuts in profit margins. The cessation of the growth of income might therefore be accompanied by a further worsening of its distribution. A more likely formula to maximize social tension can hardly be imagined.

81. (vii) *The imperfection of the capital market.* One of the most important basic conditions for the optimal working of the price mechanism and for the use of global controls is the existence of a perfect capital market. If there were a great number of marginally differing projects

and if they were of marginal importance only, the rate of interest might be conceived as the optimal selector of projects. Investment would naturally have to be interest-elastic, smoothly adapting itself even to slight movements of the rate of interest.[27]

82. It is also essential for the optimal functioning of the system that savings should respond elastically to changes in interest rates, that the cost of channelling savings towards investment should be minimal and that the process should take place without friction or delay.

83. These basic conditions for the optimal operation of the price system are not fulfilled in Latin America. But even if they were, there is a grave weakness in the price system, especially so far as countries in the course of development are concerned. This weakness springs from the fact that the benefit from an act of investment is greater than the resultant increase in the income of the investor when the additions to capital are not marginal but significant and change the pattern of capital equipment significantly. The extent of this indirect benefit will be determined by the physical location of the investment. The investment will increase incomes and also probably cheapen production, thus benefiting other industries and consumers. No doubt some losses will also occur, but there will be a net gain beyond the return to the investor. Thus the price mechanism is inherently incapable of expressing the real social desirability of investment. Unconditional reliance on it would not, conditions being as they are in Latin America, bring about an optimum use of resources.

84. The financial structure, including the system of intermediaries, must be organized on a competitive basis to keep the cost of channelling savings into investment to a minimum. Apart from the fact that in an under-developed area projects are *grosso modo* rather than marginal, the financial organization assumed by monetary theorists simply does not exist. There is in most cases a tight oligopolistic control of banking and finance. In times of inflation, the control of the banks is often used to obtain credit at favourable (in real terms often negative) rates of interest. In times of stability, the gross profit margin of banking might be several times the normal level of the total rate of interest charged in highly developed areas, perhaps as high as 12-16 per cent, so that the gap between the borrowers' and lenders' raters of interest would alone be big enough to destroy any hopes of the optimal working of the system.

85. The distortion of the capital market is aggravated by the psychological impact of the past monetary history. Whether inflation was caused by monetary or by structural defects, it certainly results in deep-seated unbalance in the attitude of investors to saving and to financial investment. Instead of being attracted by productive projects, investors — especially the smaller investors — turn towards real estate speculation and luxury building. The correlation in many countries between the ratio of building to total investment and the level of the capital-output ratio are striking.

86. Two consequences, both evil, follow. An artificial stimulus is imparted to export and import activities, because they can be financed internationally, to the detriment of domestic production. And an immense further stimulus is given to industrial monopoly, for only enterprises which are able to shift the burden of such high rates of interest on to the consumer will survive.

87. The price mechanism, far from being an optimum allocator of resources among various investment possibilities, becomes one of the most potent forces confirming monopoly, privileged finance and the sectoral and general fragmentation of the economy. There need not be, and in most cases there is not, a visible tendency towards an equalization in factor rewards, including industrial returns. The unleashing under these circumstances of the "free" forces of such markets will perpetuate the malaise. It certainly cannot ensure the optimal functioning of the economy.

88. In most under-developed countries with feudal or mercantile governing classes, a relatively low propensity to save is found together with a high propensity to indulge in luxury imports and travel abroad. Redistribution towards the rich, which is commonly regarded as a means of increasing savings, investment and economic progress, certainly produces no such results in these countries.[28] It might even lead to a worsening in the balance of payments and to unemployment, as the products of low-quality home handicrafts and industry are displaced by high-grade imports.[29]

89. In this context it must be noted that a large part of the so-called savings in under-developed areas are used to buy luxury buildings. These should properly be excluded from savings and investment altogether. They represent a kind of durable goods consumption. The misleading high savings ratios and correspondingly abnormal capital-output ratios which have no meaning in the context of a discussion of economic growth, would then be corrected, so that they bore a more sensible relation to the growth rates experienced.[30]

90. An increase in the rate of interest, according to historical experience, does not seem to have an influence on the rate of saving. Thus claims that tight or dear money could expedite economic progress by permitting a higher rate of investment are unfounded. A redistribution in income towards the poorer classes in general would not necessarily lead to a shrinkage in savings. Even if it did, its unfavourable effects might be more than offset by an improvement in the quality of private investment, e.g. the reduction of luxury building and of investment of oligopolistic excess capacity in industry (especially in industry producing luxury consumption goods). The capital-output ratio would then fall.

91. Policy, however, might be concentrated not so much on a redistribution of income at this stage as on increasing saving through deliberate budget surpluses.[31] A redistribution towards the poor can be supported on different

---

[27] Even in highly developed wealthy countries with broad capital markets, investment has shown itself impervious to changes in interest rates. Direct rationing of credit and psychological shock were the two means by which investment and consumption have been restrained. Even in a well-integrated economy with a broad capital market, in which oligopoly and political influence are somewhat restrained, optimal functioning is difficult to claim for the system. Reference can be made in this connexion to the papers submitted to the Radcliffe Committee, op. cit., vol. 2.

[28] Inflationary finance which redistributes income towards profits has not in this framework been able to increase the rate of savings and investment appreciably.

[29] In countries with a completely rigid agriculture, an increase in the income of the poorer classes might not lead to an improvement in the balance of payments as imports of food might become necessary.

[30] The use of fixed capital-output ratios to determine investment needs should be subject to a clear statement on how the effectiveness of the proposed investment is to be secured.

[31] This was the conclusion of the Staff Report of the Joint Economic Committee of the United States Congress.

grounds, which the report of FAO on Mediterranean development has clearly brought out.[32] This is that most of these countries have unemployed capacity in the handicraft or coarse consumer goods industries. Thus a redistribution of income towards the poor, if well managed, could bring about a fall in the propensity to import which in turn would permit an increase in national income without a fall in investment. This would have to be very carefully managed, as it might get dangerously out of hand and cause inflation.

92. To sum up, the greater the monopolistic or feudal agrarian distortions of the "normal" working of the price mechanism (which has, of course, never worked "normally"), the greater the force of the cost-push factors. Thus the greater will be the degree of unemployment induced by global policies which attempt to offset the upward push on the price level, and the more reliance will have to be placed on the psychological shock-effects of credit policy and on rationing by private bankers. This state of affairs can be contrasted with the classical and systematic effect of monetary policy on investment and business activity in general through changes in interest rates. But once the systematic operation of the price system as a selector between investment projects disappears, the justification of the claim that monetary policy automatically secures an optimal factor allocation is no longer valid. No one could claim that bankers in the milieu of an under-developed country will act on the basis of long-run social considerations.[33] To summarize, the greater the distortions, the less optimal and the more haphazard will be the working of the capital market and of the price system.

[32] FAO, *Interim Report*, op. cit. chapter III.

[33] *Interim Report*, op. cit., chapter III.

CONCLUSION

93. These considerations lead irresistibly to the conclusion that the optimal allocation functions of the price mechanism in the economic framework of under-developed areas are paralysed in the following ways:

(*a*) the structural fissures and disjointedness of the economic systems of under-developed countries fatally obstruct the working of the price mechanism. There is no inherent tendency in these systems either to equalization of factor remuneration (including interest), or to the elimination of monopolistic profit margins. Nor are production and prices sensitively adjusted to slight changes in demand, in a way consistent with the assumption of perfect competition or even of homogeneous, i.e. iso-monopolistic,[34] market organization.

(*b*) the factor allocation therefore is also faulted; in particular, the fissure between agricultural incomes and urban wages encourages an obsolescent type of primary production incompatible with social optimum returns. This also encourages monopolistic tendencies in industry and the labour market which in turn aggravate the distortions. The historical development of the economy, especially of its substructure (e.g. railways and public utilities) and its financial institutions, magnify the already great advantages of the enclaves of the fully developed foreign export sectors, preventing orderly diversification of production and exports. In particular, the allocation function of international trade and price relations are almost entirely paralysed.

(*c*) the underemployment and unemployment in rural as well as urban areas cause actual money wage costs to exceed considerably the true social cost, and their permanence vitiates the significance of exchange rates. Even at balance-of-payments equilibrium, the rate of exchange is grossly overvalued if unemployment is taken into account. A devaluation, far from remedying the position, might aggravate it by reducing the foreign exchange receipts of the country, *inter alia*, by increasing the profits of foreign-owned large scale enterprise.

94. The elasticity of the productive system is also gravely impaired:

(*a*) Agriculture, is, generally speaking, not subject to the usual motivations of enterprise which are at the base of recommendations for a negative "freeing" of the market forces to restore flexibility and stimulate progress. The inequality of land distribution and the desire to maximize security and enjoyment of income at a minimum of trouble and risk lead to the perpetuation of extensive agriculture, even on large holdings. Small owners lack knowledge and capital and the ability to carry through improvement schemes essential to the full utilization of modern productive techniques.

(*b*) The paralysis of the factor-allocation function of the price system necessitates protective measures for starting new (import substitute) industries. The all-pervasive monopolization of industry renders these inefficient, wastes scarce capital and renders the price structure inelastic downwards, but prone to increases whenever demand expands.

(*c*) The classical distributive functions of the capital market are not performed by the financial structure as it exists. On the contrary, it is a jumble of monopolistic interrelations which widen the discrepancy between the lenders' and borrowers' rates of interest to an unusual degree. The "free" working of the price system in this framework increases the degree of monopoly.

(*d*) The lack of budgetary means, due partly to ineffectual and to some extent regressive tax legislation, and partly to onerous expenditure on administrative staffs (a really wasteful way of creating employment) and on defence, has resulted in lagging expenditure on education, especially technical education. The consequent extreme differences in literacy, knowledge, skill and bargaining power have fractured the labour market, increasing monopolistic tendencies and hindering balanced development and the absorption of agricultural unemployed in industry. The rigidity of the productive structure is further enhanced.

95. It may therefore be concluded that the assumption is illegitimate that a mere negative elimination or ending of inflationary pressure would produce a balanced system, with optimal resource allocation automatically poised to promote optimal growth. Beyond and apart from inflation and whatever extra distortions it may have caused, the economic system remains in continued grave unbalance, liable to instability and stagnation. Only carefully discriminatory policies, equating money price with social costs can establish those conditions in which the classical precepts and policy-means (e.g. monetary policy) can operate, and the existence of which is implicitly assumed by traditional doctrine. In addition a complex of structural reforms are needed to create elasticity and competitive balance in agriculture, industry and the capital market.

[34] Iso-monopolistic refers to a situation in which there is identical strength of monopoly control in all markets.

REPORT OF THE EXPERT WORKING GROUP ON SOCIAL ASPECTS OF ECONOMIC DEVELOPMENT IN LATIN AMERICA

Held under the joint auspices of the United Nations Educational, Scientific and Cultural Organization, the United Nations Bureau of Social Affairs and Bureau of Technical Assistance Operations and the Economic Commission for Latin America

(Mexico City, 12 to 21 December 1960)

INTRODUCTION

1. The Economic Commission for Latin America, at its sixth session (Bogotá, Colombia, August 1955) recommended in Resolution 82 (VI) that Latin American Governments, when studying and formulating plans of economic development or social policy, "take into account the interdependence existing between economic and social factors", and stressed the need to "undertake an exchange of information and, as far as possible, co-ordination with institutions concerned with this type of problem".

2. As one method of implementing this resolution the Executive Secretary invited the participation of UNESCO in the organization of a seminar on social aspects of economic development in Latin America, to be conducted jointly by the secretariat of ECLA, the United Nations Bureau of Social Affairs, and UNESCO, in cooperation with the specialized agencies and the Organization of American States (OAS).

3. Following inter-agency discussion it was decided that instead of holding a seminar as originally envisaged it would be best as a first step to organize a meeting of an Expert Working Group of Social Scientists active in the disciplines concerned, which would have the task of clarifying the problems involved with a view to making such recommendations as it deemed advisable, and suggesting future lines of study and research. At the invitation of the Director General of UNESCO a preparatory meeting was convened in December 1959 at the Department of Social Sciences of UNESCO, at which specialists from the ECLA secretariat and the specialized agencies met with a small group of experts (economists, sociologists, demographers) in order to plan the documentation required for the Expert Working Group to meet a year later in Mexico City.

4. The Expert Working Group was presided over by Mr. Daniel Cosío Villegas, President of the College of Mexico and former President of the United Nations Economic and Social Council, and met between 12 and 21 December 1960, in the library of the ECLA Office in Mexico City. A list of the experts who attended, the documents prepared and the agenda of the meeting are set out as annexes I and II of the present report.

5. This report represents the consensus of the Expert Working Group and reflects the results of a series of intensive discussions at which the specialists concerned with the different aspects of economic and social development attempted to integrate their approaches and findings. It is the work of an Expert Group and does not necessarily represent the official views of the sponsoring organizations. Mr. Egbert de Vries, who had served as Chairman of the preparatory meeting and special consultant for this project, acted as rapporteur in the preparation of the present report.

6. In addition to this report, drafted in its present form for submission to the ninth session of the Economic Commission for Latin America and for the use of other organs of the sponsoring organizations, two volumes will be issued by UNESCO in its series of publications in the social sciences, one dealing with the work of the Expert Working Group and the other containing a selection of the papers prepared. The rapporteurs for the full report are Mr. Benjamin Higgins, Mr. José Medina Echavarría and Mr. H. M. Phillips.

I. THE SITUATION IN LATIN AMERICA

7. At the outset, it must be stated that Latin America, although it has in large measure a common history and cultural heritage, presents a far from uniform picture from the economic, social and political point of view. Thus, any attempt to sum up the character of this great sub-continent in only a few pages must do injustice to its diversity. Hence, many statements in this short preliminary report are oversimplifications which do not apply to specific countries. The Latin American countries nevertheless also have much in common, including the fact that their society is in a state of flux in reality as well as in its aspirations and in the image it has of itself.

8. From the *economic* point of view there has been development, rapid in some areas, slower and more erratic in others. The hopes — or perhaps dreams — of the war years of rapidly expanding markets for raw materials under stable market conditions have nevertheless failed to materialize.[1] In some countries, but not in others, industrial development based on import substitution has been rapid and successful. On the other hand, food production for export and even for domestic consumption and intracontinental trade has lagged. The development of basic industries and the manufacture of capital goods have been obstructed for one reason or another.

[1] The rapid development of African agricultural and mineral production (coffee, cocoa, cotton, copper, industrial diamonds, sisal, etc.) played an important role.

9. What is worse, there is no reason to believe that sustained economic development is in sight for the majority of Latin American countries. This uncertainty results partly from extreme sensitivity to the vagaries of the world market, and partly from lack of structural and organizational integration of domestic markets. In some countries sustained growth is difficult to achieve because population and aggregate national products are generally small.

10. The *social structure* of Latin America has in the past been characterized by a serious lack of integration. The small ruling groups had a way of life and aspirations completely different from those of the broad masses who worked the soil. However, with economic development and diversification, some countries witnessed the emergence of a new upper and middle class, whose ties with the old landowner class were rather tenuous. As could be expected, the size of these new social groups is related to the achievement of a higher per capita income and also the development of the educational system. While historical research provides no final satisfactory answer to the relationship between cause and effect, a strong cumulative interaction may be assumed to have occurred.

11. In Latin America the appearance of a substantial tertiary sector (services) has preceded rather than followed the development of an important secondary or manufacturing sector. Indeed, expressed in terms of persons employed, the share of the tertiary sector is excessive. Although it comprises some high-income professional groups — bankers and civil servants — it also contains large low-income groups such as domestics. Very little is known of the specific composition of this sector, the changes in that composition and the extent to which development is responsible for those changes.

12. A characteristic feature of Latin American countries is their rapid population growth. In a few countries where the birth rate is moderate the death rate is also the lowest, resulting in a high natural increase. There is no prospect that this rapid increase (2.5-3 per cent per annum) will subside. More research is needed into family life, its effect on people's activities and the changes it is undergoing.

13. The rate of urbanization has been high in most Latin American countries — at least as compared to other low income areas — and this process continues. The towns attract a large number of people from very low income rural areas and mobility among these groups is high. The economic, social and cultural influence of the towns on the countryside is limited and uneven.

14. Cultural and social facilities are very unevenly spread among the countries, and, generally speaking, within them as well. In spite of the rapid rate of development of primary education in most countries in recent years, shortcomings still exist in many, especially in rural areas. The data available on the size and distribution of educational facilities, their nature and adaptation to local conditions (often completely lacking) indicate that they are not contributing adequately towards a rapid development of the rural areas. There is a general deficiency in vocational, secondary and higher education.

15. There has been substantial entrepreneurship, but the scope and nature of its activities are not such as to ensure a continued high rate of economic growth. It has emerged mainly from the old feudal upper class or recently settled immigrant groups rather than from a national middle class. Its type is changing, although "the managerial revolution" is only now beginning to take place in Latin America. Most Latin American business enterprises have grown under a system of *laissez-faire* liberalism, often in conjunction with a high degree of governmental effort to promote industrialization or proliferation of unplanned regulations. Wherever an authoritarian political system prevailed, the entrepreneurs were usually part of the ruling group or in close contact with it.

16. The *public administration systems* of Latin America in general, and for a long time, have been patterned on nineteenth century liberalism, mainly of the French type. However, a professional civil service, divorced from membership in ruling classes, has as a rule failed to develop in Latin America. The career civil servant often had a low social status and many public services had to be performed by the social elite or by members of the professions on a part-time basis. This was accompanied by a formal rather than substantive democratic system of government. When a strong "demonstration effect" prompted many nations to adopt the outward forms of a service state, public administration systems could only adapt themselves slowly to the requirements of a much wider function. A smaller number of better trained, better paid, full-time civil servants is perhaps the answer to the problem. In the meantime, confusion will continue to prevail. For instance, while some highly efficient professional cadres of engineers have been established, others (e.g. tax policy experts) are virtually non-existent.

17. Attempts to overcome inefficiency in the lower ranks by centralization of daily administrative decisions cannot succeed and some devolution of responsibility is necessary as the duties of the state multiply.

18. The political scientists in the Working Group stressed the need for a more thorough study of the effects of democratization, or of the participation of a larger share of the population in the political processes of a country as it develops.

19. Economic development, in many countries, also requires substantive changes in prevailing legal systems, juridical institutions and law-enforcement agencies.

20. In an effort to determine policies suitable for specific regions in Latin America, the group considered the steps that had been taken to establish a *typology* of Latin American countries.[2] Whereas these attempts were based upon the *status quo* rather than upon the processes of development in various fields, a rather surprising degree of convergence between economic indicators, social stratification statistics and educational statistics nevertheless became apparent. The group noted, however, that in many respects statistics were either unavailable or inadequate. For various reasons, no correlation appeared between the typology proposed and recent rates of national product growth. In the political and administrative field, a typology based upon measurable data is more speculative. Moreover, because of the enormous differences in economic and social conditions within a country a national average is often rather devoid of meaning. In a number of social fields, studies in depth of the monographic type, carried out within certain countries, might shed more light upon the value of the typology derived from national comparisons.

21. The picture of Latin America would be very incom-

[2] Provisionally, five groups were distinguished: (a) Argentina, Chile and Uruguay; (b-1) Brazil and Mexico; (b-2) Colombia, Cuba and Venezuela; (c) Bolivia, Ecuador, Paraguay and Peru; (d) Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama, and (e) Dominican Republic and Haiti.

plete if no mention were made of the *aspirations* of nations and the *expectations* of their people. Undoubtedly, the inequality of the various interrelated social processes causes tensions and anxiety. While actual conditions generally lag far behind aspirations, the real nature of the expectations cannot easily be gauged. There is — at least among important groups — a desire to increase the rational factor in development through the application of well defined socio-political theories or through the more technical means of programmed development.

22. The tenor of the documents and discussions was not such as to indicate any great attraction to the North Atlantic or the communist images of society; at the same time, the liberal heritage of the Mediterranean countries had lost its appeal. Perhaps it can be said that Latin America is yearning for more coherent and pervasive changes in its socio-political and economic structure without disrupting its own identity. It is recognized that these changes must be accompanied, and even encouraged, by greater efficiency in production and administration as well as by more rationality in the adoption of decisions.

23. At the same time, however — and development programming in various fields must bear these psychological undercurrents in mind — there runs through the papers and discussions a threefold social ideal — an urge for freedom, progress and social justice. The three are not always compatible, and different groups or countries will not readily agree on which should come first, if a choice is to be made. To many, however, all three are of great value.

24. The desire for freedom underlies suspicion of foreign influence and even leads to mistrust of foreign aid. It underlies the feelings of many against national bureaucracies, which are not considered agents of justice or progress. Progress, in the mind of people, must be tangible and rapid. Latin American nations have little patience with carefully-laid plans which are not executed and often mistake conspicuous public works for progress. However, they now expect their governments — and the world at large — to give them the opportunity to make rapid changes. The yearning for social justice — or, to use a less dramatic word, equity — in domestic affairs has become a compelling reason for demanding changes in domestic income distribution. It also influences the views of the Latin American nations with regard to the world market for its raw materials.

25. This short survey, necessarily incomplete and based on generalities, leads to the conclusion that there is in Latin America an objective and subjective need for more comprehensive general economic and social programming. It is sincerely hoped that a comprehensive analysis of the situation and potentialities of the various countries will produce programmes and techniques which will help to promote a rapid development of human and natural resources and profound changes in social structures, leading to greater national coherence and unity.

II. THE PROCESS OF ECONOMIC AND SOCIAL DEVELOPMENT

26. In considering the processes of economic and social development, the Working Group agreed that, within the framework of the task entrusted to it, an important distinction should be made between various types of "social aspects" of economic development.

27. On the one hand, economic development almost inevitably brings certain social changes. Where these changes are uneven — a matter to be deplored — an insufficiently rapid economic tempo or a serious lack of uniformity in the economic development process itself may be responsible. A shift of emphasis in the economic programme might then produce the desired social changes.

28. On the other hand, economic development might be hampered by obstacles of a social or socio-psychological nature. If so, the economist would in a sense be helpless unless social scientists developed techniques to diagnose, overcome or circumvent such social obstacles.

29. Lack of detailed information prevented a definite conclusion from being reached as to the relative importance of the two types of "social aspects of economic development".

30. First, it was agreed that rapid economic development would have consequential effects on the socio-political aspects of society to such an extent as to make an economic "big push" the real answer to many of Latin America's social problems as well.

31. Secondly, it was recognized that rapid rational or programmed economic development was itself dependent upon the political will of the leading groups in society; and therefore, in most countries, a change in the attitude of these leading groups, or their replacement by others, was a prerequisite for solving economic problems.

32. Thirdly, the view was expressed that sustained economic development, over a sufficient period of time, would only be possible if society as a whole participated in the changes and the process of development. The profound dichotomy of Latin America's socio-economic structure into two parts, one "dynamic" and the other "stationary" would prevent even a major economic drive, achieved merely through capital investment and personnel training in *part* of the country, from creating *overall* conditions of rapid and balanced socio-economic development.

33. It should be pointed out that the presentation of these three views did not coincide with the tripartite composition of the group as economists, political scientists and sociologists. It was further admitted that these views would not be incompatible under favourable circumstances.

34. Assuming that there exists in their respective countries the determination to promote development and the political authority and administrative ability to carry out the desired programmes, economists could very well set out prerequisites to and methods of economic and social development for that part of society which is already in the process of development. In this particular area, there seem to be no social impediments peculiar to Latin America which would require special treatment. However, a "big push" in economic development calls particularly for the following: (a) an increase in capital formation through appropriate, properly enforced taxation and effective means of stimulating private savings; (b) the acceptance and assurance of foreign aid and capital to bridge the gap between the utmost that countries can do themselves and their absorptive capacity; (c) incentives for workers, employees and farmers to improve their performance; (d) the strengthening of the new group of business managers, and the development of economic leadership at less than the previous cost to society as a whole; (e) the promotion of technological progress,

especially through well-planned training and education programmes which would involve every effort to train enough people at the right time for their new role in society; (f) a reduction in technological dualism, especially in agriculture, which would require agrarian reform.

35. It was pointed out that lack of stability in export markets of raw materials and short-term, project-by-project foreign aid impeded sustained economic growth and imposed severe limitations on economic programming.

36. If this analysis of conditions and prerequisites is valid, the major obstacles to rapid and sustained economic development are to be found at two levels.

37. First, the existence of an economic ruling group (both private and governmental) with a genuine desire to promote economic development and the necessary administrative and organizational ability to do so, is a pre-condition which is not fulfilled in every country. In this respect, one can only hope for a strengthening of four factors operating at present throughout Latin America: (a) the political-socio-economic "demonstration effect" of events in other countries both within and outside the continent; (b) the increasing degree of participation in political processes; (c) the effects of international co-operation and joint endeavours to accelerate economic development; (d) the improvement of programming and administrative techniques. Many Latin American countries certainly have serious political problems of this kind.

38. Secondly, technological dualism, although diminishing in some countries, is serious and persistent in others. Ethnological and linguistic discontinuities coincide with geographical isolation and educational deficiencies. The peasant and rural worker doing his job often suffers from physical obstacles, health handicaps, and limitations imposed by land tenure. Consequently, he cannot adequately meet the need for increased production. If circumstances permit, he is often eager to join the dynamic society of urban centres; however, he arrives badly prepared bringing his social dualism into the dynamic segments of society.

39. The view was expressed that an integral approach to planning and execution would be necessary in order to achieve development in this more or less static sector of the economy. Anthropologists, sociologists, educationists, economists, agronomists and administrators must develop programmes carefully and governments must carry them out boldly. It may be assumed that while in the early stages the absorptive capacity of the backward rural areas, expressed in capital funds, would be moderate, their need for well trained, dedicated personnel would be very great indeed. It seemed obvious that increases in agricultural productivity would speed up rather than slow down the need for jobs outside agriculture.

40. The various programmes of rural development in Latin America, including types of agrarian reform must be studied, compared and evaluated in order to define more clearly the existing opportunities and limitations. Land reform must be expected to cause a short-term decrease in agricultural productivity. At that point, foreign aid could be most constructive and welcome.

41. Emphasis in this short report has naturally been placed on governments and public administration on the one hand, and on rural areas on the other. It must be emphasized that in many countries economic and social development, at least in some sections of society, is indeed very rapid. This underlines the need for strengthening all those technological, economic and social forces — both private through management and organized labour, and public through education and administration — which are beginning to transform the structure of Latin American society.

III. POLICIES AND PROGRAMME RECOMMENDATIONS

42. Having analyzed the situation and potentialities of the region in the process of development, the Working Group has drawn the conclusions set out in sections A, B and C on the policies and programmes to be followed.

43. It was perhaps for the first time, that an international group of experts from such a variety of social sciences had been called together to offer recommendations to intergovernmental agencies and interested governments, on policies and programmes derived from a multi-disciplinary analysis of the needs and prospects of an area like Latin America.

44. The consensus reached in ten days of discussion has given further support to the idea that integration of approaches may lead to more concerted action.

45. The Latin American region, with 200 million people spread over twenty countries, undoubtedly has rich potentialities, but considerable effort will be required in order to achieve well-integrated rapid development through increased productivity of all groups of inhabitants and an equitable distribution of the aggregate national product. The Working Group believes that while the targets it has considered in research, programming and execution are realistic, much remains to be done before they can be achieved.

46. In the policy recommendations from the point of view of the economist, the sociologist and the political scientist, it is apparent that economists can be more specific than other social scientists, particularly political scientists. This is understandable in view of the much greater effort made all over the world to apply economic theory in policy formation. It does not mean that the contributions of the other branches of the social sciences to development policies could not also become most important and even decisive. At present, however, knowledge of social structures and people's attitudes is insufficient for specific programmes of action to be elaborated.

47. The social sciences can systematize the study of people's values and beliefs, their attitudes and action; they can help evaluate the effectiveness of their organization for production, distribution and administration; they can describe their social groups and the changes in these groups. Through comparison with human activities elsewhere they can also advise on the likely effects of programmes and policies.

48. Action, however, depends upon the unity of will in society itself. This, of course, the social sciences cannot create.

A. The economist's recommendations

(1) The economic development of Latin America is being handicapped by two important limitations that must be overcome. In its present form economic development (*a*) does not bring about social integration; (*b*) does

not ensure sustained or steady growth over a long period of time.

(2) Three conditions are essential if development is to be integrated: (*a*) per capita income growth must be substantial enough for people to be aware of it and to appreciate its effect in broadening their opportunities; (*b*) the form of development must be conducive to a reduction of personal, sectoral and regional differences of income and wealth; (*c*) it must bring about a substantial reduction in unemployment and underemployment.

(3) An annual increase of 3 per cent in per capita income is the minimum acceptable target for rapid growth. Given the rates of population growth in Latin American countries, this is equivalent to a total annual income growth rate of 5 to 6 per cent.

(4) The achievement of this rate of growth might be sought over a period of some ten years or alternatively within a period of three or four years. Of these two alternatives the second (the "big push") will prove necessary in many Latin American countries in order to create rapidly a complex of complementary productive facilities and a psychological atmosphere favourable to expansion of private investment.

(5) One of the principal obstacles to the acceleration of development by means of the "big push" is the increased foreign exchange which this policy requires. If foreign financial aid is to be available in adequate amounts, economic and social factors should be taken into account. One of the most important requirements is to assure the availability of a specific sum, year after year, to stimulate the preparation of carefully worked out programmes and projects. Secondly, it must be recognized that medium-term loans merely postpone the solution of financial problems. Long-term loans at low interests rates and, under certain circumstances, outright grants, are essential. From the socio-political point of view, sufficient weight should be given to Latin American national sentiment, which makes it advisable to provide aid on a mutilateral rather than a bilateral basis. Similarly loans to governments would be preferred over direct private foreign investment. Finally, loans should be made available for economic development programmes as a whole, rather than for individual projects.

(6) Another major obstacle to acceleration of development is the inadequacy of existing taxation systems and governmental machinery. In view of the stage of development of most Latin American countries the State will probably continue to play in the economic field a role as great as or greater than it has played in the past. Taxes as well as direct government investments will have to be increased. Substantial tax reforms are thus necessary in the majority of Latin American countries. Taxation should serve to stimulate efficiency in the use of productive resources as well as to check inflation. The foreseeable growth in governmental functions will further emphasize the serious deficiencies already apparent in public administration in Latin America, especially in regard to the machinery for the elaboration of economic and social policies and the means of gathering information.

(7) Private domestic savings must also be increased. Total savings can be expanded without difficulty where income grows rapidly and is unevenly distributed; however, it is also essential to encourage more people to participate in the process of savings.

(8) Every country should prepare a careful analysis of the effects of monetary expansion on price and wage structures (including sectoral and regional structures) and thus on the level and composition of investment and the labour supply.

(9) The continuous introduction of technological and organizational innovations is essential for accelerated development, especially in agriculture. The mechanization of Latin American agriculture is a problem of agricultural research, agricultural credit, extension services, improved land tenure systems, and the introduction of incentives and penalties. To a lesser degree it is also a matter of mechanization.

(10) If rapid economic development is desired, resource surveys must be carried out and, as development proceeds, potential resources including mineral, agricultural, energy, and man-power resources, should be constantly reappraised.

(11) Rapid economic development can improve income distribution since increases in income can be equitably distributed without actually reducing the income of any group. In order to effect a better distribution of personal income the following policies must be applied:

(a) Investment should be so directed as to ensure a more rapid increase in the production of goods and services consumed by wage-earners than in that of other goods and services;

(b) The chief causes of the wide income gap must be eliminated. These causes are technological (agricultural-urban) dualism, the great concentration of agricultural land ownership, and the inequalities of educational opportunity;

(c) Labour organizations should be strengthened and their membership broadened. Their leaders, without ceasing to represent the interests of the wage-earners, should be aware of their responsibilities for accelerating economic development and should participate in the formulation of national development policy;

(d) The minimum wage policy should take into account intersectoral and regional differences in productivity and should reflect changes in these as development proceeds.

(12) Social integration should also be sought through development. The backward regions of each country should be incorporated into the process. On the other hand, it must be remembered that excessive emphasis on regional balance may retard development of the economy as a whole.

(13) To achieve a sound development process the purchasing power of Latin American exports, the main source of present instability, must be stabilized. Stability can be achieved by the following measures:

(a) Establishment of price stabilization programmes on raw materials exports;

(b) Diversification of exports;

(c) Development of import substitutes within the framework of the common market;

(d) Establishment of a compensatory international financing system, and mainly

(e) By accelerating the establishment of a broad regional common market.

(14) The instability of growth is also connected with underdevelopment of industries producing capital goods. The growth of these industries is to some extent limited by the small size of the market. The establishment of a broad common market would help to remove this limitation.

(15) Another important factor in sustained and steady development is an organization for creating and diffusing innovations, which scarcely exist in Latin America at present. Innovation by imitation is not sufficient. Both governments and associations of private enterprises should be encouraged to assist in setting up such an organization.

(16) In order to attain the objectives of steady and integrating development, available programming techniques should be utilized to the full. However, effective programming is more than a matter of technique. It is also a matter of: (a) information; (b) personnel; (c) administrative organization. Just as the objectives of development are not purely economic, programming techniques are defective if they do not represent an integrated approach. The development of such an approach requires a good deal of research.

(17) In choosing instruments of economic policy, it must be borne in mind that no instrument is neutral as regards its effects on: (i) distribution of income, and (ii) development of the different regions or cultures within the same country. For this reason, instruments that are regarded as neutral and homogeneous in their influence are not applicable in Latin America in view of the duality and heterogeneity found in each country.

B. The sociologist's recommendations

(1) Latin America should not surrender to spontaneous social change. Both the planning and forecasting of change must become a matter of rational social policy.

(2) This induced social change presupposes parallel action in both economic and social development. Some of the changes will inevitably produce discontinuities in social patterns. These need to be identified and positive measures taken to alleviate the corresponding social costs.

(3) Scientific effort must be pursued in order to achieve, whenever possible, the preparation of models in which the economic and social aspects of social change are integrated.

(4) Development, as far as its social prerequisites are concerned, calls for increased national integration and international co-operation. It presupposes, from an economic point of view, not only an increase in general welfare but also an attempt to achieve a more satisfactory distribution of income.

(5) Social integration of Latin America, in many cases, requires structural modification in agrarian systems, even at the cost of a short-term decline in productivity.

(6) These modifications should lead, in one way or another, to a reduction in the social and cultural inequality between rural and urban areas, even at the expense of the current position of large cities. This problem is common to all Latin American countries.

(7) Particular attention must be paid to demographic research and to the dissemination of the results obtained. Much additional basic social data is either lacking or of poor quality. Basic information on the present situation and past trends is essential to rational planning.

(8) There seems to be a common basic need for active measures with respect to the educational system in all its forms and at all levels and for steps to achieve rapidly the necessary changes in its content, methods, and results. Such educational changes are useful from the social, as well as the political and economic points of view.

(9) The training and improvement of the labour force, including both technical and professional education and the training of employees at all levels by business enterprises themselves, are equally important.

(10) Responsible and effective labour union activity can help to integrate workers into the new, expanded social structures and also to protect the economic interests of union members.

(11) An increase in opportunities for entrepreneurial action, particularly in a larger supply of trained managers at various levels of responsibility, is desirable.

(12) Improvement in governmental administration at all levels, particularly in regional and municipal governments, is urgently required. Insistence upon merit as the sole criterion for appointment and promotion, adequately remunerated, will improve both the quality and standing of the civil servant.

(13) Popular support, essential to development policies, must be enlisted. In particular, the participation of all social groups in the tasks of development, both political and social, should be encouraged. Participation at the local community level is of special importance.

(14) Social mobility should be promoted, and inducement to higher levels of aspiration and hopes for advancement simply will not suffice. Assurance of objective rewards, in all social activities, based on actual merit, is necessary.

(15) The juridical system should be revised with a view to ensuring the maximum degree of security to those engaged in economic and social activities. Both confidence and equity are essential in legal and judicial processes.

(16) Since plans and reforms are not carried out in a social vacuum, the varying functional interrelations within Latin American societies must be taken into account in formulating development programmes.

C. Recommendations of the political scientist

1. *General remarks*

Whereas scientific and objective knowledge of political events in Latin America does not, as yet, provide a sufficient basis for specific recommendations, and since even the theoretical aspects have not been thoroughly explored, the Working Group recommends that, if a meeting similar to the present one is held in the near future, it should be organized with a view to examining the political aspects of economic development in Latin America and that, if so, the following outline should be taken as a point of departure for the discussions.

2. *Basic assumptions*

The following are the premises on which the recommendations for further study and discussion are based:

(1) In order to carry out programmed economic development, a relationship must be maintained between the requirements of the development plan and those of the process of authority in the respective community.

(2) This relationship depends on the extent to which the political process represents society and the government reflects the political process.

(3) The adaptation achieved between the political process and society depends on the type and degree of participation of its members.

(4) The adaptation achieved between government and the political process depends on the representativeness of political parties and the degree of responsibility of members of the government.

(5) The possibility of furthering in a deliberate manner the maximum representative character of the political process and maximum governmental responsibility is generally determined by the social structure of the community.

3. *Basic ideas*

(1) From the point of view of political science, ideologies could be interpreted as an attempt — successful or not — to rationalize the interests of one or more social strata in order to achieve the greatest possible support of other groups. Consequently, political science attempts to consider ideologies from a functional point of view independently of the scientist's personal values system.

(2) The functional requirements of ideologies are, in general:

(a) Their representative character, in other words, the degree of relationship between ideology and the situational interests of the social strata that sustain them;

(b) Their historical viability.

(3) Preparation of a political typology corresponding to different social structures is both possible and desirable. In this case, and from the point of view of economic development, it is probable that every social structure has a political model best suited to it.

(4) The political model is not so much an ideal system but is the best of the systems available by which to achieve economic development.

(5) In actual society, where economic development is not the only objective, the aforementioned political model may no longer be determined by the desired social objectives.

4. *Political typology*

(1) It is essential that political science should offer a general political typology through which a typology specifically applicable to Latin America could be prepared. The following standards might be acceptable for the latter:

(a) The criterion of the possibility of survival and expansion of the nation-State, assuming that certain conditions regarding territory, population, national resources, and geographic location have been met;

(b) The criterion of social structure, i.e., the relationship between the different social classes;

(c) The dynamic criterion of the possible structural relationships that might arise in a process of change.

(2) In so far as its application to Latin America is concerned, and in relation to the criterion referred to in sub-paragraph (b) above, the ability of the State to overcome the social crisis resulting from the "demonstration effect" and the political crisis deriving, on the one hand, from lack of representativeness of the political process, and on the other, lack of responsibility of the governmental process, should be borne in mind.

(3) The lack of representativeness of the political process is caused by insufficient integration of Latin American societies which impedes the establishment of organizations able to give formal expression to their interests and needs. This, in turn, weakens effective governmental responsibility in the dual sense that it limits the expression of popular support and the existence of popular control.

(4) The preparation of a political typology would allow political models appropriate to each social structure and favouring rapid economic development to be defined. These models would serve, moreover, as a yardstick by which to measure the degree of adaptation of the political system prevalent in each country, from the point of view of its functioning in economic development.

(5) The preparation of political models applicable to Latin American countries would probably include various combinations, among others, of the following preponderant factors:

(a) National middle-class entrepreneurial classes and/or technocratic middle-classes;

(b) Parliaments with a predominance of political parties which, because of nationalist aspirations, support economic development as a fundamental political force, or centralized political groups of a profoundly reformatory nature, under the leadership of the middle-class technocratic group;

(c) Governments which prepare programmes for and impose taxes on economic development efforts carried out principally by national entrepreneurs, or governments that assume the entrepreneurial role because of inadequate private effort.

IV. RESEARCH NEEDS

49. In the course of its work the Working Group was handicapped by the lack of social data available in Latin America, and recommended that research should be initiated or intensified over a wide range of subjects which needed further study for a proper understanding of conditions in Latin America. Accordingly it drew up the list of research needs which is shown at the end of this report.

50. The possibility of grouping the research needs under broad problem headings was considered. It was felt, however, that the subjects might best be listed as they emerged from the discussion itself, because of the overlap between different aspects of the subject and different disciplines, and the need to view the subject as a whole.

51. This list is by no means exhaustive, and the omission of a number of items does not necessarily mean that enough is known about them. The list contains a priority group of subjects (marked with an asterisk). In selecting these priorities the Working Group was alive to the fact that the best use should be made of the research resources available, which, in the field of social sciences as a whole, are not very extensive and in Latin America are far short of what is required.

52. The group heard a statement from Professor Gino Germani, representing the Governing Body of the Latin American Research Centre in the Social Sciences at Rio de Janeiro, and the Latin American Faculty of Social Sciences at Santiago, Chile, two regional centres established by the countries of Latin America under UNESCO auspices. Professor Germani explained the work programmes of

these two centres and drew attention to the need for additional funds to expand their activities. The Working Group recommended that these centres, particularly the regional Research Centre at Rio de Janeiro, should increase their "clearing house" facilities in order to ensure the maximum use of existing research findings and methods.

53. The Working Group wishes to draw the governments' attention to the need to develop research instruments, particularly census data, as an absolute prerequisite for economic and social development programming.

54. The Group recognized that the provision of adequate social data depended not only on the action of governments in requiring the data for programming and planning, but also upon the action of independent research institutes and the universities in developing the necessary research personnel and methods, with such outside assistance as might be required.

55. Accordingly, steps should be taken to intensify both social science research and teaching in Latin America and to ensure greater contact between the social scientists of the different countries and an exchange of research experience.

56. In addition, the Group believed that the reports of experts under the technical assistance programmes of international agencies would provide a valuable source of information on the problems discussed at the meeting, and it hoped that the agencies would find a way of making these reports more widely available to social scientists, under proper safeguards in view of their confidential character as reports to governments.

V. FINAL OBSERVATIONS

57. In presenting the results of its findings to international agencies and interested governments, the Working Group hopes to reach the nations of Latin America. It is the people and their governments who shape their own destiny through the choice of a programme of action and — this should be stressed — equally through failure to choose a concerted programme of action. Sustained economic and social development requires widespread popular support.

58. The work of the Group will be published in full detail at a later date. In presenting this summary report, with recommendations for policies and research, the Working Group expresses its conviction that action at various levels need not await evaluation of the full report. Governmental and inter-governmental agencies, universities and non-governmental organizations will, it is hoped, find an incentive even in the preliminary results of this meeting to cordinated and effective activities.

LIST OF RESEARCH NEEDS

1. Historical studies at the national level of political, social and economic development of the Latin American countries which may lend themselves to comparison and synthesis.*
2. Study of the functioning of different types of political systems (degree of diparticipation of different groups, sources of political power, how decisions are made, etc.)*
3. Comparative studies of organization (public and private) at different levels of development.
4. What models of social development do the different types of political systems permit? Study of problems of timing of social change, spontaneous and induced, in relation to economic development.*
5. What forms of democratic government are appropriate to societies at different levels of economic and social development.*
6. Methodology of social planning, and of integrating social with economic planning.*
7. Forms of social differentiation ("stratification") in Latin American countries.
8. Data on the distribution of income, and studies of the consequences of measures adopted in different Latin American countries leading to the redistribution of income (income taxes, subsidies, minimum wage laws, family allowance, etc.)*
9. Study of the "intellectual proletariat" (origins, outlets, relation to educational systems and to the economic and sociological situation).
10. Study of the structure of Latin American elites.
11. Study of "intelligentsia" in relation to economic and social development (attitudes, opportunities for leadership, etc.).
12. Study of Latin American youth (from 16 to 25). Images of and attitudes to economic and social change.
13. Students' participation in political movements and interest groups.
14. Study of the role of trade unions and other voluntary associations of an economic and social character in Latin American economic, social and political development.*
15. Study of participation of low income groups in the political, social, economic and cultural life of the country.*
16. Role of mass communication media (newspaper, radio, TV) in relations between the government, intellectuals and the "masses" in respect of development needs.*
17. Study of the role of entrepreneurs in Latin America and changing concepts of entrepreneurship and attitudes to it (social, political, psychological).*
18. Relation between systems of remuneration and economic and social change.
19. Nature of disguised unemployment and reasons for it (economic, educational, demographic, social structure).
20. Study of economic and social mobility of Latin American populations (both overall and individual turnover, and relation to educational systems.)*
21. Study of the relative advantage of the two methods of developing backward areas in a country by bringing capital to the under-developed areas or by shifting the population to developed areas.
22. Study of social aspects of land tenure and land reform as factors in economic development.*
23. Relations between town and country (economic, sociological, demographic, political).*
24. Analyses of population densities, transport facilities and social and economic resources in rural areas.
25. Study of means of bringing the subsistence section of the economy into the economic market, with particular reference to the means of promoting changes of attitude in rural areas designed to increase agricultural productivity.*

* Indicates priority.

26. Studies of methods of choosing technologies required and adopted both in industry and agriculture.

27. Study of new occupations in the last 20 years; educational requirements and training (where given) in selected Latin American countries.

28. Study of employment of women and its relation to population growth, social change and economic growth.

29. Study of a number of occupational groups influencing socio-economic change at local level (small shopkeepers, moneylenders owener-drivers of lorries, etc.).

30. Methods of calculating the needs of manpower and its training (inventory of resources and needs).*

31. Study of motivations for saving, and forms of saving.

32. An analysis of implicit and explicit values in primary and secondary school curricula and textbooks.

33. Training of administrators, managers and entrepreneurs; study of methods by which an adequate supply can be made available for both the private and public sectors.

34. Studies of relations between private and public school population and social stratification.

35. Adult education in relation to community development programmes: studies of interrelationships.

36. Educational implications of the prevalent values and attitudes in rural and indigenous communities.

37. Role of formal education in Latin American economic and political life.*

38. What are the processes of attitude formation in education?

39. Studies of differential fertility and of attitudes and motivation in respect of fertility (including adult educational programmes).*

RESEARCH INSTRUMENTS

40. Systematic collection and dissemination of the research being carried out by all kinds of agencies and of which even other investigators in the same country are unaware.

41. Measures by international agencies engaged in technical assistance to provide wider access to the information on social and economic questions contained in the reports of experts.

42. Dissemination of a methodology handbook for research workers.

43. Clearing-house role of the Latin American Centre for Research in the Social Sciences (Rio) and the university *"Institutos de Investigaciones Socio-económicas"*, (including publication of research abstracts and journals and their circulation, holding of regular conferences among social scientists, etc.).

44. Improvement of demographic and national census data, their tabulation, analysis and publication.

45. Improvement of basic social data and training of research personnel.

* Indicates priority.

Annex I

LIST OF PARTICIPANTS

1. EXPERTS

Chairman of the meeting: Daniel Cosío Villegas, President, *El Colegio de México*, Mexico City, Mexico
Rapporteur for the meeting and Special Consultant: Egbert de Vries, Rector, The Institute of Social Studies, The Hague, Netherlands
Rapporteur for the full report: Benjamin Higgins, Chairman, Department of Economics, University of Texas, Austin, Texas, United States of America
José Medina Echavarría, Acting Director, Social Affairs Division, Economic Commission for Latin America, Santiago, Chile
H. M. Phillips, Chief, Division of Applied Social Sciences, Department of Social Sciences, United Nations Educational, Scientific and Cultural Organization, Paris, France
James C. Abegglen, Social Psychologist, Cambridge, Massachusetts, United States of America
Jorge Ahumada, Director, Economic Development Division, Economic Commission for Latin America, Santiago, Chile.
Herbert Emmerich, Senior Consultant, Division for Public Administration, Department of Economic and Social Affairs, United Nations, New York
Florestan Fernandes, Professor of Sociology, University of São Paulo, Brazil
Gino Germani, Director, Department of Sociology, University of Buenos Aires, Argentina
David Glass, Professor of Sociology, London School of Economics, London, United Kingdom
Hélio Jaguaribe, Professor of the Brazilian Institute for Higher Studies, Ministry of Education, Brazil
Jacques Lambert, Director, Institute of Comparative Law and Professor of the Faculty of Law, Lyons, France
Wilbert E. Moore, Professor of Sociology, Princeton University, United States of America
Felipe Pazos, Economic Consultant, Banco Gubernamental de Fomento para Puerto Rico
Jeanne Sylvain, Regional Social Affairs Adviser, ECLA Mexico Office, Mexico City, Mexico
Rev. Roger Vekemans, Expert of the Organization of American States, (OAS)
Oscar Vera, Assistant Director of the UNESCO Regional Centre for the Western Hemisphere, Havana, Cuba

2. REPRESENTATIVES OF SPONSORING ORGANIZATIONS

United Nations Educational, Scientific and Cultural Organization
H. M. Phillips
United Nations Bureau of Social Affairs
Marshall Wolfe
Economic Commission for Latin America
Alfonso Santa Cruz
Cristóbal Lara Beautell
Joseph Moscarella

3. REPRESENTATIVES OF SPECIALIZED AGENCIES

International Labour Organization (ILO)
L. Costa
M. Rodríguez
Food and Agriculture Organization (FAO)
Ricardo Téllez
World health organization (WHO)
Jorge Castillo

4. REPRESENTATIVES OF INTER-GOVERNMENTAL ORGANIZATIONS

Organization of American States (OAS)
Remy Bastien
Centro de Estudios Monetarios Latinoamericanos (CEMLA)
Javier Márquez

5. SPECIAL OBSERVERS

Frank Bonilla, American University Field Staff, Río de Janeiro, Brazil
Kalman H. Silvart, American University Field Staff, Buenos Aires, Argentina

6. SPECIAL MEXICAN GUESTS

Pablo González Casanova, Director of the School of Political and Social Sciences, National Autonomous University of Mexico
Victor L. Urquidi, Member, *Colegio Nacional*

II. AGENDA AND LIST OF DOCUMENTS

I. The situation in Latin America

A. *The economic situation*

Documents:

Economic development and problems of social change in Latin America (ST/ECLA/CONF.6/L.A-1) (Part II)
by Jorge Ahumada of the Economic Commission for Latin America

Requirements for rapid economic development in Latin America: the view of an economist (UNESCO/SS/SAED:LA/B-2b) (Part II)
by Benjamin Higgins, Chairman, Department of Economics, The University of Texas, Austin, Texas, United States of America

B. *The social situation*

Documents:

Population growth and structure: a social-demographic study by David Glass, Professor of Sociology, London School of Economics, with the collaboration of Carmen Miró, Director, Regional Centre for Demographic Training and Research in Latin America, Santiago, Chile (UNESCO/SS/SAED:LA/A-2)

Review of the socio-economic typology of the Latin American countries (UNESCO/SS/SAED:LA/A-3)
by Rev. Roger Vekemans, of the Organization of American States

Pattern and rate of development in Latin America (ST/ECLA/CONF.6/L.B-5)
by Florestan Fernandes, Professor of Sociology, University of São Paulo, Brazil

Relationships between economic and social institution: a theoretical model applicable to Latin America (ST/ECLA/CONF.6/L.C-1)
by José Medina Echavarría of the Economic Commission for Latin America

The strategy of fostering mobility (ST/ECLA/CONF.6/L.B-4)
by Gino Germani, Director, Department of Sociology, University of Buenos Aires, Argentina

C. *The political, educational and administrative situation*

Documents:

Programmed economic development and political organization (ST/ECLA/CONF.6/L.C-2a)
by Daniel Cosío Villegas, President of *El Colegio de México* (Chairman of the Expert Working Group)

Programmed economic development and political organization (An effort to identify inconsistencies) (ST/ECLA/CONF.6/L.C-2b and Add. 1)
by Hélio Jaguaribe, Professor of the Brazilian Institute for Higher Studies, Ministry of Education, Brazil

The position of education in Latin America, including a discussion of educational requirements in the region (UNESCO/SS/SAED:LA/C-3b)
by Oscar Vera, Deputy Director of the UNESCO Regional Centre for the Western Hemisphere, Havana, Cuba, and Co-ordinator of the Major Project for the Extension of Primary Education in Latin America

Administrative roadblocks to co-ordinated development (ST/ECLA/CONF.6/L.C-4)
by Herbert Emmerich, Senior Consultant, Division for Public Administration, United Nations Department of Economic and Social Affairs

D. *Integration of points of view*

II. The process of economic and social development

A. *The economic view*

Documents:

Economic development and problems of social change in Latin America (ST/ECLA/CONF.6/L.A-1) (Part III)
by Jorge Ahumada of the Economic Commission for Latin America

Requirements for rapid economic and social development: an economist's point of view (ST/ECLA/CONF.6/L.B-2a)
by Felipe Pazos, Economic Consultant, *Banco Gubernamental de Fomento para Puerto Rico*

Requirements for rapid economic development in Latin America: the view of an economist (UNESCO/SS/SAED:LA/B-2b) (Part I)
by Benjamin Higgins, Chairman, Department of Economics, The University of Texas, Austin, Texas, United States of America

B. *The sociologist's view*

Documents:

Requirements for rapid economic and social development: the view of the historian and sociologist (UNESCO/SS/SAED:LA/B-1)
by Jacques Lambert, Director, Institute of Comparative Law and Professor of the Faculty of Law, Lyons, France

The strategy of fostering performance and responsibility (UNESCO/SS/SAED:LA/B-3)
by Wilbert E. Moore, Professor of Sociology, Princeton University, United States of America

The relationship between economic and social programming in Latin America, with special reference to: Scientific research, technology and social structure; manpower needs, resources and utilization; values and conflicts; importance of innovations and imitation; education and general educational requirements (UNESCO/SS/SAED:LA/C3a)
by James C. Abegglen, Social Psychologist, Cambridge, Mass., United States of America

C. *The views of the political scientist and the administrator*

Documents:

Relationships between economic and social institutions: a theoretical model applicable to Latin America (ST/ECLA/CONF.6/L.C-1)
by José Medina Echavarría of the Economic Commission for Latin America

Programmed economic development and political organization (ST/ECLA/CONF.6/L.C-2a)
by Daniel Cosío Villegas, President of *El Colegio de México* (Chairman of the Expert Working Group)

Programmed economic development and political organization (An effort to identify inconsistencies) (ST/ECLA/CONF.6/L.C-2b and Add. 1)
by Hélio Jaguaribe, Professor of the Brazilian Institute for Higher Studies, Ministry of Education, Brazil

D. *Integration of points of view*

III. Policy for economic and social development

A. *The economist's recommendations*
Special presentation by Mr. Jorge Ahumada

B. *The sociologist's recommendations*
Special presentation by M. José Medina Echavarría

C. *The political scientist's recommendations*
Special presentation by Mr. Hélio Jaguaribe

D. *Research needs*
Special presentation by Mr. H. M. Phillips

E. *Integration of programmes: policy and research*
Special presentation by Mr. Egbert de Vries

Reference and information documents

Report of Planning Meeting held from 8 to 10 December 1959 at UNESCO Headquarters, Paris (UNESCO/SS/SAED:Mexico/1)

[United Nations Bureau of Social Affairs] Planning for balanced social and economic development in Poland

The middle classes in Central America: present characteristics and development needs (E/CN.12/CCE/176/Rev.2)