

CEPAL Review

Director

RAUL PREBISCH

Technical Editor

ADOLFO GURRIERI



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

CEPAL

Review

Number 10

April 1980

CONTENTS

The energy challenge <i>Enrique V. Iglesias</i>	7
Meeting on a new Latin America in a changing world economy Introduction <i>Abraham F. Lowenthal and David H. Pollock</i>	20
The export of manufactures <i>Pedro I. Mendive</i>	21
Exports of non-fuel primary products <i>Jere R. Behrman</i>	32
A new Latin America in a new international capital market <i>Albert Fishlow</i>	49
Latin America and the international monetary system: some comments and suggestions <i>Carlos Massad</i>	59
The Latin American countries and the New International Economic Order <i>Pedro Malan</i>	66
Technological development in Latin America and the Caribbean <i>Jorge A. Sábato</i>	81
The major unresolved issues in the negotiations on the UNCTAD Code of Conduct for the transfer of technology <i>Miguel Wionczek</i>	95
International economic reform and income distribution <i>William R. Cline</i>	103
Interpretative summary <i>Colin I. Bradford, Jr.</i>	113
Monetary and real repercussions of financial opening-up to the exterior. The case of Chile, 1975-1978. <i>Roberto Zahler</i>	127
Towards a theory of change <i>Raúl Prebisch</i>	155
Some CEPAL publications	209

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

*Carlos Massad**

I

The functioning of the system

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

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

Generalized floating of currencies became unavoidable as the Bretton Woods system proved incapable of providing enough adjustment incentives for reserve currency countries, essentially the United States and the countries with surpluses. In fact, IMF "discipline" could only apply to non-reserve-currency deficit countries. Reserve currency deficit countries could finance their deficits with their own

currency, while countries with surpluses did not need to request IMF assistance.

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

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

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

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

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

*Co-ordinator of the UNDP/CEPAL Joint Project "Implications for Latin America of the state of the international monetary and financial system" (RLA/77/021).

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

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

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

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

and the destabilizing effect of expectations formed in the way described above should tend to disappear. The length of the learning period is, however, unknown.

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

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

Furthermore, changes produced through the capital account may tend to reinforce those

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

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

2. *The international transmission of economic disturbances*

With fixed exchange rates, it was expected that inflation rates in the world would tend towards equality, since it was argued that any discrepancy would bring about imbalances in foreign payments that would force adjustment. As exchange rates were not completely fixed, however, some discrepancy in inflation rates was allowed for, over and above that coming from different rates of change in productivity. Between 1960 and 1970 the average yearly rate of inflation for 9 industrial countries¹ was 3.5%, with a standard deviation of 1.5 and a coefficient of variability of 0.43. Floating, it was argued, would allow for more freedom in domestic monetary policy, since variation in

exchange rates would insulate countries from external shocks. On these grounds, rates of inflation should have diverged after 1973 more than they did before, and particularly before 1970.

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

3. *Creation of international liquidity*

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

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

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

centres are usually not subjected to the same types of controls as their domestic currency operations, the supply of international liquidity becomes demand-determined. And insofar as the foreign exchange holdings of the private sector are a good substitute for domestic (or national) money, changes in the supply of the first will affect the demand for the second. Through this process, national central banks lose control over the relevant monetary aggregates. This is not because they cannot control

the supply of domestic money in the short run, but because the demand for such money changes, with the result that control or regulation not only of the rate of growth of international liquidity, but also of liquidity in general, becomes much less effective. Of course, if the supply of liquidity in the form of foreign exchange becomes essentially demand-determined, the relative importance of SDRs is bound to suffer.

II

The effects on Latin American and other developing countries

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

There are more deep-seated problems than this, however. Thus, if floating does not

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

As a matter of fact, equilibrium on the current account is not an ideal situation. Non-oil-exporting developing countries are net capital importers, so that the desired position of their current account is one of deficit, to be financed with a surplus on the capital account. In the case of Latin America, the average deficit on the current account of the non-oil-exporting countries for the period 1974-1978 is five times larger than for the period 1966-1970. The capital surplus should be high enough to cover the deficit on the current account and the necessary increase in reserve holdings. But a surplus on the capital account is only a more

respectable way to refer to a net increase in foreign debt, since unrequited transfers are negligible and direct foreign investment is not on the increase and is concentrated in a few

countries. At all events, new net indebtedness accounts for at least 80% of the surplus on the capital account of the non-oil-exporting Latin American countries.

Table 1
EXTERNAL FINANCING OF LATIN AMERICAN NON-OIL-EXPORTING COUNTRIES
(Billions of dollars)

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

Sources: International Monetary Fund, *Balance of Payments Yearbook*; Bank for International Settlements: supplements for July and December 1978 and Yearbook; CEPAL estimates.

^aExcluding official donations.

^bPositive figure indicates an increase in reserves.

^cIncludes long, medium and short-term non-compensatory and compensatory loans.

^dAll figures for 1978 are provisional.

Table 2
ESTIMATED OVERALL INDEBTEDNESS
OF LATIN AMERICAN NON-OIL-
EXPORTING COUNTRIES
(Billions of dollars)

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

^aIncludes debt to IMF.

^bFigures for 1978 are provisional.

Despite the levels already reached by such debt (over 100 billion dollars for the non-oil-exporting countries of Latin America by the end of 1978) it must go on increasing for many years if the development process is to continue and if world resources are to be more efficiently allocated. The additional short-run instability in the balance of payments which is a by-product of floating, however, does not facilitate official decisions in industrial countries about long-term development finance, while private financial markets expand rapidly. Thus, the terms of the new financing are substantially worse than those of the past, both in terms of interest rates and of amortizations schedules. "Debt burden" becomes a problem for further borrowing, a problem which is more a consequence of the present system than of "mis-

behaviour", even though the latter is not always absent. Moreover, as debt terms deteriorate, borrowing countries need to increase their reserve holdings, both in order to present a better "image" and in order to be ready to offset possible outflows. So, as the terms deteriorate, the necessary rate of accumulation of reserves tends to grow, and so does the necessary net borrowing per year.

An obvious way out of this problem for LDCs would be to expand exports. If exports grew at a rapid rate, both the "debt burden" and the current account deficit could be reduced. However, as pointed out above, in the present circumstances the developed countries tend to yield more easily to protectionist pres-

ures, so that this way out does not seem to be feasible. In fact, a recent article in *IMF Survey* reaches the conclusions that protectionism has increased significantly in the recent past, and the trend does not show signs of abating.² Regrettably, this trend has emerged precisely when a good number of LDCs, at least in Latin America, are following an outward-oriented strategy.

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

III

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

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

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

But of course close co-ordination of domestic policies is an ideal which is very difficult to reach. Different countries have different institutions, different interest groups and different

social and political forces. For example, some countries can export their unemployed and so can accept more restrictive economic policies than others.

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

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

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

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

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

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

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

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

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

(c) Countries with net reserves higher than, say, 4 months' imports and with reserves growing faster than a given rate per year would pay a tax on their reserves. One way to apply this concept, for example, would be not to allocate SDRs to such countries in a future allocation, the SDRs not allocated to them

being assigned to LDCs in proportion to their quotas in the IMF. In this way, an incentive for surplus countries to adjust would be established. One might call this the "adjustment link".

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

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

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

CEPAL Review

Director

RAUL PREBISCH

Technical Editor

ADOLFO GURRIERI



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

CEPAL

Review

Number 10

April 1980

CONTENTS

The energy challenge <i>Enrique V. Iglesias</i>	7
Meeting on a new Latin America in a changing world economy Introduction <i>Abraham F. Lowenthal and David H. Pollock</i>	20
The export of manufactures <i>Pedro I. Mendive</i>	21
Exports of non-fuel primary products <i>Jere R. Behrman</i>	32
A new Latin America in a new international capital market <i>Albert Fishlow</i>	49
Latin America and the international monetary system: some comments and suggestions <i>Carlos Massad</i>	59
The Latin American countries and the New International Economic Order <i>Pedro Malan</i>	66
Technological development in Latin America and the Caribbean <i>Jorge A. Sábato</i>	81
The major unresolved issues in the negotiations on the UNCTAD Code of Conduct for the transfer of technology <i>Miguel Wionczek</i>	95
International economic reform and income distribution <i>William R. Cline</i>	103
Interpretative summary <i>Colin I. Bradford, Jr.</i>	113
Monetary and real repercussions of financial opening-up to the exterior. The case of Chile, 1975-1978. <i>Roberto Zahler</i>	127
Towards a theory of change <i>Raúl Prebisch</i>	155
Some CEPAL publications	209

The Latin American countries and the New International Economic Order

Pedro Malan*

Introduction

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

(developing or developed) outside the region? In other words, is there anything specific to Latin America as a region, or to Latin American countries *qua* Latin American countries, in terms of either the international resource-transfer mechanisms or the international distribution of political power, both presently under sharp criticism in all international forums?

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

I

The *political* process of identification of what Professor Hirschman considered to be the most pressing problems³ to be tackled by public policy is both a global one (taking place at international forums such as the United

Nations, UNCTAD, CIEC meetings and all conferences where so-called North-South

*Department of Economics, Catholic University of Rio de Janeiro.

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

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

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

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

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

The outcome of these talks is as yet unpredictable. The failure of the eighteen-month CIEC meeting in Paris in 1976 was not a final result, and the whole panoply of economic issues that make up the North-South agenda again came under discussion at UNCTAD V

in May 1979. Much depends on the Northern countries' response to the as yet somewhat unarticulated specific demands of the LDCs. The issues and criticisms raised so far, however, will not vanish into thin air—they are likely to remain on the agenda, both economic and political, for the whole of the 1980s. Few would disagree that we are living now through a period of economic and institutional crisis such as the world had not experienced since the 1930s—nearly half a century ago.

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

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

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

Indeed, the response of the Northern countries to Southern pressures will probably develop according to the (non-mutually-exclusive) patterns of: (a) *resistance* (whenever the challenge from the LDCs can easily be turned back); (b) *co-optation* of some of the bigger and higher-income LDCs⁶ and (c) *compromise* (whenever some concessions must be made to preserve the Northern economies' control of the basic decisions). However, much more important than to guess prospective response from the North is to assess the dominant attitudes prevailing in these societies, especially in the United States, which, despite its declining importance (as compared with the immediate post-war period), is still the key country influencing the future outcome of the North-South conflict.

There seem to be four dominant attitudes in the North on issues related to this conflict. The first one is what Roger Hansen called the "Southern Unity Won't Last" attitude.⁷ It was clearly the policy outcome which the major industrial countries (especially the United States) were hoping to bring about, and is still very influential. Its first major setback was the inability to set non-oil developing countries against the oil exporters shortly after OPEC's first dramatic price rise, while the second was the refusal by OPEC and all the other LDCs to restrict the Paris Conference to a discussion of energy problems alone. This attitude is still very much alive, however, and cannot be ruled out. What do Brazil, Upper Volta, Sri Lanka and Iraq have in common? Perhaps only a shared sense of deprivation *vis-à-vis* the OECD countries. But as R. Hansen rightly reminded us, this "unnatural alliance" should not be underestimated "especially when faced

by intransigent Northern solidarity ... and if no other card is played at the bargaining table".⁸ The events of the last five years do suggest that Northern responses will have to move progressively away from resistance and towards co-optation and compromise formulae.

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

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

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

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

⁸R. Hansen, *op. cit.*, p. 29.

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

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

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

In short, summing up this rather brief sketch of dominant Northern perspectives, two of them (the "Southern Unity Won't Last" and the "Global Multilateral Approach") may lead to Northern policy options which are essentially a continuation of the present policies with *ad hoc* marginal changes to accommodate demands which cannot be—as in the

past—effectively resisted. The other two attitudes ("Equity" and "Basic Needs") attempt to partially shift the blame for the present unsatisfactory (in view of the LDCs) workings of the international economic order essentially on to the developing countries' *own* internal policies or political systems. The setting may well evolve into a sort of "dialogue of the deaf" if some basic agreement about the agenda and about some long-run perspectives both in the North and in the South is not reached in time. The next few paragraphs deal with the likely effect of these Northern perspectives—and Northern structural trends—on the peripheral economies, with special reference to Latin America. In our view, any discussion about international economic relations must start with a grasp of world structural changes and of present Northern attitudes. After all, even if initiatives come from the South it is the Northern response to them which will shape the future arrangements.

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

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

¹¹R. Hansen, *op. cit.*, p. 34.

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

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

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

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

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

clude an analysis of the question of the State in Southern and Northern countries.

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

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

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

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

mizing knowledge of how markets actually operate. Studies of the operation of imperfect markets should be an important item in the agenda, since the LDC case for reshaping the

world economic order depends ultimately upon the alleged existence of imperfect international markets working to their disadvantage.

II

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

Latin America, broadly defined (i.e., including Cuba and the Caribbean area), contains twenty-five legally sovereign countries enjoying United Nations and World Bank membership. The region's total population is presently about 325 million, growing at an average of more than 2.6% a year, while its combined GNP for 1978 in current dollars was about US\$ 400 billion. Obviously the old clichés about structural heterogeneity, asymmetrical degrees of development and national potentialities apply just as much to the region as they do to the so-called Third World as a whole. Levels of per capita income range from US\$ 200 (Haiti) to US\$ 3,300 (Bahamas), al-

though the majority (15) of these 25 legally sovereign countries fall into the US\$ 600-1,000 range of per capita income. Above the level of US\$ 1,140 there are only five countries: Argentina, Trinidad and Tobago, Venezuela, Barbados and Bahamas, while below the US\$ 600 level are El Salvador, Guyana, Honduras, Bolivia and Haiti. According to the World Bank's recent classification, excluding the countries with population less than one million (Guyana, Barbados and Bahamas), centrally-planned Cuba and extremely poor Haiti, all the other 20 Latin American countries fall into the "Middle Income Countries" category, which includes 58 out of the present 153 members of the United Nations and the World Bank.¹⁶

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

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

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

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

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

The share of non-OECD countries in world exports declined during the 1950s and 1960s from 34% in 1950 to less than 20% in 1969. Latin America's share declined from 10% to 5% over the same period. The proportion of manufactures in world trade rose from below 40% in the thirties to 45% in 1953, 54% in 1970 and 67% in 1969;¹⁷ a phenomenon very closely related to international investments of the transnational corporations and very like Linder's well-known hypothesis about the influence of patterns of demand and income levels on the shaping of trade among developing countries. For most observers, this outcome was the natural result of the great post-

war liberalization project which experienced its golden age from 1959 (European return to convertibility) to 1971 (*de facto* collapse of the Bretton Woods arrangement). The "success" of the project was gauged by the rapid expansion of international trade (partly due to the progressive dismantling of the generalized protectionism of the inter-war period), by the growing internationalization of capital (partly mediated by the transnational corporations) and by the resurgence of international (private) financial markets which had collapsed with the 1929 crash and the Depression years.

However, as noted by more than one observer: "at the time when the OECD countries were rapidly dismantling their trade barriers against each other, they were equally feverishly creating new barriers to keep out light manufactures from the tropics".¹⁸ Indeed, a recent study of the World Bank does show that over the last twenty-five years developing countries have emerged as major markets for the manufactured exports of the industrialized countries. These exports increased by 7% a year in the 1950s and the increase accelerated to 8.5% a year in real terms between 1960 and 1975.¹⁹ Trade with developing countries accounted for only 29% of the increase in the industrialized countries' exports of manufactures. Much more important, however, is the fact that trade with developing countries accounted for only 9% of the industrialized countries' imports of manufactures, thereby confirming Sir Arthur Lewis's assertions above. Trade among industrialized countries and trade within Western Europe accounted for nearly 80% of the increase in the industrialized countries' imports of manufactures over the 1960-1975 period.²⁰

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

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

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

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

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

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

In a recent paper, Chenery and Keesing²² have attempted to clarify the comparative advantage of country groups by classifying LDC trade and production patterns into four groups: (a) countries that specialized relatively early in exports of manufactures and have followed generally outward-looking policies; (b) large semi-industrial countries with relatively low export/GNP ratios that have achieved success in industrialization based on the domestic market and have also moved

to promote exports of manufactures; (c) countries now emerging from primary specialization which are changing their policies in an attempt to diversify their exports and accelerate development; (d) large poor countries with significant exports of manufactures. What is the significance of such a classification for the Latin American countries?

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

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

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

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

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

²⁴A. W. Lewis, *op. cit.*, p. 44.

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

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

The third group is made up of countries emerging from primary specialization. Their apparent success is basically due to the extremely favourable international conditions prevailing in the sixties, especially from 1967 to 1973, when world trade grew at nearly 19% a year in current dollar terms. Their prospects are not so bright under the conditions likely to prevail in the 1980s, however, as we shall see shortly. In Latin America, Colombia's expansion of exports of manufactures and Chile's recent attempts to liberalize its economy are the only examples of this category of "emergence from primary specialization" towards diversification (in the case of Chile diversification of both exports and imports). The fourth group (large poor countries) is not relevant to Latin America, since it is made up of countries such as India and Pakistan and the only possible Latin American examples (Brazil and Mexico) are not that poor. Interesting as it may seem, however, this classification does not go to the crucial issue at stake: the prospects for outward-looking strategies under *present* world conditions, and the prospects for the future. Part of the discussion in this connexion will take place in the section dealing with the present "non-system" and the future international monetary system. For the purposes of the present section, it is sufficient to note a crucial structural factor associated with the internationalization of capital and the international diffusion of technical knowledge. Both, as noted by R. Cooper "... reduce the costs, in terms of output foregone, of shifting resources

from the production of one good to another —that is, these changes make the conventional production possibilities frontier flatter ... [although] ... it is true that this means that trade becomes less profitable in the sense that the difference between the cost of producing for export and the cost of producing the import-competing goods at home has diminished".²⁶ It is obvious that the volume of trade (relative to income) need not fall if, for instance, innovations are more frequent in the export industries and/or demand patterns converge internationally more rapidly than the structures of production costs —both trends which have been observed up to the present. There are no signs, however, that these past events are likely to be repeated in the future. The rate of growth of world trade, for example, is not likely to remain at more than 7% a year as in the past twenty-five years.

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

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

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

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

2. The question of foreign investment and technology

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

The perceptions dominant in the North usually emphasize what is perceived as a sort of schizophrenic attitude of Southern countries with regard to foreign direct investment. On the one hand, the South seems to need, demand, and often compete for more foreign investment, perhaps influenced by the so-called success stories of capital accumulation *cum* industrial diversification observed after the war (but especially in the sixties) in countries such as Brazil, Mexico, Taiwan, South Korea, Hong Kong and other "newly industrializing countries", all of which relied upon

a significant contribution of foreign capital. On the other hand, the North sees the South (or the major part of it) as refusing to abide by internationally defined rules and procedures (especially with respect to expropriation) and neglecting the creation of a proper "investment climate" through the reduction of political risks as perceived by would-be private investors.

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

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

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

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

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

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

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

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

Indeed, since the work of Penrose, Hymer, Rowthorn, Vernon, Knickerbocker, Caves and others, the understanding of these flows is based mainly on the theory of the growth of the (big) firm, and especially on the reaction of firms in oligopolistic market structures to the actual or perceived threat to their respective market shares. In other words, when we talk about foreign direct investment today, we do not mean decisions to locate small repair shops or grocery stores in Karachi or Tegucigalpa,

but huge sums of indivisible expenditures aimed at gaining or retaining control of specific resources and/or promising markets. To quote Vernon again: "Foreign investments in oligopolistic industries are often made in order to counter a threat to the stability of the oligopoly structure itself, that is, in order to protect and prolong an existing oligopoly rent".³³

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

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

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

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

³³*Ibid.*, p. 100.

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

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

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

As is becoming increasingly well-known by now, the world crisis of the early 1970s was not

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

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

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

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

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

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

Globally speaking, some optimistic observers have concluded that the adjustment to the "oil crisis" is over, in the sense that the OPEC surplus is not a worry anymore (German and Japanese surpluses were indeed higher than OPEC's in 1978), and that the recycling was done with the proper speed. We hope to show, however, that there are no grounds for such optimism. To begin with, the present international monetary system is still what J. Williamson called a "non-system" in which the traditional problems of *confidence* (in a stable

reserve currency), of *adjustment* to asymmetries in balance-of-payments positions among major trading countries, and of control of the expansion of international *liquidity* remain unsolved. With respect to the first problem, there is no longer a single risk-free asset in the system. The dollar played this role in the past, but a fluctuating dollar cannot serve any more as a satisfactory international monetary standard. Fluctuations really have been too big: a 12% swing (such as the one experienced by the dollar in 1978) *vis-à-vis* the average of other rates seems unduly high. These swings have a peculiar effect on prices: they push prices up in depreciating countries but they do not pull prices down in the appreciating countries, so they exercise a net inflationary effect which in due course may affect the terms of trade against developing countries.

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

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

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

This joint defence of common interests might be easier to advocate than to realize, however. The world encompasses today more than 150 legally sovereign countries, inescapably interdependent, but in a rather special way. Indeed, as Triffin noted recently, “a minimum of realism will force each country to focus its negotiating capabilities on co-ordinating its intervention policies with those of the handful of partner countries most important in their foreign transactions and most ready to accept and implement co-ordination commitments”.³⁷ The emerging European Monetary System is a case in point—and one to which Latin America should have been paying much more attention. Thus, while Latin American countries absorb only 16% of Latin America's

total exports, European Community countries absorb more than half of the participating countries' merchandise exports. Obviously, this proportion is much higher still for other transactions and therefore for their current account receipts and expenditures in general. Moreover, as Triffin notes, the exchange rates of many other European, Middle East and African countries are likely to gravitate also around the proposed European Currency Unit. Triffin estimates that the “emerging European exchange area will probably account for 2/3 to 3/4 of the member countries' external transactions”.³⁸

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

³⁷R. Triffin, “The Emerging European Monetary System”, *mimeo*, March 1979, p. 3.

³⁸R. Triffin, *ibid.*, p. 5.

inescapably interdependent world into which even centrally planned economies are increasingly integrated. Paradoxically enough, the Latin American countries' influence in the

framing of an eventual New International Economic Order will be greater, the sooner those countries recognize the global nature of their concerns—and act accordingly.