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**TOWARDS A DYNAMIC  
DEVELOPMENT POLICY  
FOR LATIN AMERICA**



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## FOREWORD

As Dag Hammarskjöld said to me on one occasion, there are things that cannot be done every day but must be done from time to time. He was referring to a report presented by our secretariat, with the co-operation of a group of eminent Latin Americans, to the ill-fated Quintandinha conference (November 1954), at the request of the Inter-American Economic and Social Council of the Organization of American States.\* This is another such report. It is the outcome of our great concern for the course of events in this part of the world—a concern which, on the occasion of the ECLA secretariat's fifteenth anniversary, finds expression in the reflections set forth in the ensuing pages. They should also be viewed as representing a needful "creative pause" on the part of one who has been in charge of the secretariat throughout almost the whole of that period.

The report presented here constitutes by its very nature a fabric of inevitable generalizations drawn from continuous and systematic analysis of the real state of affairs in Latin America. But they do not relate to any individual country or group of leaders, since the divergencies that would have to be noted are many and significant.

Nevertheless, it is our hope that within the pattern of this fabric each country may find a clue to the significance of its own special case, at this time of imperative need to consider what our past has been, what our present is, and what we should wish to make of our future through the exercise of deliberate control over the forces of economic and social development.

Raúl PREBISCH

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\* See *International Co-operation in a Latin American Development Policy* (E/CN.12/359), United Nations publication, Sales No.: 54.II.G.2.

## **A. THE GENERAL THESIS**





## 1. Structural reforms to clear the way for development

The ills besetting the Latin American economy are not determined by circumstantial or transient factors. They are an expression of the critical state of affairs in our time and of the incapacity of the economic system—owing to structural defects that it has been beyond our ability or our power to remedy—to achieve and maintain a rate of development consonant with the growth of the population and with its demands for a speedy improvement in its levels of living.

The increase in the population is certainly phenomenal. At the beginning of the century, there were 63 million inhabitants in Latin America, and the annual rate of demographic growth was 1.8 per cent. Now we number 220 million, and we are multiplying at an annual rate of 2.9 per cent which shows signs of rising even higher.<sup>1</sup>

On the basis of conjectural data, it may be estimated that about half the existing population has a tiny average personal income of 120 dollars a year.<sup>2</sup> And this vast social aggregate accounts for only about one-fifth of total personal consumption in Latin America, showing the highest coefficients of undernourishment, poor clothing and worse housing, as well as of disease and illiteracy; and, at the same time, the highest rates of reproduction.

It is here that the development effort must primarily be concentrated. The notion, which dies hard, that development takes place spontaneously, without a rational and deliberate effort to achieve it, has proved to be an illusion, both in Latin America and in the other peripheral regions of the world. For a century now our economies have been linked to the international economy, and fifty per cent of the population is still stagnating in pre-capitalist conditions which are incompatible with its growing economic and social aspirations.

Even so, average per capita income in Latin America is appreciably higher than in other peripheral regions, and thus affords an advantageous starting-point for the realization of

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<sup>1</sup> In 1900 the population increased by 1.1 million inhabitants, and in 1960 by 6.4 million—almost six times that figure.

<sup>2</sup> See the chapter on "Income distribution in Latin America" in *The Economic Development of Latin America in the Post-War Period* (E/CN.12/659/Rev.1), United Nations publication, Sales No.: 64.II.G.6.

what is no longer a utopian dream: the eradication of poverty and its inherent evils, by virtue of the tremendous potential of contemporary technology and the possibility of assimilating it more quickly than was the case with the capitalistic evolution of the more advanced countries.

However, this rapid penetration of technique demands and carries with it radical changes: changes both in the pattern of production and in the structure of the economy which could not be effectively brought about without a basic reform of the social structure.

The social structure prevalent in Latin America constitutes a serious obstacle to technical progress and, consequently, to economic and social development. The principal manifestations of this fact are:

(a) The structure in question considerably hampers social mobility, that is, the emergence and rise of the dynamic elements in society, men of drive and initiative, capable of taking risks and responsibilities both in technical and economic matters and in the other aspects of community life;

(b) The social structure is largely characterized by a situation of privilege in the distribution of wealth and therefore of income. Privilege weakens or destroys the incentive to economic activity, to the detriment of the efficient utilization of human resources, land and machinery;

(c) This state of privilege in regard to distribution is reflected not in a rapid rate of net capital formation, but in extravagant patterns of consumption in the upper strata of society, over against the unsatisfactory living conditions of the broad masses of the population.

In these days of zeal for planning there is a great deal of talk about the prime importance of the role of private enterprise in Latin America and the need to keep it intact. But what is meant by this, in the last analysis? Is it suggested that the present system, under which the energies of individual initiative are cramped by social stratification and privilege, should be kept intact? Or is the way to be cleared for this initiative by the structural reforms referred to, so that the system may acquire the full dynamic force it lacks at present?

## **2. Capital formation and income distribution**

The test of a system's dynamic strength lies in its ability to accelerate the rate of development and progressively improve the distribution of income. If the annual rate of growth of average per capita income could be raised from the very low figure of 1 per

cent registered of late to a minimum of 3 per cent in Latin America as a whole, a rational redistribution policy would enable the personal income of the under-privileged half of the population to be doubled in seventeen years, and the lot of the middle-income groups to be improved likewise, although at a less rapid rate.

This is where the first step towards reform of the social structure becomes essential, since such a rate of growth is not feasible without substantial restriction of the consumption of the higher-income brackets.

The social contrast is striking indeed. While 50 per cent of the population accounts for approximately two-tenths of total personal consumption, at the other end of the scale of distribution 5 per cent of the inhabitants of the region enjoy nearly three-tenths of that total, according to the conjectural estimates referred to above. A policy of austerity mainly affecting this latter social group, and supplemented by the contribution of international resources, would permit an increase in net capital formation and the attainment of the above-mentioned growth target for per capita income, while at the same time redistribution policy would see to it that the income increment thus obtained was passed on to the lower strata of the social aggregate.

Herein lies the essence of redistribution policy. It is not a matter of taking income away from the upper minority and simply distributing it among the broad masses of the population, for with per capita personal income in Latin America as a whole barely amounting to 370 dollars, the benefits of such a redistribution would not stretch very far. But if, on the other hand, restrictions on the consumption of the privileged groups were reflected in a steady increase in net capital formation, the standard of living of the bulk of the population would rise progressively faster.

Technology has made this dynamic concept of redistribution viable for the first time in history, for without the immense potential it places at the disposal of developing countries, the effects of the redistribution operation would be very limited in their scope. Thus, the problems of capital formation and income distribution assume very different forms from those they took during the capitalistic evolution of the more advanced countries.

At that time it was capital formation that came first, and the gradual redistribution of income followed. Now, on the other hand, both these requirements present themselves—as they are bound to do—simultaneously, under the increasing political and trade-union pressure exerted by the lower income groups.

The only available means of meeting them is by directly combating one of the anomalies that most affect the development of Latin America, namely, the marked failure of capital formation to

reach the levels demanded by contemporary technology, as against the extravagant pattern of consumption of the high-income groups.

Among these upper strata (5 per cent of the population), which account for about three-tenths of Latin America's total consumption, average consumption per household is fifteen times greater than that of the lower strata (50 per cent of the population). If this ratio were reduced to 11:1, by the restriction of consumption in favour of increased investment, the annual rate of growth of per capita income could rise from 1 per cent to 3 per cent. And if restriction of consumption brought the ratio down to 9:1, the rate of growth might reach 4 per cent or even more, according to the political feasibility of this operation and the capacity of each country to put it into effect.

### 3. International co-operation and the structure of trade

This capacity might be seriously handicapped by the external bottleneck in development, which, in conjunction with the limitations of domestic production of capital goods, would make it impossible for all the additional saving obtained to be invested in such goods. Hence the vital need for international resources, until the structural reforms advocated here enable full advantage to be taken of the increase in savings.

The contribution to be made by international resources is thus of a temporary nature. It would cease to be necessary once the reforms referred to had borne the full crop of results to be expected of them. They are not a matter for Latin America alone, since it is also essential to work for the elimination of the external bottleneck by remodelling the existing structure of international trade.

The countries in which industrialization advances most rapidly tend to be affected more and more by the bottleneck in question. Their difficulties do not originate solely in the social structure, but also in the type of trade structure which characterized the epoch of externally-gearred development that preceded the world depression of the thirties. Here again, as in other aspects of Latin America's development problems, a whole constellation of out-of-date ideas survives. It is true that the industrialization of the peripheral regions has at last been accepted as an indispensable requisite for economic development. But what is still perpetuated is the anachronistic trade pattern inherent in the peculiar concept of the international division of labour which was prevalent up to a short time ago—the trading of primary commodities against manufactured goods. This is the framework within which the industrialization of the Latin American countries has been taking place. And the obstacle to economic development that it represents is now beginning to loom larger at every turn, for whereas the

upward trend of demand for the manufactured goods we import is very sharp, primary exports are expanding relatively slowly, largely for reasons over which the Latin American countries have no control. Thus there is a latent tendency towards disequilibrium which is aggravated as economic development gains speed.

This is a new phenomenon not experienced by the more advanced countries in the past. Hence it is that only now is its significance beginning to be understood, and recognition accorded to the vital need to encourage the industrial exports of the peripheral countries, especially those which have completed the first stage of the industrialization process.

This encouragement of industrial exports, in addition to exports of primary commodities, cannot be achieved within the narrow bounds of the existing markets. It is essential to alter the geographical structure of trade, as well as its composition by products.

Latin America's exports are of course affected by the universal slowness of the growth of demand for primary commodities, in contrast with the buoyancy of demand for manufactured goods as per capita income rises. But this circumstance conjoins with other factors of considerable importance. In the first place, the moderate rate of economic development of the United States has combined with its import restrictions to exert an adverse influence on Latin America's export trade. And, secondly, the protection and discrimination practised by the European Common Market prevent us from taking full advantage of the steady expansion of demand for primary commodities in the vast economic area it represents.

Without prejudice to measures aimed at eliminating or reducing these barriers to trade, it is a matter of urgent necessity to explore, with the utmost diligence, the possibilities for trade with other regions of the world, especially those—the socialist economies, for example—which show a high rate of development.

While it is true that basically the solution of such problems depends upon the great industrial countries and the degree to which their trade policy favours liberalization, it is no less certain that the Latin American countries too must put forth a tremendous effort in the same direction. In this sense, the formation of a common market is an undertaking that brooks no delay. Its importance has been realized by the Central American countries, whose determination to establish such a market has been bold and resolute. The problem of the Latin American Free-Trade Association is more difficult, for the very reason that the development of industrialization in watertight compartments has created vested interests and prejudices which oppose reciprocal trade without taking account of the serious effects of such an attitude on eco-

conomic development. This is not a merely technical matter; it is a question of important policy decisions which must follow up the Montevideo Treaty. The technical groundwork for these decisions is basically complete; all that remains to be done is to study and select the best ways of putting them into practice.

#### 4. The closed type of development in Latin America

The external bottleneck in development is not due solely to the slow upward trend of exports of primary commodities as against the rapid expansion of industrial imports from the great centres, or to the low level of inter-Latin American trade; it has also largely been determined, in recent years, by the deterioration of the terms of trade and its serious effects on the purchasing power of exports. The action of all these factors in combination reduced the per capita value of Latin America's exports from 58 dollars in 1930 to 39 dollars in 1960 (at 1950 prices).

The recent decline in the terms of trade is yet another indication of the peripheral countries' inherent incapacity to retain the whole of the benefits accruing from their technical progress. There is not much consolation to be had from the reflection that in the future, when the Latin American countries reach more advanced stages of development and their industrialization process is complete, this state of affairs will some day be brought to an end; it will all take a long time, and in the meanwhile the deterioration of the terms of trade is aggravating the external bottleneck and exerting a marked depressive influence on domestic capacity for capital formation, to the detriment of development itself.

From a different angle, the other notion that still survives in some circles, to the effect that the external bottleneck and the disequilibria in international accounts in which it is reflected are mere matters of monetary operation, has had deplorable consequences, since its practical application—besides adversely affecting economic development—has diverted attention from the basic solutions which this structural phenomenon demands.

This is a point of considerable importance for Latin America, for unless the solutions in question are resolutely sought, our countries will be swept by the force of circumstances towards an increasingly closed type of development, and a steady contraction of their share in trade with the rest of the world, which will add further difficulties to those inherent in such a process. In default of sufficient international co-operation in overcoming these difficulties, both in the field of trade and in that of financing, all kinds of authoritarian measures might supervene, with grave consequences for the progressive development of democracy in Latin America.

## 5. Internal bottlenecks

The intensification of development is not simply a question of increasing net capital formation. While this is necessary, it is by no means sufficient, since development may be cramped by a variety of factors. Those of an external kind have already been mentioned, but there are also internal bottlenecks that circumscribe or hamper the expansive force of net capital formation.

Furthermore, there is usually a wide margin for the immediate growth of production in our countries because of idle capacity in a number of branches. But the factors in question either rule out this possibility or bring inflationary pressures of a non-monetary kind in their train if a policy directed towards the full utilization of idle capacity is put into force.

There is no doubt that the most persistent bottleneck in the whole of Latin America's development process is generally to be found in agricultural production.<sup>3</sup> Several factors are jointly responsible for this: the system of land tenure, which makes it difficult for modern techniques to be assimilated; inadequate State aid in the work of adapting and diffusing these techniques; and the unsatisfactory investment situation. However thoroughly these three problems are coped with, unless farmers are given proper incentives, efforts to accelerate development are liable to find their most formidable stumbling-block in the agricultural sector, as has been the case in a number of countries with differing economic systems.

The incentives may be of various kinds, but the most important is that agriculture should reap the benefits of the technical progress it makes, as regards both external aspects and the interplay of internal economic forces. This is the only way in which the wide gap between average income figures in rural and in urban areas can be gradually narrowed. The fact is that the impoverished half of the population is largely to be found in rural areas.

With a little thought, it will be seen that the externally-gearred growth of earlier periods, based on the characteristic types of foreign enclave which do not spread technical progress to the internal economy, broke up the original pre-capitalistic integration of the countryside with the towns. And industrialization tends to widen rather than reduce the breach by aggravating the social and economic dichotomy. Steps must now be taken to remedy this.

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<sup>3</sup> This internal bottleneck—in common with others frequently encountered in the Latin American development process—has frustrated a number of attempts to redistribute income; these have been limited to improving the monetary level of wages and salaries, irrespective of the investment required to raise production, especially in the agricultural sector, and to satisfying the increase produced in popular demand by the redistribution of income, without inflationary pressure.

The widening of the gap is due not only to the structural features of the rural sector, but also to the fact that internal development has not been dynamic enough to raise the farmer's income. What is more, it is the farmer who is usually called upon to bear a considerable part of the cost of import substitution, excessive protection and unfair marketing practices, as well as social security and other State services from which the rural worker reaps virtually no benefit because he can exert no trade-union pressure and has no political contacts. In fact, he continues to play Lazarus to the Dives of urban politics.

No exhaustive examination has yet been made of all the repercussions of these factors on the drift from the countryside to the bigger Latin American towns, which is a striking and disquieting sign of economic and social disequilibrium. There is no doubt that in-migration is bound to take place; nor is there any doubt that the increased technical progress of the rural areas will tend to give it greater momentum. But is it necessary for the displaced population to congregate in the big towns? Why should they not stay in the rural milieu, living in small and medium-sized communities and employed in industries and services that would satisfy some of the requirements of that milieu itself? Why have the bigger towns in Latin America grown, at the expense of the medium-sized and small towns, to an extraordinary extent that is quite disproportionate to the trend of events in more advanced countries?

These questions cannot be answered satisfactorily without careful research. Perhaps the weakness of rural demand, or, to put it another way, the concentration of demand in the big towns as a result of the structural<sup>4</sup> and adventitious factors mentioned above, may have played an important part in this phenomenon. And, as in the case of other social phenomena, there have been no countervailing reactions, but a self-perpetuating spiral, since the agglomeration of people in big towns concentrates demand there even more, and this in turn leads to further population congestion. It may therefore be concluded that the geographical redistribution of income is also of great social importance.

## 6. Why should development forces be deliberately controlled?

One dominant idea runs through the whole of this paper: Latin America must quicken its rate of economic development and redistribute income in favour of the broad masses of the popula-

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<sup>4</sup> With respect to these structural factors, it should be taken into account that, because of the system of land tenure in force, much of the income from the land—particularly that of the big landowners—is spent in the towns and not in the countryside.



tion. The attainment of this objective cannot be indefinitely postponed, nor are there grounds for expecting that economic development will take place first and be followed in the natural course of events by social development. Both must be achieved gradually and side by side. This will entail rational and deliberate action to influence the forces of development; the spontaneous interplay of these forces will not suffice here, as it did in the capitalistic evolution of the advanced countries.

The notion that this type of evolution might be reproduced in Latin America has been very misleading. In the advanced countries economic development has been essentially a spontaneous phenomenon, but the same is not true of social development, which has largely been shaped by deliberate policy measures. And it is clear that in those countries the need for action of this sort, the need for planning, is also gaining recognition.

There is one overriding argument: today, when man is acquiring a power over the forces of nature hitherto undreamed-of, he cannot resign himself to remaining at the mercy of the spontaneous play of economic forces, with its manifest incapacity to maintain or achieve a satisfactory rate of growth while at the same time reducing cyclical fluctuations, and to bring about equitable income distribution.

The impracticability of history's repeating itself in this respect makes the reasons for finding new paths particularly cogent. The assimilation of an already highly-developed technique in a fairly short space of time is a very different matter from the gradual development of such a technique, since serious incongruities or disparities appear which have to be dealt with by State action.

First, during the evolution of the capitalist economies, technology was gradually incorporated into the production process as the necessary capital formation took place. The countries now developing, on the other hand, have to assimilate a technology that is ready-made. And if they are to climb progressively towards the higher stage already reached by the more advanced countries, the rate of increase of per capita income will have to be more rapid in their case than it was in the industrial countries in the past.

Then too, the technology in question and the continual innovations it entails call for substantial capital per head, which the advanced countries can easily build up on the strength of their high per capita income. The developing countries, on the other hand, in face of the same extremely capital-intensive technology, have an average per capita income barely comparable to that of the former countries nearly a century ago. Hence there is no way out but for the State deliberately to reduce the consumption of the higher income groups in the community, whereas there was no necessity for this when the capitalist economies were developing,

since saving on the part of those same groups was spontaneous and almost automatic.

These two incongruities bring in their train another, to which reference has already been made. Whereas in the advanced countries net capital formation came first and the redistribution of income later, in our countries the two problems have now to be solved simultaneously, particularly with the model of the Soviet method of economic development forever before our eyes.

To add to this, there is the rapidity with which techniques for the prevention and cure of disease are spread, and the ensuing sharp drop in the mortality rate, a phenomenon that took place very slowly during the evolutionary stage of the more advanced countries, and was accompanied by an equally gradual fall in the birth rate. There the increase in income fostered changes in the psychological attitude to family formation which are not yet in evidence among the broad masses of the Latin American population with their meagre resources. This explains the disparity between the exceptionally high rate of population growth in Latin America and the relatively moderate rate prevailing during the evolution of the capitalist economies.

The high rate of demographic growth entails a more intensive capital formation effort and enhances the incongruity between the inexhaustible supply of manpower in our countries and the technology we must assimilate, as evolved in the big industrial centres under the spur of an ever-increasing labour shortage.

Lastly, mention must be made of the incongruity or disparity between import and export demand, which was likewise no problem in the past. Thus the big centres, as they grew, did not show that trend towards the formation of external bottlenecks which is characteristic of the Latin American countries.

The task of coping with these incongruities and promoting development entails three forms of State action. First and foremost, action to reform the social structure and thereby remove the obstacles to development; this consists essentially in making full use of the savings potential, encouraging the intensive utilization of land and capital and freeing the huge potential of individual initiative which now goes to waste, so as to give the system its full dynamic force.

These changes in the social structure pave the way for others, affecting the production pattern and structure of the economy, which are inherent in the spread and absorption of contemporary technology.

Lastly, State action is indispensable if the marked disparities in income distribution are to be progressively remedied by virtue of the increase in income accompanying the changes introduced.

## 7. Opposition to reforms and responsibility for carrying them out

These internal structural changes, and international co-operation in development, are the subject-matter of the present document. It is designed as much for those who resist such changes within their own countries as for those who propose to carry them out. It is also directed at those outside the region who fail to grasp the nature and gravity of events in Latin America.

To the first of these groups, we should like to demonstrate the ineluctable necessity of introducing the changes in question into the social structure so that the pattern of production and the structure of the economy can respond to development requirements. If they are anxious to keep their position in the distribution scale inviolate, we would emphasize for their benefit that a point in history has been reached when it is no longer feasible to maintain consumption patterns that imply the dissipation of a substantial capital formation potential, in a fashion totally incompatible with the region's vast capital formation requirements. And if they are concerned for the future of democracy, it will not be amiss to suggest that nothing will do more to strengthen it in Latin America than social mobility, the emergence and rise of the dynamic elements of society, by virtue of the reforms in question; and that stubborn opposition to such measures might compel other men, whose ultimate motive was the same, to ride roughshod over democratic procedure in order to achieve this aim, perhaps in the illusory belief that the opportunities for sound democratic development which would thus be lost in social strife could be recovered in the course of time.

Those who are resolved to carry out the reforms are faced with a tremendous responsibility. Considerable emotional force is building up in Latin America, the emotional force of great mass movements. It must be channelled towards clear and constructive ends. Nothing can be accomplished without thought and rational planning. But neither can bold decisions be taken—such decisions as our countries need—without the driving-power of this force. The acid test of ultimate efficacy will lie in the ability of the leaders to fuse these elements into a development policy.

There is, of course, always the risk that such reforms and the necessary follow-up action may be bungled if the primary objectives are lost sight of. There will be no genuine reforms in the structure of society if all that happens is that the existing privileges change hands or that new privileges and sinecures are added to the old.

Furthermore, it must be understood both in our countries and outside them that in all this we are confronted with new requirements. In the evolution of the capitalist economies a devel-

opment policy was not essential, because of the spontaneity of the process itself. This type of evolution cannot be repeated in the Latin American countries.

Outside Latin America, naturally enough, it may seem not only possible but desirable for the region to follow the path which led the developed countries to achieve such impressive results. But unfortunately this is often conducive to deplorable attitudes of mind, even in those who are actuated by a genuine desire to co-operate, since there are also some who look to international co-operation to produce results which have some virtue viewed from the political angle, but which, however effective as stop-gaps, would be self-defeating over the long run. The only admissible political meaning of such co-operation, from the Latin American standpoint, is its contribution towards the political viability of an intensive internal development effort.

### **8. A system of ideas and a changed outlook**

All this presents Latin America with a new set of problems, very different from that with which previous generations were faced. In the midst of the world depression we did not know the true nature of Latin America's development difficulties: the dominant idea was simply to restore normal conditions, to return to the past. Fifteen years ago we were already able to attempt to define the set of problems in question and to point with deep conviction to certain basic solutions. And today sufficient progress has been made to work out a system of ideas, a dynamic view of economic and social development leading to practical action. Now the task is to promote public discussion and above all to gain the ear of political and trade-union leaders. What has to be done is to overcome the ideological poverty that prevails in our countries in this field, the traditional propensity to introduce from abroad nostrums that are largely alien to the real requirements of Latin America's situation.

If the ideas that we Latin American economists have worked out are to serve as a guide to the State in acting on the forces of development, they must be presented in a clear and accessible form. There is no idea in the development field that cannot be explained in simple terms, even though its working-out may have required complicated reasoning and mathematical procedures to improve the level of thinking—not to reduce the need for it. We economists must acquire this ability to make ourselves understood; if we do not succeed, the failure should be attributed to confusion on our part rather than to the limitations of others. In fact, if our arguments are not concise and clear, this is generally because they have not been properly sifted, or because we have not

altogether freed ourselves from the frame of mind that looks to the esoteric for the material of intellectual prestige. Or perhaps confusion results from the play of economic or political interests, or from a certain tendency to wrap one's thoughts in vague terms in order to shun the responsibility for definite views.

This, too, involves a new problem. There was no need for public discussion of development when it took place of its own accord as the capitalist economies evolved; there was no reason then to expound the problem of capital formation, since the solution came about spontaneously.

This is undoubtedly the crucial problem of Latin American development. Given that very firm measures must be adopted to increase the flow of savings, steps must also be taken to ensure that the funds thus obtained are in fact used to augment capital, and that this capital is devoted to achieving the aims of the development plan.

Here we must watch for an ever-present risk. The social tensions of today will not infrequently make for the use of an excessively high proportion of such funds to improve present consumption, or to effect social investment for immediate welfare purposes, at the expense of economic investment which would promote welfare at a later, although not remote, date. To yield to this pressure would spell utter failure to attain the social objective of achieving a steady and vigorous improvement in the living conditions of the broad masses.

What is more, military expenditure often absorbs an appreciable proportion of total income, to the detriment of economic development. Certain very significant questions arise in this context. Does not the evolution of military technology also call for a searching review of the prevailing ideas? And would this involve an increase in such expenditure, or might it not be possible, by virtue of this technology and the limitation of armaments, to reduce the armed forces, at the same time increasing their effectiveness and curtailing military expenditure in favour of economic development?

All these questions open up, for the first time in our countries, a very broad field in which public awareness of development can be shaped. This does not apply solely to the lofty ideas and grand designs that capture the popular imagination. The practical process of development also provides very varied opportunities for channelling the energies of the community into the many specific tasks that are part of a development plan. There are visible signs in our countries of vast latent wealth of enthusiasm and initiative that springs less from personal interest than from a community spirit which the women of Latin America too are demonstrating by their increasing participation in political and social life.

Furthermore, community action, like the co-operative movement, will permit simplification of State action by confining it to the efficient manipulation of the machinery of the system, and leaving to individuals the tasks that can better be performed by them on their own initiative and responsibility, since the State is already taking on some very thorny problems as part of development planning. Generally speaking it is not equipped to do so in the Latin American countries, and in this respect too sweeping changes will have to be made if the State is to assume new and exacting responsibilities.

In fact neither structural reforms nor planning can be approached on the basis of simple formulas that, once crystallized in the form of legislation and decrees, will operate automatically, by virtue of the mere fact that a plan has been approved and international funds have been promised. In periods of externally-gearred development this typical expectation that all problems will somehow solve themselves is strongly entrenched, and at times it is found in the least likely quarters. This has already become a danger to planning.

We must turn aside from such mirages. There is not going to be any easy way out for Latin America. Planning means a strictly methodical although not a strait-jacket approach to development problems, and an unremitting discipline in State action. It consists in a series of acts of foresight, of anticipation of future needs, of rationally relating the method of meeting those needs to the scanty resources available.

All this shows that the design of influencing the forces of development is a vast undertaking in terms both of time and of scope. It requires not only changed structures, but also changes in outlook, approach, and modes of action. But are such changes feasible in our countries? This question often evokes a feeling of scepticism that discourages action. But the attempt must be made, for there is no other way out. Reliance on the mere play of market forces, on foreign private investment and on a "hands-off" State policy is no solution.

## 9. Latin America must find its own paths to development

Development policy must be based on a correct interpretation of the real state of affairs in Latin America. The theories that we have taken up, and are still taking up, from the countries at the centre of the world economy often make a fallacious claim to be generally applicable. It is essentially incumbent on us who are on the periphery to play our part in correcting these theories and introducing the dynamic elements needed to bring them into line with our own situation.

The same is true of the practical side of development. The uncompromising opposition to the industrialization of our countries has already been overcome, and we are now successfully combating the reluctance to recognize the significance of the deterioration in the terms of trade. But we have a long way to go—and perhaps even less time to lose—in the field of monetary policy, where it is still the practice to impute inflationary leanings to those who refuse to admit that inflation is a phenomenon unconnected with the social structure.

In the actual planning of development it is obvious that we must make our own way. In the most advanced Western countries planning experience is being accumulated, but in conditions different from those existing in Latin America. This experience must be closely followed, and so must that of the socialist countries, where planning is of longer standing and is based on direct economic action by the State and the political system that would appear to be inherent in this.

In Latin America the propensity to import ideologies is still very strong—as strong as the propensity of the central industrial countries to export them. This is an obvious legacy from the times of externally-g geared development. Let us be quite clear; there is no question of closing our minds to what is being thought and done in other countries. Happily, in the great world centres there is a growing interest in development theory and problems, and it would be a serious mistake not to take advantage of the valuable assistance thus made available to us. But nothing can absolve us from the intellectual obligation to analyse our own phenomena and to seek our own true image in our endeavour to change the existing order. Let us make intelligent use of the thought and experience of others, but only as a means of crystallizing our own ideas.

This does not apply to the economic field alone. Our vital problem is a much broader one, for we must not lose sight of the real object of development or fail to project, in addition, the image of what we want the Latin American citizen to become within the next few generations.

The rapid assimilation of technology entails new patterns of living and new attitudes of mind. Nevertheless, there is nothing in this vast process of change that requires the relegation of human values to second place. On the contrary, present-day technology opens up infinite possibilities for a variety of ways of life and a freedom of individual choice that until recently, in terms of history, were confined to a small fraction of mankind.

But the production technique of today also makes possible an enormous concentration of economic power in a few hands, and this is perhaps even more true of information techniques and mass

communication of ideas. Everything depends on the use we make of such techniques for the purpose of exercising conscious and deliberate control over the forces of economic and social development—on whether we use them to place some men under the dominion of others, or to enhance the dignity of the human personality.

#### **10. The concentration of economic power and its political effects**

However, circumstances might well lead Latin America to take decisions that are not based on an objective view of such arguments. Resistance to the structural reforms postulated in the Charter of Punta del Este is all too well known in our countries. It may safely be assumed that some of the avowed opposition to State intervention is due at times to the simple fact that the prime purpose of such intervention is to effect these reforms. Ideological beliefs are invoked to dress up a basic opposition rather than because they are deeply held. Possibly the authoritarian State, and the disintegration of democracy, would not be regarded as nearly so distasteful by some critics if they thought that by such means it would be possible to achieve their goal—fantastic and illusory as this is—of keeping the present structure intact.

This dissentient note often meets with a response in certain circles outside Latin America, where this is only to be expected, since the economic and social complex that hampers development also includes certain exogenous elements. Thus once more the old argument emerges, both at home and abroad: first, we must complete the stage of economic development, and social reforms will follow; to speak of them now is to discourage private initiative.

This is a profoundly mistaken belief. There can be no speed-up in economic development without a change in the social structure. And it is also a cause of deep concern for those who envisaged the Charter of Punta del Este as heralding a new policy of international co-operation with those countries that were resolute in undertaking such structural reforms. It is easy to understand that certain private investments may be held up while there is uncertainty as to the issue of the reforms in question. Without attempting to establish a strict parallel, it may be pointed out that equal uncertainty prevailed in the countries of Western Europe after the war; but the immediate threat that existed then was banished, not by private investment or appeals to repatriate European flight capital, but by the superb daring of the Marshall Plan. It was after this development that private investment began to flourish and the flight capital returned.

We are living in an epoch that is, and will continue to be, decisive, and that calls for a long-term approach. The postpone-



ment or emasculation of reforms for fear of a temporary discouragement of private investment will not mean that an atmosphere favourable to foreign private investment is created. On the contrary, it will jeopardize the very existence of private enterprise, not to mention the endeavour to give it full dynamic impetus.

Let us not deceive ourselves. This is not a question that can be resolved on a doctrinaire level; it is essentially political. The political banner under which Latin American development is carried out is not a mere matter of intellectual preference, but will depend largely on the actual course of events in the next few years. There is a certain element of determinism in these events, and the only way to circumvent it is to influence their course in anticipation.

I have already stressed this point in these early pages, and there is no need to labour it further. Suffice it to recall the many serious difficulties that are attending the trend towards closed development. A supreme effort is called for to reverse this trend in national, Latin American and international plans, since if this is not done, and done in time, the outcome may be the authoritarian State, and incentives to economic activity may be superseded by compulsion.

We have spoken of determinism in relation to events; and perhaps there is an inexorable logic in their consequences. For if development were to become progressively more closed, we should also have to withdraw to some extent from the outside world, to avoid the contamination of new tastes, new needs or new aspirations, and this withdrawal would be interwoven into the fabric of an ideology that, on the basis of the same repressive machinery, would have to be similarly safeguarded from the harsh breath of criticism.

There are many paths leading to the authoritarian State; this is not the only one. Another is resistance to the structural changes that fling wide the gateways for the forces of development. But in this case the starting-point is political, not economic, although both paths lead to the same destination. If there were unyielding opposition, either to the reforms as such or to their execution, extremely critical situations might arise.

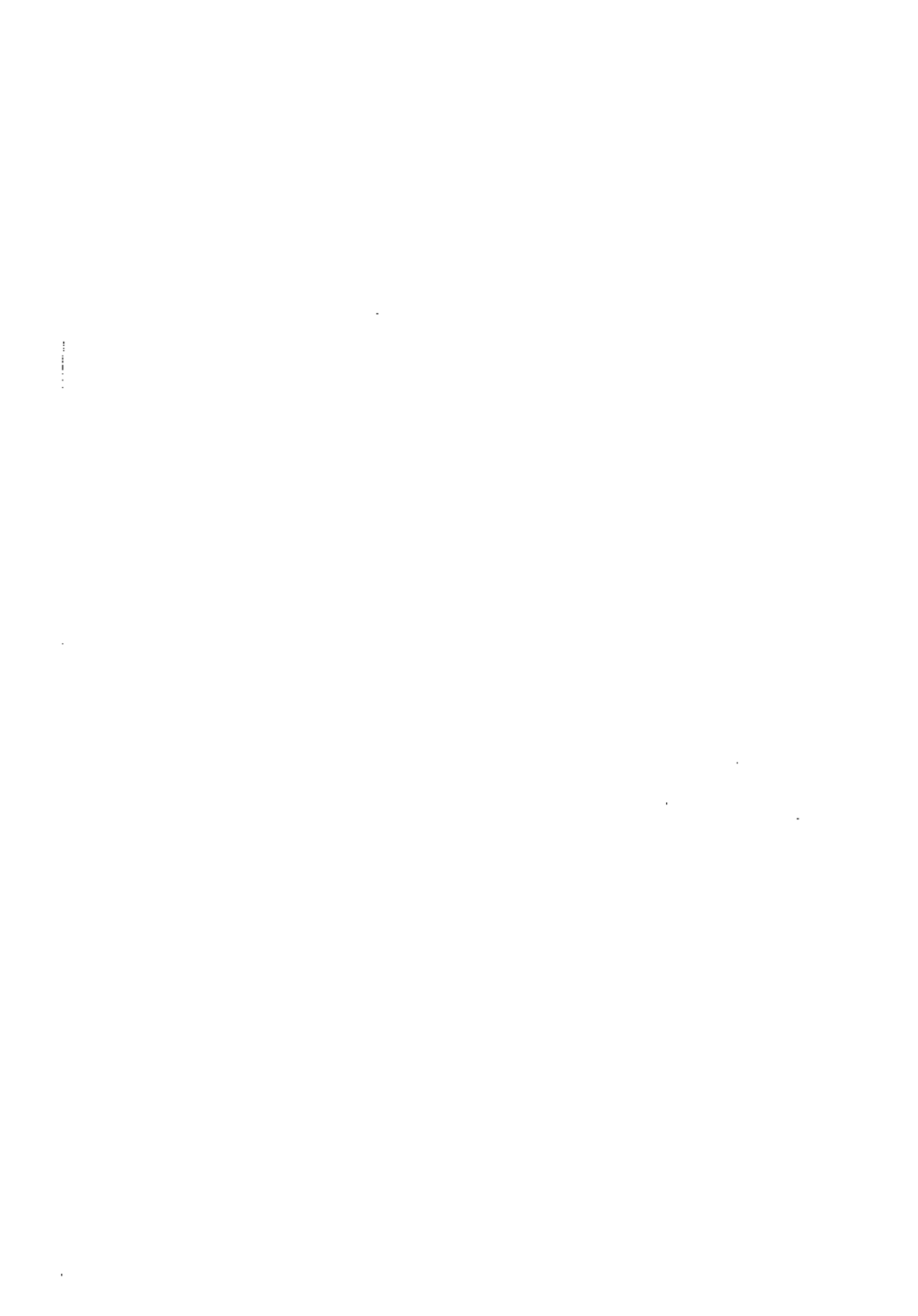
And the men who acquire the political power to carry out these reforms as the result of a possibly irresistible tide of popular feeling, may be forced to concentrate economic power in their hands in order that their political power may be strengthened and consolidated, and perhaps also to use the whole of the savings potential of the community, in face of the magnitude of the problem confronting them and the contraction of private investment—an economic power far exceeding anything the State possessed during the evolution of the capitalist economies.

The concentration of economic power in any form is always a threat to the true spirit of democracy. The State is not an abstract and disembodied entity, and those who operate its machinery are inevitably swayed by interests and passions as well as by community aims. It is hardly conceivable that when they hold the economic power in their hands, when they have seized it under the spur of these interests and pressures, they will refrain from subjecting other men to their own will, or that these others can be independent in their outlook and decisions if their every activity and their very means of existence depend on those in power, and any alternative is denied them.

The basic question lies here, not in planning, since even those who hold deep and firm democratic convictions, who believe in political freedom and human rights, might find themselves compelled to compromise first of all by the force of circumstance, and secondly by the actual logic of events.

This is certainly not the state of affairs we would wish to substitute for the status quo. It would be a tragedy if in order to free man from want we had to sacrifice other values and subject him to the demands of an arbitrary power. The very idea is fundamentally incompatible with the genius of the Latin American peoples, with their latent urge to shake off the trammels of poverty in order to liberate the human personality and give full rein, by means of economic development, to democracy and human rights, especially as regards the underprivileged half of the population of Latin America; in order to ensure that both there and in all strata of society, social mobility will allow the best elements to move upwards, for the good of economic development and of democracy. The goal must be a social order free from privilege, and not only economic privilege, but also that baneful sort whereby some men usurp dominion over the ideas of the rest, over the creative forces of the spirit and over the deepest feelings of the heart.

## **B. INTERNAL STRUCTURAL FACTORS**



## Chapter I

### THE DYNAMIC WEAKNESS OF LATIN AMERICA'S DEVELOPMENT

#### I. PRODUCTIVE ABSORPTION OF MANPOWER

##### 1. *Slow growth rate and surplus manpower*

The very low annual growth rate of 1 per cent registered by per capita income in Latin America as a whole since the mid-fifties is clear proof of the lack of dynamism in Latin America's development. Comparison of this rate with the 3.7 per cent attained in Western Europe during the last decade, Japan's 8.3 per cent, and the annual per capita rates of between 5.3 and 9.0 per cent in the socialist countries of Eastern Europe, brings home the full significance of the fact. At the rate of 1 per cent it would take seventy years to double per capita income in Latin America as a whole—although there are marked differences between countries.<sup>1</sup>

This in itself is very serious. But there is another fact that is perhaps an even greater cause of social tension. An appreciable proportion of the increase in the active population is not properly absorbed in the production process; economic development passes it by. This is mainly true of the population that moves from the country areas to the towns. In the country the rate of demographic growth is possibly higher than the over-all average of 2.9 per cent per annum, but in the last decade those who remained on the land represented only about 1.5 per cent. This must inevitably happen in the process of economic development, but what is not inevitable is the fate of such people. Far from achieving integration in city life, and sharing in better patterns of living, they put up their wretched shanty towns and eke out a hand-to-mouth existence in a whole wide range of ill-paid personal services, with periods of out-and-out unemployment.

Thus poverty, frustration and resentment surge in from the country to the towns, where the symptoms of the concentration of income are already so conspicuous. This is clear proof of the explosive social polarization of development, imputable to its dynamic weakness and distributional shortcomings.

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<sup>1</sup> See *The Economic Development of Latin America in the Post-war Period* (E/CN.12/659/Rev.1), op. cit., chapter II.

Here there is a twofold phenomenon that needs explaining: the displacement of the population from the rural areas to the towns, and the unsatisfactory absorption of the migrants. The reasons for the displacement are sufficiently well known; demand increases more slowly for primary commodities than for industrial goods as the general level of per capita demand rises. Recent experience in Latin America as a whole indicates that for each 1 per cent increment in over-all demand, agricultural demand increased by only 0.5 per cent, whereas industrial demand did so by about 1.4 per cent.

This fact alone suffices to account for the large-scale drift of the active population increment to the towns. But it is not the only explanation, for as productivity improves in agriculture and in other primary occupations, the displacement must increase—other things being equal—and it will also increase in proportion to the percentage whereby the natural growth rate of the rural population exceeds that of the urban population.

Not all the redundant manpower comes from agriculture and other primary activities. In the towns there is generally a plethora of workers with very low incomes: in addition to the unemployed, there are all those engaged in unskilled personal services, from domestic service to very small-scale street trading, together with artisan activities of the pre-capitalistic type. All these people are outside the area of technical progress; but as the labour-absorbing activities develop, the increment in the active population and even in the population forming these lowest groups tends to move into them in search of better pay.

But what are these labour-absorbing activities? First, industry and allied activities relating to the movement of goods (trade and transport), which all tend to grow more rapidly than income, and, secondly, other activities that also tend to expand relatively fast as income increases, thus accelerating its upward trend; these comprise a large range of skilled personal services that require varying degrees of vocational training, and government services.

Industry and related activities play a key role in the dynamic development of the labour force. And in order to fulfill this function of providing employment and stimulating the second group of activities to do the same, they must grow at a given pace, which cannot be arbitrarily defined. Otherwise, one section of the displaced agricultural population will be driven into the underpaid groups in the towns, that is, the groups engaged in the various unskilled services. Furthermore, those so engaged will find it difficult to obtain proper employment in the manpower-absorbing activities in so far as the growth rate of those activities is not in proportion to the population to be absorbed.

Thus there is a minimum rate of development which is essential if the manpower-absorbing function is to be fully discharged. And if this pace is not maintained, part of the population displaced from agriculture and other primary occupations—if it does not merely remain where it is, marking time—will move to the towns to look for work in the unskilled and underpaid personal services, or will cover up the fact that it represents superfluous manpower by performing unnecessary tasks in public administration and primary activities.

But there is yet another point to consider. The people engaged in these personal services, who are also trying to move into the manpower-absorbing activities, can do so only to a limited extent. The result is an uncontrolled mushroom growth of marginal activities in the medium-sized and small towns, with the serious consequences such a process entails. All this is due to the dynamic weakness of the system as it functions at present, and its inability to attain the minimum rate of development with a satisfactory rate of capital formation.<sup>2</sup>

## *2. Increased productivity and the need for new investment*

The above considerations enable us to throw some light on a very important phenomenon: in view of the dominant role of industry and allied activities in absorbing manpower, their growth rate must increase proportionately with the improvement in their average productivity; and a similar responsibility is imposed on them by any increase in productivity in agricultural and other primary activities.

It may be said that the rise in productivity resulting from technical progress must also be accompanied by a rise in the coefficient of investment. In line with the technique introduced at the various stages of the production process, a minimum investment coefficient and a minimum rate of income growth are needed if the manpower-absorbing activities are to play their part to the full.

The annual growth of 1 per cent registered for per capita income is far below this minimum level, and even the rate of 2.5 per cent referred to in the Charter of Punta del Este is insufficient from this standpoint. Consequently it is hardly to be wondered at that surplus active population is to be found not only in unskilled personal services, but also often in industry itself, and in business and transport, or else moves into public administration,

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<sup>2</sup> There are extreme cases in Latin America where capital formation will have to increase at a virtually impossible rate if this labour-absorbing function is to be fulfilled. This points to the need for special measures to keep the superfluous rural population in the country areas, and avoid mechanization patterns that will aggravate the problem.

needlessly swelling the ranks at the expense of efficiency—that is, when it does not stay in the rural areas as redundant labour.

This is not a problem that can be solved piecemeal, and it is easy to understand why the trade unions should resist piecemeal solutions. Basically, it is pointless to introduce measures to clear away the dead wood in employment here or there, let alone to make a drive to increase productivity, if there is no corresponding increase in the economy's capacity to absorb manpower. On the other hand resistance would no longer be justified if the latter aim were achieved by means of a strong impetus to economic development.

This surplus manpower bottleneck is a characteristic feature of Latin American development. Between 1945 and 1962, when the active population increased at an annual rate of 2.6 per cent, and employment in production and transport of goods absorbed manpower at a rate of 1.9 per cent, employment in services increased at the high annual rate of 5 per cent. In 1945, 21 per cent of the active population was employed in services, and this proportion has now increased to 30 per cent.

Unfortunately, it is not possible to make a thorough study of the composition of this very heterogeneous group, comprising skilled and unskilled services, trade and public administration. But the contrast between the growth rates of employment in these services and in the production and transport of goods is irrefutable proof of the existence of redundant manpower in the former category.

In order to bring out the significance of this, a rough calculation has been made of the minimum rate of income growth that would have permitted employment of this redundant manpower in activities connected with the production and transport of goods. The point of departure is the arbitrary though not unreasonable assumption that services in general did not require an increase in employment higher than the 2.6 per cent growth rate of the active population; or, in other words, the 5 per cent growth rate actually registered represented an excess annual increase of 2.4 per cent.

The absorption of this surplus would have required at present an available supply of capital for the production and transport of goods about 27 per cent above the existing level; and the average annual growth rate of the per capita product in these activities would have had to be 3.7 instead of 2.3 per cent.

It should be noted that this marked rise in the over-all growth rate of the product would have been obtained with the same rates of increase in productivity in these activities.<sup>8</sup> This is of special

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<sup>8</sup> That is, annual rates of 2.6 per cent in agriculture and 2.9 per cent in industry, energy and transport.



significance from the dynamic standpoint, and it is explained by the transfer of manpower away from agriculture, where in 1962 the product was barely 530 dollars per unit of the active population, into those other activities—the production and transport of goods—where the average was 1,840 dollars.

These rates refer only to the production and transport of goods. To pass on from these sectors to the Latin American economy as a whole, another somewhat arbitrary assumption must be adopted, for want of better data, namely, that the output figures for services would be maintained despite the fact that absorption of manpower would increase at an annual rate of 2.6 per cent instead of 5 per cent, or, in other words, that there would be an average increase in productivity of 2.0 per cent.

On this assumption, the per capita growth rate, which averaged 2.2 per cent per year between 1945 and 1962—a period that includes a fair proportion of favourable years as regards the terms of trade—would have had to be not less than 3.1 per cent to absorb the surplus population.

### 3. *Main causes of dynamic weakness*

What is the explanation of this lack of dynamism? It is largely to be found in the disequilibrium between productivity and investment to which allusion has just been made. It is true that the rise in income deriving from an increase in productivity generates greater capacity to save. But the capital needed in order to absorb the surplus manpower resulting from this higher productivity exceeds the savings which could at present be obtained; and only with the passage of time will it be possible to achieve a proper balance between the increase in capital formation entailed by an improvement in productivity and the expanded capacity to save which the latter brings in its train. The disequilibrium is thus a temporary but highly important phenomenon which will have to be combated by means of the restriction of consumption wherever this is socially practicable, and with the aid of international resources.

Rightly considered, this disequilibrium, in the guise and degree in which it makes itself felt in developing countries, springs from the obvious contrast between the technique they have to assimilate and their present capacity for capital formation. The technique in question, perfected in the great industrial centres, is based mainly on the need to save labour by increasing the amount of capital per head. In the centres referred to, this presents no difficulties, thanks to their high income levels. The same cannot be said of developing countries. And as it is inexpedient to revert to out-of-date techniques, in an endeavour to adopt those com-

patible with the existing capacity for capital formation, the only alternative open to developing countries is to achieve an exceptional increase in that capacity, commensurate with the requirements of production technique.

However, this disequilibrium or disparity is aggravated by a number of serious distortions in the production process in Latin America. Let us try to describe them briefly.

While a regression in respect of production techniques is certainly not feasible, as has just been remarked, it is none the less true that there are possibilities of choosing between higher and lower levels of employment of manpower, according to the ratio between the cost of labour and the cost of capital, as determined by factor prices and by rates of interest on investment resources.<sup>4</sup> This is a problem that will not solve itself of its own accord, although such a possibility is conceivable in the abstract. The terms in which it presents itself were described earlier in this document, but from another standpoint. Capital formation is insufficient to absorb, at the relatively high level of productivity of the labour-absorbing activities, the manpower released by the labour-expelling industries whose productivity or income per worker is lower. In effecting their investment, entrepreneurs adopt the techniques that suit them best in the light of the cost of labour and of capital.

That this investment results, to a greater or lesser degree, in a saving of manpower which is thus left without satisfactory employment, or in failure to absorb the active population thrown out of work by the labour-expelling activities, is a point that entrepreneurs do not, of course, take into account in their calculations. For them the problem begins and ends with their own individual case, regardless of the possible effects of their line of action on the remainder of the community.

Strictly speaking, it is conceivable that in a very fluid market the ratio between the cost of labour and the cost of capital might be such as to ensure optimum employment of manpower—that is, a ratio permitting the maximum absorption of human resources compatible with the maximum increase in the product. This is what accounting prices signify in the evaluation of the economic sound-

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<sup>4</sup> These possibilities vary according to the branches of industry concerned, but are never negligible, except perhaps in the extreme case of continuous-process activities like the chemical industries. In the textile industry, for example, recent ECLA studies have shown that two technical alternatives, characterized by differing degrees of automatic control of equipment, represented a difference in the product-capital ratio of a little over 50 per cent (in an integrated cotton mill). That is, the selection of the less highly mechanized (but nevertheless up-to-date) technique would enable the value added per unit of capital invested in equipment to be approximately doubled.

ness of investment. Not enough progress has yet been made in respect of the possibilities for the practical application of this concept, except as regards investment by the State, which can get away from the current fallacious notion of what constitutes economic expediency. If, for example, a higher rate of interest than is paid by the State on the resources it borrows is applied in the relevant calculations, certain types of investment which result in a saving of manpower become anti-economic, and others involving the employment of more labour are found to be economically sound.

But this procedure is not, of course, applicable in private activities, except as a guide to the adoption of measures aimed at ensuring economic viability. The possible nature of these measures cannot be defined at present with any degree of certainty, for as this important aspect of the question does not concern the great industrial centres, but the peripheral countries, it has not yet been explored as thoroughly as it deserves.<sup>5</sup>

Moreover, in the Latin American countries the tendency to apply capital in ways that have an unfavourable influence on the absorption of manpower is aggravated by the effect on production costs of customs protection (especially when carried to excess), social security contributions and indirect taxation; whereas in many instances tariff surcharges are not payable on the prices of imported capital goods, or are relatively low. Another factor that helps to foster the tendency in question is the comparatively low rate of interest—lower than the current market rate—on certain international financing operations; this is a good thing as regards the real cost of such operations for the country, but not in its effects on entrepreneurs' calculations.

The asymmetry of protectionist policy—explained in an earlier document<sup>6</sup>—has also contributed to the development of labour-expelling industries, at the expense of others with a higher labour-absorbing capacity. Protection implies subsidizing import substitution industries but not export industries. This has militated against the economic soundness of the industrialization process, since activities have been developed to serve the domestic market whose costs, in relation to the world level, are higher than those of other

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<sup>5</sup> Nor has sufficient progress been made in the study of methods whereby a saving in construction materials might be achieved and more human labour employed in engineering works—bridges, roads, dams, buildings—, which absorb a significant proportion of total investment in Latin America. The technical standards applied are generally brought from the industrial centres, where the wage-materials ratio is much higher than in Latin America. *Inter alia*, therefore, empirical research is needed to determine the technical standards best suited to the special conditions prevailing in the Latin American region.

<sup>6</sup> See *Economic Development, Planning and International Co-operation* (E/CN.12/582/Rev.1), United Nations publication, Sales No.: 61.II.G.6.

activities that have had no chance to develop, either for the domestic market or for export. For example, from the economic standpoint there would seem to have been no good reason to encourage, by means of protection, substitution activities with costs 30 per cent above the international level, if by means of subsidies of one kind or another it would have been possible to promote export industries in which the differences in costs were not so great.

Yet the asymmetry of protectionist policy has led to the adoption of these anti-economic alternatives. And among the import substitution industries thus established there are some whose excessively high costs are due to a low capital content and high labour content; whereas among the industries that might have been established to produce export commodities besides supplying the domestic market, those with a high labour content and low capital content would have enjoyed special, although not exclusive, advantages.

These adverse effects of asymmetrical protectionism on the absorption of manpower would have been produced even if the ratio between the cost of labour and the cost of capital had been correct. But they have unquestionably been aggravated by the distortion of this ratio. Unfortunately, this important aspect of the question has not yet been the subject of practical research, nor has it been clearly elucidated from the theoretical angle.

Similar anti-absorbent effects seem to be produced by the wide disparities in income distribution. Consumption in the upper strata of society is also primarily directed towards the products of industries that absorb relatively little labour and a great deal of capital, whereas the reverse is true for the rest of the population. The progressive redistribution of income postulated here will therefore be conducive to the absorption of more manpower per unit of capital invested. This general effect might acquire particular importance in the case of agriculture.

Lastly, there is a considerable waste of capital in Latin America, owing to the unsatisfactory terms of competition in economic activity. The capital invested could have a much higher productivity than at present if it were more efficiently utilized. In some cases, this intensive utilization of capital—like intensive methods of farming—would involve the employment of more manpower to obtain a higher product per unit of capital (or of land). But even if this did not happen, the mere raising of the product-capital ratio would leave more capital available for the absorption of manpower in other activities.

The serious dynamic weakness in the development of Latin America must be combated in several ways at once: first, by more intensive capital formation and more efficient utilization of the

existing stock of capital; secondly, by the more rational use of capital in whatever ways are most advantageous from the standpoint of the absorption of human potential. In short, the more rational application of capital in relation to the different possibilities offered by technology, and the more efficient utilization of the existing stock of capital, would redound to the benefit of the product-capital ratio, and, in consequence, would correlatively reduce the proportion of capital required to secure a specific rate of development. This should be particularly borne in mind in relation to the following section.

It is not, of course, a question of arbitrarily increasing the size of the labour force employed with the available capital, but of devising applications which yield the maximum aggregate product, for only in this way will the maximum per capita product be achieved in the economy as a whole.

## II. CAPITAL FORMATION

### 1. *The possibility of reducing consumption*

All these measures designed to economize in capital and to increase manpower absorption will necessarily take some time to put into effect. Yet the problem of lack of dynamism in development brooks no further delay. Accordingly, attention must first be centred on measures aimed at a swift increase in capital formation, without prejudice to those designed to limit its use.

It was suggested in part A of this document that consumption on the part of the higher income groups might be reduced as a way of achieving this objective. Let us examine this point more closely on the basis of the hypothetical figures mentioned in that connexion. It must be recalled that these are merely approximate figures which give a preliminary notion of the problems but do not provide a sound foundation for the adoption of specific measures, since these require careful study in the light of each country's particular conditions.

As will be remembered, the upper strata, consisting of about 5 per cent of the Latin American population, are responsible for nearly three-tenths of total personal consumption. At the opposite end of the social scale, 50 per cent of the population account for barely two-tenths of the total. Between these two extremes the middle income groups, comprising about 45 per cent of the population, represent approximately the remaining 50 per cent of total personal consumption.<sup>7</sup>

<sup>7</sup> In advanced countries such as the United States and those of Western Europe, consumption by the high income groups is not more than nine to ten times that of the lower strata.

This impressive disproportion in the consumption of the groups in question, and in the income transferred abroad for investment and hoarding, implies an ample savings potential which would permit a sharp increase in the rate of development, provided other conditions were met at the same time.

In fact, if consumption by the upper strata were brought down to not more than eleven times that of the lower strata, the annual per capita income growth rate could be raised from 1 per cent to 3 per cent, and if it were only nine times as great, the annual per capita rate could rise to 4 per cent.

What this would mean for the upper income groups is illustrated roughly by the following figures. Annual average consumption by a family of five persons in these groups is about 8,000 dollars. This would be reduced to 5,700 dollars (that is, by 28 per cent), if the measure of the disparity decreased to eleven times the consumption of the lower strata, or to some 4,600 dollars, if it dropped to nine times as much, in accordance with the foregoing hypothesis. This gives some idea of the difficulties involved.

However, the problem of speeding up the rate of development would not be solved by this drastic curtailment of consumption and increase in savings; these additional savings must also be converted into capital goods. And here we come up against another formidable barrier in the Latin American countries.

The fact of the matter is that in these countries internal capacity to produce capital goods and the capacity to import them are alike inadequate. At present the coefficient of gross investment is about 15.5 per cent (10 per cent net). To achieve a growth rate of 3 per cent this coefficient would have to be raised to 20.5 per cent, and to 23 per cent in order to obtain a 4 per cent growth rate. This means that in the two instances given imports of capital goods would have to be increased forthwith by 32 per cent and 48 per cent, respectively. Such targets are beyond the reach of most—if not all—of the countries concerned, in view of the prevailing external bottleneck.<sup>8</sup> To this must be added the fact that the increase in domestic demand for capital goods as well as for consumer goods in consequence of the rise in income could only be partly met by using idle production capacity. In addition it would be essential to expand the capacity in question, a process which takes time. In the meanwhile, this aspect of demand too would have to be met through increased imports.

Clearly, then, under present conditions, Latin America would be unable to accelerate its growth rate without external cooperation. A temporary inflow of international resources is re-

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<sup>8</sup> See in this connexion part C, chapter I, of this document.

quired until such time as import substitution and increased exports permit internal and external use of the additional savings obtained through a contraction of consumption. Moreover, these international resources would have to be channelled first and foremost into investment aimed at achieving the objectives indicated and eliminating the causes of the internal bottleneck.

All this is essential if effective use is to be made of this savings potential, and likewise in order to increase it, since most of the Latin American countries have production capacity which is not utilized because of internal or external bottlenecks. Once these are disposed of, income can be increased rapidly with a relatively small volume of investment compared with the amount normally required; and this income growth will, in turn, increase the capacity to save for future investment.

## *2. Initial coercion and incentives to economic activity*

Let us now consider another very important facet of this subject. Such a drastic contraction in the consumption of the upper strata can obviously not be achieved unless strong coercive measures are applied. How far would these measures be compatible with the incentive to individual economic activity? Would they not weaken the dynamism of the system, with all the consequences this entails, rather than give it the full validity which is so essential?

A basic distinction must be made between structural reforms and the operation of the economic system. The former can obviously not be achieved through the mere action of incentives; coercive measures are unavoidable. On the other hand, the operation of the system calls for incentives rather than compulsion, both in the interests of its efficiency and for basic political reasons.

Land tenure provides a good example of this distinction. Reform of the structure of land tenure is a major means of curtailing consumption if land is not paid for at its commercial value, as will be explained later.<sup>9</sup> And if payment is spread over a relatively long period, at a low rate of interest, incentives are obviously ruled out. On the other hand, the new owners of the land will have to be given incentives to induce them to increase and improve production, and these incentives will have to be essentially economic. To put it differently: contraction of consumption with a view to private or government savings, after the land tenure system has been reformed, will have to be the result of such incentives rather than of coercive measures.

This is a far-reaching problem, and its solution is of decisive importance. Its significance will be better understood when we

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<sup>9</sup> See section III of the present chapter.

come to consider the question of social mobility.<sup>10</sup> If the economic system is to operate effectively and to function democratically the emergence of the dynamic elements in all strata of society and their upward economic and social mobility must be promoted; and the operation of incentives is of major significance. From among these dynamic elements will come the experts, administrators and leaders in all branches of economic activity; and their personal income must be commensurate with their effective contribution to the economic process. There will therefore be disparities in income distribution; but these will not be the result of a system of privilege, and will, on the whole, be much smaller than those prevailing at present.

They will always have to be reduced to a reasonable degree from the social standpoint by means of taxation, but if the savings drive places too heavy a burden on these new dynamic groups it may jeopardize their contribution to the economic process.

Moreover, a more rapid rate of development combined with income distribution policy will enable the normal effort to increase savings—as distinct from the exceptional effort inherent in structural reforms and essential to the achievement of an increase in the rate of development—to be gradually extended to all levels of society. In this case, however, it would no longer be a matter of curtailing present consumption but rather of increasing consumption in all the social strata. Popular saving would then have to be stimulated also by means of adequate incentives.<sup>11</sup>

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<sup>10</sup> See part B, chapter II, section I, 1, of this study.

<sup>11</sup> In this connexion, the following was stated in another report: "The loan of investment resources as a means of promoting the eventual formation of capital does not have to be confined to enterprises. It may also be extended to workers. This may turn out to be one of the most effective means of achieving popular capital formation and a question arises in this connexion which should be given some consideration. The use of credit for the purchase of durable consumer goods has been rapidly gaining ground in the Latin American countries. This is clearly a way to afford the broad masses of the population access to goods which it would be difficult for them to obtain in any other way. But this, in common with inflation, is a grave threat to saving practices. Perhaps such practices could be encouraged by credits for the purchase of securities by the workers themselves, either in the enterprises in which they work or in others. These possibilities should be explored and the organizations that finance development might play a very important part in this respect.

Loans for capital investment have so far been made direct to enterprises. A substantial part could be made indirectly, i.e., through loans to workers for the purchase of securities. Reference has just been made above to the need for international credit institutions to devote a large part of their operations in Latin America to encouraging initiative on the part of firms and concerns in the area. These operations could be co-ordinated, in one way or another, with the growing participation of workers in the capital formation process.



This is actually a very serious argument in favour of a maximum initial effort to encourage savings. For if this effort were limited to achievement of an annual per capita growth rate target of 3 per cent, the possibility of offering incentives would be less than if a rate of 4 per cent or more were attained.

In fact, all that the 3 per cent rate could achieve would be a relatively rapid improvement in consumption by the lower strata, i.e., the underprivileged half of the Latin American population. With the help of an adequate income redistribution policy, consumption by this sector could be increased at an annual rate of 4.2 per cent and thus doubled in seventeen years. In the middle strata improvement would be somewhat slower, and in the upper strata extremely slow.<sup>12</sup> On the other hand, a growth rate of 4 per cent or more would lead to more rapid improvement not only for the lower strata but for the middle and upper strata as well. This is very important, inasmuch as the dynamic elements in the upper strata would be able to overcome the initial curtailment of their consumption caused by structural reforms, and the new dynamic elements moving up from the bottom would have much stronger incentives to reach the top.

Needless to say, this discussion of time schedules must not be taken as a proposal for a plan to accelerate development. Our purpose is merely to shed light on the nature of the phenomena and their possible magnitude in terms of time and effort. Acceleration of the rate of development is a complex operation requiring thorough preparation designed to achieve, as a first step, the removal of the internal and external obstacles in its way.

### 3. *The population problem*

One final observation. Throughout this document the population growth rate is considered to be one of the basic data as far as the development problem is concerned. The impressive increase

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The Latin American countries regularly face a very serious problem of capital formation in their public services. The use of international assistance for the purchase of securities in these services could have very important repercussions on the accumulation of capital and on the management of the enterprise. The participation of the producers and users of such services could provide a new way out of the common dilemma of choosing between foreign ownership and management by the State."

(See *Economic Development, Planning and International Co-operation*, op. cit., p. 11.)

<sup>12</sup> Contraction of consumption by the 5 per cent of the population in the upper income groups would amount to about 14 per cent. Half the population would double its per capita consumption in the stated period of seventeen years, and the middle strata (45 per cent of the population) would do so in twenty-two years. The upper strata, once their consumption had been reduced, would increase it again at the very slow rate mentioned in the text.

in this rate has undoubtedly added considerably to the complexity of the problem. A lower rate of population growth could do much to smooth the path for the acceleration of development. Of the net investment coefficient of 10 per cent of income (gross coefficient 15.5 per cent) only one-fourth can be applied for the purpose of increasing per capita productivity and income. The remaining three-fourths are needed to keep pace with population growth. For example, if the population had continued to increase at a rate of 1.8 per cent, as it did at the beginning of the century, the present volume of investment would have produced a 2.2 per cent increase in per capita income, instead of the 1 per cent registered on an average over the past few years. It is not suggested that this could be an alternative to full use of the savings potential; but it would be an additional means of accelerating growth. However, we shall not go into this delicate matter in the present document, since factors come into play which touch deep-seated feelings of the Latin American peoples, and it is not for the economist, as such, to suggest appropriate solutions.

### III. THE LAND: AN OBSTACLE TO DEVELOPMENT

#### 1. *The growth of agricultural production in the past, and future requirements*

An annual growth rate of 3 per cent for per capita income would call for a considerable effort on the part of Latin American agricultural production, much greater than in the past. Hitherto, the effort made has been appreciable but not adequate. In the twenty years just ended agricultural production expanded by 80 per cent (2.6 per cent annually), that is, at a higher rate than in other regions of the world, as pointed out in another report.<sup>13</sup> Nevertheless, if population growth is taken into account, the per capita production increment barely amounted to 0.2 per cent annually, a negligible proportion exceeded in the other regions of the world where demographic growth is much slower than in Latin America.

Moreover, this annual rate of growth of 2.6 per cent for aggregate production was well below that of consumption, which increased at a rate of 3.7 per cent. The deficiency in production was made up mainly by reducing exports and expanding agricultural imports from the rest of the world. These imports constitute a relatively small percentage of total consumption; nevertheless, they add up to a very considerable sum, i.e., about 450 million dollars' worth of items which, given a rational production policy and reciprocal trade, could be largely obtained in Latin America itself.

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<sup>13</sup> See *Agriculture in Latin America: Problems and Prospects* (E/CN.12/686).

Admittedly, this imbalance between production and consumption is mainly attributable to Argentina, where the substantial increase in domestic requirements had to be covered at the expense of exports, because of the scant technical progress made by agriculture.<sup>14</sup> But, even if this country is excluded from the Latin American total, production obviously fell short of requirements, since it expanded by only 3.2 per cent, while consumption rose by 4.2 per cent annually.

If a minimum annual development rate of 3 per cent per capita were achieved, and if, in addition, a resolute policy of income redistribution were put into force, the growth of production would have to be much faster than before, and faster still if it were hoped to slow down the rate at which agricultural imports are increasing and so contribute to the removal of the external bottleneck. In such circumstances, it has been estimated that over-all consumption of agricultural commodities will have to increase at a rate of 4.6 per cent annually and production by 4.2 per cent. This means that in the next twenty years production should expand slightly more than 130 per cent, i.e., by considerably more than the increment of 80 per cent recorded over the previous twenty years. The point is that exports are expected to lag behind production in rate of growth (2.5 as against 4.2 per cent), thereby enabling consumption to increase more intensively than production (by 4.6 per cent).

Such, then, is the magnitude of the problem that Latin America will have to deal with if it hopes to achieve the objectives of development and income redistribution. Everything points to the fact that the achievement of an increase in production on this scale will have to be based mainly on an improvement in the yield from land and not on an extension of the cultivated area as hitherto. Past trends will have to be reversed. A review of twenty-four staple agricultural commodities shows that the 60 per cent increment in output during the last twenty years was obtained by enlarging the cultivated area by 38 per cent and yields by only 16 per cent, i.e., at an annual rate of 0.7 per cent.<sup>15</sup>

## 2. *The inescapable need to raise yields*

It would not be easy to pursue the trend towards extension of the area farmed, first, because the amount of land that is readily accessible has been gradually diminishing and, secondly, because of the vast investment entailed by the incorporation of new land

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<sup>14</sup> In the rest of Latin America there was an increase in exports, especially in respect of coffee, cotton, sugar and bananas.

<sup>15</sup> These commodities took up approximately 50 per cent of the total cultivated area.

and its preparation for productive farming. Then, again, it might be asked why this should be done if there are such good prospects of increasing the yield of the land already in use. To judge by the experience of other countries, it would not be unduly optimistic to estimate that, provided a valiant effort is made, yield in the next twenty years could be raised by 60 per cent, i.e., at an annual rate of 2.4 per cent. If this were done, the cultivated area would have to be enlarged by 35 per cent to meet the production target specified, i.e., by about 35 million hectares.

Putting the accent on improved yield is also the course dictated by social considerations, since this is the only way to raise the extremely low level of living of the rural population. Land reform is, of course, indispensable, but the redistribution of income that might be achieved thereby would not be enough in itself to solve this particular problem satisfactorily, just as it would also fail to solve the problems of the economy as a whole.

None the less, the social objective that higher yield would thus promote could not be attained irrespective of the development rate, since agriculture and the other sectors of the economy are closely interdependent. It will be recalled that the annual rate of increase of 4.2 per cent in agricultural production was estimated in relation to an annual income growth rate of 3 per cent and a level of demand for agricultural commodities that was in line with the relative intensity of growth of internal and external consumption.

Now, if this rate of growth could not be attained or if consumption were to expand less vigorously, there would be a decline in the ratio of the prices of agricultural commodities to those of other products, and the agricultural sector would lose all or part of the fruits of its technical progress, which would go to benefit the rest of the economy instead. In such an event, the displaced agricultural population would be unable to find satisfactory employment in the manpower-absorbing activities, and this would tend to aggravate the situation of the marginal urban population.

Again, if unit yield were to improve more than is expected, and the levels of production envisaged could be attained with less addition to the cultivated area, there would be a bigger rural surplus that could not be properly absorbed without an adequate increase in the economy's over-all rate of growth.

This point is extremely important as far as the mechanization of agriculture is concerned. If capital is invested to mechanize farming and cut down on labour, and if the workers thus displaced are unable to find employment in the labour-absorbing activities, the investment will have been wasted, that is, the meagre capital of the community will have been thrown away. As has already been said, this adverse consequence is not incompatible with the

personal interests of the entrepreneur, which lead him to aim at mechanization without any thought for the social implications of what he is doing.

Thus, the choice of methods of increasing agricultural productivity should not be left solely to the whim of private interests when there is not enough capacity to absorb displaced labour, as is the case in Latin America. Preference should therefore be given to those methods of introducing modern techniques that raise productivity by increasing the yield from the land rather than by labour-saving investment.

The only difficulty is that this requires prior technological research, together with the dissemination of its findings, which would not be needed in the same way in the case of mechanization; in other words, preliminary groundwork by the State is called for.

It should be noted that the projection in question is simply a rational presentation of the scale of these development phenomena, and does not represent the choice of a particular alternative, which would be arbitrary in the absence of a thorough analysis of each country's situation and possibilities.

### 3. *Dynamic significance of agrarian reform*

This quantitative approach enables the burning topic of agrarian reform to be looked at from the angle of dynamic development. Reform is urgently needed for three main reasons: (a) to bring about structural changes such as would enable the savings potential to be used to the full and promote social mobility, with its important economic, social and political consequences; (b) to satisfy the demand of a rapidly increasing population that needs to improve its diet; and (c) to raise the level of living of the rural population.

The last two aims can be achieved solely through an increase in agricultural productivity. Land redistribution alone, unaccompanied by a rise in productivity, might ease social tension in rural areas, but only ephemerally, since, however the land is redistributed, little improvement can be effected with an average product per actively employed person of about 500 dollars a year, including the landowner's income. True, a reform of the land tenure system implies an extremely important social consequence in that it liberates forces that are now held in check in the rural areas. But this might be a source of new tensions unless the changes went hand in hand with a rapid increase in productivity and income.

This should on no account be taken to mean that such considerations counsel slow progress. The terms of the agrarian

reform, which will not be the same in all countries or even in every part of a single country, must of course be accurately defined, and the appropriate solution decided upon in each case. Similarly, the key personnel will have to be trained. But once all this has been accomplished—and without unnecessary delay—reform will have to be swift and extensive, not only to alleviate the social tension in the rural areas but for other reasons as well. There must be a large-scale mobilization of economic and social forces, which cannot be brought about unless the reform is radical. Such mobilization is essential, since although the role of the State is certainly of decisive importance, it is equally true that the community spirit of the people and their willingness to co-operate must be stimulated and turned to account, both in the rural areas and elsewhere, to ensure that State action is prompt and effective. Reform calls for the enthusiastic support of the community, which must be directed into constructive channels.

Only by launching the reform wholesale can we learn how to carry it out. It is impossible to foresee all the complications that will arise or to avert many of the mistakes that may be made. What is essential is to have a properly thought-out plan for reform and to avail ourselves of the lessons of experience in order to rectify such mistakes with flexibility.

Even though land redistribution—whether effected directly or through taxation—is essential for the introduction of modern techniques in rural areas, it is far from being enough. State action is also indispensable, as well as incentives to farmers to adopt the new techniques.

#### 4. *Technical action by the State*

There is no more serious symptom of the anachronistic outlook of the Latin American public sector and of its inability to meet the demands of economic development than its virtually complete neglect of agricultural research, of the dissemination of the findings obtained and of the basic education and technical training of the rural population, except in a few outstanding cases. These technical tasks could not have been accomplished by individual effort alone. The impressive technical progress of United States agriculture has been the product of an undeniably effective combination: (a) the "socialization" of technology and (b) the provision of incentives to individuals to apply it. Technology was "socialized" in the sense that it was not private enterprise actuated by the profit motive that brought technical progress, but the action of the State and the universities, inspired by the desire to help the community. To this were added incentives to individual initiative in the shape of technical facilities, investment resources and protection of the agricultural terms of trade. What made it possible

to do all this with an eye to the needs of the community were two salient factors: a farsighted land tenure policy and the constant absorption of rural labour into urban activities. Without these, all that technical progress could have done would have been simply to augment the income from the land but not the income of the whole of the agricultural population.

Once the problem of tenure has been resolved, the inevitable complement to technical action by the State is the provision of incentives for farmers. Under the prevailing system of land tenure, the incentive of higher prices generally succeeded in expanding production when the necessary land was available. But when there was no land, or it was difficult to come by, the price incentive usually changed the composition if not the volume of over-all production, and, in the last analysis, increased the income from the land with the regressive distribution implied by such a situation. The increase of yield through the use of new production techniques—new, that is, for Latin America—can be achieved only if these techniques are made accessible by State action and if landowners are disposed to make the extra effort entailed. This is often incompatible with the way of life of the big landowners, whose huge incomes relieve them of the need to adopt new patterns of living in order to introduce techniques for raising yield. This explains why so few attempts have been made under the existing land tenure system, even in cases where the State has fulfilled its responsibilities on the technical side.

##### 5. *Incentives to agricultural production*

Furthermore, it cannot be said that incentives to the agricultural producer have been a matter of general or lasting concern in our countries. This is a most important point in relation to the success of agrarian reform, and should be touched upon, even if briefly.

There have actually been a number of factors that have adversely affected incentives to agricultural development. These factors have their origin in urban activities, and relate mainly to relative prices, the distribution costs of agricultural products, and incentives to investment in agriculture.

A factor that has often tended to cause a deterioration in the internal terms of trade is an increase in the prices of manufactured goods and services consumed by the rural population, due to import substitution and excessive protectionism. To this must be added the cost of social welfare benefits and other State services not absorbed by an increase in urban productivity and therefore to some extent passed on to the prices of goods and services required in rural areas. These benefits and services are generally

confined to urban activities, and have been extended to rural activities either not at all or to a lesser degree.

There also seems to have been a relative rise in the cost of marketing agricultural products, both because the increase in real income was greater in these activities than in agriculture, and because of the all too well-known defects in the organization of marketing. Much the same applies to the transport of agricultural commodities, and the situation has perhaps been aggravated by the urbanization process.

Lastly, the high profits resulting from excessive tariff protection, investment in the splitting-up of urban property and in building, and other types of speculative investment, have helped to divert from agriculture investment funds originating in that sector, to the detriment of its technical progress. Unfortunately, the lack of research on these and other aspects of Latin American agriculture makes it impossible to determine how and to what extent such factors have operated, and whether or not they have been offset by contrary forces.

It may occasionally have happened that a vigorous increase in demand for agricultural commodities has boosted prices sufficiently for these factors' adverse effects on agriculture to be counteracted or even completely overcome. There have apparently been cases in which the buoyancy of demand has made it possible to retransfer to the urban consumer the impact of unfavourable relative prices, so that it has been cushioned or even warded off altogether as the agricultural terms of trade have improved. Tariff protection of some agricultural commodities, and the relative shortage of land with which to expand production, must have facilitated this movement.

In other instances this transfer of adverse effects has been prevented by imports or price controls.<sup>16</sup> In these cases—by no means infrequent—incentives to increase, or even maintain, the volume of production have been weakened or removed.

Over-valuation of the currency has had similar effects by preventing agricultural prices from rising to keep up with domestic inflation or to counteract an adverse movement of the internal terms of trade. Over-valuation is widely recognized as having affected not only products for domestic consumption but also export commodities. In some cases this has resulted in serious discouragement of production, especially when an unfavourable trend

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<sup>16</sup> In this connexion attention should be drawn to the unfavourable situation of certain essential agricultural commodities—milk, wheat, rice, etc.—which in many countries are subject to the fixing of ceiling prices as a political measure. The aim of favouring the consumer is laudable; but the result is a serious disincentive for the producer.



in internal relative prices has been combined with a deterioration of the external terms of trade.

#### 6. *Over-valuation of land and agrarian reform*

All this relates not only to the agricultural development policy that accompanies agrarian reform, but also to the nature of the reform itself. It is often true in Latin America that the economic yield of land is comparatively low in relation to its market value. First, the above-mentioned adverse factors have tended to depress this yield, and secondly inflation has contributed to the over-valuation of land for reasons that are well known, including the desire to lessen or evade the tax burden by land purchases. This is, of course, the type of buying that hinders technical progress rather than promoting it.

When land is thus over-valued, to transfer it at the inflated values in the process of agrarian reform would mean that the new owners—whether individuals or co-operatives—would be saddled with a heavy burden, much more difficult to carry than in the case of large properties, precisely because of the amount of income derived from these. Hence the desirability of fixing the value of the land on the basis of its current yield and establishing long payment terms and moderate rates of interest.<sup>17</sup> Otherwise there might be an appreciable weakening of the new owners' incentive to increase productivity, which would endanger the success of the agrarian reform. This is a crucial point, for all the reasons given above. And to encourage technical progress it might be advisable to combine the purchase of land at a value representing its current yield with a tax on the potential value of the redistributed land. This potential value could be determined in relation to the improvement in productivity that could be achieved with relatively simple techniques, while periodic readjustments could be made to stimulate further progress.

Without the vigorous introduction of more advanced agricultural techniques, the social objective of agrarian reform, namely, to provide a means of steadily improving the lot of the rural population, would be a mirage, just as it would be idle to suppose that the aim of this great structural metamorphosis was to improve the level of living of the urban population, by providing them with cheaper food.

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<sup>17</sup> Moreover, a low rate of interest is necessary for the harnessing of the savings potential, either by the State or by the new owners, as explained in section II of the present chapter.

## Chapter II

### THE OPERATION OF THE SYSTEM AND THE SOCIAL STRUCTURE

#### I. DISTRIBUTIONAL PRIVILEGE AND THE EFFICACY OF THE SYSTEM

##### 1. *Social mobility and the dynamic elements*

The changes in the production pattern and structure of the economy that are called for by the spread of modern technology entail, in their turn, a transformation of the social structure in order to impart dynamic force to the economic system and promote income redistribution. Under the prevailing social structure a large proportion of the savings potential of the upper income groups is left untapped, together with much of the potential embodied in human, land and capital resources.

During the period of externally-gearred development, technology made little headway. It gained most ground in export activities and in the activities allied to them in one way or another. The techniques introduced were usually simple, and compatible with a social structure based on land monopolization and extensive farming methods. Complex techniques were also introduced from time to time, but in those cases the activities involved were far from being an integral part of Latin American life, since they generally constituted foreign enclaves, particularly in so far as the exploitation of natural resources was concerned.

The industrialization movement had no radical effect upon this state of affairs. Another upper stratum was added to the existing structure and the middle class was gradually drawn into it, becoming numerically stronger in the process, but failing to establish a definite personality of its own.

During the first stage of industrialization there was actually no need for changes to be made in the social structure. The kind of industrialization that took place was mainly extensive, characterized by fairly easy techniques and the lack of any imperative need to make intensive use of the scanty capital and of the human resources available; in this it resembled the extensive type of farming indulged in on large estates.

The possibilities of this type of development are nearly exhausted. In order to quicken its tempo modern techniques must

be introduced into agriculture and yield substantially raised. Industry will have to advance towards increasingly complex patterns, explore the possibilities of finding the markets it needs abroad and rapidly conquer the vast area within the region where under-consumption is rife.

Why is it necessary to transform the social structure if this new stage of accelerated development is to supervene? There are cogent reasons. The social structure has an adverse effect on development in two respects that are of supreme importance: (a) the emergence of the dynamic elements in a given society; and (b) the way in which these elements play their part in the production process.

Modern production techniques have an ever-increasing need of these dynamic elements, men of initiative, drive and resolution who are capable of taking risks and shouldering responsibility. They are needed at a vast number of levels, ranging from skilled workers to top-level technical experts and the organizers and administrators of all the phases of the economic process. They are also required in other branches of human activity. The need for these dynamic elements increases at a rate far more rapid than that of development itself. In other words, if development is speeded up, the task of singling out and training such men will have to be pursued much more vigorously. In industry alone, it has been calculated that for every one per cent by which production increases, there will have to be four per cent<sup>1</sup> more technicians in every category to ensure production efficiency. The same is true of other branches of economic activity.

What is being done in this connexion in Latin America is little enough if the magnitude of the problem and the marked differences between the Latin American countries are taken into account. A considerable human potential is left untapped, since very few dynamic elements succeed in forcing their way up from the lower and middle strata of society. Naturally, a larger proportion comes from the middle strata, although there are often serious obstacles in the way of their absorption. The lack of proper social mobility is clear evidence of social stratification.

The starting-point for social mobility is education. By now it is fully recognized that education in Latin America has fundamental shortcomings, that there is a high illiteracy rate and that the educational system bears no relation to the requirements of economic development, quite apart from the serious deficiencies that exist in other basic cultural respects.

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<sup>1</sup> See F. H. Harbison, *The Process of Educational Planning*, Information document No. 5, Conference on Education and Economic and Social Development in Latin America, March 1962.

But this is not all. Strictly speaking, the extremely low income level of half the population and the straitened circumstances of much of the remainder prevent the dynamic elements from emerging and taking advantage of the whole range of opportunities for education and technical training, even when these exist. The first concrete expression of an income redistribution policy should be in this field, through social investment in the development and training of human resources and in the provision of effective means of access to education at all levels. This would bring about a new order of things in which the dynamic elements that reach the upper strata would be proportionate to the numerical size of the social strata from which they come. Perhaps one of the most decisive factors in the remarkable development first of the United States and then of the Soviet Union—despite the fundamental divergencies in their systems—has been the common denominator of a highly active process of social mobility which had not been observable previously under the aegis of industrialization.

These dynamic elements are not confined exclusively to the economic field, but pertain to society as a whole. They are the men who set their stamp on each generation. Although their opportunities for education and for rising in the social scale are severely limited, this does not diminish their *élan vital* or the strength of their aspirations. And if the sluggish pace of development prevents their being turned to account in the economic and social process and hampers their ascent to the different levels of activity within this process, there is a natural feeling of resentment, and their pent-up energy will inevitably brim over into other channels. What course these dynamic elements will eventually follow if the slow rate of development persists is another of the unknown quantities in Latin America, and herein lies one more great opportunity for exercising rational control over the forces of economic and social development.

## 2. *Privilege and its effects on incentives to economic activity*

Nevertheless, the mere fact of bringing these dynamic elements to the fore and giving them training does not necessarily mean that they will effectually fulfil their function in the economic and social development process. At this point we are confronted with the other outstanding problem linked to the social structure. In the Latin American countries certain forms of privilege are rife which considerably weaken the incentive to technical progress in all its manifestations, and, consequently, the chances of getting the best out of the men of initiative and ability that modern technology requires.

It is common knowledge that the extreme disparities in the size of landed properties militate against the application of up-to-

date intensive farming techniques—in the case of the latifundia, because they yield a lucrative income without the introduction of such practices, and in that of the mimifundia, on account of their very poverty and ineffectiveness.

But this state of affairs is not confined to the land. In industry, too, the edge of the incentives to technical progress has been blunted by excessive protection and the positions of privilege it creates. Private enterprise needs constant application of the spur of competition to keep it on the alert. And in Latin American industry as a whole, competition is seldom very keen. Here we are treading on delicate ground, where—to forestall misinterpretations—a clear line of demarcation must be drawn between criticism of the operation of the system and fair acknowledgement of what industrialization has achieved.

The role of private enterprise is not only to establish new industries and expand those already in existence, but also to turn the limited capital available to the best possible account. This is essentially a matter of having the right men to call on. Protection carried to excess affords no encouragement to train efficient workers and make good use of their services. Production equipment is often misguidedly used, with the result that its performance is inferior to that registered even in countries with medium industrial yields, not to mention those where productivity is high. Several factors combine to determine this situation: the organization of the factory and the system of distribution of labour, defective raw materials, inadequate supervision, careless treatment of machinery and plant. All these problems can be solved. That is, they can be solved provided private enterprise does not confine its efforts to the initial functions of promotion. It must also be indefatigable in its endeavours to increase yields and reduce costs. And this is where nothing can replace the spur of competition.

In the shelter of high tariff barriers and other import restrictions or prohibitions, anti-competitive practices, if not virtually monopolistic combines, have become widespread. Well-equipped establishments operate alongside others whose costs are high, in a sort of tacit mutual benefit society, the latter safeguarding their marginal existence and the former reaping the big profits that accrue from the cost differential.

Of the need for income redistribution measures to redress the existing grave social disparities, no further evidence is required than has already been submitted elsewhere in the present document.<sup>2</sup> But such measures do not represent a complete and basic solution, since the disparities in question, and the forms they assume, are largely the outcome of the defective operation of the

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<sup>2</sup> See particularly part A, section 2, and part B, chapter I, section II.

economic system; there is no close relation between personal income and the real contribution made by its recipients to the economic and social development process.

This defective pattern of distribution does not, of course, enhance the prestige of the system of private enterprise in the Latin American countries, despite the fact that in each of them many cases are observable in which a high income level is clearly the result of technical progress and of ability to innovate, to introduce new methods, to give better service to the community. It is men with just such capabilities that are needed for the acceleration of development. By virtue of social mobility and competition, increasing numbers of them must be given the opportunity to rise from the ranks and receive the necessary training.

In discussion of such topics, the relation between these two decisive factors in economic progress is often forgotten. Free enterprise and competition are inseverably linked, since in default of the latter the former is doomed to wilt in the atmosphere of privilege. Given a combination of the two, there will be abundant scope for private enterprise and its energetic participation in the planning of development.

Reflection will show that the ability of a small number of people to concentrate in their hands a high proportion of collective income has its roots deep in history. Our ancestors failed to do what other equally new or even newer societies did to clear the way for economic development and stabilize the foundations of democracy—namely, abolish privilege in respect of land ownership. In these latitudes, the great fortunes of the past derived largely from appropriation of the land and its subsequent rise in value. To this was later added the further privilege created by excessive protection. And at all stages, there has been inflation as a powerful instrument for the arbitrary acquisition of wealth.

No attempt is made here to analyse all the factors that have conduced to the concentration of wealth and income, since in that case attention would have to be devoted to the consequences of the misuse of political power or of certain types of artificial State intervention in economic activity, as well as to the effects of restrictive business combines and certain harmful practices fostered by defective organization or supervision of the banking system. Only the principal determinants are indicated, the most widespread, whose significant influence on income distribution and the efficacy of the economic system is giving rise to serious manifestations of social strife.

All these forms of privilege in the distribution of wealth and income are sapping the energies of the dynamic elements in process of emergence, undermining their capacity for struggle and achieve-

ment. Of those who are prevented from becoming an active part of the economic system, by its lack of dynamism, some are driven by their very sense of frustration, and the contrast between their own situation and that of the more fortunate, into the resentful attitude of which something has already been said; while others, especially those from the middle strata of society, seek refuge in public administration, a field of activity that is as apt to demoralize the dynamic elements as to attract those that are not dynamic, those that have been unable to find a niche in private economic activity, either because of the latter's own shortcomings, or because the aforesaid divorce between education and development has disqualified them to do so.

In such circumstances, functions and functionaries spread and multiply in the civil and military spheres. And the State, whether prompted by essential considerations or not, takes on entrepreneurial activities and indulges in different forms of intervention or control which—dictated as they are by the wish to remedy deficiencies in the system—seldom deal with development phenomena, much less promote development, since they are frequently of a negative or interdictory character.

Thus, alongside men who discharge their functions with efficiency and public spirit, there are many who take shelter behind these other forms of privilege incorporated in the social structure. The latter tend to assimilate the living patterns of the ruling groups and to rely on their patronage, thus wasting the reforming power they might have wielded at their own social level.<sup>8</sup>

These social phenomena emanate essentially from the lack of dynamism of the development process and at the same time tend to aggravate it, not only because State action is diverted into the channels indicated above, but also because the dynamic elements are devitalized, and net capital formation is thus deprived of substantial resources.

## II. INFLATION AND THE SOCIAL STRUCTURE

### 1. *The social background of inflation*

The power of certain social groups to exercise an arbitrary influence over the distribution of income is what lies behind inflation in Latin America. It gives rise to factors that have a direct or indirect inflationary impact. This impact is direct, if recourse is had to credit expansion as a means of meeting investment requirements, instead of to the restriction of consumption, or if the necessary effort to meet the government deficit by taxation or budgetary

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<sup>8</sup> See José Medina Echavarría, *Economic Development in Latin America. Sociological Considerations* (E/CN.12/646).

means is shirked, either in boom periods, when this effort is relatively easy, or in slump periods, when it becomes difficult. The effect of the factors in question is indirect, when it is the broad masses of the population that have to bear the consequences of the existence of structural stumbling-blocks to development and of the regressive methods chosen to deal with these obstacles. This is particularly true of import substitution activities, whose costs, plus the excessive profit margins permitted by tariff protection, are transferred to prices; and it also applies to the higher cost of certain agricultural products, often important items of mass consumption, mainly because of the obstacles to increased production arising from the prevailing form of land tenure. These and other elements constitute non-monetary inflationary factors.

The lower strata of the Latin American population are beginning to use their growing political and trade union power to defend themselves against the rise in prices resulting from these monetary and non-monetary inflationary factors. They are doing so by means of wage increases, in the first place, and, secondly, by obtaining social security benefits and other State services intended to improve their situation. But when increases in wages, social security contributions and indirect taxes are not or cannot be absorbed by entrepreneurs' profits, as is generally the case, they force up costs and are transferred to prices, thus promoting credit expansion, and leading to new increases in wages, security benefits and taxes, in the all-too-familiar spiral. This does not mean that some of the workers and employees do not generally succeed in recouping themselves for the effects of price increases, and even in more than offsetting them; but they do so only at the expense of other social groups. The chief victims are the rural workers, who have no trade union power, generally receive little or nothing in the way of social security benefits, and do not enjoy the same State services as people in the towns. Other groups affected are those workers and employers, either active or retired, who because they are less well-equipped to defend themselves are left behind when it comes to wage increases, or those who share with the entrepreneurs the ill-effects of currency over-valuation on the income of export or substitution activities, which also aggravate the tendency for the external sector to become a development bottleneck. Lastly, the understandable reluctance to increase taxes or public utility rates in proportion to the wage increases of those employed by the State or by the enterprises concerned enables the rest of the community to defend their real income to a corresponding extent, but not on any lasting basis, since the deficit resulting from such attitudes inevitably leads to a blanket rise in prices.

These delays in raising the wages of the groups left in the rear, and in adjusting exchange rates, taxes and public utility



tariffs, cannot continue indefinitely, and as the under-privileged groups succeed in gaining ground and the State changes its attitude, the spiral is given increasing impetus, and is even further intensified if the pace of economic activity is reduced.

## 2. *Reluctance to adopt drastic solutions*

Thus the spiral gradually exhausts its corrective effects and becomes an increasingly disruptive influence. Unquestionably, this is fully known and understood. But what other recourse remains if basic solutions are shirked? Letting the spiral take its course is generally the easiest way out in the short run. It is usual to resort to what is feasible from a political point of view even if it is not advisable from a rational standpoint.

Suffice it to note the obvious contrast between the formidable opposition usually aroused by any attempt to even up distributional disparities through tax reform, and the very liberal nature of certain social security benefits and State services whose costs fall, in the last analysis (although very unevenly), on the broad masses of the population who are supposed to benefit. Much the same is true of mass wage and salary increases.

But what is the point of these solutions? They are certainly not simple. The problem is greatly complicated by the fact that to the elements of traditional inflation have been added those others whose elimination will be a lengthy business, since they derive from structural weaknesses.

In the traditional type of inflation, of a monetary character, real wages can recoup their losses at the expense of inflationary entrepreneurial profits. But the situation is different when price increases have a non-monetary basis. This is a question of inflationary elements which, because they cannot be absorbed by increases in productivity, have long and steadily been moving up the spiral.

In such cases the basic solution can only be more rapid development, accompanied by a policy of income redistribution. However, this takes time, and during the interval an anti-inflationary policy means a sacrifice by the lower strata of the population such as could only be tolerated from the psychological and political standpoints if an expansionist policy were simultaneously introduced to stimulate the use of the economy's idle capacity, with the ensuing rapid rise in income, and a policy of austerity in respect of the higher groups to reduce their consumption sharply and promote an increase in investment. All this should be combined with the timely contribution of international resources. The resulting improvement in the rate of development would be the only means

of compensating real wages for what they had lost through the non-monetary forms of inflation.

As can be seen, this is a strictly political aspect of the problem, since a solution of this nature requires, in addition to the firm decisions involved, the full support and understanding of the masses, although this support must not be undermined by premature or excessive pressure or demands that would wreck the whole programme of rehabilitation and expansion.

### 3. *Stabilization policy*

Thus monetary stabilization is not conceivable except in relation to a policy of economic development and social justice. In fact, regarding stabilization as a solution in itself has often led to failure in the laudable attempt to end inflation.

The principal instrument of this type of stabilization is credit machinery. Undeniably, an external imbalance can be temporarily eliminated through a reduction of total income brought about by restrictive use of this instrument. It can be eliminated, but not remedied, since however long the depressive effects of the policy involved may be endured, sooner or later rational measures aimed at recovery will have to be taken, and the consequent rise in income will resurrect the external disequilibrium.

With respect to internal imbalances, an attempt to remedy the government deficit by economic contraction generally has exactly the opposite effect, because of its depressive repercussions on the country's tax capacity, and also—to the detriment of investment—on the capacity to save.

From another standpoint, the social strife implicit in inflation is generally intensified by the dynamic weakness referred to earlier,<sup>4</sup> that is, the inability of the system, as it functions at present, to absorb the population displaced from rural areas and those already living in the towns who have been unable to find employment in productive activities. In the meantime, these people take refuge in unskilled personal services, and redundant or unnecessary work in private and State activities, and the brunt of all this is borne by the lower social strata. Thus, lack of dynamism becomes another of the potent causes of non-monetary inflation.

In the final analysis the superfluous staff taken on in private administration, who do not produce a corresponding amount of goods and services, create pressure on the goods and services produced by others, and thus provide a powerful stimulus to the inflationary spiral.

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<sup>4</sup> See chapter I of this part of the study.

Here too the simplistic approach has its own formula, which is merely to send these superfluous workers packing. One of the implicit advantages of credit restriction is in fact to break public or trade union resistance to these so-called economic rehabilitation measures. Here again, all that is done is to side-step a problem which must be faced, namely, that of increasing the pace of development to correct the lack of dynamism.

Our frank stand against such simplistic views is usually interpreted as defence of inflation and opposition to anti-inflationary measures. This is far from being the case, since inflation, in the final analysis, is the result of a structure that is curbing development, both by preventing full use of the savings potential and by putting obstacles in the path of technical progress. Thus the problem of inflation is inseparable from the development problem, and monetary policy must be an integral part of the policy of economic and social development. Otherwise anti-inflationary measures are sooner or later doomed to failure.

But continuing inflation is not a valid alternative either. As we wrote some time ago in another paper: "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."<sup>8</sup>

### III. TWO TYPES OF FOREIGN CAPITAL

#### 1. *The persistence of enclaves*

The social structure handed down from the times of externally-gearred development was associated with the characteristic type of foreign investment aimed mainly at serving, in one way or another, the interests of the major centres of which the undertakings concerned were an offshoot. They continue essentially, now as then, to lean towards the development of mineral resources, export and allied activities, and public utility concessions.

These are the enclaves to which reference has already been made. In those days, any inflow of advanced techniques was confined to them. They made no attempt to disseminate such techniques within the country, nor was there any reason for them to do so, since extensive farming of the land by the country's own rural population usually required no more than a rudimentary technology. Moreover, such private enterprise as emerged from

<sup>8</sup> See "Economic Development or Monetary Stability: the False Dilemma", *Economic Bulletin for Latin America*, vol. VI, No. 1, March 1961, p. 25.

time to time in our countries to engage in activities similar to those of the enclaves often ended in the domestic efforts being engulfed by them or disappearing under their economic pressure.

However, this did not affect the compatibility of the foreign enterprises with the prevailing social structure. On the contrary, the latter is gaining strength and substance as time goes by; the ruling groups—relying on their privileged position as landowners—are enjoying the benefits of the steady increase in the value of the land deriving from population growth and from the externally-gearred development fostered by the foreign enterprises. At the same time they participate, albeit tangentially, in the activities of these enterprises, chiefly by being of service to them in their relations with the public authorities. They are thus able to lead that typical life of ease which is conducive to the enjoyment of European culture—cultural development within under-development—and to participation in political campaigning often confined to these same ruling groups, the broad masses being called upon regularly or occasionally to accommodate their internal differences.

These enclaves of the past, which are still with us, must either change of themselves or give way to domestic enterprise. The days when foreign enterprise came in to do what Latin America could not do are definitely over. We need the outside world to help us to cultivate our own ability, so that the population as a whole can be brought to share in the process of development. Thus, the foreign enterprise must be a nucleus for the dissemination of technology, as it already is in some cases.

While there are a few encouraging signs of such a change, much still remains to be done. Of course, the proportion of net income left in a given country by these enterprises is usually larger than before, when they were relatively small. But the nationals concerned generally have little—if any—access to technology, and decisions are taken abroad, without the country's influencing them to any great extent, however important they may be to its interests. There are even cases where the actual pattern of exports is beyond the control of Latin American trade policy.

There is a pressing need for new formulas to solve these problems, not only in connexion with this form of business activity *per se* but also because the new formulas in question will help to create an atmosphere conducive to the co-operation of foreign capital in the new stage of industrialization which must be embarked upon without delay.

Strictly speaking, a clear distinction must be made between two types of foreign capital: the out-dated type, with the enclaves which still subsist, and the new type which takes a determined share in the intensive process of industrialization.

## 2. *Other problems of foreign capital*

Of course, this latter mode of procedure also raises some problems, but they can be solved without too much difficulty. Among the more important are those deriving from the policy of the country itself.

In the first place, the huge profits made by some firms. The profit incentive is clearly essential if foreign private enterprise is to be attracted. However, it should be the consequence of the advanced techniques such firms bring into the country, the new patterns of production, organization and marketing they introduce into the local milieu. No impartial view can call this in question. But here too the effects of undue protection and inflation are left, to which must be added some cases of spurious incorporation of foreign capital under the protection of official action itself. As regards this whole state of affairs, the Latin American Governments are in a position to apply corrective measures not so much to suppress its effects as to attack its very causes in respect of both foreign and domestic firms.

The other problem, which demands a much greater and more sustained effort, is the technical and economic inferiority of Latin American enterprise as compared with its foreign counterpart. We have many times commented on this. While it is a quite natural phenomenon, measures leading to the progressive establishment of a reasonable balance should be adopted. Elsewhere in the present document reference is made to these measures, which need not be confined to the common market, although it is there that the need for them is most pressing.<sup>6</sup>

Rightly considered, undue protection also influences the technical inferiority of the domestic enterprise because it weakens the initiative of the executives and thus does not encourage them to improve their techniques. On more than one occasion we have seen domestic firms either absorbed or dislodged by foreign enterprises when engaged in activities in which it would not have been difficult—with greater initiative and more funds—to assimilate new production techniques.

Even more complicated is the problem created by some firms which are part of international trusts and which, by dividing the markets among themselves, usually hamper the domestic production effort. Here State intervention, either to do what has to be done or to let others do it, is unavoidable.

Moreover, in a development plan it is quite right that each country should clearly define those priority areas in which it would like to have the co-operation of foreign private enterprise. While

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<sup>6</sup> See part C.

no attempt can be made to suggest these areas here and now, it would seem obvious that, in a programme designed to encourage exports, foreign enterprise has a very important part to play, both because of its knowledge of export practices and external markets, and on account of its level of technical and economic know-how, which domestic firms cannot usually attain in a short time. Here, as in any other industrial activity, a partnership between foreign and Latin American enterprise might be a very suitable solution, from the standpoint both of dissemination of techniques and of improved relations with domestic interests. Such a partnership should be a clearly-defined objective in the granting of tax exemptions by capital-importing countries. Otherwise, foreign investment might carry undue weight in some branches of economic activity, which would be undesirable from various points of view.

By thus acting as an agent for the propagation of advanced techniques within the country concerned, the foreign enterprise would play a part in the development of Latin America very different from the role it had in the past, notwithstanding the significance of its contribution to externally-g geared development. In those days, however, the existing type of foreign enterprise fitted easily into the social structure, and as this structure changes to meet the exigencies of development, the foreign enterprise must inevitably change as well.

#### IV. PLANNING AND THE OPERATION OF THE ECONOMIC SYSTEM

##### 1. *Public administration as it reflects the social structure*

If Latin American private enterprise is lagging behind the requirements of development, it is not surprising that the same is true of public administration. Its organization is a survival from times past, with additions and adjustments, but without basic changes.

It is not that there is any unawareness of the defects of the public administration, or any lack of urgent calls for reform; but for reasons similar to those that have led to the maintenance of the existing social structure, and others as well, the public administration in our countries has not undergone any change.

Actually, the prevailing type of public administration is in line with the social structure. The fact that nearly half the active population ekes out a living in agriculture has had no more effect than to procure the allocation of a tiny fraction of budget resources for technological research and the dissemination of its findings, since the prevailing system of land tenure does not demand such measures. Taxation, properly used, is a powerful instrument for economic development and distributional justice, and our countries'

experience would suffice, in combination with some external assistance, to enable us to organize the tax machinery efficiently, prevent evasion and modify the fiscal system in general. If this has not been achieved in the way and to the extent necessary, the resistance of the ruling groups is largely to blame. Many other examples could be mentioned. Broadly speaking, these groups do not demand efficiency; and what is more serious, the political movements of the lower groups have seldom made much endeavour to improve public administration.

In fact, all the old ways survive, and one clientele gives way to another in the administration, since there are few Latin American countries that have an effective civil service. Quantity rather than quality is the basis of staffing, and the poor salaries—in some cases reduced by inflation to unbelievably low levels, until the spiral makes it possible to recover what has been lost, or a part of it—drive away the most able and disorganize the whole system.

Given this state of affairs, the plan—essentially popular in its origin—of transferring certain foreign-owned enclaves to national ownership has often had disastrous results. This does not mean that it is impossible to find, or train, men who can run such activities efficiently, but the impetus of strong feeling is not enough; judicious selection, discipline, and steadfastness are a *sine qua non*.

Nevertheless, it would be a mistake to see in all this merely the play of economic interests, political pressures or perhaps the warping of certain State machinery from its true purpose. There is a background of inertia, of perpetuation of inefficiency, which is preventing the public administration in Latin America from adapting itself to the requirements of economic development, except in a few special cases. This applies to simple as well as to complicated functions, and the result is apparent in the needless trammelling of economic activity—in fact of all activities that bear any relation to the State—and in every imaginable kind of inefficient and time-consuming procedure. Naturally, ours has the weaknesses inherent in all bureaucracies, but it displays marked symptoms of underdevelopment as well. In short, the public sector betrays itself as behind the times, not only in its administrative functions, but also in the inadequacy of the existing machinery when it comes to bringing new ideas to the fore, and formulating and carrying out a rational development policy.

## 2. Plans and planning

In our countries the State is not organized for the last-named functions. This must be frankly admitted, now that we are beginning to open our minds to the idea of planning. Plans are beginning to be put forward, but the actual work of planning, in the broadest

and most responsible sense, is either non-existent or exists only in embryo.<sup>7</sup>

Planning has three separate aspects, although they are all closely linked: (a) the conception of the plan, (b) the translation of this plan into a series of practical measures and specific projects, and (c) the administrative organization required for the two previous tasks and for the execution and supervision of the plan, as well as its constant adjustment to changed circumstances. In other words, an economic and social development plan entails the planning of a public administration capable of furthering its objectives.

The most significant advance has been achieved mainly in the first phase, that of conception. Much less progress has been made in planning proper, although there are signs that the Governments are beginning to recognize the significance of this fact.

Once the over-all development targets have been quantified, together with individual goals for the various economic and social sectors, and the funds necessary to achieve them have been determined, the next step should be to embark on the actual measures and specific projects at once. Many of these can even be prepared and carried out as the plan takes shape. However, this does not generally happen with the necessary dispatch, even in cases where there are sufficient internal or external funds for the preparation of projects. It is not unusual to find measures that clash with the aims of the plan, for when there is no proper planning organization, there is generally a characteristic dichotomy between current problems and development problems, between immediate action and planning, as if these were not merely two sides of the same coin.

Thus, a plan without planning activity is pointless. At best it is the rational formulation of a body of ideas, valuable enough as an ordered presentation of problems and possible ways of solving them, but not as a complex of elements that can serve as the basis for practical action.

Furthermore, as a result of the pressure of circumstances, plans have often tended to be drawn up by a small group of people who have been unable to make use of the piecemeal experience of a host of government departments—the experience of the vast number of people who will have to execute the plan without having had the opportunity of co-operating in the determination of its aims. In other words, the body responsible for formulating the plan is often superimposed on the existing administrative organization without in any way becoming a part of it. There must be an effort

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<sup>7</sup> The secretariat has carried out a study on the existing situation in this field. See *Progress in the Planning Field in Latin America* (E/CN.12/677).



to achieve integration, following one basic principle: the plan must not be created only from above; it must come from below, travelling up through all the responsible levels of the administration.

All these weaknesses are easy to understand, and in no way detract from the admirable achievement of those Governments who have undertaken the formulation of plans; if they had not done so the weaknesses in question would not have appeared. The next step is to carry out the far from easy task of making the administrative machinery capable of responding to the needs of planning. The unremitting labour it involves can only be successfully undertaken if a firm decision at the top has the backing of the senior officials in the administration, since they must all take an active part in the work of planning.

### *3. The power of the State and ways of exercising it*

From another standpoint, this planning task, the effort to act consciously upon the forces of development, means giving the State considerable power. We cannot deny this, or escape the anxious misgivings that often trouble even those who are convinced of the need to carry out the structural changes referred to and clear the way for State planning, to say nothing of those who are strongly opposed to such a course. How far will the endeavour to regulate the forces of development subordinate individuals to the power of the State? Shall we have to sound a retreat in the historic struggle to prevent the dominion of a few men, of a minority, over the rest of the community? Is there a basic conflict between the acceleration of development and a steady advance towards democracy? Or can we succeed in synthesizing these two aims by giving Latin American democracy an economic and social content?

An understandable confusion exists in regard to all this. If we are to achieve a synthesis we must, in influencing the forces of development, combine economic and social aims with political objectives. And to reconcile the two we must effect a harmonious combination of State action with individual initiative. The State will not prescribe the conduct of individuals, that is, say what they must do or leave undone in their economic activity. It acquires an impersonal power not over them but over the forces that actuate them. This power must be exercised basically by means of incentives to economic action, rather than by coercion, once the structural problems that stifle development have been overcome, because coercive elements in the operation of the system open the way to arbitrary dominion of the State over the individual.

This is a fundamental and crucial point, which it is essential to clarify. We must consider whether the ways in which the State carries out its plan to regulate the forces of development do or do

not interfere with the behaviour of the individual, or endanger the independence of his personal decisions.

In this context, what is the significance of State action to ensure that better use is made of the savings potential? What consequences will flow from the way in which the State tries to influence individual enterprise in order to induce it to fulfil the aims of the plan? How far is the technical action of the State likely to affect the independence of personal decisions?

Let us look first at the problem of capital formation. As stated in the preceding chapter, a distinction must be drawn between the initial steps to make full use of the savings potential, and the subsequent operation of the system. As to the former, it was stated that this problem could not be envisaged solely in the light of the distributional privileges that characterize the present social structure, since these must be gradually reduced and eliminated by structural reforms.

Thus, the problem of capital formation must also be considered from the standpoint of the ultimate operation of the system. Once the structural changes have taken place, the State will have to continue intervening by means of incentives to encourage saving, or by taking part of personal income in the form of taxes.

Only experience can show how far this aim can be attained by means of incentives, and how far coercion will have to be used. Nevertheless, there are limits beyond which coercion cannot be pushed within the existing institutional systems, since to do so would dangerously weaken incentives to economic activity. This is a most important point, since once these limits have been exceeded the way will be open to direct economic action by the State and to the concentration of economic power in its hands, thus increasing its capacity to interfere in the personal freedom of action of the individual.

But as long as this extreme is not reached, the power of the State, great as it may be, can be exercised at an absolutely impersonal level, without implying in any way the subordination of the individual. Consumption can be restricted in relation to income levels, not to persons. Every man will be free to consume and to use his savings as he wishes. The same can be said of measures for redistributing income: this should be done in relation not to the individual, but to his social level, so that it can be raised without distinction of persons.

But even if the validity of these arguments were admitted, the discovery of the unknown quantity would not be complete. In order to regulate the forces of development the State must influence individual enterprise in economic activity. And another question immediately arises: will this not give the State the opportunity of

interfering with personal freedom of action, of compelling the individual to do what he does not want to do? Furthermore, why must the State intervene? Is not the play of market forces sufficient to guide individual decisions?

The response to these questions covers two main points: (a) the State must intervene because the pointers afforded by the market do not always lead to action that will promote the most economic use of the available resources, and (b) it must do so because the indications provided by market forces have a bearing only on some of the decisions of the individual, not on all of them, and in particular not on those that are of considerable importance in development. State intervention is essential to guide private activity, and to induce it, without coercion of any kind, to fulfil certain development aims.

We need not concern ourselves with the first point, since it has been explained in the preceding chapter how the labour-cost/capital-cost ratio has been distorted, at the expense of the most economic use of resources. This situation can also be remedied on an impersonal basis, by the creation of certain conditions that will induce private enterprise to take one path or another, without compulsory measures of any kind.

Now let us consider the second point. As we know, the indications that determine individual economic behaviour in the market are given by price movements. Price is an effective pointer to the road that new investment should follow. This applies to most goods and services, and the State usually has no reason to intervene, except when the operation of competition is distorted.<sup>8</sup> However, it can enable individuals to make their own forecasts on the basis of better information on market movements and the probable course of future demand.

But there are a small number of goods and services, of strategic importance in economic development, in the case of which investments take a relatively long time to bring in a return and price is no guide. A deficit in the supply of these goods and services usually has a serious effect on the development of the whole economy. This is where the State must supply other pointers to make up for the lack of spontaneous indicators, and provide inducements to private enterprise to follow the pointers in question. In Latin America critical situations have arisen most frequently in connexion with energy, transport, and public utilities in general, with agricultural production, and with import substitution. In none of these fields does the market provide any sound indicators, and

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<sup>8</sup> Naturally, there are also non-economic reasons—ethical, health or cultural factors—which may make State action advisable, but this has nothing to do with planning.

consequently private enterprise cannot act effectively without State guidance. Future demand must be estimated in accordance with the desired rate of income growth, production conditions must be studied and investment promoted a number of years in advance, by means of incentives offered by the State. All this is beyond the capacity of private persons operating in the market.

With respect to import substitution—which holds and must continue to hold such an important place in our national and regional development planning—this special feature of course exists. In a number of cases demand estimates must relate to goods imported not directly but as the component parts of the finished article. Consequently the price system plays no part. When the goods in question are replaced by domestically-produced articles, these components have to be imported—whether in the form of raw materials or intermediate goods—and so do the capital goods needed to manufacture the articles concerned. All this can be foreseen, and such prevision is essential if investment is to be correctly channelled and the external bottleneck avoided. The development of industrial exports that must take place in order to solve this problem will introduce new factors into the work of anticipating future demand, as regards exports both to the common market and to the rest of the world.

As can be seen, although this task of guiding private enterprise by State intervention is of considerable importance, it can be carried out without coercion, by the mere deployment of incentives and disincentives. Thus there is no encroachment of any kind on the independence of individual decisions, nor is the behaviour of individuals governed by what the State determines in each case.

The same can be said of technical action by the State to stimulate the assimilation of modern technology. This is a question not only of guiding individual enterprise, but of direct State action, both in research and the spread of technology, and in respect of the education needed to apply this technology. The price system can play no part in solving these problems. It is the State, for the most part, that must determine what is best to be done and how to do it, and must make large-scale investment. But this does not impose any kind of compulsion on individuals to use this technology, or to train themselves to apply it. This too is a matter of incentives and disincentives.

However, there is one very important exception, relating to the conservation and use of natural resources. Here coercive measures are required in order to prevent the destruction of a country's natural wealth by private enterprise, but this action, too, is impersonal in character.

#### 4. *Direct economic action by the State*

The State does not need to have all the power in its hands in order to regulate the forces of development and social progress. But it is easy to see why there is still a great deal of confusion as to the meaning of planning action by the State to achieve this aim, since until a few years ago planning took place only as part of a socialist conception of the economy.

Under the influence of the socialist experience, it is often thought that direct economic action by the State is essential to planning action. Thus the discussion frequently wanders off on to the hackneyed topic of the merits or demerits of private enterprise as opposed to State enterprise. This abstract plane is certainly not the appropriate one for the discussion, since it has to be made clear what kind of private enterprise is being thus extolled.

Is it simply and solely the form that prevails in the present social structure, or is it the type that would rise vigorously to the surface if that structure were changed?

If the second question were answered in the affirmative, and not the first, the discussion could be confined to indicating those typical cases in which, even if the system were to acquire its full dynamic impetus, there would be weighty reasons for State action in our countries. Some of these reasons have to do with economic development. There are cases in which the State has had to undertake activities in the strategic areas of the economic system, or make investments which have not proved attractive to private enterprise. In other instances, State action has had the virtue of building up a technical capacity that would have been difficult to achieve otherwise.

Apart from these development considerations, there are other motives that in Latin America's experience are generally important: avoidance of an excessive concentration of economic power, and, consequently, of political influence, in private hands; and the taking-over by the State of enterprises that by their nature are monopolistic, or of activities which might otherwise be carried out by international combines that limit competition, and are unfavourable to certain national development aims.

But all these weighty reasons, and others that are perhaps less so, are extraneous to the actual requirements of planning, since the State, as already indicated, can effectively achieve its development objectives by incentives and disincentives to private enterprise. And from this point of view, direct State action would be justified if such instruments did not give the desired results.

These considerations relating to the tools to be used are of great pragmatic importance, and the following aspect of the prob-

lem should be approached on a pragmatic basis too. Needless to say, planning requires the State to undertake highly complex functions. One of the reasons for the lack of ability to tackle certain development problems demonstrated thus far by the public administration in our countries has been the proliferation of tasks and responsibilities, great and small, which generally overburden officials at the higher levels. It is true that this is above all a question of good organization and delegation of responsibilities within the administrative hierarchy; but it is equally undeniable that the farther State action is extended, the more difficult it will be for the higher levels of the administration to devote attention to decisions on development planning.

The essential aim must be to make the State more capable of regulating the forces of development by means of the machinery of the system, without interfering with the personal behaviour of the individual. There is nothing inherent in planning, or in the dissemination of modern technology, that must lead to the subordination of the individual at the expense of his fundamental rights.

**C. DEVELOPMENT AND THE  
EXTERNAL BOTTLENECK**





## Chapter I

### DISPARITIES IN DEMAND AND THEIR EFFECT ON ECONOMIC DEVELOPMENT

#### I. EXTERNAL IMBALANCE

##### 1. *The importance of disparities in international demand*

The two world wars and the intervening great depression disrupted the international economic system handed down from the nineteenth century. The persistent delusion that this system could be restored under conditions far different from those which prevailed at that time has finally had to be abandoned, and has given way to the realization that a new order is essential in the international field as well.

The European Common Market, the COMECON of the socialist countries, the new United States policy of lowering and abolishing customs tariffs among the major industrial centres of the Atlantic Community, are clear manifestations of the energetic search for a fresh approach. The proposals for Latin American integration are another case in point: bold and decisive for the small Central American countries, and a trifle apprehensive, but nevertheless promising, in their initial stages, for the Latin American Free-Trade Association.

This piecemeal and at times self-contradictory search for new solutions postulates the need for a thorough review of the present state of affairs. No other meaning can be attached to the world Conference on Trade and Development convened by the United Nations. The fact that the Latin American countries are prominent among those which promote this initiative is an encouraging sign. The Conference will give to all of them, and to all the peripheral countries of the world, an historic and unique opportunity to contribute, conjointly with the developed countries, to the establishment of a new international economic order, although in very different circumstances from those attending the Havana Conference, which has now been outstripped by events.

Vast opportunities can be clearly discerned. The countries of Europe—those with a private-enterprise economy as well as the socialist countries—have achieved high growth rates. Japan too has done so, and it is to be expected that the United States, with

its vast capital formation and consumption potential, will succeed in doing so likewise. How can the developing countries turn this economic expansion in the more advanced countries to good account? How can the latter find in the expansion of the peripheral economies a growing market for goods which are difficult to manufacture and with respect to which the developed countries are clearly in an advantageous position?

This raises a substantive problem, not as an intellectual exercise but as a living expression of the growing external difficulties that beset the developing countries. We are witnessing a manifest trend towards an external bottleneck in economic development. Temporary factors are not responsible for this situation, although they may add to the difficulties in question. Its cause is to be found in a persistent phenomenon which must be combated: the divergent trends of international demand and their effect on exports and the relative prices of these. The internal effort made by our countries to overcome this handicap has been inadequate, and moreover, is meeting with obstacles on an increasing scale.

The factors responsible for the disparity between the growth of internal demand for primary products in our countries and that of demand for manufactured goods and skilled services, as per capita income increases, also affect the international field. But there they display certain peculiarities. In the first place, the fact that the population of the major centres which purchase Latin American primary commodities is growing less quickly than that of our countries is reflected unduly in the slow rate of increase of demand. Secondly, the income-elasticity of demand for food is not great as in our countries, and there is less demand for raw materials, since the use of natural raw materials has been reduced, eliminated or rendered more efficient by technical progress.

To these spontaneous factors prejudicial to demand for primary commodities should be added the recrudescence of restrictive measures which limit or prohibit the entry of such products into the major industrial centres, and the adverse repercussions on production in the developing countries deriving from the liquidation of surpluses on world markets, at prices below those prevailing in the domestic market. All this has sharpened—at times very considerably—the divergent trends in international demand which are reflected in the slow growth rate of exports from countries producing primary commodities, as compared with the strength of their demand for imports of manufactured goods.

The policy which thus adversely affects the peripheral countries actually began with the world depression; until then protectionism had not been excessive—except in the United States—nor had there been direct restrictions, or surpluses to be unloaded.

Moreover, the nineteenth century was on the whole characterized in the major centres by the promotion of imports of foodstuffs and raw materials at the expense of domestic production.

While these spontaneous disparities in international demand no doubt began to develop before that grave world event—the depression—they did not have an appreciable effect on the externally-gearred development which was typical of the Latin American countries, and was carried forward by the sheer dynamic impetus of their exports and the foreign investment aimed at encouraging these. The world depression definitely marked the end of this pattern of development; and the disparities became serious and persistent, with most unfavourable effects on international commerce and on the terms of trade. Given the impossibility of maintaining or accelerating the previous growth rate of traditional exports, recourse was inevitably had to import substitution—chiefly in respect of industrial items—in an attempt to counteract the disparities in question, and thus began the internally-gearred development of the Latin American countries.

This internally-gearred development has already fulfilled its most important role: without it, average per capita income, which is now 60 per cent higher than it was in 1930 for Latin America as a whole, could not have been raised. But while the result was definitely positive, it could have been better. We see this clearly now, and can more readily appreciate the grave shortcomings inherent in this type of makeshift development, which is leading us to an increasingly serious external bottleneck.

## *2. The end of the easy stage of import substitution policy*

The possibilities of development based exclusively on traditional exports and on import substitution are rapidly being exhausted in the countries where the process of industrialization is most advanced; for exports are expanding at a relatively slow rate, and the continuation of the substitution process so that the rate of internal development may be much more rapid than the growth of exports tends to meet with increasing difficulties.

In fact, the stage of easy substitution is past. It was relatively simple to substitute domestic production for imports of industrial items of current consumption and of some durable consumer and capital goods, and there is little margin left for substitution in this field in most of Latin America. We are now moving into the stage of import substitution in respect of intermediate goods or durable consumer or capital goods, which, besides being difficult to manufacture, require markets much larger than those of the individual Latin American countries. Moreover, there are some intermediate goods for which substitution possibilities are

few, or simply non-existent, because of the shortage or total lack of natural resources. With respect to foodstuffs, substitution prospects are still very good for some items, while others present increasing difficulties in view of the growth of the population and its needs.

In short, substitution must be a continuing process so long as the divergent trends have not been corrected, and corrected they cannot be if the present pattern of trade is maintained. When some substitutions have been effected, the need for others crops up, and additional and greater obstacles are encountered all the time.

Thus a paradoxical situation has been reached. Imports at present account for a relatively small share (12 per cent) of Latin America's over-all income, whereas they represented 28 per cent of that income before the world depression. The new substitutions—since they represent an increasingly smaller fraction of over-all income—could logically have been expected to entail less effort. Today, however, the external bottleneck produced by the disparities referred to is much more difficult to eliminate.

This is due not only to the complexity and cost of the items now involved in the substitution process, but also to the fact that the reducible margin of imports has disappeared or has been reduced to a negligible proportion. As long as there was an ample margin of imports which could be dispensed with in the immediate future, or deferred, the expansion of some imports could for the moment be held up or their volume restricted while substitution was being effected in respect of other items. Imports of essential or urgently-needed goods could thus steadily increase without affecting the tempo of internal economic activity. But once this margin narrows or disappears altogether, this proceeding cannot be repeated, particularly when the flow of exports is reduced or their volume is contracted, while demand for such imports continues to grow. In these circumstances, external disequilibrium—and a pressing need for international resources—is the only alternative to a slowing-up or definite contraction of the rate of economic activity.

The effects of import substitution as a means of correcting this disequilibrium do not last very long for further increases in import demand, unaccompanied by a corresponding rise in exports, once again lead to an external bottleneck.

### *3. Internally-gearred industrialization and exports*

Could this have happened in any other way? Could the pattern have been changed during those thirty years? A set of conditions hardly conceivable in those days would have been required. Until recently, circumstances did not favour expansion of foreign trade.

In the years during which the effects of the great depression and the post-war period—not to speak of the Second World War itself—were still making themselves felt, there was no reason to think that the major industrial countries would open their doors to exports of peripheral manufactures, or that the Latin American countries would be prepared to strive for a foothold in the external market, so long as easy import substitutions offered them a growing and reliable internal market, protected against imports in every possible way. Hence, there was no vital need to export industrial goods.

An industrial structure virtually isolated from the outside world thus grew up in our countries. In view of the pressing need for import substitution, an attempt was made to produce internally all items of which importation could be discontinued, at least temporarily, as not being essential to continued economic activity or to mass consumption. Imports deemed to be superfluous were the first to be restricted or abolished, with the consequent encouragement of substitution activities, in which scarce capital resources were invested. The criterion by which the choice was determined was based not on considerations of economic expediency, but on immediate feasibility, whatever the cost of production.<sup>1</sup>

The tendency has been for prohibitions and restrictions to take the form of customs tariffs. This is a step in the right direction. However, these tariffs have been carried to such a pitch that they are undoubtedly—on an average—the highest in the world. It is not uncommon to find tariff duties of over 500 per cent.

As is well known, the proliferation of industries of every kind in a closed market has deprived the Latin American countries of the advantages of specialization and economies of scale, and, owing to the protection afforded by excessive tariff duties and restrictions, a healthy form of internal competition has failed to develop, to the detriment of efficient production.<sup>2</sup>

Protection has, of course, been essential in the Latin American countries. But it has not been applied with moderation, nor has there generally been a policy laid down rationally and with the foresight which is essential for the alleviation, if not the prevention, of balance-of-payments crises.

Moreover, the fact that these crises erupt at intervals has engendered a most understandable resistance to a policy of moderate tariffs designed, within limits, to encourage competition from

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<sup>1</sup> A critical analysis of the process of industrialization was offered earlier, in the article already quoted: "Economic Development or Monetary Stability: the False Dilemma", *Economic Bulletin for Latin America*, vol. VI, No. 1.

<sup>2</sup> See in this connexion *Problemas y perspectivas de la industrialización latinoamericana* (E/CN.12/664).

abroad. Furthermore, the few experiments along these lines have generally proved unsuccessful, since they have resulted in external disequilibrium. A more liberal import policy cannot be applied unless exports also develop more freely.

Nor is this all. The closed industrialization fostered by excessive protectionism, as well as the unduly high customs tariffs applied to some staple agricultural commodities, have created a cost structure which makes it extremely difficult for Latin America to export manufactured goods to the rest of the world.

The difficulties of this problem have already been explained. The high initial costs of industrialization have created a need for protection, and excessive protection has resulted in a cost structure to which indirect taxes and social security contributions are added. All this militates both against the export trade and against a more rational import policy, and thus makes for the perpetuation of the closed system, to the serious detriment of economic development.

Moreover, the failure of our countries to take the trouble to find a solution to this state of affairs is understandable, although not justifiable, since a solution would not carry them very far without the benefit of the essential complement to this policy: the lowering or abolition of customs tariffs in the major industrial centres.

In those centres, factors conducive to a more liberal import policy are developing. There is a clear trend towards a progressive shortage of manpower, particularly in countries where the rate of economic development has been high. This might lead naturally to an acceleration of the growth of the capital-intensive industries that require a relatively small labour input, and expand more slowly than the industries which need a relatively large labour force and are less capital-intensive.

If this should be the case, the major centres would have to import the products of the latter in order to meet part of their growing demand.<sup>3</sup> The developing countries would thus find a

<sup>3</sup> This seems to be confirmed by an interesting specific case. In one of the papers prepared for the Seminar on Industrial Programming recently held at São Paulo, Brazil, the secretariat presented—as a preliminary investigation—a projection of the probable comparative evolution of production techniques during the next fifteen to twenty years in the textile industries of a Latin American country, selected European countries and the United States, as well as of wages, labour productivity, and performance of machinery. The provisional conclusion arrived at was that in view of the expected development of techniques, the relative factor costs and the considerable expansion of the markets in the more developed areas, the latter will find it cheaper to import from the Latin American countries—and others where conditions are similar—the items needed to cover rapidly growing sections of their internal demand.

promising export field for a type of industry which they should be particularly anxious to develop as being highly manpower-absorbing.

This does not mean that exports of manufactured goods by the developing countries will have to be confined to the products of industries requiring simple techniques, since there are some with advanced techniques in which the high manpower coefficient might encourage peripheral exports.<sup>4</sup> There may also be industries where the ability of the developing countries to compete depends less on the proportion of manpower than on the fact that they can specialize because of better natural resources or other favourable factors, such as differences in the transport costs of exports of raw materials and of manufactured goods.<sup>5</sup>

In this connexion, the differential tariff treatment according to degrees of precessing so often applied in the major centres constitutes a decided obstacle, the removal of which might give a strong impetus to some exports, even if the processing of the raw materials used were not characterized by a high labour content and low capital input.

As stated elsewhere, this is a field in which it is important for empirical research to be undertaken simultaneously in developed and developing countries, in order to see what the possibilities are and to direct this new policy of individual trade on a basis of reciprocal benefits; the great centres would export those manufactured goods which they are best qualified to produce, and the peripheral countries could carry out their industrialization process along more economic lines.

#### *4. Implicit reciprocity in the major centres*

Some general principles may help to promote this policy from the outset. Perhaps the most important of these springs from the consideration which has long been advanced in our reports. The peripheral countries are in a position diametrically opposed to that of the major centres with respect to trade reciprocity. The great industrial centres export manufactured goods for which demand increases sharply as income rises in the peripheral countries, whereas these latter export primary commodities for which the

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<sup>4</sup> This applies to the manufacture of some basic equipment which, by its very nature and the fact that it is manufactured to order, requires a large labour force. Partly for this reason, manufacturing costs in the more developed Latin American countries for much of the equipment in question compare favourably with the corresponding costs in countries with more advanced techniques.

<sup>5</sup> The chemical industries provide several cases in which possibilities of competition exist.

upward trend of demand is more gradual as income rises in the major centres.

Thus the great centres have no need to engage in import substitution from this point of view, since the trade disequilibrium with the peripheral countries tends to be positive in their case; in other words, exports are in excess. On the other hand, the trend towards a negative imbalance in the peripheral countries compels them to resort to substitution within the present pattern of trade in order to avoid a deficit in their balance of payments.

Moreover, if the major centres, for other reasons which may or may not be justified, embark on substitution with respect to imports from the peripheral countries, they aggravate this disparity in international demand. On the other hand, import substitution by the peripheral countries with respect to items from the major centres tends to reduce the disparity and thus to make development possible.

This basic inequality calls for a revision of the concept of reciprocity accepted until now, for if the great centres reduce or abolish their customs tariffs, the peripheral countries can increase their exports to them. And if this happens, the imports of the peripheral countries will also increase, in view of the buoyancy of demand for the goods concerned. This is a spontaneous effect not requiring any reduction or abolition of tariff duties. Indeed, the greater capacity to import thus acquired by the peripheral countries will enable them to speed up their development without additional substitution, or with less substitution than they would otherwise have to undertake; in other words, without having to resort to new forms of protection to the same extent.

To require a developing country to grant equivalent tariff concessions would hamper its industrialization, to the obvious detriment of its economic development.<sup>6</sup> However, this relates only to a transitional period, though not, of course, a short one. If the export trade of a developing country, thanks to the expansion of its external markets, successfully keeps pace with its import demand, it will have corrected its trade disparities and will not need to continue the policy of import substitution.

The peculiar nature of our development phenomena and the need for a specific policy to deal with them are manifest in this as in other aspects of the problem. These are phenomena which are inherent in the phase of transition to the more advanced stages already reached by the developed countries, and with which the latter did not have to cope because they were the first to develop,

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<sup>6</sup> This point is explained in more detail in the report on *Economic Development, Planning and International Co-operation*, op. cit.



and because they did so in international conditions very different from those obtaining today.

### 5. *The need to lower tariffs*

There is no suggestion, of course, that in the light of this new concept of implicit reciprocity, nothing at all should be done about customs tariffs in developing countries. On the contrary, it has already been said that Latin America suffers from excessive protectionism. The protective barriers do not have to be removed in order to apply the concept of reciprocity. To accumulate foreign exchange, rather than to import, when its exports increase is not typical of Latin America. A more characteristic trait is a tendency to import beyond its capacity to do so. From this point of view, there is no need to revise tariffs. But from the standpoint of development itself revision is necessary, so as gradually to correct the serious shortcomings of industrialization. The customs tariffs in force for the rest of the world must gradually be lowered, both in the light of economic expediency and to ensure that industry is constantly encouraged by external competition to narrow the gap in productivity *vis-à-vis* the major centres.

A reform of this kind obviously cannot be carried out where an increasing bottleneck exists. Relief must come rather from the external sector, in the shape of speeding-up in the tempo of the export trade. In other words, a rational customs tariff must be part of an international plan to expand trade on new bases. Tariff reform cannot be a prelude to such a policy, but must stem from it.

This being so, another problem arises. If the overhauling of the customs tariff must come in the wake of the development of new exports, how can such development take place if the present structure of high costs and prices is maintained? The question deserves careful study, and one of the avenues which might be explored is a readjustment of the rate of exchange. A currency devaluation is conceivable which, with a minimum of internal disruption, might have important external repercussions. Tariffs could be reduced in proportion to the increase in the exchange rate, and this would not involve either a change in the existing degree of protection or higher import prices, except where the duties concerned were lower than the reduced tariffs. On the other hand, it would improve the external competitive position of a series of industries which are unable to export today because of their high prices. External prices could be lowered while the same nominal internal costs were maintained.

The traditional exports do not, of course, require this incentive as much as new export lines, except in a few specific cases.

Devaluation must therefore be accompanied by a tax to prevent excessive profits on exports of traditional commodities or on industrial exports which do not need the stimulus in question. The income derived from this tax could be used to compensate for the loss of fiscal resources arising from the tariff reduction, and to grant import subsidies in favour of mass consumer goods for which prices must not be allowed to rise until the increments can be absorbed by an increase in income.

In view of the prevailing high level of tariffs, a relatively moderate devaluation followed by a corresponding tariff reduction would be a step in the right direction, but it would not mean that protection was reduced to rational levels. This would have to come after positive effects on exports had been achieved.

No specific proposal is being made here. This is merely an idea worth exploring. It has no doubt its drawbacks, but these should be considered not so much in themselves as from the standpoint of the fundamental solution sought.

If industrial exports are thus encouraged, the asymmetry in protection explained earlier will tend to correct itself; and they will make it possible to import items which it would be too costly to replace by domestically-produced counterparts, and to obtain through trade a greater quantity of goods—in some cases of better quality—than could be obtained through the substitution process at its present stage.

#### *6. The expansion of world trade*

The Latin American common market is only a partial alternative to the development of industrial exports to the rest of the world. Trade policy must be channelled in both directions. The common market will undoubtedly offer great advantages on which there is no need to dwell here. It will make it possible to ensure a rational division of labour in the new substitution activities and to avoid the serious mistakes committed in the past, and will enable the effects of these mistakes in existing activities, whether agricultural or industrial, to be gradually rectified. But it will not help us, or at least not as effectively as is needed, to solve the problem of labour absorption which exists in every Latin American country, although not always to the same extent. Hence, industrial interchange can hardly be of the same type as in the major centres.

This is important in itself, but there is another point that also has weighty implications. International trade is not static; new products and new forms and types of existing products are continually making their appearance, precisely by virtue of the technological evolution in the great centres. Moreover, new import requirements are bound to be constantly emerging in our countries,

to add to those that already exist. In some cases it will be both possible and desirable to replace these imports by domestic production, whereas it will be inadvisable to do so in others, both on the grounds of cost and in order to keep abreast of technical progress by continuing to import products that are representative of it. But the chances of doing so will be gradually lessened if our capacity to import from the major centres continues to be dependent on primary exports. For instance, if these were to grow at the rate of 2.5 per cent annually—in line with the post-war trend—and per capita income were to increase 3 per cent annually in keeping with the minimum target already mentioned, within about twenty years the coefficient of imports from the rest of the world would have dropped to only 6 per cent as against its present level of 11 per cent.

To grasp the significance of this, it need only be recalled that the six countries forming the European Common Market have a coefficient of 16 per cent (1960), likewise vis-à-vis the rest of the world. The United States proposal to make substantial cuts in its tariff in exchange for equivalent concessions in the six countries' external tariff is inspired precisely by the desire to prevent that coefficient from declining instead of increasing. Similar concern is felt in the COMECON countries; the reasons that have induced them to oppose the European Common Market are not merely political.

In addition, the need for the Common Market to look outwards to the expansion of world trade has been emphatically stressed by the Chairman of the Commission of the European Economic Community, who recently made the following statement in Brussels: "For some time past references have been made to the danger of the Community's becoming internally-g geared. I do not know who is responsible for this catchword. It is, in any case, completely divorced from reality. Neither the workings of the Community nor our economic interests nor our political outlook would allow us to become a closed shop. And the rapid expansion of our external trade testifies that we are not doing so. However, our trading partners undoubtedly are anxious that the Community's future development should be as swift as in the past. For only now are we coming into possession of the ways and means of translating our political aims of untrammelled trade, co-operation and aid into practical terms in the best possible way".<sup>7</sup>

There is no doubt that the progressive establishment of a Latin American common market would make it possible to take an active part in this policy of international trade expansion, since, by favourably influencing industrial production costs, it would

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<sup>7</sup> See the speech by Dr. W. Hallstein at the closing session of the European Forum on Latin America (Brussels, 21-23 November 1962).

place the Latin American countries on a better competitive footing as regards their new exports and would also help them—in view of the considerations set forth above—to undertake the revision of their tariff policy vis-à-vis the rest of the world.

## X II. THE INHERENT WEAKNESS OF THE PERIPHERAL COUNTRIES AND THE TERMS OF TRADE

### 1. *The factors underlying peripheral weakness*

Ever since the ECLA secretariat issued its first studies, the importance of the deterioration in the terms of trade has been stressed, and attempts have been made to analyse the forces that were tending to cause it. Perhaps because of the piecemeal nature of these explanations, our ideas have not always been correctly interpreted. It may be well to set them out afresh in the form of an elucidatory synthesis, since the deterioration, which has been so clearly marked in the last ten years,<sup>8</sup> may persist in future and have serious repercussions on economic development, even if there is no further decline from its present level.

The origin of this phenomenon is to be found in the relatively slow rate at which world demand for primary commodities grows in comparison with that for industrial products. The disparity need not necessarily bring about any decline in primary prices so long as production adjusts itself continually and easily to the tempo of demand. But for this to be possible, three conditions which are not observed in practice would have to be satisfied:

(a) The redundant proportion of the increment in the economically active population in primary activities would have to be displaced, so that production could expand at a rate not exceeding the rate of growth of demand. Other factors being equal, the more productivity in primary activities was stepped up, the more displacement would have to be intensified;

(b) The manpower thus displaced would have to be employed in industry and other labour-absorbing activities, as explained before;<sup>9</sup> and

<sup>8</sup> If the average terms of trade for the period 1950-54 are selected as a yardstick, the effect of the deterioration in 1955-60 can be estimated at 7,400 million dollars. In other words, more than 60 per cent of the annual increment in exports was wiped out by the deterioration. The net inflow of foreign capital in 1955-60 is estimated to have been about 7,700 million dollars (at 1950-54 prices), which means that the repercussions of the terms-of-trade position nullified the additional purchasing power achieved by the Latin American countries on the basis of that capital. It should be noted that relative prices were favourable in 1950-54, even though the level prevailing before the world depression was not fully recovered.

<sup>9</sup> See part B, chapter I, section I.

(c) The manpower in question would have to be absorbed quickly and completely enough for the real wages of workers in primary activities to rise and advantage to be taken of the increment in the productivity of the latter.

As a rule, the wage level in primary activities is lower than in urban labour-absorbing activities. If absorption is intensive, wages in primary production may mount to the urban level, which will rise little by little in keeping with the increase in productivity in labour-absorbing activities. Beyond this level, the increment in primary productivity will not be retained by the wage increase, even if the three conditions stipulated above are complied with.

If they are not, and the level of wages in primary activities fails to rise to the extent permitted by the increase in productivity, the latter will be transmuted into a profit gain and will go to stimulate the growth of production beyond the tempo imposed by the growth of demand, thereby forcing down the relative prices of primary commodities as compared with those of industrial goods.

The phenomenon of deterioration is to be found as much in primary production for domestic consumption as in production for export. In the former case, it simply means that the benefits of the increase in productivity are transferred internally. In the latter, there is a loss of income which the expansion in the volume of export trade can do relatively little to offset in comparison with the improvement that would have to take place in order to keep pace with demand.

To put the idea in a nutshell, deterioration is caused by the lack of dynamism in development, which hinders or precludes absorption of the surplus manpower resulting from the sluggish growth of demand and higher productivity in primary activities. The same factor is instrumental in preventing the wages of workers in primary activities from rising on a par with the increase in productivity, and to the extent that they fail to do so, primary production loses all or part of the benefits of its technical progress.

Such is the nature of the deterioration phenomenon. It presupposes that the rate of expansion of production may outstrip that imposed by the relatively slow growth of demand, on the basis of availability of land and other natural resources and of manpower. Otherwise, if production were to lag behind demand, relative prices would tend to improve. Whether this improvement is entirely expressed in terms of an increase in income from the land or is also shared to some extent by the workers depends—as in the former case—on the effect produced by labour absorption in urban activities on the real level of wages in primary production.

What grounds are there for hoping that conditions favouring an improvement in the terms of trade will prevail during these

next ten or fifteen years that will be decisive for Latin America's economic development? There are no visible signs that they will. On the contrary, the effort to quicken the slow growth of exports is becoming increasingly apparent in both the Latin American countries and the other countries in process of development that are competing with them in respect of production. And it is natural that in order to accomplish this aim efforts should be made to increase productivity. Moreover, these efforts will have to be extended to the whole of agricultural production if it is to meet the increasing claims of domestic demand. The manpower thus displaced by technical progress will present a serious absorption problem which, if not solved, will curb the rise in wages that technical progress itself might make possible in primary export activities.

## *2. The impossibility of treating the deterioration as an isolated problem*

The absorption problem is not confined to particular producer countries but is common to all alike. If one country succeeds in making development sufficiently dynamic and creating suitable conditions for the retention of the benefits of technical progress in primary activities through a rise in wages, this does not mean that they can actually be retained, since unless other producer countries succeed in remedying the lack of dynamism also, their production will continue to expand at a rate faster than that dictated by the income-elasticity of demand, and relative prices will decline. The first country will obviously have to follow the same trend in order to be able to compete on the world market. And to the extent that wages in its primary activities have undergone an improvement it will have to resort to subsidizing exports or devaluating the currency; in either case it will inevitably lose all or part of the fruits of its technical progress.

By protection, of course, the level of nominal wages can be raised in conjunction with internal prices. This would contribute towards the retention of the benefits in question, provided that adequate manpower-absorption took place. But in this case again the other competitors would have to be in a position to do the same in order to prevent deterioration. And this is not a state of affairs that occurs in practice.

The same applies to taxes. If the State were to tax exports commensurately with the increase in productivity in export activities, the benefits could be retained just as if wages had been raised; but all the producer countries would have to adopt the same measure.

Thus, it is clear that the problem of deterioration will not solve itself of its own accord, so long as the developing countries

fail to remedy their dynamic weakness—which will take a very long time—or if difficulties supervene that cannot be dealt with by technical advances in the development of primary production.

### 3. *Differences between central and peripheral countries*

So far the phenomenon of deterioration has been considered in relation to the peripheral countries. The next question is whether forces are not also to be found in the great centres whereby the fruits of their technical progress tend to be shifted abroad. It may be argued that such transfers do, in fact, take place, and that any deterioration in the terms of trade for the export activities of the peripheral countries is due to the fact that technical progress there has been more marked than in the industrial export activities of the great centres.<sup>10</sup> In other words, the behaviour of the terms of trade in the past was attributable to the relative increase in productivity as between primary commodities and industrial goods.

This argument might be admissible in a world in which every country had reached the same stage of development, but not while the disparities that are now apparent between the great centres and the peripheral countries still persist. From the standpoint of the terms of trade, the fundamental differences are as follows.

First and foremost, the essentially industrial nature of exports from the great centres. Industrial goods usually have a very high income-elasticity of demand, and as soon as demand for certain products shows signs of becoming saturated with the passage of time, new products or new types of existing products appear which act as a continual stimulus to industrial demand. Labour is dis-

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<sup>10</sup> This seems to have been the argument put forward by Lincoln Gordon, economist and United States Ambassador to Brazil, in his speech to the Brazilian National Economic Council on 29 January 1963, when he stated: "There have long been conflicting general theories about inherent long-range trends in the terms of trade. One old theory, now discredited, held that agricultural prices were bound to improve in relation to industrial prices because an increasing world population on a limited surface or arable land would be constantly bidding up food prices, whereas industrial output was indefinitely expansible. This disregarded the effects of the technological advance in agriculture, which have increased productivity even more rapidly than in industry, at least in the free world. For some years, the ECLA secretariat was arguing the contrary thesis, namely that the long-term trend was necessarily unfavourable to agriculture, but this argument was based largely on nineteenth-century British data which did not allow for reductions in shipping costs or for inherent difficulties in any long-term measurement of comparative prices for manufactured goods. The nature of industrial products changes completely from decade to decade as new inventions are made, and they are also subject to constant improvements in quality. As a result, most serious scholars today are very skeptical as to the validity of any long-term generalizations about inherent trends in the terms of trade." *FYI News Digest*, United States Information Service, 63/7, Santiago, Chile, 4 April 1963.

placed from one industry to another, but industrial activity as a whole absorbs an increasing proportion of the increment in the economically active population, at least up to a certain limit, beyond which this function is progressively transferred to other labour-absorbing activities. In primary production the reverse takes place; demand for existing products is relatively slow in expanding, and new products or new varieties of products do not appear except in rare instances. Even when this occurs, it does not take place on a large enough scale to counteract the tendency of the labour force to shift to urban activities.

The second basic disparity is that in the big industrial countries the absorption of labour from primary production and other labour-expelling activities has made great strides, a relatively small proportion of the economically active population remaining in those activities. For instance, the proportion in agriculture is 7 per cent in the United States and about 15 per cent in the major industrialized countries of Western Europe. This is highly significant, since the same increment in productivity in Latin American agriculture—where the average proportion is 45 per cent—represents a relatively much greater displacement of labour than in the advanced centres. If the large proportion of the economically active population that is still to be found in artisan activities and unskilled personal services is also taken into account, together with its tendency to shift to labour-absorbing activities, the full extent of the difference will be grasped. To put it another way, in the great centres a very large proportion of the economically active population is found in the labour-absorbing activities and a very small proportion is found in those that are labour-expelling, while the reverse occurs in the peripheral countries.

Consequently, the pressure exerted by the displaced population on the level of wages in the labour-absorbing activities is relatively weak in the advanced centres and relatively heavy in the countries on the periphery. This is undoubtedly one of the reasons why trade unions in the former have acquired an increasing ability to keep wages rising on a par with or even faster than the increase in productivity. What is more, in countries which are also manifestly lacking in dynamic force, the trade unions succeed in raising the level of wages in spite of unemployment.

In the peripheral countries, on the other hand, the relatively strong pressure applied by labour that is displaced or seeks to move elsewhere is a heavy handicap to trade union action. In so far as Latin America is concerned, it is only in exceptional cases that the trade unions have succeeded in getting wages raised in certain export activities irrespective of the general level in the region. But even if trade union action were effective in the case of export activities by virtue of the increase in productivity and



notwithstanding the dynamic weakness of the economy, the real wage increments could not be maintained for long unless they were matched by increments in other exporter countries that had likewise stepped up their productivity.

In other words, it is not the relative differences in productivity increments in the primary export activities of the peripheral countries as compared with industrial activities in the great centres that are responsible for the trend of the terms of trade. Generally speaking, it is rather the differences between productivity in the centres, on the one hand, and in the peripheral countries, on the other, that have not been absorbed by the respective increases in wage rates. The ability to raise wages is very marked in the great centres, at least to the extent that the productivity of industrial activities improves, and only those industries whose productivity increment is above the average tend to transfer the balance abroad. In the peripheral countries, on the contrary, the fact that it is difficult to raise wages in export activities—and primary production in general—means that they are constantly in danger of losing all or part of the average productivity increment in the activities concerned. Moreover, if technical progress has been greater in some countries than in others, the decline in prices brought about by the former may deprive the latter of a larger proportion of income than would correspond to their particular productivity increment.

The favourable trend of the terms of trade in the distant past may have been due to the fact that, as the capacity of the industrial centres to raise the level of wages was then far less pronounced, the course of events was much the same as that now occurring in the peripheral countries. There may also have been difficulties in increasing primary production, whereas later this became easier because of the rise in productivity as a result of land reclamation and the utilization of new natural resources, as well as of improved transport facilities.

#### *4. Deterioration in the great industrial centres*

At all events, everything would seem to suggest that this inherent incapacity of the peripheral regions to retain the benefits of their technical progress will persist for a long time yet. The very situation of agricultural production in the large industrial centres, despite the advanced stage of development reached, affords striking evidence of this fact. There too relative prices are following a downward trend, which is not incompatible with the tendency of industrial wages to appropriate the increases in productivity to the detriment of the primary activities.

In the great centres no one has attempted to deny the existence of this trend, or to belittle its importance on the grounds that

have been adduced in connexion with the corresponding deterioration in the peripheral regions, namely, that statistics do not reflect the improvement in the quality of industrial products, or that the ratio cannot be accurately calculated on the basis of price indices. Perhaps this is because the reasons for the decline have become obvious. In the United States a technological revolution has taken place in agriculture which is now spreading to Western Europe, with similar consequences; there too the tempo of production is tending to outstrip the rate of growth of demand. A further population shift from the rural areas would be necessary—small as is the proportion of the active population still living there—and people are unwilling to migrate to the towns; they do not want to abandon their land, even in countries where the intensive absorption of manpower in industry and other activities is attracting labour from abroad.

To defend the internal terms of trade, recourse is had to various procedures: in the United States, to internal support prices which maintain a variable parity with the prices of the industrial goods purchased by agricultural workers, and to subsidies for exports to the international market; in Western Europe, to the tightening of restrictions on imports of agricultural commodities, as a means of broadening the market for the region's own production and supporting high internal prices. Another possibility contemplated is that of subsidizing exports to the world market if and when surpluses exist.

These measures to defend agricultural relative prices on the home market—understandable as they are from the standpoint of the great centres—imply a still further aggravation of the consequences of the slow growth of demand for agricultural exports from the peripheral countries. However, they have the merit of affording a concrete demonstration of the importance attached by the world centres to the decline in the prices of primary commodities, and at the same time indicate a possible way of solving the problem at the international level.

##### *5. Possibility of international retransfer of income*

Strictly speaking, what do these forms of intervention signify? Simply the recognition that market forces do not provide an equitable solution for the problem in question. The technical progress achieved in industrial activities in the world centres had left agricultural production lagging in the rear. But as agriculture manages to make up its leeway, the effects of its technical progress tend to be passed on to the rest of the community. The solution is therefore of a moral and political character: to retransfer to agricultural producers whatever income they may have lost through the operation of market forces whose action has been

preventing the levelling-up of their income with that of the urban sectors. In the long run, every income redistribution measure is essentially of this nature.

Viewed from this angle, the process of remedying the deterioration of the terms of trade in the peripheral countries becomes one vast problem of international redistribution of income, as a measure dictated not only by justice, but by the great policy design of helping the developing countries to cure their congenital weakness, acquire the ability to retain the benefits of their technical progress and accelerate their economic and social development. But this involves something more than international co-operation. It would be impossible to adduce valid arguments based on international equity unless a serious effort were made to tackle the problem of internal equity, and the savings potential of the higher income groups were thoroughly exploited with the same end in view—that of speeding up the rate of development.

Consequently, the international retransfer of income to compensate the peripheral countries for the deterioration of their terms of trade could not be an automatic measure, but would have to be closely linked to their development plans, and to the economic and social effectiveness of the plans in question.

This idea of retransfer really represents the more detailed working out of a suggestion put forward in 1954 at the Quintandinha session. In the report presented by the ECLA secretariat<sup>11</sup> at the request of OAS, the agency sponsoring the conference, it was proposed that the countries which were consumers of primary commodities might establish an import duty equivalent in amount to the decrease in prices, and that the revenue accruing from this duty should be passed back to the producer countries.

The results of a measure of this kind would be similar to those that might be obtained by the producer countries if they reached agreements to defend their prices not only against periodical fluctuations, but also against a persistent downward trend. The complexity of such procedures is undeniable, as is the fact that if prices were stabilized at relatively high levels, the expansion of production would be encouraged, with the consequent aggravation of the price decline. Professor Kaldor suggests how these consequences might be averted in a brief report prepared not long ago.<sup>12</sup>

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<sup>11</sup> See again *International Co-operation in a Latin American Development Policy*, op. cit.

<sup>12</sup> See "Stabilizing the Terms of Trade of Under-developed Countries", *Economic Bulletin for Latin America*, vol. VIII, No. 1, Santiago, Chile, March 1963, pp. 1 et seq.

In any case, the retransfer of income to primary-producing countries represents a very simple solution, since the resultant inflow of international resources would be used to increase capital formation, as a means of helping to remedy the lack of dynamism in the development process. Investment in rural areas would, of course, have to be assigned a high priority. The retransferred income would therefore not be used to compensate the decline in internal prices, except when they had reached a level so critically low as to discourage production.

The scope of this idea should be clearly understood. Most of the rural workers fall within that half of the Latin American population whose income levels are extremely low. Would the application of international resources to economic development rather than to prices be effected at the expense of the effort to improve their standard of living? Obviously not. This latter aim would be served, however, by direct action to influence workers' income levels rather than prices, for export activities constitute only a fraction of the whole group of primary activities, and the income of workers employed in them could not be higher—save in exceptional cases—than the level prevailing in the primary activities in general. As has already been shown, the solution of this problem lies in remedying the lack of dynamism in the development process, without prejudice to the pursuit of a wage policy reflecting the primary activities' increase in productivity. It is true that competition from other countries which did not follow a similar policy would adversely affect export prices in the way described elsewhere. Critical situations would thus arise, as a result of which part of the international resources would have to be used for supporting a domestic price level commensurate with the increase in the real income of rural workers. We would stress that these are general ideas rather than concrete suggestions, and that they are presented here as a basis for the discussion of this vital problem of relative prices.

#### *6. External bottleneck and contribution of international resources*

The present chapter, which is now drawing to a close, has been devoted to an explanation of the persistent trend towards an external bottleneck in the Latin American countries and the essential need to combat it on two convergent fronts: (a) by promoting industrial exports to the rest of the world, especially to the great centres, without neglecting to encourage traditional exports to existing and new markets; and (b) by safeguarding the terms of trade. Another similarly convergent line of approach will subsequently be considered, namely, the Latin American common market.<sup>18</sup>

<sup>18</sup> See chapter II below.

The contribution of international resources is not in itself an alternative solution to the bottleneck problem. Such resources are certainly of vital importance, but as a means of enabling structural changes to be introduced in foreign trade so that this problem can be attacked at the root. Unless the causes of the situation are thus extirpated, external contributions will be required indefinitely and in increasing volume.

The consequences of this steady piling-up of external debt, under the present trade régime, have already made themselves manifest. The slow growth of exports and the downward trend of prices on the one hand, and the increasing service payments on foreign capital on the other, are progressively weakening the capacity to import, vis-à-vis the growing import requirements in respect of essential goods which are needed without delay and for which it is increasingly difficult to substitute domestic production.

A more and more serious incompatibility between services and imports thus arises, and is frequently aggravated by the shortness of loan maturity periods, which entails excessively heavy amortization payments.<sup>14</sup> And as imports cannot easily be reduced, the only way out is to obtain further international resources to defray service payments, even when such contributions are not absolutely essential to fill the gaps in external capital formation. What can prevent the recurrence of this phenomenon if the structure of foreign trade is not remodelled?

Certainly not exhortations to financial good conduct; this will no longer suffice as a preventive. It might have been enough in the nineteenth century. There was then a clear and logical link between externally-gearred development and foreign loans and investment. The latter were primarily applied, in one way or another, to the expansion of exports. And this expansion made it relatively easy to defray the similarly growing service payments, without the necessity for international contributions to be increased, as is now the case for reasons of external disequilibrium and shortage of capital. What is more, in several instances the expansion of exports permitted the gradual repatriation of the external capital received, so that the burden of services was lightened. If difficulties supervened, they were due to financial ill-conduct, generally internal, but also, in some instances, external, for there was a little of everything in those vanished days.

Within the logic of externally-gearred development, the granting of financial favours had no place. Foreign loans and investment were a straightforward expression of mutual interest. Nor

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<sup>14</sup> It would be desirable to overhaul this burdensome amortization system—as is already being done in some cases—in order to secure some immediate relief in respect of external payments.

did the connotation of "assistance" exist on which emphasis is naturally laid during the periodical development crises. Loan operations in this way often become politically vulnerable in certain respects, both for the givers of the loans and for the receivers.

Basically, the problem does not lie in inability to meet service payments—which might increase without representing an intolerable burden—but in the transfer difficulties which the bottleneck creates. Longer-term loans and a rapid expansion of exports would also make the burden in question very easy to carry, as far as external accounts were concerned. There would then be plenty of scope for good advice to bear fruit; and, moreover, a deaf ear could be turned to those admonitions—uttered from a monetary standpoint—which often suggest a false dilemma in relation to stability and development, for if the external sector were restored to prosperity in a new pattern very different from that at present followed, our countries would be released from harassing pressures, and would acquire the essential freedom of choice. And only when the structural obstacles that now make choice inevitable had been surmounted, would the alternatives present themselves in their proper terms: external co-operation to accelerate development, or a more thorough-going internal effort to do so.

## Chapter II

### OBSTACLES TO THE LATIN AMERICAN COMMON MARKET

#### I. QUANTITATIVE TARGETS

##### 1. *Description of targets*

Within the obsolete pattern of international trade which has been discussed elsewhere, the Latin American economies focused their development—as they still do—upon the great industrial centres, making little contact with one another except for a limited trade in certain primary commodities; industrialization developed in watertight compartments, as the time-honoured phrase has it; and a common market has become an imperative need as another means of correcting the trend towards an external bottleneck and promoting the economic viability of the industrialization process.

The Latin American Free-Trade Area, concerted with notable speed, has easily surpassed, during the first two years of its existence, the minimum liberalization commitments stipulated in the Montevideo Treaty. But in face of the herculean task it is called upon to perform, its rate of progress might become unduly deliberate and cautious. Such a rate might be justifiable if our times were like those former days in which the striking expansion of international trade gave a steady impetus to the Latin American economies; but not as matters stand at present, when the serious obstacles to their development uncompromisingly demand a new outlook, firm determination and a boldly constructive spirit.

It would be a mistake to consider that the instruments established under the Treaty are not intrinsically efficacious. They are; but important policy decisions are required before this efficacy can be reflected in concrete achievements capable of withstanding whatever factors may make for stagnation in the near future. The system of periodical selective negotiations at present applied may perhaps find the atmosphere becoming unpropitious, with the consequent risk that the whole business may be limited to a series of narrow and halfhearted preferential arrangements.

This danger will persist until the quantitative targets for the reduction and elimination of tariffs and other restrictions within a specific time-limit are more clearly established, since without them there will be no definite points of reference on which the

negotiations can be based. But it would not be advisable to set up these targets in isolation, without laying the foundations for complementarity agreements under which industries of great importance for development strategy could be programmed; and this could not be done unless the idea of reciprocity were clarified and effective ways of ensuring it devised. Nor could this in its turn be satisfactorily achieved unless organs to promote reciprocal trade were established. All these are matters for the important policy decisions referred to above.

Why is it so essential to fix these quantitative targets? The Governments have assumed tariff elimination commitments, in respect of traditional commodities particularly, in order to comply with GATT regulations. But this is a relatively minor undertaking. It is also indispensable that industrial products should be covered, including both those that are manufactured today and those that will inevitably have to be manufactured tomorrow, with increasingly difficult and costly techniques.

In order that the benefits of the Area may be gradually extended to the whole range of Latin American production, the quantitative targets will have to be established forthwith. Otherwise, the negotiations would very quickly lose their binding and automatic character, and the next step would be pressure from individual countries to obtain concessions in respect of specific products, which might often fail to coincide with the interests and claims of the rest; and this would entail the risk that the process of reducing and eliminating tariff duties might be gradually brought to a standstill. The establishment of quantitative targets would help to bring about a radical change in such an attitude; each country would have to make the effort to introduce a minimum number of reductions and eliminations every year so that the targets agreed upon could gradually be attained.

In what might these targets consist? Several formulas are conceivable, but the simplest and most practicable is the arithmetic mean of tariff duties. We suggest, therefore, that within a period of twelve years—the time-limit is not what matters most, and it might be a little longer or shorter—the tariff average among the countries members of the Association should be lowered to not more than 15 per cent, and that, furthermore, within the same period all other restrictions of a protectionist nature should be lifted.

The establishment of these targets should be combined with the obligation to reduce all duties to a maximum of 30 per cent in the case of existing industries developing at the natural rate of growth, as well as in that of agricultural activities, and of 10 per cent in the case of dynamic industries—a distinction prompted by motives which will be expounded later.



It would be inexpedient to confine attention to the final target, without agreeing upon a gradual procedure with intermediary objectives. Thus, by halfway through the period stipulated, the tariff average should not exceed 30 per cent, and the maximum should not be higher than 60 per cent for non-dynamic industries and agriculture and 20 per cent for dynamic industries: i.e., double the rates established as the final target. Other restrictions would also have to be reduced by one-half midway through the twelve-year period, and before the final time-limit was reached a new agreement would have to be concluded, in the light of the experience acquired, so that the same policy might be pursued during a second stage which it would be premature to envisage now.

It would also be advisable to agree upon a special procedure for very high tariffs, for example, those which were more than treble the maximum allowable for the group to which the product pertained (dynamic or non-dynamic industries). The reduction from the present tariff level to a level three times as high as the maximum which was to be reached in two stages would be effected proportionally and in the course of a very few years. When three times the maximum had been reached, the process of reduction would continue as described above. The importance of this more rapid constriction of the margin of excess in the case of very high duties lies in the fact that the reductions which may in practice give rise to market competition and spur on the producer activities are those corresponding to the lowest step of the extremely high duty; for example, to a level not above 90 per cent in the case of the products of slow-growth industries. If in such instances a special procedure were not adopted, the lowering of these very high duties might be completely inoperative from the standpoints of competition and trade throughout almost the whole of the transitional period. Its practical effects would make themselves felt only in the course of the final two or three years, with the result that not only would the advance towards integration be retarded, but difficult situations would pile up that might arouse strong opposition.

There is no need to go into technical details in order to adopt a policy decision. A standard nomenclature would of course have to be introduced; but these and others are questions on which technical experts would have to formulate recommendations for submission to the Governments. The essential point is that a high-level policy decision should establish the quantitative targets, since in the absence of fixed cardinal points there is good cause to fear that discussion might go on for years and years and still no significant progress be achieved.

Within the system of averages different situations would arise; while tariff duties on one series of products might be completely eliminated in the period agreed upon, in other instances it would be expedient to maintain a reasonable degree of protection. The time-limits might be extended for countries at a relatively less advanced stage of development, in conformity with a principle which is fortunately enshrined in the Montevideo Treaty.

There is no escaping the fact that the targets suggested may not seem very encouraging to those who would like to make straight for the common market by means of the total elimination of tariffs, and, at the other extreme, may appear recklessly ambitious to those who bestow the name of "prudence" on the tremendous imprudence of taking only clumsy and hesitant steps to meet the grave historic challenge of these and other structural reforms.

Those who advocate the immediate establishment of the common market through total tariff liberalization cherish the hope that the free interplay of economic forces will solve all problems, without any kind of planning. Planning is not incompatible with competition. The latter is an indispensable requisite for the efficacious operation of the economic system under which we live. Paradoxical as it may seem, some intervention in the free play of economic forces is necessary in order to create the right conditions for competition to function: impersonal intervention on the part of the State, designed to guide, safeguard and encourage individual action in economic life, but not to interfere with it or subject it to arbitrary restrictions.

Customs protection has been carried to excess and, by limiting or completely preventing competition from abroad, has frequently given rise to internal restrictive practices or monopolistic combines which weaken the incentive to attain satisfactory levels of productivity.

Even without the Latin American Free-Trade Area, it would have been advisable gradually to reduce protection to a reasonable level, if the chronic trend towards balance-of-payments disequilibria had not so frequently intervened.

## *2. The play of competitive forces, and its limitations*

Once the need to revitalize competition is recognized, the question is how this is to be done. There are three main areas to consider: (a) agriculture, (b) existing non-dynamic industries, and (c) the dynamic industries.

In agriculture the traditional export products are already the subject of an undertaking to abolish tariffs completely within the

next ten years. But it is not enough to assume a commitment of this nature and then leave things to work out on their own. Programmes for the rational distribution of production within the Area must be formulated, that take into account not only present demand, but also the considerable increase in demand in the future, which will make it necessary to cultivate land of widely differing productivity. Such programmes will in some cases require special regulatory measures. Only thus can competition develop without bringing distortions in its train, since at all costs we must ensure that productive land does not lie fallow, even if it is used otherwise than at present, and that manpower is not left unemployed, with no possibility of absorption either in agriculture or elsewhere. An outright abolition of tariffs might have this disastrous result, for both traditional and other agricultural commodities.

The situation is similar as regards existing industries, most of which have reached a vegetative stage of growth, where demand increases only gradually, in line with the growth of the population. Income redistribution would undoubtedly give a strong impetus to these industries, and facilitate their adaptation to the needs of the common market. To allow the industries time to effect this adaptation, a gradual and well-thought-out reduction and abolition of tariffs is essential. If the pace were too rapid, and the aim were total abolition of protection in this first stage, there might be a flood of new investment to replace the stock of capital in order to increase productivity at the expense of manpower absorption.

In fact, this is the main reason behind the "average" formula, according to which some tariffs are reduced to zero, while others can continue their protective functions in moderation. Nevertheless, it is all a question of degree, and the flexibility in question must not in any case be used to maintain tariffs higher than the above-mentioned maximum of 30 per cent for longer than twelve months, for either the existing non-dynamic industries or primary production.

The case of the dynamic industries is generally very different, since they have great development possibilities, especially the new industries that will have to be established in the next few years to continue the import substitution policy, but this time within the multi-national framework of the Area. As we know, these are industries manufacturing capital goods, durable consumer goods, and intermediate products. In many of these cases a total abolition of tariffs would be desirable, whereas in others the tariffs will have to be maintained, but at a level not exceeding the 10-per-cent maximum previously referred to.

It will also be advisable to abolish all tariff duties within a short time—perhaps half the period—for basic raw materials of

either mineral or agricultural origin, including petrochemical products. This step is of great importance, for the disparities between the prices of the industrial products of different countries often derive from the varying prices at which the raw materials are available. Some countries customarily protect marginal production of such materials, and as a result industry has to operate at a high cost level, even though its relative efficiency may be superior to that of the countries of the Area which have access to cheap raw materials, or import them under low tariffs.

The countries belonging to the Latin American Free-Trade Area produce practically all the basic raw materials, from fuels to metals, from cotton to wool, from leather to iron ore. If import duties on these basic raw materials were abolished, and a common tariff worked out to apply to third countries, it would be possible to affect large-scale substitution in respect of imports from outside the Area.

It is very likely that a policy of this kind would in some cases mean the end of marginal production. It would then be necessary to seek means of compensating workers and entrepreneurs for the resulting hardship. This could be one of the functions of the Fund advocated below.

Basic raw materials generally have a very low unit value, and the incidence of freight is so high that in itself it constitutes a form of protection for the production of areas far apart as those of Latin America. Consequently it may be that the adjustments that will have to be made in the marginal sectors in question will be on a smaller scale than those required in the rest of industry.

### *3. Industrial complementarity agreements*

The dynamic industries are those that offer the greatest possibilities for complementarity agreements. Let us now take up this second point, which, like the first, calls for a high-level policy decision. Unlike the slower-growing industries, the dynamic industries need not so much a renewal of the stock of capital as capital investment in new industrial plants, or a sharp expansion of available capacity in order to meet a rapidly increasing demand. Here the problem is to ensure that all the individual member countries will derive equal benefits within the common market from the co-ordination of investment and its due distribution, either in the same industries appropriately integrated, or in different activities. But this relates to the application of the principle of reciprocity under discussion: what needs to be underlined here is that an equitable distribution of benefits cannot be expected merely as a result of the play of economic forces. It will have to be ensured by programmes for industrial complementarity between particular

industries in this sector, and between those industries and other activities.

There are various possible ways of achieving this distribution of industries. One would be to give preference within the Area to the exports of a country to which a particular industrial activity had been allocated under the programme, without extending this preference to the other member countries. But this might result in a patchwork of preferential treatments, and might also lead to monopolies, at the expense of technical progress and of the consumer. The same would occur if in the other member countries it were forbidden to establish industries not allocated to them under the programme. Undoubtedly such privileges could be limited in duration, but there would be a risk that the industries thus sheltered would become accustomed to protection, and it would be difficult, if not impossible, to abandon preferential treatment and restore competition within the Area.<sup>1</sup>

Does this mean that the activities established in a country in accordance with a complementarity programme would be exposed from the outset to the establishment and the competition of similar plants, either in the same country or in other member countries? If this were so, there might be insufficient inducement in some cases to take part in a programme that might founder within a short period. The solution is to provide incentives to the industries established under the programme, in the form of tax benefits, technical assistance and long-term financing, which for a given period could not be extended to other similar plants whose establishment might be contemplated either in the same country or in the Area. Thus there would be initial advantages for the programmed industries, but they would have to keep constantly on the alert for potential competition from the other plants in question, and this would drive them to make use of those initial advantages to consolidate their technical and financial position and produce at a reasonable cost level.

The Montevideo Treaty provides for such complementarity agreements, but the system of incentives has not yet been organized. However, it is not solely for this reason that thus far only one agreement has been concerted, in spite of the fact that the prospects looked so promising. It should be recalled that the exorbitant restrictions imposed by many of our countries on certain imported goods, for balance-of-payments reasons—over and above the excessive tariffs already existing—have led private enterprise to follow the easier path of confining itself to the domestic market,

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<sup>1</sup> These observations do not apply to Central America, where the establishment of a common market in particular conditions of industrial development is well advanced.

producing at a very high cost level, but nevertheless making substantial profits.

What is happening in the motor vehicle industry is instructive. Not only are there a number of countries all trying to do the same thing, but there is also an unbelievable proliferation of anti-economic plants within single countries.<sup>2</sup> It is to be feared that any programme, either in this industry or in other complementarity industries, however equitable it may be, will meet with perhaps insuperable opposition, if there is no firm resolve to abolish restrictions and gradually reduce duties as between the member countries until moderate tariffs are reached that do not exceed the maximum of 10 per cent previously referred to. In these circumstances the experts asked to study a given programme would not discuss whether or not complementarity arrangements would be expedient for this or that industry, and whether or not protection ought to be reduced, but how to put the Governments' decisions into effect.

The case is not the same for the steel industry, but this is clearly developing in each country on a basis of self-sufficiency with the aim of producing the full range of products whatever the cost. Furthermore, a very odd position tends to be adopted here: let us first integrate within our own country, and then think about multi-national integration. Unfortunately it will then be too late. At present Latin America has a production capacity of 5.5 million tons of steel ingots, and by 1970 this figure will have risen to 18 million tons, according to existing plans. Yet 20 per cent of total consumption will have to be supplied through imports. The equivalent of 3,000 million dollars will be needed to carry out these plans. Will this considerable amount of funds in short supply be invested on the basis of the actual structure now existing in each country, or will some form of specialization be sought?

There is a vast field for these complementarity arrangements, without by any means excluding some of the non-dynamic industries. But it is on a number of dynamic activities that attention will have to be concentrated, since they do not face the same handicaps as the slower-growing industries when it comes to a definite tariff liberalization policy.

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<sup>2</sup> Suffice it to mention that, apart from Argentina and Brazil, countries that already manufacture motor vehicles in the strict sense of the term, there are four other countries—Chile, Colombia, Mexico and Venezuela—that have vehicle assembly plants and are about to embark on production. The total Latin American market for passenger cars, estimated at slightly over 300,000 units a year, will have to be divided between something like forty existing and potential producers, whereas each of the main European producers supplies the market with between 250,000 and 500,000 units a year.

Nevertheless, it is likely that certain difficulties will arise if all countries, on an equitable footing, are to find their own way in establishing new production lines aimed at the common market, within the same industrial branch, in the light of each country's particular resources or industrial structure. In order to cope with this problem, it may be appropriate for the complementarity agreements to be prepared and negotiated simultaneously for a wide range and variety of industrial activities, so as to make it easier for each country to secure the essential reciprocity in the development of new industries capable of competing in the common market.

#### 4. *The principle of reciprocity*

In the last analysis, the effectiveness both of such agreements and of the whole system under consideration also depends on the application of the principle of reciprocity. The interpretation of this principle, enshrined in the Montevideo Treaty, must be crystal clear. No member country can expect to derive from the Area more benefits than it offers. But the Treaty does not stipulate what measures will have to be adopted to correct a persistent inequality of benefits in its application.

In this connexion, the first thing to do is to provide for the technical and financial means by which activities in the less favoured countries can be promoted. This must be a collective commitment entered into by all members of the Association, in the manner explained below.

Secondly, the countries which constantly export more than they import from the Area must take measures to restore equitable treatment. A more rapid reduction of restrictions and tariffs with a view to stimulating exports to deficit countries might be effective if accompanied by a reasonable margin of preferential treatment in favour of Area products. Here there is a serious lacuna in the Treaty which must be filled. Tariff reduction would be pointless if its application to the rest of the world involved the abolition of preferential treatment or reduced it to ineffectual proportions. Provision would thus have to be made for a minimum margin of preferential treatment within the Area in favour of items for which tariffs were reduced. At some point maximum margins must be set, but this should be considered together with the common tariff applicable to the rest of the world.

Thirdly, the less favoured countries might reduce their tariffs and abolish restrictions at a slower rate in order to remedy the disequilibrium with respect to benefits, in extreme cases where the other measures had not had the desired effect; but this would not exempt them from taking their own corrective measures, par-

ticularly, in regard to the over-valuation of currency, which might vitiate the whole process of reciprocity. Monetary distortions of this or any other kind must be ruled out if the Area is to function properly.

A clear definition of the principle of reciprocity will help to dispel the misgivings entertained in some circles regarding complementarity agreements. It will not always be possible to work out absolutely equal levels of trade benefits in every agreement or set of agreements. Hence equality will have to be sought through the medium of other activities. If this had to be done in every instance, the conclusion of complementarity agreements might become lengthy and complicated, when it should be precisely the opposite. Herein lies the significance of the following principle: each member country should be given an assurance that if the agreements and the reduction or abolition of duties do not provide equality of benefits, other measures will be taken to achieve it. This must be a binding obligation on all the countries concerned, and particularly those which regularly export more than they import.

From another angle, it would seem desirable that the application of the principle of reciprocity should also be linked to a payments agreement. The effect of measures to ensure equality of benefits for a particular country might not be felt for some time, and meanwhile the country concerned would have to spend dollars, which are usually in short supply, to pay the creditor countries of the Area. Little imagination is needed to appreciate the reluctance of monetary authorities to support agreements on complementarity or tariff reductions designed to stimulate competition, if these are likely to entail disequilibria which will take time to correct. The debtor country must be given ample time to pay and the creditor country must be urged to use its balances for additional imports from the Area and, at the same time, to take measures aimed at preventing further disequilibria. All this would be done as a practical expression of the principle of reciprocity. Of course, such payments agreements, confined to the Area, would lose much of their point if an increase in exports to the rest of the world improved the balance of payments. In the meantime, they would stimulate the move towards the common market.

## II. THE OPERATION OF THE COMMON MARKET

### 1. *Promotional organs*

At this juncture another important question should be raised which calls for top-level policy decisions and concerns the need for promotional organs within the common market. First, however, a brief digression will be made on a subject that has a bearing not



only on the common market but on economic development in its broadest sense—the technically and economically backward state of Latin American enterprise in comparison with its counterpart in the great industrial centres. Unless an extensive and sustained effort is made to narrow the gap little by little, there is a danger of building on quicksands.

The formation of the common market offers a peculiarly favourable opportunity for finding a solution to this problem. There is general concern lest foreign enterprise, because of the superiority referred to above, as well as its knowledge of the different markets, will make better use of the vast opportunities for trade that are emerging in the member countries and assume a leading role in complementarity agreements and in the area in general. Unless the risk is averted, this great undertaking will not be able to advance very far because of the formidable opposition it is liable to provoke. The fundamental solution is to support Latin American enterprise so that it can acquire maximum impetus in the formation of the common market, and stand up to foreign enterprise, either by making common cause with it or by competing on an equal footing, since competition on an unequal basis usually entails the alternative of liquidation of the weaker party of its subordination to the stronger.

Systematic support for Latin American enterprise in industry and agriculture is called for in three main areas: (a) complementarity activities; (b) export activities, particularly in the countries that are less advanced and those that have not secured equality of reciprocal benefits; and (c) the activities that should be modified in the light of competition, as well as those that it may prove necessary to establish in order to absorb the manpower turned away in the process of adjustment.

Looked at from another angle, the work of promotion should be carried out in the two fields of tax incentives and of technical and financial action. On the technical side, a promotional organ should be set up to plan and organize the studies required for the fulfilment of the aims set forth above, in close contact with Governments and with the private sector.

The experience acquired by the ECLA secretariat through its contacts with industrial circles in our countries has convinced us of the need for promotion activities of this kind, and of the effective collaboration that can be given by these same circles. There is no suggestion that a vast and complex mechanism should be set up comprising a host of experts of various kinds; what is involved is preparatory co-ordinating work, the services of such experts being obtained within the present system of international or bilateral technical assistance, or on the basis of special contracts.

A promotional organ of this kind could also play a useful part in the submission of plans in order to obtain the requisite funds, as well as in the preparation of the projects in which the plans must find expression once they are approved in principle. This is another of the weak points in Latin American experience, with respect to which the promotional organ could help by channelling international technical assistance, both public and private, and combining it with local technical skills. Lastly, it could also collaborate in engaging the technical services necessary for putting the plants into operation in the first instance. Its functions would, in reality, be similar to those carried out by development agencies in some of the Latin American countries. In the present case its sphere of action would extend to several countries, but it would work in very close contact with the development agencies. In fact, it would be a kind of development corporation for the common market.

Support for Latin American enterprise in the formation of the common market must be complemented by suitable medium and long-term financing schemes. The Inter-American Development Bank has repeatedly evinced its determination to take an active part in this operation. If the Governments concerned decide to give a strong impetus to the advance towards a common market, by taking the major policy decisions that are needed, it may be asked whether the limited resources with which the Bank in question has come into being—apart, of course, from any subsequent requirements of the Latin American Free-Trade Area—will enable it to assume the leading role that it should undoubtedly take in this great task. Admittedly, there is no definite basis of judgement for determining the volume of additional resources that such special financing operations will need, but it would not be over-rash to estimate them at about 500 million dollars, in the form of quotas, with all due allowance for the possible and desirable participation of private foreign capital in complementarity arrangements.<sup>8</sup>

It is evident that the policy decision to create such a fund would be merely symbolic if it were confined to the member Governments. The United States has indicated that it is willing to cooperate in the formation of the common market; and its participation in this fund, besides being intrinsically significant, would be clear proof that its primary motive is not the desire to open up new fields for private United States investment, but the wish to make a positive contribution to the cultivation of our own development capacity.

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<sup>8</sup> This type of financing for common market industries and other activities should not be confused with the system of export credits that is being contemplated by IDB, although the two are of course closely linked.

This might also afford an opportunity for the members of the European Common Market—and other developed countries—to support the effort in question. It is true that such financial co-operation could not act as an alternative to the suppression of the discriminatory treatments applied to Latin American products and the modification of the excessive protectionism whereby their entry into the developed countries is hindered or prevented. Both measures are needed. But there can be no doubt that the technical and financial co-operation of such countries in the establishment of the Latin American common market, by whatever channel were deemed appropriate, and their backing for Latin American enterprise itself, will be of powerful aid in dispelling the concern and misgiving widely felt throughout the region with respect to its future relations with the European Common Market countries.

## *2. The economic unity of Central America*

The Central American countries have made significant progress towards the establishment of their regional common market. They have assumed firm commitments to put it into complete operation in a few years, and the Governments are displaying active interest in the planning of integration industries. Central America is thus moving towards economic unity, and will therefore be able to join the free-trade area as a unit, entirely without detriment to the implementation of its own plans. It should also be accorded the treatment established for an economic unit at a relatively less advanced stage of development, which would mean that it could reduce its external tariff vis-à-vis other States members of the Latin American Free-Trade Association at a slower rate than was expected of the more highly-developed member countries.

## *3. Progress towards the common market: magnitude of the effort required*

Practical and simultaneous action in all the fields just mentioned is an essential requisite if elements of automaticity are to be incorporated, without risk, in the system of targets proposed. But this same automaticity intensifies the urgency of the need to lay down clearly-defined guidelines for the gradual advance towards the common market, since from them will have to be deduced the indispensable basic principles for the formulation of each country's economic development plans. Planning itself, as it evolves, will gradually afford better criteria in the light of which to tackle common market problems. In other words, there must be a close and reciprocal relation between the principles determining the allocation of resources under national plans and the measures establishing the common market.

All this calls for a more sustained and far-reaching effort than Latin America has ever yet had to undertake. And it must be approached with foresight and courage, without which nothing great or lasting can be achieved in community life. Many formidable obstacles will have to be surmounted. Discipline will have to be imposed on competition; and competition conditioned by State intervention will necessitate major adjustments in economic activity as tariffs are lowered or eliminated. But this is a *sine qua non* for the dynamic effectiveness of the system.

Difficulties of another kind will also have to be faced. As a general rule, integration efforts are being carried out independently of the work of planning, and co-ordination will be indispensable. The proposals of the Latin American Free-Trade Association in this connexion are worth noting.<sup>4</sup> Similarly, integration efforts will have to be taken into consideration in the introduction of structural reforms, and instruments that are not incompatible with them chosen; while, in turn, the commitments emanating from such efforts will likewise have to be compatible with the structural reforms.

In other words, the advance towards the common market will entail a continuous series of co-ordination efforts, which will not be spontaneously generated, but will grow out of carefully-devised measures adopted at the national or international level, as the case may be. It will undoubtedly involve the imposition of discipline on internal economic policy—a discipline which in any event is inevitable, irrespective of common-market considerations. Over-valuation or under-valuation of currencies will cause serious disruptions of reciprocal trade. This does not mean, however, that the common market cannot be brought into operation, but merely that steps must be taken to put an end to such distortions, which do harm not only to inter-Latin American trade but to trade as a whole, besides producing other serious repercussions of an internal nature. The existence of a common market will certainly make the need for a sound monetary policy, adapted to development requirements, yet more imperative.

All this will not be easy. But too much is at stake in Latin America today for the difficulties to be shirked. They must be tackled in all fields, and discouragement, indifference and defeatism must not be allowed to gain ground among those who fail to grasp the true significance of what is going on. The course of events cannot be halted, for on the horizon glimmers the dawning of a

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<sup>4</sup> At a meeting of the representatives of the ALALC agencies concerned with the planning, encouragement and guidance of industrial development, which was to be held at Lima about the time of writing, several problems of this type were to be discussed.

new will to achieve—perhaps in the not too distant future—what at present is left undone, in a futile endeavour to perpetuate all that must be demolished because it no longer meets dynamic requirements. Let us demolish it with our own hands and in our own way, now, when history beckons impatiently to Latin America and offers it, in the midst of a world of antagonisms and anomalies, a unique opportunity to build anew, and to set its own vigorously authentic stamp on the ineluctable and sweeping process of change.