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Three dots (...) indicate that data are not available or are not separately reported.
A dash (—) indicates that the amount is nil or negligible.
A blank space in a table means that the item in question is not applicable.
A minus sign (-) indicates a deficit or decrease, unless otherwise specified.
A point (.) is used to indicate decimals.
A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.
Use of a hyphen (-) between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.
Reference to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated.
Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates.
Individual figures and percentages in tables do not necessarily add up to corresponding totals, because of rounding.

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Note by the secretariat

As the fifth anniversary of the death of Raúl Prebisch drew near, we set ourselves the task of organizing a seminar in order to examine some of the main areas of endeavour of ECLAC and of the man who had such a crucial influence on its development and growth. We were fully supported in this task by the Office of the Executive Secretary, which for some time now has been working to rebuild and enrich that pool of knowledge in the light of new regional and international circumstances and of the ideological confrontation which has accompanied them.

This seminar, which focused on "The ideas of ECLAC and of Raúl Prebisch", took place in Santiago, Chile, from 3 to 5 September 1990 and was attended by renowned members of Latin American intellectual circles. Some of these people had worked with Prebisch to help build the Institution and its theoretical foundations; others, of the same generation, had contributed ideas of a different stamp which also did their part to enrich the common pool of knowledge. There were also those who joined the effort later on and opened up new vistas, and still others who belong to a new generation which has had to face the challenges posed by a tumultuous and conflictive present, a present that has called the thinking of ECLAC into question.

In addition to representing a number of different generations, the assembled participants also represented different countries and areas of the region, although it is clear that some were not included for varying and valid reasons.

In honour of Raúl Prebisch, some of the papers presented at the seminar are being published in this edition of the *Review*. It should be emphasized, however, that the seminar's work was confined to addressing some of the basic areas of ECLAC's work, highlighting others that the current dialogue brings to the fore, and considering a number of national situations as a means of shedding light upon the diversity of the mosaic that forms this region.

OPENING STATEMENT DELIVERED BY THE EXECUTIVE SECRETARY OF ECLAC, MR. GERT ROSENTHAL, AT THE SEMINAR ON "THE IDEAS OF ECLAC AND OF RAUL PREBISCH"
(Santiago, Chile, 3 September 1990)

I would like you to know, first of all, that welcoming you to the opening session of this seminar is not just another routine event for me. It is the affirmation of an institutional identity which unquestionably bears the original stamp of Raúl Prebisch. It is a gathering of people who have helped to make ECLAC what it is, people who, although belonging to a number of different generations, have many things in common: firstly, their identity and calling as Latin Americans; secondly, their commitment to integral development; and thirdly, the fact that they approach their work in a way that strives to reconcile theory with praxis or, in other words, to bridge the gap between thought and action. These three traits have given this institution an identity of its own throughout the 42 years of its existence, an identity which sets it apart from other United Nations bodies and institutions and which, indeed, makes it unique among organizations of its type.

The other element which gives it this special identity –this originality– is the content of ECLAC thinking. This content is not static; the *ideés-force* of ECLAC were not conceived as a doctrine but rather as a dynamic body of thought which expressly recognized the need to adapt to changing economic and social circumstances, including those changes brought about by development policies themselves. As you will recall, Raúl Prebisch himself repeatedly called upon us to "re-work our ideas unceasingly".

This was no doubt the reason why, when Aníbal Pinto came to me with the inspired idea of holding this seminar, he hastened to make it clear that he was not thinking of a nostalgic event or of a retrospective or historical analysis of the germinal ideas of Raúl Prebisch and ECLAC. He told me that his intention was instead to analyse the major themes that concerned the pioneers of this institution, but within the context of present and future circumstances. His clarification was unnecessary: the analysis of past and present ECLAC thinking is an integral part of the effort to update its ideas which the secretariat has been making for some time now.

There is no question about the fact that ECLAC succeeded, in its early years, in articulating a coherent body of thought regarding Latin American economic progress in the initial decades of the post-war period and that this message became part of the region's collective consciousness. Some refer to this message as the institution's "*ideés-force*"; others simply call it "the thinking of ECLAC". By whatever name, this message both offered a conceptual framework and set forth general guidelines for action which were valid for the majority of the countries. In other words, many of these ideas proved to be highly relevant because they both fulfilled their purpose in pragmatic terms and served the equally important function of stimulating debate.

It is also clear that, beginning in the 1960s, this message was called into question from various standpoints and that it came under increasing fire in subsequent decades as changes –in the objective situation as well as in the prevailing interpretations of that situation– occurred both outside the region and within it. At the same time, the differences among various groupings of countries in the region were widening, thereby making it increasingly difficult to send a "message" that would be equally relevant to a small, agro-exporting country and to such a giant as Brazil. The secretariat's response to this questioning and to the changing times was, on occasion, a cause of some perplexity, although it was always tempered by attempts to update its original message. This was accompanied, as many of you know, by the emergence of a debate within the secretariat as to the wisdom of addressing all-embracing themes or of concentrating its efforts on specific problems. Be that as it may, the institution, faithful to its legacy, never renounced the idea of seeking out "Latin American paths" to development.

In all modesty, I believe that in recent times we have succeeded in capitalizing upon those many years of effort, in delineating what are at least the main parameters of an updated body of thought; these ideas are set forth in our study, *Changing Production Patterns with Social Equity*, with which all of you are familiar, and are part of what Osvaldo Sunkel, in his contribution to this seminar, has called "neo-structuralist" thinking. Our proposals and interpretations undoubtedly suffer from some gaps and weaknesses, but they nonetheless offer a frame of reference which will enable us to carry our work forward, to probe more deeply into some subject areas, to update our proposals on an ongoing basis as circumstances change, and to adapt them to the differing situations in individual countries.

Although it was not our specific intention, our recent proposals address the same concerns that were explored in the germinal works of the Commission, which also correspond to the major subject areas into which the discussions to take place at this seminar have been divided. Today, as yesterday, our attention is drawn to the subject of the application of technical progress to the production process, although now our main focus is on *systems* of production, in their role as vehicles of innovation, rather than on industrialization *per se*. Today, as yesterday, we stress the impact of the institutional rigidities and structural obstacles that hamper economic development, and therefore contend that the free operation of market signals is not in itself enough to overcome all those obstacles. Nevertheless, we also recognize that the redefinition of the role of the State and its adaptation to the new demands being placed upon it and society is an imperative of our times. Today, as yesterday, we place emphasis on the asymmetrical relations existing between the countries of the "centre" and those of the "periphery", even though our proposal as to how to rectify that asymmetry may have taken on a somewhat different shading. Today, as yesterday, we are concerned with social equity, and with democracy; we argue that there can be no lasting changes in production patterns without greater social equity, and that the converse is also true. Today, as yesterday, we seek modalities of economic integration that will be functional in terms of the national development strategies chosen by the countries of the region.

Thus, this seminar provides us with an opportunity to take a fresh look at old topics within a new context, as well as to avail ourselves of the presence of so many eminent representatives of different stages of Latin American economic and social thought. We are honoured by the presence of each and every one of you, from the pioneering Celso Furtado to my predecessor in this post, Norberto González; from my former colleagues Eric Calcagno and David Ibarra, to those who did so much to enrich the thinking of ECLAC in the 1960s and 1970s, such as Aldo Ferrer, Germánico Salgado, Felipe Pazos, Manuel Balboa and Fernando Henrique Cardozo; from the unfaltering champion of numerous causes, María de Conceição Tavares, to the many colleagues who still serve the secretariat as staff members or consultants and who are participating in this event; from Aníbal Pinto, the Director of the *CEPAL Review*, and Osvaldo Sunkel, the Director of the journal *Pensamiento Iberoamericano*, to the new generations of Latin American economists so ably represented by José Manuel Salazar, Félix Jiménez, Francisco Arroyo and Miguel Sandoval.

I am deeply pleased to extend the warmest of welcomes to you, and to express the hope that this inter-generational meeting will serve as a source of enlightenment, in the best ECLAC tradition, for the good of the countries of our region.

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The nature of the "principal cyclical centre"

*Celso Furtado**

In the author's opinion, Prebisch's greatest contribution was his idea of a structural rift in the international economy caused by the slow spread of technical progress and kept in being by the international division of labour which existed at that time. According to this approach, external trade was no longer viewed as an extension of the domestic economy but was considered to have a dynamism of its own which depended on the linkages between the central economies and the efficiency of the principal centre in exercising its "regulatory" functions.

An important difference between the United Kingdom and the United States, as principal centres, has been their degree of integration into the international economy. The United States had a low import coefficient, which weakened its potential external drive, whereas the United Kingdom had a high import coefficient: higher than that of its exports. Its trade deficit was covered by the remittances of profits generated abroad by its earlier investments. Those investments, for their part, had been financed by the initial trade balance generated by the country's situation of technological leadership.

The United States had not received the necessary preparation to act as the principal centre, and it lacked the capacity to act as regulator of the world economy. The relative decline in its rate of increase of productivity and the simultaneous drop in its rate of saving, which were to be observed as from the early 1970s, prevented that country from playing the role of principal centre of the capitalist economy, and this process accelerated still further in the 1980s with the appearance of a deficit which absorbed an amount of resources greater than the total private saving.

At present, the United States continues to play part of its role as the principal centre, since the dollar still continues to play a very important part in the world economy. Other countries, however, are now the main suppliers of international resources.

The article concludes that if the international economy is to keep on functioning without there being a true principal centre, there must be a system of regulation by consensus among the main central countries, and indeed, the world seems to be moving in this direction.

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In a summary presentation of his theoretical works,[1] Raúl Prebisch referred to the idea of "a system of international economic relations which I named the 'centre-periphery' system", which had arisen as a by-product of his reflections on the cyclical fluctuations that occur in international activities. At first, it seemed to him that the cycles originated in the economies of the industrialized countries and then spread to the international sphere. In that process of spreading, the countries specializing in the production and export of primary commodities behaved in a "passive" manner, even though the fluctuations in the level of economic activity affected them with particular force.

This reflection on the spread of the cycle led Prebisch to perceive that the system of the international division of labour had arisen primarily to serve the interests of the countries which were in the vanguard of the industrialization process. "The countries producing and exporting raw materials were thus linked with the centre as a function of their natural resources, thereby forming a vast and heterogeneous periphery incorporated in the system in different ways and to different extents." [2]

This global view of the capitalist economy, which revealed that it was suffering from a structural break initially caused by the slow spread of technical progress and perpetuated by the system of the international division of labour which existed at that time, was Prebisch's main theoretical contribution and formed the starting point for the theory of underdevelopment which dominated Latin American thinking and strongly influenced other regions of the world too. For Prebisch, underdevelopment stems from "the concentration of technical progress and its fruits in economic activities oriented towards exports", giving rise to heterogeneous social structures "in which a large part of the population remains on the sidelines of development". [3]

In this late synthesis of his ideas, Prebisch limited his explanation of the Centre-Periphery view to the structural imbalances caused by the slow spread of technical progress, which he claimed was responsible for the downward trend in the terms of

[1] Raúl Prebisch, "Five stages in my thinking on development", in *Pioneers in Development*, Gerald M. Meier and Dudley Seers (eds.), a World Bank publication, New York, Oxford University Press, 1984, p. 175.

[2] *Ibid.*, pp. 176-177.

[3] *Ibid.*, p. 177.

trade of the commodity-exporting countries. In his classic text of 1949,[4] however, Prebisch strove to construct the nucleus of a dynamic theory of the international economy on the basis of his Centre-Periphery view. He started with a critique of the current theory of balance-of-payments imbalances, which was a mere extension of the quantitative theory of money, considered in this case as being a good of unlimited demand (gold). Prebisch denounced the static nature of this theory, which merely registers the fact that "each disturbance represents transition from one period of equilibrium to another".[5] In his criticism he went further, however, noting that the prevailing theory might have had some validity when the centre of the capitalist economy was the United Kingdom, in view of the profound integration of that country into the system of the international division of labour, since the high degree of openness of the British economy (its import coefficient averaged over 30% between 1870 and 1914) meant that that country had a considerable capacity to respond to external stimuli. In the economy of the United Kingdom, its exports "fulfilled a dynamic function similar to that of capital investment".[6] If other industrialized countries activated their economies and increased their imports from the United Kingdom, the stimulating effect on the latter was felt immediately, so that British imports grew rapidly too. Thus, there was no tendency towards an accumulation of gold reserves by the then principal centre.

According to Prebisch, this situation underwent a radical change when the United States took over the function of the principal centre of the capitalist economy, since its import coefficient was extremely low. If the cyclical reactivation began in the United States, then the external inductive power generated by that country's imports was only small; if it began in another industrial economy, then the response of the United States economy was extremely slow. This unfavourable situation for the peripheral economies –which depend on external impulses for their growth– was rendered still more adverse by the constant downward trend in the latter country's import coefficient, which sank from 6% in 1925 to 3.1% in 1949.

[4] See ECLAC (Economic Commission for Latin America and the Caribbean), "Growth, disequilibrium and disparities: interpretation of the process of economic development", *Economic Survey of Latin America 1949* (E/CN.12/164/Rev.1), New York, Part I, 11 January 1951, United Nations publication, Sales No. 1951.II.G.1.

[5] *Ibid.*, p. 38.

[6] *Ibid.*, p. 36.

For Prebisch, the world economy is not just a structure which reproduces itself, but rather a system which registers cyclical expansion under the influence of the spread of technical progress. Departing from the traditional approach, which sees external trade as a mere prolongation of domestic productive activity –a sort of bartering of surpluses which makes it possible to increase the productivity of the relatively most abundant factors– Prebisch assigns it a dynamism of its own which depends on the interlinkages of the central economies and the efficiency with which the principal centre carries out its regulatory functions.

Contrary to what is implicit in the traditional balance-of-payments theory, the time factor plays a fundamental part in Prebisch's concept, and this factor is a function of the degree of openness to the exterior of the principal centre.

Technical progress spreads from the central economies outwards, while they in turn are under the influence of a principal centre. This process of interaction among the central economies underwent a considerable change when the United States became the principal centre.

In contrast with the first aspect of the Centre-Periphery concept –which was the starting point of the theory of underdevelopment– this second aspect was not duly elaborated in the years following its formulation, even though balance-of-payments imbalances had become the main problem of the international economy from the 1960s onwards.

Prebisch drew attention to the fact that when the United Kingdom was playing the role of the principal centre, its import coefficient was much higher than its export coefficient. Indeed, in the late 1920s the United Kingdom paid for a third or more of its imports with the profits from its investments abroad. The principal centre had initially built up its position thanks to its technological leadership, which was reflected in the strong penetration capacity of its exports and the consequent big trade surplus. Thus, a considerable proportion of British savings was quite naturally channelled abroad, so that, in a first stage, the principal centre played the self-created role of the main disseminator of technological progress. In a later stage, this principal centre received the benefit of the returns on these foreign investments: its currency was overvalued because of the entry of royalties and dividends, and this favoured an increase in imports over exports. This was the culmination of an economy which benefited from big returns from the profits generated abroad by previous investments.

Prebisch did not return to the question of the balance-of-payments adjustment problems of the central countries in the period following the appearance of his classic 1949 study. The entry into action of the Bretton Woods institutions seemed to indicate that this matter was now closed.

In the period from the end of the Second World War to the end of the 1950s, the United States enjoyed a substantial trade surplus on the current account which permitted it to finance heavy spending abroad in both the military and investment fields. This was the period of the "dollar shortage", which many economists attributed to the positive productivity differential of the United States economy. At that time, it was taken for granted that its leading position as regards productivity –the result of heavy spending on research and development– would guarantee the United States' position as the principal centre of the capitalist economy for a long time to come. The relatively faster growth of productivity observed immediately after the war in other industrialized countries was explained away as being due to the process of "economic recovery" in which they were involved. It was explained that when they got nearer the higher level which the United States had already reached, it would not be so easy for them to keep up uch high rates of growth in productivity.

Since the 1960s, however, there has been a process of profound changes in the relations between the central economies which has seriously affected the United States' position as the principal centre. The system of fixed exchange rates, which linked the dollar to gold, gave rise to a patent overvaluation of that currency, which adversely affected the external competitiveness of the United States economy. Paradoxically, this situation favoured foreign investments by United States firms, which also helped to put pressure on the country's gold reserves. In 1963, the Johnson Administration brought in the *Interest Equalization Act*, whereby it sought to check the outflow of capital –the first sign of weakness in the economy which had been acting as the principal centre of the capitalist world. An unexpected result of this measure was the strengthening of the incipient Eurodollar market, since United States enterprises operating abroad began to keep part of their liquid assets outside the country. With the accumulation of massive liquid assets in dollars in the Central Banks of certain central countries, as well as in United States private banks abroad, the convertibility of the dollar against gold could no longer be sustained.

The official suspension of such convertibility took place in 1971 and gave rise to a big increase in the price of gold. The dollar value (and, to a lesser extent, the value in terms of other currencies) of reserves held in the form of this metal rose exorbitantly, thus greatly inflating international liquidity. Two years later the United States Government definitively abandoned the fixed exchange rate system. In spite of the intervention of the most powerful Central Banks, there was a considerable devaluation of the dollar *vis-à-vis* the currencies of the other central countries, and the resulting flight towards real assets gave rise to a wave of speculation on international markets.

The prolonged overvaluation of the dollar –from the Second World War until 1973– must naturally have been a major influence in the weakening of the United States' position as the principal centre. In order to keep up that position, it would have been necessary to maintain a level of reserves and an accumulation of reproductive assets abroad capable of preserving the dollar from any threat whatever, regardless of the level of activity of the United States economy. The principal centre is the country which issues the currency that serves as a reserve for the whole of the capitalist system: a prerogative which naturally demands an exceptionally solid balance-of-payments current account position. By this I mean solid not only *vis-à-vis* changes in the international situation but also with regard to abrupt changes in domestic conditions. The monetary policy of the principal centre must also be such as to contribute to the fluidity of international flows of short-term capital.

If we take the analysis further, we see that it was not only the overvaluation of the dollar which helped to undermine the solidity of the position that the United States undoubtedly occupied as principal centre until the early 1970s. Nothing contributed more to this result than the burden of the United States Government's outlays on the establishment of a defence system with installations in every continent. The United States faced restrictions on its spending abroad precisely because of the relatively closed nature of its economy. With the passage of time, its huge military spending forced Washington to cover its outlays abroad with paper currency that it virtually forced into international circulation by obliging the Central Banks of other countries to build up excessive reserves in dollars which were subsequently transformed into United States Treasury debt paper. It is sufficient to observe the behaviour of military spending –an increasing proportion of which took place outside the country in the 1960s– in order to grasp the magnitude of the distortions produced in the United States economy, which reduced it to a situation of financial dependency *vis-à-vis* other central economies. In 1973, military spending represented 5.6% of the United States GDP, and this spending reduced the capacity of the public sector to make investments in economic and social activities. From that year onwards, a marked decline was to be observed in the growth rate of average United States productivity.

In the 10 years from 1973, productivity grew at no more than half the rate of the previous ten years. This slowdown in productivity growth did not prevent military spending from increasing, however, to such a point that it came to 6. 6% of GDP in 1983. Furthermore, the rate of saving dropped from 9. 5% to 6.7% over that same 10-year period. The truth is that United States society was simply not prepared for exercising the dominant international role that fell to its lot as a result of the Second World War.

The absence of a principal centre capable of keeping the capitalist economy in order is of course a major factor in the great upsets observed in the international economy from the 1970s onward, the most striking manifestation of which is the enormous size of the peripheral countries' external debt.

The disorder that took root in the international monetary and financial system as a result of the excess of liquidity caused by the crisis of the dollar was the factor that created favourable conditions for the process of indebtedness of almost all the countries of the periphery. In 1973, interest rates were not more than 2% negative, but the following year they went down to 6% negative, remaining extremely low until the end of the decade. This situation of maladjustment was aggravated in the second half of 1973 by the abrupt rise in petroleum prices, which permitted a group of countries with little or no capacity to absorb large amounts of financial resources to rapidly build up enormous reserves in the form of certificates of deposit in the international banks.

The imbalances caused in the external accounts of the central countries –almost all of them heavy importers of petroleum– led them to boost their exports. Thus, the efforts of the industrial economies to increase their external trade in the period following the oil price shock brought about an increase in the imports of the peripheral countries as well as the conversion of the excess liquidity of the international banks into loans to those countries. The under-developed countries, which had always had to struggle with a severe shortage of capital in the past, suddenly found themselves faced with a virtually unlimited supply of financial resources on the international market, and moreover at negative interest rates.

This combination of an unrestricted supply of capital on the international market, plus the striving of the central countries to correct the imbalances in their external accounts caused by the sudden rise in oil prices, explains the rapid build-up of external debt by countries which sought ways of increasing their growth rates or simply raising their level of expenditure.

The system of floating exchange rates, by permitting the rapid devaluation of the previously overvalued dollar, set off a wave of price rises at the international level. In the countries which were forcing their exports, financed by the banks which were trying to manage the glut of international liquidity, there were additional inflationary pressures too. Consequently, there was a run on real assets and on the building-up of stocks. Food prices on the international market rose by 54% in 1973 and 60% in 1974, while metal prices increased by 45% and 25% in the same two years. Double-digit inflation was widespread in the industrialized capitalist world: something not seen since the Second World War.

In 1979, the United States Government decided to abandon its carefree attitude to inflation and adopted a shock policy of the most uncompromising monetary type. The fact is that the international monetary system is based on the dollar, and Eurodollars are no more than a credit multiplier based on dollar deposits outside the United States. The United States monetary authorities therefore have the power to influence the international monetary market through manipulation of the monetary base in the United States. If the Federal Reserve raises interest rates, there is immediately a flow of financial resources towards that country, together with a rise in interest rates on the international market.

When it applied a restrictive monetary policy in these circumstances, Washington discovered how easy it was to finance its needs abroad, thus opening the way to the uncontrolled expansion of its own expenditure. The United States current account remained in balance up to 1978, but at the beginning of the 1980s it became negative: in 1983 the deficit came to US$45 billion, and by 1987 it had reached the staggering figure of US$147 billion.

The deficit on the United States current account was the second great break in the international structure of the capitalist economy, and it is the basic cause of the abnormal rise in real interest rates that has taken place over the last decade. In 1980 those rates were already over 8%, and by 1982 they had reached 12%.

Thus, two adjustment processes which took place in the central economies –the first one connected with the effort made by those countries to recover their external equilibrium after the first oil price shock and made possible by the uncontrolled glut of international liquidity, and the second one connected with the restrictive monetary policies of the United States Government and the financing of its fiscal deficit with resources attracted from abroad by high interest rates– lie at the root of the enormous debt now burdening the countries that make up the periphery of the capitalist system.

The relative decline in the growth rate of productivity and the simultaneous drop in the rate of saving which were observed from the early 1970s on prevented the United States from playing its role as principal centre of the capitalist system. This process speeded up in the 1980s with the appearance of a fiscal deficit which absorbed a quantity of resources greater than the whole of private saving. This qualitative change in the international position of the United States economy is illustrated by the behaviour of the enterprises of that country. Direct Japanese investment in the United States rose from US$4.7 billion in 1980 to US$53.3 billion in 1988, while direct United States investment in Japan grew from US$6.2 billion to US$16.9 billion over the same period. The same is true with respect to the European Economic Community, since direct investments by its member countries in the United States rose from US$50 billion in 1980 to US$193 billion in 1988, with United States direct investments in the Community growing from US$80 billion to US$126 billion over the same period.[7]

An important indication of the changed situation of the United States economy is that in the last quarter of 1987 the payments of interest and dividends to the exterior exceeded the receipts under this heading. In 1980, the net external investments position of the United States was positive to the tune of US$106 billion dollars, but as from 1985 the situation became negative. In 1986, United States assets abroad totalled US$1 067 900 million, whereas foreign assets in the United States in the same year totalled US$1 331 500 million.[8]

The problem now facing us is to know how the function of the principal centre is being carried out at present. The United States continues to carry out part of this function, since the international monetary system is still based on the dollar. However, the United States no longer plays the role of the main supplier of international financial resources, which is now carried out by Japan and the Federal Republic of Germany. All we need do is look at the balance-of-payments current accounts in recent years. In 1987, the deficit of US$147 billion dollars of the United States contrasted with the surpluses of US$84 billion for Japan and US$50 billion for the Federal Republic of Germany. This situation obviously cannot last for ever, since it involves the growing indebtedness of the United States to the other two great central countries. As long as this situation of financial dependence continues, interest rates will continue to be high, which means growing deterioration of the United States position. The negative consequences of this situation for the over-indebted countries are only too obvious.

In order for the capitalist economy to function properly in the absence of a principal centre, it is necessary that the main central countries should reach consensus on appropriate forms of regulation. It may be wondered whether the appearance of such co-ordination groups as the 10 and the seven main capitalist countries is not a step in this direction. However, there are only two countries which are really competing for the leadership of the system, and it remains to be seen whether these countries would not really prefer to extend the present process of increasing financial dependence of the United States. There would seem to be no doubt that we are moving in the direction of a system of regulation by consensus. However, such consensus will only reflect the will of a few countries, and the relative weight of these nations still remains to be determined. At all events, the possibility of a single economy playing the role of the principal centre no longer exists.

[7] Figures based on *Survey of Current Business*, published in *Le Monde*, Paris, 31 October 1989.

[8] UNCTAD (United Nations Conference on Trade and Development), *Trade and Development Report, 1988* (UNCTAD/TDR/8), Geneva, 1988, United Nations publications, Sales No. E.88.II.D.8, p. 68.

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The present morphology of the centre-periphery system

*Jan Kñakal**

In the 40 years or so that have elapsed since the first postulations by ECLAC and Raúl Prebisch on the centre-periphery system, two periods with different evolutions are clearly distinguishable: that of the 1950s and 1960s, which was marked by a rate of economic expansion unparalleled since the eighteenth century, and that of the following decades (especially from 1973 onwards) –usually known as the period of the energy and financial crisis– which has been characterized by the slackening and even complete stagnation of world economic development, especially in the peripheral countries.

Both periods have witnessed profound changes, the main aspects of which are summed up in the first part of this article in line with the original concepts of Prebisch and ECLAC: the polarization, marginalization and deteriorating terms of trade of the periphery in contrast with the changes in production and technology in the centre. In the second part of the article, an analysis is made of the changes in the periphery's relations with the principal capitalist centre and with the Eastern European countries, in the light of the evolution undergone by those regions. Finally, some comments are made on the unfinished history of the centre-periphery system.

This article is based on the seminal study published by Prebisch in 1949, on the research begun in the early 1970s in the ECLAC Economic Research and Development Division, and on studies by Aníbal Pinto and by the present author. The statistical data are taken from official publications of the United Nations, the World Bank, the United Nations Conference on Trade and Development (UNCTAD) and the Organization for Economic Co-operation and Development (OECD).

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I
The periphery

1. *Back where we started, but on an even more unequal basis*

Generally speaking, studies on the centre-periphery system have confirmed the validity of the fundamental theses of Raúl Prebisch and ECLAC on the relationship between the terms of trade, the polarization and marginalization of the periphery, the unequal spread of technology, and the vital need for industrialization. The situation of the 1970s, characterized by the meteoric rise of the Organization of Petroleum Exporting Countries (OPEC), the considerable improvement in commodity prices, the massive inflow of Eurodollars and petrodollars (but without tied direct foreign investment or other restrictive conditions), all of which led to the narrowing of the gap between North and South, was followed –especially in Latin America and Africa– by the "lost decade" of the 1980s, which brought these regions back to their starting point: i.e., the level already reached back in 1970.

Between 1970 and 1981, the terms of trade of the periphery rose by a factor of more than 2.5, but they then fell back in the 1980s to levels only comparable with those of the 1930s Depression. The period of booms and oil shocks which interrupted the periphery's relentless drift towards marginalization for the first time in history was followed by a drastic fall in the periphery's share in the world GDP and in international exports and investments. This deterioration attained dramatic levels in Latin America, which ceased to enjoy its traditional situation as a net importer of capital and instead began to export capital to the centre.

These general pictures conceal an important qualitative change in the traditional heterogeneity of the periphery: a regressive trend towards greater polarization between the nations and social strata struggling to keep their heads above water in circumstances of extreme poverty and those with aspirations to gradual entry into the industrialized centre. In 1965, the per capita GDP of the countries with a per capita income of up to US$400, which represent 55% of the population of the periphery, was equivalent to 4.5% of the corresponding GDP of the capitalist centre, but by 1985 it had dropped to only

2.2%. In contrast, the corresponding figures for the main oil-exporting countries (which have only 0.5% of the population of the periphery) were 53% in 1965, 132% in 1980 and 84% in 1985. The steadiest equilibrium was attained by the newly-industrialized countries of South and Southeast Asia.

In Latin America and the Caribbean, the "lost decade" was reflected in an 8.3% drop in per capita GDP, so that the region lost ground compared with Asia. Likewise, the region's share in world exports fell from 5.5% in 1970 to 3.8% in 1987.

In view of the fact that in underdeveloped countries economic crises have regressive effects on national income distribution, it may be concluded that in the 1980s there was a worsening of the situations of extreme poverty and of polarization of the system, both in relation to the centre and within the periphery itself.

2. *Marginalization and dependence*

In the peripheral countries, the energy crisis and (after 1982) the debt crisis had a marked influence on the nature of their traditional marginalization and their dependence on the centre. The longer-term structural changes which had been building up in the centre and also in part of the periphery (especially Asia) likewise influence the links between the two poles.

In the mid-1980s, the periphery satisfied less than a quarter of the total external demand of the centre: that is to say, its degree of marginalization was just as great as in 1960 (although its importance to the centre had increased during the energy crisis). The opposite relationship –that concerning the degree of dependence of the periphery's exports on the markets of the centre– remained almost three times as great (72%) in the 1960s and 1970s, but went down markedly in the 1980s: in 1984 over a third of the periphery's markets were outside the centre. A similar change took place in the periphery's dependence on imports of manufactures from the centre, even though in 1984 over three-quarters of the periphery's needs were satisfied from that source. These changes were due to the stronger horizontal links within the periphery and its relations with the socialist countries. They also reflect the considerable progress made in increasing the industrial content of the periphery's exports.

On the financial level, there has been a process of transnationalization due to the growing dependence of the periphery on the commercial banks of the centre, at the expense of official aid and direct foreign investment by transnational enterprises. Between the early 1960s and the mid-1980s, the importance of the commercial banks rose from 6% to 25%, official aid dropped from 56% to 40%, and direct foreign investment fell from 19% to 11%, all as proportions of total financial flows. Moreover, these flows were used mainly to refinance and service the "unpayable" debt. The share of the periphery in direct foreign investment flows fell from 26% in 1981 to 17% in 1988. In the latter year, Asia took first place, absorbing 52% of the total flows to the periphery, compared with 37% for Latin America (moreover, half the latter figure corresponded to debt conversion, so that there was in fact no contribution of fresh capital).

3. *The frustrated hopes of the New International Economic Order (NIEO)*

The challenge by OPEC and the commodity boom in the first five years of the 1970s paved the way for important initiatives by the peripheral countries which seemed to indicate a strengthening of the bargaining power of the exporters of petroleum and other commodities *vis-à-vis* the industrialized centre countries. Among these initiatives, which were mainly promoted by the Group of 77 in their capacity as representatives of the periphery in the United Nations system, were: the Declaration and Programme of Action on the Establishment of a New International Economic Order (NIEO) (General Assembly, 1974); the Conference on International Economic Co-operation (Paris, 1975); and the global negotiations on international economic co-operation for development and the formulation of the international development strategies for the 1970s and 1980s (General Assembly).

Within UNCTAD, negotiations took place on particular demands by the periphery such as those reflected in the Integrated Programme on Commodities and the associated Common Fund; the agreements on specific commodities, and the Compensatory Financing Facility. In addition –following the example of OPEC– various associations of countries that produced and exported certain commodities such as copper, tin, coffee and bananas were set up or strengthened. In the case of coffee and bananas, efforts were also made in Latin America to reduce the oligopolistic power of the transnational corporations in the marketing of these goods by establishing multinational enterprises formed by the countries of the region themselves (PANCAFE and COMUNBANA).

The failure of the periphery's plans (as incorporated in the demands of the NIEO and other global or partial programmes) to come to fruition, plus the deterioration of the terms of trade with the centre, meant that when the debt crisis came the periphery's bargaining power was seriously weakened. As ECLAC had already foreseen in 1973, it had not been possible to achieve any substantial turnaround in the relative positions of strength of the centre and the periphery.

There were many reasons for this frustrating outcome. On the one hand, the energy crisis and the stagnation of the world economy led to a fall in both the export volumes and prices of primary commodities. On the other hand, and taking a longer-term view, it must be remembered that the centre's demand for the periphery's commodities is always in strict relation with the structural changes and technological progress (the "Third Industrial Revolution") that have taken place in the industrialized countries.

4. *The consequences of the changes in production and technology in the centre*

Important trends towards changes in production patterns are to be observed in the centre. Thus, there is a decline in the growth rate of manufacturing, favouring in particular the services sector. In the United States, for example, the share of services in the GDP rose from 41% to 50% between 1974 and 1986, while there was also a radical change in the structure of personal consumption: in 1960 spending on food and clothing accounted for 37% of the family budget, but by 1987 this had gone down to 26%, largely in favour of services. A similar situation is to be seen in other industrialized countries.

Within manufacturing itself, the traditional branches (metal products, machinery and equipment ment and basic consumer goods) are losing relative weight to electrical equipment and especially microelectronics. This is due to the greater demand not only from military activities and the space race, but also to the worldwide development of international informatics, telecommunications and telematics services. According to OECD data, between 1970 and 1985 the relative importance of imports based on natural inputs fell from 31% to 22%, to the benefit of diversified goods in which research and development applications predominated.

Technological changes involving the use of new types of materials and energy, miniaturization, automation and robotization point in the same direction of saving inputs and labour and attaining greater efficiency, as do the ever-wider application of biotechnology and the changes in the organization and linkages of the transnational corporations, integrated manufacturing systems, the "just in time" (JIT) principle, etc.

The trends displayed by the new style of development of the centre, further strengthened by its technological reaction to the energy crisis, usually have two main consequences for the periphery. Firstly, in real terms they further intensify its marginalization from the centre, thus increasing the latter's relative advantage as regards spearhead technologies, based on the intensive use of human knowledge, which are gradually driving out the technologies that make intensive use of labour, natural resources, energy and capital. In other words, there is a further worsening of the unequal spread of technological progress and the dependence of the periphery on the transnational corporations of the centre, which are the leading actors in these changes.

Secondly, the new style of development of the centre has important repercussions on its own interests and its global and individual policies towards the periphery. The industrialized countries not only consider the New International Economic Order promoted by the commodity-exporting countries using cheap labour to be dead and buried but are also putting forward new demands and new international policies concerning the expansion of the transnational trade in services, their export, and the right of foreign direct investments to enjoy the same treatment as national investments on the markets of the recipient countries; the provision of effective protection for the intellectual property of transnational corporations; and the replacement of the Code of Conduct on the latter through the gradual elimination of the Trade-Related Investment Measures (TRIM). According to the industrialized countries –especially the United States, judging from its statements in the Uruguay Round of GATT– these are the main government measures (applied by the countries that receive direct foreign investment and investment by branches of transnational corporations) which affect the centre's trade and financial freedom.

The countries of the periphery, of course, naturally defend their right to regulate the inflow of foreign investment in accordance with their own needs and to develop their own spearhead technology, as in the case of the pharmaceutical, computer and informatics industries in Brazil.

The above hypotheses seem to be confirmed in the international trade in foodstuffs. As the agricultural production of the centre has not yet been incorporated in the new style of technological development and the periphery still enjoys in most cases the advantages of its environment and its relatively cheaper labour, the governments of the industrialized countries are obliged to protect the interests of their farmers (who still form an important social and electoral group). According to UNCTAD data, over the last 10 years the five most important markets (United States, European Economic Community, Japan, Australia and Canada) have considerably raised their subsidies to their producers of milk, sugar, wheat, rice and maize. In 1987-1988 the United States and the EEC gave an annual average of US$25 billion in support to their farmers: that is to say, much more than in the 1982-1985 period (US$15 billion). In 1980-1983 Japan spent an average of US$13 billion per year for the same purpose. In order to get an idea of the importance of the centre's protectionist practices in agriculture, it is only necessary to note that in 1984 the periphery's exports of foodstuffs to these three areas totalled some US$32 billion, while the direct subsidies were also supplemented with tariff and other barriers (import quotas, plant health rules, etc.).

5. *The industrialization of the periphery and Latin America's lag in this respect*

The faster growth rate of manufacturing on the periphery compared with the centre has meant that between 1965 and 1985 the former increased its share in world manufacturing production (from 15% to 18%) and especially in exports (from 7% to 18%). The countries of Latin America and the Caribbean display a relative lag in this respect, however, compared with other regions and especially the newly-industrialized countries of South and Southeast Asia. If the degree of industrialization is measured as the share of manufactures in the total GDP, the stagnation of the region's industrialization process is to be noted not only during the economic and financial crisis of the 1980s but also in the longer term.

In the 1960s the degree of industrialization of Latin America and the Caribbean increased from 21% to 23%, rising still further to 24% in 1980, only to drop back to its 1970 level in 1983. In contrast, the industrialization of South and Southeast Asia was steady and unbroken: it rose from 14% in 1960 to 16% in 1970 and 21% in 1980, and was still at that level in 1983. In the latter year, the share of manufactures in the external sales of the main exporters of such goods –among which the only Latin American country was Brazil– reached a level of 27%.

The lag is even greater with regard to the periphery's share in the markets for manufactures. Between 1970 and 1984 these products more than doubled their share in the total exports of the periphery to the industrialized countries (from 14% to 30%), considerably exceeding the share of primary commodities other than fuels (22% in 1984). Apparently, the dynamism of the periphery's performance in the international economy will always be determined by the degree of industrialization of its economies and of its trade. During the period in question, however, the share of manufactures in the total exports of South and Southeast Asia rose from 44% to 63%, whereas the corresponding proportions for Latin America and the Caribbean were 7% and 19%, respectively. Over the same period, the presence of the Asian subregion on the markets for manufactures in the centre trebled from 3% to 10%, thus matching the levels of the industrialized countries of the European Free Trade Association (EFTA), whose manufactures represented 64% of their total exports in 1984 and supplied 9% of the world market. The relative lag of Latin America (19%) and the Caribbean (2%) is therefore a basic issue in the regional debate on the need to change production patterns and raise the international competitiveness of Latin American exports.

6. *Preliminary conclusions*

The rise and fall of OPEC and other commodity producers' associations would seem to indicate that when the historical downward trend in the terms of trade between commodities and manufactures (including services) was reversed thanks to the unilateral raising of the prices of some commodities, this did not automatically bring about the more balanced spread of technological progress or reduce the marginalization and state of dependence of the periphery.

This state of dependence and the financial exactions involved in the export of capital to the centre through the transnational banks were more salient factors than the commercial exactions due to the unfavourable terms of trade. It was therefore vitally necessary to reappraise both the role of the productive transnational enterprises and that of governmental financial assistance from the centre (even through its international organizations) with a view to reducing the burden of the "unpayable" debt.

The strategy of the Latin American governments and ECLAC for the 1990s, which seeks to achieve changing production patterns with social equity, reflects the experience accumulated in the deeper analysis of Prebisch's original postulations that industrialization is essential if the periphery is to improve its position on world markets, where it is currently at the mercy of the demand for primary commodities, the role of which in economic growth is shrinking at an everincreasing rate because of the present technological revolution.

Finally, the new endogenous and integral nature of technological progress –especially in electronics and informatics– also calls for a reformulation of the original thesis of a passive role for the periphery in the propagation and spread of such progress. In order to modernize and attain greater international competitiveness, the economies of the periphery must take active steps to gain possession of advanced technology (as occurred in Japan and other Asian countries and in Brazil). This can be achieved through the application of suitable State policies and, above all, the mobilization and stimulation of the economic and social agents by assuring them greater equity in the distribution of the fruits of progress.

II
The centres and their links with the periphery

1. *The capitalist centres*

While the regressive differentiation of the periphery continues, the correlation of economic forces in the capitalist centre moves towards greater equilibrium. Regardless of the ups and downs of the short-term situation, such as the past energy crises, the current financial crisis and the impact of "Reaganomics", in the long term a single clear tendency prevails: the economic hegemony of the principal centre (the United States) is weakening compared with the emerging powers in Europe (Germany) and Asia (Japan). At the same time, the new centres and the former principal centre are locked in a mutual struggle and are forming regional blocs of countries with common characteristics and interests. Without going any further into the complex history and causes of this process (which are analysed in this same issue of *CEPAL Review* by Celso Furtado), we will simply outline its longer-term projections in the cases of the United States, West Germany and Japan, especially insofar as they affect the periphery. Over the period 1950-1987, Japan's average economic growth rate was more than double that of the United States (7.1% and 3.2%, respectively), so that it jumped from ninth to fourth place in the world GDP table, moving ahead of West Germany, which had moved up from sixth to fifth place. In 1987, the per capita GDP of Japan and West Germany was nearly US$10 000 –only a third less than that of the United States. In the same year, the first exporter in the world was West Germany, with the United States second and Japan third. Germany and Japan were also ahead of the United States in improvement of labour productivity, propensity to save and invest, and world financial position (West Germany and Japan were the world's leading creditor countries, while the United States was the principal debtor). The relative decline of the former principal centre also extended to its direct foreign investment: in 1986 it invested US$26 billion less abroad than the year before, but it absorbed 41% of the total world flow of direct foreign investment: i.e., half the total for the whole of the industrialized countries.

For 25 years (1960-1985) there was a trend towards the marginalization of the periphery from the markets of all the industrialized centres except Japan. The periphery suffered worse marginalization in the United States market than in Europe, but its share of the Japanese market increased. Between 1970 and 1985, the share of Latin America and the Caribbean in the United States market went down from 15% to 12%, and their share in the African market fell from 4% to 2%, but their share in Asia rose from 9% to

17%. The strengthening of the links between the United States and the newly-industrialized countries of Asia led to the disappearance of the latter's traditional preference for Latin America, however.

In the markets of the Western European trade groupings (EEC and EFTA), the share of the periphery also suffered a decline, with these groupings maintaining their traditional preference for the Asian and African countries, which, in 1985, accounted for three-quarters of their imports from the periphery. In that year, Latin America's share in the EEC market was only a quarter of its level of trade with the United States, while in the case of EFTA it was only one-sixth. The delinking between Europe and Latin America was clearly reflected in the EEC's exports to the region, which went down by 38% between 1981 and 1985 (compared with drops of 20% and 11% for the exports of the United States and Japan). In 1985 Europe's trade deficit with the region was US$12 billion. This imbalance confirms the ECLAC theory: in order to pay the debt and at the same time increase imports from the centres it is essential to lighten the debt burden and achieve greater openness (less protectionism) of the markets of the centres. In the case of the EEC, the most important issues are the preferential treatment (discriminatory against our region) granted to the 64 ACP (Africa, Caribbean and Pacific) countries under the Lomé Convention and the subsidies and protectionism involved in the Common Agricultural Policy.

The manifestly growing importance of the Japanese market for the periphery is due largely to its continued dependence on oil imports and the emergence of a new integrated centre for the Pacific nations. Between 1985 and 1987, for example, the exports by South Korea and Taiwan to the Japanese market increased from US$7.5 billion to US$15.2 billion: i.e., they doubled in three years. The links with the Japanese transnational enterprises and banks that (together with the similar United States firms) make possible the access of the newly-industrialized Asian countries to spearhead technologies and trade in highly sophisticated goods are also growing. Japan is becoming the new centre of a subregion characterized by very dynamic growth and rapid change in the fields of production and technology.

Africa and Latin America have always been more marginalized from the Japanese market. In contrast with this marginalization (a 4% share in 1985), however, there has been the larger financial investment directed to the region. Whereas the flow of direct foreign investment from the United States went down, the average annual flows from Japan increased by a factor of over 2.5 between 1976-1980 and 1981-1984: much more than those directed to the industrialized nations or the other developing regions. The role of Latin America in the direct foreign investment and also in the loans of the Japanese transnational banks suggests that that country could help to solve the debt crisis in the future by promoting changes and modernization in Latin America's production and increasing the region's exports.

2. *The Eastern European member countries of the Council for Mutual Economic Assistance (CMEA)*

In order to understand the profound economic and social changes that have taken place in the Soviet Union and Eastern Europe, it is necessary to bear in mind their structural crisis. The concentration of resources on extensive industrialization enabled these countries to attain higher growth rates than the centre-periphery capitalist system during the period of expansion of the world economy. Centralized planning and management ran into a crisis situation in the late 1960s, however, in the relatively more highly developed economies of the German Democratic Republic, Czechoslovakia, Hungary, and later Poland. These countries most clearly reflected the common problems of lagging technology and low labour productivity associated with a voluntaristic economic approach and isolation from the capitalist markets.

The period of peaceful coexistence of the 1970s, with its greater openness for economic and cultural exchanges, showed that the military and geopolitical balance between the socialist and capitalist blocs was not matched in the economic sphere, and especially in its spearhead sectors (except in areas directly related to the military competition between the two superpowers).

These domestic factors were compounded by the effects of the energy crisis and the world economic recession, which slowed the growth of the socialist countries and reduced their capacity to compete with the capitalist system. According to UNCTAD estimates, between 1975 and 1982 those countries' share in world GDP went down from 12% to 9%, while their share of world trade fell from 11% in 1960 to only 8% in 1987.

The loss of dynamism and international competitiveness of the CMEA countries may be illustrated with some indicators of the economic competition between the Soviet Union and the United States. In the 1960s, the Soviet Union was catching up on its big lag behind the United States in terms of national income and manufacturing product, since the gaps of 42% and 45% which had existed in 1960 had been reduced to 35% and 25% by 1970. Fifteen years later, in 1985, however, the corresponding lags were 34% and 20%: i.e., only a little less than in 1970. Moreover, in 1985 the lag was even greater in per capita terms: 43% in the case of national income and 31% in manufacturing product (all these data are taken from official USSR statistics).

The USSR's lag was even more marked as regards the structure and efficiency of its production. According to the same official statistics, in 1960 the labour productivity in Soviet manufacturing was 56% less than in the United States, and although by 1970 the gap narrowed to 47%, in 1985 it was almost as great as ever: 45%.

The stagnation of the international competitiveness of the countries practising "true socialism" is connected with the semi-peripheral nature of their participation in the world economy. To begin with, they concentrate on trade within the CMEA, and this tendency was further strengthened in the 1980s when the Soviet Union's comparative advantages as an oil exporter were reduced (the weight of intra-CMEA trade in the bloc's transactions went up from 51% at the beginning of the decade to 58% in 1987). Such cohesion within the CMEA was due more to the centralized political system than to the comparative advantages of its participants. The principal centre of the system, the Soviet Union, mainly supplied its partners with petroleum, gas and other primary commodities in return for their manufactures. Its fellow-CMEA countries, for their part, needed Western technology to modernize their economies, and because of the shortage of hard currency, aggravated by the energy crisis, they ran up heavy debts with the countries of the capitalist centre. The most flagrant case of this was Poland, which, like Mexico, suffered a veritable financial collapse in 1980 when the external debt service commitments exceeded the payments capacity of exports.

Secondly, the links of the Soviet Union and Eastern Europe with the industrialized countries are also of a peripheral nature. In 1987, only 21.5% of the CMEA countries' total exports went to the industrialized countries, and they represented only 2.5% of the latter's imports (6.4% for EFTA, 3.2% for the EEC and 0.5% for the United States). This marginalization is largely due to the prevailing type of trade: in the mid-1980s fuels and other primary commodities accounted for a bigger share of the CMEA countries' exports than those of the periphery (78% as against 70%), while although manufactures predominated in the CMEA's imports (57%) an increasing proportion of the latter consisted of foodstuffs (because of the Soviet Union's grain deficit).

Thirdly, trade with the countries of the periphery had less importance for the CMEA countries than for the capitalist centre (12% for the latter but only 5% for the former in 1987). Moreover, the predominantly political criteria of the CMEA countries caused them to prefer to trade with the socialist countries (Cuba and some Asian countries), which accounted for over a third of this trade, with the discrimination being even more marked in the case of official financial assistance, about two-thirds of which went to the latter-named countries. In the sectoral composition of the CMEA's mutual trade, fuels and other primary commodities predominated, with manufactures playing a bigger role in the group's exports than in its imports. Latin America's exports satisfied only 4% of the total demand of the CMEA countries, and even then this trade was mainly limited to Cuba and Argentina (sugar and grains).

3. *The horizontal linkages of the periphery*

The continual marginalization of the periphery from the markets of the centre has been accompanied in recent decades by an increase in the importance of horizontal links within the former: i.e., an increase in mutual trade in goods within the peripheral area. In this aspect too, however, the Latin American region has lagged behind. Thus, intra-regional trade went down from a peak of 19% in 1980 to only 14% in 1987, when the degree of regional integration was 27% for the periphery as a whole (excluding the OPEC countries) and as much as 61% for the European Economic Community.

The effects of the debt crisis and the political situation in Central America were not favourable to economic co-operation in the region. Fortunately, the democratization process in the Southern Cone has involved the establishment of major programmes of sectoral integration and business co-operation between Argentina and Brazil and, more recently, Uruguay too, and there are prospects for the expansion and deepening of this process to include other countries such as Chile. As this first phase involves relatively industrialized countries, it may be assumed that this economic integration process will advance faster than previous initiatives and that it will further the transformation and modernization of the economies in question.

III

The unfinished history of the system, and some queries for the 1990s

Francis Fukuyama recently said that with the collapse of true socialism in Eastern Europe the history of mankind has come to an end: in other words, omnipresent capitalism is entering upon a period of everlasting peace. The development of the centre-periphery system since that term was coined by Prebisch and ECLAC in 1949 –i.e., its evolution over four decades since the end of the war– shows that this is a biased and voluntaristic view, however. Our generation –young hopefuls when the war ended but now advanced in years– has gone through various failures and seen the frustration of its forecasts of both triumph and disaster. Let us recall, for example, the pride and ambitions of the young African nations freed from the colonial yoke, only to be followed by tribal wars and mass famine; our joy at the exploits of OPEC in 1973, with the prospect of an unlimited flow of petrodollars; the adoption by the United Nations General Assembly of the New International Economic Order, the International Development Strategies for the 1970s and 1980s, the UNCTAD programmes, etc., only to culminate in the present lost decade for the region, and more recently the buoyantly hopeful programmes of the post-dictatorship governments in Brazil, Argentina and Peru, contrasting with the present economic and social chaos in those countries.

With regard to disasters, the author would like to make just one personal and self-critical comment which is totally contrary to the position taken by Fukuyama: the whole generation of Czechoslovak stalinists and, after the Russian occupation in 1968, reformists, revisionists and "traitors to the cause" lived and strove to further their views under two false slogans, which, it may be noted, were shared by most of the European and Latin American left. The first of these was the need to write "finis" to the history of world capitalism in the present phase of its general crisis heightened by neo-imperialism, global transnationalization, the struggle between rich classes and nations and their exploited and dominated counterparts, and so forth. According to Stalin, Khrushchev, etc., the five-year plans of the Party and the State would make it possible to catch up with and overtake the decadent imperialist economies –especially that of the United States– and attain world socialist revolution, based on Leninist/Soviet, Maoist Chinese or Castroite Cuban models.

The second disaster theory –that of the local opponents of the communist governments, shared by distinguished Kremlinologists and Western statesmen– was that it is not possible to attain from within or by peaceful means any thorough-going or systematic change in an Eastern Europe dominated by the administrative and military apparatus of a superpower permeated with the Brezhnev doctrine. The result which we now all know so well is the perestroika of Gorbachev and the bloodless revolutions of Eastern Europe (setting aside, of course, the terror unleashed by the tyranny of Ceaucescu and, in Asia, the Tianamen massacre).

The fate suffered by the triumph- or disaster-oriented approaches shows that the history of mankind and of the centre-periphery system has not come to an end, as Fukuyama claims, with some specific events, even though these may decisively influence the course of a particular period in history. On the contrary, we believe –in line with the views of our great friend and mentor Aníbal Pinto– that the greatest challenge for analysts is the fact that the history of the centre/periphery system is not yet complete. The same is true of the thinking of Raúl

Prebisch and his perhaps over-modest band of disciples. Francis Fukuyama's forecast implicitly includes the thesis –shared by many public figures and intellectuals not only of the Centre but also of Latin America– that the validity of the centre-periphery approach is now a thing of the past for all of us and that we now universally and definitively accept the neo-liberal approach, albeit subject to some of its many qualifications. The work done by ECLAC in recent years, and especially the common governmental programme adopted in Caracas on change and modernization with social equity, however, also gives the lie to this view, which claims the triumph of the so-called "Chicago boys" and the rout of those of us from ECLAC who are cast in the Prebisch mould

Moreover, it stands to reason that a substantial group of distinguished personalities did not meet in Caracas earlier this year simply to pay a nostalgic tribute to Raúl Prebisch, nor to justify his proposals with one of the many works of the Master, along the lines of the selective utilization of the dogmas of Karl Marx the younger or the elder, but came together rather in order to develop the unfinished thinking of the ECLAC of Prebisch's days, in an open and innovative discussion.

Among the questions that we might raise with regard to the situation at the end of the century are the following:

— Will the new situations as regards world production, trade and finance lead to the heightening of inter-capitalist competition and the emergence of a new principal centre, or will they result rather in a better regulated or co-ordinated multipolar balance?
— What will the system be like without the principal centres?
— What links will it have with the ongoing military hegemony of the two superpowers?
— What effects will be exerted on the periphery by, firstly, the profound geopolitical changes involved in the creation of a European Common Market including a unified Germany and the subsequent successive entry into that market of the Eastern European countries; secondly, by the integration or formation of blocs between the United States, Mexico and eventually other countries of the region under the Bush initiative; and finally the process of integration in South and Southeast Asia under the aegis of Japan?

Decidedly, the history of the centre-periphery system is still far from finished.

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The early teachings of Raúl Prebisch

Aldo Ferrer

This article recalls two periods in the author's relationship with Prebisch. The first relates to Prebisch's teaching at the University of Buenos Aires in 1948, and the second to his work as economic advisor to the Argentine Government that followed the overthrow of Perón in 1955.

As a result of his disagreement with traditional economic thought, Prebisch, in his capacity as a shaper of Argentine economic policy in the 1930s, searched for solutions to the problem of the massive imbalance in external payments. To do so, he had to break new ground in matters of fiscal, foreign-exchange and monetary policy. In this effort, Prebisch was one of the first economists to recognize the Keynesian revolution and make it known in Latin America. On the basis of these ideas, he developed a point of view concerning industrialization and State intervention in foreign-exchange operations and other markets.

In 1955 the set of proposals which he presented to the new Argentine Government was called the Prebisch Plan. In the new circumstances, Prebisch's first concern was to restore macroeconomic balances through an adjustment process. These short-term proposals encountered considerable resistance in Argentina, a country in which both images of Prebisch are still remembered today.

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Raúl Prebisch was my Professor of Political Economy at the University of Buenos Aires in 1948. From that time until the end of his life, I maintained a friendly and warm relationship with my former teacher, although it was not without disagreements concerning Argentine economic policy. In this article, I recall two periods in my relationship with Prebisch: his early teaching at the University of Buenos Aires and his work as economic advisor to the Argentine Government after the overthrow of Perón in 1955.

When classes began in the academic year of 1948, the story spread through the Economic Sciences Department of the University of Buenos Aires that Raúl Prebisch would be teaching Economic Dynamics again. He had withdrawn from teaching when he resigned as the General Manager of the Central Bank after the military coup of 1943. Prebisch's return generated an air of expectancy. Most of us students felt a visceral opposition to the conservative regimes which Prebisch had served in important posts. Nevertheless, his academic prestige placed him above the vicissitudes of political life.

On the first day of classes, in mid-March, Prebisch entered the small lecture room at the intersection of Avenida Córdoba and Junín, facing the present site of the Professors' Hall. That day I watched the arrival of a fine-looking man, head erect, of medium height, in his mid-forties. His dark suit, white shirt and pale tie gave him an elegance that matched his demeanour. He stepped up onto the podium, looked out over his audience and began in a firm and steady voice: "Gentlemen, today we shall start a course in which I propose to present to you my ideas about the behaviour of the economic system under present-day conditions."

Simultaneously with the course, Prebisch conducted a seminar which gave students a greater opportunity for dialogue and closer acquaintance with the Professor. In the first meeting of the seminar, Prebisch put a question to the students. He began by saying that he was profoundly disillusioned with the neoclassical thought prevalent in academic circles at the time, with its interpretation of problems and with its principles of economic policy. Then he asked: "To what do you attribute this reaction of mine to traditional economic thought?" The students remained silent for a few moments. Watching the Professor's look of expectation, I found the courage to reply: "Doctor", I said, "the reason must be that kind of thought does not help solve the problems of the real world". Prebisch looked at me and answered: "Exactly, that's right." He went on to discuss the problems he had faced in shaping Argentine economic policy during the 1930s, especially in the management of the Central Bank. He explained that the conventional approach was incapable of responding to the consequences of the world crisis and its impact on the Argentine economy. Then, tentatively and without a theoretical frame of reference, he proceeded to search for the fiscal, monetary and foreign-exchange policy answers that would help in resolving the severe imbalance in external payments caused by the collapse of the buying power of exports and the marked decrease in production and employment. In practice and throughout this search, Prebisch promoted and applied compensatory policies which would prove to be pioneering ideas at about the same time by a Professor at Cambridge whose theoretical foundations were being laid down. Prebisch was one of the first economists to take note of the Keynesian revolution and disseminate it in Latin America.

At the end of each meeting of the seminar, Prebisch left the Department and walked toward the corner of Callao and Charcas, the former site of our school. Don Raúl was always a great one for walking. Among the factors that explained his excellent health, he included walking, a form of exercise to which, years later, aerobic functions would be attributed. Prebisch knew this instinctively without the aid of the theories of Dr. Cooper and other specialists in the subject. I accompanied Prebisch many times on those walks.

One of the assignments in the seminar consisted in preparing brief monographs. My first academic work in economics was assigned by Prebisch and consisted of a commentary on Fritz Machlup's book on the multiplier effect in foreign trade. The Professor liked my work and remarked: "You have a considerably larger vocabulary than most economists, whose knowledge of language is rather mediocre." Prebisch always maintained a justified concern with questions of style. The clarity of his own language helps to explain the impact of his ideas. His works can be understood. This is more than can be said for the intellectual products of a good many of his colleagues, who surround the discipline with frequently sterile exercises reserved for the experts.

At mid-year, the course and the seminar ended. Shortly thereafter, the Government again barred Prebisch from teaching. Thus ended his teaching career at the University of Buenos Aires. Prebisch then sought new horizons abroad which later established him as the most famous economist of Latin America and of the developing world.

The ideas which Prebisch disseminated in his writings through ECLAC were first put forward in organic fashion at the University of Buenos Aires in 1948. It is no accident that the renovation of economic theory in Latin America was begun by an Argentine economist. Towards the end of the 1940s our country was the most advanced in the region. With its natural and human resources, by 1930 Argentina's economy had achieved the highest levels of income and international participation. Seventy years of growth linked to the world market had made it possible to involve most of the active population. The style of outward-looking growth had reached its highest level of development in Argentina during the years before the crisis of the 1930s. Its financial system was the most sophisticated, and when the crisis came, its capital market was more developed than that of any other Latin American country.

Towards the end of the 1920s, exports accounted for about 25% of GDP, and imports for a similar share of the total demand. Such a high degree of international involvement made Argentina highly vulnerable to changes in world market activity levels and especially to changes in the hegemonic Power to which Argentina was closely tied. That instability, resulting from the economic cycle in the United Kingdom, inevitably attracted the attention of so acute an observer as Prebisch. Other features of the Argentine experience would also be decisive in shaping his main ideas.

When the crisis came, Argentina was a sub-industrialized country, to judge by the low ratio of manufacturing activity to per capita income and population. Even so, there was considerable diversity in the country's productive structure and a high level of ability in its human resources. The development achieved in the country's energy, transport and communications infrastructure, in the industries that processed commodities for export (refrigeration plants, mills, etc.), in the machine shops, support services and support manufacturing for the country's stock of capital goods, together with the rather sophisticated services available in a society with a high average income, constituted an abundance of human resources and a productive system which were capable of more complex undertakings. At the same time, there were imports which could easily be replaced with national products in the textile industry, food processing, light machinery and chemical enterprises and other areas requiring relatively simple technology and low-intensity capital.

On the global scene, at that time, the most important economies were following strongly interventionist policies and assigning to the State responsibilities previously unknown in the prevalent liberal pattern. In the case of Argentina, the military coup of 1930 and the conservative regimes imposed through fraud and through the exclusion of majority political expression made it possible to suppress the struggles over distribution and to respond without much trouble to the conflicts arising from the initial process of import substitution.

In this setting, one can readily understand the viability of a process of industrialization based on the domestic market and reductions in the import coefficient and, at the same time, the feasibility of keeping conflicts concerning distribution under control, while maintaining macroeconomic balances. Optimism about the prospect of transforming reality through public policy and of bringing about change in the behaviour of participants in social action was possible in that context.

This message of confidence in our own capacity to understand the world and change it helps to explain the widespread acceptance of Prebisch's early ideas and, later, of the ECLAC model.

That was the scene. And what kind of man was the man acting in it? First of all, he was a clear-headed man, with a profound vocation for analysis, willing to understand the reality around him in terms beyond conventional theoretical clichés. Moreover, Prebisch had a rich store of operational experience. This produced a distinctive stamp of his career: understand in order to act. Constantly and uninterruptedly, he moved forward from theoretical ideas to the conclusions needed to make proposals for economic policy. From the 1920s on, he distinguished himself as an astute analyst. In the 1930s, he held important economic policy posts, culminating in 1935 with his assignment as General Manager of the recently formed Central Bank. These personal traits and this experience constituted the personality of the professor who, on that mid-March morning in 1948, began his discourses in the Economic Sciences Department of the University of Buenos Aires.

What were Prebisch's reservations about the neoclassical model and its interpretation of tendencies in the real world of the early post-war period? What conclusions were to be drawn from the depression of the 1930s which brought about the collapse of the international economic order and ultimately led to the Second World War? What were the implications of the theoretical revision he set in motion?

Until the crisis of 1930, the neoclassical approach had prevailed in Latin America. It guaranteed the balance of international payments with optimum use of available resources so long as free-trade policies were maintained. Freedom in trade and international payments made possible the exploitation of the comparative advantages arising from the availability of resources and ensured a balance in prices, interest rates and exchange rates. Any deviation due to imprudent policies that increased domestic credit and public spending brought about a drop in international reserves, a shrinking of the monetary base, a rise in the interest rate, a drop in demand and, eventually, the restoration of balance. If the initial deviations were caused by a change in international conditions for example, a drop in export prices the economy would follow the same course of adjustment. The system made it possible to absorb changes in the real income of productive factors and to maintain the stability of overall price levels.

The initial effort to respond to the extraordinary events brought on by the global crisis of the 1930s with that theoretical scaffolding produced a disaster. The collapse of world trade and the crisis of the financial markets generated an imbalance in international payments which proved to be unmanageable with conventional policies. Attempts to recover the lost balance through reductions in spending accelerated the collapse of production and employment. The resulting reduction of imports was insufficient to offset the violent drop in exports. With the notable exception of Argentina, the crisis in international payments made unilateral decisions to declare foreign-debt moratoria the rule in Latin America.

The 1930s burned into the collective memory of the region the conviction that the crisis of that decade was not merely another phase of the economic cycle. In Argentina, since the mid-1930s, attempts were made through foreign-exchange, fiscal and monetary policies to compensate for the impact of the contraction in exports and capital inputs on domestic demand, production and employment. Moreover, Keynes's theoretical revision, the policies of the New Deal and the expansion of State intervention aimed at remedying the consequences of the crisis were gaining influence in the region. Protectionism and foreign-exchange controls became the general practice in industrialized countries. In Germany and Italy the crisis swept away theoretical models and conventional policies and also wiped out democratic systems.

The Second World War provoked further disruptions in Latin America. The interruption of imports from traditional sources brought about the forced isolation of the region's economies. Import substitution was dictated by events. Each national economy responded on the basis of its previously accumulated industrial and technological capacity, the size of its domestic market, the response capacity of the public sector and the maturity of its private sector.

When the war ended, 15 years of considerable transformations in the economic structure and international participation of Latin America had elapsed. In the rest of the world, the post-war reconstruction of Europe and Japan was based on protectionist policies and on regulations controlling foreign trade and international payments. The sphere of State action was broadened through the nationalization of enterprises within the financial sector and through income policies based on price and wage controls.

By the end of the 1940s, the neoclassical theoretical structure that had been predominant in Latin America from the mid-nineteenth century until 1930 was in ruins. With the collapse of theoretical models, traditional policies became discredited. At that time the region lacked a theory of long-term development and short-term balance. The gold standard, free trade, limits on State intervention and respect for the virtues of market laws could not withstand the onslaught of the 15 years that began in 1930 and ended with the end of the war.

The way was open to search for new solutions to the problems of development and balance. Prebisch's greatest contribution lay in his decision to understand these problems from our point of view that is, on the basis of the reality of what he defined soon thereafter as the peripheral countries. Traditionally, the economic universe had been studied according to theories generated in the centres of the international system. This hindered our understanding of our own reality and, consequently, the discovery of valid solutions to the problems of growth and stability. The cost of operating with borrowed ideas during the crisis years had been overwhelming. That error was not to be repeated. When, beginning in the 1970s, orthodox monetarist thought again became predominant in Latin America, the accuracy of Prebisch's ideas became evident once more.

In 1948 Prebisch was engaged in explaining the behaviour of the terms of trade between the export of basic commodities from the periphery and the export of manufactured goods from the centres. In his judgement, this was the principal factor that shed light on the distribution of the fruits of technological progress throughout the world economy. The cause that explained the phenomena lay in the fact that manpower was more plentiful in the periphery than in the centres. For that reason, in industrial countries the increases in productivity generated by technological progress were held back by productive factors through real wages and earnings. In the periphery, on the other hand, those increases were transferred to buyers through the relatively lower prices of exports. The inability to increase employment to the same real-wage levels kept labour from sharing in the fruits of technological progress. This unequal relationship between centre and periphery cast doubt on the validity of the neoclassical model. At the same time, it revealed inequities in the distribution of the benefits generated by the international division of labour and by the comparative advantages resulting from the relative abundance of productive factors.

Moreover, the gold standard and the free circulation of capital subjected periphery countries to the effects of ups and downs of the economic cycle in the industrial centres. The gold standard made the periphery impotent in the face of variations occurring in the central economies of the system. In those circumstances, the process of adjustment was painful and imposed high economic and social costs on the periphery countries.

If this was the behaviour of the global economy, free-market policies caused long-term economic stagnation and short-term production and employment instability in the periphery. The frontal challenge to these consequences of market dynamics led inevitably to a rejection of the free-trade model and to the creation of an alternative economic policy. Since specialization in the production and export of basic commodities was incompatible with domestic retention of the fruits of technological progress, it was necessary to create other productive activities and sources of employment. In other words, industrialization was necessary. At the same time, given that the free movement of capital and freedom in exchange rates brought about an adjustment process with high economic and social costs, it was also necessary to regulate both the exchange market and the movement of funds between Latin America and other regions.

All this had, in fact, been happening since the 1930s. These were the ad hoc policy responses of a number of Latin American countries to the problems arising from the global crisis. But according to Prebisch's revision of theory, these policies were no longer of a transitory nature, to be maintained until "normality", that is, the neoclassical universe, could be restored. Instead, since that time, industrialization and State intervention in international foreign-exchange and in other markets became central economic policy objectives and instruments. From being temporary emergency measures, they had become policies aimed at transforming the country's production system and its participation in the international economy by means of direct political intervention in the allocation of resources.

These early measures provoked a chain reaction. If industrialization was to assume the leadership position in development, it was necessary to study what had been done in other countries whose industrial development had come much later than that of the United Kingdom, the leader of the first industrial revolution. The experience of the United States, Germany, Japan and other countries was revealing. In every case, industrialization had been supported by protection of the domestic market and its reservation for the country's own industrial production. Moreover, State intervention had not been limited to the imposition of restrictions on imports that would compete with domestic production. It had also included other support instruments, in particular the financing of capital formation.

Consequently, it was necessary to base industrialization on the domestic market and to extend public measures to a number of areas whose activities were aimed at the same target of industrialization. In that way, beginning in the late 1940s, inward-looking growth was supported by convincing theoretical arguments and, in some countries, by policies which were increasingly divergent from the free-trade model.

The evolution of economic policy in the main economies of the region reinforced tendencies that had been observed since the 1930s. The State emerged as a leading participant in the development process, intervening in three main areas: first, by raising tariffs and implementing trade controls and other import restrictions in order to reserve the domestic market for domestic products and to make import substitution viable; second, by improving transport, communications and energy infrastructures through increased public investment and the creation of State companies in those areas and, increasingly, in certain other basic industries requiring large capital investment; third, by applying subsidies and, especially, by manipulating relative prices in favour of growth industries. By the end of the 1940s, the principal economies of the region were armed not only with a theory to justify public intervention in the promotion of industrialization and the transformation of productive structures but also with an interventionist arsenal that exerted a powerful influence on the functioning of markets, the determination of production and income, foreign trade, capital formation, relative prices and income distribution.

Prebisch's teachings at the University of Buenos Aires were optimistic in content. The efforts at development and the international context posed serious challenges, but those could be faced successfully on the basis of a clear diagnosis rooted in our own interpretations of reality.

After Prebisch left the University, I did not see him until we met in early 1950 in New York, where I was working at the United Nations Secretariat. At that time Prebisch was negotiating his transfer from the Studies Directorate of ECLAC to the leadership of it Executive Secretariat. The United Nations Secretariat was at that time one of the powerhouses of new development theories and had on its staff such eminent economists as Michael Kalecki and Hans Singer. The latter, together with Prebisch, later sponsored the theory of the secular tendency towards deterioration of the terms of trade of basic commodities. In New York I followed ECLAC's pioneering research closely and published my first studies. One of these, relating to real wages and income distribution, was produced in collaboration with the Mexican economist Horacio Flores de la Peña, member of Kalecki's team. The most important ECLAC economists often visited the Secretariat, and on those occasions I established my first friendships and intellectual ties with Celso Furtado and other eminent Latin American economists.

In early 1953 I resigned my post at the United Nations and returned to Buenos Aires. I became involved in politics as a member of the Unión Cívica Radical, whose National Committee had as its Chairman a rising and talented young politician named Arturo Frondizi. Those were the last days of the first Peronist Government. The regime was collapsing, exhausted by the conflicts generated by its own policies and by the divisions existing in Argentine society.

Within the party, I served as economic advisor to the National Committee and the group of national representatives led by Oscar Alende. Some other members of our advisory team were Norberto González, Federico Herschell and Samuel Itzcovich. We prepared various papers in support of the critical positions taken by the Radicals. From the standpoint of the theoretical model emerging in Latin America at that time, we criticized the irrationality of the Peronist income policy, the lags in investment, the inadequate development of infrastructure and basic industries, the actions taken against export activities and the Government's promotion of foreign-capital participation in the petroleum industry and other sectors. In other words, we were criticizing Peronism for being inconsistent with a number of its initial proposals for change. That criticism was made within the context of a rejection of Peronism's violations of democratic legality. Our approach represented the "national and popular" positions embodied by Radicalism in the Avellaneda Declaration of 1947. One of the main exponents of that line of thought was Frondizi himself, whose book *Petróleo y Política* was part of the anti-imperialist and progressive current.

These references are relevant to my second recollection of my relationship with Prebisch. In September 1955 Perón was overthrown, and shortly thereafter the new Government, known as the Government of the Liberating Revolution, summoned Raúl Prebisch, who was Executive Secretary of ECLAC at that time. Prebisch agreed to serve as economic advisor without assuming any executive responsibilities. During the final months of 1955 he prepared a number of reports which he submitted to the authorities and which became the subject of vigorous public debate. The first was *Informe preliminar acerca de la situación económica* ["Preliminary report on the economic situation"]. Later, he submitted two other papers: *Moneda sana o inflación incontrolable* ["Sound money or uncontrolled inflation"] and *Plan de restablecimiento económico* ["Plan of economic restoration"]. That set of ideas and proposals was referred to at the time as the Prebisch Plan.

Prebisch's return to the field of Argentine economic policy occurred in circumstances very different from those he had faced previously as the principal participant in the country's economic management during the 1930s and up to the military coup of 1943. The situation was very different for various reasons. In the first place, the problem of development was more complex than at the time of the collapse of the primary export model. The balance-of-payments crisis was primarily due not to a reduced capacity to cover foreign debts as a result of a shrinking world market but to the structural deficit arising from industry's orientation towards the domestic market and its dependence on traditional farm-export earnings. By 1955 industrialization, growth and foreign balances were considered in terms very different from those that Prebisch had known up to 1943 as administrator of economic policy. In the second place, the country's social and political realities had changed radically. The social forces unleashed by Peronism since the mid-1940s defined the struggle over distribution and short-term policy management in terms that were more complex and more difficult to deal with administratively than in the past. Political instability had brought a radicalization of positions. The traditional Right tied to farm production intended for export, exerted powerful pressures for the modification of relative prices in its favour, mainly through devaluations of the currency. At the same time, workers and other urban sectors sought to increase their share of overall income through an increase in wages and in the margins of industry and services profit. By 1955, the price-wage-devaluation spiral had generated conditions that later came to be known as inertial inflation. Lastly, the State which Prebisch found in 1955 was not the one he had left in 1943. It was much larger, intervened powerfully in income distribution and resource allocation and suffered from a chronic tendency towards imbalance.

In those circumstances, Prebisch's first concern was to re-establish macroeconomic balance or, in a well-known phrase, to put the house in order. That was indeed a necessary condition for the realistic renewal of development strategy after the overthrow of Perón in 1955. It is understandable that his proposals encountered resistance from popular sectors, which felt aggrieved by the adjustment strategy, and from the Right, which rejected the ideas for transformation and industrialization that Prebisch had popularized in his leadership position at ECLAC.

The Unión Cívica Radical adopted a critical position with respect to Prebisch's programme. We, the young economic advisors to the National Committee and to the party's representatives in the Junta Consultiva, whose chief delegate was Oscar Alende, prepared various studies which provided data and arguments for the party's spokesmen. Prebisch's approach seemed to us to be very conservative, with excessive emphasis on foreign adjustments, price stability, the virtues of foreign capital and the freer play of market forces. We also criticized the gaps we detected in structural and social questions and in others that would strengthen Argentina's position in the face of foreign interests.

Don Raúl was perplexed by the criticism coming from those who had been his disciples and the followers of his main ideas in theoretical matters. We dared to suppose that, when he returned to Argentina to concern himself with the concrete and urgent problems of the nations's economy, he became once again the old conservative-regime functionary of the 1930s, with his old friends and his predominant interests in monetary and balance-of-payments questions. At the same time, it was true that traditional conservatives also rejected the ideas he had developed and promoted in Argentina and throughout Latin America. Prebisch's positions on the short-term management of the Argentine economy, a question to which he returned several times during the years following 1955, reawakened the doubts of both his disciples and other economists who recognized in him a pioneer of new ideas about development. While in the rest of Latin America and in the third world Prebisch is viewed as the main exponent of reform thought, in Argentina his image retains more complex and contradictory nuances.

Shortly thereafter, I was assigned to the Argentine Embassy in London as an economic advisor, and in mid-1956, I was a member of the Argentine delegation to the United Nations Economic and Social Council in Geneva. Prebisch was there, having returned to ECLAC after leaving his post as economic advisor to the revolutionary Government. We spoke at length about the events of the past year and the critical position taken by the Radicals. Prebisch was particularly concerned about the criticism from the "progressive" camp. I tried to explain that Radicalism was seeking a new synthesis for integration with the popular forces of a defeated Peronism and an economic policy model far removed from orthodox recipes and based on "national and popular" proposals. This naturally implied short-term unorthodox management which, even if one recognized the need for fiscal balance and monetary prudence, was far removed from the emphasis Prebisch had placed on the adjustment process and the reincorporation of Argentina into international financial circles. Of course, I did not convince him. When his mission in Geneva ended, I went to the airport to see him off. I found him eating an excellent luncheon. When he had finished with good wine and a variety of cheeses, he asked for coffee and –of all things– saccharine! When he saw my smile, he said, "Don't laugh. Saccharine, like confession for Catholics, wipes away sin".

In 1959, while I was serving as Minister of Economy and Finance in the Alende government of the Province of Buenos Aires, I met Prebisch again. Towards the end of the preceding year the Frondizi Government had signed an agreement with the International Monetary Fund and was pursuing an orthodox fiscal and monetary policy. There was great displeasure in the ranks of intransigent Radicalism. When we met in Buenos Aires, Don Raúl chided me: "Tell me, my friend, can you explain to me now why you criticized my proposals?" At that time, I found it difficult to answer. From a historical perspective it could be said that those decisions taken by Frondizi and Rogelio Frigerio were part of what would be described today as a "capitalist shock" for accumulation and growth, but that is a different question altogether.

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Neo-structuralism versus neo-liberalism in the 1990s

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This article is a critical reflection on the long-term development strategies currently being proposed by the neo-liberal and neo-structuralist schools. Obviously, a given theoretical programme can turn out to be substantially different when put into practice and can be conditioned by the particular characteristics of each country. Nevertheless, we choose to limit our consideration to the proposals themselves in order to place the discussion on the most objective and most realistic level possible.

After a brief introduction, the basic elements of the neo-liberal proposal for structural adjustment and growth are summarized; these are based on recent versions representative of the orthodox line of analysis. The second section presents the neo-structuralist response to the neo-liberal proposal, centring the analysis on the basic policy guidelines arising from the new proposed strategy for development "from within".

Finally, a critical comparison is made of the basic principles underlying the two proposals, in the type that they will afford positive guidance for tackling the major problems of economic policy and development in Latin America.

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Introduction

When the problem of the external debt arose in 1982, with Mexico's moratorium and the consequent abrupt cut-off of the flow of external capital, an economic and financial crisis of huge proportions was unleashed in most underdeveloped countries, especially in Latin America. This crisis, owing to its magnitude and its dramatic effects, has been called by most economic analysts the worst crisis since the depression of the 1930s.

Faced with the impossibility of financing the heavy external deficit in a context of severe deterioration of the terms of trade, high international interest rates and no access to voluntary external credit, all the Latin American countries have negotiated periodically with the multilateral credit agencies, especially the International Monetary Fund and the World Bank. The purpose of these negotiations is to reprogramme the debt service and ease the restricted access to new financial resources, in order to soften the destabilizing domestic impact of these deficits on the external accounts.

As is well known, these agencies have granted new credits on the condition that the debtor countries initiate a series of economic, political and institutional reforms along marked neo-liberal lines. Because of their extensive short-term and long-term effects, these reforms are known as "structural adjustment" programmes. Their explicit objective is to recover the macroeconomic balance and the potential growth rate, in order to ensure the balance of payments over the middle term (Michalopoulos, 1987).

However, whatever strategy has been followed until now, the negative effects of the external-debt crisis have not been overcome. Moreover, most of the countries of the region have not recovered sustained growth; on the contrary, the basic disequilibria have become noticeably worse. Latin America's per capita income stagnated throughout the 1980s and remained much below the levels attained at the end of the 1970s. This trend continues in most of the countries, producing regressive social effects and severe political conflicts, with unpredictable consequences for the recently restored democracies. Faced with this gloomy picture, economists have described the 1980s as a lost decade for Latin American development.

The situation has prompted a serious effort to grasp the real nature of the economic problems in all their complexity, in order to elaborate alternative solutions for the twofold challenge facing the Governments of the region. They must overcome the crisis and return to the path of solid and sustained growth, in a democratic spirit and with equity. This effort has taken shape, for example, in the recent proposals on "changing production patterns with social equity" (ECLAC, 1990) and "development from within" (O. Sunkel, in press). Such proposals are especially but not exclusively inspired by the Latin American school of structuralist thought, renewed and reformulated by the neo-structuralist contribution of the last decade.

I

Structural adjustment and growth: the neo-liberal response to the crisis of economic growth in Latin America[1]

Neo-liberal analysts agree that one of the immediate causes of the economic crisis in Latin America is the international recession of the 1980s, especially the sharp declines in export prices and the severe rises in real international interest rates, causing a huge deficit in the region's external accounts. The situation worsened when the flow of private external inancing, at one time abundant, was abruptly and severely reduced. However, the neo-liberalists feel that the debt problem only revealed and intensified much deeper problems which were already present in the Latin American economies and indeed which had been identified before the crisis (Balassa *et al.*, 1986).

Some of the reasons that led these authors to such a conclusion were the rapid recovery of other developing countries at least as seriously affected as those of the region, and the deterioration of the relative long-term economic situation of Latin America. This deterioration was apparent in the capital flight from some countries caused by loss of confidence in their development possibilities; in high rates of unemployment and underemployment; in periodic outbreaks and surges of inflation; and in the appalling income distribution characteristic of most countries.

For Balassa and his collaborators, these problems arose especially from mistaken and unsustainable domestic policies and institutions. Important among these are the notable tendency of the Latin American economies towards inward-looking growth, and especially their readiness to allow their currencies to be overvalued and to continue with highly protectionist policies. They failed to provide incentives to save, both domestically and externally, and allocated inefficiently the savings that did exist. Completing this bleak panorama were the excessive importance and suffocating role of the State in the economy and the subsequent weakness of the private sector.

Even though these authors do not explicitly call for structural adjustment of the same magnitude as we know today, their pioneering efforts to design a new development strategy, which they define as "urgently necessary and of proven feasibility" for recovering growth, aptly represent the current direction of the new orthodox proposals on adjustment and growth. From this standpoint, the economic challenge that the countries of the region must confront is to find some efficient way of recovering self-sustained growth which would guarantee productive employment to a growing population and re-establish the confidence of the external financial markets by serving the debt "without fail and on time". In the same way, the new policies should have an immediate positive social impact, in order to recover previous living standards, strengthen the incipient and widespread return to democracy, and favour private initiative. In addition, and in a spirit of global economic interdependence, the developed countries should complement the new development strategies with their own efforts to have sustained and sustaining policies.

In more specific terms, the proposal of Balassa and his collaborators presents four strategic action areas for the Latin American countries:

[1] This section is essentially based on three works that are representative of the recent literature on structural adjustment: Balassa *et al.* (1986), Michalopoulos (1987) and Selowsky (1989). Within this same perspective, see also the works of Barandiaran (1988), Rodríguez (1989) and Williamson (1990).

a) They must *orient their economic policy toward the exterior*, giving particular attention to exports and to the efficient substitution of imports by maintaining competitive exchange rates, avoiding excessive protection on imports and providing incentives for internationally accepted exports.

b) They must *increase and allocate domestic savings efficiently to investment projects*, on the basis of positive (but not excessive) real interest rates; a fiscal policy that encourages saving instead of consumption; the reduction of budgetary deficits because of their effects on inflation and their displacement of productive investment; and incentives for the entry of foreign private capital, particularly in ways that do not create debt, such as direct foreign investment and efforts to reverse capital flight;

c) They must *reform the role of the State in the economy*, by a considerable degree of market deregulation as an impetus for entrepreneurial dynamism; a reduction of the State's function as a producer of goods and services (privatization), and the concentration of its action on the provision of social services and the establishment of a stable overall framework for growth with supportive macro and micro-economic policies;

d) They must *obtain international support for this strategy*, especially from the United States and the industrialized countries, through a commitment on their part to maintain world economic growth rates of at least 3% a year, by adopting measures to liberalize world trade that avoid new restrictions on imports and subsidies for exports; by supporting the reduction of the United States budget deficit and lower margins for the creditor banks in order to ensure lower real interest rates for debtor countries; and, finally, through a substantial contribution of new funds for Latin America of around US$20 billion a year, from the private sector, the Inter-American Development Bank and the World Bank.

The changes these authors suggest would make for greater international competitiveness, encourage growth and the creation of sources of productive employment, and would increase export revenues for servicing the debt. The stimulation of private initiative would more than compensate for the job losses caused by reducing public enterprises and lifting government regulations. At the same time, a successful move towards the exterior would generate economic benefits that would offset the losses arising from the gradual elimination of non-productive activities. Existing resources and the recovery of investment would move towards the more productive sectors, with higher wages and a more intensive use of labour.

Finally, Balassa and his collaborators state that a key element for guaranteeing the success of this strategy is continuity of policy, in order to generate a reasonably stable economic scenario for long-term plans and the confidence of private investors. The necessary adjustments, to the extent that they change external conditions and those derived from national development, should not affect the coherence nor the continuity of the purpose and direction of the new strategy.

Domestic challenges aside, external support is vital for the success of the strategy for adjustment with growth. However, since foreign creditor banks are unwilling to renew the voluntary flow of credit, our countries have become overly dependent on negotiations with the multilateral financial agencies, the International Monetary Fund and the World Bank. These agencies conditioned access to new financing on the application of a new programme of reforms in the indebted economies, which because of their wide-ranging scope have been called "structural adjustments".[2]

The proposals contained in a structural adjustment programme are generally similar to those of the strategy outlined by Balassa and others (1986). Even so, the structural adjustment programmes include new, more sophisticated elements that adapt them to a changing reality, especially with respect to the depth, speed and sequence of the economic reforms that have to be introduced, as well as the macroeconomic policies appropriate for the transition towards a less distorted economy (Michalopoulos, 1987).[3]

[2] The financial assistance programmes of the International Monetary Fund and the structural adjustment programmes of the World Bank are the most representative practical examples of the new face of neo-liberal orthodoxy. Moreover, both agencies are expected to develop even closer relations and coordination of their stabilization and adjustment policies (Meller, 1988).

[3] Michalopoulos' article is especially representative of the current line of thinking of the international financial agencies, particularly the World Bank. Consequently, and as stated in the introduction, our presentation of these issues closely follows the development of Michalopoulos' own study.

The World Bank's view, as presented by Michalopoulos, gives high priority to the task of confronting significant and prolonged domestic aggregate disequilibria (inflation and balance-of-payments deficit), because of their inevitable negative effects on long-term growth. Otherwise, the delay in re-establishing minimum macro-economic stability will worsen the impact of the subsequent adjustment on the short-term product. As part of the stabilization efforts, it is recommended that domestic consumption be reduced to levels compatible with the potential growth of the product and the sustainable deficit on current account. The World Bank also points out in passing that declines in activity over the short term are practically a prerequisite for the success of a stabilization programme, since that success depends on the application of contractive measures to the economy as a whole.

The key to adjustment with growth, according to the World Bank, lies in the right combination and balanced handling of the instruments of monetary, fiscal and exchange policies, which, for a given level of external financing, fulfil objectives of stabilization, promote structural change and cost less in terms of growth over the short run. On the other hand, if the general macroeconomic imbalance has one particular cause (the "fiscal deficit" in Latin America), all the actions of the policy package should be directed to solving that problem, but without concentrating on public investments in physical and social infrastructure that compromise the possibilities of future growth. Also, every stabilization programme should avoid introducing distortions that could ruin the success of the adjustment. Specifically, if a country needs to eliminate a bias against exports and allocate resources to the production of tradeable goods, the real exchange rate should not be raised nor should taxes be levied on exports as instruments for stabilization.

Since stabilization alone does not guarantee growth, the specific components of a policy package for promoting structural change and growth need to be considered. Although the starting points are different in each country, the policies that require priority attention are as follows:

a) To increase public saving by reducing expenditures and increasing revenues to broaden the tax base, and by improving tax collection. This can be done by privatizing public enterprises or improving their management by drastically reducing subsidies for prices or public utility services for the middle class, and consequently by directing the distributive action of the State towards groups in extreme poverty or highly vulnerable groups.

b) To increase private savings, which requires strengthening domestic financial institutions and maintaining a stable and predictable economic policy.

c) To achieve greater economic efficiency and improve private investment by eliminating micro-economic distortions such as price controls, highly differentiated incentives in the area of external trade, subsidized interest rates, credit rationing, and impediments to labour mobility and adjustments of real wages. In a highly regulated economy, the allocation of resources and productivity can be improved by eliminating price controls and simultaneously deregulating the domestic labour market. In addition, the deregulation of financial markets (subject to appropriate regulations for bank supervision) improves the allocation of credit and distributes investment more efficiently.

d) To allocate public investment more efficiently by redistributing public resources towards activities that merit greater positive externalities, such as the development of human resources and physical infrastructure.

e) To increase the supply of tradeable goods, which calls for two important policy measures: the maintenance of an appropriate real exchange rate and a correct incentive structure, giving equal treatment to production for the domestic market and production for export. This last point demands, as a minimum, the elimination of the bias against exports prevalent in many countries by liberalizing and rationalizing the system of external trade, which includes removing quantitative restrictions, reducing tariffs and eventually making them uniform, and diminishing or eliminating as far as possible taxes on exports. Obviously, liberalization will cause a contraction in inefficient sectors, which will eventually be replaced by the corresponding expansion of efficient sectors, giving shape to a new productive structure better adapted to the demands of international competition and better prepared to face external shocks.

Michalopoulos, in another part of his article, emphasizes that, despite the broad consensus about the nature of the reform package in question, disagreements abound once implementation begins, since less is known about how the reform actually works; that depends partially on the conditions in place at the beginning of implementation and partially on the political situation of each country. As mentioned above, three important elements must be introduced at this point in the discussion: the sequence of the reforms, their speed and the appropriate macroeconomic policy package.

The debate about the sequence of economic reforms involves two questions. First, what is the correct sequence between measures for achieving stabilization and those for structural adjustment? Second, how can we establish the appropriate order for eliminating distortions in regulated markets? As regards the first question, there are only minor disagreements about whether structural adjustment is easier if it takes place in a stable macroeconomic context, especially when inflation is under control. The basic reason is that, when both programmes are applied simultaneously, the net contractive pressure on the productive apparatus can be too strong and lead to bankruptcies, transitory unemployment and other costs, such as a growing political opposition, that would seriously compromise the viability of the reforms.[4]

As regards the question of the order of measures for eliminating domestic market distortions related to the liberalization of international economic relations, the experience of different countries gathered by the World Bank shows that the deregulation of the domestic labour market should precede other reforms, in order to guarantee the necessary mobility of labour and thus achieve the benefits of the reforms in the goods market. In the same way, it is considered important to undertake at an early stage the reform of the domestic financial markets that operate in a context of credit rationing; interest rates on loans should be liberalized first and then those on deposits. As regards external accounts proper, it is considered better to first liberalize the current account of the balance of payments, leaving the opening of the capital account for later. The argument for this position is that it prevents capital from flowing towards inefficient sectors that enjoy an artificially high profit margin due to protectionist measures. More important, it prevents the more rapid adjustment of the capital market from starting a huge movement of capital with undesirable effects on the real exchange rate.

As to the speed of the reforms, the debate centres on whether the trade opening should be achieved in a short period or take from five to 10 years, and whether price controls should be eliminated immediately or gradually. It is important to consider here the crucial role played by price expectations, and therefore, the importance of credibility for any reform package. Reform initiatives, for these reasons, should be programmed with a realistic time frame which allows them to achieve their objectives. These will differ from one kind of policy to another and from one country to another. Thus, the greater the initial imbalance, the faster the pace for implementing the reforms, and the more conditions of political feasibility are ignored, the greater will be the costs of the transition provoked by the structural adjustment programme, causing a serious risk of failure and a loss of credibility for future adjustment efforts. In any case, a delay in applying the policies will retard the development of export activities and interest groups that support them. Needed reforms in the allocation of resources will not take place unless the signals given are sufficiently strong and clear to make the changes credible.

Finally, in the area of macroeconomic policies that accompany the adjustment process, numerous and complex tasks are suggested for the moment when external accounts are liberalized. These are to achieve simultaneously an appropriate and stable level of the exchange rate, a lower rate of inflation and a sustainable position in the balance of payments. At the same time, other macroeconomic instruments should be designed to support liberalization. These include a monetary policy compatible with current exchange regulations and with inflationary expectations, thus avoiding a crisis of confidence that could ruin the success of the whole package. Fiscal policy should be conducted in such a way that budget deficits are kept at levels consistent with the levels of expansion of domestic credit and with the availability of external financing.

Selowsky presents a very innovative and representative vision of this new approach by the World Bank (Selowsky, 1989).[5] In this study, the

[4]According to the author, this is because of the links between stabilization and liberalization of the trade system. On the one hand, successful stabilization depends on the application of contractive measures in the aggregate, and on the other, the rationalization of trade policies aims to reduce the activity of highly protected import-substitution industries. This does not mean that other aspects of structural adjustment, such as the rationalization of public expenditures, for example, cannot be approached at the same time as stabilization, especially when recognizing that the success of stabilization can depend on such action being undertaken early in the process.

[5]Also see Rosales (1990).

author identifies a logical sequence of three stages in the adjustment process through which the Latin American countries must pass in order to recover growth and reduce their levels of external indebtedness. An important point in Selowsky's analysis, which deserves to be highlighted, is the strong complementarity that he postulates between improvements in domestic policies and support from external financing. Even though he states that the precise way in which that complementarity functions is different in each stage of the adjustment, the author recognizes that domestic economic reforms without additional external financing are risky for the whole process, making the adjustment socially and politically rather costly. Nor would it be helpful to have external support and fail to undertake the necessary reforms, since the funds would ultimately become part of capital flight or finance unproductive government consumption or investment projects with little social benefit.

The main objective of each stage of the adjustment is to create the preconditions, or the atmosphere, which stimulate a high level of socially productive investments by the private sector, both local and international, which is identified as the motor of growth. For the author, the solution of the over-indebtedness of the Latin American countries will also contribute to this climate. In many cases this involves a significant reduction of the debt rather than a continuous reprogramming of payments on the principal and interest.

The basic goal of the first stage is to achieve a solid foundation for macroeconomic stability by reducing inflation and the real interest rate. This demands action on two fronts: to generate a sustained growth of the primary fiscal surplus (revenues minus expenditures, except for interest payments), and to achieve a critical level of external financing or lower net transfers of resources, which will mitigate the recessive effects of such a fiscal adjustment. A particularly new element in the policy recommendations made by Selowsky for this stage of the adjustment is his recognition of the less recessive character of some measures contained in the heterodox plans for stabilization. These are related to transitory agreements governing wages and prices in a way that guarantees the rapid convergence of the inflation rate at a level compatible with the new rate of monetary expansion.

Once a minimum level of macroeconomic stability is achieved, the second stage begins with the implementation of profound structural reforms aimed at increasing both external and domestic competitiveness in goods, inputs and financial markets, together with the rationalization of the overall system of regulations and institutional reforms that promote a sustained increase of public saving. The policies seek an efficient reallocation of resources and the recovery of import levels and full productive capacity. They include trade reforms that give the same incentives to exports as to import substitution; deregulation of interest rates and the decompression of the financial system; and open-door policies for foreign investment. In sum, the incentives should be based on transparent rules of the game and on market signals instead of the discretional allocation of resources by way of public policy. Finally, it is hoped, that at this stage additional external financing will be used to import intermediate inputs, making possible a better use of installed capacity.

The third stage consolidates the reforms. The main objective is the sustained recovery of investment levels. Here the preconditions for sustained growth are in place and they can be seen in the desire of private local investors to invest within the country because of its high levels of social and private productivity. The only constraint to growth is the rationing of external financing despite high interest rates and a strong demand for investment funds. Consequently, at this stage external financing is not only crucial for increasing domestic private investment; it is also essential to reduce the level of external overindebtedness of the Latin American economies, in order to mitigate the climate of uncertainty, increase the confidence of local investors and ensure that external shocks or prolonged negotiations of the debt do not threaten the structural reforms already achieved.

In this brief summary we have tried to present as objectively as possible the main lines of the proposal for structural adjustment and growth, put forward by the international financial agencies. At the end of this article we will deal with the central aspects of this proposal which merit criticism.

II

Development from within: a neo-structuralist response to the problems of Latin American development[6]

From a specifically Latin American perspective, the present advocates of neo-structuralism affirm that the main economic problems and the underdevelopment still prevalent in our countries are due not so much to distortions induced by economic policies as to historical causes of an endogenous and structural nature. In the opinion of Rosales (1988), the truth of this theory is revealed in three crucial characteristics of the Latin American economy at the end of the 1980s: a) a continuing pattern of external insertion which, given the trends in international trade and the international financial system, leads to an impoverishing specialization; b) the predominance of an uncoordinated production apparatus, which is vulnerable and highly heterogeneous, concentrates technical progress, and is incapable of absorbing productively the growth of the labour force; c) the persistence of a very concentrated and exclusive income distribution, which reveals the system's incapacity to reduce poverty.[7]

Consequently, our countries must do more than carry out marginal adjustments to the change curve –a reflection of their exclusive preoccupation with the efficient allocation of productive factors. They must generate a dynamic process that gradually moves the economy towards the curve of production possibilities and continuously and accumulatively pushes this curve towards new productive frontiers. In particular, this movement must be capable of generating a dynamic insertion into the international economy and of responding to the need to increase the production of the poorer sectors. Hence growth demands more than a policy of liberalization designed to promote correct prices for an optimum allocation of productive factors in a static situation and in conditions of an extremely unequal distribution of income. On the contrary, the interplay of the market should be significantly complemented by dynamic action on the part of the State. Apart from its classical functions (public property, macroeconomic equilibria, equity), the State should include within the range of its administrative capacity: a) the promotion or simulation of markets that are lacking (long-term capital markets, currency futures markets); b) the strengthening of incomplete markets (technology market); c) the elimination or reduction of structural distortions (the asymmetrical character of external insertion, heterogeneity of the productive structure, the concentration of property, the fragmentation of the capital and labour markets); d) the elimination of, or compensation for, the more important defects in the market arising from output at different scales; e) externalities and the learning process (in the industrial or external sector), among others.

These are the basic policy guidelines behind recent efforts to present a renewed strategic proposal for the recovery and consolidation of development in Latin America (ECLAC, 1990 and Sunkel, ed., 1990). In line with the initial neo-structuralist analysis, both alternatives provide concrete propositions for shaping a productive structure that allows for dynamic growth, ensures an efficient insertion of our countries in the world economy, increases the generation of productive employment and reduces structural heterogeneity. In this way, income distribution will be enhanced and the extreme poverty of most Latin Americans will be alleviated.

As regards the general guidelines outlined by Sunkel, the strategy of development "from within" seeks to take up once again and go beyond Prebisch's original challenge to industrialize. The aim is to generate an endogenous accumulation process that absorbs and generates technical advances –including the use of foreign private investment. This process will give a country its own decision-making capacity for dynamic growth. Such a strategic concept is not biased *a priori* in favour of import substitution, which would ultimately lead it into a blind alley. On the contrary, this proposal leaves open the options to orient industrialization from within to the priority domestic and external markets which are more promising for the long-term development strategy. In these markets our countries already have or can acquire levels of relative excellence which would guarantee them a solid insertion into the world economy.

[6] This section is based on Ramos and Sunkel (1990).

[7] A more profound analysis and background documents which support this kind of analysis are found in the works of Ocampo (1990), Tokman (1990) and Lustig (1990).

In other words, it is not so much a question of demand. What is vital is a dynamic effort on the supply side: accumulation, quality, flexibility; the combination and efficient use of productive resources; the deliberate incorporation of technical progress, innovation and creativity; organizational capacity, social harmony and discipline; frugal private and public consumption and emphasis on national savings, and the acquisition of the capacity to insert the national economy dynamically into the world economy. In short, our countries must make a deliberate effort "from within", with the active participation of the State and private economic agents, to achieve self-sustained development.

Some elements of ECLAC's proposal for changing production patterns with social equity (1990) come very close to this conception. Development "from within" is clearly identified with the criterion of genuine competitiveness which seeks to progress from the "perishable income" derived from natural resources to the "dynamic income" derived from the incorporation of technical progress into productive activity. Likewise, both proposals stress the systematic character of this competitiveness, and therefore, the integral effort demanded by a dynamic insertion into world markets. They recognize that in the economies that compete in those markets the individual firm is integrated into a broad network of linkages with the educational system, with the technological, energy and transport infrastructure, with employer-worker relations, with public and private institutions and with the financial system.

Another important element in both proposals is the commitment to re-establish and maintain basic macroeconomic equilibria as a necessary condition for achieving the sustainability of the development process. One of the ways of doing this is to reduce external transfers as debt service. However, such a reduction will be insufficient if it is not accompanied by domestic stabilization policies which regain control of fiscal accounts (including increased public revenues and not just reduced expenditures) and which serve as a guide for expectations through a suitable management of prices and income in order to minimize the recessive impact of greater fiscal discipline. Adjustment policies should stimulate the reallocation of resources towards the production of tradeable goods with particularly strong incentives during the first few years, especially for exports. In the interests of social efficiency, the adjustment should be gradual; in the case of high inflation, shock policies are more appropriate and inevitable. In practice this approach differs from the traditional recommendations of the International Monetary Fund, which are usually too drastic as regards adjustment and too gradualist as regards inflation (Ramos, 1990).

An essential objective which affects every aspect of the neo-structuralist agenda for development is to achieve equity and social justice and to strengthen democratic institutions. In the context of the constraints imposed by the economic crisis, top priority must be given to problems of extreme poverty and to policies designed to alleviate and eradicate it once and for all. Once back on the road to stable growth, basic medium- and long-term changes to achieve greater equity can be introduced to overcome the high degree of heterogeneity prevalent in the productive structure.

For this purpose, the State must concentrate on three priority aims: a) to minimize the impact of external shocks on the poorer and more vulnerable groups by supporting their production and productivity as well as their income levels and social services; b) to lower the costs of relocating manpower associated with the structural reforms inherent in the adjustment; c) to facilitate the eradication of poverty and the excessive concentration of income and wealth, once growth has been recovered (Lustig, 1990). Also, in order to improve the functioning of the labour markets and the absorption of manpower, it is imperative to adopt a new strategy that takes serious account of the informal sector. As a result of the recent crisis, this sector has expanded and contains a high concentration of poor people. There is increasing evidence that only a small amount of resources is needed to promote their activity. There are two schools of thought on this point, which are not necessarily contradictory, but have a different emphasis and involve different proposals. The first attempts to solve the structural problems affecting the existence, duration and operation of the informal sector; the second deals with the institutional aspects and centres its analysis primarily on the current juridical order, transferring the cause of the problem, in a certain sense, from the structural to the juridical level (Tokman, 1990).

ECLAC's proposal (1990), accentuating this tendency to emphasize production more than social assistance, suggests that the changes in production patterns should be accompanied by complementary measures for redistribution. These include programmes of technical, financial and marketing services that support microenterprises, own-account workers and small farmers. The proposal also emphasizes the urgency of reforming different regulatory mechanisms that prevent the formation of microenterprises with the capacity to change.

Notwithstanding the importance of defining this general strategic framework, any attempt to formulate a modern and influential neo-structuralist proposal also acquires a realistic approach in order to pinpoint the most important problems and work out practical proposals to solve them. In order to observe the neo-structuralist contribution to economic policy, we examine below how the advocates of that school of thought would tackle certain basic economic problems at this time, and what proposals they would suggest to deal with the structural and institutional problems, as well as the problem of prices.

1. *Changing and modernizing production patterns*

Already in the 1960s there were warnings that import-substitution policy was creating a lopsided structure of incentives, favouring production for the domestic market, and that it needed to be reformulated (ECLAC, 1961). It is logical to suppose that, if the incentives for generating foreign exchange through export expansion were equal to the incentives for saving foreign exchange through import substitution, exports would respond more. And if another special incentive were needed, it would be for insertion into the external market –the real "infant industry" of the future. In this way, instead of import tariffs, it would be more important to subsidize the exports of pioneer enterprises that introduce new products and open up new external markets. Owing to the process of import substitution in the past, imports today consist almost entirely of capital inputs and goods; tariffs should therefore be reduced and rationalized to facilitate exports and competitive substitution. The output of the multinational corporations established in the region should also be exported; advantage should be taken of their international marketing network; and export commitments should be negotiated in exchange for the purchase of inputs at current international prices. Basically, what is proposed is a selective intervention that seeks to establish dynamic comparative advantages in international markets, since exporting is the natural next step to take in order to benefit from the industrial base already in existence.

Within this logic of restructuring and reforms aimed at modernizing production patterns, it is important to consider the changing international context and the strategic conditions it imposes on Latin America's external economic policy options. There is an interaction between structural factors (associated with technological and organizational innovations in the countries of the centre and their recent acceleration and the expectations of institutional changes in economic blocs and of an unstable evolution in the short-term world macroeconomic situation. This interaction has been decisively changing the determinants of the strategic decisions of governments and transnational corporations. Undoubtedly, such transformations in the international environment have an important influence –both positive and negative– on the ability of the Latin American countries to find their place in the new international division of labour now emerging, and to reformulate effectively their long-term development policies. Moreover, the many theoretical and empirical studies on the evolution of the terms of trade for the region indicate that the pronounced deterioration has spread from the characteristics of exported products to the characteristics of the exporting country, thus including the export of manufactures (Fritsch, 1990; Ocampo, 1990).

These points, if confirmed, would require us to ponder the specific modalities of international insertion and the patterns of productive specialization, and consequently, the importance of industrial and trade policies in promoting levels of competitiveness which are acceptable in the more dynamic branches of international trade. A neo-structuralist frame of reference for industrial policy implies the more efficient utilization of market signals, of entrepreneurial perception, information, coordination and initiative, and of international competition. Here, the State's responsibility is to create an institutional environment which stimulates the creativity and dynamism of the productive agents (employers and workers) and their capacity for agreement and coordination among themselves. In turn, specific sectoral options should not be imposed by government technocrats but should be a flexible result of those initiatives and of that coordination. It is basically a question of options that make maximum use of the information offered by domestic and external markets and technological, institutional and organizational trends (Muñoz, 1990).

By following this new path of industrialization our countries should also overcome the false dilemma about postponing agricultural development. It is recognized that the structural nature of the agricultural problems to be solved demands the action of the State on two levels. On the macroeconomic level, emphasis is given to the State's role in providing incentives aimed at taking advantage of potential domestic demand, but recognition is also given to the importance of safeguarding the stability of the economy. In the sectoral area, as a means of dealing with the risks and uncertainties characteristic of agriculture, the neo-structuralists advocate policies which guarantee prices and price ranges; technological innovations which promote the development of high-yield varieties resistant to pests and weather variations; institutional innovations aimed at creating and strengthening post-harvest services, futures markets and agricultural insurance markets; and the introduction into rural areas of activities to industrialize agricultural products (Figueroa, 1990).

Finally, in this whole series of proposals for productive restructuring to fight against the scarcity of foreign exchange, the environmental challenges involved in these reforms cannot be ignored. Our countries must recognize, on the one hand, the structural origin of environmental problems, and on this basis elaborate alternatives and policies aimed at environmental sustainability. On the other hand, they must admit that natural resources will constitute an exceptional asset for the future development of Latin America to the extent that there is constant public concern and action to ensure that rational exploitation preserves, replaces and even expands the potential of this rich patrimony.

Such objectives demand the attention of the highest levels of government. The question of the environment is highly controversial and requires a profound adaptation of economy policy in general and by sector. For example, on the general level, priority must be given to policies dealing with science and technology, with institutional organization and with education, which encourage the incorporation of an environmental component into development strategy. In this way, our countries should create a model for generating, adopting and disseminating technology which is environment-friendly and reduces the ecological cost of transformations generated in the development process. They should set in motion agencies which coordinate environmental actions by sector and location and which encourage forms of sustainable and profitable environmental development through permanent economic activities (re-training, treatment of residues, forests for energy, etc.). And they should elaborate on all levels policies for environmental education. In the sectoral sphere, they should promote the development of the forestry and agricultural sector with a proper regard for the behaviour and attributes of the living ecosystem and the extent of its transformation by man. On that level, particular attention should be paid to solving the problems of rural poverty which frequently lead to overexploitation of the environment (Gligo, 1990).

2. *Technology and innovation*

In retrospect and considering the historical realities of the time, we may criticize the Keynesian strategy for growth followed in the region in the past. It consisted mainly in ensuring the demand and integration of the domestic market, but it ignored productive efficiency. In fact, the security of the market deadened innovation, giving rise to a business attitude concerned only with profits. Our countries should have adopted a Schumpeterian approach in which incentives for production stimulate technological learning and innovation and mobilize an increasing number of entrepreneurs.

Such a change requires a new conception "from within" of technological progress in support of institutions that promote scientific and technological activity for development, since one of the reasons for the innovation gap in the countries of the periphery appears to lie in the institutional diversity of their agents of technological change. Consequently, and as an example, systematic and organized research and development should be promoted and public policies should be established that spread among society some of the risks of that process. Likewise, an important factor for closing the technological gap is the creation of a highly developed scientific and technological infrastructure coordinated with productive sectors in the context of decisions regarding long-term specialization. The successful completion of this operation will provide access to original research and will thus make it possible to obtain comparative advantages in strategic and vanguard sectors in external markets.

The reconquest of international markets with products of higher technological content constitutes a series of challenges for public policy. For example, the government should encourage the participation of small and medium-sized enterprises in this modernization process. It should establish subcontracting agencies and organizations to supervise quality control; it should promote the innovative capacity of different sectors of the economy by means of technological management programmes and the dissemination of innovations; and it should provide financing to projects of technological innovation in priority areas.

Finally, the consequences of the third technological revolution require profound changes in the social organization of production with the explicit objective of obtaining maximum benefit from the new technology. The road to development demands a consensus between the public and private sector, between worker and employer organizations, and between enterprises of the same sector, to guarantee flexibility and the capacity to adapt to the speed of technological change (Rodríguez, 1990).

3. *Capital formation and the use of productive capacity*

As a consequence of the debt crisis, one of the distinctive features of the Latin American economies during the 1980s was the low rate of capital formation, together with a low rate of utilization of productive capital. There was a corresponding decline in *ex-post* productivity because both factors and their obvious interrelations play a decisive role in incorporating technological innovations and in entrepreneurial operations.

It is well known that both the volume and the quality of investment are affected by the prevailing macroeconomic climate. In Latin America, emphasis on trade balances and stabilization ignored capital formation and the regulation of the level of economic activity. This seems to be a serious deficiency which –together with the crisis– helps explain the marked reduction in the formation of new capital and in the utilization of installed capacity recorded during this decade.

The neo-structuralists seek to regulate capital movements, the exchange rate, trade policy and the interest rate, in order to build a stable macroeconomic framework which, as a source of confidence in future economic policy, promotes capital formation and the acquisition of comparative advantages as a means of taking advantage of and increasing investment and innovation opportunities. On the other hand, they also recommend direct public actions that affect the development of comparative advantages and complement private investment initiatives (Ffrench-Davis, 1990).

4. *The renovation of the State* [8]

Today the State is clearly overwhelmed by demands and its financial position is weak, especially after the debt crisis. Governments have had serious difficulties in fulfilling their basic economic functions of supervising macroeconomic equilibria, promoting equity and avoiding stagnation with regard to foreign exchange, savings and investment. The neo-structuralists recognize many of these problems and, following a pragmatic approach and using the lessons of experience, are seeking to build a consensus as regards the new role of the State.

According to this consensus, where the question is not so much the size of the State as its capacity for management and concerted action, its main economic function can be defined as follows: it must formulate a strategic vision of the development process; it must reorder and maintain economic incentives and relative prices in a manner coherent with this strategy; and through constructive dialogue and concerted action, it must ensure that all social and political sectors are committed to this strategy. A State efficiently organized in this way around a central function, i.e., a State based on concerted action, would represent a new stage in Latin American development, characterized by an emerging democracy and the need to adjust the development strategy.

Considering these necessary adaptations and redefinitions, the neo-structuralists maintain that the role of the State needs to be strengthened in its classical functions (providing public goods, maintaining macroeconomic equilibria and equity, etc.); in its basic functions (minimum transport and communications infrastructure, health care, housing, education, etc.); and in its auxiliary functions (support for structural competitiveness of the economy by promoting or simulating markets not yet in existence, development of the scientific and technological infrastructure, elimination of or compensation for the defects of the market, etc.). These functions are more important than its entrepreneurial and productive functions which were critical in the past but today are

[8] See Salazar (1990).

less necessary. The State should reorganize its finances, especially by consolidating its sources of revenues through tax reform. As for expenditures, it must establish investment priorities and rational the public investment programme, it must also reduce subsidies, except for those that are truly redistributive. Actions to increase the efficiency of public enterprises are also important. For example, the State must limit their objectives to those that are productive. It must make them more competitive by granting them greater financial and managerial autonomy, by allowing them to charge prices similar to those of a private enterprise, by fixing "social" prices only in a limited and exceptional fashion, by subcontracting and inviting bids for auxiliary services and by privatizing "non-strategic" productive enterprises.

Given the need for development "from within" for the support of an efficient State, it is essential that an optimal strategy for intervention should be designed. Neo-structuralism emphasizes the following elements for such a strategy.

First, since the administrative resources of the public sector are limited, its action cannot attempt to attack the innumerable distortions of the economy, but only the most important ones. Therefore, priorities must be established for State intervention.

A second and urgent requisite is to decentralize and depoliticize public administration, since the more conflicts are resolved by the political system (as opposed to the market), or on a central level (as opposed to regional or local governments), the greater the burden of social demands on the central government, all of which creates problems for and overwhelms its capacity for action. Thus, if it can decentralize and depoliticize conflicts, this will help in an indirect but real way to reduce the overload and improve its efficiency. This rule is obviously not valid in the case of those defects and conflicts which would be poorly resolved on decentralized levels or by the market.

Finally, another important issue is that of providing institutional counterweights to asymmetrical pressure in favour of intervention. Since those who benefit from an increase of intervention are few (those who exert pressure) and those who benefit from reducing it are many (and therefore exert less pressure), intervention has a unidirectional character: it tends to increase rather than diminish. Therefore, automatic mechanisms should be created which anticipate this situation and which serve as counter weights. For example, a policy of differentiated tariffs will produce growing and rising disparities between sectors; tariffs not only become different but they also have a higher average value. Thus, when a differentiated policy is established, an average tariff can be established: every time one tariff rises, another one has to be lowered in compensation. This provides a kind of institutional counterweight against a natural rising trend.

We end here the synthesis of the more important aspects of the neo-structuralist agenda for Latin American development. In the following and final section, we will analyse to what extent neo-structuralism comes close to or departs from its neo-liberal counterpart, which was summarized, at least in its main lines, in the previous section.

III

Neo-liberalism versus neo-structuralism: a critical balance

As already mentioned, this final section presents a critical examination of the proposals we have analysed, in order to draw positive lessons for economic policy and development in Latin America. It would appear that on the basis of pragmatic considerations and the lessons of experience correctly interpreted, our countries are moving towards a compromise between the less extreme neo-liberal positions and the traditional economic conceptions of Latin American development, duly reformulated.

This compromise between the two proposals is derived perhaps from frustrating experiences in one camp or the other, from the crisis conditions which continue painfully and interminably, and from the less ideological and more pragmatic attitudes that are beginning to dominate in these first years after the cold war. However, this does not modify the basic difference in the axiomatic and philosophical premises underlying both proposals. This is not the place to delve into this question, since it belongs to another level of abstraction. Nevertheless, it should be recalled, however briefly, that liberalism and structuralism and their corresponding "neo" versions conceive of and explain in very different ways the behaviour of the individual in society.

The Liberals, as the heirs of individualism and utilitarianism, presuppose the existence of the abstract categories of freedom of choice and the rational calculations of the individual economic agent in the market, be he producer or consumer. This assumption gives shape to the most efficient forms of action. On the basis of this generic concept of individual conduct, they postulate the elimination of any interference that limits the people's freedom of choice and flexibility, especially from the State, which they consider to be the originator and ultimate guarantor of any kind of interference.

The Structuralists, in turn, at least in Latin America, interpret the economic behaviour of individual agents according to historical contexts, especially of a socio-economic and institutional character, in which such agents formulate their options and develop their conduct. They consider that individuals form themselves into organized social groups in a multitude of public and private institutions, which develop over time a series of values and rules of behaviour. These forms of social organization constitute, in turn, veritable cultures which limit and orient individual conduct. Thus, because of their different national historical experience and international relations, Latin American societies and economies have their own distinctive structural and institutional characteristics, which proposed development policies have to take into account. Hence, even though the general lines of development policy may be very similar, considerable differences can persist in the sphere of action and in policy instruments, especially, of course, with respect to the role of the State.

Against this background we can now discuss development proposals themselves. However, first we must clarify some points concerning the real roots of the current economic crisis in Latin America. We should recall again that already in the 1960s ECLAC was warning about the deep structural problems of Latin American development: excessive protectionism, narrowing of the reducible margin of imports, huge external and fiscal imbalances together with a loss of economic dynamism and growing unemployment. Many countries of the region accepted the structuralist recommendations and elaborated economic policies aimed at correcting the excessive distortions by gradually and constantly adjusting the exchange rate, reducing and rationalizing tariffs and promoting exports. However, the overabundance of cheap external financing during the 1970s, the concomitant financial permissiveness and the mistaken signals from a deregulated financial market obviated the need for adjustment policies and exacerbated the disequilibria by covering them over with the veil of external indebtedness.

In this regard, the real lost decade, from the perspective of opportunities and possibilities, was the 1970s. Resources were available then for gradually improving the productive and financial apparatus on the basis of an explicit policy of restructuring and development. The present situation is exactly the opposite. External indebtedness and liberalization policies have made the disequilibria worse: unmanageable external debt, critical levels of domestic indebtedness, severe fiscal imbalance, runaway inflation, vertical fall in the investment rate, etc. None of these problems was so acute in the early 1970s.

Having made these clarifications, we can now begin the actual debate on structural adjustment in Latin America. A perusal of the proposals outlined in the preceding sections shows that both the neo-liberals and the neo-structuralists agree on the immediate need for profound changes in the economic structure of our countries. Nevertheless, there is considerable disagreement about the policies needed to introduce those changes, and about the size of the role played by the State and the market in the strategy of recovering and consolidating development.

Originally, the neo-structuralists wanted to provide an alternative to the orthodox neo-liberal view of adjustment. They sought less recessive and less regressive solutions to the problems of inflation and trade imbalance through the stabilization and heterodox adjustment programmes of the 1980s (Lustig, 1988). Like that of the neo-liberalists, theirs was an essentially short-term approach. But, to the extent that many of the adjustment plans of either side failed and the crisis persisted, the neo-structuralists returned for inspiration to the positive legacy of a specifically Latin American doctrine: the structuralism of the post-war decades. Despite this close identification with the original structuralist arguments and as a consequence of the change of historical circumstances in which they were formulated, the neo-structuralists revised some of their assumptions and tried to remedy their deficiencies. These included an excessive confidence in the value of State intervention, an exaggerated and overly prolonged pessimism about external markets, and an incautious management of short-term economic policy which failed to provide timely and practical answers to conjunctural problems, particularly by underestimating the monetary and financial position (Rosales, 1988). Thus, they recognized explicitly that recommendations cannot be made for the long term without a clear picture of the possible repercussions of structural change and without devising methods of handling problems arising from the transition (Lustig, 1988).

From this new standpoint, which shows an undeniable concern for development in its broadest sense, the neo-structuralists have criticized neo-liberalism mainly because of the extreme nature of its policy agenda. They consider it to be closer to the old sayings about the moral superiority of the market than to economic rationality and empirical corroboration of its practical successes in the real world. This impression is clearest in the discussion about the State's role in the economy. In particular, the neo-liberalists avoid any discussion of the effective capacity of State administration and its ability to change economic incentives and the mechanisms and institutional processes for decision-making. What they want in practice is the automatic reduction of the size of the public sector with no clear theoretical backing for its relation to economic growth.

This attitude is clearly reflected in proposals like that of Selowsky (1989) which seek to achieve a fiscal surplus by reducing expenditures in a context of reforms designed to reduce taxes, all of which constantly undermine the financial capacity of the public sector. Besides the indispensable modernization of the system for collecting taxes and controlling tax evasion, the tax structure would have to be reorganized so as to give greater relative weight to income and property taxes. To some extent, this would be a return to the progressive taxation which the crisis and neo-liberal policies have been reducing (Rosales, 1990). Similarly, the justification for privatization is based especially on criticisms which emphasize the poor performance of public enterprises, the negative fiscal effects of unprofitable enterprises and the defects and inefficiencies supposedly inherent in public administration. However, the structure of the markets is just as important –or even more so– in explaining the comparative performance of enterprises, not to mention management objectives in themselves which escape conventional norms for evaluating a private enterprise. Moreover, the fiscal impact can be negative when profitable public enterprises are privatized (Salazar, 1990).

Consequently, because of this ideological assumption that the origin of every imbalance lies in the public sector, neo-liberal policy-makers are very sensitive to any imbalance in this sector, while almost completely ignoring the possibility that the private sector might have a destabilizing influence.[9] The neo-liberal experience in the Southern Cone during the mid-1970s revealed that private interests could seriously destabilize the economy, either because they made mistakes in their inflationary expectations or because they created financial bubbles out of collective euphoria and monetary permissiveness. They forgot that these private interests could follow anti-social or even counterproductive policies in a context of a serious and widespread lack of competition and of broad disequilibria (Ramos, 1984).

Nevertheless, we must heed the neo-liberal warning of the dangers of the limitless expansion of State management, which results when the government tries to satisfy the interests of the more organized groups in society rather than the common good. For this reason, the neo-structuralists stress that the public sector must be modernized, depolitized and decentralized; that an optimum intervention strategy must be designed for deliberately promoting development; and that selectivity, competitiveness and professionalism must be the main guidelines for the social efficiency of public action (Ffrench-Davis, 1988).

On the other hand, the neo-liberals argue quite logically that markets should be liberalized and price mechanisms rationalized. But they have become unilaterally obsessed with exogenous or government-imposed distortions and fail to observe how the economic system behaves when a market plagued with endogenous or intrinsic distortions is liberated, a basic concern of the neo-structuralists. Clearly, there is no basis in economic theory for a policy that tries

[9] They also ignore the complementary character or the crowding-in of public and private investment, especially as regards infrastructure, technological promotion and the level of public social expenditure, all of which leads us to question their desire to cut off resources to the public sector and limit its capacity for action in areas as relevant as the development of our economies and public investment.

to limit all the distortions imposed by the government, whether in the trading system or on the home front, while ignoring endogenous distortions and the specific structures of the markets.[10]

The neo-structuralists feel that structural distortions are the main cause of economic problems and largely explain the persistence of the region's underdevelopment. But they also recognize that these distortions give rise to defects and errors in economic policy. Hence, they want to complement the action of the market with vigorous and selective State action in order to remedy the serious structural imperfections which are still prevalent in our economies. However, owing to the asymmetrical nature of the pressures for State intervention –in favour of more and not less intervention– the neo-structuralist suggestion about defining automatic institutional counterweights is particularly relevant for preventing this situation.

In addition, in the formulation of a commercial strategy, the neo-liberalists tend to establish a strict equivalence between export-promotion policies and free-trade policies based on the principles of static comparative advantages, the absence of State intervention in the price system, and in some cases, *laissez faire*, and the marked absence of an active and promotional role for the State. Therefore, even though the neo-liberal critics of development strategy are right to insist on the importance of utilizing external markets as dynamic sources of demand, we may question their tendency to assign equal importance to outward-looking policies, free trade and the absence of State intervention (Salazar, 1990).

The neo-structuralists have a substantial interest in devising the best means of promoting external competitiveness. The reduction of trade barriers can be considered an indispensable initial step, but even so, it is clearly insufficient. Indeed, if they are to improve their trade insertion over the medium term, our countries must achieve a competitiveness reinforced by technological innovations and productivity increases going far beyond the short-term earnings which can motivate the rationalization of price incentives. Such a challenge involves the more structural elements of the economy which are related to technological policy, industrial policy and the educational system and which are systematized in the norms of international competitiveness now in effect. In this regard, the concern with trade liberalization is only part of a broader problem: how to coordinate and modernize the productive apparatus and make it more competitive (Rosales, 1990).

In another area it is interesting to note the extent of the agreement between the two proposals that there can be no definitive solution to the crisis without reversing the net transfer of resources from Latin America to the exterior. The difference lies in the degree of confidence which the advocates of structural adjustment have in a solution proposed by the international banks, the multinational credit agencies and the governments of the industrialized nations –a solution which the debtor countries would have to support with an open-door policy for foreign investment.[11] The neo-structuralists want the Latin American countries to adopt a more decisive attitude and recommend a negotiated total or partial suspension of external transfers, provided that they undertake to channel the resources thus released into a national fund for productive restructuring and social development to finance projects mainly designed to increase the efficient production of tradeable goods and to tackle the most serious social problems (Sunkel, 1990).

Finally, we should ponder the dramatic recessive and regressive effects of the neo-liberal experiments in structural adjustment. The emphasis on reducing aggregate expenditure in order to achieve minimum macroeconomic stability and manageable external imbalances has led to a sharp decline of the product, high unemployment and sharp cuts in real wages. Moreover, in the fiscal counterpart of this recessive adjustment, the reduction of public expenditure was concentrated in social services and investment. As a result, the poorer sectors have become much worse off and the possibilities of future growth have been seriously threatened.

[10] As Anne Krueger recognizes, the analysis of the effects on well-being of alternative trade policies (and of others) becomes excessively complex when it is assumed that it is impossible to eliminate all distortions. When attention is centred on the effects of changing a policy instrument, while keeping in place the distortions in other parts of the system, the general theory of the second-best indicates that anything can happen (Salazar, 1990).

[11] In Rosales' opinion (1990), it remains to be seen whether or not the debtor countries can count on *ex-ante* external support which would facilitate stabilization and structural reforms. For the author, external financing has not functioned in this way for many of the Latin American economies, and the failure of the Baker initiative and Mexico's difficult negotiations to begin to reduce the debt under the Brady initiative are good examples of this. In fact, the conditionality arising from the debt crisis is considered to be the main instrument for exerting pressure in favour of structural adjustment, which would ultimately open the doors to capital and private external financing.

It is no surprise, then, that the neo-structuralists share the concern for policies which re-establish basic macroeconomic equilibria, but at the smallest possible recessive cost. Theoretical considerations and well-grounded empirical observations provide evidence that heterodox adjustment programmes may prevent a recession or at least minimize its effects. Such programmes –whose less recessive character has already been recognized in studies representative of a more orthodox line (Selowsky, 1989)– call for policies that not only control aggregate demand but also, as regards adjustment, provide a sharp initial stimulus to the reallocation of resources towards the production of treadable goods, and as regards stabilization, influence expectations through price and income policies. The consideration that equity is a prerequisite for, rather than the result of the sustainability of every development process explains the greater emphasis given to productivity instead of aid in the social efforts of governments. Undoubtedly, if they follow these criteria, they will have a better chance of achieving an adjustment with growth and more equity.

There must also be a permanent concern for the political and social implications of each economic change. This special aspect of structuralist policy makes it impossible to treat these issues with the idea of joining forces to counteract opposition to the reforms. Rather, the State must call for concerted action to promote cooperation instead of conflict between the social partners so that they decisively commit themselves to a more equitable and democratic vision of national development.

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CEPAL REVIEW No. 42

Evolution and present situation of styles of development

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The subject of styles of development represents a systematization, carried out largely in ECLAC during the periods following those of Prebisch. However, it is based on the fundamental themes of two works on peripheral capitalism: the evolution of the periphery, its social structure, income distribution, the appropriation of surplus, the opposition between centre and periphery, the criticism of economic liberalism, crisis and transformation.

Section I of this article offers a general overview of studies on styles of development and their linkage with mathematical simulation as an instrument for hypothesis testing. Section II analyses the interrelationships between systems (capitalism and socialism), structures (developed and underdeveloped) and styles of development. It seems useful to distinguish between these categories of analysis, given the confusion that exists between them and, above all, given the present opposition between the arguments favouring homogenization (only one model is possible, namely, the neoliberal one) and the pluralistic position, which recognizes the heterogeneity existing in various countries and which will probably prevail in the future, in accordance with the relations established in each society. Section III states some conclusions on various aspects of the conceptualization of development.

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I
Styles of development

1. *Definitions*

One of the concerns of ECLAC and its leading theoreticians was the study of the qualitative features of development, independently or as a complement to the extent of growth. This broadens the definition of development to imply much more than growth, since it refers not only to the dynamism of the main economic aggregates but also to their structure and their political and social projection. Development "consists of systematically interrelated processes of growth and change" and "expresses an aspiration to a better society".[1] In this way the concept of development comes to include elements of political and economic power and social, technological, sectoral and regional elements that shape the kind of society one wishes to arrive at.

Within this overall exposition, Aníbal Pinto has described the "style of development" as a category of analysis, linking it with systems (capitalism and socialism) and with structures (developed and underdeveloped). Style would then mean the political, social and economic option adopted within a given system and structure.[2]

The term "social style" is applied to the way in which a society lives, works and evolves. It includes a style of consumption, work, technology, science, art and political action. If the desired society is different from the present one, essentially in terms of productive forces and property, it is logical that the word "style" should be very similar to the expression "mode of production". If there is influence from anthropologists, historians or philosophers, the word will coincide with some of the meanings of "culture".[3] In the economic sphere, style of development is defined as "the way in which human

[1] See Marshall Wolfe, *El desarrollo esquivo: exploraciones en la política social y la realidad sociopolítica*, Mexico City, Fondo de Cultura Económica, 1976, pp. 23 *et seq.*

[2] See Aníbal Pinto, "Styles of development in Latin America", *CEPAL Review*, No. 1, Santiago, Chile, first semester of 1976. United Nations publication, Sales No. E.76.II.G.2, pp. 99 *et seq.*

[3] See Oscar Varsavsky, *Obras escogidas*, Buenos Aires, Centro Editor de América Latina, 1982, p. 12.

and material resources are organized and assigned within a particular system with the object of solving such questions as what goods and services to produce, how and for whom".[4]

The utopias that are part of human history were the historic equivalents of styles of development. Basically, what is involved is an attempt to guide development according to certain values. In recent years these values have been justice, social homogeneity, national self-determination, ecological balance and the like.

2. *Brief history of studies on styles*

In the matter of styles, Latin American studies not only were outstanding but predated those of developed countries. In the early 1960s attention began to be given in the developed countries of the North to the question how the growth rate they had reached, for which Keynesian policies were being applied, could be maintained. At that time the liberal orthodoxy that International Monetary Fund policies sought to implement was being questioned in underdeveloped countries. The structure and operation of "peripheral capitalism" was being judged on the basis of a global criterion: "the phenomena of development cannot be explained by economic theory alone; one must arrive at a global theory that will integrate all the elements of the world system of capitalism. Peripheral capitalism is part of this world system, but it has its own specificity".[5] "Styles of development" thus appear as a productive and autonomous line of analysis of our own problems and crises. In what follows, I shall outline the beginning of these studies in Latin America, carried out by the Centre for Development Studies [Centro de Estudios del Desarrollo - CENDES] of the Central University of Venezuela, Caracas, and by ECLAC during the 1960s and up to the mid-1970s.[6]

The CENDES studies were guided by Oscar Varsavsky. Their originality lies not only in their having been pioneering attempts –the first works date from 1962– but in having provided the theoretical concept with an instrument for the testing of hypotheses. The preparation and application of the method of mathematical simulation (defined in section 3b of this chapter) produced a suitable tool for evaluating the feasibility and the consequences of alternative styles of development. The CENDES group has rightly maintained that "the possibilities of making theoretical comparisons between hypothetical alternative styles of development were rare and questionable before the appearance of detailed mathematical models and simulation" and that "It is time for the qualitative aspects of development to be brought to the forefront, and it is interesting that people are starting to do this with numerical methods".[7]

The CENDES studies are predominantly methodological. Initially they were based on Edward P. Holland's doctoral thesis, which contained an outline of mathematical simulation applied to the economy of India.[8] In 1961, Holland settled in Caracas to work at CENDES, with the support of Jorge Ahumada, its founder, and of Héctor Hurtado, Director of CORDIPLAN. After three years of work, he presented the V-2 model, which reproduced Venezuelan economic history between 1950 and 1962.

Oscar Varsavsky, who analysed these studies, formed a group of "modelists" in 1962 at the Institute of Computing [Instituto de Cálculo] of the School of Exact Sciences [Facultad de Ciencias Exactas] of the National University of Buenos Aires (MEIC-0).[9] In late 1964, Oscar Varsavsky and Carlos Domingo decided to carry out a sociological application of the method. They formalized Sir Thomas More's *Utopia*, which was programmed and experimented upon

[4] See Aníbal Pinto, *op. cit.*, p. 105.

[5] See Raúl Prebisch, *op. cit.*, p. 30.

[6] A collection of the main works may be found in Oscar Varsavsky and Alfredo Eric Calcagno (comps.), *América Latina: modelos matemáticos. Ensayos de aplicación de modelos de experimentación numérica a la política económica y las ciencias sociales*, Santiago, Chile, Editorial Universitaria, 1971.

[7] See CENDES (Centre for Development Studies), Grupo de modelos matemáticos, "Estilos de desarrollo", *El Trimestre Económico*, vol. 36, No. 144, Mexico City, October-December 1969, pp. 517 and 518.

[8] See Edward P. Holland, *Simulation of an economy with development problems*, Cambridge, MIT (Massachusetts Institute of Technology), 1961, doctoral thesis.

[9] The team consisted of Arturo O'Connell, Helios Paulero, Jorge F. Sábato, Víctor Yohai, Nélida Lugo and Mario Malajovich.

simultaneously in Caracas and in Buenos Aires, with the collaboration of Jorge F. Sábato. At the same time, mathematical simulation techniques were used to formalize economic models –with the incorporation of social variables– for Chile (1965) and Bolivia (1968).[10] In mid-1966 a new group of mathematical models was set up at CENDES, Caracas, directed by Oscar Varsavsky, who constructed a series of models that were used by CORDIPLAN (Prod-ingre, Dem and Educ).[11] At its fourteenth session (Santiago, Chile, 1971), ECLAC submitted the study prepared by the Economic Projections Centre for Latin America [Centro Latinoamericano de Proyecciones Económicas] on "a model for comparing styles of development or optional economic policies".[12] In 1975, also under Varsavsky's guidance, the ECLAC Office in Buenos Aires began to prepare a model of the Argentine economy, with major social and economic implications. This had to be interrupted in mid-1976.

In 1966, at the Massachusetts Institute of Technology, José Agustín Silva Michelena applied the *Utopia* model to a real society (that of Venezuela).[13] The study on *Utopia* encouraged Oscar Cornblit, Torcuato Di Tella and Ezequiel Gallo to prepare and apply a model of political change in Latin America.[14] In 1972, Alfredo Eric Calcagno, Pedro Sáinz and Juan De Barbieri published *Estilos políticos latinoamericanos*, based on lectures given by the authors at FLACSO between 1966 and 1969. In this study a mathematical model was formulated and applied to concrete cases of Latin American political experience.[15]

At the Santiago, Chile, branch of the Pan American Sanitary Bureau Mario Testa prepared a health model.[16] Similarly, a joint ECLAC/ILPES project developed a demographic model, under the guidance of Angel Fucaraccio, for studying problems of integration.

Conceptual development was begun at CENDES and was later concretized in ECLAC, particularly in the works of Oscar Varsavsky. The central elements are put forward in Oscar Varsavsky's book *Proyectos Nacionales* and Marshall Wolfe's book *El desarrollo esquivo* and in articles by Aníbal Pinto, Marshall Wolfe and Jorge Graciarena.[17] Subsequently, in the 1970s, this theoretical approach converges with studies on the United Nations Secretariat's unified approach to development and with works on the International Development Strategy. It was then that the preparation of studies on "other development" was begun in developed countries. However, this research concentrated on conceptual aspects and lacked the mathematical tools for projecting towards the future and for testing hypotheses.

[10] See Juan de Barbieri *et al.*, *Modelos para estudios de inflación en Chile*, Santiago, Chile, Latin American and Caribbean Institute of Economic and Social Planning (ILPES), 1965; Mario La Fuente and Arturo Núñez del Prado, *Modelo de experimentación numérica para la formulación de políticas de corto plazo en Bolivia*, La Paz, Ministry of Finance, 1968.

[11] See CENDES (Centre for Development Studies), Grupo de Modelos Matemáticos, *Modelo para planificación a mediano y largo plazo, "PROD-INGRE"*, Documentos de trabajo series, No. 4, Caracas, 1968. The team led by Varsavsky was made up of specialists with a high turnover rate; among those who made a significant contribution are José Bianciotto, Roberto Frenkel, Luis Leal, Luis Marzulli, Arturo O'Connell, Juan P. Pérez Castillo, Mario Testa and Lourdes Yero; and for CORDIPLAN (Central Office for Planning and Coordination), Héctor Hurtado, Jorge Trebino, Mauricio Valery and Lincoln García.

[12] ECLAC (Economic Commission for Latin America and the Caribbean), *Modelo para comparar estilos de desarrollo o políticas económicas optativas* (E/CN.12/0907), Santiago, Chile, April 1971.

[13] See José Agustín Silva Michelena, "Venutopia I: modelo experimental de un sistema político nacional", *Cambio político en Venezuela*, Caracas, Centre for Development Studies (CENDES), 1967.

[14] See Oscar Cornblit, Torcuato Di Tella and Ezequiel Gallo, "Un modelo de cambio político para América Latina", *Desarrollo Económico*, vol. 7, No. 28, Buenos Aires, Instituto de Desarrollo Económico y Social (IDES), January-March 1968.

[15] See Alfredo Eric Calcagno, Pedro Sáinz and Juan De Barbieri, *Estilos políticos latinoamericanos: un método de análisis y nueve casos*, Santiago, Chile, Latin American Faculty of Social Sciences (FLACSO), 1972.

[16] See Mario Testa, "Formulación de políticas de salud", Centro Panamericano de Planificación de Salud, Santiago, Chile, 1975, *mimeo*; *Saude em debate*, No. 1, Rio de Janeiro, 1976; and M. Bernacchi *et al.*, "Modelos numéricos: su aplicación para el análisis de una política de financiamiento de la atención médica", *Atención Médica*, vol. 1, No. 3/4, Buenos Aires, December 1972-March 1973, pp. 70-136.

[17] See Oscar Varsavsky, *Proyectos nacionales: planteo y estudio de viabilidad*, Buenos Aires, Ediciones Periferia, 1971; Marshall Wolfe, *El desarrollo esquivo . . ., op. cit.*; Aníbal Pinto, "Notas sobre estilos de desarrollo en América Latina" (ECLA/IDE/DRAFT/103), Santiago, Chile, ECLAC, December 1973, and the revised and expanded edition, 1975, *op. cit.*; Marshall Wolfe, *Styles of development*, Santiago, Chile, Social Development Division, ECLAC, January 1974; Jorge Graciarena, *A propósito de los estilos de desarrollo: una nota heterodoxa*, Santiago, Chile, Social Development Division, ECLAC, 1975.

3. *Convergence of theoretical analysis and method: styles and mathematical simulation*

a) *Styles of development*

A characteristic feature of Latin American studies on styles of development is that the analysis of the degree of satisfaction of the needs of various sectors of the population, which makes up the style of development, is combined with the mathematical instruments to reproduce reality and test hypotheses. In this aspect I shall follow the analysis of Oscar Varsavsky.[18]

One begins by defining the needs that society must take into account in order to satisfy them to some extent, or not to satisfy them; these included: i) physical needs: food and clothing; housing, home furnishings and services; other durable goods; health care; transport and other personal services; ii) social needs: social security, including solidarity and integration; access to global information and communications; the basic social nucleus (family and/or other); form of urbanization; equality in the distribution of products and prestige; guaranteed individual liberties and the organization of individual life; limits and distribution of working time for each age; iii) cultural needs: education and training; recreational leisure and sports; creative and innovative leisure, (scientific, artistic, handicrafts); world view; satisfaction at work (physical conditions, stimuli, alienation); iv) political needs: participation in various types and levels of decisions; various types of national autonomy and the country's role in the world; private property (guarantees and limits); regional development policy for the country; freedom to change national projects and the ultimate legacy of resources; methods for resolving social conflict; policy for population size and structure; institutional structure (organization and type of institutions).[19]

Once needs have been determined, major population groups are classified according to the extent to which these needs are met. This gives rise to a first classification of styles according to "whether production is aimed at the population's needs or at the needs of the companies themselves and of those who control them. Thus there appear two classes of styles, which we inelegantly refer to as 'people-centric' and 'company-centric'".[20]

Next, an attempt is made to determine the feasibility of given strategies for satisfying the listed needs to the extent desired. First, one tries to ascertain whether they are physically feasible. i.e., whether the available resources –natural, human, technological and capital– are sufficient to produce the goods and services required. The second question is whether they are socially feasible, i.e., whether they are compatible with the attitudes and traditions of social groups and with institutional organization. Lastly, one determines whether they are politically feasible (including ideological and military aspects), which involves knowing whether the strategies have the support of political forces that possess the power necessary to implement them.[21]

b) *Mathematical simulation*

Mathematical simulation models are realistic models of major social systems applicable to subjects such as economic development, social conflicts, political strategies, the evolution of civilizations or economic imbalances. They are used as criteria for qualitative decisions: choosing between a few alternative courses of action, whose effects the model helps to compare.[22]

The model used in experiments carried out in ECLAC "is based on a computable scheme that is calculated year by year with the aid of the usual coefficients, trends, elasticities and rates, on which there is copious information, obtained directly or through international comparisons, and which permit some reasonable suppositions to be formulated with little risk. In essence, an attempt is made only to reproduce the usual calculations and lines of reasoning, but –and this is the *raison d'être* of the model– to do so in an integrated fashion, in a coherent and easily manageable scheme". "The model makes it possible to calculate the effects of complex policies, formed by various simultaneous measures whose consequences are not always convergent, so

[18] See Pedro Sáinz and Alfredo Eric Calcagno, preface to *Obras escogidas*, Oscar Varsavsky, *op. cit.*, pp. 12 *et seq.*

[19] Oscar Varsavsky, *Proyectos nacionales . . .*, *op. cit.*, pp. 34 and 35.

[20] Oscar Varsavsky, *Obras escogidas*, *op. cit.*, p. 25.

[21] *Ibid.*, p. 23.

[22] *Ibid.*, pp. 352-355.

that their ultimate effects cannot be intuitively foreseen. For example, it would not be a simple matter to use a mental or intuitive scheme to foresee the feasibility and consequences of a policy that attempts to combine labour-intensive technology with an improvement in income distribution, which in turn would change the sectoral structure of demand and would reverse trends in import needs. It must be stressed that the degree of reliability of quantitative results will depend on the accuracy of available data and hypotheses on technical coefficients (e.g., the productivity of labour and capital, average useful life, input coefficients and import substitution, each of which is broken down according to sector and technology)."[23]

The model makes it possible to carry out comparative policy studies, analyses of parameter sensitivity, analyses of reasonableness (search for reasonable parameter values that would render a desirable policy feasible) and to make the results constantly better. Moreover, the short and long terms can be coherently taken into account. Basic characteristics, methods, results and costs are simultaneously analysed. Studies conducted by CENDES referred to three styles of development: creative, consumerist and authoritarian. The following description is that outlined by the CENDES group of mathematical models.[24]

The creative style places priority on the development of creative capacity, and therefore on education. Its goal is an autonomous culture that is not isolated but is critical and creative. Imitation of developed countries is discouraged. Employment increases greatly, and since real wages do not decrease, enterprises are adversely affected in terms of wage costs, though not in market terms. The State becomes more involved in production. Wages do not increase either, but one must add to them the income attributable to governmental services and the reduced cost of marketing. Private services and agriculture have a smaller share in output. There is an increase in public services, construction and all branches of industry. Taxation policy is severe and progressive, so as to finance the cost of education, health care and other free services. Foreign investment is discouraged.

[23] See ECLAC, *Modelo para comparar...*, *op. cit.*, pp. 4 *et seq.*

[24] See CENDES, Grupo de modelos matemáticos, *op. cit.*, "Estilos de ...", *op. cit.*, p. 519.

The consumerist style attempts to catch up with developed countries; in other words, the aim is to achieve a welfare society in which the diversification of consumer goods is encouraged and efforts are made to create a market for them. Its culture is "imitative": copying the major countries in habits of consumption, fashion, arts, science and technology. Its organization is liberal-monopolistic, with copied but very state-of-the-art technology, and it encourages foreign investment. There is little State intervention in production. Education is seen as an instrument for training the human resources indispensable for the country's technology. Wage policy is dual: on the one hand, wages must increase in order to create a domestic market, and on the other, they must decrease in order to ensure competitive export prices. This leads to low wages in dynamic activities and high wages in all others. Fiscal policy tends to be more "progressive", but it must encourage foreign investment.

In the authoritarian style, the predominant values are authority and order for maintaining the traditional society (with a certain measure of modernization). A strong nation is desired, but realism requires accepting the leadership and patronage of one or another of the major world blocs. Its culture is a blend of traditional values and imitation. It will create a strategic infrastructure (communications) and heavy industry, even if it must use foreign capital. Labour productivity increases slowly, and wages at a somewhat lower rate. There is a large bureaucratic and security apparatus (domestic and external) facilitated by the pressure of unemployment. There is little participation by the State in production, except in heavy and military industry. Government is the most dynamic factor in product growth, followed by construction. Industry and services maintain their participation, and that of agriculture is lowered somewhat.

In the mathematical simulation carried out both at CENDES and at ECLAC the feasibility and consequences of each style were analysed in detail. The conclusion reached was that every development plan requires the prior selection of a style of development as a frame of reference and that this style must be concretely expressed in terms of economic variables, giving them the most explicit qualitative content possible.[25]

[25] *Ibid.*, p. 538.

II
Systems, structures and styles

1. *General approach*

At a time when the possibility of economic and social solutions offering an alternative to present ones tends to be denied, it seems appropriate to use styles of development as instruments for observing reality. In the study below, I shall use the categories of analysis established by Aníbal Pinto, which distinguish different systems, structures and styles.[26]

The systems –capitalism and socialism– differ particularly in their institutional organization and socio-political structure. In the economic sphere, the basic contrast between them is said to lie in the "relative importance of public and private expenditure, in terms of both consumption and investment. In the capitalist system, the composition and dynamics of demand are primarily linked with market forces in the area of private consumption and investment, and with the rate of return on the allocation of resources. In the socialist system, the main elements are decisions by the State (or the Plan) regarding investment and public community consumption".[27]

A second category arises from the classification into developed and underdeveloped countries. "The essential difference here is in structure and consequently, in manner of operation and in place and relationship (dominant or subordinate) in the world scheme."[28]

"... [I]n these contexts of system and structure, owing to a variety of significant factors, widely differing specific styles manifest at all levels of social life may be discerned within each of these broad groups."[29] Table 1 shows a variety of styles within the capitalist and socialist systems and of developed and underdeveloped structures. It is intended to indicate the fundamental traits of coherent global models, and consequently a fundamental logic within a system-structure complex. The alternatives cited are not intended to set up questionable antinomies but rather aim at pointing out the predominant ingredients in the solution of given problems.

The interrelationships between systems, structures and styles may contribute to systematizing and clarifying some current situations and conflicts, e.g., the extent to which the liberal style hinders getting out of a structure (underdevelopment), or how the authoritarian style is an offence against a system (socialism).

In this work I shall deal only with the relationship of styles to the capitalist system, within the underdeveloped structure. I exclude the developed structure for lack of space, and an analysis of the situation within the socialist area would require recent information which I do not possess.

2. *Styles in underdeveloped capitalism*

I shall refer only to the general situation in Latin America, since the analysis of other regions or of particular countries would require a much more exhaustive analysis.

a) *Some characteristics*

i) Economic and social

The socio-economic situation of Latin America is dominated by two contradictory features: on the one hand, by the enormous progress made over the last 30 years, both in overall results and in the emergence of new economic and social structures; and on the other hand, by structural heterogeneity, which leads to the persistence of enormous differences between countries, sectors and social classes.[30]

As is pointed out in an ECLAC document that outlines what has occurred between 1950 and 1984, "there is a tendency towards the reproduction of incorporation and exclusion, integration and disjointedness, modernization and heterogeneity, almost as an operating condition of the modality",

[26] See Aníbal Pinto, "Styles of development ...", *op. cit.*, pp. 99 *et seq.*

[27] *Ibid.*, p. 102.

[28] *Ibid.*, p. 103.

[29] *Ibid.*, pp. 103-104.

[30] See Alfredo Eric Calcagno, *El pensamiento económico latinoamericano: estructuralistas, liberales y socialistas*, Madrid, Ediciones de Cultura Hispánica, 1989, pp. 19 *et seq.*

Table 1

STYLES OF DEVELOPMENT WITHIN SYSTEMS AND STRUCTURES

System \ Structure		Developed	Underdeveloped
Capitalist	Political:	Conservatives. Social democracy.	Dependent oligarchy. Popular nationalism.
	Economic:	Liberalism. Mixed economy.	Liberalism. Mixed economy.
	Social:	Unemployment. Employment.	Marginal population. Integrated population
	Cultural:	"American way of life" Originality.	Imitation. Creativity.
Socialist	Political:	Authoritarianism. Participation	Authoritarianism. Participation.
	Economic:	Centralized planning. Market mechanisms.	Agriculture. Industrialization.
	Social:	Satisfaction of consumption with privileges. Mass primary consumption.	Unsatisfied higher-quality consumption. Satisfaction of primary needs.
	Cultural:	Openness. Closure.	Imitation. Creativity.

i.e., of the current style of development. Inequitable societies were thus formed, with very different levels of productivity and with a marked concentration of power and income. External relations were governed by asymmetry and vulnerability, and the age-old subordination –based on unequal trade– became more acute with financial and technological dependence.[31]

Within this underdeveloped capitalism –to follow the framework of system and structure– various styles of development are generated (table 1).

ii) Political

By definition, the countries considered are externally dependent and domestically underdeveloped. As a result, the articulating role of the State is determined by what is being articulated: an international context that uses coercion to bring about subordination to hegemonic Powers, and a national society with enormous inequalities and with a great concentration of power and income. In terms of power, it would be logical for the "articulating" instrument and its policies to be the result of this scheme of forces, and consequently it would respond to the interests of developed countries and local oligarchies. But this system is incompatible with democracy. Thus, if one seeks to obtain a minimum of legitimacy –i.e., to enjoy some measure of popular consensus– there arises a contradiction in which supranational powers and dominant local groups are pitted against the majority of the people.

These idiosyncrasies of underdeveloped countries give a different meaning to the role of the State and another sense to the attributes of sovereignty and legitimacy. The enormous imbalances between potential and real sovereignty and between full legitimacy and the legitimacy that exists in practice are manifest in the lack of social consensus on the role of the State and in the ruthless struggle for control of it. Since the range of possibilities is very broad, the State could be either the direct executor of an economic policy favouring the popular classes or the manager of a policy guaranteeing the order necessary for the traditional politics of the oligarchy and for multinational corporations and banks. Moreover, this role of the State is irreplaceable: there is no other instrument accessible to the popular forces for imposing their policies; and conversely, the oligarchic and multinational forces need the State, as an instrument not only for imposing social discipline but also for financing and subsidizing their activities.

[31] ECLAC, "Change and crisis: Latin America and the Caribbean 1950-1984", *Crisis and Development: The Present Situation and Future Prospects of Latin America and the Caribbean* (LC/L.332(SEM.22/3)), vol. 1, Santiago, Chile, 1985.

Table 2

INFLUENCE OF POLITICAL AND SOCIAL FORCES IN EACH POLITICAL STYLE

	Neoliberal capitalism	Military-oligarchic dictatorship	Popular nationalism	Moderate socialism	Advanced socialism
Political forces					
Executive power	X	XXX	XXX	XX	XXX
Political parties	XX	-	X	XX	-
Social forces					
Agricultural entrepreneurs	XX	XX	X	-	
Industrial entrepreneurs	XX	X	XXX	XXX	-
Financial oligarchy	XXX	XXX	X	X	-
Exporters and importers	XXX	XXX	X	X	-
Foreign capital	XXX	XXX	X	X	-
Industrial workers	X	-	XXX	XXX	XX
Farmworkers	X	-	X	XX	XX
Marginal population	-	X	XX	-	-
Armed forces	X	XXX	XXX	X	XX
State bureaucracy	X	X	XXX	XXX	XXX

Note: The degree of influence ranges from - (minimum influence) to XXX (maximum influence).

b) *Political styles*

Political styles which are currently predominant in Latin America or which could eventually be established are: i) neoliberal capitalism; ii) military-oligarchic dictatorship; iii) popular nationalism; iv) moderate socialism; and v) advanced socialism. Each of these regimes has its own internal power structures and combines with the international context (table 2).[32]

i) Neoliberal capitalism

Regimes of this nature presuppose the prevalence of a constellation of forces made up of financial capital, of multinational and large national corporations and of importers and exporters, with a notable weakening of entrepreneurs and workers of the remaining majority, at least in the domain of the economic and social constellation. At the formal political level, democracy remains in force. The economic role of the State is not the one theoretically assigned to it in neoliberalism, since, far from being neutral, it dictates the norms that suit the hegemonic group. The productive structure becomes subordinate to the country's international position, and the most dynamic sector of the economy is linked to foreign trade. Moreover, there is a regressive redistribution of income, and as a result, several possibilities can arise: either the government maintains the democratic forms and loses the elections; or the regime shifts towards more spurious political forms, in which it maintains the democratic forms but betrays the governmental programme which it was elected to carry out; or it manipulates the mass communications media; or a military-oligarchic dictatorship is established. At the same time, it pursues a policy of assistance to those living in conditions of abject poverty in order to prevent mass protests or violent outbursts from the marginal population, while the large number of unemployed persons makes it impossible for those who do have work to offer any resistance.

ii) Military-oligarchic dictatorship

In this case the economic situation that arises is similar to the preceding one, but it includes an authoritarian regime which does not respect the right

[32] On this point I shall summarize part of the work we prepared in collaboration with Benjamín Hopenhayn, "Especulaciones sobre la estructura política de América Latina hacia el año 2000", *América en el año 2000. Situación social de América Latina en el año 2000*, Lima, Instituto Peruano de Estudios

to life and suppresses or severely curtails individual liberties, in particular those of association for political or trade-union purposes and the expression of ideas. The main social support groups are the same as in the preceding case, but there is an increase in political control and a disappearance of political parties and trade unions. The two regimes would tend to establish the same "style of development" by different means. There could also be a differentiation which depends on whether the traditional or the modernizing character of the regime is accentuated; in the former situation the landowning and commercial sectors will prevail, particularly those linked to exports, and in the latter, foreign capital and the financial oligarchy will do so. In both cases, social disassociation may occur, with the majority of the population being excluded.

iii) Popular nationalism

The basis of support here would be the workers, national entrepreneurs and part of the middle class. The economic scheme would be based on the domestic market and the Latin American regional market but not necessarily limited to it, to the extent that non-spurious competitiveness is gradually achieved in the various branches of activity. The State would play an essential role, both as manager of the economic process and as entrepreneur. At the cultural level, technological development and inherent cultural values would be encouraged.

iv) Moderate socialism

Presupposes the practice of domestic democracy based on a party system, combined with vigorous State action at the economic level. It would involve a socialism which would tend to limit external conflicts and whose base of support would be a democratic State that would respond to workers' organizations and to small and medium-sized entrepreneurs. There would be progress in the nationalization of industrial conglomerates –particularly the multinational ones– of the banking and financial system and of foreign trade.

v) Advanced socialism

In the present case of Latin America, presupposes a system that overcomes the old class hierarchy through a change in the external framework. At all levels of economic activity the main enterprises would be nationalized, and the regime would change to one of self-managing or centralized administration.

c) *Economic styles*

Economic styles, outlined above when we considered global strategies, can be grouped into two archetypes: the neoliberal and the popular nationalist. Each of these models has a "genetic code" that is manifest not only in the general concept but also in the country's international position, in the dominant economic agents, in the industrial and agricultural profiles, in income policy and in the accumulation of capital. These distinctive traits are summarized in table 3. Recently, the most outstanding distinctive features of these styles have involved the financial sector and the role of the State.

In the neoliberal style, reliance is placed on the benevolence of the automatic operation of the market, which is looked upon as becoming a source of reason and justice. However, the unrestrained boom of the financial sector and its lack of linkage with production, together with the negation of the ethical aims of politics and economics, has led to the emergence of a new kind of capitalism: predatory capitalism, in which the only matter of interest is obtaining the maximum profit possible.

In the popular nationalist style, an attempt is made to strengthen the State and substantially increase its efficiency in terms of national objectives (not on the basis of an exclusively mercantile criterion), as the defender of national sovereignty, the executor of public expenditure and the promoter of genuine private investment.

d) *Social styles*

Social styles correspond to a comprehensive strategy of segregation or exclusion on the one hand and integration on the other.

The strategy of segregation is based on the view that current problems cannot be resolved for the entire population within the current scheme. As Pedro Vuskovic states, "issues such as the external imbalance, the satisfaction of social aspirations and demands, the overcoming of shortages within the various aspects of general living conditions, the contradictions between technical progress and the magnitude of unemployment and underemployment of the work force would be impossible to resolve for the entire economic system or the population as a whole in the light of the current crisis and the heritage of the past. In fact, the constraints on mobilizable resources, external conditioning and restrictions of every kind would make a policy of concentration and selectiveness mandatory. Hence, the strategic key to setting the process in motion would be to concentrate all possible resources and apply them to one segment of society, accepting, as the supposedly unavoidable counterpart, some form of marginalization of the rest".[33]

[33] See Pedro Vuskovic, "La situación actual y las perspectivas de América Latina", Mexico City, 1989, *mimeo.*

Table 3

PROBABLE ECONOMIC POLICIES IN ALTERNATIVE ECONOMIC STYLES

	Popular nationalist style	Neoliberal style
Global model of development	Industrializing model that favours the domestic and Latin American market. New exporting branches based on skilled labour. Driving social forces: workers and national industrial entrepreneurs; support from a large proportion of middle-class wage-earners. Significant State action. Full employment.	Primary exporting model; industrial exports, based primarily on low wages. Driving social forces: the financial sector, large national farming and industrial interests and the multinational sector; support from the non-wage-earning middle class. Less participation by the State. Boosting of extractive mining activity for export.
Position on the international scene	Greater autonomy with respect to the major developed capitalist countries. Latin American integration. Cooperation with other under-developed countries. Control on rate of exchange. Restrictions on imports.	Close relations with developed capitalist countries. Production policy and foreign-exchange policy geared to promoting exports. Denationalization of public enterprises.
Economic agents	Preponderant State action. Incentives to national entrepreneurs, particularly medium-sized and small ones. Worker participation.	Preponderance of multinational corporations and banks and large national entrepreneurs. State action in support of these groups. Subordination of workers.
Industrial model	Strong and integrated industrial sector in pursuit of international competitiveness in some branches, based on technological development, and therefore on the added value of products and on highly skilled labour.	Boosting of export industries based on public incentives, low wages and natural resources. Creation of export enclaves.
Farming model	Improve control of foreign trade. Tax structure that prevents deficient land use. Support for technological improvements.	Full operation of the market. Appropriation and allocation of surplus by producers and exporting companies. Boosting of technological improvement.
Income policy	Redistribution in favour of wage-earners. Increase in fiscal revenues through progressive taxation. Increase in "indirect wages". Increase in employment.	Redistribution in favour of non-wage-earners. Incentives to exporters. Increase in fiscal revenue, maintaining the preponderance of indirect taxation. Significant drain of resources to other countries.
Accumulation of capital	Maximum utilization of domestic savings and export income. Prevention of offences and abuses against the State in this area and earmarking of such funds for investment.	Appropriation of surplus by predominant entrepreneurs. Incentives to the entry of foreign capital.
Economic thought	Economic planning. Preservation of national independence. Policy with a strong social and regional content. Favouring of work and production as against speculation.	Laying the groundwork for prevalence of the market. The State must guarantee order. Social aspects are not governed by economics and are manageable through a policy of assistance.

The strategy of integration implies the pursuit of social homogeneity and political participation, as well as the satisfaction of the basic needs of all inhabitants, with solidarity as the basis of social relations.

The present situation tends towards segregation. Its seriousness is reflected in the ECLAC study on changing production patterns with social equity: "the lack of economic dynamism, the modifications of the employment situation" (growth of the informal labour market and the deterioration of real wages), "and the cutbacks on public spending all contributed, in one way or another, to the increase of extreme poverty, particularly in urban areas. In very general terms, it is estimated that in 1980 some 112 million Latin Americans and West Indians (35% of households) lived below the poverty line; this number rose in 1986 to 164 million, which accounted for approximately 38% of households. Similarly, in the vast majority of countries there arose pockets of productive modernity, generally associated with the export of non-traditional goods, which contrast with the panorama of backwardness".[34]

e) *Cultural styles*

Cultural styles may be described as imitative or creative. The advance of "the American way of life" as a world paradigm and of its cultural consequences is discussed. Likewise, a "culture of speculation" is being established, originating in the economic domain and spreading to the political (the "wagerers" are replacing the militants) and to the cultural. In the latter, more importance is being given to the formation of competitive and success-oriented élites, without any commitment to ethics or to social solidarity.

In Latin America there is perhaps a greater margin for local creativity, and one would have to distinguish between pressure from the media –particularly television– and pressure from cultural expressions with some originality, some of which have important historical roots.

[34] See ECLAC, *Changing Production Patterns with Social Equity. The Prime Task of Latin American and Caribbean Development in the 1990s* (LC/G.1601(SES.23/4)), Santiago, Chile, March 1990. United Nations publication, Sales No. E.90.II.G.6, p. 33.

f) *Interrelationships between systems, structures and styles*

In the reality of underdeveloped countries, political, economic, social and cultural styles are homogeneous. For example, in the cases shown in table 1, the first styles cited (dependent oligarchy, liberalism, marginalization and imitation) are coherent, as are also those mentioned second (popular nationalism, mixed economy, integration and creativity). This means not that styles are interchangeable like clothes but rather that the processes involved are gradual ones, centred in certain areas. Each style has a different degree of feasibility and tends to be anchored in or to emerge from the system or structure in force.

In the political domain, the neoliberal capitalist style and the military-oligarchic dictatorship style are typical of an underdeveloped structure and more or less openly constitute an authoritarian modality of the capitalist system. Instead of the trade-off between political legitimacy and economic accumulation (i.e., social expenditure versus productive investment), which is more typical of developed countries, we now find a cruder and more elemental trade-off between political legitimacy and the oligarchic appropriation of surplus by local or foreign groups. The popular nationalist style introduces some modalities of the socialist system and attempts to escape from underdevelopment. It would be legitimate, since it would have popular support, but it would clash with the policies of international financing centres and of local oligarchic groups, which tend to predominate.

In the economic domain, if "predatory" capitalism were consolidated and productive capitalism continued to decline, an important variable would be introduced into the system. One could no longer talk of "capitalism" without a qualifier: it would be necessary to characterize it. With regard to structure, "predatory" capitalism would leave the country anchored to underdevelopment. A popular nationalist style would practise productive capitalism with social ingredients –primarily equity– and headway would be made towards a mixed-economy regime.

In the social domain, a choice must be made between excluding and integrating the majority of the population. If economic and social policies lead to a dual society, the country will remain with an underdeveloped structure. Social integration, on the other hand, would mean an enormous step towards development.

In the cultural domain, the underdeveloped structure offers greater resistance to the effective material dissemination (through cultural apparatus, television, and the aspirations it generates) of "the American way of life" which, among other "details", would require a per capita income 10 times as high as the Latin American average. Generally speaking, these patterns have been deeply absorbed by local social groups which do in fact have such an income. For the others, cultural development will mean an intelligent assimilation of the best international culture and technology and an appreciation of Latin American creativity.

III
Conclusions

This overview of the background and methodology of styles of development and of their interrelationships with systems and structures leads to a reassessment of this approach. Its categories of analysis, the pluralist and qualitative approach, technical rigour, the relevance of the structural examination and of the medium and long term make it an excellent instrument for analysing reality. Its dynamic quality reflects the changing reality of today. The opposite analysis, with another ideology, i.e., the neoliberal ideology, which is now in the ascendant, claims to be the only valid one, whereas the pluralistic approach to "styles" considers it to be merely one more among many. Hence, in this work it is assigned a double role: as the main contradictor of "styles" and as one more among the styles considered.

1. *The categories of analysis*

The distinction between systems, structures and styles (put forward by Aníbal Pinto) makes it possible to differentiate and to pinpoint accurately the basic problems of development. At a time when there was confusion regarding the categories of analysis, he came up with a clear and dynamic scheme. Within each system and structure, the styles not only constitute "the way a society lives and works" but also "the way it evolves", i.e., goes from one modality to another within the system or structure, or even more, changes one or the other or both.

2. *The pluralistic approach*

The existence of a plurality of styles is recognized as being real and appropriate, and the qualitative aspects of growth are thus reassessed. The prevailing neoliberal theory makes it appear that growth is the natural outcome of the implementation of given macroeconomic policies and structural reforms (processes of privatization, deregulation, etc.) which spontaneously generate it, energized by the international economy. It is asserted that this scheme is inevitable –that there is no other alternative– and moreover, that it is desirable: no matter how socially unjust it may be, the prosperity it generates will eventually be disseminated to other strata of the population. In contrast, "styles of development" teach us, above all else, that there is a plurality of possible political and economic solutions, that they benefit and harm different groups and that have very different social and cultural implications. Furthermore, these styles do not develop spontaneously through the release of market forces or the lifting of cultural or informational censorship. Rather, they are achieved and consolidated through public policies and political processes. Opposed to the rigidity of the neoliberal model, which is presented as the only feasible one, there appears the entire gamut of possible styles, which, moreover, include the possibility of changing the system and structure.

3. *Technical rigour in analysis*

The Latin American application of styles of development is characterized by the technical rigour with which its mathematical simulation technique endows it. At a time when many political and economic theses in vogue are based on specious reasoning and *petitio principii* (as I believe I have shown, with regard to neoliberalism, in my book *"Versos" para no pensar*),[35] "styles of development"

[35] See Alfredo Eric Calcagno and Alfredo Fernando Calcagno, *"Versos" para no pensar. Fábulas contemporáneas sobre política y economía*, Buenos Aires, Editorial El Despertador, 1989.

are an example of technical rigour. In the mathematical methodology employed, economic operation and the operation of certain social variables in the past are reproduced in a set of equations. On this basis, alternative policies are projected, and their feasibility and consequences are shown by the model. All of this is done with complete transparency, making assumptions explicit and permitting the testing of any other alternative. In this way, qualitative hypotheses can be subjected to "experimentation" and testing.

4. *Reassessment of the structural approach and of the medium and long terms*

In "styles of development" we adopt a structural outlook that is inserted into the overall social reality, which in turn responds to a historic reality. As Aníbal Pinto states, "this definition, seemingly so 'neutral' and basic, conceals a separation from, and even a repudiation of, what could, in contrast, be called the 'atomistic' view which is still so much in vogue".[36] The liberal scheme, besides fragmenting reality, focuses on the here and now, since everything pertaining to the medium and long terms will be taken care of by the "market" in the best possible way.

5. *The social and political consequences of implementing different styles*

In the liberal model there is an incongruity between the economic and the political aspects. As has been shown repeatedly and for many years now, there is a fundamental contradiction between political and economic liberalism (political legitimacy is contradicted by the exclusion or economic misery of the majority of the population); and liberalism excludes the social aspect, which, in addition to everything else, will –or will not– improve when the market forces operate. In contrast, the "styles of development" approach forms the basis for raising the political and social objectives of legitimacy, participation and solidarity, which determine the economic scheme.

6. *Economics as the handmaiden of politics*

The liberal theses championed by the International Monetary Fund view economic policy as if it were a mixture of exact science with punishment administered as medicine. First, they contend, there is a technical problem whose consideration leads to a sole prescription that is applied and brings sound policies which will foster growth. Next comes the punishment –i.e., the adjustment– which the majority of the population suffers, as a result of policies alien to them. The inevitable nature of the solutions precludes political debate and reduces economies to the best administration of what is fatal and inevitable. This process disguises the identity of those who are helped and those who are hurt and the decline of national sovereignty, which consists in political decisions. On the other hand, the scheme of "styles of development" returns to "political economics" –the opposite of the technocratic view– and starts off with the classical affirmation that the art of economics is the handmaiden of politics, and decisions on fundamental issues are shifted to that domain.

[36] See Aníbal Pinto, preface to *Introducción a la economía*, Antonio Barros de Castro and Carlos Francisco Lessa, Mexico City, Siglo XXI Editores, 1971, pp. 4 and 5.

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Adjusting power between the State and the market

*David Ibarra**

The models that dominated economic science and policy in the first three decades of the post-war period have broken down and there are no consummate replacements. The outlook seems to be conservative. The late 1970s turned back the clock which was moving for two centuries in the direction of morally justifying State intervention intended to moderate or correct the social inequalities produced by market operations. Part I of this article explores these trends.

Today exceptional importance is given to economic efficiency and to liberalizing competition as a disciplinary incentive for producers and even for countries acquiring worldwide markets. Part II deals with these issues and part III examines, from the experience of the first world, how the Keynesian model is in decline.

Since the third-world nations do not usually produce universally accepted theses, changes in the models and ideologies of the North have to be assimilated a fortiori sooner or later. This normally generates discord of great importance between the dominant foreign doctrines and the reality of third-world countries. Part IV takes up this subject.

The clearest expressions of contemporary solutions for age-old tensions between the market and the State are found in the processes of opening to the exterior and privatization or deregulation. Parts V and VI study these questions.

The final part seeks to identify the justified demands for change in the styles of State intervention, with special reference to Latin America. Finally, some general conclusions are drawn.

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I

The upward trend of State intervention

Explaining the ebb and flow of the theory, practice and ideology underlying the models of economic policy calls for a reference to history.

Modern institutions of production began by establishing liberalism as a form of economic organization. The British industrial revolution and Adam Smith created, explained and upgraded the market to the rank of supreme coordinator of the actions of the myriad of producers, intermediaries and consumers.

This gave rise to a sharp divide between the domain of politics and the domain of economics. For the first time economic power was privatized and a dichotomy arose between the State and the market, between private law and public law, between efficiency and equality. Hitherto, the social standing of each individual determined his position in production and economic power and political power were thus always united. For that reason, the State as a social institution was quite older than the market.

The ideological justification for this first and enormous truncation of the State's traditional power was the need to counterbalance despotism and the arbitrary passions of rulers (Hirschman, 1981). The political justification was the need to incorporate peacefully within the élite the nascent entrepreneurial groups; and the economic justification was the need to reorganize production and its institutions on foundations more consistent with the technological and institutional progress of the time.

From then on the pendulum began to swing in the opposite direction. Economic models, ideologies and especially social pressures led the State to recover some of its lost ground as a governing power. The unrestricted functioning of the market, although it facilitated capital formation and efficient production, rewarded only the winners of the competition. By so doing, it created social inequalities that were unsustainable over the long term and later proliferated monopolistic or oligopolistic forms of production which nullified many of the virtues of the classical model of competition. It gradually became clear that the market, with its unequal relations in the division of labour and its formal equality among trading partners, was intrinsically unable to provide distributive equity (Bobbio, 1978). The idea of economic justice arose precisely at that time, advocating that ethical principles and the norms of social coexistence should prevail and regulate the market operations (Macpherson, 1987).[1]

With all its advantages, the economic organization of the market conceals the issues of the distribution of income and wealth and relegates them to a secondary level, giving primary emphasis to growth and accumulation. Thus, one of the key issues of any society does not receive due attention: the establishment of a community with goals not only for production, but also and inevitably, for distribution.

A free market leads to a concentration of economic power which becomes political power. For that reason, economic freedom ends up opposing the political equality and freedom increasingly demanded by social movements throughout the world. The dichotomy between private interest and public interest becomes obvious, especially during the phases of depression in the economic cycle, with their burden of social sacrifices which the market is incapable of correcting.

The market and democracy are disparate institutions; inspired by different values, they tug society in directions at times complementary, at other times the opposite, but always different.[2] Thus when dynamic tension threatens to tear the social fabric apart, political accommodations are usually made which bring into harmony –not logically but by consensus or imposition– goals as dissimilar as those of awarding the efficiency of the few while pursuing the equality of all (Ibarra, 1987).

[1] Strictly speaking, however, limits have always been placed on the legitimate action of the market, preventing it from being the only way for allocating resources, rewards or punishment. Transactions exist which are precluded from the changing sphere of commerce. Bribery, selling votes or government jobs, and simony violate the social rule that puts them outside the jurisdiction of the market.

[2] There are even important conceptual differences in the content they give to the term "freedom". Democracy understands freedom to be the capacity of a society's members to set norms for themselves with full autonomy. For the market, on the contrary, freedom means enjoying a sphere of action without State control. Consequently, the "liberal State" is where government interference is limited to a bare minimum. And the "democratic State" is where the organs of self-government are numerous (Bobbio, 1985, p. 197).

From the time of the British industrial revolution until slightly more than a decade ago, those axiological oppositions gave rise to a succession of reforms, all having as the common denominator an increase in State intervention and in legal norms so as to correct or compensate for the socially polarizing effects of the market.

Likewise, democracy, in its modern sense of granting equal rights to the whole population, is the result and the guarantee of the social struggle for equality, by attenuating the disparities resulting from the inevitable Darwinism of the economic organization of the market. The advanced Western countries were first organized as liberal societies and only very much later as democratic societies. Indeed, universal suffrage and civil rights for the whole population is a recent phenomenon. Previously the electorate consisted of privileged exclusive groups, to whom Governments had to answer for their administration.

For almost two centuries the evolution of labour legislation and controls over private activity or public expenditures faithfully reflected the results of the confrontation between the logic of the market and the logic of democracy. The public sectors of the different countries grew *pari passu* with the increase of the State's responsibilities in economic life, i.e., with repoliticization of the economy. Controls and protective labour laws, progressive taxes, antitrust provisions and the welfare State's complex of institutions were all established in response to the inequalities of distribution arising from free markets. Later, maintaining external equilibrium, the fight against inflation, anti-cyclical stabilization and the goal of full employment led the State to assume the function of administering the economy within stable paths of prosperity.

Reflecting the cultural and ideological climate dominant in the world during a good part of the present century, the developing nations followed interventionist trends. They added, however, a new dimension –this time taken from the planning experience of the socialist countries and the countries who rebuilt after the Second World War II– deliberate government involvement in production in order to overcome backwardness and poverty. That made an important difference: instead of placing controls on private activity or creating social-welfare institutions, public intervention in Latin America was guided, in almost all cases, into starting up directly productive enterprises. More than a welfare State, there was a State concerned with encouraging, but also replacing normally weak private entrepreneurs.

It is not surprising, then, that public expenditure during the present century rose from 10% to 40-60% of the domestic product of the industrialized nations and reached the range of 30-50% in the Latin American countries. Long gone were the days when Governments accepted no responsibility whatsoever for the lot of the poor, for compensating for the economic cycle, for generating growth, when material wealth was socially admired rather than resented (DeJasay, 1985). The State became the *locus* where the demands frequently found in different interest groups were not only settled but also met, and where the balance between the values of democracy and the market had to be determined.

The interventionist cycle –or the cycle of market regression– did not come to an end until the last decade, when formulations that had been brewing for a long time in some countries of the first world sprang to the fore and when many Latin American countries, having reached intermediate levels of industrial progress, were witnessing increasingly more serious struggles between stronger entrepreneurial classes and the traditional instigator State.

II
Economic models

On the level of ideas, economic liberalism, soon after it became the dominant model, had to face criticism, resist dissident doctrines and assimilate reforms dictated by the change of events or the evolution of theoretical thought.

Economists cannot claim to be innocent of participation in the turmoil of concepts concerning the roles of the State and the market. Leaving out schismatics and backsliders, the dominant ideological currents greatly influenced tremendous changes in public opinion. Analysis of the market's defects, monopoly, unfair competition and later, non-essentials, technically justified a broad range of government regulations. In the macroeconomic sector, the elimination of chronic unemployment, compounded fluctuations, or price and exchange-rate volatility removed any scruples about State management of the economy. In some cases the contribution of economic thought was a critique of market functioning –with proposed remedies; in other cases, ideological currents that had already become strong in political theses and practices were simply incorporated.

Today the critique is at the other extreme. Economists have stopped pointing out the faults of the market in order to dedicate themselves to identifying the faults of State intervention. They have been equally successful in this new terrain. Bureaucratism and bureaucratic power, excessive regulation, the lack of initiative, waste, welfare-State paternalism, abusive tax burdens, and the proliferation of parastatal enterprises are some of the issues that have awakened the interest of economic scientists.

Once more the third world is following those trends in their dual aspect of economic doctrine and political ideology. The reason is simple: those nations do not, on their own, usually generate formulations with an appreciable degree of universality. The phenomenon of dependence is more patent in cultural, scientific and technical subordination than in economic relations, and a state of development is not always congruent with sociopolitical models, which usually unite or "harmonize", without vast gaps, the reality and culture of advanced countries.

For all the correspondence existing between world ideological movements and the specific circumstances of the third world, there is always some historical inconsistency. It is true that the ideas of political and economic liberalism gave enormous impetus to the modernization of Latin American societies in the last century. But it is also certain that they helped to accentuate or leave aside some very important socio-economic problems, such as the concentration of land or genuine democratization of governmental systems.

There was no flagrant inconsistency between the conditions in Latin America and the Keynesian model; actually they were rather complementary. Without fully reintegrating the economy into the domain of politics, the idea of placing the management of large economic complexes under public tutelage made it possible to form a social consensus that brought widespread benefits with it.

The State took over part of the role of the "invisible hand" in trying to resolve the cycles of prosperity and depression which escaped the powers of the market. Workers and the middle class benefited from guaranteed full employment in the present and greater future participation in the benefits of material progress. The stability of demand supported the generation of profits and multiplied the investment opportunities of private enterprise (Ibarra, 1987).

More than 30 years of world prosperity after the Second World War bear testimony to the efficacy of the Keynesian political consensus. Under its aegis the goal of full employment in the advanced countries could become, with no ideological contradiction, the growth objective of the third world, initiated and given impetus by State intervention. Thus Latin America undertook changes of tremendous magnitude, promoting industrialization, encouraging urbanization or forming middle-class strata. Moreover, the sustained expansion of world markets benefited Latin American foreign trade with unusual intensity, in spite of the import-substitution strategies.

Prosperity, however, had its costs and gave rise to new problems. Note how the banner of employment and growth, precisely because of their efficiency in harmonizing interests and concentrating social energies into a small group of issues, eliminated the reformist nucleus of democratic thought from public debate and the action of political parties. Indeed, by making economic development the central objective of the State's action and by becoming its main source of legitimation, the modernization of political systems was ignored. Thus, with very few exceptions, during the period of the greatest economic boom *the three decades following the Second World War* authoritarianism, *coups d'état*, the violation of human and civil rights were all frequent symptoms of a prolonged political crisis still in search of a stable solution in Latin America.

The Keynesian arrangement began to fall apart in the 1970s, owing to a complex combination of causes –which we can only briefly outline here– in the industrial countries. Fiscal equilibria broke down under the triple onslaught of the demands of the welfare State, support for private capital formation, and military expenditures. The rise of new industrial centres exacerbated worldwide market competition, transnationalized production and intensified technological change. Resources for meeting commitments to social justice began to thin out, owing to the community's resistance to tax increases, and the fact that they had to compete with demands of higher political priority: military expenditures and those related to remaining in the vanguard of international economic competition. Moreover, where it was still in effect, the out-of-date post-war model made the inflationary and payment imbalances even worse, as happened in the United States when it tried to finance simultaneously the war in Vietnam and President Johnson's Great Society project.

Anglo-Saxon political analysis of those same phenomena emphasizes the presence of inflationary expectations, fed by the mass media, political parties and the proliferation of interest groups. Social demands mounting at an explosive rate outstripped the economic and administrative capacity of the State. That, along with the influence of intellectuals –creators of an adversary culture– weakened the popular will to obey or made societies more and more ungovernable (Steinfels, 1979; Crozier *et al.*, 1975; Bell, 1976).

Faced with these changed circumstances and attitudes, a new model gradually took shape, with values shared by neo-liberals and neo-conservatives, based on many of the following theses.

a) Strengthening the market as the proper mechanism for allocating resources efficiently and for absorbing the activities that overwhelm State administration. To the extent that it ceases to participate or intervene in the economy, the State will be able to elude more easily the demands of different interest groups which jeopardize the political legitimacy of the State when their demands are heard less and less. Where excessive demands doom many government programmes to failure, the public authorities should protect themselves by dispersing the responsibility for deficiencies as much as possible (Steinfels, 1974, p. 64).

b) Defending the traditional principle of equal opportunities, but rejecting the equalization of social or economic conditions (of income or results) as dangerous for freedom. The welfare State is not repudiated entirely, but it is restricted to providing services and security with a minimum of interference in private affairs, and to not ruining the incentives for investment and work. The past expansion of public activity is proof not of a Government's strength but rather of its and the political leaders' weakness in not rejecting irrelevant demands from different social groups (Crozier, 1975, p. 164; Kristol, 1981).

c) The rescheduling of social priorities in the agenda of government action: in the economic sector, employment or growth loses ground as dominant policy objectives. Prior to them, price stability has to be ensured, incentives for investment and international competitive efficiency have to be re-established, and other so-called structural adjustments have to be made.

Unlike the Keynesian model (which sought to make the widespread distribution of benefits the basis of consensual agreement), the new approach seeks to underpin the working of the economy, by revitalizing profits and private capital formation, i.e., by submitting to the discipline of the market –without cushioning by the State– the rest of the productive agents and, of course, workers and consumers. In the long run, more investment and the absorption of technological improvements will raise productivity and facilitate growth, while simplifying the jurisdictional purview of the State will prevent the reappearance of excessive demands.

From a political viewpoint, it is a question of increasing the power and influence of entrepreneurial groups *vis-à-vis* other segments of society, in order to ensure international survival and reopen the road to or the hope for sustained prosperity.

Without a doubt, the new models reflect not only the state of economic sciences but also the circumstances and political climate of the leading countries of the industrialized world, seeking how to steer their changing societies or solve their problems. The proliferation of interest groups may complicate government action, making it necessary to erect barriers to "excessive participation" and to the pressure these groups exert on the budget and work-load of the public sector. It is also possible that the increase in the trade unions' negotiating power may have obstructed the mechanics of the market. Furthermore, the subsequent advance of the welfare State would probably have required tax increases or profits lowered beyond limits acceptable, in one case, to taxpayers and, in the other, to the business community. In its turn, the internationalization of economies limits the benefits that can be redistributed in favour of workers or the population at large, and even forces these benefits to be reduced so as to avoid losing the struggle for competitiveness, except where those costs are offset by improved productivity. Hence the pressures of the world-wide race for technological change.

Whatever the reasons may be for the shifting of models in the first world, the reality thereof obliges the developing nations to adjust to a new kind of historical discord between their reality and the dominant economic doctrines. Assimilating that discord will require in many cases enormous efforts and sacrifices, in the political sphere as well as in economic relations. In Latin America, more power has to be given to private entrepreneurs, despite the fact that democratization would rather call for increasing the participation of groups now only partially incorporated into modern life. The satisfaction of social demands has to be delayed even further, when the welfare State is still in an embryonic stage of development. Linkages to the exterior have to be strengthened when, in many cases, national identities are not yet consolidated. State intervention in production has to stop, when the enormous task of fully changing the direction and style of development is still under way. Political legitimation has to be sought in fields other than employment and growth. And furthermore, all the foregoing has to be achieved while protecting and coordinating in some way present trends, paradoxically inclined towards democracy and the modernization of political regimes.

Reforms and readaptations in the strictly economic sector are not any less demanding. First, a higher priority is given to achieving price stability and the balance of payments than to expanding production. Second, protectionism has to be fought against; the structure of relative prices has to be changed in favour of exporters; wage hikes have to be held below inflation rates; legal systems favouring foreign investment have to be established, to the point of making external demand the driving force of economic growth. Third, the severest fiscal discipline must be applied and sustained at all costs –mainly by reducing expenditures and investments, although also by raising the prices of public goods and services and increasing indirect taxation– while progressive taxes are lowered; State intervention must be reduced and public enterprises privatized or closed, until the market provides the impetus for development through private investment.

It is essentially a question of rapidly and radically changing the previous pattern of economic development. Private enterprise would exercise leadership instead of governance. The domestic market, which hitherto gave impetus and guidance to the development process, would have to be replaced by demand from international markets. At the same time, the rapid pace of change in the international economy multiplies the discrepancies to be overcome and the adjustments to be made in Latin American export structures, making productive reconversion and incorporation into the world-wide technological revolution requisites for survival in external competition.

In short, an extraordinary number of demands for reform is accumulating from both inside and outside the social systems of Latin America. Tensions overload government decision-making processes, obstruct the functioning of the economies and test the very resilience of political systems. Transferring responsibility for development to the market and the private sector demands major cultural changes. One such change consists of accepting trends in income distribution which would go against the sense of justice and equality as democratic values. Another change implies instilling in the business community a spirit of solidarity in the exercise of national responsibility, to the extent that economic power, unprecedented in this century, is placed in their hands.

"Not all the general goals of a nation are intrinsically compatible with any prevalent social order whatsoever. Whenever a conflict arises, we are obliged to choose between abandoning either the goal or the present order; if we choose the latter, we run the risk of using means which could defeat the end being pursued" (Lowe, 1987, p. 19). Such is the basic dilemma, the historical inconsistency of inserting oneself a fortiori into an international community where the standard view of the world is different in important aspects from the reality of the state of development, history and institutions of the Latin American nations. Certainly, if a disposition exists to impose the changes regardless of social costs, or if there is an overwhelming avalanche of world geopolitical forces, then any development pattern becomes possible, even if it is abhorrent to political democracy. That is what happened with the colonial model imposed by the conquest of Latin America, which destroyed the native economic systems and caused the downfall of the indigenous population in the sixteenth century.

III

Changes in economic policy

The circumstances described above are reflected directly in the radical change of approaches to economic policy. Not only are social objectives changed and narrowed, but other means are also chosen to meet them, while goals and instruments interchange positions.

Real growth of production and employment are no longer the basic and direct purpose of policies in the industrialized countries. The new economic models consider growth to be a by-product of the functioning of markets. Consequently, what is now essential is to eliminate obstacles, guarantee economic freedom and give productive agents the freedom to develop their activities.

If the welfare State is to be limited domestically, the objectives of aid to third-world development are likewise changed. The industrialized nations become more protectionist, while financing on soft terms granted to the periphery stagnates or is reduced. Moreover, the problem of the Latin American debt, which drains resources essential for development, continues unabated. Long gone are the days of Truman's Point IV programme or Kennedy's Alliance for Progress.

In this context, more emphasis is given to controlling inflation than to fighting against unemployment. The desire to gain credibility on the anti-inflationary front leads Governments to remain unmoved in the face of increased unemployment, which reach figures of 7% to 11% during the past decade in most of the industrialized economies. Thus in some cases, fiscal policy no longer makes up for fluctuations of supply and employment in order to set ceilings to the expansion of nominal demand, for the purpose of counteracting expansionary impulses that feed inflation. And, in other cases, recognition of the inconveniences and limitations of manipulating aggregate demand by fiscal policy puts an end to old-style government activism.[3] To a large extent, the high degree of economic interdependence and

[3] Even in the United States, where little has been done to eliminate fiscal deficits, the Gramm-Rudman-Hollings Act establishes objectives formally necessary for correcting those imbalances over time (Cloud, 1989).

particularly the very rapid integration of financial markets have been diminishing the autonomy of national policies, especially those that potentially claim to adhere to fiscal activism typical of the 1960s (Sachs, Warwick and Mckibbin, 1988; Volker *et al.*, 1987; Polak, 1988; Fisher, 1987).

By eclipsing the Keynesian model, monetarism comes to occupy a pre-eminent place among government policies. On the one hand, although temporarily, it substitutes for fiscal policy as the principal means for maintaining the channel and flow of the economy's nominal demand, abandoning its traditional function of regulating exchange rates (Williamson and Miller, 1987). On the other hand, the expansion of a monetary aggregate becomes the supreme goal of economic policy by taking it to be determinant, or at least univocally linked to the rate of expansion of nominal aggregate demand.

Economistic reduction of social goals reaches its most complete expression when the regulation of the money in circulation either alone or together with financial time-deposits becomes the social goal *par excellence.* The nineteenth century values of spreading and enhancing political freedoms and individual rights and the twentieth century values of full employment, growth and social rights are thus laid to rest. Is it any wonder that economic policy is losing its popular legitimating force in our time?

In relation to managing the balance of payments immediately after the Bretton Woods system (1972) was abandoned, exchange-rate stability ceased to be an objective of economic policy and became an instrument to adjust the effects of monetary policy. Indeed, when the expansion of a monetary aggregate was raised to the category of a goal, floating exchange rates had to be adopted as a means to eliminate the balance-of-payments deficit.

However, in the face of the resulting violent fluctuations in parities and interest rates, monetarist absolutism soon had to pull in its reins. Today, monetarist policy, according to some, should recover the function of limiting the swings in the exchange rate and help to control aggregate demand. In that way exchange-rate movements would cease to validate the domestic inflation of countries, forcing them to use other economic-policy instruments to control inflation instead of simply adapting to it. There are also those who reject the idea of using nominal anchors for stabilizing exchange rates as a guideline for monetary policy, in so far as they think that international trade is determined by the real magnitude of transactions.

The controversy remains unresolved. In practice, however, the industrialized countries' central banks have taken an intermediate road: without setting precise goals for stabilizing exchange rates, they have tried to bring exchange markets and interest rates to order through *ad hoc* intervention, with ample coordination between countries, which should also produce stability in the international financial system.

On the other hand, the centres unanimously agree that income policies –the consensual or forced management of the wages of certain productive agents– should be eliminated as an instrument for fighting inflation. The perception is that the use of income policies could create a lack of flexibility in the medium and long term by politicizing the economy and reducing the free market's area of influence.

Important changes are also taking place at the micro-economic level. The most significant structural change is designed to intensify competition in the market-place and reduce the State's share in value added. The deregulation of economic activity, including the financial sector, the privatization of State enterprises, the benign fiscal treatment of profits and reinvestment, and the reduction of the trade unions' power are all part of a set of measures that seek to increase efficiency, lower costs and reinforce incentives for private-capital formation.

These are the main elements of the structural reform put into effect in the early 1980s with different ranges and results in the industrialized countries, as the way to encourage production and producers, without recurring to the fiscal stimuli of demand that were so important in the Keynesian model.

In general, the main doctrinal trends in vogue downgrade government action to guide development, raise growth rates or provide employment for the work-force. Monetarists hold that Governments cannot effectively fight the ups and downs of the economic cycle. Increasing either expenditures or the money supply can perhaps cause the economy to grow momentarily, but that effect passes and a longer-lasting inflation is left behind.[4] The school of rational expectations is even more pessimistic. Indeed, it holds that economic actors, when they have

[4] Hence the recommendation that central banks should abide by a rule of steady expansion of the money supply in order to achieve price stability and thereby ensure a favourable investment climate on which long-term development depends (Friedman, 1968).

complete economic information, anticipate changes of government policies, thus cancelling their effects. Therefore Governments cannot change the course of the economy, except when they enact unexpected measures, but that can hardly be repeated without the productive agents foreseeing it. Fiscal and monetary policies, then, are barely strong enough to determine some short-term fluctuations in a long-term trend difficult to alter by deliberate government action (Lucas, 1972; Sargent and Wallace, 1983). Only the supply-side current, already on the wane, attributes a certain efficiency to economic policy for promoting capital formation, thereby making higher rates of development feasible. But those results depend on fiscal policy cutting welfare-State expenditures and increasing fiscal incentives for investment and saving, along with eliminating regulations and privatizing public activities (Gilder, 1968; Raboy, 1982).

In a nutshell, the dominant views are that government action is of little relevance as regards shaping economic phenomena and meeting the objectives of employment, growth and equity. And when they do admit more influence, they make it depend on the possibility of more generous compensation for the contribution of investors and savers *vis-à-vis* the rest of the population.

Economic policy is no longer actively promoting employment and growth or pursuing the correlative goal of an increasingly more equalizing distribution of income. To a large extent, employment, real growth and national income distribution are adjustment variables, i.e., they adjust *ex professo* when the higher objectives of price stability or competition in international markets are attained.

Therefore the elimination of income policies (price and wage controls) is relevant to the new model concerned with lowering costs and moving relative prices in favour of capital and exports, as well as reducing the negotiating power of trade unions. Also relevant is a fiscal policy less inclined to correct cyclical fluctuations and more interested in changing relative prices and the allocation of resources over the long term.

The metamorphosis of economic policies, with their objectives and instruments, is also the cause and effect of highly important cultural changes. Economic well-being, i.e., development as the social goal *par excellence*, is beginning to be less important than improvement of the quality of life of the populations in the advanced nations.[5] That is a result of the interaction of many social phenomena. High indices of material security and well-being enjoyed by first-world countries from the beginning of the post-war period, the ageing of their populations and recognition of the ecological limits of the planet are some of the many factors that explain the change over the long term in the value systems of the industrialized West, not to refer again to other factors of an economic nature (Inglehart, 1977).

Even so, the doctrinal pendulum would seem to be about to swing timidly back towards theses that allow the State a more active role in economic affairs. At least some areas of possible agreement are beginning to take shape, where disparities between facts and theory are examined in a fresh and eclectic way, over-restrictive presuppositions are abandoned, and a more rigorous basis for some economic conclusions is sought.

Of course the Keynesian belief in fine-tuning the economy or creating full employment through the easy expedient of a massive injection of public expenditures is disappearing. Also on the wane are monetarist approaches which claimed to solve problems of stability and even growth with fundamental and automatic rules for expanding the money supply. In contrast, there is agreement about the importance of the formation of expectations in determining the behaviour of economies, the presence of markets in structural disequilibrium or where open competition is not dominant, as well as the imperative need to provide much sounder micro-economic bases for macroeconomic designs. Even though a consensus is still lacking, some venture the opinion that the ingredients of a new neo-classical synthesis are beginning to take shape. State administration of the economy[6] is combined with economic freedom at the micro-economic level, with incentives for employment and production and the removal of labour-market rigidities. The restriction placed on the

[5] In the United States, Japan and Europe, investment and saving have been declining in relation to the product since the 1970s. Those highly significant behavioural changes in the economic agents and families probably explain a good part of the drop in development rates in the first world over the last 20 years (Agheveli *et. al.*, 1990, and Bosworth, 1990).

[6] Macroeconomic management implies guiding not only the levels of aggregate demand through fiscal and monetary instruments, but also the relative price structure of important variables, such as wages, exchange rates and interest rates.

autonomy of national policies by international interdependence is supposed to be solved by the industrialized countries coordinating their actions as a way of administering the world economy (Malinvaud, 1977; Friedman, 1985; Fisher, 1988; Dornbusch, 1990).[7] With regard to development, the superiority of competition is maintained, but import-substitution practices or deliberate policies for the promotion of industry and trade are no longer completely condemned, nor are they condemned with the same unanimity.[8]

The new paths opened up by contemporary economic thought and empirical analysis lead to more considered and cautious, less ambitious and assertive positions about the contribution of economic theory to achieving goals and formulating government strategies. Of course, the doctrinal crisis of economic science is hardly over and a new model is a long way off. Nevertheless, partial advances and the will to revise dogmas and admit different policy-setting viewpoints are beginning to provide interesting and practical theoretical contributions.

IV
The models as seen from Latin America

In Latin America, the new macroeconomics' lack of confidence in non-market solutions and the pressures of the economic crisis *expressed in severe disequilibria in budgets, prices and payments* have led to pre-eminence being given to short-term stabilization policies. The preferred instruments are fiscal adjustment and monetary restrictions, except in some countries where hyper-inflation made it necessary to use income policies. Moreover, the new models have become even stronger by being promoted simultaneously by the international financial institutions, bilateral aid agencies of the industrialized countries, and commercial banks. The resulting overlapping conditionality was beyond the resistance of Governments weakened by a severe lack of foreign exchange and resources.

Exchange policy, ever since the use of floating rates became widespread, has been used mainly as a valve for adjusting everything from the export sector to inflation. Efforts to stabilize exchange rates have generally been frustrated because of the extraordinary size of the disequilibria in payments and prices. The interruption of credit flows from international banks and the net transfer of saving to other countries either as debt service or capital flight directly destabilize exchange markets and public finance. Other factors are the immediate effects of opening economies to other countries, which will be discussed below.

Consequently, balance-of-payments adjustments have been mostly recessive, by having to be based on cutting down imports, given the longer period needed to increase exportable supply and the unusual size of the deficit on current account. Paradoxically, despite all the efforts to open economies, they are in fact closing.[9]

Fiscal policy has had to concentrate on eliminating budget deficits and seeking domestic sources to finance them, owing to the lack of external resources. The biggest spending cuts are in State investment and social services. Except for public-service rates or prices for goods produced by parastatal agencies, reform efforts on the side of government revenues have generally been minor or their effects have been largely counteracted by the drop in growth rates of production.

[7] It is easy to infer from the above that the return to Keynesianism is not only more cautious but also follows more conservative concepts regarding the welfare State. The liberalization of labour markets is seen as a necessary condition for reducing unemployment –beyond the natural rate– and achieving macroeconomic stability; the distributive effects of this liberalization are either ignored or considered a lesser evil.

[8] The prudence of recent theoretical approaches leads to the statement that protection should not exceed comparatively low limits or that the more complex the systems of State intervention, the greater the risks of falling into accumulative errors and inviting the frequently distortional action of pressure groups (Krugman, 1987). But, at the same time, they admit that when the unrealistic supposition of perfect competition in many international markets is no longer accepted, government intervention in favour of national enterprises may lead to better results (Helpman and Krugman, 1989; Levy and Nolan, 1989; Pompret, 1988).

[9] In relation to the product, Latin America's imports have fallen from 15.6% in the period 1976-1980 to 11.6% from 1985 to 1988.

Thus fiscal adjustment has also had strongly recessive results, in so far as it blocks public-capital formation to a large extent, and also by demanding that national bank resources be preferably channelled to financing budget deficits, making credit for private enterprise less available and more expensive. Many social demands have been eliminated, as witnessed by the cuts in social expenditures, investments and real salaries of civil servants. Despite this, other social demands have arisen and perpetuate the fiscal deficit. The conversion of private external debt into sovereign risk,[10] the large-scale transfer of Latin American savings to other countries and the high interest rates paid to citizens who bought government securities constitute expenditure items which normally represent 30% to 60% of central governments' budgets.

With very few exceptions, the inertia of external and domestic debt service, the decline in growth, as well as other restrictive factors in each country, have postponed or rendered impossible the goal of full fiscal adjustment. The same is true for the balance of payments, owing to the fact that the reconstruction of export sectors has been slow because of the natural inflexibility in transferring resources from one sector to another, especially when the process of physical and human capital formation is weak.

There seems to be more consolidation with respect to distribution, since the weight of the adjustment fell asymmetrically on certain social sectors. In almost all the countries there has been a decline in real wages –and their percentage of the product–, employment, and public outlays for social well-being, while rates for public services have risen and subsidies for mass consumption declined. Wage sacrifices have been relevant for raising interest rates and for changing relative prices in favour of so-called "marketable products". They have also been relevant for allocating the real income losses related to the deterioration of the terms of trade and the transfer abroad of savings.

[10] In 1982, the external public debt was half of Latin America's foreign debt. By 1985, it had reached 70% (ECLAC, 1990b).

Lower wages, apart from having social and political repercussions, have in some countries generated successive waves of impoverishment. The lower buying power of most of the population weakens market demand. Idle installed capacity raises unit costs, while the structure of demand is separated from the less flexible structure of supply. In these circumstances, either because of inflation in the costs of mass-consumption industries or because of excessive demand in industries that serve upper-class consumers, price and payment imbalances are worsened. This creates a need to reinforce measures for restricting demand which lead to repetitive cycles of depression.

The same sequence of events and policies weakens the capital formation process, i.e., it postpones indispensable structural adjustment on the supply side. The activities most affected are precisely those that are not consolidated. Indeed, new activities are usually the easiest to remove –no created interests are hurt– and they run greater risks despite having higher priority in long-term economic change. For example, solving the payments bottleneck mainly means increasing export capacity, and that implies investing in increasing or diversifying production, in improving the physical infrastructure –transport, communications, ports, storage facilities– and in creating support services –marketing, financing, insurance, computer services, technology and training.

The theses in vogue concerning structural change look to the market for solutions. A low, uniform and gradually descending import tariff and exchange policy as an instrument for balancing external accounts are two of the main procedures for changing relative prices in favour of marketable goods.

Without denying the suitability of the goals of the approach described above, it has often been too general actually to increase exports; in other cases, it has proved insufficient for breaking supply bottlenecks, and perhaps in still others –the successful cases– high social costs had to be paid.

Without a doubt, changing the relative price structure is the prerequisite for attracting entrepreneurial activity towards the export sector. Even so, given the congenital limitation of third-world resources, it is difficult to undertake the immediate manufacture of a broad range of new products for international markets with a good chance of succeeding. Likewise, the effective competitiveness of the developing countries is determined not only by production costs but also by a series of deficiencies in infrastructure, managerial capacity and support services. In order to remove these obstacles, public investment programmes must effectively promote export trade, and *ad hoc* industrial policy measures must be taken to allow for the manufacture and marketing of specific goods that can enhance dynamic comparative advantages.

Changing Latin America's external trade basically implies replacing the decisive role of exports that make intensive use of natural resources or labour with exports less vulnerable to decreasing yields and the inelasticities of world demand. It should be noted that vanguard activities in external trade –pharmaceutical, petrochemical, synthetic fibres, ceramics, computer and communications equipment, software, transport equipment– make intensive use of know-how and usually enjoy increasing yields.

These two characteristics, together with the fact that many markets are oligopolistic, invalidate the full applicability of the analytical model of the free-competition market. Different policy models have to be used, where State promotion and intervention can be appropriate (Helpman and Krugman, 1989; Brian, 1989; Gilroy, 1989; Levy and Nolan, 1989; ECLAC, 1990a). Efforts should be concentrated, therefore, on selectively identifying the nuclei of specialization in dynamic activities, and then do the same with respect to government support for technology, financing and insertion into external markets.

In other words, in addition to general policies for creating a macroeconomic framework conducive to structural change, micro-economic policies must be implemented to meet specific objectives where greater development potential is thought to be found and where public and private efforts can work together. Limited resources, imperfect or non-existent markets, and restrictions attaching to stabilization programmes render utopian the simultaneous attempt to achieve productive excellence in a multitude of activities and products.

Without question, the more rapidly and radically protectionist measures are dismantled, the more the change in relative prices will benefit producers of marketable goods. But that in itself does not shorten the turnaround time of investments nor the delays in transferring resources between sectors. On the other hand, the faster the process of opening the economy, the more severe the loss of jobs and production, and the greater the immediate disequilibria in payments.

When it is a matter of expanding, changing or diversifying production, demand can adjust much more rapidly than supply. There are also demands which macroeconomic policies cannot meet, when it is a question of specifically promoting particular activities, creating new comparative advantages or attaining productive excellence in specific areas of specialization. And there are conflicts or trade-offs between the objectives of stabilization, structural change and distributive equity, which oblige choosing combinations of them, knowing that they will have to be reflected in the costs of one or the other.

If the goal is to reduce social sacrifices and the time needed to consolidate complex processes of stabilization and adjustment, the macroeconomic strategies will have to be accompanied by specific industrial policies; to lower the sights on stabilization efforts at times in order to facilitate an orderly change in supply capacity; and to accept the need to complement purely market solutions with State intervention, be it to give incentives to priority activities or to ensure minimums of distributive equity, compatible with social and political stability.

The roots of price instability in Latin America are usually more complex than those of inflationary processes in the industrialized countries. In these latter countries, excessive public or private expenditures, external shocks or cost increases explain to a very large extent the emergence of pressures to raise prices. In Latin America, in addition to these factors that are often present, another series of inflationary factors comes into play: export trade poorly adapted to the structure of world demand[11] –which creates chronic exchange-rate tensions; the abrupt interruption of the flows of external savings –which raises interest rates tremendously; the rise in unit costs due to the increase of idle capacity –a product of the downward slope of demand and the enormous distributive adjustments that have been taking place; and unresolved distributive struggles, exacerbated by the unequal distribution of the adjustment costs.

[11] According to data from ECLAC, Latin America's share in the value of world exports fell by 50% between 1950 and 1980; a trend which has not been corrected despite recent efforts, as can be seen by the fact that it was further reduced from 5.5% in 1980 to 3.8% in 1989.

Fiscal policy has been incapable of fulfilling its normal functions and serving at the same time the external and domestic debt. Thus Governments have been forced to loosen the reins on expenditures or cease to invest in physical or human capital formation. Disequilibria in payments, in turn, exert pressure on the exchange market and distort expectations, feeding primary price rises which then make exchange adjustments necessary. That process, barely outlined here, obstructs private and public investments that could solve the lack of exports, efficiently substitute for purchases abroad or improve the competitive capacity of countries; and what happens with physical investments also takes place with human capital formation, as shown by the downward impact of the adjustment on social expenditures, wages and unemployment.[12]

For that reason, inflation in Latin America is far from controlled, as witness the fact that it reached record figures of 1 000% in 1989. Orthodox stabilization programmes can to a certain extent attenuate inflationary spirals, but at the cost of stagnation. And when discipline is relaxed or production expands, they return with more virulence. That explains why instruments are used which have been discarded in the industrial centres, such as income policies. That particular instrument, together with the conclusion of corporativist pacts, has been used to hold down inertial inflation and potentially could put distributive effects of adjustment and stabilization programmes in order.

[12] In Latin America from 1980 to 1987, overt unemployment increased by 16%, modern-sector employment practically stagnated, average wage earnings plummeted by 27.9%; real minimum wages deteriorated by more than 10%; social expenditures, except in Honduras and Trinidad and Tobago, dropped in relation to government expenditures and the product (ECLAC, 1989a and PREALC/ILO, 1988), while the population with incomes below the poverty line grew from a third to around 40% of the total during the first half of the 1980s (García *et al.*, 1988).

In essence, the combination of orthodox stabilization policies and open-trade policies, even though it incorporates objectives of unquestionable priority, appears after a decade of experimentation to be insufficient for ending inflation or promoting rapid structural change in Latin America's external trade and production. That very same combination of policies has had markedly adverse effects on income distribution by not including explicit goals to protect distributive equity (Bourquinon *et al.*, 1989).

The other structural ingredient of the economic strategies of many Latin American countries has led fiscal adjustment to incorporate the transfer of many public functions to the market. Equalizing public expenditures with actual revenues is undoubtedly a *sine qua non* ingredient in the fight against inflationary tensions. Likewise, many countries in the region have clearly excessive economic regulations, and over-extension of the public sector into areas of direct production is also common, hardly consistent with present and future priorities for changing productive facilities.

The critique of State intervention has its merits. But there are also ideological excesses that lead to condemning any government interference as misled, as if market shortcomings, distributive disparities and underdevelopment gaps had suddenly disappeared. Privatizing State enterprises and deregulation are usually considered the procedures for depoliticizing economic processes. Nothing is more misleading, in so far as it involves changing social objectives and because political interaction with civil society –except in dictatorships– is an obligatory ingredient for administering economies (Singh, 1989). For this reason, the combination of fiscal crisis with ideologized processes of transferring the functions of the State to the market at all costs, can erode government capacity to guide development and protect fundamental social rights.

V
Regulation and privatization

Economic regulation and State participation in production are phenomena characteristic of modern societies. Although there are differences of degrees, both imply the organization of government action to influence, direct or control the conduct of productive agents and citizens. The very existence of market institutions depends on the force of regulation and the adoption of specific organizational forms guaranteed by the State. Once the market system is established, regulatory measures originate from the need to correct the undesirable effects of its functioning and to complement it where it functions inadequately.

The fashionable model has reinforced the thesis that State intervention should be evaluated basically by market criteria. The criterion of economic efficiency alone –in part for being relatively new in steering public policy– explains, however, little of the history of government intervention. In reality, the presence of the State in the economic sector has been up till now more for social reasons than for calculations of productivity. The establishment or defence of individual and social rights, protection of human life, the correction of distributive biases, the supply of public goods, or simply the healing of divisions within civil society have been so many other objectives of State intervention. In the third world, the urgency of closing the underdevelopment gap has made it important to create other areas of government action. The most frequent cases are those protecting nascent industries or State investment in the production of goods considered to be strategic, when private enterprise, either because of weakness or because of high risks involved, does not have the capacity to give them impetus with appropriate speed or direction.

State intervention or the suppression thereof always has a regulatory character, in so far as it seeks to meet needs of the community. Limiting the abuses of monopoly or promoting economic efficiency are other goals, which, when opted for, involve an inevitable hierarchy of values. Therefore, it is a typically political –not technical– process, where the choice of objectives depends, in the last instance, on the array of social forces, the more influential ideologies, and the history and particular needs of each country.

Hence the characteristic features of State intervention and the boundaries between the public and private sectors vary enormously from nation to nation, resisting purely technical explanations. Today, however, in the face of the twofold onslaught of new models and bitter international competition –plus the economic crisis in the case of Latin America– a certain convergence is taking shape in the styles of State intervention. Even so, significant differences subsist and will subsist, arising from the different problems and institutional political environments existing between countries.

Historically, State intervention in advanced economies has had characteristics unlike those in developing economies. In the advanced economies, direct State participation in production is less frequent –there are no left-over gaps to fill– and the needs related to welfare-State institutions and military defence are much greater. The contrary is true of the developing economies, in so far as the promotion of new production and wealth has had primacy over any other objective, at least in the last half century, although excesses have certainly taken place in military expenditures.

Distinctions in meaning can also be made in the case of regulation. In the industrialized nations, regulation up to the end of the 1950s was predominantly concerned with questions of tax reform and redistribution, the system of competition, free entry into different industries, or price control. Beginning with the 1960s, regulatory efforts changed course in pursuit of objectives of public interest, such as environmental protection, the quality of consumer goods, the end of discrimination in the work-place, highway safety, or rules of conduct to be followed by the participants in some markets. Hence the intense proliferation of social regulation institutions over the last two decades have generated costs for productive activities and responded more to general interests of the population than to the demands of producers.[13] This explains the rise of resistance, especially when intense international competition is reducing the room

[13] The number of regulatory agencies in the United States doubled between 1960 and 1980, and the federal budget for those agencies trebled during the 1970s, with regulatory costs estimated to be a maximum –probably exaggerated– of US$200 billion a year (Penoyer, 1981; Breyer, 1982).

for manoeuvre and profits in a growing number of activities.[14] The basic question begins to reflect tensions between opposite social goals. A better quality of life –more leisure, environmental protection, economic security– which the populations of the first world demand with different degrees of intensity, generates costs and limits the capacity for international competition –another main objective– with newly industrialized countries, whose social aspirations are more modest.

In the developing countries, regulation has lagged behind in many aspects and taken on some trends of its own. Both phenomena are partially rooted in the different circumstances in which these nations move. Their frequently small markets and meagre industrial diversification have limited the scope of antimonopolistic regulation. Environmental protection and quality control of consumer goods have had to be modified owing to budget limitations, the need to meet other basic needs, and the insufficient supply of products with better specifications.

In contrast, import-substitution strategies and the defence of national entrepreneurs greatly increased the body of regulations relating to external trade and foreign investment in Latin America, as well as the investment of development banks and financial institutions responsible for administratively allocating credit to the benefit of national priorities. In the same way, the hope of making macroeconomic stability compatible with the structural change of supply led at different times to the proliferation of exchange and price controls, and more recently, to the implementation of income policies. Finally, the protection of e ssential consumer items and the need to direct private investment along the lines of industrial policy explain why many regulatory subsidies were granted.[15]

VI
The doctrinal debate and reality

1. *Privatization*

The welfare State's long period of growth in the first world, plus the explosion of regulations for public-interest purposes that began in the 1960s, created fiscal tensions and tensions among interest groups, which led to major changes in the policies and ideologies that support them. There were at issue here not only a natural resistance to paying taxes and the consequent disincentives to invest, save and work, or the proliferation of contradictory social demands, but also the generation of higher costs, which placed the enterprises of several industrialized countries in a situation of inferiority in international markets.

Those ideological trends have found fertile ground in the third world. Fiscal deficits had reached the level of 6% to 15% of the product since the 1970s, as a result of governments' attempts to compensate for the depressive effects of the decline of external demand and the deterioration of the terms of trade, oil shocks, the rise in interest rates and the interruption of credit flows from commercial banks. At first, attempts were made to postpone the adjustment on the premise that the international markets would soon "normalize". Later, the implementation of restrictive adjustment and stabilization policies became indispensable, a trend reinforced by the doctrinal leanings of the international financial bodies and the development agencies of the industrialized nations.

The main purpose of stabilization programmes is to correct fiscal deficits; the liberalization of external trade and foreign investment form part of the nucleus of structural reform. Consequently, privatization is seen as a hopeful means not only to hold down expenditures but also to gather additional resources

[14] Previous economic regulation was not always resisted; it favoured different entrepreneurial segments. At times, it protects producers from the excesses of competition; at other times, it aims to eliminate market defects and at still other times, to improve the information available to productive agents.

[15] Precisely these regulations and the institutions created to apply them are the ones that have to be dismantled because of the widespread change of strategies towards external openness, the broadening of market functions, and the State's decision no longer to satisfy with the same historical abundance the demands of many interest groups. Financial liberalization implies introducing organic changes much deeper than the simple admission of actors from abroad. Strictly speaking, financial liberalization would lead to eliminating a good part of the systems of administered allocation of credit, that is, to renouncing or greatly simplifying national priorities, granting a lesser role to development banks, government financial institutions, cash holdings or preferential lending institutions, as well as creating market institutions for freely channelling savings (Zysman, 1983).

through the sale of assets, in order to balance public accounts. Deregulation, in turn, is seen as the way to remove obstacles to the functioning of the market, as well as to end overt or covert subsidies and avoid excessive demands from interest groups which overburden government budgets. Both privatization and deregulation are seen as a political and economic way of giving entrepreneurs better incentives for investment and growth. Thus fiscal pressures are combined with doctrinal formulations to provoke a dramatic change in the perceptions of the State's role in economic affairs in Latin America.

Even so, the principal justification of privatization has been not so much financial pressures but rather economic efficiency. It is commonly pointed out that private enterprise raises productivity in the use of resources, to the extent that ideal conditions of competition generate Pareto optimality. Even though a more or less widespread opinion on the inferior economic efficiency of public enterprises continues to exist, there is little empirical evidence to back it up and the explanations given differ greatly.

According to the exponents of the property-rights school, government enterprises are inefficient because their managers do not seek to maximize the income or wealth of the owners (the citizens), pursue their own ends, and are comparatively less well paid; these enterprises also face excessive controls which reduce their scope for action and initiative (Alchian, 1965). Others emphasize the lack of market competition –particularly in the case of public monopolies– or the poor financial discipline when there is automatic access to credit and it is impossible to go bankrupt (De Alessi, 1980; Echert, 1979). Still others underline the alliances between government bureaucracy and the directors of public enterprises to strengthen political influence and expand expenditures and investments beyond what would be optimum from the viewpoint of the correct allocation of resources (Niskanen, 1975).

In general, critical conclusions point out that public enterprises tend to pursue multiple goals, innovate more slowly, follow price policies more loosely adjusted to the evolution of costs, have lower levels of and greater variability in profits, and invest at higher levels than do private enterprise.

It is reasonable to accept that more intense competition tends to improve efficiency in allocating resources, but it is also reasonable to recognize that reality does not correspond entirely to the model of perfect competition. Monopolies, non-essentials, higher returns to scale, indivisibilities, and the production of public goods explain in practice why many State enterprises were created. And even though technological and institutional changes may correct the faults of the market, many of the same conditions persist that once justified State intervention in strictly economic terms.

In a certain sense, the ideological dimension of the debate leads to confusing the question of private or government property with the problem of competition. Transferring a public enterprise to entrepreneurial hands can be simply transforming a public monopoly into a private one, or substituting complex and costly regulatory systems for controls inherent in direct State production. Likewise, competition can be increased without changing the property regime, especially when a policy of openness to other countries is in place and the directives and goals of public enterprises are modified (Thompson, 1986). Strictly speaking, more important than the size of the public sector is the efficacy with which parastatal enterprises use the resources at their disposition or fulfil the different objectives they are given (Cook, 1988).

Resolving the debate on efficiency by empirically examining the behaviour of public versus private enterprises also does not lead to a definitive conclusion. The first difficulty is the fact that government enterprises rarely have economic efficiency as their only objective. Few analytical efforts are dedicated to determining how efficiently they meet their objectives. Despite that, private results do not always appear to be superior to public results either in the industrialized countries or the third world (Millward, 1988; Yarrow, 1986; Hanke, 1987; Borcherding et al., 1982; Pier W. *et al.*, 1974). Moreover, when public production is compared to private, no attention is usually given to the alternate costs of regulating, monitoring and controlling private production when there is a monopoly or other market defects, as well as costs for meeting redistributive goals without using State enterprises (Borcherding *et al.*, 1982).

In any case, the old consensus on the impact of public enterprises on development is clearly gone. Only slightly more than a decade ago it was thought that direct government investment not only contributed to fulfilling economic plans but also made it possible to enter strategic sectors, create external economies and make up for the deficiencies among entrepreneurs or in capital markets (Nurkse, 1959; Prebisch, 1952; Rosenstein-Rodan, 1943). That explained actions from the creation of development banks to the formation of enterprises in the basic sectors of the economy (energy, steel, capital goods, transport).

Today, the validity of development theory and the very need of an industrial policy to close the gap, and of course, the wisdom of the welfare State[16] are all questioned. The task of industrial policy in the neo-classical framework is to change the allocation of resources between industries so as to make them more efficient and attract positive non-essentials. Put that way, the State would appear to have no particular advantage for accomplishing that task over the market and private agents. Even so, the circumscriptive criterion of efficiency in the use of resources does not adequately explain the designs of industrial policy that most countries have been putting into practice.

In fact, industrial development has sought not static efficiency but the creation and consolidation of activities that generate employment, exports, high value-added products or the manufacture of widely used inputs. Thus industrial policies reflect the political need to correct the market and cater to values or attain different social objectives. The presumed inefficiency in the resulting allocation of resources is proved by the failures of some countries and refuted by the experience of others. The history of East Asia would seem to validate the thesis of the compatibility between State intervention and rapid processes of productive modernization and growth.[17] Also, in most Latin American countries, gross domestic product enjoyed its highest growth during the period when government activism was strongest.

The virtues of privatization have been exaggerated in more than one regard. Frequently corporate change is difficult to achieve, budgetary benefits are meagre and the political costs are high. In particular, social and distributive objectives are customarily assigned to public enterprises; these would have to be sacrificed as incompatible with private entrepreneurial behaviour.

Even so, it cannot be denied that at the present time numerous cases exist in which the deficits of public enterprises excessively drain the fiscal coffers, especially when these enterprises have to respond to new demands for expenditures related to servicing the external and domestic debt, as well as the change in relative prices in favour of exporters. However, these cases would have to be rigorously examined to see if it is a question of inefficiencies properly speaking –a comparatively greater use of physical inputs– or forms of subsidizing and meeting other government objectives.

It is highly probable that the fiscal crisis and the intensification of external competition make economic efficiency more important as an objective. There is a risk, however, in reducing social objectives, in the sense of subjecting everything to the achievement of an economic goal that is in itself narrow.

It is also risky to base privatization policies on the needs of short-term public finances. If the State sells enterprises which have a strategic function for development or social equity, owing to shortages of liquidity, it would be sacrificing an important element for meeting urgent needs. Moreover, if the sources of financing are domestic, instruments of monetary policy will enable any government to obtain the same resources through credit. Indeed, if the sales are to be equitable, the present value of the future flow of net revenues of the enterprise should be approximately equal to its selling price and correspond to the market interest rate. In terms of monetary flows, the effects of a sale or a loan would be analogous, although the distribution of the funds from the transactions among the saving population would vary (Vernon, 1988, a and b).

Stated plainly, if profitable enterprises are sold, fiscal imbalance will increase in time. Naturally, if revenues obtained in that way are used to reduce government indebtedness, the fiscal imbalance would not be adversely affected; but then little or nothing would have been gained or lost, given the normal

[16] Richard Caves refers to industrial policy as a category of measures in search of an analytical frame of reference or as a political slogan in search of respectability (Caves, 1986). Hirschman thinks that development economics, after the important advances of the 1950s and 1960s, has entered a phase of decline. He attributes this to the fact that it is a discipline born of distinct ideological currents with internal tensions that have turned out to be destructive. And also to the fact that it creates exaggerated expectations, which, when they are not met, cause disillusionment and frustration (Hirschman, 1981).

[17] Japan and then Korea, together with other Asian countries, raised and still maintain protectionist barriers and schemes to promote select industries, which has not led to inefficiencies or a weakening of the spirit of entrepreneurial innovation (Zysman, 1983; Helpman, 1989; Levy, 1989).

differential between the rate of profit and the rate of interest. And if enterprises in the red are sold, the rational buyer would have to obtain the compensation of receiving deliberately undervalued assets and the right to raise prices in the future to match expenditures with revenues, apart from the advances he might make in raising productivity. That is precisely what explains why, when enterprises are privatized, prices rise or the covert or overt subsidies given by the public enterprises are revoked.[18] Obtaining other results would presuppose that the State sells above or below the market value of the enterprises to be privatized.

It has to be admitted that the presence of defects in the market could justify reservations about what is said in the previous paragraph. In industrialized countries with large capital markets, privatization can take place simply by selling shares on stock exchanges. However, in many developing economies, the privatization of enterprises involves slower and more complex processes in order to sell them as complete productive units (Cook, 1988).

Even so, privatization can be financed by repatriating capital or attracting foreign investments, where foreign credit sources are non-existent or very restricted. In that case, the sale of public enterprises could well mean a temporary relief in fiscal maladjustments and those of payments, depending on how the resources thus obtained are used.

Except for special cases, privatization usually has less of a macroeconomic scope. Few enterprises are large enough to affect overall economic behaviour or completely solve budgetary imbalances (ECLAC, 1989b). Moreover, the fact that State enterprises are only sold once and in naturally slow processes lessens the macroeconomic effects even more.

The transfer of enterprises to the private sector may increase economic efficiency in the static sense. The entrepreneur is undoubtedly less inclined to subsidize or meet social objectives and is rarely disposed to absorb losses year after year. It is also true that the sales would lighten the administrative burden of the State. Even so, there are costs that affect or can affect the development momentum, especially in third-world countries. Managerial or administrative talent is generally scarce. This affects the private sector as well as the State. Likewise, private financial resources are limited and there are inevitable trade-offs between investing them in purchases of State enterprises or undertaking new productions which would support the transformation of productive structures. Consequently, the massive sale of public enterprises –when that takes place– even though it has immediate fiscal effects, can in the medium term tie down financial resources and entrepreneurial capacity in predominantly obsolete activities which are by definition no longer, or in the process of ceasing to be, strategic for building the economy of the future.

Perhaps the restrictions mentioned can be avoided in some cases by means of direct foreign investment. As a general solution, however, foreign investment would produce well-known unfortunate effects in the economic order, if not also in the institutional and political order.

In any case, the most notable effect of privatization and deregulation is to encourage the consolidation of social agreements, through which the role and power of entrepreneurs in the economy are increased. For this reason, and to coincide with the dominant doctrinal theses in the Western world, those processes usually reinforce the business community's confidence in government policies, with direct effects –hopefully– on the stability of the exchange markets and, together with other factors, on the private propensity for capital formation.

2. *Deregulation*

The ideological debate on deregulation occurs again between those who want to broaden the domain of the market and those who are concerned about preserving intact the realm of public action or, what amounts to the same thing, the tension between economic freedoms for private production and the social need to limit those freedoms in order to meet goals of a different kind.

Other doctrines have arisen in opposition to the traditional thesis that regulation is the answer for the defects of the market and protects public interests (Wilson, 1980). According to some of these doctrines, regulatory agencies are born as enterprises, legislatures, political parties or factions, or come to be dominated by the groups to be regulated or interest groups (Stigler, 1971; Mazmanian, 1980). This gives rise to rents, i.e., highly concentrated benefits which are the incentive for covering the costs of lobbying and the political struggles involved in obtaining *ad hoc* regulatory statutes.

[18] If the aim was to revoke those subsidies in order to lessen fiscal pressures, more direct means would exist for doing so.

The criticisms of regulation move on two distinct levels. First, they are part of the thesis that any State intervention creates more problems than it solves. Second, it is argued that sooner or later regulatory agencies and regulatory procedures are taken over by those to be regulated (Stigler, 1971). To think, however, that regulations end up by being at the disposition of those to be regulated is equivalent to denying that Governments can represent or fight for general interests, or that the public or consumers can organize themselves effectively to pursue certain ends.[19]

On another level, the critics casuistically point to instances of distortions or deficiencies or where the original objectives of regulation were subverted. And from there, without examining cases to the contrary or explicitly denying the need for State intervention, they proceed to generalize the anti-regulation theses.

The real world is less extreme. Government agencies do not have absolute discretion in imposing criteria, nor are they entirely captive or passive actors in the face of interests that intervene in the definition of regulations. It is true that corporate agreements are concluded and could harm general interests. There are also excesses and errors in regulation and serious shortcomings in some institutions or agencies that apply them. Also, economic and technological changes[20] can eliminate the defects of the market, making regulations unnecessary; adopting new objectives and social strategies can have the same effect. Finally, recognition should be given to the effects of the changes on the context of political forces –movements of the relative power of interest groups– which lead to formal or substantial changes in regulatory structures.[21]

In any case, it must be admitted that economic regulation regimes are determined more and more by the interaction between Governments, public enterprises, large private corporations and, in some cases, the trade unions –that is to say, by the tensions and the arrangements, cooperative or otherwise, between the more important and larger economic organizations of a country. These are the main players in an eminently political and corporative game, where the individual citizen or the small enterprise is lost in the crowd. Not only are the form and content of regulations defined in this way, but also the decision as to what to include or exclude from the regulatory regime itself. Therefore, eliminating those regimes or reducing them to a minimum means, ultimately, yielding the stage to only one actor: private enterprise.

State participation in production, economic regulation, and industrial-policy formulation does not lend itself to universal concepts, nor are there simple rules which render it immune from the errors of the past or lead it infallibly to close the underdevelopment gap. The State does not exercise its economic functions in a vacuum. They have a historical character, namely, a link with the prior evolution of the economy and the degree of development reached. It would make little sense to organize a State enterprise to produce textiles in Germany, but it might make a good deal of sense to do so in a small country in Africa or the Caribbean.

On the other hand, those State functions also have an institutional and political dimension, in so far as they are inscribed within specific formulae for organizing the relations between civil society and the Government. The French bureaucratic tradition, expressed in hierarchical administrative forms, implies much more regulation of economic life than would be allowed, for example, in the institutional structure of the United States.

Historical facts and institutional frameworks specific to each nation contradict the a lleged scientific objectivity that some people seek to claim for the debate on State intervention in economic affairs. Furthermore, the basic issue is strictly axiological, in so far as it is a question of choosing between social goals. Economistic approaches try to make economic freedom the fundamental social value. The autonomy of the individual is to be maximized, expressed in the free play of the market; correlatively, State interference in private affairs is to be reduced. For this reason, economic efficiency

[19] Interest-group behaviour with respect to regulation is asymmetrical: while producers are few and can easily organize to obtain important benefits, consumers are many, the costs of organizing them is high, and the benefits they obtain are scarce (Olson, 1971). Therefore the interests of the non-regulated tend to be underrepresented in the political process of defining the rules of regulation. Even so, important exceptions exist, as shown by the ecological movement which is spreading to many countries.

[20] An example would be the cellular telephone which ends some of the usual defects of markets for telephone services, by allowing for open competition.

[21] A specific case is the nationalization of the banks in Mexico in 1982 and then the reverse movement of reprivatization in 1990.

(static efficiency in allocating investments) is taken as the guiding criterion for directing the behaviour of enterprises. Moreover, apart from the theory, private enterprise is considered superior to State enterprise. Thus, the more the privatization and the less the regulation, the more the "Pareto" gain, and the same amount of that gain can be obtained from removing any objective other than managerial efficiency in the enterprises that have to remain within the purview of the State.

The presupposition here is that there is an intrinsic harmony among economic goals and between economic and social goals, such as freedom, justice or democratic modernization. But if one admits, as happens in reality, that goals can be in opposition or conflict with one another, to single out one of them –freedom of the market– means reducing social phenomena to predominantly economic categories. In addition, the choice between objectives does not lend itself –despite claims to the contrary– to purely technical solutions. Admittedly, the citizens of one country might prefer economic freedom to collective equality or autonomy. But that does not scientifically validate the option. That option is legitimated by another logic, based on consensual or democratic decision-making processes.

In summary, the massive transfer of the State's functions to the market involves transposing the most important objectives of society. So long as that fact remains hidden in ideological labyrinths and technocratic messages, decisions will be adopted without indispensable public consultation and scrutiny regarding key issues of social life. Discussion of these issues constitutes the very proof of democratic modernization. Even so, on less general levels, there are clear needs, at times urgent, to adapt and modernize the ways the State intervenes or regulates the economy.

VII
Legitimate changes in State intervention

The role of the State in the economy necessarily has a series of historical and institutional bonds which give it consistency and efficiency, but which are also a source of tension when that role has to be changed according to economic policies for the future. On the one hand, the State assumes powers that vary a fortiori with the degree of development attained. On the other, on a less general level, coherence has to be achieved between government intervention and the strategies that are implemented in a given period. A third dimension that has arisen or arisen again more forcefully in recent years is the internationally shared responsibility for a global economic and financial stability that cannot be left entirely to market forces, and for protecting a planet in ecological risk due to the very advances of industrial civilization.

Thus the State's intervention in economic life cannot be seen as a fixture, rigid, without a temporal dimension. To the contrary, each historical stage has its specific attributions, which need to be periodically adapted to the changing needs of each society.

In the light of the circumstances in Latin America, the styles of State intervention urgently need to be changed so as to assume new functions and fill vacuums, as well as renew, put in order, or abandon areas that are no longer priorities. Strictly speaking, the possible frontiers of change are sufficiently broad to leave room for a variety of ways of integrating the public and private domains, if the extremes of placing everything or nothing under State control are excluded. No precise formulae exist, however. Each country has to test, with success or failure, the process of establishing the new boundary between the functions of the market and those of the State.

A bird's eye view of current problems presents a complex panorama, precisely because of the enormous accumulation of demands for change in the economy and societies of Latin America. A series of new fields exists which should be covered by State intervention. There are other new fields which should be left to the private sector. Some conspicuous cases illustrate this.

In the future, Latin American countries will have to give more emphasis to the extension and exercise of social rights to education, health care, housing, nutrition and employment, in order to attenuate the systemic trends towards concentrating wealth and economic power. Here the strengthening of democracy, the previous concentration of wealth, the burdens of the adjustment in the 1980s, and the demonstration effect of the welfare State in the industrialized countries will be driving forces for State intervention. And the same will be true for the protection of the environment where common needs and universal concerns combine.

The State's traditional function is to structure and restructure relations with the exterior. A good number of the changes in the style of government intervention will have to centre on this subject.

In general terms, while the interdependence between nations is growing, organization of the international economy is in a stage of transition where the adjustments to the new multipolar world in the North have not been completely made, nor is the new division of labour between North and South clearly established. So long as these questions remain, policies to renew the insertion of Latin America into the world markets, together with the transmission of major economic shocks from abroad, will make it necessary to implement activist policies with respect to international economic relations. International policies are more and more coordinated, especially in the first world. For example, in the well-known cases of management of the external debt or administration of exchange markets, where government intervention and coordination among Governments, central banks and international credit institutions are already a virtually permanent characteristic of the collective efforts of the industrialized nations to reduce international financial instability. It should also be noted that the world economy is far from reproducing the model of free competition. Oligopolistic practices are proliferating.[22] Governments frequently manipulate markets to favour national interests, and enormous trade imbalances subsist among the industrialized powers themselves.

In the opposite direction, i.e., the reduction of State intervention, an important fact is that Latin American development has created entrepreneurs and technicians capable of undertaking their own adventures, where the State was the only actor barely a few decades ago. In that regard, public enterprises in already consolidated sectors –and where there are no defects in the market– could be privatized or enter into agreements with private interests in order to facilitate direct State concentration on activities where the structure of supply needs to be transformed. In some cases, of course, State enterprises could simply be privatized. Others will call for successive regulatory formulae where there are risks connected with deficient market functioning.[23] It should be emphasized that substituting regulations for a public enterprise is not always an easy task; it requires scarce resources and organizational forms little known in the third world.

Along these same lines, it should be observed that institutions and regulations usually survive longer than the problems they were designed to solve. Many public enterprises began historically as failed private projects –50% in the case of Mexico (Casar, 1988)– which the State took over for reasons of employment, sectoral and regional development or other considerations. Thus Governments passively allowed the number of public enterprises to swell. And then, once placed on a sound footing or supported by subsidies, they remained within the public sector, even though they did not produce strategic goods or services.

There are also State enterprises which, after playing an outstanding role in development, have become unimportant for future-oriented strategies. Also here, as in the previous case, bureaucratic inertia can continue to invest or increase productive capacity, to the detriment of an optimum allocation of resources.

These observations lead directly to the correspondence between the pattern of development and the styles of government intervention in economic life. Take the case of the transition from an import-substitution strategy to one of open export to the international economy of a broader range of products. That implies totally removing many previous forms of State intervention, as well as amending the roles of productive agents and social actors. External demand has to become the driving force which the domestic market was in the prior phase. Local and foreign entrepreneurs have to replace the State to a large extent in promoting investments and production. The previous goals of increasing the quantity of production to meet already-created demands and protected markets have to cede to goals of improving the quality of supply in those areas of production having actual or potential comparative advantages for international trade or deliberately promoted integration schemes.

[22] For example, trade within transnational corporations (between parent companies and their subsidiaries and between the subsidiaries themselves) constitutes a third of world trade (Gilroy B., 1989).

[23] In the United Kingdom, a country where privatization has been strong, complex regulatory systems had to be established, made up of commissions, courts and codes of conduct for activities transferred to the entrepreneurial sector.

In that functional context, protectionist intervention and regulation make no sense and should be dismantled as quickly as adaptations of supply and the reaction of the social actors who will have to exercise future economic leadership permit. The logic of opening up to other countries implies dismantling the bureaucratic framework as regards tariffs, controls, licenses and other restrictions to international trade and capital movements.

On the other hand, promoting exports will demand other kinds of policies and interventions: changing the structure of relative prices, providing specific incentives, from financing and modernizing infrastructure for international trade to promoting productivity and retrofitting in activities chosen according to priorities. In other words, export policies call for creating a favourable macroeconomic framework, but also micro-economic policies that remove the bottlenecks hindering the development of specific activities.[24] Here the typical backwardness of developing countries and their chronic scarcity of resources oblige them to specialize and decide what products, branches or sectors they should modernize for international trade. Of course, mistakes can be made, but this is one of the few ways to create dynamic comparative advantages deliberately.

Making the external sector the pivot of future development –perhaps the only realistic solution for the problems of Latin America– presupposes firm commitments between Governments and entrepreneurial sectors with regard to the content of economic policies, agreements usually backed by the international financial organizations and bilateral-aid agencies. Consequently, external liberalization implies, together with privatization and deregulation, that the State will cede some autonomy to the national or international business community, that is, the market. And here the price has to be paid in advance. For this reason, it is important to support the success of strategies for export-led growth, i.e., ensure that they are not based on lowering labour costs but rather on increasing competitiveness by modernizing productive capacity.

[24] These ideas are rejected by several economic schools of thought; they believe that market mechanisms are effective on a micro-economic scale.

As seen from the experience of small and newly industrialized countries, to endure and prosper in highly competitive international markets demands *ad hoc* State support, to compensate for the advantages of huge transnational conglomerates and the abundance of resources and technology of the first world and other already consolidated competitors (Grossman and Richardson, 1985).

Unless Latin America decides to remain passive in the face of the changes in the international context, Governments will be forced to act very actively in the immediate future. Apart from the direct implications of an opening to other countries, numerous adaptations have to be made which can only be done with reasonable time-frames and costs if Governments exercise an appropriate interventionist leadership.

One early action is to promote the adaptation, absorption and development of technologies which will gradually free Latin America from having to base its external-trade position on low labour costs. Here government activism will have to be directed towards improving centres for human capital formation, institutions of applied research, on-the-job training systems, and incentives for firms interested in retrofitting or in creating technological centres or nuclei.

Another important area is the way in which nations respond to the formation of large economic blocs in the international economy. It is a question of analysing an issue complicated by the numerous options available and the trade-offs between the economic advantages to be obtained and the inevitable loss of sovereignty. For example, Mexico could pursue a union with Central America, a deeper integration with the countries of the Latin American Integration Association (ALADI), or free trade or integration with the economies of the United States and Canada. Each of these options involves major changes in the economic, social and cultural life of the countries, which call for active government leadership both in the negotiating phase and later to soften the effects of and facilitate the indispensable adjustments.

Opening national markets is a measure not only for improving the insertion of countries into international markets, but also for bringing in competition to force innovation and more efficiency among local producers, to the benefit of intermediate or final consumers. Paradoxically, then, the State should back measures for maximizing domestic competition. It is known, however, that market size and the need to compete with large transnational conglomerates place limits on the fragmentation of domestic production. Promoting the development of large enterprises usually creates defects in the domestic market –lessened by the opening to the exterior– but that is perhaps the only way of participating in international competition with some probability of success.

An analogous dilemma is presented when private activity is deregulated while bureaucratic controls on public enterprises are increased (especially in order to use their revenues and expenditures as an instrument of macroeconomic control), creating false competition and damaging the flexibility and administrative efficiency of the productive sector of the State. In the cases mentioned, the solution lies in perfecting the systems for evaluating the effects of regulations and forms of State intervention, especially during the transition period and change of the pattern of economic development.

VIII
Conclusions

From what has been said up till now, it is easy to deduce the many and complex tasks which the Latin American State has to perform in order to steer the more indispensable economic and social changes and safeguard a transition that is difficult in itself and difficult because it is taking place in the midst of a development crisis already one decade old.

The State's role in economic life has to change, but it cannot be abolished. It is dangerous to open the doors to ideological theses that condemn *urbi et orbi* all State intervention, simply to justify changes in the functions of the State without the necessary public scrutiny of their scopes and implications and the consequent distribution of their costs among the population.

Whether willingly or not, bestowing more powers on the market, "depoliticizing the economy", involves a real transfer of power to the international or local entrepreneurial sector. The need for such a change might be legitimate, but the use of ideological expedients denotes a lack of confidence in democratic procedures as a road to social agreement and order.

No doubt a series of elements are involved, such as the need to promote domestic reforms in development patterns –which a fortiori affects unequally the population and productive agents; geopolitical trends and tensions, perhaps irresistible, which explain the decline of national sovereignty, especially in the third world; an increase of world economic interdependence or the formation of large blocs in competition with one another, or simply the illogical copying of foreign models and ideologies. But while admitting the real challenges and leaving aside the false ones, it should be equally clear that, with such enormous changes needed, success depends on the highest degree of social cohesion. That presupposes formulating and debating technically, and especially democratically, the problems and options, till the needed political agreements are achieved, and then consensually deciding which roads to take.

Fortunately for everyone, old-style dictatorships and militarism, although still latent, have ceased to be an immediate threat for the political systems of Latin America. Even so, there are other risks. Perhaps the most serious one is turning the succession of power and elections into an empty ritual. Strictly speaking, the essence of democracy is participating in the key issues of society, such as identifying goals and opting for the roads to the future, recognizing the limits of the possible, determining *ex ante* the ways to distribute responsibilities and benefits among the population, and revalidating or modifying the terms of the social pact. Here is where the scant progress of Latin American democracies and the sources of civil society's discontent with Governments are visible. The lack of meaningful dialogue precludes the political consensuses indispensable for the cohesion of societies immersed in processes of major changes and adaptations. The losers in liberalization processes have essentially been excluded from participating in the formulation of economic policy instead of being reincorporated into production or into the decision-making process. The risk exists, then, of increasing social domination instead of freedom, in so far as the economic means of control can be highly concentrated.

These tasks are intrinsically important in every society that hopes to be modern. They are even more important today because of the ideological vacuum created by the crisis of the left and the onslaught of neo-conservative doctrine (Paramio, 1988). There is a real risk, then, of subverting the State's capacity to maintain balance and of widening even further the huge gaps in the economic situation of countries and of their distinct social components. Social values have a historical character. The notion of what is fair and unfair in the distribution of power or wealth changes with time. That economic stagnation and the gradual or rapid concentration of income, or its reverse, the dissemination of poverty, become acceptable facts in Latin America is a terrifying perspective, but one that is certainly possible, to judge from the experience of the last decade. That, however, would almost inevitably lead to making formally democratic societies increasingly ungovernable. The reason why is clear. So long as widespread demands for justice and economic improvement, security and freedoms are not met or accepted consensually, Governments will inevitably be cut off from those they govern. Recent electoral results are good proof of the backwardness of the political systems of Latin America. Their undemocratic isolation in decision-making, added to the real difficulties in meeting popular demands in the fields mentioned, have led and will continue to lead Governments of every political persuasion to electoral defeat.

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CEPAL REVIEW No. 42

The State and changing production patterns with social equity

*Eugenio Lahera**

This article analyses the importance of the public sector in Latin America and the Caribbean for the development of the region, although, due to its preliminary nature, it does not explore the differences to be observed between the various national economies.

In the first section, considerations relating to the role of economic agents in the development process are formulated. It is argued that the focus which results from examining the economic participation of the public sector in purely "quantitative" terms should be changed for one which would take into account the characteristics of the economic system as a whole.

The analysis and description of the Latin American and Caribbean public sector that is presented in the second section highlight important differences with respect to the industrialized nations and some developing countries of East Asia, as well as the existence of a considerable degree of heterogeneity within the region. In the same section, it is concluded that there are different patterns of relationship between the public and private sectors, varying according to periods and countries. It is demonstrated that the principal public sector characteristic that is common to the countries of the region is the depth of the fiscal-budget crisis, with its sequel of macroeconomic effects; on the other hand, it becomes apparent that the type of adjustment used tends to weaken the recovery capacity of this sector.

The third section deals with the subject of the State and development in the 1990s. After a description of the present logic of public intervention, there is an analysis of the macroeconomy of changing production patterns, the redefinition of the direct and regulated participation of the State in the economy, social and egalitarian policies, special measures favouring structural change, and public institutions and their performance.

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Introduction

Latin America is submerged in a crisis the gravity of which is comparable only to that unleashed by the Great Depression. Just as occurred then, the internal order of the countries, as well as their insertion in the international economy have been questioned. Perhaps the principal difference lies in the fact that there has been a reversal of the changes considered to be indispensable: whereas in the 1930s and 1940s greater public intervention in the economy became necessary and participation in the world economy underwent an abrupt decline, at present the alternative sought is characterized by amplification of the scope of private activities and a deepening of the financial, commercial and productive insertion of the region in the world economy.

The transition under way shows both creative and destructive components, which can ensure that the resultant institutional structure will be shaped by contradictory forces and tendencies, making it difficult to forecast its design. The State will be, at once, the object and the subject of the economic and social reorganization, given its indisputable importance in both respects. The State must preside over its own reorientation, in spite of the difficulties it faces and in the absence of a consensus and of criteria that are sufficiently well-defined for such a process. The public sector forms part of the problem and, likewise, of the solution: hence the inconsistency of the policies that are frequently proposed. We are witnessing a crisis of the State, which is passing through various dimensions of reality and which manifests itself in social, economic, political and ideological spheres.

From the viewpoint of positive economy, the State is of great significance, both direct and indirect. In fact, some present problems derive from this condition or from some of its properties. From the viewpoint of a regulated economy, the application of a strategy for changing production patterns with social equity involves a vast agenda for the State. If the matter were not so evident for the region, it would be even paradoxical: the State is an essential actor even if there is an effort to diminish the productive participation of the public sector or to alter the level of economic regulation. A public sector role is necessary, not only for the determination, in each country, of the specific objectives of changing production patterns with social equity, but likewise for the specification, application and evaluation of functional policies. From a different standpoint, it is in the State where the political options required for such a strategy can crystallize and where the macroeconomic objectives of the foreign debt conditionality are negotiated.

It is probable that the State constitutes the most relevant theme in the Latin American economy. For this reason, it is essential to approach the subject with a pragmatic attitude, that is to say, without ideologies.

I
A general view

1. *The public sector and the private sector in regional development*

Unlike what occurred in other situations considered to be typical, in which a relatively strong and homogeneous civil society organized itself into a national State, in various countries of the region the State has played or is playing the role of keeping the civil society together. The relatively precarious social and political structure of various Latin American countries required the support of the State, which thus became the arbitre and participant in a vast range of economic, political and social transactions, as well as the touchstone of ideologies, political positions and development strategies. The same reasons which led it to assume such important roles eroded, however, its strength: a technocratic vision of the common good had to coexist with strong tensions and sectoral clashes initiated by groups that were fighting to receive privileged attention for their individual problems. This aggregate of relations, in turn, was strongly influenced by ideological views, frequently originating in attitudes that had little to do with local needs.

The discussion of the role of the public sector in Latin American and Caribbean development is an old one; however its elements have been changing and, in recent years, have undergone substantial modification.

The controversy over the virtues and defects of the economic performance of the public and private sectors has traditionally been carried on in ideological and exclusive terms, frequently removed from regional realities. Whereas the public sector appeals to the general interest, the private sector seeks greater efficiency, feeling suffocated by excessive extension of the public sector. Both extremes have ingredients of objective validity, as well as elements of representation. They share a standard appraisal of the agent for which they plead, while their policy prescriptions are essentially quantitative: more private sector or more public sector.

In practice, however, it has been proved that the public sector does not always serve the general interest most efficiently and that often the private sector does not operate under conditions of perfect competition. It is not customary, in the region, to encounter price wars, the seizure of technological income and firms with high rates of capitalization. Many subsidies lack technical justification: certain incentives originally established as temporary often turn out to be permanent, and internal and external protection goes beyond what is advisable, lasting for excessively long periods; capital markets are small and not very transparent; credit is severely rationed, which, moreover, discriminates against risk or long-term operations; and in several countries capital flight is of considerable magnitude.

The relation between the public and private sectors in Latin America and the Caribbean is far from being unanimous and constant. In some cases and periods it has been one of complementarity and co-determination; in others, of distance and confrontation. Frequently, the public sector has opened up paths for the development of the private sector, through large-scale investments in infrastructure; the granting of subsidies for various cost components, such as financing and labour; or regulations for the protection or encouragement of national industry. Disagreements have been numerous but there has frequently been a mutually-advantageous symbiosis. Thus there has been experience with utilization of the public sector for the benefit of exclusively private interests, as well as examples of suffocation of private activity by the State; likewise, nationalization of the economy and privatization of the State have often occurred as part of a single process.

The development of the public sector in the region has been, moreover, heterogeneous. In some countries it has promoted the development of private activities; in others it has favoured its own socio-political role. In some countries the State is strong and technocratized; in others, weak, seeing itself periodically flooded by new political waves.

In general, public intervention in the economy has had a favourable effect on several aspects of the region's development, thanks particularly to large investments in areas crucial to growth, in which the private sector did not enter, owing to weakness or aversion to risk, or for both reasons. The broadening and improvement of the physical infrastructure and communications, energy, education, and the solution of various industrial bottlenecks are among the achievements of the public sector. This likewise had a positive, although quite heterogeneous, effect on social welfare (Mesa-Lago, 1985).

Public intervention had, however, a number of shortcomings. In the area of goods and services, projects were often poorly evaluated, had low investment returns, and were subject to non-economic goals, without subsequent evaluation. With respect to incentives and regulations, excessive protection frequently generated revenue problems. Actions oriented towards social development favoured, in a preferential way, sectors with some degree of economic insertion, reaching the poor to a lesser extent. In public administration itself, there was a tendency for inefficiency, bureaucracy and overemployment to prevail. On the other hand, the intervention of the public sector was losing effectiveness as a result of various related processes: while the tax base was eroding, the social and economic functions assigned to the State continued to expand, along with the magnitude of transfers to the different social groups. Although preconditions for transferring State responsibilities to the private sector were reached in an aggregate of areas, the decision to proceed to take such action was lacking. Inadequate regulatory standards restricted the potential contribution of direct foreign investments to regional development, limiting their operations to the respective national markets and granting them an unjustified level of protection.

The private sector, in turn, frequently demonstrated aversion to productive risk and a tendency to transfer capital abroad, to arrange tax havens, and to establish vested-interest relationships with the public sector. On the other hand, it frequently failed to respect its tax obligations, despite the high concentration of income prevailing in the region.

All in all, the public sector and the private sector are, simultaneously, the cause and the effect of the characteristics of the development process in each society, to the extent that in several cases they share virtues and weaknesses. The resultant economic system has, on the whole, been characterized by low levels of productivity, profiteering, price distortions and slow technological progress (Fajnzylber, 1989). The evasion of taxes and of controls, the payment of bribes, and illegal foreign trade activities are illustrative of a strong tendency to seek easy profit.

This summary analysis leads to the conclusion that the cause of the present crisis in the public-private sector relationship is more complex than the mere presence of an inefficient and semi-paralytic State, which has an erosionary effect on its surroundings. The public sector is one of the endogenous variables whose interaction make up the pattern of regional development: to isolate it analytically can take us farther away from an understanding of reality instead of bringing us loser to it.

2. *The main analytical problem: smaller or better public sector?*

The basis for the insertion of the public sector in the economy is the proof that the market reveals several "flaws". Among these are imperfections that make competition difficult, the existence of public goods, the presence of externalities and insufficient information (Stiglitz, 1986). The markets of the countries of the region are characterized by the existence of entry barriers, the lack of apprenticeship opportunities in practice, and the absence of technological income.

Since the beginning of studies on "development economics", there has been agreement that the role of the public sector is naturally greater in the poor countries, given the generalized existence of externalities and distortions, in both financial and product markets, and the lesser availability, in quantitative and qualitative terms, of information for private economic agents. It is clear that differences between countries of different development levels are related not only to factor endowment but also to basic aspects of economic organization, including the functioning of markets. The aggregate of economic organization is what limits the action possibilities of firms. The "market flaw" is definitely more generalized in developing countries, where imbalances are more extensive and deeper, with frequent cases of high levels of inflation and underutilization of the work force (Stiglitz, 1989).

The above-mentioned deficiencies often correspond to true market flaws, voids, or semi-voids, that the public sector has tried to fill. In the literature, this type of problem is considered to be a "dynamic" flaw (Rees, 1984). By definition, public sector activity in these cases should be purely temporary.

Thus it is apparent that there have been, and are, theoretical bases for "correct" public intervention; consequently, there is no point in seeking the automatic optimum of non-public intervention (Toye, 1987). In some cases, the possibility of making "market" corrections for "market flaws" has been, during long periods, either scarce or non-existent.

There is no doubt that there also exists what could be called "State flaws", since government has various deficiencies, some of which, such as those observed in the matter of information, are shared with the private sector. Occasionally, State intervention can effectively block the development or improvement of various markets. Likewise, it can make important strategic mistakes in the management of the main macroeconomic variables, as occurred with the management of the foreign debt. It is clear that the public sector can intervene inadequately (Lal, 1985) or for too long, thus impeding or preventing private relief activity. From another standpoint, there is the risk that State regulation may be promoted by private interests, for the purpose of obtaining undue profits (Buchanan and Tullock, 1962; Stigler, 1971; Peltzman, 1976), with the possible result of socially-negative effects (Pera, 1989).

In short, it is a matter of trying to reduce, and at length correct, the adverse effects of market imperfections. For this purpose, we must recognize the potentialities and the limitations of government intervention for correcting market flaws or faults. Since two imperfect entities are involved, each must specialize, although not necessarily exclusively, in those functions which it performs better and for which it is more indispensable. The production function belongs primarily to the market and the private sector; the State should be concerned with promoting macroeconomic equilibria and increasing degrees of equity, as well as with eliminating bottlenecks critically affecting development –availability of foreign exchange and savings and investment processes (Ramos, 1989).

The quality of State intervention is an important subject and therefore the analysis cannot be limited to merely quantitative aspects. Less State, in the abstract, is not always advisable: on the other hand, it is always possible to think in terms of better State intervention.

II
The public sector in Latin America and the Caribbean

1. *An overall view*

Whether as direct agent or regulatory body, the public sector has influenced, and is influencing, in varying degrees, basic aspects of regional development: financing and investment; income distribution and social development; and foreign trade. In the first of these it has operated through public firms in a variety of sectors, with different agencies serving as financial intermediaries, through the provision of public services and the transfer of subsidies to the poorer sectors and, occasionally, with domestic and/or international trade institutions. A considerable part of the region's technological research and development efforts has been realized in the public sphere.

On the other hand, the public sector regulates, with different coverage and purpose, various prices that are strategic for the functioning of the economy and for such micro-economic decisions as those relating to exchange rates, interest rates, tariffs and other foreign trade restrictions, minimum salaries and, at least partially, the readjustability of wages and salaries, among others.

The public sector includes activities of different origin and aim. They correspond *grosso modo* to the State as developer, the welfare State and the State as saviour of private firms with problems: the public sector includes assets transferred, for varying reasons and in different ways, from the national and transnational private sectors.

It is difficult to quantify adequately a role which is so multifaceted and whose characteristics vary significantly between countries and periods. In general the indicator used is the size of public expenditure with respect to the GNP, which fluctuated around 30% between 1982 and 1984 (IMF, 1989). This average disguises an important degree of heterogeneity of the sector in the region, since the range of participation is between 11 and 55% (table 1). While recognizing problems of an accounting and institutional nature, which erode the reliability of statistics, it is unquestionable that the differences between countries are substantial. The heterogeneity of the public sector is a basic datum of the regional situation.

Table 1
EXPENDITURES OF THE GENERAL GOVERNMENT AS A PERCENTAGE OF GNP

Country	Percentage	Year
Brazil	54.9	1987
Suriname	52.7	1986
Nicaragua	47.7	1988
Barbados	44.6	1987
Panama	33.7	1987
Argentina	33.4	1987
Chile	30.1	1987
Mexico	26.9	1984
Uruguay	26.0	1984
Venezuela	22.7	1979
Costa Rica	22.5	1985
Colombia	18.2	1983
Peru	17.8	1987
Dominican Republic	14.3	1983
Guatemala	13.8	1983
Paraguay	11.8	1984
Bolivia	11.3	1986

Source: International Monetary Fund, *Government Finance Statistical Yearbook 1989*, vol. 13, Washington, D.C., 1989, p. 113.

The World Bank has estimated price distortion indices for different countries which may indicate the relative scope of the regulations imposed by the State (World Bank, 1983). However, this approach is debatable, in its methodology as well as in its substance. Even so, it provides evidence of the dispersion prevailing in the degree of incentives and restrictions of the different countries of the region.

In addition, public participation in financial affairs shows considerable heterogeneity. Undoubtedly, the public sector has played a decisive role in capital accumulation, going beyond the problems of financing, destination and the results of such investment.[1] The participation of the public sector in regional investment is 41%, with important fluctuations according to country and period (ECLAC, several numbers).

The public sector's role in foreign trade varies greatly from one country to another. In some cases it is the main exporter while in others it has no direct participation at all in sales abroad. The same dissimilarity prevails for the public sector's role in administering national imports.

A similar situation is found for the participation of the public sector in various economic activities. At the beginning of the decade, the largest public firms were concentrated in the energy sector (38 to 78%), whereas communications represented 3 to 13%; transport, from 1 to 8%, trade, 1 to 7%, mining, 1 to 4%; and manufacturing industries, 1 to 14% (table 2). In the industrial area proper, its presence has, in general, been less, given that the transnational firms predominate here, this being one of the discrepancies between experience in the region and that of the recently industrialized Asian countries (Gereffi, 1989). The share of the public sector in sales of th e 50 largest firms of the industrial sector reached an average of 15% in 1983 (ECLAC/UNIDO, 1985).

[1] On the other hand, it has been observed that the classification of government expenditures is frequently debatable or inconsistent. For the case of Colombia, see López, 1989.

Table 2

SIX LATIN AMERICAN COUNTRIES: CLASSIFICATION BY ECONOMIC ACTIVITY OF THE 50 PUBLIC ENTERPRISES WITH THE HIGHEST SALES VOLUME, 1983

(Percentages)

Branch of economic activity	Argentina[a]	Brazil	Colombia	Chile	Mexico	Venezuela
Agriculture	-	-	-	-	-	-
Mining	-	4.7	-	48.8	1.6	2.3
Manufacturing industries	(13.1)	(14.2)	-	(7.8)	(12.0)	(9.4)
Non-durable consumer goods	4.8	2.8	-	7.3	-	
Intermediate goods	8.3	11.3	-	6.5	4.7	9.4
Automotive industry	-		-	-	-	-
Capital goods	-	-	1.3	-	-	
Household appliances	-	-	-	-	-	-
Energy	48.6	70.3	72.7	38.1	77.5	63.9
Petroleum	32.7	62.6	65.7	26.5	77.5	58.9
Electricity	15.9	7.7	7.0	11.6	-	5.0
Coal	-	-	-	-	-	-
Other fuels	9.2	-	-	-	-	-
Construction	-	-	-	-	-	-
Trade	-	2.9	6.9	-	0.8	1.7
Transport	-	-	-	-	-	-
Railway (or land)	3.0	2.6	-	-	1.8	-
Air	7.0	-	-	2.0	1.9	1.1
Maritime	3.7	-	7.7	-	0.8	0.6
Communications	13.0	5.3	12.7	3.2	3.6	2.5
Finances	-	-	-	-	-	-
Health	-	-	-	-	-	-
Education	-	-	-	-	-	-
Others	2.4	-	-	-	-	18.4
Total: 50 firms	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Joint ECLAC/UNIDO Industry and Technology Division, "Empresas estatales y privadas, nacionales y extranjeras, en la estructura industrial de América Latina", *Industrialización y desarrollo tecnológico, Informe No. 1*, Santiago, Chile, September 1985, table 6.

[a]1982.

As noted elsewhere, in Latin America and the Caribbean the public sector is handicapped by fiscal fragility of a structural nature. The considerable investment activity of the State and the constant expansion of social services, public employment and subsidies have had their counterpart in considerable increases of the tax burden. However, this tended to grow less than the share of public expenditures in the product, owing to the insufficient broadening of the tax bases and, in many cases, to the erosion of tax payments. In some countries and periods, fiscal deficits allowed the State to carry out its development-promotion and redistributive functions without major macroeconomic disturbances, receiving resources from abroad or from the domestic private sector. In most cases, however, it was necessary to have recourse to inflationary financing. The accelerated indebtedness of the 1970s and the internal financial crisis added an intolerable burden to fiscal expenditures, with the result that in most of the countries the underlying fiscal fragility was converted, at the beginning of the 1980s, into an outright fiscal crisis (Altimir, 1990).

The establishment of public enterprises resulted from different motivations: the provision of certain public goods and services based on a natural monopoly or corresponding to services it was desired to subsidize; the correction or patching up of the market flaw in sectors or activities where the private sector showed no interest or no capacity for investing; the nationalization of firms for strategic reasons or to save them from imminent bankruptcy that would have serious social repercussions.

The heterogeneous universe of these public enterprises shares diverse problems, mainly financial and administrative. The first of these can originate in price-subsidy policies, the absence of adequate control over operative and investment costs, overlapping economic and social goals of difficult joint evaluation, or in the practice of systematic transfers to the government, including credit resources secured through borrowing abroad. With respect to administrative problems, the executive function is commonly unstable and subject to an aggregate of restrictions that hamper or distort the development of the main activities. In other cases, the enterprises operate with great independence and follow their own bureaucratic goals, showing very little coordination with the rest of the public sector.

Table 3

STATE-OWNED ENTERPRISES: VALUE ADDED AS A PERCENTAGE OF NON-AGRICULTURAL GNP AND FIXED INVESTMENT AS A PERCENTAGE OF GROSS INVESTMENT, 1981-1985

(Current prices)

Country	1981	1982	1983	1984	1985
Brazil					
Value added	4.7	3.5	3.4	3.7	3.5
Fixed investment	25.8	30.0	26.9	24.4	17.5
Costa Rica					
Value added	-0.1	0.2	6.5	7.9	5.3
Fixed investment	31.3	23.2	17.9	17.1	13.2
Chile					
Value added	10.3	13.0	16.1	...	...
Fixed investment	13.9	17.5	22.8	29.3	27.5
Jamaica					
Value added	...	...	...	23.3	...
Fixed investment	...	...	...	11.0	...
Mexico					
Value added	6.9	11.6	14.8	14.4	12.7
Fixed investment	25.3	24.3	21.8	19.1	...
Dominican Republic					
Value added	2.1	2.7	3.0	3.3	0.6
Fixed investment	6.1	7.4	5.3	7.0	...
Venezuela					
Value added	31.0	26.8	26.4	32.1	...
Fixed investment	41.9	52.2	51.3	52.2	...

Source: Govindan Nair and Anastasios Filippides, *How much Do State-Owned Enterprises Contribute to Public Sector Deficits in Developing Countries - and Why?*, Policy, Planning, and Research Working Papers series, No. 45, World Bank, 1988, table 2.1 (background paper for *World Development Report 1988*).

Apart from the recurrence of some of the characteristics already mentioned, until the beginning of the 1980s, the public enterprises of the region made up a very heterogeneous group. Some operate very efficiently in competitive markets, whereas only the massive transfer of public resources allows the survival of others, which are highly inefficient and have little or no ability to capitalize. There are public enterprises with satisfactory standards of technical and financial administration, repressed by restrictive sectoral policies; enterprises that maintain a vested-interest relationship with private suppliers; and enterprises that have been nationalized in order to prevent their bankruptcy, although they are not economically viable. As is apparent, the impact of public enterprises on global efficiency can differ substantially from one case to another.

In some countries State-owned firms have a large share of gross investment and, in general, quite a smaller one in total value added (table 3). In this subsector, as in the public sector as a whole, investment displays special characteristics and there are problems of overinvestment and bad administration.

The incidence of public enterprises in the financial situation of the sector varies from one country to another and, likewise, within each one. In some cases relatively important transfers from the central government to the enterprises may be observed, while in others it is the enterprises that are contributing to the financial balance of the public sector as a whole (table 4). In general, in those countries where there was a deferment of tariff adjustment, public enterprises tended to contribute to raising the public sector's deficit.

In the period prior to the crisis, quite dissimilar policies were suggested for public enterprises: in some cases they were rationalized, bringing their tariffs up to date and improving their administration; in others they were used to obtain foreign loans (Werneck, 1989; Larrañaga, 1989).

The public sector is an important employer in most countries of the region; on average one out of each five urban employees is public, a share that fluctuates between 6 and 36% (table 5). From another point of view, public sector personnel are distributed in an unequal way between the central government, the decentralized administrations, the public enterprises, and State and municipal administrations. In most countries the first category is the most significant (Sulbrant, 1989).

Table 4

NET FINANCIAL FLOW FROM THE GOVERNMENT TO PUBLIC ENTERPRISES

(Percentages of GNP)

Country	Averages 1977-1982	1983-1985
Bolivia	-3.9	-2.3
Brazil	3.3	2.0
Colombia	1.0	...
Costa Rica	...	0.2
Chile	-6.5	-5.2
Ecuador	1.0	0.7
El Salvador	0.5	-0.2
Guatemala	2.3	0.8
Honduras	1.9	3.3
Jamaica	...	...
Mexico	1.5	2.1
Peru	0.5	0.3
Dominican Republic	0.8	1.1
Uruguay	-1.7	-2.1
Venezuela	-0.2	0.2

Source: Govindan Nair and Anastasios Filippides, *How much Do State-Owned Enterprises Contribute in Developing Countries - and Why?*, Policy, Planning and Research Working Papers series, No. 45, World Bank (background paper for *World Development Report 1988*).

Table 5

IMPORTANCE OF PUBLIC EMPLOYMENT TOWARD THE END OF THE 1980s

(Percentages)

Country	Total population PSP	PSP Total population	PSP EAP	PSB EAP Urban
Venezuela	16.8	6.0	17.0	21.0
Argentina	16.0	6.3	17.7	20.3
Mexico	21.6	4.6	14.7	20.7
Uruguay	10.8	9.2	21.7	24.7
Costa Rica	16.2	6.1	16.4	36.1
Chile	58.9	1.7	5.0	5.9
Panama	14.2	7.0	20.4	34.7
Peru	24.0	4.1	12.3	17.8
Guatemala	47.8	2.1	6.8	15.9
Honduras	60.4	1.7	5.0	11.7
Bolivia	31.7	3.2	10.0	20.2

Source: José Sulbrant, "El tamaño del sector público en América Latina. Un estudio de once países", *Draft Report*, Caracas, Latin American Centre for Development Administration (CLAD), November 1989.

PSP: Public sector personnel.

EAP: Economically active population.

From still another angle, there are in Latin America about 12 650 local governments, whose joint share in the public expenditures of their respective countries is less than 10%, except in the case of Ecuador. The shares of other levels of public administration in such expenditures shows enormous dispersion, fluctuating between 2.4 and 73.3% of the total (IMF, 1987).

2. *Some international comparisons*

The role of the public sector in Latin America differs quantitatively and qualitatively from that observed in the industrialized economies. In the region, the State intervenes more directly in the production of goods and services and is an investor or great importance; it serves as a balance between a multiplicity of global and sectoral policies and fulfills the important role of political and social structuring.

The share of the public sector in the region's GNP is much lower than the corresponding figure for the main industrialized countries, where the average was close to 45% between 1982 and 1985. On the other hand, it is higher than that of the Asian developing countries. As will be seen later, these differences are explained in part by the different breakdown of public expenditures by region.

In general terms, the region's public sector places greater emphasis on development through public social expenditure than do some of the Asian countries, and it pays less attention to defence. Its regulation is more generalized, frequently not very selective and incoherent; but its presence in the technology-led industrial sectors (In-Joung, 1987) and in investment is less than that observed in Asia (Kagami, 1989).

On the other hand, in 1986 and 1987 the public sector of the majority of the region's countries allocated for interest payments a percentage much higher than that of the industrialized countries (table 6), in circumstances where, at the beginning of the 1980s, the difference was insignificant. The allocations likewise increased in the Asian developing countries over the same period, but with less intensity.

Table 6

COMPARISON OF SOME ITEMS OF CENTRAL GOVERNMENT EXPENDITURE IN LATIN AMERICA AND THE CARIBBEAN AND ASIA WITH THOSE OF DEVELOPED COUNTRIES

(Percentages in relation to total expenditures)

Type of expenditure	Subsidies and other current transfers	Interest payments	Capital expenditures	Wages and salaries
1982				
Latin America and the Caribbean	35.4	12.8	15.4	16.6
Developed countries	49.0	9.7	5.6	13.5
Asia[a]	23.6	8.5	19.6	14.2
1983				
Latin America and the Caribbean	32.5	17.0	12.2	16.3
Developed countries	49.0	10.2	5.0	13.3
Asia[a]	23.2	10.0	18.8	14.9
1984				
Latin America and the Caribbean	32.9	20.5	11.0	16.0
Developed countries	48.5	11.2	4.7	12.9
Asia[a]	23.9	11.3	17.7	15.1
1985				
Latin America and the Caribbean	28.9	23.6	10.7	15.8
Developed countries	47.1	12.4	5.0	12.6
Asia[a]	24.3	11.3	17.6	14.6
1986				
Latin America and the Caribbean	29.5	28.0	11.0	14.7
Developed countries	47.8	12.4	5.2	12.7
Asia[a]	23.1	12.1	18.3	14.8
1987				
Latin America and the Caribbean	24.3	25.3	9.6	12.5
Developed countries	48.0	12.2	4.3	13.2
Asia[a]	25.9	14.5	16.6	15.5

Source: International Monetary Fund, *Government Finance Statistics Yearbook 1989*, vol. 13, Washington, D.C., 1989, pp. 70-77.
[a] Includes Bangladesh, Burma, India, Indonesia, South Korea, Malaysia, Pakistan, Singapore, Sri Lanka and Thailand.

Public sector capital expenditures in both Latin America and Asia had a higher incidence than those of the industrialized countries, despite their decline since the beginning of the crisis. The sharpest decline, however, occurred in Latin America and the Caribbean, owing to the type of adjustment applied.

The share of wages and salaries in the region's public expenditures declined steadily, so that the area dropped from being the highest to the lowest of the three groups of countries considered in 1987. Subsidies and other current transfers have less incidence than in the industrialized countries and in 1987 fell below that corresponding to Asia. Behind these averages, of course, are hidden significant national differences.

The breakdown of public income in the three groups of countries also reveals marked discrepancies. The share of taxes on capital is lower in Latin America and the Caribbean, but in this region social security is much more important than in Asia, while at the same time being low in comparison with the industrialized countries. (Moreover, some Asian countries do not include the social security account in the central government.) The share of taxes on foreign trade transactions is substantially less in the region than in Asia, but much higher than in the industrialized countries (table 7).

For Latin America and the Caribbean the ratio of tax revenue to GNP is significantly lower than that prevailing for the industrialized countries, although it is higher than that for the Asian countries. The burden of taxes on profits and capital is noticeably lower in the region, which means that the weight of public expenditure there is distributed less fairly.

Table 7
BREAKDOWN OF CENTRAL GOVERNMENT INCOME IN LATIN AMERICA AND THE CARIBBEAN, ASIA AND THE DEVELOPED COUNTRIES, 1982-1987
(Percentages with respect to total income)

	1982	1983	1984	1985	1986	1987
Income and profits						
Latin America and the Caribbean	22.0	19.3	21.0	21.5	21.9	18.3
Developed countries	41.2	39.7	39.6	40.0	40.2	...
Asia[a]	28.6	27.4	25.9	26.2	22.2	22.9
Social security						
Latin America and the Caribbean	18.2	16.3	17.0	16.4	18.9	13.5
Developed countries	31.4	32.3	32.8	32.7	33.6	...
Asia[a]	0.2	0.2	0.3	0.3	0.3	0.3
National goods and services						
Latin America and the Caribbean	27.6	35.3	35.3	34.0	33.6	31.6
Developed countries	15.1	15.1	15.3	14.8	14.6	...
Asia[a]	33.1	34.9	33.4	33.3	34.2	32.7
Trade and international transactions						
Latin America and the Caribbean	14.0	9.8	8.5	8.2	9.4	9.1
Developed countries	1.4	1.3	1.5	1.4	1.4	...
Asia[a]	19.1	19.3	19.8	20.1	20.1	21.0
Non-tax income						
Latin America and the Caribbean	17.8	18.6	19.5	20.9	16.6	28.2
Developed countries	9.2	10.0	9.5	9.7	9.1	8.3
Asia[a]	16.1	15.1	17.8	16.6	19.9	19.3

Source: International Monetary Fund, *Government Finance Statistics Yearbook 1988*, vol. 13, Washington, D.C., pp. 52-57.
[a] Includes Bangladesh, Burma, India, Indonesia, South Korea, Malaysia, Pakistan, Singapore, Sri Lanka and Thailand.

The magnitude of the public deficit had been more or less similar in the three regions until the recent crisis; from then on, that of the region increased more rapidly (IMF, 1989).

3. *The crisis of the economy and the crisis of the public sector*

The immediate origin of the fiscal crisis is to be found in the collapse of the financial pattern of the regional economy which had prevailed during the second half of the 1970s and until 1981. The phenomenon affected the public sector disproportionately, since, in degrees varying from one country to another, it had to take over responsibility for a fraction of the private debt. Two thirds of the swing in the transfer of resources abroad, equivalent to about 4% of GNP, correspond to the public sector.

Both exogenous and endogenous factors were involved in the external financing crisis. Among the first, those that stand out are the change in the sign of interest rates from negative to positive; the deterioration of the terms of trade; and the excessive amount of risk loans (overlending) granted by international banks (Mortimore, 1989). Among the endogenous factors, the most important are inadequate project evaluation and indebtedness in excess of the capacity to repay generated by external savings.

The public sector assumes a role of protagonist in adjustment efforts, given its diversified economic and social participation and its natural condition as regulator of the national economy. Almost all the components of the adjustment programmes, especially exchange and foreign trade policies, as well as financial and price liberalization, have repercussions in the fiscal sphere. The management of public sector adjustment efforts is a subject of the utmost importance. Often the role assigned to this sector in the adjustment has consisted, exclusively, in its own reduction (IDB, 1984, Marshall and Schmidt-Hebbel, 1989).

The crisis had a generally adverse effect on the public budget, but the intensity varied from one country to another. The interruption of capital flow limited the public sector's capacity to borrow abroad, while the rise in international interest rates increased the burden of foreign public debt service. In many

Table 8

LATIN AMERICA AND THE CARIBBEAN: EXPENDITURES FOR CENTRAL GOVERNMENT FUNCTIONS, 1982-1987

(Percentages of total expenditures)

	1982	1983	1984	1985	1986	1987
Defence	5.6	5.5	5.5	4.5	4.6	5.0
Social security and welfare	23.4	23.5	22.7	19.0	18.5	18.2
Education	9.9	9.4	9.8	9.2	8.8	9.3
Health	4.9	5.0	5.2	4.8	4.8	6.7
Housing	1.2	2.2	1.7	1.4	1.5	1.7
Economic affairs and services	20.8	22.1	18.9	17.3	15.7	13.1
Mining, manufacturing and construction	3.7	3.9	2.4	2.3	1.7	1.0
Agriculture and others	5.0	6.0	4.0	3.6	3.9	2.9
Fuel and energy	2.1	3.1	2.5	2.5	2.6	2.0
Roads	2.2	2.7	2.4	2.3	2.2	2.8
Other transport and communications	2.6	3.1	3.1	2.8	2.2	2.4
Others	5.1	3.6	4.7	3.8	3.3	2.5
Other functions	32.7	30.7	32.7	42.7	46.1	46.0

Source: International Monetary Fund, *Government Finance Statistics Yearbook 1989*, vol. 13, Washington, D.C., pp. 56-69.

countries of the region the Governments guaranteed a fraction of the commitments undertaken abroad by individuals, thus reaching high levels of public-debt responsibility. Frequently the cost of the difference between the interest rate paid and the rate of return received (especially in foreign exchange) was covered in the end by the public sector, even though it had not generated it. On some occasions the corresponding internal debt of the private sector with the public sector was watered down, on others, and with consequent pressure on public finances, the State subsidized private debtors and the domestic financial system, in order to avoid breakdown of the latter (Bresser, 1988; Eyzaguirre, 1989; Lerda, 1989).

Following the interruption of net external financing, countries had to use domestic capital, which led, among other measures, to the creation of money in circulation; the introduction of changes in reserve requirements; the requirement for banks to maintain public bonds at controlled rates; the imposition of government controls over interest rates, accompanied by credit rationing; the concession of bank loans at market rates, and the direct sale of public bonds to the non-financial public sector, at market rates (Chhiber and Khalilzadeh-Shirazi, 1988; Easterly, 1989).

Definitely, the fiscal crisis of the public sector is not the result of an increase in economic development expenditures; rather, the severe cutback of public investment has provided an easy expedient for contracting the absorption.[2] Attention to traditional functions of the public sector has been altered by the increase in interest payments charged to the State. This effect is particularly disquieting with respect to social expenditure (table 8).

In different countries and through different mechanisms (including privatization and reprivatization, partial sale, the closing down and the merger of firms) efforts have been made to modify the asset endowment under State control.

From another viewpoint, in recent years there have been profound changes in the region's incentive regime. Outstanding among these are changes in foreign exchange and trade policies, which have been aimed at the generation of trade surpluses, and in fiscal policy. Likewise, there have been important variations in price, credit, and financial policies. Similar developments occurred at the sectoral level with agricultural and industrial policies. The debate over subsidies and transfers has become heated, although frequently there is a lack of adequate information for delving more deeply into the subject. The incentives regime of the public sector has undergone several changes in different countries; in some it has substantially improved the ability of the sector to evaluate projects. Deregulation and the granting of concessions have been infrequent and

[2] In the opinion of Easterly, an investment-led contraction of absorption was attempted (Easterly, 1989).

their results negligible. On the other hand, some unsuccessful liberalizations, especially in the financial sphere, have provided useful lessons (Dornbusch and Reynoso, 1989).

In short, the diversity of initial situations has been followed by the diversity of the adjustment schemes which have been utilized. The results have also been different, as proved by the trends in interest rates and inflation, in the primary and fiscal deficit, in the balance on current account, as well as in the levels of the product, exports and imports.

4. *A provisional evaluation: subadjustment and recessive adjustment*

Conventional wisdom has insisted on a difficult agenda for achieving the region's recovery from the crisis: recessive adjustment with changing production patterns and simultaneous and high transfers abroad.

The public sector appearsas the "financier of last resort" for all accounts, which, in the light of the characteristics it was displaying even before the crisis, is not realistic. The aggregate of tasks that have been imposed on it in most of the countries is very much in excess of its financial, productive, regulatory and economic-administrative capacity. The public sector now has fewer resources and its capacity to handle them properly has deteriorated, while at the same time its responsibilities and the problems it must deal with are increasing. It is requested, simultaneously, to service the debt, reduce expenditures, invest less, pay lower wages and be more efficient, all this in the context of reduction of its aggregate participation in the economy and of a greater contribution to regional changes in productive patterns. It is clear that the "quantitative" and short-term approach entails destructive components. The private sector, for its part, has had to take refuge in the public sector, diminish its investment and hold large amounts of capital outside the national economy.

The pursuance of these contradictory, and sometimes incompatible, goals has resulted in the deterioration of public sector performance. In practice, the public type of adjustment has become perverse; in some cases through partial and limited measures, comparable to an underadjustment; in others, through policies that have exceeded the needs of a positive adjustment. The results tend to resemble each other but the causes differ in each case.

III
The State and development in the 1990s

1. *Present logic of public intervention*

Conditions favouring private development already exist in various countries of the region and consequently the degree of public intervention that was customary in the past is no longer required. There are instances where it is feasible to increase the relative importance of the private sector in the provision of public goods and services, whether through the deregulation of activities, the granting of concessions or the privatization of firms.

On the other hand, although in the present regional dilemma the public sector forms part of the problem, it should likewise form part of the solution. It cannot be expected that market signals alone will solve the crisis. The public sector is the negotiator of first instance with the multilateral financial organizations and the lending banks. The relevant negotiations will have strong repercussions on external financing and global domestic policies.

Going beyond the debate over the role of the State, it seems evident that in coming years the degree of public intervention in the regional economy will continue to be important, although it will undergo qualitative and quantitative changes. The five main aspects of such intervention may be grouped, for analytical purposes, as follows: i) the achievement of an agreement on the governability of the society; ii) the maintenance of a macroeconomic framework that is relatively stable and has fiscal equilibrium and transparency; iii) the redefinition of direct participation and the regulatory role of the public sector in the economy; iv) the execution of sectoral development policies aimed at creating or developing dynamic comparative advantages.

The dual concurrence of the public sector –in the problem and, at the same time, in the solution– complicates the debate on its future role and the adaptations that this will require. The answers have been diverse and are still in the process of preparation, which leads to the assumption that the debate will still be open in the medium term. The main options for changes proposed until now are privatization, deregulation, bids for concessions and the closing down of firms.

Less progress has been realized in proposals for new roles for the State, or for "expansive" modifications of existing ones. With respect to the possibility of achieving a *positive adjustment* of the State's role, i.e., contracting some functions and expanding others, this has been until now a carefully-kept secret. However, it is an unavoidable task, to the extent that the dual concurrence of the public sector is a reality. A sequential movement –first shrinking and later expanding the public sector selectively– entails various dangers. The public sector requires reform and reconversion simultaneously.

To sum up, it seems necessary to substitute a purely quantitative approach to the public sector's participation in the economy for another which analyses the public sector in the light of the characteristics of the economic system as a whole. In this way, the debate is transferred from the ideological or philosophical plane to a more practical one, which takes into account such aspects as organization, human resources, political interaction, public administration, etc. In the final analysis, decisions relating to public/private delimitation belong, by their nature, to the political sphere.

2. *Governability and coordination*

The State is the area where diverse national programmes and options crystallize. It is likewise the entity that is able initially to foster the social coordination required for political stability (Cortázar, 1990). The coordination itself can be based on long-term objectives referring to changing production patterns.

State reform assumes the existence of the social will to achieve it, which must be expressed in the political system. The diverse aspects of the reform can meet with varying degrees of political support, but it is also probable that certain groups will be in favour of some changes and opposed to others. The engineering capacity required for achieving a successful reformist coalition is to be found not in the technical area but inevitably in the political area.

Governability, which is a result and not an independent variable whose evolution can be controlled directly, has both economic and political antecedents. Among the first is the necessary coincidence between the type and the level of activities that are entrusted to the State and the adequate financing of such activities by society. Among the second is the need to achieve agreement among the different political and social groups, at least in matters concerning the rules for the political functioning of society, including alternation in power and respect for both majorities and minorities.

These antecedents, in turn, involve assumptions which are not realistic or, at best, are difficult to apply. In some cases, the high income strata have achieved a privileged position in the international economy, which isolates them from the rest of the country; these groups are concerned with exports, legal or illegal, whose financial flows circulate through the national economy only as speculative capital and whose consumption patterns differ radically from those of the average sectors of society. In other cases, an oligarchical political system or very traditional systems of land-holding generate conditions of endemic violence that assume their own logic of division and extermination. Moreover, it is probable that there are no politicians capable of achieving agreement on a pact of governability that would overcome traditional rivalries or atavistic prejudices.

The degree of governability constitutes an essential characteristic of any political system. It can be defined as the changing relationship between political and institutional control and the evolution of the principal political, economic and social variables (Tula, 1990). A State that is impotent, overwhelmed by internal conflicts, is typical of a society with problems of governability. On the contrary, a well-run State, which concentrates on the administration of a discreet aggregate of strategic variables, is a precondition of governability.

3. *The macroeconomics of changing production patterns*

Macroeconomic management must be clear and stable and seek the preservation of the economy's basic equilibria.

Changing production patterns requires that the deterioration of regional investment be reversed and that financial resources be concentrated in the tradeable goods sector. Both processes cover numerous requisites and suppositions, many of which involve the public sector.

It is indispensable that the fiscal deficit be reduced drastically, since it increases inflationary pressures and erodes investment potential. To this end, the net transfer of resources abroad to service the foreign debt must be halted, current public expenditures must be reduced, and fiscal revenue increased. The latter, in turn, requires tax reform that would broaden the tax base, simplify the system and improve the collection process.

In spite of the fact that regional defence expenditures are lower than those of other developing regions, there is room for some compression, since they are already equivalent to 54% of the amount spent on education (table 8). With some exceptions, Latin America's expenditures on military equipment have a smaller multiplier effect, which makes the region suitable as a recipient of the "dividends of peace".

An improvement of fiscal sincerity is likewise required. Society must assume the integral financing of the initiatives it is prepared to approve; otherwise accounts will not balance (Schumpeter, 1954). The "Tax State" implies a contractuality in which means and ends are democratically clarified and decided. Under present conditions, an improvement in the tax yield is indispensable, since, as a general rule, this is low. Tax reform should contemplate the abolition of low-yield taxes, the unification of charges on identical taxable materials, the rationalization of exemptions and, in particular, the modernization of the collection system (IMF, 1989).

Public and private investment must be increased and its yield should be improved. Several roads are open for achieving this result, including concentration of effort and control, and evaluation of the different programmes. Public investment will have to be diversified and recognition given to the decisive role of various intangible assets. It is absolutely essential, likewise, to maintain and improve capital flow, avoiding exclusive concentration in new investments.

A determining factor of present disequilibrium is the foreign debt service; this requires a concerted and adequately-financed solution. However, in all cases there will be an imperative need to carry out internal economic reforms simultaneously with efforts to improve the external financing structure (Selowsky, 1989). Where private foreign exchange income is concerned, it is particularly urgent that the subject of internal transfers receive adequate attention.

Regarding private investment, it is of fundamental importance that economic uncertainty be reduced and that assurance be given that the policies instituted will be maintained, thus avoiding the capital flight that would severely restrict the financing of economic reform programmes.[3] The repatriation of this capital, which is an important objective, is sometimes impeded by legal rather than economic considerations. It has to be encouraged wherever its net result will be positive: if a real devaluation is insufficient, the resultant income transfers can increase the flight that it is sought to reverse (Dornbusch, 1989). Several alternatives may be suggested: exchange amnesty, tax advantages, investment in stocks or bonds without justification of origin, and non-reimbursable import licenses for capital goods, among others.

The orientation of investment toward the production of tradeable goods will be conditioned by exchange and foreign trade policies, which must be realistic and stable.

4. *Direct participation and State regulation of the economy*

a) *Public firms*

The excessive emphasis placed lately on the reduction of the size of the State sector has made people forget that public enterprises will continue, in general, to play an important role, since privatization will not be able to reach the aggregate of the public sector. To concentrate on changing the ownership of assets without modifying the operating conditions of State enterprises would mean leaving them at a dead end. The most serious cases involve enterprises that cannot be privatized; on the other hand, many of the reprivatized firms do not form an important part of the problem or do not alleviate it to any great extent. Obviously, in the case of enterprises for which privatization is not practicable another type of solution is required.

The restoration to good health of the nucleus of enterprises with problems –a few tend to be responsible for the major part of the fiscal deficit– requires the adoption of approaches and specific solutions which include their reorganization, the underwriting of agreements with national and foreign investors and the subcontracting of operations.

[3] At the end of 1988 the stock of such capital was 166% of Venezuela's foreign debt; almost 90% of Uruguay's; close to 80% of Mexico's and Argentina's; 64% of Ecuador's; 41% of Colombia's; 35% of Bolivia's and 26% of Brazil's. (*The Journal of Commerce*, 1989.) It is probable that the value of this capital exceeds the value of the region's debt in the secondary market.

The large productive public enterprises of the region constitute an asset of the greatest importance in cases where their economic base is solid and their administration efficient. There are cases where the resource endowment exceeds the requirements of immediate objectives and generates over-capitalization or excessive employment or engineering capacity or even underutilization of installations and equipment. In such circumstances, changes must be made either in goals or resource endowment, or both at the same time.

It is desirable to put greater emphasis on transforming the large governmental enterprises into pivots of technological change, applied research and the development of activities which would integrate the interindustrial chain and pave the way for regional complementarity agreements.

Regarding the fixing of tariffs, it is necessary to satisfy the economic efficiency principle, according to which the price of the additional physical unit must equal the cost of resources to provide it. On the other hand, the tariffs charged must generate sufficient income to cover at least the operating and maintenance costs. In order to favour the added efficiency of the economic system, the tariff structures must be intelligible, so that they provide unequivocal signs for the adoption of investment decisions. In order to apply the criteria of economic efficiency to the case of public resources in natural monopolies, it must be established whether the relevant marginal cost is a short or a long-term one, in order to optimize efficiency and, simultaneously, consider an adequate level of financing for the respective enterprise. As already mentioned, it definitely will be necessary to set the rates at marginal cost, introducing the necessary adjustments to allow the self-financing of an efficient enterprise, as a way of simulating its operation in a competitive market (Alé, 1990).

The distortions in the costs for labour, materials and financing should be eliminated, as well as the price subsidies for various categories of final consumers. Where social goals proper are concerned, it will be necessary to specify and explain them, quantifying their magnitude and evaluating efficiency in achieving the aggregate of the enterprise's objectives. Various criteria may be employed for this purpose, apart from profitability. In addition, it is recommended that the transparency of the various flows between the enterprises and the public sector be increased, which could lead to substantial changes in salary and working conditions in the public sector. Where economies of scale are not a determining condition of their size, it probably will be found desirable to divide public enterprises into smaller units.

To the extent that it is viable, public enterprises should compete not only among themselves but also with the private sector. Greater financial autonomy and transparency should be promoted; advances should be made in the elimination of subsidies; or, when they are necessary, quantitative deadlines and ceilings should be applied. The accounts of public administrations should be audited externally and the results published promptly.

Personnel policies of public enterprises must correspond to their importance: a reasonable degree of stability and autonomy, as well as a competitive level of remuneration, would seem to be indispensable requisites.

Transparency in the relations of public enterprises with their suppliers, whatever their origin, will contribute to the promotion of healthy competition among the latter, thus avoiding the consolidation of vested interests.

The practice of "saviour nationalizations" should be restricted to truly exceptional situations. For public enterprises in this situation, various alternatives should be analysed: rationalization and sale, final closure or transfer.

The situation of public enterprises conceived in order to overcome a market flaw or void has to be evaluated in a realistic way. In those cases where preconditions for market development exist, the activity can be transferred to the private sector; in cases where these preconditions have not been achieved probably the effort will lead either to the reorganization or elimination of the enterprises.

To sum up, the reconversion of the sector is absolutely essential, if public enterprises are to optimize their contribution to the achievement of development with changing production patterns and social equity. This requires applying policies that grant greater financial capacity and autonomy in a context of gradual elimination of subsidies and specific treatment, according to the individual situation of each enterprise.

b) *Privatization*

There are various situations where the alternative of privatization appears to be advisable. This may actually form part of an aggregate of measures taken with respect to public enterprises affected by chronic deficits; or it could be suggested for those that operate in markets where it is possible to replace them with private firms; or privatization could be the logical solution for firms that were originally private and the rationalization of which has made them viable (Lahera, 1989; Vernon, 1989).

Privatization, understood as the mere transfer of public assets to the private sector, appears to be a solution which is simplistic in conception and difficult to carry out. This is because it is based on an approach which emphasizes unilaterally the view of the agents concerned, without giving adequate consideration to the incentives and regulations regime, or to the structure of the respective market.

In some approaches it is assumed, openly or implicitly, that the mere change of ownership of the assets will automatically bring with it a change in the mode of operation and the results of the privatized enterprise. However, privatization in itself does not modify the economic incentives and regulations regime. If this action, when advisable, is to be successful, it is first essential to correct various imbalances; this will likewise permit more accurate judgement concerning the advisability of privatizing. The debate concerning the differential effects of asset ownership by various types of agents becomes more specific and relevant in a context in which other operating conditions have already been discerned. The confusion in these matters favours the introduction of a strong ideological component in the discussions.

Privatization and increasing competitiveness are not necessarily synonymous. The impact of the former on efficiency of resource assignment will depend, in part at least, on the structure of the market, more than on the type of ownership. If, originally, competition did not exist in the sector in question, privatization will have a positive impact on efficiency only if it is accompanied by liberalizing policies which remove market restrictions and intensify external competition. In a context of competition or of correction of the incentives regime, privatization can effectively promote greater competition and productive and economic efficiency. On the other hand, the extreme case of conversion of a public monopoly to a private one, with the same lack of regulation, proves that the transfer to the private sector does not offer, in itself alone, any guarantees in this respect. Thus it is evident that privatization is not an end in itself, but rather an instrument of public sector reconversion in accordance with the new needs of each country.

The way in which privatization is carried out will be a determinant of its results. In fact, the diversity of situations that can arise from its initiation and even after its conclusion –with respect to regulation, for example– makes very different formulas foreseeable. It is of special importance that, in the sequence of operations, the change of agents should not precede, but rather follow, the deregulation, stabilization and liberalization efforts.

Undoubtedly there are objective limits for the depth and speed of privatization programmes; if the advance is too forced, it can cause excessive pressure on local financing and the interest-rate level. On the other hand, it is indispensable that clear rules of procedure be established; that the relevant assessment be entrusted to an autonomous entity; that some degree of competition be introduced; and that excessive concentration of ownership be avoided. Finally, the transfers resulting from the privatization process must not involve undue privileges or subsidies that could weaken the overall effect or simply alter the cost-benefit ratio. Likewise to be avoided is the constitution or reinforcement of inadequate ties between the financial and industrial sectors. In monopoly situations that are difficult to deregulate, privatization does not constitute the best alternative, and the competitive granting of operational contracts might be explored.

c) *Regulation of the economy*

A clearer dividing line is required for the activities assigned to the public sector, as well as for progress in dismantling unjustified obstacles to private-sector activity. The regime of incentives and regulations must be as transparent as possible, since this is the starting point from which public and private agents formulate their expectations.

The private sector has the right to demand, as a counterpart of entrepreneurial risk, some stability in the rules of the game relating to ownership and the macroeconomic framework. In turn, the concession of subsidies for private operations, on the part of the State, should be governed by the most rigorously objective criteria and should prevail for clearly-defined periods of time.

Excessive controls, redundancies, and delays in procedures may be the subject of drastic, well-focused reform, the results of which may be perceptible in the short run. In some cases, the very existence of regulations is a source of income for agents located outside the public sector while in close contact with it, i.e., contractors for the State. The standardization of procedures, publicity given to operations and the competitive nature of acquisitions are steps in the direction of modifying these vested interests.

It has been stressed that it is not enough to have "correct prices" in order to establish firm bases for development. Undoubtedly, this condition is not sufficient but it should not be forgotten that it is absolutely essential that there should be a relation between the different prices of the economy and the marginal costs of the respective production.

Various financial liberalization episodes have ended abruptly, in the face of reversals in international financial and trade circumstances, or because of serious errors in the way the corresponding processes have been carried out. Nevertheless, the aims of ensuring that the market determines the rates of interest and of allowing a sensible balance between savings and investment remain valid. Important lessons must be learned from the errors of the past (Villanueva and Mirakahor, 1990).

The regulation of the labour market should not prejudice the free enterprise of the firm, avoiding excessive rigidity in labour relations. At the same time, it is advisable to promote the establishment of an unemployment insurance system or some similar formula and to strengthen training activities which can permit displaced workers to find other jobs.

Auctioning of concessions and provision of private services is infrequent in the region. However, this represents an important potential for increasing productivity. The fruits of such an increase should also benefit the user of the service auctioned, not only in price but also in quality of the service.

The concession is the act by virtue of which the State grants to a private firm the right to provide a public service, in exchange for the rigorous fulfilment of clear and stable requirements. The concessionary firms are obliged to deliver the service to anyone who solicits it, in accordance with established requisites (Alé, 1990). In the case of non-fulfilment of some of the conditions required, the State can fine the firm and even put an end to the concession.

Incentives must be proportionate and efficient with respect to the specific ends sought, avoiding excesses and remaining in effect for prudent and precise periods. The implementation requisites should be few and susceptible to objective evaluation.

5. *Social equity policies*

The State has an irreplaceable role in the satisfaction of the population's basic needs, which is, in turn, a requisite of structural change. The existence of increasing degrees of social equity constitutes likewise a moral imperative and responds to the right of the citizens of a country to participate in the fruits of progress. The viability and the dynamism of a development strategy is founded on full employment of existing resources, especially human resources, on the attainment of basic welfare standards which confer meaning on belonging to a political system, and on growing access to goods the added value of which is steadily increasing.

On the subject of income distribution we must distinguish between aspects which are actually distributive and those which are redistributive. Whereas the former depend mainly on income generation and have important institutional connotations, the latter are related to income already generated. The traditional problems in social relations impede the advance of modernity, often making it spasmodic. From another viewpoint, the extreme inequality of income distribution severely limits changes in production patterns, since it impedes symmetry between the costs and the benefits of such changes (Sarmiento, 1990).

The institutional reforms pave the way for greater participation through the opening up of opportunities for social negotiation and coordination. Outstanding in this sense are labour reforms aimed at promoting the organization and authentic representation of the workers. The institutional sphere includes reforms designed to combat such outdated social customs as the *latifundio* and servile work relationships.

In the short term, we must devise a social policy which responds to the population's most critical needs. In this respect, we must adopt a concentrated approach, which attempts to reduce action in favour of groups that do not require the specific assistance being offered. There has frequently been a tendency to counterbalance the use of the concentration technique with the principle of universality of benefits, which is indispensable with regard to the most pressing needs, those which do not manage to generate economic demand. The truth is that such criteria correspond to different planes: concentration is, in fact, a way of making social expenditure more efficient, not one of diminishing its positive impact. General policies in the fields of education, social security, housing, nutrition and health are irreplaceable. What is more, most countries of the region are in dire need not only of restructuring but also of an increase in expenditures on basic social services.

6. *Special policies favouring structural change*

The public sector has no advantage over the private sector in terms of ability to predict the degree of success of different projects. However, it is better prepared to identify those projects that are more likely to generate beneficial externalities (Fritsch and Franco, 1989). Other things being equal, what should be subsidized is the potential for generating these externalities. Obviously, the public sector is irreplaceable in the creation of general conditions for the development of these capacities.

State action should give way to market orientations where this exist; and where this is not the case, it must help to develop them through an aggregate of measures that range from the establishment of basic conditions for advancing in the direction desired, to selective programmes in which the public sector assumes a catalytic role in economic activity.

As indicated earlier, strategic designs traditionally started with a sharp differentiation between the various productive sectors, with most of the credits going to industry. Now, however, the drastic separation between branches and sectors has lost a good part of its significance. Technological development has confused frontiers, to the extent that increasing overlapping is observed; this is a basic element to be taken into account in policy formulation. Productive activities tend to form a chain through the multiplication of links between agricultural, mining, industrial or service activities. It is imperative, particularly in the smaller countries, to apply a large dose of selectivity in identifying the link which it is desired to favour. The key criterion in this sense is the possession of comparative advantages susceptible of being dynamized (Ominami and Madrid, 1988).

The success of this policy assumes action in different areas: entrepreneurial development and worker training, which includes stimulating medium-sized firms and supporting the small ones; the formation of service networks for producers and support of foreign trade; tax, credit and insurance incentives for exports; measures for counteracting the effects of unfair competition (anti-dumping), financial aid and international cooperation; regulations on national engineering; technological transfer programmes for public and private development institutes; special tax treatment of advisory services, training and reorganization of firms (Castillo, 1989).

Policy instruments are also varied: publication of information on markets and technology; creation of subcontracting exchanges and regional markets; tax exemptions, soft loans, direct subsidies, technical assistance; guarantee funds, commercial endorsements, risk capital and joint ventures; industrial promotion; economic regulation; protection of the consumer and anti-monopoly legislation; intellectual property and industrial security (Castillo, 1989).

The public sector can promote technological change by various means. Apart from trying to strengthen its own ability in this field, it could appropriately take the following action with respect to the private sectors: i) stimulate the creation of risk-sharing mechanisms, private, public or mixed, that would be both transparent and impartial; ii) protect innovations with adequate legislation and compensate innovating entrepreneurs who cannot otherwise profit from their efforts; iii) complement research and development activities of the private sector that may be necessary for advancing technology where it is either stagnating or close to stagnation; iv) request the opinion of the entrepreneurial sector concerning the allocation of public resources to activities leading to the creation of technological innovation; and v) prepare and provide to the public sector information of general usefulness which is trustworthy, clear and timely (Wylie, 1990).

When a vigorous effort to improve human resources is lacking, the dissemination of technology is slower or more difficult. Education and the levels of skill in the labour force are factors determining the competitivity and productivity of an economic system. Technical education is a variable of the utmt importance (UNIDO, 1989).

It is recommended that, in the case of the small and medium-sized firms, cooperation and coordination strategies be initiated so that they can compensate for the restrictions imposed by their size (table 9).

Table 9

ASSOCIATIVE SCHEMES FOR SMALL AND MEDIUM-SIZED FIRMS

Marketing:	They centralize the technical and financial resources of a certain number of small and medium-sized industries for the purpose of joint marketing, whether for the internal or external market.
Purchasing centres:	A group of entrepreneurs purchase their inputs jointly, thus obtaining better prices.
Subcontracting exchanges:	They articulate supply with demand. A large industry subcontracts various small ones for the manufacture of parts, components or semi-assembled products that will be subsequently integrated in a final product.
Guarantee and endorsement associations:	Entrepreneurs form an association in order to provide loan endorsements and guarantees before the banks.
Savings and credit *cooperatives:*	A group of entrepreneurs saves and extends credit with its own funds.
Microfirm incubators:	A group of new or growing firms is concentrated in one place, which permits them to share services and equipment and receive technical assistance, administrative support for accounting, training, etc. The aim is to strengthen new firms.
Industrial parks:	Firms are installed in the same area and share common services, which facilitate technological transfer, training and integration among them.
Design centres:	Firms form an association in order to share the design function, a formula that is particularly useful for exporters not competing in the same market.

Source: Lysette Henriquez, manager of Technical Cooperation Service (SERCOTEC) in *El Diario Financiero*, Santiago, Chile, 9 July 1990, p. 18.

7. *Institutions and public administration*

In almost all countries of the region the public administration has undergone a long process of deterioration, accentuated by adjustment efforts. This retrocession illustrates one of the main contradictions affecting the State today: while its present situation is deplorable, it is not possible to ignore it, if the next stage of regional development is to be a success. Tasks as important as the design, supervision and the application of a consistent combination of macroeconomic and sectoral policies depend critically on an aggregate of institutional and technical factors and a relatively small group of persons (Israel, 1989). The public sector must be technically and politically capacitated to carry on a fruitful dialogue with economic and social personnel, in such a way that it may be possible to reach agreements which clarify, or establish, the rules of the game.

Personnel selection, the ability to retain good public administrators, and to cast aside the inefficient ones, as well as the training of existing personnel, are all timely and important subjects, even in a period of adjustment (United Nations, 1983; Grossman, 1983). Experience has demonstrated, however, that it is not very realistic to add administrative reform to the already multiple tasks demanded by the adjustment and the restructuring of production, although this need not be an obstacle to studies of such reform that could be carried out by high-level commissions and that would lead to proposals for organic administrative changes, including transition plans.

At some levels of management, reform of administrative practices cannot be delayed. Adequate understanding and effective management of these situations depends critically on the focus with which they are analysed. Without prejudice to the importance of bureaucratic aspects proper, which in addition to hampering public administration, affect the economy's productivity, priority should be given to the consideration of institutional dimensions and the examination of public policies, viewing these as a flow of specific content.

The public administration is facing endogenous problems which, in some countries are causing its paralysis. The manager, then is rather like a doctor for his own illness, which is not functional for achieving other objectives and becomes a problem in itself.

Public management takes place almost always at the periphery. What can be changed is never much, owing to restrictions of a financial, legal, administrative, or political nature, or a combination of these.

The central organization has to follow closely the flow of information and decisions, avoiding the temptation to create hypothetical situations. Intraministerial or interministerial coordination in megaministries is of great utility, which justifies considering it as a substantive function in itself.

The concept of public policies is sufficiently generic. It can be assimilated into those courses of action that the authority adopts in relation to a certain goal and which contribute to creating or transforming conditions, ends, or means in which economic agents carry out their activities. The existence of public policies may derive from written provisions or from bureaucratic practice, whether these are general or specific, direct or indirect, universal or individual.

In addition to public policies with a specific object, there are those of "second degree". The latter are characterized by their complexity and result from the simultaneous application of a combination of specific policies. In practice, it can be observed that the more general the object of public policies the greater the number of these that will be affected. Inversely, the more general the public policies, the larger the number of sectors, in reality, that will be affected by the object (Lahera, 1980).

The various public policies affect the situation constituting their object in very diverse ways, in some cases neither obvious nor direct. Hence the imperative of making an effort to determine the relations between policies and reality, rather than describing in an exhaustive and formally explicit manner the different categories of policies. It is necessary to explore the fields of force created by public policies that are superimposed on pre-existing reality and to discern the intensity of each one.

The management and evaluation of specific public policies makes it possible to diagnose their efficiency with accuracy and facilitates their marginal correction, starting from the detection of deficiencies. The consequent search for alternative solutions is designed to generate and present information on results and on the most efficient manner of realizing the objectives.

Finally, it should be pointed out that the coordination and evaluation of policies constitutes a prerequisite for their efficacy. In the public administration field, the successes are accumulated marginally; the errors, on the contrary, are amplified.

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CEPAL REVIEW No. 42

Runaway inflation: experiences and options

*Felipe Pazos**

Inflation was a major concern for Prebisch from his time in central banking up to the end of his career, when he stressed the need for new thinking by Latin American economists about stabilization policy. The topic is of vital importance, not only for Latin America, but also for the world in general, for specialists in industrialized countries have also been unable to elaborate policy recommendations for their governments that will resolve the dilemma between inflation and monetary restriction.

Economists have searched arduously for a theory of inflation that corresponds with the facts, but have not achieved a consensus. On the contrary, strong disagreement persists as to why inflation behaves in ways so different from those described in established theory. Consequently, there are also differences in policies designed to halt or slow the process.

Given this lack of a policy that can stop it, inflation presents serious obstacles to economic growth throughout the world and causes very serious social problems in many countries. For fear of accelerating inflation, industrial nations are limiting economic activity to levels below productive capacity and, due to the lack of politically feasible stabilization programmes, a number of developing countries (especially in Latin America) are undergoing inflationary processes that cause severe damage to their economic, social and political structures. Therefore, today, the control of inflation constitutes the highest priority for economic science.

*Economic Adviser to the Central Bank of Venezuela.

"We have not offered governments a set of coherent and attainable principles that will allow them to escape the dilemma between inflation and monetary orthodoxy. We Latin American economists are in debt to the politicians of our countries."

Raul Prebisch
El falso dilema entre desarrollo económico y estabilidad monetaria, March 1961.

"... I am convinced that we must renew our thinking about stabilization and capital accumulation policy."

Raul Prebisch
Statement at the twenty-first session of ECLAC, 24 April 1986.

I
Price trends in Latin America: 1961-1990

Table 1 presents average retail price increases in 19 Latin American countries during the 1960s and 1970s and the annual figures for the 1980s. During these three decades, inflation was constant and generalized. The only exceptions were Guatemala in 1982 and Panama in 1986, 1988 and 1989, years in which real economic activity experienced strong contractions in those countries. It is also possible that there are errors in the figures because, during the years in question, prices rose in the United States, the main supplier of both countries. Examination of the table reveals, first of all, that inflation was a persistent phenomenon in all Latin American countries during the last three decades. This is an entirely expected conclusion and cannot surprise either economists or lay persons in the era of global inflation. However, its causes must be investigated in depth.

Further analysis of the table leads to the second observation that inflation has accelerated during the period, at a moderate rate during the 1970s and explosively in the 1980s. In the 1960s, four countries experienced annual inflation rates of 20% to 50%, another four, from 5% to 20%, while the rest registered rates the same or lower than that of the United States, yielding an average of 21% for the region, as a whole. In the 1970s, inflation rose more rapidly: two countries registered annual rates of more than 100%, 13 registered increases of between 10% and 50%, while the remaining figures are above 5%, yielding an annual average of 39% for all of Latin America. In the 1980s, inflation went out of control: five countries had annual rates of more than 1 000%,

Table 1
RETAIL PRICES: 1961-1989

(For 1961-1970 and 1971-1980: annual average change; for 1981-1989: percentage increases over previous year)

Countries	1961-1970	1971-1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Latin America	21	39	57	85	130	185	274	64	198	758	994
Argentina	21	136	104	165	344	627	672	90	131	343	3 731
Bolivia	6	20	32	127	276	1 281	11 743	276	15	16	16
Brazil	45	37	106	98	142	197	227	146	230	497	1 476
Colombia	12	21	27	24	20	16	24	19	23	28	27
Costa Rica	2	11	37	90	33	12	15	15	16	25	14
Chile	27	174	20	10	27	20	31	19	20	15	21
Ecuador	5	12	13	16	48	31	28	31	29	86	59
El Salvador	1	11	15	12	13	11	22	22	13	4	21
Guatemala	1	10	11	-	15	10	25	38	13	10	14
Haiti	3	11	11	7	10	6	7	11	17	4	6
Honduras	2	9	10	10	9	5	3	4	3	4	11
Mexico	3	15	28	59	102	65	58	86	132	114	18
Nicaragua	-	18	24	25	31	36	219	681	912	10 205	3 452
Panama	2	7	7	4	2	2	1	-	1	-	-
Paraguay	3	13	14	7	13	20	26	32	22	23	29
Peru	10	32	75	64	111	110	163	78	86	150	2 949
Dominican Republic	2	10	7	8	5	27	42	10	16	34	43
Uruguay	48	62	34	19	49	55	72	76	63	62	82
Venezuela	1	8	16	10	6	12	12	11	40	35	90

Source: International Monetary Fund, *Yearbook of International Financial Statistics*, 1985 and ECLAC, *Preliminary overview of the Latin American and Caribbean economy.*

and three reached or, at times, surpassed monthly rates of 50% (13 000% annually), which Philip Cagan considers to be definitive of hyperinflation.[1] To complete the scene, it must be noted that two of the five countries with annual rates higher than 1 000% managed to lower those rates to below 20%. Inflation in Bolivia fell abruptly from an annual rate of 21 000% in August 1985 to -25% the following month. It fluctuated erratically until January 1986 and, since then, has remained below 20%. Mexico, for its part, managed to lower inflation from an annual rate of 214% in January 1988 to 16% in July, a level it has maintained since then. In Argentina, inflation registered very marked fluctuations in the 1980s: in the first half of the decade, it rose rapidly to an annual rate of 2 500% in July 1985 and fell to an average annual rate of 30% in the second half of that year, although it began to rise again the following year, rising constantly and rapidly for four consecutive years to reach an annual rate of 400 000% towards the end of July 1989. Then, it fell during several months but again shot up to its current hyperinflationary levels (March 1990).

The third fact to be observed from the table is that, in spite of a clear tendency to rise, the tempo of price increases fell on occasion, at times considerably. There are few examples of successful stabilization policies, but the table shows pronounced declines in Chile from 1974 to 1982, in Bolivia from 1985 to 1987 and in Mexico from 1987 to 1989; and less spectacular declines in Argentina and Brazil from 1985 to 1986; and in Ecuador and Nicaragua between 1988 and 1989. In periods prior to those reported in the table or hidden in the 10-year averages there were considerable reductions in inflation in Paraguay in 1953-1954; Bolivia 1956-1958; Argentina 1959-1960 and 1967-1969; Chile 1960-1961; Brazil 1964-1969; and Uruguay 1968-1970. Reducing inflation is a very difficult task but it has been achieved on many occasions. For that reason, we should analyse how it was achieved in each case. We must study the successes of the past and learn from them.

[1] Philip Cagan, "The monetary dynamics of hyperinflation", *Studies in the Quantity Theory of Money*, Milton Freidman (ed.), Chicago, University of Chicago Press, 1956

A further finding, as important as those cited above, as becomes clear in the analysis of table 2, is that in each of the last four decades inflation in Latin America has been considerably higher than that of other developing countries and very much higher than in industrial countries. Equally serious is the fact that this greater inflationary intensity has become gradually more pronounced: in the 1950s, it was a little more than double that of other developing countries and nearly four times higher than in industrial nations; in the 1980s it was seven times higher than in the Middle East, 20 times higher than in Asia and nearly 30 times higher than in the industrial countries.

Table 2

RETAIL PRICES IN FOUR GROUPS OF COUNTRIES: 1951-1989

(Percentage increases over previous year)

Regions	1951-60	1961-70	1971-80	1981-89
Industrial countries	2.1	3.3	8.7	4.9
Asia	3.3	5.8	9.1	7.4
Middle East	3.6	3.8	19.6	19.0
Latin America	7.9	21.2	39.4	149.0
World	2.4	4.4	11.0	12.7

Source: International Monetary Fund, *Yearbook of International Financial Statistics.*

II
The persistence of inflation

1. *The great enigma of contemporary economics*

In order to analyse the problem of prices in recent years, we first must ask why inflation has continued, since accelerated price hikes have occurred within a pre-existent process. And, more importantly, in order to elaborate and implement an effective anti-inflationary policy, we must understand the mechanism that sustains the phenomenon. The persistence of inflation is the great enigma of contemporary economics.

Economic theory clearly identifies the pressures which give rise to inflation but not the factors or mechanisms that maintain it. Economic literature contains extensive and intensive analyses of the origins and nature of increases in aggregate demand beyond available supply, of cost increases and of the partial supply deficiencies that disorganize the economy, all of which cause prices to rise; but the reasons for the persistence of inflation have not been studied in depth. Unfortunately, economists of industrial countries have resigned themselves to a constant annual inflation rate of from 3% to 4%. They consider it to be a consequence of the power of labour organizations, of imperfect competition in the goods and services market, and of expectations.

We specialists in developing countries, especially Latin Americans, have accepted much higher inflation with the same passivity, as long as it did not surpass 40% or 50% annually. We considered it to be the nearly inevitable result of the instability of our foreign trade. This resignation has meant a tacit renunciation of in-depth investigation into the causes of the persistence of the phenomenon. It has had the severely negative effect of inducing industrial nations to apply very restrictive policies and to impede the design of effective anti-inflationary programmes in Latin America. Therefore, we must study in depth, the causes of the persistence of inflation both of the slow rates of inflation in industrial nations and of the intermediate rates of inflation in Latin America.

Current imperfections in the markets for labour, goods and services are a necessary condition for the persistence of inflation because the power of labour organizations together with unemployment insurance allow workers to obtain pay hikes even in times of unemployment; nevertheless, these factors are not its cause. This lies rather in the deterioration of real wages arising from the use of annual or multi-year labour contracts, which freeze wages while general price levels rise. Monopolistic price-fixing among producers is also a necessary condition for the persistence of inflation because it allows companies to reduce production while continuing to raise prices when the Government applies restrictive fiscal and monetary policies; but this is not a cause of price increases either. These result from wage hikes that occur in the renewal of work contracts.

Expectations tend more to intensify short-term price rises, than long-term increases. In the short term, they exacerbate inflation, encouraging hoarding, with the consequent drop in supply; but this accumulation produces a deflationary effect over time. As long as they last, inflationary expectations lead to hoarding; nevertheless, this cannot continue indefinitely due to limits on storage space and the costs involved. When the process ends, inflationary expectations take on a deflationary role.

Expectations of persistent price hikes raise the costs of longer-term projects and affect labour and rent contract negotiations. Nevertheless, the main objective of the workers in contract renewal has more to do with recovering their real wage losses derived from past price hikes than with protecting themselves in advance from those they expect to occur in the future; and the same can be said with respect to landlords and the rent they charge. In practice, contract adjustments serve both to replace losses occasioned by past inflation and to cover losses expected from future inflation; but the first objective is the most important, since these wage and rent hikes would have to take place even if there existed absolute security that inflation would stop. Failure to make these adjustments would undercut wages and rents in real terms.

2. *Temporary lag and periodic over-adjustment of wages, rent, exchange rates and public service charges*

The imperfect nature of competition in the markets for labour, goods and services creates conditions for the persistence of inflation. Inflationary expectations help maintain it, but the fundamental cause of its persistence is the temporary lag and periodic overadjustment of those prices subject to fixed-term contracts, such as wages and rent or subject to official regulation, such as exchange rates and public service charges.

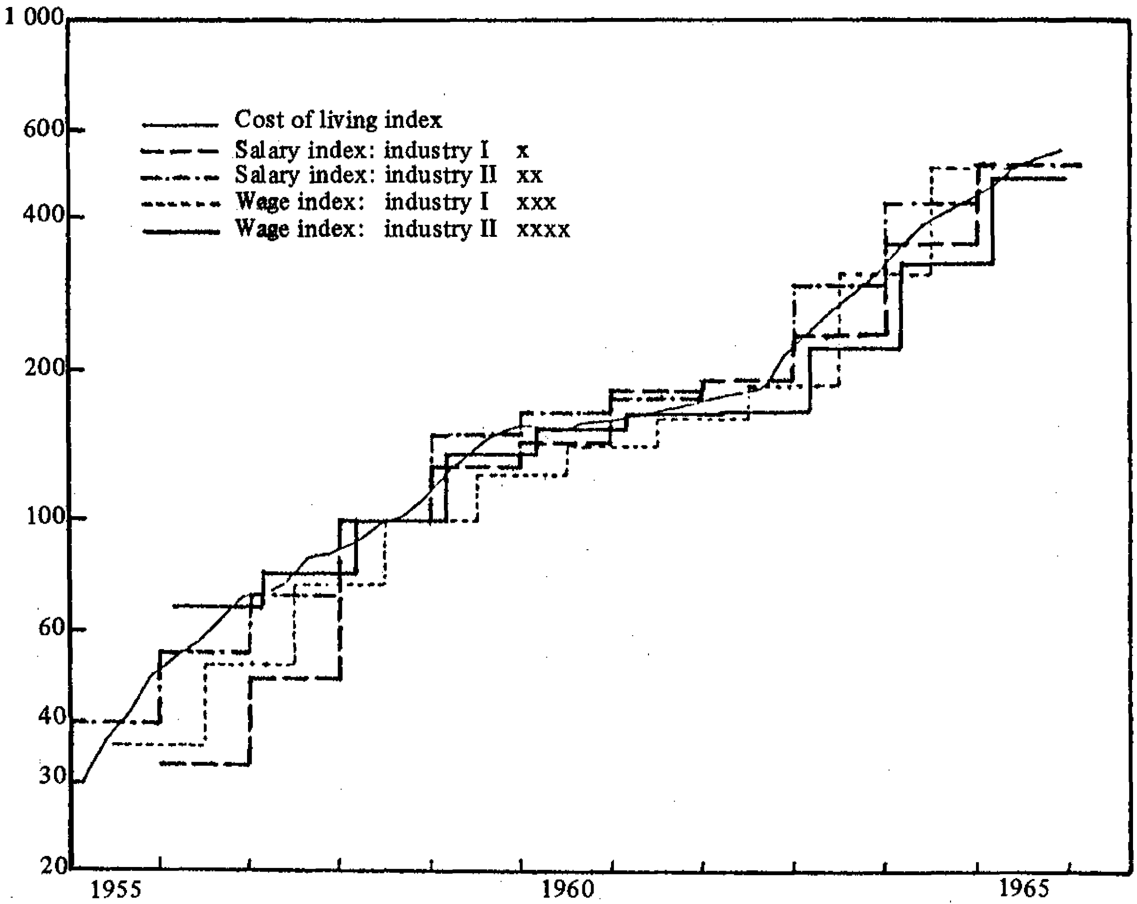
Work and rent contracts are usually signed for periods of one year, or, at times, for two years or more, which means that wages and rent are kept stable for those periods and gradually lose value with respect to general price levels, which means that the incomes of workers and landlords lose buying power during that time. When it is time to renew contracts, workers and landlords demand increases that will restore their real incomes and, in the case of workers, take into account increased productivity arising from technological progress and, in the case of landlords, changes in the property market. These increases occur in stages that intercross the annual price curve (figure 1). The data used in the figure are 35 years old but they are used here because labour contract structures have not changed. Consequently, the search for recent information would have entailed unnecessary effort.

Wage hikes periodically surpass price index increases, pushing these into new increases (figure 2). The increases are, therefore, overadjustments and not simply the re-establishment of equilibrium. This seems to surpass the goal of the workers to recover their real wages, together with the companies' policy of maintaining real wages, without paying very much greater amounts. Therefore, it is necessary to investigate the causes of these overadjustments in circumstances in which the increases could be limited to the amount necessary to bring wages into equilibrium that would not put pressure on prices. In order to clarify this problem, it will be convenient to divide the question into two: i) Why are equilibrium wages not re-established in the first adjustments that occur during the early phases of inflation? and ii) Once inflation is under way, why do overadjustments occur?

In the first rounds of contract renewal that occur in the early phases of inflation, the workers demand and obtain increases necessary to restore their wages to pre-inflationary levels, probably apart from small additional percentages due to productivity increments. However, the prior real level is no longer a real equilibrium wage because it has been reduced by inflation. The recovery of the prior real level involves an overadjustment that puts upward pressure on prices. In subsequent renewals, efforts to recover real income prior to inflation and incorporate productivity increases will continue to raise wages above equilibrium levels. Once inflation is under way, the mechanism that will maintain it is installed, i.e., the temporal lag and periodic overadjustment of wages and other prices subject to fixed term contracts or official regulation.

The mechanism for the transmission of inflationary pressures expounded here is not a theory accepted in academic circles but is rather an explanation put forward in a conference sponsored by

Figure 1
CHILE: WAGES AND SALARIES IN TWO INDUSTRIES: 1955-1965
(1958 = 100)



Source: Personal archives of author and *Boletín Mensual*, Central Bank of Chile.
Symbols: x Area supervisor: Rayonhill, Industria Nacional de Rayón, S.A.
xx Area supervisor: Fábrica Victoria, Puente Alto, S.A.
xxx Average daily wage: Rayonhill, Industria Nacional de Rayón, S.A.
xxxx Average daily wage: Fábrica Victoria, Puente Alto, S.A.

the Central Bank of Chile in August 1965[2] and developed in a book published in Spanish in 1969[3] and translated into English in 1972.[4] This explanation was not refuted but neither was it accepted until Dornbusch endorsed it in 1984, in a conference of the Institute of International Economics,[5] and repeating it subsequently in a number of papers.[6]

[2] Central Bank of Chile, *Boletín Mensual*, No. 451, Santiago, Chile, September 1965.

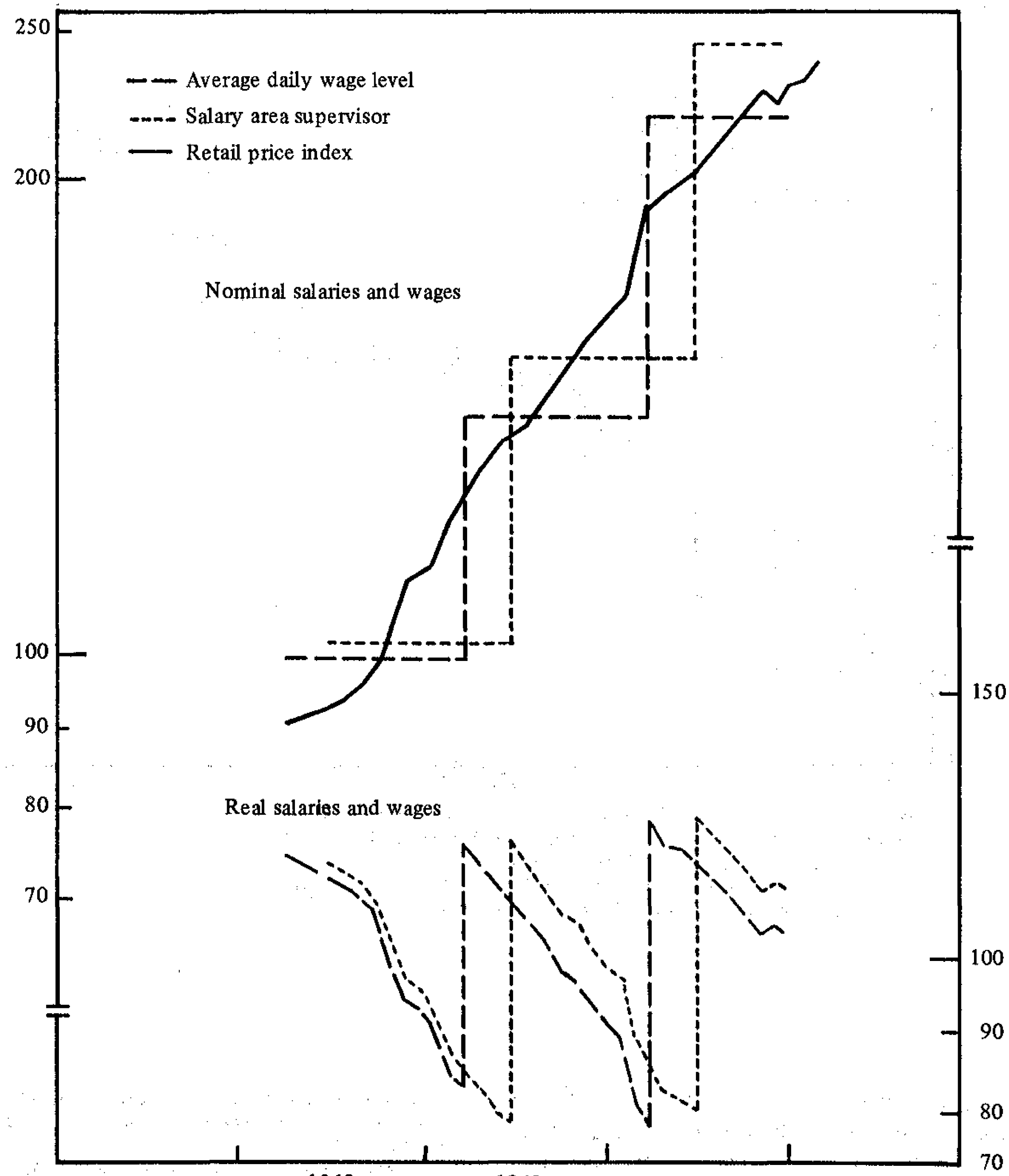
[3] Centre for Latin American Monetary Studies (CEMLA), *Medidas para detener la inflación crónica en América Latina*, Mexico City, 1969.

[4] *Chronic Inflation in Latin America*, New York, Praeger Publishers, 1972.

[5] Institute for International Economics, *Inflation and Indexation*, Washington, D.C., 1965.

[6] Rudiger Dornbusch, *Inflation, Exchange Rates and Stabilization*, Essays in International Finance, No. 165, Princeton, N.J., 1986; Rudiger Dornbusch and Juan Carlos de Pablo, *Deuda externa e inestabilidad macroeconómica en Argentina*, Buenos Aires, Editorial Sudamericana, 1988.

Figure 2
CHILE: ANNUAL SALARY ADJUSTMENTS IN ONE COMPANY [a]
(April 1962-March 163 = 100)



Source: Personal archives of author and ***Boletín Mensual,*** Central Bank of Chile.
[a]Industria Nacional de Rayón, S.A., Rayonhill.

3. *Diversity in productivity rate increases*

Another cause of the persistence of inflation lies in the fact that industries that increase productivity more rapidly do not lower the prices they charge consumers but, rather, raise wages, thus establishing the norm for wage levels to be based on economic activities with lower productivity increases. In those areas less favoured by technological progress, the fact that wages rise more than productivity forces increases in their prices, with the consequent impact on the general cost of living index. In the United States, since the end of the Second World War, average merchandise prices have risen at an annual rate of 3.8%, while those of services have risen at an annual rate of 5.3%, giving an annual average increase of 4.4% in the general consumer price index (table 3).

The persistence of inflation due to cost increases in activities of lower productivity accounts for only 1% or 2% annually. This is not important in annual inflation rates of 30% or 40% but is significant in annual inflation rates of 3% or 4%, as is commonly the case in industrial nations.

Table 3
UNITED STATES: PRICE INCREASES OF DIFFERENT TYPES OF PRODUCTS
(1982-1984 = 100.0)

	1946	1988	Annual rate of exchange
Merchandise	22.9	111.1	3.8
Food	19.8	117.8	4.3
Durable goods	29.2	110.2	3.2
Non-durable goods	23.6	105.5	3.6
Services	14.1	125.5	5.3
Medical service	10.4	137.9	6.4
Other services	13.1	124.1	5.5
General index	19.5	118.0	4.4

Source: *Economic Report of the President*, Washington, D.C., 1989.

III
Inflationary acceleration in the last two decades

1. *The causes of acceleration*

The acceleration of price increases in Latin America in the last two decades was caused by a number of factors, some general in character and others specific to certain countries. In the 1970s, the sharp rise in oil prices, the much lower, yet substantial, increases in the prices of other primary products, and the considerable rise in prices of exports from industrial nations accelerated inflation which, however, was moderate in comparison with that of the 1980s. Then, the surge in prices was caused mainly by: a) the efforts of Latin American Governments to soften the domestic effects of the sharp decline in the acquisition of foreign resources resulting from the debt crisis and b) the drop in primary product prices. To these factors, a) and b), others must be added which affected only certain countries; c) monetary expansion not geared to absorb a decrease in foreign resources; d) the increase in the exchange rate resulting from the liberalization of previous controls or arising from expectations of international payment disequilibria; e) guerrilla wars; and f) the automatic acceleration of inflation when the process surpasses certain levels.

As we will see, factor c) has been the cause of acceleration, at one time or another, in nearly all the countries of the region but especially in Argentina, Bolivia, Brazil, Chile, Mexico, Peru and Uruguay; factor d) has accelerated inflation in Chile, Mexico and Venezuela; factor e) in El Salvador and Nicaragua; and factor f) in Argentina, Bolivia, Brazil, Nicaragua and Peru.

Two of the six factors mentioned, a) and b), are of foreign origin and are not, therefore, attributable to domestic policies, although these could have been more effective. For their part, guerrilla wars constitute a serious non-economic national problem. The other three factors are directly and immediately related to economic and financial policy and, therefore, must be studied with care in order to avoid them in the future.

2. *Increases in the prices of oil, other primary products and imported manufactured goods*

Oil prices rose sharply in 1973-1974 and again in 1979 and 1980, with the result that average fuel prices in the 1970s were eight times higher than in the 1960s (table 4). Also in 1973-1974, the prices of other primary products began a trend of increases that continued until 1980, raising their average value to double that of the 1960s; a similar trend occurred in the prices of exports from industrialized nations or in the prices of imported manufactured goods, which is the same thing. Given this increase in oil and other primary product prices, which led to considerable income and cost increases in producer countries, raising prices from the demand side and pushing them up from the cost side; and, given, moreover, the higher value of imported manufactured goods, it is no wonder that Latin American inflation rose from an average annual rate of 21% in the 1960s to 39% in the 1970s and to around 50% by the end of that decade.

Table 4
LATIN AMERICA: IN BASIC PRODUCT PRICES AND RATES OF INFLATION: 1961-1980
(1961-1970 = 100)

	Index 1971-1980	Increase (%)
Price of oil	828.5	728.5
Price of basic products	212.1	112.1
Price of industrial country exports	211.6	111.6
Average industrial country rate of inflation[a]	263.0	163.0
Average rate of inflation[b]	185.7	85.7

Source: International Monetary Fund, *Yearbooks of International Financial Statistics.*
[a] 3.3% in the period 1961-1970 and 8.7% in 1971-1980.
[b] 21.2% in the period 1961-1970 and 39.1% in 1971-1980.

3. *Policy to offset the decline in assets and foreign loans*

As can be seen in table 5, during the 1960s, net financial transfers (new loans and direct investment less amortization, dividend and interest payments) left a negative average annual balance of US$700 million.

Positive annual averages of US$12.6 billion were achieved in 1971-1975 and US$23.4 billion in 1976-1981 in the following six years, 1982-1987, they became negative again, with an average annual loss of US$22 billion, i.e., a decline of US$45.4 billion in the annual average of net financial transfers between one period and another (computed, as all the other figures in constant 1986 buying-power dollars).

Table 5
NET FINANCIAL TRANSFERS: 1961-1987
(Annual averages in billions of 1986 dollars)

	1961-1970	1971-1975	1976-1981	1982-1987
Direct investment	2.6	3.9	5.5	3.3
Loans	4.1	17.3	41.9	9.7
Acquisition of capital	6.7	21.2	47.4	13.0
Interest and dividend payments	-7.4	-8.6	-24.0	-35.0
Net financial transfers	-0.7	12.6	23.4	-22.0

Source: International Monetary Fund, *International Financial Statistics*; International Bank for Reconstruction and Development, *World Debt Tables*; and Economic Commission for Latin America and the Caribbean, *Preliminary overview of the economy of Latin America and the Caribbean.*

Latin American exports attained their maximum value of US$108.2 billion in 1981, fluctuating below that amount during the following years and averaging US$94.8 billion during the 1982-1987 period. That average was higher than that of the preceding five years, even if computed in terms of 1986 prices; however, as table 6 shows, total acquisition of foreign resources (exports plus net financial transfers) fell from an annual average of US$103.2 billion in 1976-1981 to US$72.8 billion in 1982-1987, i.e., a decline of US$30.4 billion. This figure is equivalent to 3.6% of regional GDP, 22.7% of exports and 17.3% of fiscal income.

Table 6
NET FOREIGN RESOURCE ACQUISITION: 1961-1987
(Annual averages in billions of 1986 dollars)

	1961-1970	1971-1975	1976-1981	1982-1987
Exports	28.8	52.4	79.8	94.8
Net financial transfers	-0.7	12.6	23.4	-22.0
Net foreign resource acquisitions	28.1	65.0	103.2	72.8

Source: International Monetary Fund, *International Financial Statistics* and table 3.

The drastic decline in foreign income presented governments with the dilemma either of allowing this phenomenon to provoke a violent contraction of economic activity and employment or of applying compensatory policies which would inevitably accelerate inflation. Governments chose the second alternative but, even so, could not avoid GDP contractions of 1.4% in 1982 and 2.9% in 1983, with a very slow rate of growth in the following years, which was less than population growth. For its part, the average Latin American inflation rate rose from 57% in 1981 to 85%, 130%, 185% and 274% in the following years (table 1).

In the process described, inflationary acceleration was caused by economic policy aimed at absorbing a sharp drop in the acquisition of foreign resources. This outlines the situation which gave rise to the structuralist theory of inflation, first articulated by Juan F. Noyola and later reformulated in more systematic form by Osvaldo Sunkel, Aníbal Pinto and Raúl Prebisch. This theory argued that Latin American inflation was not due to lack of foresight or extravagance but to imperfections in the productive apparatus and instability in foreign trade. These factors forced governments to implement compensatory policies which generated inflationary trends.[7]

[7]Juan F. Noyola Vázquez, "El desarrollo económico y la inflación en México y otros países latinoamericanos", *Investigación económica*, vol. 16, No. 4, Mexico City, National School of Economy, 1956; Osvaldo Sunkel, "La inflación chilena: un enfoque heterodoxo", *El trimestre económico*, vol. 25, No. 4, Fondo de Cultura Económica, October-December, 1958; Aníbal Pinto, *Ni estabilidad ni desarrollo: la política del Fondo Monetario*, Santiago, Chile, Centre for Research and Social Action, 1960; Raúl Prebisch, "Economic development or monetary stability: The false dilemma", *Economic Bulletin for Latin America*, vol. 6, No. 1, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), March 1961, Dudley Seers, "A theory of inflation and growth in underdeveloped countries", *Oxford Economic Papers*, vol. 14, London, Oxford University Press, 1962; Aldo Ferrer, "Reflexiones acerca de la política de estabilización en la Argentina", *El trimestre económico*, vol. 30, No. 4, Mexico City, Fondo de Cultura Económica, October-December, 1963; Eduardo García, "Inflation in Chile, a quantitative analysis", 1964, *mimeo; Héctor Malavé Mata, "Metodología del análisis estructural de la inflación", El trimestre económico*, vol. 35, No. 3, Mexico City, Fondo de Cultura Económica, July-September 1968; and Camilo Dagum, "Un modelo econométrico sobre la inflación estructural", *El trimestre económico*, vol. 37, No. 1, Mexico City, Fondo de Cultura Económica, January-March 1970.

4. *Monetary expansion not aimed at absorbing the drop in foreign assets*

The direct and immediate cause of inflation is obviously monetary expansion. As explained above, such expansion can be used to finance compensatory policies, or can originate from the idea that monetary expansion does not raise prices in situations of unemployment and unused productive capacity, or can result from irresponsible financial policies. The first cause has been analysed in the previous section and the third cannot be justified, but the second is little understood and, therefore, merits explanation.

The belief that, in situations of unemployment and unused productive capacity, monetary expansion does not generate inflation is based on an erroneous application of Keynesian theory which forgets that this will be true in closed but not in open economies and in countries with low gold reserves and affected by a lack of funds. When a country with an open economy and unused productive capacity possesses international reserves, the expansion of demand can, for a time, increase production without provoking inflation, because accumulated funds will finance the increased imports resulting from greater domestic activity. However, when the reserves are spent, inflation takes off, the economy becomes disorganized, production contracts and unemployment increases.

Expansion of demand as an instrument of development policy has been applied, at one time or another, in many of our countries. To illustrate its effects, it is sufficient to study the figures (table 7) for the main macroeconomic variables of Chile in 1970-1973 and Peru in 1985-1988, when this policy was applied. In Chile, the deliberate expansion of demand was successful during the first two years, when the real product rose and the inflation rate was stable, but it began to have negative effects during the third year and became critical during the fourth year, in which inflation took off, economic activity contracted sharply and real salaries plummeted. In Peru, the favourable effects lasted three years but the crisis that began in the fourth year was even more serious than that suffered by Chile.

In spite of these arguments and the facts themselves, we economists have frequently maintained the illusion that, when labour and infrastructure are available, monetary expansion will increase production and not prices. On the basis of this illusion, we have had recourse to monetary expansion, although it is difficult to discern when this has been motivated by the hope of increasing

Table 7

CHILE AND PERU: EFFECTS OF DELIBERATE EXPANSION OF DEMAND AS DEVELOPMENT POLICY

	Chile				Peru			
	1970	1971	1972	1973	1985	1986	1987	1988
Rate of increase in public spending (%)	47	76	88	378	158	80	87	395
Inflation rate (%)	35	35	217	606	158	63	11.5	1 722
Rate of real growth (%)	2.1	9.0	-1.2	-5.6	2.5	9.5	6.9	-8.4
Commercial balance (millions of dollars)	246	73	-161	-13	1 173	-67	-463	-84
International reserves (millions of dollars)	320	129	95	36	1 842	1 407	646	518
Real wages (first year = 100)	100	112	108	89	100	114	124	95

Source: Rudiger Dornbusch and Sebastian Edwards, "Economic crises and the macroeconomics of populism in Latin America: lesson from Chile and Peru", *mimeo*, March 1989.

production or when it was merely irresponsibility. Be that as it may, inflationary acceleration, in many cases, has been the consequence of monetary expansion that should not have occurred.

5. *Increases in exchange rates due to liberalization of controls or unfavourable expectations*

During 1971-1973, while a policy involving the deliberate expansion of demand was being applied in Chile, inflation was partially contained through the overvaluation of the exchange rate. Table 8 shows that, between 1969 and the third trimester of 1973, the exchange rate rose nearly 250%, more than three times retail prices (860%). The liberalization of the exchange rate decreed by the new authorities caused it to rise more than 2 300% in the following 15 months, a period in which retail prices rose little more than 1 000%. In 1975, the exchange rate rose 490% and prices 375%. This inflationary acceleration was basically a consequence of the liberation of pressures restrained by the overvalued exchange rate of the previous three years but it also had its own momentum. In fact, a devaluation to equilibrium would have meant an increase of from 25 to 90 pesos per dollar in December 1973, and not to 360 pesos per dollar, which is what happened in the free market. Such a devaluation would perhaps have been able to contain the increase of the dollar from 90 to only 200 pesos, or less, in the following 12 months, in contrast to the 1 870 pesos of December 1974.[8] The extremely high rate of inflation in Chile in 1974, 1975 and 1976 was a consequence not only of the liberation of previously contained pressures but of the multiplication of these pressures in the exchange rate-prices-wages spiral.

Table 8

CHILE: EXCHANGE RATE AND RETAIL PRICE INCREASES: 1970-1976

(Percentages)

Year	Exchange rate increase	Retail price increase
1970	20.3	33.0
1971	8.3	35.0
1972	38.5	77.3
1973[a]	38.5	170.3
1974[b]	2 328.0	1 014.4
1975	490.3	374.7
1976	165.8	211.8

Source: International Monetary Fund, *International Financial Statistics*.

[a] First three quarters.

[b] Last quarter of 1973 and all of 1974.

Inflationary acceleration stimulated by autonomous rises of the exchange rate took place in Mexico in 1982-1988 and in Venezuela in 1989. The strong increase in the rate of inflation in Mexico, from 28% in 1981 to 59% in 1982 and to figures that fluctuated around 100% for six years, was basically, though not exclusively, due to capital flight provoked by the debt crisis. The effects of inflation themselves caused the exchange rate to rise rapidly, which, in turn, accelerated price hikes. In Venezuela, inflation increases, from an average rate of 35% in 1988 to 90% the following year, were due to the exchange

[8] This figures does not coincide with that of table 8 because the latter reports annual averages and not end-of-year values.

unification decreed in February 1989, which caused the average import exchange rate to rise from 18.1 bolivars per dollar that month to a free and unified rate which fluctuated between 36.9 and 34.7 bolivars between March and December, a 120% real exchange rate increase. Table 10 presents variations in the real exchange rate and the monthly and annual inflation rates for 1989 and the first three months of 1990.

Table 9
MEXICO: EXCHANGE RATE AND RETAIL PRICE INCREASES: 1982-1989
(Percentages)

	Exchange rate increase	Retail price increase
1982	130	59
1983	114	102
1984	40	65
1985	53	58
1986	138	86
1987	125	132
1988	65	114
1989	8	18

Source: International Monetary Fund, *International Financial Statistics.*

Table 10
VENEZUELA: EXCHANGE RATE AND RETAIL PRICE INCREASES: 1989-1990

Year and month	Exchange rate variation (%) (with respect to previous month)	Retail prices: Monthy variation in annual terms (%)	Retail prices: 12-month change (%)
1989			
January	0.2	14.0	36.4
February	117.1	45.9	43.5
March	-5.9	884.9	74.3
April	2.7	357.0	93.8
May	2.1	110.5	103.3
June	-1.9	45.9	99.8
July	-0.21	34.5	94.9
August	3.2	29.8	94.5
September	0.8	42.9	97.6
October	8.6	42.6	95.0
November	4.5	16.8	90.0
December	-1.7	22.4	80.9
1990			
January	0.9	32.9	83.2
February	-0.7	25.3	91.1
March	2.1	23.9	51.9

Source: International Monetary Fund, *International Financial Statistics.*

6. *Guerrilla movements*

In Latin America, guerrilla movements have become strong enough to increase inflation in El Salvador and Nicaragua. El Salvador went from an average rate of 1% in the 1960s to 11% in the 1970s and to rates slightly higher than 20% in 1985, 1986 and 1989. In Nicaragua, the tempo of price hikes rose from 1% in the 1960s to 18% in the 1970s and to rapidly rising annual rates in the 1980s, reaching levels of hyperinflation. Probably in Peru, the guerrilla movement has contributed to inflation, although the determinant factor clearly was the policy of deliberate expansion of demand.

Given the great difference between the intensity of inflation in El Salvador and Nicaragua, it would be worth while to investigate the cause. This would require obtaining information on the damage caused by the guerrilla movement in each country. Without such information, it can be assumed that the lower inflation observed in El Salvador was due to the much greater foreign aid received by that country, which allowed it to maintain a much more stable exchange rate and to apply more conservative fiscal and monetary policies.

7. *Automatic acceleration of inflation when certain levels are surpassed*

When the rate of inflation rises above tolerance levels, more and more worker organizations demand and obtain wage increases before their contracts expire. These increases further stimulate inflation and provoke a further reduction of the adjustment interval, which is initially cut to six months and, then, to three months, one month, one week, one day. At first, the adjustment is based on the cost of living index but, since today it is published after one or two months have passed, it is replaced by another price hike indicator: the best known and most up-to-date is the current price of some foreign currency, generally the dollar. As adjustment periods become shorter, the persistence mechanism grows progressively weaker, until it disappears completely. This is why there comes a time when hyperinflation loses its momentum and suddenly stops, with the cessation of exogenous pressures of demand and costs, or of the partial deficiency of supply which affected the economy.

This mechanism has been the cause of the acceleration of price hikes to hyperinflationary levels in Argentina, Bolivia, Brazil, Nicaragua and Peru and has conferred specific characteristics on the processes of those countries, which must be taken into account in the design of policies designed to stop them.

Table 11
HYPERINFLATION
(Monthly percentage price increases for the last five months of hyperinflation and the following five months

Months	Germany[a]	Austria[b]	Hungary[c]	Poland[d]	Greece[e]
1	205	41	6	38	305
2	1 276	33	8	275	349
3	4 126	92	25	148	1 909
4	3 773	134	29	109	8 894
5	35 875	82	79	70	85 507 000
6	-10	-8	13	6	63
7	-7	-6	3	-1	-8
8	-3	-2	6	-	5
9	1	1	-3	-1	7
10	2	2	4	-1	2

Source: Felipe Pazos, *Chronic inflation in Latin America*, Praeger Publishers, New York, 1972.
[a] July 1923-April 1924.
[b] May 1923-February 1924.
[c] October 1923-July 1924.
[d] September 1923-June 1924.
[e] July 1944-April 1945.

IV
Measures for stopping inflation

1. *Successful policies in the past*

The information in table 12 demonstrates that, in the last decades, some Latin American countries have managed to reduce their inflation rates substantially, for shorter or longer periods of time. Since the author of this article is not fully familiar with the policies applied in Paraguay in 1953-1954 and in Bolivia in 1956-1958, they will not be considered in the following analysis. In the other cases, eight countries took measures especially designed to disconnect the mechanism of overadjustment; two began a drastic deceleration of the depreciation of the exchange rate; and the last country adopted an orthodox programme which brought about a sharp drop in its hyperinflation, in a way similar to that which ended hyperinflation in Central Europe after the World Wars.

Policies for ending the overadjustment process have assumed three different modalities over the years. In the 1950s and the first half of the 1960s, the procedure consisted in limiting the wage hikes established in contract renewals to the equivalent of half the inflation rate of the adjustment period, plus a small percentage for increased productivity. Towards the end of the 1960s, a formula of scaled wage increases tended to prevail, by virtue of which greater increases benefited those workers who had gone longer without an adjustment. Finally, in the 1980s, the choice was made to create a new monetary unit and to regulate the conversion of work contracts signed in terms of the previous monetary unit into contracts using the new money.

The first procedure allowed for the reduction of inflation in Chile, from 76% in 1955 to 29% in 1958 and from 39% in 1959 to 8% in 1961; in Argentina, from 114% in 1959 to 27% in 1960; and in Brazil, form 91% in 1964 to 22% in 1968, making an average growth rate of 9.4% possible for the following eight years.

The second method was applied in Argentina during the 1967-1969 period and brought about a decrease in inflation from 29% to 8%; and in Uruguay from 125% to 17% in 1968-1970. Finally, the third formula was used in the Austral and Cruzado Plans implemented by the Governments of Argentina and Brazil respectively, both in 1985-1986. The Austral Plan lowered inflation from an annual rate of 2 554% in July 1985, to an average annual rate of 33% in the following seven months, although prices were soon to rise sharply again. In Brazil, the Cruzado Plan caused inflation to fall from an annual rate of 535% in February, 1986 to an average rate of 14.6% in the following seven months, a period at the end of which, however, prices rose again exponentially.

We will now deal with programmes designed not to disconnect the overadjustment mechanism but to decelerate the exchange rate depreciation. For example, Chile reduced inflation from slightly more than 1 000% in 1974 to 20% in 1981 through a stabilization plan whose essential element was the deceleration of the rise in the dollar exchange rate from 2 328% in 1974 to zero in 1981, followed by low incremental increases in the following years.

Mexico reduced inflation from an annual rate of 214% in January 1988 to 18% in the following September, by applying a policy designed mainly to freeze the exchange rate for that year, limiting depreciation to 1.3% monthly (16.8% annually) beginning in January 1989.

The halt in exchange rate depreciation is an effective anti-inflationary policy because it slows price increases for internationally tradeable goods, whose weight in the cost of living index is less than 30%. By containing increases in that area, this policy leads to moderation in wage hikes, as the annual contracts of different worker groups come up for renewal. In the absence of other inflationary pressures, the deceleration of exchange rate depreciation can halt the inflation process in one or two years and in even briefer periods, if the interval between wage adjustments has been shortened due to the intensity of price hikes. However, this method achieves its objective at the cost of overvaluing the currency and discouraging exports which, after a short time, provokes an exchange crisis that sparks inflation once again.

Both in Chile and Mexico, policies of exchange overvaluation were implemented after a period of rapid depreciation, which stimulated inflation but which was, in fact, more rapid (tables 8 and 9). The exchange rate was obviously undervalued, which gave room for revaluating it without letting it go too high. However, those were exceptional circumstances, since exchange revaluation is a highly risky policy, by no means advisable as a means of detaining inflation.

Table 12

LATIN AMERICA: CASES IN WHICH INFLATION HAS BEEN REDUCED

Country	Period	Annual inflation rate		Duration of "stability"
		Initial	At end of programme	
Paraguay	1953-1954	62	21	23 years
Chile	1955-1958	76	29	2 years
Bolivia	1956-1958	115	20	12 years
Argentina	1959-1960	114	27	5 years
Chile	1959-1961	39	8	2 years
Brazil	1964-1967	91	22	8 years
Argentina	1967-1969	29	8	2 years
Uruguay	1968-1970	125	17	2 years
Chile	1974-1981	504	20	to present
Argentina	1985-1986	2 554	27	7 months
Brazil	1985-1986	535	17	8 months
Bolivia	1985-1986	11 743	16	to present
Mexico	1987-1989	214	18	to present

Source: International Monetary Fund, *International Financial Statistics*

The third effective anti-inflationary plan was that of Bolivia, the first Latin American country to which levels defined by Cagan as hyperinflation and, until the recent price explosions in Argentina, Brazil and Peru, the only country in the world in which this process had not been caused by war or revolution. Hyperinflation in Bolivia was the result of systematic fiscal disequilibria, freely financed by foreign banks between 1975 and 1980 and by the Central Bank during the first half of the 1980s. Prices rose from an annual average rate of 20% in the 1970s to 32% in 1981 and accelerated in the following years, to 127% in 1982, 276% in 1983 and 1 281% in 1984, reaching 11 743% in 1985. This last figure is the equivalent of a monthly average of 49%, which rose to 56% in the last week of August, before falling sharply to a negative rate of 2.9% in the first week of September. Hyperinflation ended in the same sudden fashion in Central Europe at the end of the World Wars and, as in those cases, its end can be attributed to the loss of inertial persistence, more than to the measures taken to stop it, which had been implemented only days before.

The stabilization plan of Bolivia consisted in an orthodox programme of public expense reductions, tax and public service tariff hikes, privatization of State companies and general economic liberalization. Credit cannot be given to the programme for the end of hyperinflation, since it did not have time to achieve that goal, although it did halt pressures in the following months and maintained inflation below an annual rate of 20% in subsequent years.

2. *Characteristics and lessons of successful plans*

The study of Latin American plans which have been successful in substantially reducing inflation reveals that all of them ended the process of overadjustment, applying wage and price controls, or decelerated the process, slowing exchange rate depreciation.

It is also clear that none of the plans was based exclusively or mainly on restriction of aggregate demand.

Controls applied to end the process of overadjustment have been transitory and have not affected market operations nor have they distorted the structure of relative prices. Neither has deceleration of the exchange rate brought about negative effects, due to the special circumstances in the countries which had recourse to that policy.

It is also clear that plans which have not implemented adequate measures for the restoration of financial equilibrium have been effective for only brief periods, after which inflation reappeared with great force; on the other hand, countries which took such measures have maintained relative stability for longer periods.

The substantial reduction in price increases achieved by these plans shows that inflation is controllable. This is a very important conclusion because one of the obstacles which the struggle against inflation in Latin America faces is the belief that it is an unavoidable evil, due to the instability of foreign trade and imperfections in the economic structures of our countries, according to some, or to deficient government administration, according to others.

3. *The need to end the process of overadjustment and re-establish basic economic equilibria*

Analysis of the causes of inflation and of the plans which have managed to contain it shows that it is necessary to end the process of overadjustment. It also demonstrates that the more advisable of the two formulae available for this purpose consists in establishing transitory wage and price controls because the deceleration of the process through gradual revaluation of the exchange rate implies the risk of overvaluation and, therefore, of discouraging growth of exports.

In their book on Argentina,[9] Dornbusch and De Pablo clearly and convincingly explain that temporary wage and price controls do not seek to replace the mechanism of the market and consumer freedom but seek rather to re-establish the normal functioning of that mechanism and allow economic agents to obtain undistorted information for their decisions. Temporary control can be effective when it is not prolonged beyond a couple of months because, in that short time, the structure of relative prices is not distorted by that control.

[9] Rudiger Dornbusch and J.C. De Pablo, *op. cit.*

It is necessary to understand clearly how and why temporary controls designed to break inflationary inertia do not replace the mechanism of the market but rather perfect it. Failure to understand this phenomenon prejudices many economists against an indispensable policy for halting inflation or for reducing its intensity to bearable rates.

The temporary wage and price controls necessary to break inflationary inertia are not an alternative to the adoption of financial policy that would balance aggregate demand and total supply. Measures to rationalize the budget and halt monetary expansion must be taken simultaneously. If financial equilibrium is not restored, excessive demand will make prices rise and reactivate inflation.

When formulating policies for fiscal correction, financial authorities must be aware that, measured in real terms, government assets fall when inflation accelerates and rise again when inflation falls. This can be attributed to the Oliveira-Tanzi effect, i.e., to the fact that government assets lose real value between the date when taxes are computed and that on which they are collected, losses being greater in conditions of higher inflation. It is foreseeable, then, that income will increase in real terms when inflation decreases, although not to the extent necessary to balance the budget. Consequently, it is necessary to raise taxes and public service charges or reduce expenses to cover the budget deficit which will probably remain, in spite of increased real income due to decelerated inflation.

Financial authorities must also be aware that economic agents reduce their monetary balances to painfully low levels during periods of rapid inflation and restore them to normal levels when inflation slackens. For this reason, it is possible to expand monetary supply in this phase, without provoking inflationary effects, up to the amount required to restore normal liquid balances. Nevertheless, this does not mean that stabilization can be achieved with a lax monetary policy: for the positive effects of breaking inflationary inertia to become firmly established, fiscal policy and monetary policy must achieve and maintain strict macroeconomic equilibrium.

4. *Equilibrium in international payments*

The fiscal and monetary policies designed to balance domestic accounts, also balance international payments on regular accounts, although it does so at a low level of economic activity. Therefore, strategy for stabilization must be accompanied by policies designed to promote a high level of exports, taking into account the possibility that this high level of activity may lead to foreign deficits, which would require financing with international reserves or by postponing foreign debt service. Consequently, maintaining foreign equilibrium and high production and employment levels simultaneously requires: i) application of conservative financial policy; ii) establishment of an exchange rate that stimulates exports; iii) implementation of an anticyclic policy with respect to international reserves and foreign debt service.

These are the three classic prescriptions in this matter, except the third recommends anticyclic policies, not with respect to acquiring new foreign loans, but to interest and amortization payments on previously contracted loans. In the circumstances in which Latin American countries currently operate, with a debt many times greater than their capacity to pay, an increase of that debt cannot be recommended. Rather, they must try to lower the rate of growth of that debt as much as possible.

5. *The special case of hyperinflation*

When price hikes have reached hyperinflationary levels, it is no longer necessary to install temporary controls to end the process of lags and overadjustments, since the shortening of intervals between increases has already performed that task. This explains why hyperinflation ended from one month to the next in Germany, Austria, Hungary and Poland after the First World War; and in Greece, after the Second. And it explains the abrupt end of the recent hyperinflation in Bolivia.

Given the rapid disappearance of the phenomenon in the countries of Central Europe after the World Wars and the more recent experience of Bolivia, it was reasonable to expect that the same process would occur in Argentina and Brazil, overwhelmed by explosive inflation. But this has not happened. More than half a year after the implementation of rigorous stabilization programmes in these two countries, in July 1990, retail prices were rising at an annual rate of more than 340% in Argentina and around 430% in Brazil. Why has the hyperinflation of these two countries not behaved in ways similar to those observed in other countries in the past? This is a question to which we must dedicate our best efforts.

VI
Conclusions

In Latin America, as in the rest of the world, inflation is maintained by lags and subsequent overadjustments of prices subject to contract or official regulation and is accelerated or decelerated by deficits or positive balances in the country's foreign or domestic accounts. Consequently, anti-inflationary programmes must attack both factors, with measures to reduce overadjustments to normal levels and policies that will balance domestic assets and debits and international payments. The reduction of overadjustments to normal levels requires the application of simple controls for brief periods, which need not distort the structure of relative prices nor affect the efficient allocation of resources which will continue to occur through the mechanism of the market. Domestic financial balance must be re-established through higher taxes and public service charges or reduced public expenses, or through a combination of both measures; and foreign equilibrium must be achieved and maintained through the application of i) a policy of domestic financial balance; ii) an exchange rate that stimulates exports; iii) an anticyclic foreign debt service plan which will lower payments when the country's export income falls and raise them when exports rise.

In situations of hyperinflation, wage and price controls are not necessary to put an end to the process of lag and overadjustment. With daily adjustments, wages no longer lose ground with respect to average prices. However, it is still absolutely necessary to re-establish domestic and foreign financial equilibrium and create confidence that it will be maintained.

The spectacular worsening of inflation in Latin America in recent years could facilitate the struggle against this social and economic scourge and reduce its intensity to the levels found in industrial countries, because it has obliged us to scrutinize the measures necessary to achieve this goal and because it ought to give us the resolve to apply these measures.

It is perhaps justified, then, to repeat that control of inflation constitutes the most urgent task for economic science and the central problem that we Latin American economists must solve in order to alleviate the suffering of millions of persons, renew the development of our countries and rescue the prestige of our profession.

CEPAL REVIEW No. 42

Structural elements of spiralling inflation

*Héctor Assael**

This paper reviews some of Prebisch's ideas on inflation and comments on the article by Felipe Pazos which appears in this number of the *Review*.

It is pointed out that inflation and stabilization policies were not among the subjects most frequently dealt with by Prebisch. Nevertheless, in the earliest ECLAC documents, when Prebisch became the Executive Secretary, a "structural" interpretation was developed of the phenomenon of inflation in Latin America.

The paper also reviews the causes put forward by Pazos of the present period of spiralling inflation. It emphasizes the significance of "imported inflation" and of recessive adjustment policies as causes of inflation. It goes on to analyse the responsibility of the fiscal deficit for inflation and warns that this does not justify conclusions about adjusting the size of the public sector, given the form in which the external debt service was transferred to it.

Finally, the paper analyses various anti-inflationary measures. An integral stabilization policy should make a joint and coordinated attack on both the structural factors of inflation and the ways in which it spreads. From another point of view, orthodox fiscal and monetary measures should be coordinated with unconventional measures, such as controlling a set of key prices and wages. In cases where inflation is accompanied by significant disequilibria in the balance of payments, the situation of external strangulation must be attacked. Finally, an effective and rapid anti-inflationary programme needs broad public support.

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I

One of the reasons it is particularly important for me to participate in this seminar is that it gives me the opportunity to comment on the spiralling inflation in Latin America. I shall, therefore, look at some of the subjects which were given special attention by distinguished Latin American economists such as Raúl Prebisch, Felipe Pazos, Aníbal Pinto, Juan Noyola, and Osvaldo Sunkel, who have had an extensive and profound influence on economic and social thought in the region.

I will then make separate brief comments on some points, to facilitate a subsequent interchange of ideas.

II

It can be stated that inflation and stabilization policies were not among the subjects most frequently dealt with by Prebisch, especially when its small relative weight in the enormous intellectual legacy he left us is taken into account. However, it can also be claimed that it was present in the earliest ECLAC documents, dating from the beginning of his work as Executive Secretary, and that these documents put forward a "structural" interpretation of the inflation phenomenon in Latin America. This was the beginning of a school of thought which was later perfected by other economists of the region.

A preliminary stage in Prebisch's thinking on inflation appeared at the end of the 1940s when he wrote the original version of the introduction to the *Economic Survey of Latin America, 1948,* in a section called "Capital formation and the inflationary process".[1] By way of illustration, the following paragraph from this section is quoted:

> "The considerable pressure of those individual and collective needs on a relatively scarce supply of resources, is usually accompanied by inflation phenomena, such as those which so rightly worry governments at this time. Simultaneously, a school of thought has been developing not only among the more privileged, but also among those, concerned only with the general good, who consider inflation an unavoidable means of forced capitalization in situations where spontaneous saving is notoriously insufficient."

[1] See, *La obra de Prebisch en la CEPAL*. Selection by Adolfo Gurrieri (1982). Mexico, D.F., Fondo de Cultura Económica, pp. 99-155.

At this stage which, in my opinion, culminated in 1961 with the publication of his work, "Economic development or monetary stability: the false dilemma",[2] Prebisch seems to put forward three essential ideas on the subject of inflation: a) the set of relationships generated between Latin American economic and social growth and the corresponding changes in both the level of prices and the pricing system in the various countries; b) the role inflation can play in correcting imbalances in the development process, i.e., its incidental "effect"; and c) the relationships existing between the external strangulation of the regional economies and their propensity to inflation.

There was a final stage based on all his work on "peripheral capitalism" carried out over most of the 1970s and continuing to his death in 1986. As a means of recalling this different and novel concept of structural inflation, it is useful to quote a paragraph of his article "Socio-economic structure and crisis of peripheral capitalism",[3] which originally appeared in the *CEPAL Review,* 1978:

"Thus we approach the system's critical limit. In order to understand what happens when this is reached, it is worthwhile to recall an indispensable requirement of the dynamics of the system. If the consumer society is to operate smoothly, it is essential that the growth rate of the surplus should be at least the same as that of the global product. Otherwise, if the pressure of the middle strata through the various forms of participation which have just been described, and the incidence of the tax burden on the surplus, were to prevent the fulfilment of this requisite, the attenuation of the surplus would reduce the rate of accumulation, and that would bring down the growth rate of the product and would correspondingly reduce the part of the surplus earmarked for the consumption of the upper strata. In this case, enterprises would endeavour to retrieve the surplus by raising prices in order to restore the dynamics of the system."

Prebisch later continued developing and perfecting these ideas.

III

Dr. Felipe Pazos has presented an excellent paper which shows clearly that he is an expert on the subject of inflation and stabilization policies and he has made valuable contributions to the study of the numerous aspects of this problem. In this respect, it should be remembered that as early as 1969 Dr. Pazos made an in-depth analysis of what he called the "chronic inflation" of Argentina, Brazil, Chile, and Uruguay, in his book called *Medidas para detener la inflación crónica en América Latina,* published by the Centre for Latin American Monetary Studies (CEMLA).

On this occasion, Dr. Pazos's paper is aimed essentially at clarifying the causes of spiralling inflation in Latin America over the last two decades, as well as at reviewing appropriate measures to contain it. He also examines briefly the recent stabilization plans of four countries in the region (Argentina, Bolivia, Brazil, and Mexico).

Dr. Pazos puts forward the following as the main causes of spiralling inflation in the region: a) in the 1960s, the vertical rise in oil prices, the much lesser but substantial increase in the price of other primary products, and the considerable increase in the price of exports from the industrialized countries; b) the attempts of Latin American Governments in the 1980s to cushion the domestic effects of the steep decline in foreign exchange returns, complicated by the foreign debt crisis and the reduction in prices of primary products. To factors a) and b) which had a general impact, he adds others which affected only some of the countries: c) monetary expansion which was not aimed at cushioning the fall in foreign exchange returns; d) rises in the exchange rate resulting from the lifting of earlier controls or from predictions that there would be an imbalance in international payments; e) the guerillas; and f) the automatic spiralling of inflation which occurs when a specific point is reached.

It is easy to comment on a diagnosis which is correct; however, I would like to make two comments.

In the first place, in the 1960s as in the 1980s, "imported inflation" was of basic significance as a

[2] See, Raúl Prebisch, "Economic development or monetary stability: the false dilemma", *Economic Bulletin for Latin America,* vol. VI, No. 1, Santiago, Chile, March 1961.

[3] Raúl Prebisch, "Socio-economic structure and crisis of peripheral capitalism", *CEPAL Review,* Second half of 1978. United Nations Publication, sales No. S.78.II.G.4, Santiago, Chile.

structural factor in destabilizing internal prices in many Latin American countries.

Later, with the appearance of this structural phenomenon, various propagating mechanisms began to operate. Naturally, they became much more active in the 1980s, particularly in some economies of the region. The recessive adjustment policies followed in Latin America contained, themselves, a very significant inflationary element, since they were aimed persistently at bringing about a thorough change in relative prices, favouring tradeable products over non-tradeable products. Thus, flexible exchange rate policies were largely used to achieve a stable and considerable undervaluation of the domestic currencies of many of the countries in the region.

In the second place, as I see it, there has not been sufficient academic study of the spiralling inflation of the 1980s to support claims that public deficits and their effect on monetary expansion have exerted a significant impact on the growth of inflation.

This observation does not directly lead to conclusions about the enormous size and inefficiency of the Latin American public sector. This is because it is always forgotten that before the debt crisis, Governments in the region often took on responsibility for the private sector foreign debt without having sufficient access to the corresponding funds in domestic currency required for this service.

In other words, the Governments, in "guaranteeing" the private sector foreign debt, made the situation twice as bad: on the one hand, they needed access to the foreign exchange indispensable for servicing the debt and, on the other, they had some how to obtain, largely through monetary emissions favouring the public sector, funds in domestic currency equivalent to these foreign payments.

For example, in Brazil in recent years, the Government has received from the private sector, according to a rough estimate, the equivalent of some US$5 billion less in domestic currency (5% of the foreign debt) per year, when it is taken into account that about 50% of the total debt was "transferred" from the private to the public sector and assuming, as well, an average annual interest rate on the debt of 10%. Because of its magnitude, this sum, approximately 2% of the gross domestic product and a very high proportion of the money available in the country, has undoubtedly great inflationary potential.

IV

A complete section of Dr. Pazos's paper examines what measures can be taken to contain inflation. He tackles the question directly without specifying whether these measures could be differently defined and ordered according to the essential characteristics of specific inflationary processes. For example, in the case of purely monetary inflation of a primarily structural nature or with a predominant inertial element, there could be various alternative stabilization strategies each with relatively differentiated policies and measures with respect to the inclusion or exclusion of each component and in the various combinations of anti-inflationary measures that could be feasibly conceived.

In the final analysis, Dr. Pazos places the necessary components of a stabilization policy in three groups: a) measures for ending the overadjustment of contracted or officially regulated prices; b) measures to cushion, as far as possible, the effects of variations in export prices and capital movements; and c) an economic policy for reestablishing equilibrium between aggregate demand and total supply.

This classification of the major components of anti-inflationary policy might seem, at first glance, to be somewhat generalized. However, this impression disappears on further reading since throughout the paper appropriate descriptions are given of the different actions to be included in each of the three groups.

The special case of hyperinflation is dealt with in the paper and is defined as inflation where the rate of price increase is higher than 50% per month, or 13 000% per year.

Curiously, Dr. Pazos has a somewhat optimistic view of hyperinflation since, in his opinion, when price increases have reached this level, there is no need for temporary controls to stop the process of delays and overadjustments, since the shortening of the intervals between increases has already done this. He adds, however, that when the overadjustment mechanism is discontinued, hyperinflation can only be contained by establishing financial equilibrium in the fiscal as well as in the monetary and exchange rate areas. Confidence is restored when equilibrium has been reached.

Although Dr. Pazos quotes some historical cases of the sudden halt of hyperinflation, particularly in Europe in the 1920s and 1940s, and more recently in Bolivia, there remains some doubt about the implications of his argument.

This doubt is especially valid considering that in some countries inflation can remain at relatively high levels (for instance, between 20% and 50% per month) over long periods of time, without the process getting out of control and without the hyperinflationary limit being soon reached. In these cases, the automatic corrections of overadjusted prices would not occur, but conversely, could aggravate serious distortions among the various elements of the pricing system.

V

To conclude these comments on Dr. Pazos's paper, I would like to try to describe what he feels should be the essential characteristics of a reasonable, integral anti-inflationary policy with a good chance of success in achieving a substantial and stable slowdown of price increases in various specific situations.

The first condition of this integral stabilization policy is that it should make a joint and coordinated attack on both the structural elements of inflation and those propagating it. The structuralist interpretation of inflation does not try to ignore the importance of monetary policy in controlling inflation, but it does emphasize that monetary imbalances are usually deeply rooted in the economic system (for instance, production maladjustments or social problems) and that these must also be eliminated.

Second, to combat inflation, a combination of orthodox and unconventional measures are necessary, particularly in cases of inertial inflation involving prolonged price increases. In this kind of situation, it is very costly to eliminate it only by orthodox fiscal and monetary measures. We must apply unconventional complementary and temporary measures, such as controlling a set of key prices and wages and/or setting price and wage guidelines, in order to break inflationary inertia without excessive costs to economic activity.

Third, if this inflationary process is accompanied by a significant disruption in the balance of payments, the formulation and management of the necessary stabilization policy is highly complicated. Here we must usually combine anti-inflationary policies with strategies for structural change to combat as quickly as possible the foreign strangulation which is affecting the economy. The tactics resulting from this approach should have a simultaneous effect on the current and capital accounts of the balance of payments.

Fourth, an effective anti-inflation programme needs a wide social consensus. As is well known, when inflation is high, extensive and sharp fluctuations occur in prices and relative incomes. The result is social unrest and acute rivalries among the factors of production. In this situation, the struggle against inflation requires wide social acceptance or agreement among the various economic partners (above all, government, workers, enterprises and consumers) in order to promote concerted action without serious and permanent disputes.

Lastly, a reasonable stabilization policy must quickly bring down prices and re-establish the necessary conditions for renewing economic growth and social development. Otherwise, the policy may be politically unviable and short-lived, since various social and economic interests will soon combine to oppose it and finally put an end to it.

CEPAL REVIEW No. 42

Latin American integration and external openness

*Germánico Salgado**

The economic integration of the region reached a turning point in early 1984. From that moment on, there has been a growing number of initiatives that have given dynamism to what was a languishing process. According to the author, this new surge towards integration is the region's response to a world that seems to be restructuring itself into large economic groupings.

Two stages can be distinguished in this process of reactivation: a first stage, which could be described as cautious and rather timid, and a second one which began with the agreement between Argentina and Brazil in mid-1986. This latter stage reflects an intention to speed up and deepen economic integration by resorting to new forms or to much greater openness at a more rapid pace.

The signs of openness in the region's economies are more and more frequent, to the point where economic integration should be seen rather as a derivative of a wider attitude that seeks to shift the centre of gravity of development policy towards the world market. Indeed, in some cases trade was first liberalized with third countries, so that what took place with regional integration was only an extension of what was taking place with foreign trade systems in general. On the other hand, there has been no significant progress in fields that are critically important for reintegration, such as payments clearing arrangements and balance-of-payments support systems.

Can indiscriminate opening-up to the international economy be reconciled with regional integration? It may be assumed that as both processes advance, it will be necessary to decide to give priority to one or the other, unless it is possible to find levels of openness and selections of activities which make them compatible. The author concludes that without a significant margin of preference it would be useless to propose the integration of markets, and still less the integration of production.

Selective integration would be easier to reconcile with the general trend towards openness. The aspects of the integration processes that merit the most attention are the most dynamic currents of intraregional trade and the development of activities with a high knowledge content and those that are critical for progress in the transformation of production.

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I
Recollection and homage

Interest in economic integration has sprung back to life in recent years in Latin America. The short-term economic situation has continued to be unfavourable, but apparently uncertainty about the future and awareness of Latin America's diminishing part in the world concert were even stronger motives. At first sight there is something in common between this moment and that time long ago when the first steps towards integration in the region took shape: the Central American Common Market in 1960 and the Latin American Free Trade Association (ALALC) in 1961, both of which were decisively influenced by the signing of the Treaty of Rome (1957) and the early dynamism of the European Economic Community (EEC). Now the impetus is coming from a multitude of initiatives, among them once again the EEC, with its Single European Act as perhaps the most relevant example.

But there are differences. Towards the end of the 1950s, the personality of Dr. Raúl Prebisch and the ideas of ECLAC inspired a coherent line of promotional action with clear objectives. Ultimately, however, neither ALALC nor the Central American Common Market faithfully followed Prebisch's postulates in their articles of association, and this was later to prove unfortunate.[1]

But neither these discrepancies nor the uneven and frustrating experience of these efforts should make us forget that the birth of Latin American integration was the result of mature reflection about the requirements for the sound development of the region. A strongly vertebrate Latin America, with all its parts closely articulated thanks to integration, was the image that Raúl Prebisch insisted on. That is what he meant when he spoke of the "globality" of regional integration: a term he used to emphasize the need for the formula chosen to include all Latin American countries, with different treatment

[1] See Germánico Salgado, "The Latin American regional market: the project and the reality", *CEPAL Review*, No. 7 (E/CEPAL/1084), Santiago, Chile, April 1979, pp. 85-132. United Nations publication, Sales No. E.79.II.G.2.

according to the situation of each one, but with no exclusions nor segmentations,[2] except for Central America, where he admitted that for the time being a subregional form of integration was called for. Never again was the integration of Latin America to be posed in such global terms, even though ever since clip-service has been paid to that old model when people speak of the remote objective of a "Latin American common market" or a "regional market".

Today, in a context of enormous instability and extreme pressure, Latin America has returned to the search for unity. As we have already noted, there is no longer a vision of the whole. There have been a number of attempts, some bold and imaginative, others virtual improvisations, but they all clearly contain an element of a makeshift response to a difficult and uncertain situation. It is also clear that now, more than ever, we need to base our efforts on a regional project elaborated by all concerned.

II
Once again, integration...

When the Latin American Economic Conference was held in Quito in January 1984, its call for integration appeared to be just another tip of the hat to the myth of Latin American unity. Normally the admonition would very soon have disappeared, leaving no visible trace. But this time, apparently, something else happened: the Latin American Integration Association soon thereafter initiated the regional round of negotiations, the Andean Group accelerated the preparations for its reform of the Cartagena Agreement, and Brazil and Argentina launched in record time an Economic Integration and Co-operation Programme which was unlike any of the usual agreements of this kind. Even in Central America, despite the divisions and tensions, a new spirit was born with the Esquipulas II Agreement and the signing in Guatemala of the treaty establishing the Central American Parliament and connected agencies, while in the Caribbean Community (CARICOM), the Nassau Consensus of 1984 was a genuine attempt to overcome the obstacles to intraregional trade. There were many examples of joint actions in the political and economic spheres in Latin America: the Cartagena Consensus, the Contadora Group, the Support Group and later, the Permanent Mechanism for Consultation and Policy Co-ordination, also known as the Group of Eight. Nor has there been any lack of decisions designed to make regional co-operation a major factor in foreign policy, such as Mexico's programme with Central America, the Oil Facility of the San José Agreement on Energy Co-operation, and the Group of Eight's Acapulco Commitment to Peace, Development and Democracy in Central America.

This renewed interest in integration and co-operation has continued even more intensely since that time, giving rise to still bolder proposals, as we will see shortly.

The Latin American Economic Conference in Quito was not, of course, the only cause of this wave of initiatives: the region was deeply concerned about the future, and this led to a new reappraisal of the efforts and initiatives to promote integration and solidarity.

There are many good reasons for this concern. It would be hard to imagine a more difficult situation for Latin America than the present one. The problem of the debt is everywhere, at all levels and all times, and other issues in the region which could have much more serious consequences in the medium term are only just beginning to receive attention. Such issues could, for example, make it much more difficult for us to eventually overcome our financial straits. This is the case of the scientific and technological gap displayed by almost all the countries of the region: a gap which is steadily growing and already represents a tremendous obstacle to our entering the international economy on dynamic terms. We have lost our proper share in the expansion of world trade, especially in exports of manufactures. In relative terms, the region is now less important for foreign

[2] United Nations, *The Latin American Common Market* (E/CN.12/531), Mexico City, 1959, United Nations publication, Sales No. 59.II.G.4.

investment. The already visible symptoms of the progressive deterioration of the importance of Latin America –and the developing world in general– as a source of raw materials are so well known that they scarcely need to be mentioned again here. There is a clear excess of supply, face to face with a level of demand which tends to grow only at a snail's pace because, *inter alia*, production increasingly demands more knowledge and information and less natural resources. The prospects are no better for producers of industrial goods, whether these are barely-processed raw materials or medium-technology exports. In both cases the protectionism of the big markets places prohibitive limits on the possibilities of expansion.

And this is only one side of the economic constraints that the region has been unable to overcome. If we add to it the economic instability of almost all the countries of the region, the traumatic alternatives of adjustment policies, and stagnating production with its consequent high unemployment, we have a partial explanation for the growing demoralization of the more educated elements of the population, especially young people. The lamentable period of boundless political repression in the 1970s has left open wounds in many countries. On top of that, we are now in a period of constant constraints, bordering on chaos in some countries. Not surprisingly, their best-trained citizens are once again beginning to migrate to the rich countries. Before, the reason was repression or violence; now it is unemployment, uncertainty and the almost total lack of horizons.

Naturally, the problems are not this extreme throughout the entire region, and in some countries the prospects may even be quite encouraging. The vast majority of the population of the region, however, is living in a truly difficult situation, and moreover has been doing so for more than a decade. For that majority, the brief reference we have made to their hardships is neither tendentious nor exaggerated. It is true that there are positive facts to put on the other side of the scale, such as the spread of democratic political forms, which are undoubtedly an asset. But, at the same time, we also cannot forget that many countries of the region have suffered or still suffer from scourges like political violence or drug trafficking.

I have pinted this scene in strong colours because I believe that we must seek the explanation for much of what is happening now in Latin America in the marks these difficulties and problems have left on the typical Latin American, be he simple citizen or political leader. When facing the rest of the world, and especially the industrialized world, Latin Americans feel like persons in desperate straits, who, moreover, have lost the solidarity of all the other poor countries. In spite of some recent signs of attention by the United States, Latin Americans perceive that the region's problems are steadily losing importance for that country and the other rich countries. The best symbol of this attitude is the title of a book recently published in Colombia which sums up the results of a seminar. The book is entitled *América Latina se ha quedado sola* (Latin America has been left on its own),[3] and despite its somewhat dramatic tone it reflects a state of feeling which explains certain special features of the situation, as we shall see below.

One of these features is this rebirth of the motivation for integration, after this ideal had vegetated for decades, except in the mind's of a few highly motivated people, at a time when the circumstances –especially the degree of macro-economic imbalance affecting almost all the countries– make it particularly difficult to embark on such a difficult enterprise. This interest in integration has clearly returned not only because of the logical need for joint action or bigger scales of production, but also because of the example of the more powerful countries, which have already organized themselves into integrated blocs or are in the process of doing so. A look at the international economy during these years clearly shows effects of the tension of intense competition –today, without a doubt, even stronger than political rivalry, which is diminishing– so it is natural to unite in order to gain increased power. Jacques Delors, one of those responsible for the impact caused by the Single European Act, openly expresses this motivation when he states that the signatories of the Act are competing in a worldwide race where the stakes are economic survival and, ultimately, the capacity for expression and political action.[4]

[3] Alvaro Tirado Mejía, *et al.*, *América Latina se ha quedado sola*, Bogotá, Santillana, 1989.

[4] Paolo Cecchini, foreword to *Europa 1992: una apuesta de futuro*, Madrid, Alianza Editorial, 1988, p. 9.

That is the view of a European who, as we mentioned, was the driving force behind the Single European Act. According to this same Act, by the end of 1992 the internal market of the Europe of the Twelve will have been established as, "a space with no internal frontiers, in which the free circulation of merchandise, persons, services and capital will be guaranteed ...".[5]

The concern that the Single European Act signed in 1986 would lead to a "fortress Europe", closed and protected, was probably one of the reasons that led the United States to sign a Free Trade Agreement with Canada in 1988.

That concern and the evident preoccupation of the United States about the hitherto unstoppable advance of Japan as an exporter of high-technology products also explain the recent negotiations with Mexico to constitute some kind of free-trade area. There was talk that the United States was interested in incorporating Latin America into a similar arrangement, but President Bush's recent proposal to extend the free-trade area to all of the Americas –North, Central and South– was a real surprise. His intention is clear. President Bush was proposing in effect to initiate a process of creating a free-trade area for the whole hemisphere, from Anchorage to Tierra del Fuego.[6] This goes back, in very different circumstances, to an invitation already made to Latin America during the last century by Secretary of State Blaine.

[5] Single European Act", art. 13, Ibero-American Co-operation Institute (ICI) and Economic Commission for Latin America and the Caribbean (ECLAC), *Pensamiento Iberoamericano,* No. 15, January-June 1989.

[6] Text of the speech given on 27 June in Washington, D.C.

Japan, for its part, has the Pacific Basin as a space in which to progressively build up a bloc of countries with itself as nucleus. Without resorting to any formal integration model, Japan already has close economic relations with the Association of South-East Asian Nations (ASEAN), which, though it too has no formal integration structure, nevertheless functions for all practical purposes as if it did have one. Japan also looks beyond to the great amphitheater which is the vital sphere of its business activities, congregated today in the Pacific Economic Co-operation Conference.

The dizzy changes seen in recent months also raise dramatic questions about the future evolution of the EEC. The reunification of Germany will mean the incorporation of the German Democratic Republic, and the EEC is expected to establish some kind of relationship with the other Eastern-bloc countries too, especially Hungary, Poland and Czechoslovakia.

Thus, as it emerges from the turbulent 1980s, the world is made up of groups of States –blocs is a better word to express their growing cohesion– gathered around the United States, Western Europe, the Soviet Union as it emerges from "perestroika", and Japan. China and India are currently hovering discreetly in the background, but no projection into the future can forget that they will have a decisive place on the international stage, with their billions of inhabitants.

Clearly, a fragmented Latin America can only look forward to a subordinate and passive fate in such a world. What is happening with this new drive towards integration is above all a response from Latin America to a world which is marching inexorably towards large groupings of States, either as common markets or, as is also probable in some cases, associations of States of a federal or confederational character.

III
The two phases of reactivation

What has happened with regard to the integration of Latin America in recent years is truly disconcerting. The process that we have described as a rebirth of integration consists in reality of two quite different phases. The first of these was a lukewarm revival, in which an attempt was made to save the existing efforts (basically ALADI, the Andean Group and CARICOM) from stagnation or regression. During this time, the Central American Common Market was suffering the consequences of its armed conflicts and little could be done to motivate it. It was kept formally alive, however, and that in itself was no small accomplishment. As for the other three groupings, ALADI initiated in this period the regional round of negotiations, the reform of the Cartagena Agreement was gradually defined and negotiated, and the Nassau Consensus was worked out at a meeting of the Conference of the Heads of Government of the Caribbean Community, held in 1984. ALADI began its regional round of negotiations in 1985 and ended the preparatory phase in 1987, which was also the year in which the Quito Protocol reforming the Cartagena Agreement was signed. Thus, this first stage of cautious and rather timid reactivation runs from 1984 to 1987.

The second stage –a radical break from the previous inertia– is characterized by the will to accelerate and deepen economic integration by resorting either to different formulas or simply to greater mutual openness and more rapid action. The Programme for Economic Integration and Co-operation between Argentina and Brazil certainly belongs to this kind of initiative. It was signed in mid-1986, chronologically towards the end of what we termed the first stage, but because of its selective character, which distinguishes it from the usual integration formulas, and its patent audacity, it merits being singled out as part of this more innovative stage. Uruguay associated itself with the programme, albeit still in general terms, under the 1988 Alvorada agreement.[7]

More typical of this second stage are the recent initiatives that have modified, at least formally, the integration efforts previously mentioned. Chronologically, the first of these initiatives is the Treaty on Integration, Co-operation and Development between the Argentine Republic and the Federative Republic of Brazil (signed in November 1988), according to which the two countries undertake to establish a general free-trade area within 10 years. Next comes the approval of the Strategic Design for the Orientation of the Andean Group contained in the Galápagos Declaration adopted at the Summit Meeting of the Andean Presidents in December 1989. In comparison with the stipulations of the Quito Protocol or the Protocol Modifying the Cartagena Agreement, signed in 1987, this Strategic Design speeds up considerably the constitution of a customs union and also calls for the rapid revision of industrial programmes and another series of steps which must also be taken well before the Protocol goes into effect. This initiative, which signifies a radical acceleration of Andean integration, was preceded by the agreements to intensify trade relations between Venezuela and Colombia, and between these countries and Mexico, Central America and the Caribbean. Also, in December 1989, ALADI took initiatives to widen the scope of certain instruments and speed up the regional round of negotiations. This new attitude resulted in the approval in June 1990 of the regional agreement which substantially reinforces the Regional Tariff Preference (RTP).

[7] The forms of association will be progressively established later. For the time being, three protocols have been signed in this regard.

IV
The moment of caution

The contrast between the two phases could not be stronger. The first fully merits Juan Mario Vacchino's characterization of the spirit of the action pursued at that time, namely "...to begin a new phase, more operative, pragmatic and adapted to the conditions of an international scenario whose long-term profile is not easy to establish with any precision".[8] Clearly, it was not sought to make revolutionary changes in the integration schemes, and in the best of cases the aim was to get them working again and thus overcome their stagnation.

As we already mentioned, the regional round of negotiations of ALADI corresponded to this kind of initiative. It took exactly two years to move from the resolution of the Council of Ministers of Foreign Affairs in March 1985 to the adoption of the programme to establish a regional system for trade and payments (March, 1987), and in reality, the concrete results of the round are still meager. The programme put into effect in March 1987 included several specific actions: reinforcing the Regional Tariff Preference (RTP), the Regional Agreement for the Recovery and Expansion of Trade, the commitment to dismantle tariff restrictions, and the creation of a mechanism to offset trade imbalances.

As we can see, the scheduled content of the regional round of negotiations is symptomatic of a more open and decisive attitude towards the intensification of regional trade than the approach taken up till then in ALALC and later in ALADI. However, the initial negotiations were entered upon with reservations, and the results did not come up to expectations.

In the Regional Tariff Preference –the Latin American preference that received so much attention when the ALADI treaty was negotiated– a basic preference of 10% was agreed for countries of the same class, while the maximum preference reached 22% for the landlocked countries. These are useful concessions, but not enough to bring about noticeable changes in trade.

In its early decisions, the Regional Agreement for the Recovery and Expansion of Trade formulated the ambitious goal of diverting towards the region 30% of imports from third countries, with basic preferences of around 60%. These initial aspirations were considerably reduced in the course of the negotiations, especially in the case of those relating to the percentages of diversion of trade with third parties, which finally stood at amounts varying from 2% to 20%, according to the class of country: certainly far below the 30% originally planned.

The rest of the elements of the agreement were in serious danger of becoming a dead letter. The elimination of non-tariff restrictions did not seem feasible for some countries that depended on those instruments to defend themselves from balance-of-payments problems, and moreover the agreement included a multitude of exceptions which reduced its effectiveness. Apart from progressing on some general definitions, very little has been done to implement the mechanism for lessening the impact of imbalances in regional trade, and still less has been done to put into effect balance-of-payments support mechanisms or systems for regulating State purchases: two issues included in the regional round of negotiations because of their critical importance for regional integration.

In ALADI, the most dynamic elements have continued to be the limited-scope agreements, while the complementation agreements could also become a dynamic element in the future. By way of example, we could cite the agreements that link Uruguay with Argentina, and Brazil with Mexico; those that incorporate the matters negotiated in the integration treaty between Argentina and Brazil; the complementation agreements between Argentina and Colombia and between Colombia and Peru, and those recently drawn up between Colombia and Venezuela. Unfortunately, there has been no progress in establishing systems which would allow for converging limited-scope actions into global multilateral action. If multilateral instruments like the Regional Agreement for the Recovery and Expansion of Trade and the Regional Tariff Preference have no decisive effect on trade, then there would be a need for quantitatively significant preferences applicable to

[8] See Juan Mario Vacchino, "Esquemas latinoamericanos de integración. Problemas y desarrollo", Pensamiento Iberoamericano, No. 15, Madrid, ICI/ECLAC, January-June, 1989, p. 69.

a wide sphere of trade, that is to say, not limited by the mass of current exceptions, and ALADI would most probably become in the future a system of integration in which different velocities would coexist, with all the difficulties one could expect from such a complex network of bilateral relations.

As we will see later, the multilateral instruments could possibly become more important and the system could work more dynamically than in the past. That, at least, is the dominant tone today, in clear contrast with a recent past in which a cautious stinginess prevailed, particularly in the larger countries.

In spite of all these limitations, trade within ALADI grew in 1988 and 1989, the preliminary figure for total intraregional exports in the latter year being US$10 238 million: 10.5% more than in 1988, when the value of intraregional exports had grown by 12.5% in relation to 1987, thus indicating a more or less steady recovery from the extremely low figure of US$7 016 million recorded in 1983. Brazil and Argentina provided more than half of these exports in 1988 (56.3%), and a good part of the growth is explained by the increased trade between these two countries. The sources of trade imbalances between the members continued to be the same, and in 1988 Brazil continued to achieve positive trade balances (more than US$1.9 billion by the end of the year).

In the present situation, the Protocol Modifying the Cartagena Agreement, or the Quito Protocol, now has an almost purely historical value, since it has been basically replaced by the Strategic Design as approved at the Galápagos Meeting. At all events, it is worth briefly examining the features of the reform made in 1987, since it offers an interesting contrast with the attitudes in vogue today.

The reform of the Cartagena Agreement as made in the Quito Protocol of May 1987, corrected an economic integration model which incorporated the technical concepts of integration common in Latin America after a decade of experience with ALALC and the Central American Common Market. With its emphasis on selective industrial programming, it further developed the old formulations of Prebisch and ECLAC which it had not been able to bring to fruition in ALALC nor in the Central American Common Market. The Cartagena Agreement was for that same reason the prototype of an integration system designed to support a policy of import substitution: in no way did it exclude the expansion of exports to the rest of the world, but that was not an explicit objective either, since the first goal of the integration process was precisely to build a larger domestic market.

The defects that prevented the Cartagena Agreement from fulfilling its goals have been widely studied, and this is not the place to recall them. Suffice it to point out that, formally, the Andean Group had to reform its statutes once it became clear that it was impossible to approve a common external tariff and arrive at a customs union,[9] as called for by the Cartagena Agreement. The reform process that culminated in the Quito Protocol, that is to say, the Protocol Modifying the Cartagena Agreement, began at that time, and the preparation and negotiation of the reform went on for years. The final product, the Quito Protocol reformed the Cartagena Agreement in the following ways: i) it reduced the original demands regarding deadlines, leaving some open, like the one for adopting a common external tariff; it also allowed for restrictive systems, such as managed trade, which in fact limited the sphere of the liberalization programme; ii) several of its stipulations (especially complementation agreements between two or more countries and lists of trade managed by the countries) allow for bilateral arrangements which (as occurred in ALADI) broke the unity of the multilateral system of the original agreement; iii) industrial programming lost the central character it had in the Cartagena Agreement; the Quito Protocol maintained several forms of industrial programming, but it was evident that its use would be very limited and not very effective, especially as there was a tendency –soon becoming a virtual rule– not to assign industries to certain countries.

The Quito Protocol did, however, have the merit of breaking a years-old impasse, which had affected the credibility of the Agreement and had led to multiple failures to comply with its stipulations. The Cartagena Agreement assumed a more clearly commercial character than before and suffered the weakening of its basic compensation instrument –industrial programming– which was supposed to

[9] The open-economy currents which were beginning at that time (the second half of the 1970s) in Latin America and within the Andean Group partially explain the impossibility of reaching agreements about the level of tariffs.

ensure an equitable distribution of the benefits of integration. But its agencies were able to function normally and use the Agreement's renewed juridical validity to reduce non-compliance with and violations of its stipulations.

This did indeed happen, but the application of the managed-trade lists and escape clauses, as was predictable, were serious obstacles to the recovery of trade. Intraregional exports increased strongly in 1987 (from US$662 million in 1986 to US$1 054 million in 1987), but then dropped slightly to remain almost stationary in 1988 and 1989 (US$974 million and US$957 million, respectively).

It was clear that unless the managed-trade lists were suppressed, or at least reformed, it was impossible to reactivate Andean integration. That issue, however, like the revision of the industrial programmes which had been approved in the 1970s, was conflictive and urgently needed to be reformed for technical reasons. It was evident towards the end of the 1980s that the Protocol had put off the solution to some fundamental problems –among them, the very definition of the real objectives of the integration formula– while it had created other problems that required an urgent solution, such as the case of managed trade, mentioned above.

V

Latin America's way to the cross: the incentive for change

This disconcerting stage of radical change is, in my view, the result of various circumstances facing the region today to an extent that, while no longer surprising, is nevertheless undoubtedly unusual. Sacrificing nuances and shades of meaning for the sake of clarity, these circumstances are the following:

i) The perception of a loss of solvency, influence and prestige in the international sphere, with its inevitable consequence of a deterioration in bargaining power. One element in this perception is the consciousness of the growing lag in the development of activities involving the technological innovation characteristic of modern societies, which are being rapidly transformed by that same innovation and other forces.

ii) The awareness that the overwhelming internationalization of economic life calls for the rethinking of the economic-policy schemes with which the region has functioned up till now and for the adoption of the scheme (or schemes) most suitable for taking advantage of the most dynamic currents in the world economy, assimilating the new technologies, and endogenously generating a capacity for innovation and management of production. Such awareness of the outworn nature of the present structures and of the inevitability of having to take an active part in the international economy in order to take advantage of its drive, with all the risks that might bring, forms the mental background to the positions of the so-called "openness" which prevails today in the region, with a whole gamut of critical and acritical variants.

iii) The influence exercised (or the conditions imposed) by the centres of the world economy to obtain that "openness" –as fully and quickly as possible– as a prerequisite for arriving at solutions to the pressing financial problems affecting the region today. It is no secret that the governments of the United States and the other creditor countries, either directly or through the World Bank and the International Monetary Fund (IMF), impose "policy reforms" or "structural adjustment" as a condition for initiating negotiations in connection with the Brady Plan: the possibility of renegotiations that may loosen the hangman's knot of the external debt is certainly a powerfully effective lure.

iv) The consciousness of a common identity among the people of Latin America, which has grown stronger with recent events, in which many analogies and affinities are perceived, especially the restoration of democratic institutions in the nations that were under dictatorial governments during the 1960s and 1970s. Painful experiences lived in common, such as the constraints created by the external debt, have also contributed to this growing closeness. For these reasons, this seems to be a circumstance that particularly favours the political motivation of co-operation and co-ordination among Latin American States. Unfortunately, however, the balance-of-payments constraints and instability typical of this time of hardship in the region create conditions that militate against the continuity needed for successful economic integration policies.

v) The awareness that an important feature of the period we are entering is the regrouping of forces on the international level in order to compete with the maximum impact and autonomy in the worldwide race to which Delors referred in the quotation cited above. This race could be a test of the nations' capacity to compete and will, in any case, be a confrontation of economic powers for which the countries' need to prepare themselves by joining forces and capacities through economic and, if necessary, political integration is increasingly evident. Something much more important than the possibility of competing depends on this preparation. Paraphrasing Delors, we could say that "economic survival" is at stake, and even "the capacity of expression and political action", that is to say, sovereignty.

It seems to me that these perceptions and concerns have a place in the collective consciousness that spawns new and novel economic and political ideas, which are rapidly gaining support and even widespread popularity in the region. The concept of "openness" has this characteristic, insofar as it is seen as a way of securing insertion into the international economy. The liberal concepts that insist on a reduced and subsidiary State enjoy similar acceptance. Beyond ideologies, political solidarity and co-operation (and their concrete expressions in joint action) have also gained new esteem on the basis of this background of collective feelings. The desirability of integration has once again come to occupy a leading place, and that may explain this phase of bold, rapid decisions regarding integration policies, in contrast with the slower and more cautious approach of the past. We should not, however, overlook the serious difficulties that these policies will have to face as long as the financial crisis continues and unless something is done to dispel the contradictions to which we could be exposed if greater openness to the world economy is not reconciled with integration in the region. This last point is the basic concern of the rest of this article.

VI

A sudden flash of boldness: the vitality and contradictions of the reactivation process

Midway between these two phases, and with only a brief gestation period, came the Argentine-Brazilian Integration Agreement signed in July 1986: the first step in one of the most original initiatives for Latin American integration. At least for those not involved in its creation, this Agreement came as a surprise which aroused sudden interest in the integration of the region. The novelty and audacity of the formula, which broke with all the traditional schemes imposed by the classical integration theory and by the General Agreement on Tariffs and Trade (GATT), were in themselves sufficient cause for the expectations to which it gave rise. But its main effect was the shock it gave to the structure of political and economic relations which had immobilized the region, and especially South America, for many years. The way ALALC (later ALADI) functioned was one of the manifestations of this immobility. If the triangle formed by Argentina, Brazil and Mexico had wanted to, it could have imparted dynamism to trade and the integration of production throughout the region. The Argentine-Brazilian Agreement was a radical change which could mean a break with ALADI or an injection of vitality. The action of the two countries soon proved that the latter would be the case,[10] if other countries took up the challenge. The upheaval in the old geopolitical concepts was even more patent. Several of the traditional pillars of the relations between Latin American countries were swept away. A powerful Atlantic axis surfaced which called for a complete rethinking of foreign policy and economic integration. The Andean Group[11] suddenly found

[10] The Protocol on the Expansion of Trade and the Protocol on Capital Goods were incorporated into the Latin American Integration Association (ALADI) as a Partial-Scope Agreement and as a Complementarity Agreement, respectively. Uruguay has joined this integration through tripartite decisions.

[11] See Edgardo Mercado Jarrín, "El proceso de integración argentino-brasileña y sus repercusiones en el Pacto Andino. Un esquema general de concertación", Lima, 1986 p. 15, *mimeo.*

itself corralled in the northern part of South America, with Venezuela gravitating towards Brazil and Argentina.[12] Mexico itself, displaced from its relation with the two other large countries of the region, must have felt that it was losing its place in the South and that this was pushing it perilously towards its neighbour to the north, which in turn made no secret of its interest in establishing a special trade relationship with Mexico.

However, the economic situation of Argentina and Brazil was not exactly propitious for in-depth integration, even if it were selective. The Governments of Alfonsín and Sarney –the first democratic and civilian régimes after long years of military governments– were going through the worst moments of tremendously difficult stabilization and adjustment policies. The circumstances at the time, and what happened afterwards, indicate that the motivation was primarily political: one of the first signs of that new spirit, born of frustrating experiences but also of solidarity, which we have tried to describe in the section above.

The formula or model followed by the Economic Integration and Co-operation Programme between Argentina and Brazil has been widely described, so there is no need for us to do so again here. The main point is that it is a selective action of integration and co-operation, concentrating on specific tasks considered by the two countries to be of priority importance. According to the available information, 24 protocols have been signed so far, each one dealing with one of those tasks. Protocol No. 1 concerns capital goods; the last one, Protocol No. 24, refers to economic and social planning. These two are good examples of the character of this enterprise: the objective of the Protocol on Capital Goods is to reach a kind of common market for this sector, even involving commitments regarding State purchases. Protocol No. 24, on economic and social planning, creates machinery for consultation and co-ordination of macroeconomic policies between the two countries. The other protocols contain a series of initiatives for integration or co-operation in fields as varied as food supply, scientific research (biotechnology) and cultural integration.

In its four years of operation, the Programme has produced positive results, especially if we consider the difficulties of keeping this kind of relation alive during such an unstable period in the two countries.

Bilateral trade grew substantially from 1986 onwards, and the increase in Brazilian exports since 1987 has been particularly noteworthy. Argentina persistently tends to run overall deficits (US$463 million in 1988), but trade in capital goods under Protocol No. 1 –the one of greatest interest to both countries– is in balance. Argentina's exports of capital goods to Brazil trebled between 1986 and 1988, rising from US$17.7 million to US$51.4 million, and this increase is entirely attributable to exports of goods on the Common List of that Protocol. Brazilian exports also increased in absolute terms (from US$45 million to US$83 million during the same period). The deficit in capital-goods trade thus decreased noticeably, and if we only consider products on the Common List of capital goods, Argentina ended 1988 with a slight surplus (US$2.5 million). The Protocol has effectively stimulated trade in capital goods, even though the figures did not reach the goals established, which were patently over-ambitious.[13]

The same protocol made it possible to take advantage of part of the potential demand for capital goods in both countries, although for the time being without any significant changes in investments or the structure of supply. Porta and Fontanals conclude that, at least for Argentina, there have been no dynamic effects in the sector,[14] with the possible exception of the sub-branches of machine tools and packaging equipment. The cause of this lack of dynamism would appear to lie in the aftermath of Argentina's recent industrial history, characterized by declines in production and employment, the persistence of recessive adjustment policies, and policies that run counter to the attempts to open up

[12] Helio Jaguaribe, "La integración Argentina-Brasil", *Integración Latinoamericana*, No. 129, Buenos Aires, Institute for Latin American Integration, November 1987, p. 6.

[13] Fernando Porta and Jorge Fontanals, "La integración intraindustrial: el caso del Acuerdo Argentino-Brasileño en el sector de bienes de capital", *Integración Latinoamericana*, No. 152, Buenos Aires, Institute for Latin American Integration (INTAL), December 1989, p. 19.

[14] *Ibid.*, p. 22.

the country to capital-goods imports from third countries. Other elements within the framework of the same formula have not functioned efficiently either: the product-by-product method of negotiation impedes strategies for complementarity; barely any progress has been made in public-sector purchases, and there have been delays in the execution of the protocols on the Investment Fund and the Statute on Binational Enterprises, which could have been decisive in stimulating the restructuring of production in the capital-goods sector.[15]

It is not known what stage has been reached by the Argentine-Brazilian programme at the present time (July 1990). The harsh adjustment policies applied in both countries and the brutal contraction they produced must have provoked a real paralysis of trade. If these efforts are successful, bilateral trade could begin to expand again and a dynamic restructuring process could be gradually put into effect to allow for complementarity between the two countries. This would call for an active and coherent industrial policy, under the leadership of the State.[16] Without such a policy, the possibilities offered by this integration will soon be exhausted, with very little effect for both countries.

Both countries undoubtedly are vitally interested in continuing their integration efforts, as demonstrated by recent decisions which will be discussed later. It is true that the gradual and selective approach taken by this formula has its limits, and it might soon be necessary to broaden the field of integration.[17] The interesting thing to note, however, is that this formula, despite the adverse economic situation, has served and is still serving as a starting point. It is very doubtful that a comprehensive across-the-board system would have been viable in the conditions prevailing at the time. In contrast, with a formula of selective integration, balanced (by specific areas and not intrasectorally) and applied in a graduated, flexible and progressiv manner,[18] it has been possible at least to begin to intensify integration in the higher-priority sectors. It may be noted in passing that this description recalls the theses of ECLAC in the 1950s, when Raúl Prebisch spoke of gradual, balanced (reciprocal) and selective integration.

As if to bow to the criticisms previously levelled at limited sectoral integration, in November 1988 Argentina and Brazil signed a Treaty on Integration, Co-operation and Development which seems a throwback to the orthodox integration model. The objective is to first establish a customs union and then a common market. With a conciseness that is not usually found in Latin American integration instruments,[19] this treaty provides for broad tariff and non-tariff liberalization of trade in goods and services over a period of 10 years. The proposal is ambitious, especially because of it includes services, but negotiating product-by-product could turn out to be a slow and cumbersome process. The common market would come into effect in the second stage, once the necessary harmonization of policies had been accomplished. The Treaty is so vague, however, that its real content remains to be defined. It is an interesting gesture on the part of the two countries, but not much more than that. In reality, the 24 protocols of what is now the "old" pact will continue to be the basis of this binational integration process. The treaty is also extremely laconic about institutions; it only states that it will be directed and administered by an intergovernmental body, without mentioning a secretariat. This is one more manifestation of the traditional aversion of both countries, and especially of Brazil, to anything that sounds like supranationality.

Argentina ratified the treaty on 23 August 1989,[20] but apparently there has not yet been any attempt to put it into effect. One can understand the

[15] *Ibid.*, p. 24.

[16] *Ibid.*, p. 26.

[17] Basically because of the difficulties in harmonizing comprehensive policies with the attempt to limit them to one sector. See D. Chudnovsky and F. Porta, "On Argentine-Brazilian economic integration", *CEPAL Review*, No. 39 (LC/G.1583-P), Santiago, Chile, December 1989.

[18] Juan Mario Vacchino, "El programa de integración argentino-brasileña y las relaciones de América Latina y Europa. Reflexiones complementarias", *Integración Latinoamericana*, No. 133, Buenos Aires, Institute for Latin American Integration (INTAL), April 1988, p. 59.

[19] And much more concise than the Treaty of Rome, which in Latin America would be taken to be overly regulatory, without being so.

[20] By the Government of Menem. It was signed during the Government of Alfonsín. It is not yet known whether Brazil has ratified the treaty or not.

reasons for both countries trying to introduce a broad integration programme, but in view of the complexities of their economic situation, it is hard to see how it could be implemented any time soon and contribute to reactivating both economies.

At all events, it marks a trend which quickly made its appearance elsewhere in the region. Thus, for example, in the final declaration (known as the Ica Declaration) of the Third Presidential Meeting of the Permanent Mechanism for Consultation and Policy Co-ordination (the Group of Eight), held on 11-12 October 1989 in Ica, Peru, special attention was paid to the question of integration and the problem of the external debt. In the Communiqué which ends the declaration, the Ministers of Foreign Relations, Economics and Finance, and Planning of the Group of Eight were instructed to meet soon thereafter, in December 1989, to examine a series of concrete issues relating to integration which had been raised by the Presidents: the replacement of quantitative restrictions with tariffs, projected complementarity agreements, etc.

The group of Ministers met on 4-5 December 1989 in Argentina, where they issued the Buenos Aires Declaration. This is a relatively brief document, but replete with initiatives for reactivating integration, especially within the framework of ALADI. It sets out four basic lines, namely:

i) the elimination of non-tariff restrictions on reciprocal trade;
ii) the broadening and further development of the regional tariff preference (PAR) to cover all products;
iii) the broadening and further development of bilateral agreements;
v) the lowering of the tariff levels applied in reciprocal trade, through successive rounds of trade negotiations.

The Declaration lays down specific tasks in respect of each of these points, some with obligatory deadlines. These decisions were to be presented at the Fifth Meeting of the Council of Ministers of Foreign Affairs of ALADI, held in Mexico City at the end of April 1990. One of the points on the agenda of this meeting concerned concrete measures for intensifying the integration process in the areas of trade, transportation, and economic complementarity. Of these, trade was the issue that aroused the most interest. The Buenos Aires Declaration had been specific on some trade policy measures, particularly the further development of the regional tariff preference, both with respect to levels (a 50% increase) as well as the number of exceptions allowed (reduction by 10%). Because of last-minute difficulties in the negotiations, which we will mention later, the Mexico City meeting was unable to arrive at decisions on these issues. It did take decisions on some other points of interest (the inapplicability of non-tariff restrictions in the list of market openings; elimination of non-tariff restrictions in limited-scope agreements, when such elimination had been accepted in those agreements; a regional programme of economic complementarity and technological co-operation applied to production, etc.), but none of them had the political importance of the issues affecting the Regional Tariff Preference. Finally, on 20 June, more than a month and a half later, the second protocol modifying the regional agreement (No. 4) establishing the Regional Tariff Preference, was signed in Montevideo. This Protocol increases the levels of the preference by far more than the recommended 50%. Thus, the basic preference went up from 10% to 20% and the maximum level (in favour of landlocked countries) rose from 22% to 48%. It was agreed that non-tariff restrictions would not be applied to products covered by the Regional Tariff Preference and the exceptions to this Preference were significantly reduced (by more than the 10% recommended by the Buenos Aires Declaration).

These latter decisions, which far surpass the terms of the Buenos Aires Declaration, faithfully represent the new spirit of Latin American integration. If the tariff level for third countries is not very low, even the basic preference of 20% (for countries in the same class) would be an interesting stimulus for the expansion of intraregional trade. No important progress was made on the other issues. Unfortunately, the *status quo* was maintained for some of them (financing of payments and trade), but, perhaps quite rightly, the Regional Tariff Preference –a multilateral instrument– was chosen to express the disposition towards openness and solidarity which characterizes integration at this time.

Another result, partially due to the influence of the Group of Eight is the change which seems to have taken place in the Andean Group.

As was to be expected, the reforms introduced by the Quito Protocol soon ran up against the problems created by managed trade, centering especially on the so-called "sensitive" products, which were precisely those that had been the most dynamic items in the intraregional trade of some of the member countries. Several other important issues remained to be resolved, such as the definitions concerning existing industrial programmes, but they were being worked on. It was obvious, however, that some way had to be found to get round the problems presented by managed trade and continue to make progress. The Board of the Agreement had proposed ending that system, and once again a conflictive situation was created, thereby slowing down the process.

High-ranking officials of the five countries[21] met in May 1989 in Cartagena de Indias in accordance with the commitment they had made in Caracas, at the inauguration ceremony of Carlos Andrés Pérez, to meet on a regular basis (twice a year). In Cartagena, the officials set themselves the task of studying the means of promoting economic integration, which was clearly going through a difficult period despite the recent reforms. The document containing this consensus was named the Manifesto of Cartagena de Indias.[22] It is an interesting document, devoted almost entirely to finding ways to reactivate integration. Its basic points are:

i) to organize a follow-up system with the participation of the highest authorities of the respective countries.[23] This task was given to the periodical meeting of Presidents, with the support of the Council of Foreign Ministers of the Andean Group, which became the organ of the agreement;

ii) to stimulate the reactivation of Andean integration. Apart from the mention of concrete measures,[24] the Andean Council of Foreign Ministers was asked to present to the next meeting of the Presidents a strategic design for the orientation of the Group which would have comprehensive coverage and would include short-, medium-, and long-term actions for strengthening subregional integration;

iii) to give the Andean process a more comprehensive and less "commercial" character; several foreign-policy initiatives were specifically mentioned in this respect.

It seems likely that these elements of the Declaration will have a decisive influence in the life of the process. The strategic design was in fact presented at the next meeting of Presidents (in the Galápagos Islands), with the effects that will be described below.

The organization for follow-up and co-ordination did serious work, as demonstrated by what happened at the following meetings of the Presidents and the Andean Council. There are signs of an effort to expand the areas of action and deal with non-economic activities also of interest for the process, some of which had been practically abandoned, (for example, labour issues).

By the time the second Summit Meeting of Andean Presidents was held (Galápagos Islands, 17-18 December 1989), six months after the Cartagena meeting, the third meeting of Presidents of the Group of Eight had already taken place (October 1989), and the meeting of Ministers of the group had issued the Buenos Aires Declaration only a few days before. The spirit of these two meetings and their insistence on prompt action no doubt influenced the Galápagos meeting, while what happened in Ica must have also influenced the work done by the Board of the Cartagena Agreement in preparing the draft strategic design requested by the Andean Presidents, which was presented at the Galápagos meeting. The result, for anyone familiar with the way of life of the Cartagena Agreement, was completely surprising and disconcerting.

Thus, at the Galápagos meeting, the Andean Presidents approved a programme of short-, medium-, and long-term action for the Andean Group, covering items ranging from trade up to joint foreign relations and including all the areas of economic integration activity covered by the Cartagena Agreement. They did so almost without amending the draft prepared by the Board of the Agreement. These decisions radically changed the pace of action called for in the 1987 Quito Protocol, and the Andean process was now committed to a programme of substantial acceleration, especially with respect to trade, which was the area that had received the most attention and up till then had been the most conflictive.

[21] Four Presidents and the Minister of Foreign Relations of Bolivia.

[22] It was the 20th anniversary of the Cartagena Agreement, signed in the same city where this summit meeting was being held.

[23] Manifesto of Cartagena de Indias, Board, of the Cartagena Agreement JUN/ di 1237, 29 May 1989.

[24] For example, revise and adjust the current minimum common external tariff in order to adapt it to the present needs of the subregion, and other similar actions

In its "Galápagos Declaration: The Andean Commitment to Peace, Security and Co-operation", the summit meeting of Andean Presidents, decided, *inter alia*:

i) to achieve customs union by 1995 on the part of Colombia, Peru and Venezuela, and by 1999 on the part of Bolivia and Ecuador; these last two countries will have to complete the liberalization programme by 1995 and adopt, the common external tariff by 1999, beginning this process in 1992;

ii) to reduce by 80% in 1990, the reserve list for industrial programming (already carried out), and do away with the list of exceptions (except for a residue) between 1991 and 1992 for the large countries, and between 1995 and 1997 for Bolivia and Ecuador. These two measures mean a considerable extension of the liberalization programme;

iii) the above-mentioned radical reduction of the reserve list means in practice eliminating industrial programming as the mechanism designed to guarantee the equity of the process, thus completing the process of rejection of that mechanism which had begun with the Quito Protocol;

iv) to substantially reduce the Common Minimum External Tariff during the first quarter of 1990. This reduction has been made, and the highest nominal level of this tariff is now 50%, whereas before it was approximately 80%;

v) to eliminate by 1991 the system of managed trade created by the Quito Protocol, which was scheduled to last, with intermediate reductions, up to 1997.

The Strategic Design contains many other measures, including commitments to harmonize policies, but the above are the most important and immediate decisions. What they involve is, firstly, to define the objective precisely, establish a customs union, and substantially accelerate the process for putting it into effect. In the Quito Protocol, the objective was not defined, there was no deadline for the adoption of the Common External Tariff, and even the improvement of the liberalization programme depended on an evaluation of Bolivia's and Ecuador's situation within the agreement.

Secondly, these changes convert the Cartagena Agreement *de jure* and *de facto* into a classical trade integration scheme. There is virtually no provision for any mechanism to supplement or correct in certain sectors the functioning of the market. The industrial programme of the Agreement could not reach its goals for several reasons, but now what remains of that programme is functionally innocuous.

As we can see, there is a profound difference between this attitude towards integration and the very concept of economic policy behind it on the one hand, and the attitudes that were prevailing when the Agreement was signed, or even those that still existed only two years ago, when the Quito Protocol was adopted. The changes in ALADI and those observed in the integration between Argentina and Brazil point in the same direction. The governments involved are obviously affected by the circumstances and concerns summed up in section V of this article, which characterize what we called the second phase in this stage of integration in Latin America. If political life had been more normal in Central America, something similar probably would have taken place there, in line of course with the special characteristics of that sub-region. This is only a conjecture, but it has its grounds in the concern that Central America too must be linked to the international economy. [25]

The manifestations of this flood-tide of openness are more and more frequent, so its expression in economic integration should be seen more as a derivative –a special case– of a broader attitude which is attempting at the very least to move the centre of gravity of development policy towards the world market. The reforms in their external trade policies recently adopted by some Latin American countries have that intention, and it is a fact that protection against the rest of the world has diminished substantially. It may be said in those cases that, chronologically, trade with third parties was liberalized first, so that what has taken place with regional integration is only an extension of what was happening in general with foreign trade. Thus, Bolivia, Mexico, Argentina and Venezuela drastically reduced the protection applied in their domestic markets well before the initiatives for regional openness described above took shape. We have not mentioned Chile, whose liberalization process goes back to the 1970s, but Bolivia, for example, opened

[25] See the references to the attitude of the business sectors in Costa Rica and other Central American countries in Alfredo Guerra-Borges, *Desarrollo e integración en Centroamérica: del pasado a las perspectivas*, Mexico City, CRIES-IIEC, Ediciones de Cultura Popular, 1988, p. 99.

its economy in 1985 as part of an anti-inflation policy, and this policy of openness has remained practically untouched since that time. In Central America, even though the rules of the Common Market have not changed formally, Costa Rica recently inaugurated a policy of comprehensive liberalization, and the other countries will probably have to do the same once conditions allow the negotiation of a reform in Central American integration.

At least for the countries mentioned, these facts bear out the previous affirmation about the apparently subsidiary nature of the present emphasis on accelerating the trade element of economic integration. This conjecture is strengthened when one thinks of what has happened with those integration instruments that are different from the classical forms of trade integration, i.e., according to the case, liberalization or preferential tariff programmes and a common external tariff. In contrast with the decided support for openness that has been prevalent in recent initiatives with respect to these instruments, there has been no significant progress in other fields (some of them critically important), such as systems for settling payments and balance-of-payments support.

This might, at all events, be too hasty a judgment, since there may be different and equally intense motivations for comprehensive openness and for regional openness. In that case, however, there should be a clear concept of the functions that each one would have to fulfill in the new development model, with the corresponding delimitation of spheres and the consequent discrimination of policies. Judging from the decisions made up to the present, there are no indications that the measures taken correspond to a strategic concept of the objectives that regional integration should accomplish within a model of comprehensive openness. This is a serious concern that, so far, the facts have not yet put to rest.

The question is important, not only because some of the countries that have already begun these reforms are the heavyweights of regional trade, but also because practically all of the Latin American countries seem to be heading in the same direction. Colombia has already substantially changed its system of foreign trade, including its methods of protection (tariff and non-tariff), while Ecuador has begun to reform its tariffs and its foreign-trade policies. That will also probably be the option of countries like Brazil, which has in fact already begun to open up its economy: a process it will very likely intensify as soon as it finishes its "shock treatment". Peru's new government will most probably follow the same path. Information on Central America and the Caribbean is not available, but a similar inclination is predictable.

Apart from governments' sincere conviction –which they undoubtedly hold– that a policy change along these lines is genuinely needed, a realistic appreciation of the forces pushing for a policy reform is important for our view of the future. Decisive among these forces is the pressure of the multilateral credit agencies, which have almost arbitrary power in renegotiations of the external debt and consider structural adjustment of the economy to be a prior condition for this. Structural adjustment means profoundly changing key macroeconomic policies regarding exchange rates, interest rates, tariffs and other instruments for regulating foreign trade, as well as modifications of legislation governing investment, apart from the policies for different productive sectors. The theories in vogue with respect to protection are well known: a low and uniform national tariff, to ensure a low effective protection with effects that are as neutral as possible on the different activities. A single equilibrium exchange rate is supposed to compensate for the tariff reduction and be the basic instrument of protection from then on. Its effectiveness should not be diminished or distorted by quantitative restrictions on imports, nor by incentives to invest in productive activities other than those needed to promote exports in order to compensate for the bias arising from the existence of an import tariff, if there is one.

Recommendations on "structural adjustment" are naturally much more complex and contain elements that fit in with the conditions of each country. There is no need to go into detail about them here. We will only describe what we consider to be the essential nucleus of the recommended reform, which, as far as we know, effectively tends to be substantially the same in all the countries. That nucleus, together with the suggestion for overall deregulation, constitutes the basic direction of the changes that our countries are beginning to make in their foreign-trade systems and policies. By way of example, we may take the case of one of them, Venezuela, which has made changes characteristic of this new trade policy and which demonstrates better than the other countries the objectives being pursued, since it is further along the road to reform.[26] The change is directed, for the

[26] Decree No. 239 of 24 May 1989, providing for a New Integral Economic Strategy, *Gaceta Oficial,* No. 34230, 30 May 1989.

moment, at the manufacturing sector, and will consist in the adjustment of tariffs and the progressive elimination of non-tariff restrictions (article 2). By June 1989 the reduction of the *ad valorem* tariff should leave it at a maximum of 80% for consumer goods and 50% for intermediate and capital goods and raw materials (article 5), as a measure of transitory protection, to be reduced in time. That measure has already been adopted. With two intermediate steps, the objective of the tariff reform is scheduled to be achieved in 1993, when the maximum tariff will be 20%, with only two tariff levels (article 9). At the same time, as from 1989, all non-tariff restrictions on imports and tax exemptions on imports of manufactured goods will be progressively dismantled. Article 12 even establishes the commitment to move toward eliminating public and private import monopolies, in addition to the deregulation of exports referred to in article 17, and the creation of an export subsidy linked to the level of import tariffs, by anticipating the lowering of this subsidy as tariff reform advances (article 18).

This undoubtedly important change, it is worth mentioning, was adopted before the decisions of the Ica meeting of the Group of Eight that sought to revitalize ALADI, and before the Galápagos summit, which tried to do the same for the Andean Group. The spirit of openness evident in Venezuela's Decree No. 239 preceded consideration of integration issues, so we can say that the latter derived from the former. This conclusion becomes evident as soon as we read the text of article 13 of the Decree in question, where it says that the National Executive will negotiate Venezuela's commitments under the Andean Pact and other international agreements in line with the provisions of this decree. It is clear, however, that commitments as precise as a maximum tariff level of 20% by 1993 are more a negotiating position than material for later renegotiation.

VII

Desirable and feasible levels of regional integration in the context of openness

In the present situation, with its inclination –which seems to be spreading– towards uncompromising openness to the world economy, at the same time that a recessive adjustment process persists in almost all Latin American countries, the future of regional integration is extremely uncertain, even though it is true that a series of sudden decisions have been taken which seek to reactivate that integration, and that this is undoubtedly the will of the governments involved.

It might be asked, however, if such reactivation or relaunching is really feasible in the context of trade liberalization with third parties, as already discussed. That is a prior and unavoidable question, which, if answered in the affirmative, still leaves intact other concerns about the kind of integration that would be best for Latin America in the present circumstances of the international economy, the region's need to be linked to the more dynamic currents of that economy, and the financial constraints in which the region would presumably have to develop in the foreseeable future.

The nature of this article demands that we generalize and refer to Latin America as a whole. That abstraction conceals the consequences of the diversity of the national economies and prevents us from arriving at specific conclusions. We hope, in any case, that the conclusions of this article will be pertinent and will allow whoever so desires to examine them in the light of national realities.

The first question implies a more general query: can indiscriminate openness to the international economy be reconciled with regional integration? In customs union theory, the question was usually posed as a dilemma, that is, presented as two mutually exclusive options. In the eyes of that theory, free trade was more beneficial than regional integration, which was only acceptable as a step towards free trade, if it served as a net creator of trade. The consideration of other benefits, among them the possibility of increasing exports as a result of regional liberalization and the dynamic effects of a greater interest in development, gave more arguments, however, for justifying the inherent attraction of regional integration. Finally, opting for regional integration meant giving preference to liberalizing trade within the integration zone rather than opting for unilateral, non-reciprocal liberalization with respect to the whole world. They were clearly mutually exclusive options, even if integration were understood as a temporary state which would make it possible to increase exports and develop comparative advantages in order to later compete dynamically in the international economy.

At least *a priori,* it does not seem that the Latin American countries have opted for a form of regional integration that excludes the comprehensive liberalization of trade. The two processes have progressed together, and in reality, the expressions of openness preceded the most recent decisions to reactivate integration. We have to suppose, however, that when it comes to intensifying the processes, an option for one or the other will have to be made early on, and logically, we should expect that that option would be in favour of regional integration, while continuing to open up trade within pre-established limits. It could even be accepted that this option might be of limited duration, lasting up to the time when a desired level of development (for all or some activities) was achieved, in order to later open up more to international competition. In any case, the immediate effects are interesting for our question, and in those effects regional integration would have to predominate over greater openness.

Under these conditions, the two processes would be reconcilable in either of the following situations: a) comprehensive openness only up to a level that allows for discrimination (also comprehensive) in favour of the countries belonging to the integration area; and b) selective opening-up to the whole world for certain activities, which would allow for the functioning of a form of regional integration (also selective) for all those activities not included in the comprehensive openness.

Judging from the character of the liberalizing reforms adopted up till now, the predominant direction would be comprehensive openness, with minor exceptions for a minimum of activities (for example, the motor industry in Venezuela, Colombia and Ecuador). Moreover, the position of the United States Government, the World Bank and the IMF is precisely in favour of comprehensive openness, and this is what characterizes the policy reform commitments undertaken with them by several Latin American countries, with certain specific concessions. We will return to this aspect when we speak of the kind of regional integration that would be best for Latin America in the present situation. For now, it is sufficient to note that the reform is moving towards comprehensive openness, so that we can see the possibility that the situation described in point a) above will take place. It would exist if study of the characteristics of openness shows that there is room for discriminating sufficiently in favour of regional markets. In the usual terms of Latin American integration, that is the equivalent of posing the problem of the so-called regional *margin of preference* and evaluating its adequacy with respect to the liberalization policies in vogue.

Obviously, in the current situation it is impossible to rigorously evaluate the existing or proposed preference for regional production. The reform of foreign-trade policies is presumably still underway in all of the countries, and even if it has been completed somewhere, the local circumstances vary so much from country to country that we would need far more information and macroeconomic evaluations than it would be possible to handle within the limits of this article. We can only conjecture about where current trends towards openness could lead, using our personal experiences as a basis for venturing an opinion, which can only be an expression of concern or preoccupation about the evolution of policies that, at least superficially, do not seem to correspond in most cases to well-thought-out plans for development.

Even with these reservations, a judgment about the adequacy of a margin of preference requires a prior comment about the instrument or instruments which would most probably have to be used to discriminate in favour of regional production. Our view is that this instrument should be the import tariff, not only because regional integration has primarily used tariff concessions or liberalization (even occasionally common external tariffs) to promote trade, but also because the very direction of the reform of foreign-trade policies makes tariffs the only instrument possible –even though in a very limited and uniform way or with rather limited discrimination– for protecting the domestic market over and above the basic protection given by the exchange rate. In theory there are several instruments other than tariffs which could be useful for discriminating in favour of regional integration, and they could possibly be developed in the future, but experience so far in their use is rather negative.

Regional integration policies have failed in their handling of direct-allocation instruments, such as industrial programming, and even in the little-used complementarity agreements the central mechanism used has been tariffs. Such policies have been unable to mobilize State purchases, even in the case of the selective integration between Argentina and Brazil. For this same reason, regional trade integration in Latin America basically uses tariffs to allocate a margin of preference for regional production. With respect to the reform of general foreign trade policies, we should remember that the essential components of the reform include the elimination of non-tariff restrictions and the limitation or elimination of other means that could sidetrack the market signals, such as State purchases (State monopolies, State-owned enterprises, etc.).

In practice, and if there are no unforeseen changes, the tariffs remain the only instrument capable of giving a margin of preference to regional or subregional production. If we go by the known goals of the reforms promoted by the multilateral agencies, which are similar in all countries –maximum tariffs of 20%, with only two tariff levels– the conclusion is that for many activities (especially those that involve a certain technological complexity) the possible margin of preference, given the instruments in use, would not be sufficient. This is evident almost *a priori* in the case of ALADI's concessions, where the norm [27] is a reduction of tariffs, not total liberation. And that is true both for limited and regional agreements. [28] There could be some doubt in the case of goods that are totally liberated in intraregional trade –for example, those already duty-free in the Andean Group– but even there, in the majority of the countries the list of products that would be interesting to develop but for which the margin of preference is insufficient is quite long. Naturally, those who would suffer the most from that situation would be the less developed countries, since this would make trade integration even more inequitable, with all the consequent problems for its future stability.

Despite the fact that we are at the beginning of a period of change, experience shows what could happen: after evaluating the Protocol on Capital Goods between Argentina and Brazil, Porta and Fontanals indicate that the tendency to open up to third parties has already created a contradictory scenario, since on the one hand there are attempts to open up markets, even giving priority to the indiscriminate liberalization of imports in the capital-goods sector, while on the other hand the margin of preference for complementarity becomes uncertain and tends to be even less.[29] This has helped, as the authors point out, to prevent integration from having had dynamic effects on that sector in Argentina.

The same concern exists, and very strongly too, in the case of the other integration efforts, and thought is being given (rather unrealistically, in our judgment) to mechanisms which could make up for the lack of a margin of tariff preference: for example, provision of financing for the buyer has been mentioned. [30]

It should be pointed out that most products would not need high tariffs against third countries in order to achieve the desired effect. Transportation costs can in some cases be an effective barrier which hardly needs to be complemented by a tariff. There are other circumstances, however, which demand (even though temporarily) tariffs of a certain level and the support of other instruments which the countries must learn how to use: such is the case, for example, for certain nationally-produced capital goods that meet with resistance because their origins or brands are little known. Here, joint action between producers, major users and governments is to be recommended. In this and other cases, however, a margin of tariff preference is still a useful and frequently indispensable instrument, as shown by the experience mentioned above.

[27] The formal exception consists of the concessions made in the list of market openings for the relatively less developed countries, in which imports are exempted from duty.

[28] Recall our previous remarks about the tightness of the margin in the case of the basic regional preference of 20%; if the level of the external tariff were 20%, the regional preference would only be 4%.

[29] Porta and Fontanals, *op. cit.*, p. 24.

[30] See David Moctesuma, "Integración económica, deuda externa y perspectivas para los años noventa", Report of the Seminar on Economic and Social Integration: Perspectives for Latin America and the Caribbean in the 1990s, Mexico City, Society for International Development (SID), September, 1989, p. 81.

Recent events[31] raise the spectre of even more adverse circumstances: negative margins for intraregional trade. Trade arrangements with the United States and other industrial countries, which ignore the most-favoured-nation clause stipulated by all the instruments of regional integration, and even more seriously, the linking of certain Latin American countries with the United States and other industrialized countries in free-trade areas –linkages which imply ignoring the most-favoured-nation clause of regional agreements– would extend a situation of negative margins[32] that leaves no other solution for the countries involved than to openly opt for one or other system of preferential trade.

The conclusion of this summary reflection would appear to be that if these trends in economic policy remain and spread, there will be no room for a regional economic integration process of any significance. That does not exclude the possibility that political and even economic co-operation in concrete projects and initiatives could continue and even grow stronger. But without a margin of significant preference it would be useless to propose the integration of markets, and much less of production. There is no doubt, however, that the Latin American countries have in recent years once again shown a real willingness to reactivate and accelerate regional integration. In spite of the contradictions brought on by the need to find a different centre of gravity for their economic policies, that will for union has been expressed in the series of recent initiatives described above. We should, therefore, radically change the direction of our analysis and, instead of asking what kind of regional integration would be compatible with openness to the exterior, we should try to find out directly what are the characteristics of the openness to the exterior that could be compatible with the regional integration that Latin America needs for its development. The answer to this question would allow us to spell out the conditions needed in order for such openness to be compatible with an authentic and dynamic form of regional integration. In reality, this is the logical sequence for reconciling the options facing the region today.

As we mentioned above, there are at least three elements that must be taken into account in order to define the form or kind of viable integration that Latin America needs.

The first element is the present international economy and its circumstances. We hardly need to insist that the great force for change behind the competition prevailing in the world today is the extraordinarily dynamic process of technological innovation. As happened in the case of the great technological changes of the past, but even more markedly now, the truth is that he who possesses and exercises the capacity to innovate is in a position to take control of the most dynamic functions of international specialization. The gap between rich countries and developing nations is now basically a question of knowledge, and this is probably the hardest to overcome. In the graphic words of David Landes, capital is not the main problem. Theoretical knowledge and know-how are increasingly esoteric and obscure, and hence more difficult to acquire.[33] The potential advantage that latecomers traditionally had is becoming increasingly problematical, because the costs of crossing the technological threshold are now very high. For that reason, it is vital that Latin America should do everything it can to close the technology gap without delay and not fall further behind.

There are other phenomena in the international economy which are also important, especially the internationalization of capital and certain services, but the technological gap is one of the most crucial and is also the ultimate justification for opening up to the exterior.

The second element concerns the wave of liberalization of foreign trade (and other external transactions) now prevalent in our economies. We have already mentioned that this liberalization responds to the growing conviction that the development model needs to be changed to make exports the motor of economic growth. Openness can stimulate exports and is an incentive for greater efficiency in existing activities, but if we want to put our development on a firmer basis we must obviously modify the structure of exports by gradually incorporating more products with a high component

[31] Basically this refers to the difficulties at the last meeting of the Council of Ministers for Foreign Affairs of ALADI in achieving unanimous approval for the Protocol for Deepening the Regional Tariff Preference.

[32] That is to say, a tariff preference even greater for third parties than that given to countries of the region.

[33] Richard T. Ely, Lecture, "Why are we so rich and they so poor", *American Economic Review*, Papers and Proceedings, vol. 80, No. 2, May 1990, p. 9.

of knowledge, be they primary or industrial goods or services. In other words, our present productive base is unable to take full advantage of an open economy. The only export structure that can lay the foundations for stable progress is one based on the new conditions of technology. In terms which have now become common, openness is justified to the extent that it allows for the development of dynamic comparative advantages in a world whose forthcoming evolution will depend on technological innovation.

It is a fact, however, that theoretical knowledge, technical skills, know-how and innovative capacity are all manifestations of a social quality –scientific and technological progress– which is impossible to assimilate or incorporate through openness alone. As Landes said, it is obscure and elusive. Openness may help to foment competition and create a more propitious atmosphere for knowledge and contact with the outside world, and even for foreign investment, but the final results will depend much more on a complicated set of national policies in the fields of science and technology, education, production, etc., to say nothing of social motivations, which are by their nature even more elusive.

It is precisely in such a decisive area of national policy, involving high costs of innovation and difficulties in learning and disseminating technology, that regional integration could be most useful, especially if combined with an openness that breaks with the *status quo*. ECLAC treats this issue in its recent report entitled *Changing Production Patterns with Social Equity*, calling it the "symbiosis between external and regional demand".[34]

If this is so, then that combination should be carefully studied, establishing the content of the regional integration effort and reserving areas that would not be included in the overall liberalization process, or at least would not be included on the same lines as the rest of the activities. That means discrimination with respect to third parties and inevitably "protection", in order to induce an action in an area where there are obvious disadvantages in comparison with the outside world.

In this case, the content of integration programmes is probably much more important than the efficiency of the instruments of discrimination, among which, in theory, tariff preferences would not be the most efficient. Nevertheless, for reasons already given, these preferences have been the only valid instrument so far. If more suitable instruments can be found, so much the better, but for the time being, even for reasons functional to the liberalization processes, a preference that would give a clear stimulus has to be maintained.

The third element that has to be taken into account in order to move towards viable integration is the climate of persistent financial constraint and instability caused by the external debt crisis, the adjustment policies, and our own past and present errors. A recent analysis[35] examined the effects of this extreme situation on integration. The consequences were devastating in the first years of the crisis (1983-1986), and in spite of the accommodation which has taken place with the passage of time, regional trade is still affected and is still below its 1980-1981 figures. Unless we solve the debt problem and recover adequate external financing, the immediate future looks equally foreboding.

What kind of regional integration could best weather the storm and contribute more positively to the future of Latin America in this period of constraints and liberalization? There are obvious priorities which have not been implemented: for example, strengthening the systems for settling payments and for balance-of-payments support. With regard to intraregional trade, the crisis has meant in fact that one kind of selective unilateral liberalization has predominated. This kind of liberalization has now been moderated, but has still not disappeared. This is seen by the treatment given to key products.[36]

Despite that, as we have seen, all the schemes have included substantial reforms to accelerate and broaden regional liberalization, and moreover a process of comprehensive external openness has been initiated which looks as though it will be profound in its effects.

[34] An attempt should be made to promote the gradual improvement of comparative advantages in those sectors where technological development and learning are facilitated by regional action". ECLAC, *Changing Production Patterns with Social Equity* (LC/G.1601-P), United Nations publication, Sales No. E.90.II.G.6. Santiago, Chile, March 1990, p. 166.

[35] Víctor Urquidi and Javier Villanueva (eds.), "Integración latinoamericana: problemas de hoy y nuevos rumbos", *Crisis y crecimiento en América Latina*, Buenos Aires, Raúl Prebisch Foundation, Editorial Tesis S.A., 1989, pp. 321-370.

[36] It should be noted that the choice of existing activities, perhaps the least efficient, was purely defensive.

It would be interesting to know what could happen with regional integration. If the reforms substantially expand intraregional trade, at least some of the stagnation of priority productive sectors will have been offset and we would be better able to take advantage of the opening to the exterior. We fear, however, that the serious disequilibria in intraregional trade will persist and that this will lead once again to paralysis. This would be much more likely if liberalization with third parties leads to balance-of-payments problems, which is probable at least in the medium term. The danger points would, of course, be the weaker countries, because the integration systems have now become more inequitable than before.

These concerns lead to a question worth exploring. Would this not be a good time to study certain programmes on which regional integration could be selectively concentrated, while continuing as far as possible with the reactivation now being initiated? Obviously, the priority issues would be indicated, at least partially, by the need for changing production patterns.

With these comments on the three elements, we can finally give a summary opinion on the thrust that should be given to regional integration in these difficult times when it is exposed to so many contradictions and, at the same time, so essential for the future. As we have already stated, we must necessarily speak in general terms and not refer to any particular effort.

For various reasons, selective integration would be easier to reconcile with the general trend towards openness, and more importantly, could better serve the development needs of the region. Existing integration schemes need not be formally modified, but efforts should be made to maintain or establish in the selected areas a minimum of policies discriminating against third countries.

In order to define the aspects of the integration processes which could most usefully be emphasized, two main objectives should be pointed out:

a) The need to preserve and increase the most dynamic currents of intraregional trade; it would be an aberration if premature openness to third countries led to a contraction in intraregional trade and affected the lines of production with the most rapidly growing sales, especially if they involve scale effects and external economies, which indicate the existence of unusued potential;

b) The need to stimulate the development of activities (production of goods and services) with a high knowledge content, as well as those of critical importance for furthering the change in production patterns. We have already stated our case in this regard; the only thing to add is that all the countries should be given the opportunity to participate in the structural change: the more advanced, through activities on the frontiers of technology;[37] the less developed in this respect, through forms of production that do most to further the learning process and the dissemination of technology.

Tariff preferences are indispensable as incentives for proper management in these areas. The margin of preference can be ensured by placing limits on comprehensive openness or by reducing regional tariffs. Especially for the areas chosen in function of point a) above, integration would have to undertake complex action[38] and develop mechanisms for promotion which in the terms used some time ago by Professor Tinbergen, lead to the authentic integration of *positive* production, that is to say, not mechanisms based on merely removing obstacles.

Clearly, the proper linking and co-ordinating of the processes of comprehensive and regional openness is not a job that can be improvised. Difficult strategy definitions need to be studied and political decisions have to be negotiated. If the countries, integration agencies, the Latin American Economic System (SELA) and ECLAC itself do not immediately take up this task, it will be too late and an opportunity will be lost which may not present itself again for generations to come.

Moreover, a preoccupation still exists which the facts have not yet been able to pu to rest: at the moment of truth, will all or most Latin American countries still have the political will to keep open a field for significant regional integration? We have presupposed an affirmative answer in this article, but only the future will tell if our assumption was right.

[37] See Chudnovsky and Porta, *op. cit.*, pp. 141-144.

[38] The relevant action for technology is referred to in ECLAC, 1990, *op. cit.*, especially chapter VI, section 2, pp. 164-170.

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Present and future integration in Central America

José Manuel Salazar

Has the idea of integration in Central America been abandoned for the 1990s, while strategies for economic "openness" and other forms of entry into world markets are adopted? Are there any other ways? According to the author, there are grounds for moderate optimism as regards reinforcing Central American integration in this decade.

One cycle in the history of integration has come to an end but the issues debated in the 1950s on ways of promoting economic integration and on its contribution to development will continue to be the centre of discussion in this decade. For this reason, this article starts with a review of Prebisch's original ideas on these subjects and their development by ECLAC.

In section II, it is proposed that regional economic integration, defined in new terms, is both conducive to and complementary to a strategy for gaining greater access to the world economy, based on achieving international competitiveness. One guideline is to eliminate the anti-Central American bias and to promote intraregional trade, for which there are promising prospects thanks to the plan to reactivate the intraregional trade which is being implemented, as described in section III.

The possibility of exploiting the new global economic conditions to the fullest depends on Central America's ability to make the transition from a static, passive trade policy to an alert and active policy, i.e., to maximize the strategic advantages of joint action in the areas of trade, finance and international cooperation. In section IV, various options are analysed, with special reference to trade strategy.

The cost-benefit ratio, arising from integration, acquires new dimensions in a context of export-oriented strategies. Sections V and VI, analyse several areas for joint action aimed at increasing international competitiveness and stimulating industrial specialization and complementarity at the regional level, which may give integration a positive balance both for the region as a whole and for each individual economy.

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I

Theory and practice in the origins of integration

The precariousness of the economic and infrastructural ties of the Central American Isthmus during the colonial period was a factor that contributed to the failure of the project to establish a federal republic, after its independence from Spain in 1821, when the countries opted to form five separate States. Nevertheless, the idea of integration endured as a political ideal, giving rise to various partial projects for regional linkage, one of the latest of which was the creation of the Organization of Central American States (ODECA) in 1951, consisting of the ministers for foreign affairs.

However, it was ECLAC that put forward a totally novel approach for promoting Central American unity in contrast to the usual political approach and the previous inadequate economic initiatives. In fact, as early as 1951, on the occasion of the establishment of ODECA, a decision was taken to move towards regional economic integration, although the framework for achieving that goal was not clear.

From 1951 to 1958, ECLAC spent considerable energy on assisting and steering the Governments of Central America. This activity culminated with the signing of the Multilateral Treaty on Free Trade and Central American Economic Integration, followed by the Agreement on the Régime for Central American Integration Industries and Central American Agreement on the Equalization of Import Charges. However, these commitments were later amended by the Treaty of Economic Association and the General Treaty on Central American Economic Integration, signed in 1960.

There were important differences between the original ECLAC approach and the decisions set forth in the Treaty of Economic Association and the General Treaty on Central American Economic Integration, decisions significantly influenced by the attitude of the United States and that country's preference for rapid progress toward a free-trade zone with a common foreign tariff within which the free-market forces would prevail, thus eliminating the elements proposed by ECLAC for the purpose of providing a rationale for the process, namely, planning, reciprocity, the "integration industries" system and the negotiation procedure for eliminating tariffs.

The contrast between the original ideas and the final decisions has been well documented in the literature on the Central American Common Market (CACM).[1] Less attention has been paid to the dynamic vision of industrialization, formulated by Raúl Prebisch: on the sequence of import substitution, common market, and industrial exports to the rest of the world; on the role of progressive forms of integration into the world economy; and on his recommendations that trade policy should managed so as to implement the sequence in a balanced, efficient and rational process of industrialization. Given his current relevance for Central America and on the occasion of this special issue dedicated to him, the ideas of Raúl Prebisch on this matter are examined in the following section.

II

The thought of Raúl Prebisch on industrialization and economic integration

1. *Industrialization, common market and development*

As Prebisch observed: "The urgency of the need for progressive forms of economic integration began to claim attention from the time of the secretariat's very earliest studies, subsequently reasserting itself..." (Prebisch, 1959a: 5). Among those early studies, the *Economic Survey of Latin America, 1949* is outstanding. In it the argument is advanced that the First World War demonstrated the possibilities inherent in industrial development, a lesson later corroborated by the Great Depression and the Second World War, and the "conviction that those possibilities had to be used in order to offset, by means of internal development, the manifest failure of the external incentive which until then had stimulated Latin American economy" (ECLAC, 1951: 4).[2]

The effects of the universal propagation of technology provide the momentum for the centro-periphery model which Prebisch used in his analyses. With this model, Prebisch concluded that the deliberate stimulation of industrialization, together with the development of complementary activities (transport, trade, services), was a policy for the peripheral countries that was necessary for absorbing population growth, while raising pro- ductivity and living standards.

Nevertheless, in the analysis he emphasized that the narrowness of regional markets limits efficient industrialization: "[...] as progress is made in this direction, increasingly complex activities, in which the size of the market is a supremely important factor of productivity, will in fact have to be undertaken. Thus, the continued development of production in twenty watertight compartments, as under the present system, will steadily widen the gap between the yield of the new capital investment [...] and the results obtained in the great industrial centres with broader markets at their disposal" (Prebisch, 1959a: 6). For Prebisch "the chief weakness of the industrialization process consists in the fact that it has developed in watertight compartments, within which each country attempts to do the same as the rest, without specialization or reciprocal trade" (Prebisch, 1959a: 18).

From this perspective, he derived the rationale for a common market: a process of efficient industrialization will depend on the continuing and systematic expansion of markets. This, for Prebisch, is precisely the function to be performed by progressive stages of economic integration.[3]

[1] The classic work on the origins of CACM is Cohen (1972). See also Bodenheimer (1974), Guerra-Borges (1988) and Bulmer-Thomas (1989).

[2] Osvaldo Sunkel, for the purpose of refocusing on what, for Prebisch, was a central element in his vision of development (the internal factors of supply and the endogenous industrial and technological dynamic based on the creation and spread of technical progress, overcoming the errors inherent in a definition that would compare "outward" development with "inward" development), has retrieved a concept which manages to break away from traditional confines: a strategy for international access "from within" (Sunkel, 1990).

[3] "In reality, the common market is an expression of the effort to create a new pattern for an inter-regional trade capable of meeting two exacting demands, namely, the requirements of industrialization and the need to lessen the external vulnerability of the Latin American countries" (Prebisch, 1959a: 6).

2. *The importance of planning the economic integration process*

Prebisch and ECLAC conceived the common market as a broad, negotiated and rational effort to achieve industrial specialization and reciprocity aimed at attaining the basic objectives of "improving traditional trade in primary products" and "ensuring the rational industrialization of the Latin American countries" (Prebisch, 1959a: 20). The following sections present Prebisch's main recommendations for promoting the integration process.[4]

a) *The stages, sequence and speed of the process*

A first stage of 10 years is proposed, during which reciprocal trade will be given a strong impetus by means of the following measures: elimination of all non-tariff trade barriers; reduction of the average level of intraregional trade tariffs, maintaining a certain level of uniform protection against the rest of the world; and the development of an effective system of credit and payments. This first stage is understood to be experimental and exploratory. The goal of achieving a common market –the liberalization of trade– is to be dealt with in a second stage of negotiation among Governments, bearing in mind the experience of the first stage. This gradual approach is justified by what we would call today the costs of adjustment, with respect to which Prebisch emphasized as a basic principle that "no solution entailing persistent unemployment of the factors of production would be acceptable" (Prebisch, 1959a: 5).

b) *The form commitments would take*

Commitments determining quantitative goals for reducing the average level of customs tariffs are recommended, both among common-market member countries and the rest of the world. With respect to the world market: "The final aim would be the establishment of a single external tariff, in order to ensure that all the contracting parties were in a position to compete on equal terms [...] All such points would have to be dealt with in a series of negotiations, until, with the passage of time, the common market was established in the form of a customs union" (Prebisch, 1959a: 15). As for the liberalization of intraregional trade, the method of drawing up inclusive lists is recommended, i.e., liberalizing trade in the products included in the lists, as opposed to exclusion lists which take free trade as the norm, except for the products on the exclusion lists. Moreover, for the purpose of defining the pace of tariff reduction, ECLAC distinguished diverse categories of products according to their agricultural or industrial nature, the income-elasticity of demand, the potential for import substitution, and the effects of a sudden outbreak of competition.

c) *Differential treatment for countries in the early stages of development*

In order to reconcile the demands of a common market –more trade and specialization thanks to the liberalization of intraregional trade– with the need for moderately higher levels of protection for less productive countries in the early stages of development, a regime of special concessions is recommended. This would constitute an exception to the most-favoured-nation principle in the sense that the reduction or elimination of tariffs, which a more advanced nation would concede to a country in the early stages of development, would not be extended to the other members of the common market, but only to those in the early stages of development. This exception would not only benefit the less developed economies but would also allow the more advanced nations to go much further in granting them special concessions, if they are not also extended to other advanced countries. This is precisely the principle adopted in the General Agreement on Tariffs and Trade (GATT) during the Tokyo Round of multilateral trade negotiations and it applies to the Caribbean Basin Initiative.[5]

[4] In 1959, Prebisch published his work *El Mercado Común Latinoamericano*. This book brings together, on the one hand, the ideas developed by ECLAC during the period of intense efforts to advise and guide the process of Central American integration beginning in 1951 and, on the other hand, the recommendations of the Working Group organized by the ECLAC secretariat for the purpose of offering suggestions to Governments for the establishing of a Latin American common market.

[5] Differentiated and most favoured treatment, reciprocity and greater developing country participation. See the Decision of 28 November 1979, in GATT (1986).

d) *The principle of reciprocity*

The concept of reciprocity refers to the important fact that member-country imports can be financed by their own *additional industrial exports* from the earning of their primary exports. This concept is fundamental to the Prebisch and ECLAC positions on trade policy and can, naturally, be extended, not only to trade within a Latin American common market, but also to integration in any larger trade bloc. Without this principle, trade liberalization policies would not promote industrialization as such, nor the development of associated services.[6]

Prebisch points out that, in practice, the competitive strength of certain countries, in a context of liberalized trade, would make their exports dominant in the market of less competitive countries, and that it is essential for the trade dynamics of the common market (or trade bloc) to prevent this type of situation from provoking restrictive measures. The principle of reciprocity implies that the more competitive countries must take complementary liberalization steps to step up their own industrial imports from relatively less developed and less competitive countries.

Another dimension of reciprocity has to do with the fact that protection has a different meaning in countries specializing in primary products and in the industrial centres. Given that the income-elasticity of demand for industrial imports in the periphery is greater than the income-elasticity of demand for primary products in the centres, a moderate level of protection in the periphery is a way to correct that bias. On the other hand, protection of industrial centres against agricultural and primary imports from the periphery accentuates the bias, tends to retard periphery development and slows the pace of growth of world trade.

Another inference drawn by Prebisch from the foregoing is that diminished protection in the centres implies elements of reciprocity, because the resulting increase in periphery primary exports will lead to a correlative increase in their imports of industrial products. This occurs even without tariff reduction in periphery countries owing to the greater income-elasticity of their demand for industrial imports. "The traditional form of reciprocity, under which peripheral countries are asked to grant duty concessions similar to those introduced by the centers, does not take into account this implicit element of reciprocity" (Prebisch, 1959b: 264). As import capacity increases in the periphery, reciprocal customs concessions with industrial centres could impair the industrial development possibilities of peripheral countries instead of helping them to achieve higher rates of growth.

Two conclusions must be noted on this issue: a) Prebisch's concept of reciprocity is different from the traditional concept because it explicitly implies a notion of trade balance in the exchanges of industrial products and, therefore, *an argument in favour of promoting industrial exports* in relatively less developed countries; and b) it is clear that the planning suggested by Prebisch to guide the integration process does not involve nationalization, nor market substitution, nor obliging the private sector to fulfil predetermined plans; it does imply, however, the implementation of a trade policy directed towards progressive and strategic international trade competition, based on negotiated and rational efforts to achieve increasingly broader trade relations. This last point is amplified below.

3. *Forms of progressive integration and promotion of industrial exports to the rest of the world*

According to Prebisch, the path leading to industrialization which demands permanent and systematic market expansion, requires progressive forms of economic integration. Prebisch noted that this, in turn, required appropriate incentive policies and, specifically, a review of the protectionist tariffs: "*As progress is made in import substitution, modifications will have to be gradually introduced* [in customs tariffs] because of the need to give protection to the new substitution industries, although this will not affect whatever reductions of duties it may be possible to establish in respect to industries already in existence" (Prebisch, 1959a: 8).

[6] At the present time, the technological revolution, the growth of intra-industrial trade in services and activities involving intensive know-how and new patterns in product and marketing/exportation chains require a reinterpretation of reciprocity narrowly defined in terms of industrial product trade balances. Nevertheless, the concept remains valuable because it directs attention directly to foreign-trade structures and their effects on the pattern of development (Antonelli, 1989; Rowthorn and Wells, 1987).

In the dynamic scenario constructed by Prebisch, efficient import substitution in a broad common market would serve as a bridge for passing to a stage of mutually beneficial trade in industrial products with the centres: "[...] *the common market by helping to lower costs, might boost certain lines of industrial exports*" (Prebisch, 1959a: 8).[7] Cost reductions would, in turn, justify a reduction of average tariff levels *vis à vis* the rest of the world. This means that the common market offers the opportunity to negotiate reciprocal tariff reductions *vis à vis* the rest of the world as a trade bloc, which would be beneficial for international trade.

Nevertheless, by 1959, Prebisch observed that cost reductions for efficient import substitution had not occurred to a sufficient degree because "*since in many cases protectionist policy, in the shape of very severe import restrictions, if not bans, has been carried too far, the atmosphere of competition in the internal market has become appreciably less intense*". Therefore, "*the return to the customs tariff as an instrument of protection, the lowering of intra-regional duties in some case and their abolition in others would do much to restore the spirit of competition, greatly to the benefit of industrialization policy*: In this new environment, the gradual development of a flow of industrial exports to the rest of the world might be one of the objectives of Latin American trade policy. [...] It is thus possible to imagine reciprocally advantageous patterns of industrial trade which would have a significance very different from that of the traditional exchange of raw materials for manufactured products". Nevertheless, for that "trade policy would have to be readjusted in keeping with the new state of affairs. Otherwise, the Latin American common market would not suffice in itself to foster trade with the great industrial centres" (Prebisch, 1959a: 8-9).[8]

In 1964, Prebisch returned to this issue and argued the following: "Industrialization based on import substitution has certainly been of great assistance in *raising income in those developing countries, but it has done so to a much lesser extent than could have been the case had there been a rational policy judiciously combining import substitution with industrial exports*" (Prebisch, 1964: 21).

In conclusion, in Prebisch's view, the common market is not an end in itself but rather an instrument for facilitating industrialization and progress towards new forms of integration into the world economy based on international competitiveness and reciprocal trade in industrial products with the centres.

4. *Application of the ECLAC model in Central America*

A great number of the criticisms levelled against import substitution assume that the ECLAC strategy was tried and failed. However, in the light of the foregoing paragraphs, it is clear that, except for the central element of industrial promotion based on the regional market, the ECLAC model was not followed in Central America.[9]

First, early in the process, the principles of gradual progress and reciprocity proposed by ECLAC to guide and plan the transition towards the creation of a free-trade zone were discarded in favour of a rapid transition based on free trade behind the common foreign tariff. Therefore, the economic upswing which occurred and the cost-and-benefit distribution within the common market were thus determined by only one of the components envisaged by ECLAC in the process: the free market and the private decisions of investors. The other complementary element, which emphasized regional-level production and investment planning in order to face the problem of relatively less developed countries, was lost with this approach.

Secondly, and perhaps more importantly, the Central American Common Market foreign-trade policy in the last three decades also did not follow the strategy proposed by Prebisch and ECLAC: protection was exaggerated; incentives were not reviewed at the appropriate time; the domestic competitive environment dwindled; and industrial exports to the rest of the world were not promoted. In other words, far from being planned and adapted dynamically to new conditions, the structure of incentives remained frozen and relatively static for 25 years.

[7] This scenario was devised by Paul Krugman in his article on import substitution as export promotion, in Kierzkowski (1984).

[8] With respect to the increase in industrial exports to the rest of the world, Prebisch noted, in 1959, that "this is precisely what is happening to the countries of Western Europe in the market of the United States. What is more, some Asian countries are currently developing textile exports to European countries" (Prebisch, 1959a: 8).

[9] Various analysts of the Central American integration process have arrived at this conclusion. For example, Eduardo Lizano (1980) notes that there is a domestic policy, followed for years, that has nothing to do with the ECLAC model. Alfredo Guerra-Borges (1988: 19) argues that "the final decisions moved away from the original CEPAL ideas completely". Bulmer-Thomas (1989) notes that the CMCA problems arose more from ineffective policies than from import substitution *per se*.

Thirdly, the domestic market too was not sufficiently enlarged by redistributive, agrarian and other social reform policies, as had been proposed by ECLAC. Finally, the objective that integration would serve as training for competitive participation in world markets was fulfilled to the extent that the current industrial estate and acquired technological skills are precisely the basis for the development of export capacity in the 1990s. However, the crisis of the 1980s destroyed part of that training and learning.

It can be argued that a good number of the problems which marked import substitution in the Central American Common Market framework were not due to the ECLAC model, but rather arose from not following its recommendations. Far from being supplanted by history, the original ideas of Raúl Prebisch on trade policy, ways of efficiently combining economic integration with international competitiveness, the common market and the industrial exports to the rest of the world, are still relevant and can serve as a source of inspiration for reconsidering the development and economic integration strategy under way in Central America.

There are several reasons for moderate optimism as regards Central American development and economic integration in the 1990s.

The first reason is that, in political terms, the progress achieved by Governments in the areas of peace and democracy has strengthened faith in the outcome of dialogue and negotiation and in the determination of those Governments to continue efforts along genuinely Central American lines.[10] Overcoming serious obstacles, the efforts of the 1980s culminated in the Esquipulas I and II meetings, at which, apart from reaffirming their decision to be masters of their own destiny, the Presidents of Central America assumed formal commitments with respect to amnesty, cease-fires, the consolidation of peace, arms limitations, democratization and free elections, civil and political rights, care of displaced persons and refugees, and acceleration of development. Since early 1989, there have been free elections in five countries. There has never been such democratic and political uniformity nor a greater peaceful situation as in the last decade, although the situation is certainly vulnerable in several countries.

The second reason for optimism is the decision of Governments to concentrate on development, together with the opportunities arising from radical changes in the international economy. At the meeting held at Montelimar, Nicaragua, on 3 April 1990, the Presidents of Central America reaffirmed the thesis that peace, democracy and development are inseparable and decided that, in view of the progress due to the success of the first two factors, the time had come to concentrate attention and energy on the third, i.e., on development and economic reconstruction, to which end they met again in Guatemala, in June, at an economic summit dedicated exclusively to that issue.[11]

As the Sanford Commission report notes, starting from the Esquipulas II agreement, Central Americans have made an extraordinary effort to coordinate measures and proposals. This process, which includes activities ranging from presidential and vice-presidential meetings to regional caucuses of numerous private associations, reflects enthusiasm for integration and has laid some foundations for institutionalized coordination among Governments (INCEP, 1989). The summit adopted the Central American Plan for Economic Action which includes the following commitments and guidelines, some of which are analysed below:

To establish the new regional payments system and implement the Central American Programme for the Elimination of Trade Barriers, both of which have already been formulated and negotiated and are ready to operate;

To promote a physical infrastructure construction and reconstruction programme which will support trade integration, with a view to comprehensive inward-looking and outward-looking development;

[10] Guido Fernández (1989) offers an insider's view of those efforts, particularly of the genesis and development of the Peace Plan of Dr. Oscar Arias, President of Costa Rica, which served as the basis for the Esquipulas I and II agreements.

[11] Together with the respective Ministries of Economy, different integration bodies and ECLAC, as Technical Secretariat to the interinstitutional commission, played active roles in preparing for the meeting and formulating the Governments' approach to the issue. See ECLAC (1990b), the document drafted by the Interinstitutional Commission for the Fulfilment of the Decisions of the Central American Isthmus Economic Cooperation Committee, whose members are: the Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA), the Central American Bank for Economic Integration (BCIE), the Central American Monetary Council (CMCA), the Central American Research Institute for Industry (ICAITI), the Central American Institute of Public Administration (ICAP), the Institute of Nutrition of Central America and Panama (INCAP) and ECLAC.

To tighten regional coordination of external trade, foreign investment and tourism, including coordinated action for joining and participating in GATT;

To promote consensus-building, consultation and participation processes among Governments and various social sectors;

To promote a gradual and selective industrial retrofitting policy at the regional level;

To support the transformation of State enterprises, encouraging broad-based stock ownership and economic democratization;

To set a three-month deadline for formulating a coordinated agricultural policy;

To set a six-month deadline for formulating a regional policy and programme in science and technology which will support the new joint strategy *vis à vis* third markets;

To promote coordination of macroeconomic adjustment processes;

To promote social compensation programmes for economic adjustment;

To establish a consultation and coordination forum on foreign debt.

A third reason for optimism is the willingness and interest of the Central American business sector, increasingly more organized and coordinated, to make progress on the issues included in the Central American Plan for Economic Action and even to move beyond it. At the economic summit, the business sector, regionally participating in the Federation of Central American and Panamanian Private Entities, proposed to the Central American presidents: the creation of a Central American economic community through the adoption of a regional social and economic development strategy; the development of a joint project among the public and productive sectors and regional agencies in order to devise and operate the Central American economic community; and the integration of Panama into that community (Federation of Central American and Panamanian Private Entities, 1990).

The new bases for the integration process emerging from the technical process and the dialogue can be summarized as follows:

Integration for entry into world markets. Integration must be reconsidered so as to make it functional for, and complementary to, a strategy based on international competitiveness and on greater integration of the Central American economies into world markets. Perhaps the most important proposition of the Central American governmental and private sectors, and which was reiterated by them at the economic summit, is economic integration, defined on new bases, that is compatible with and functional for this new strategy. As mentioned earlier, for Prebisch the gradual and negotiated incorporation into increasingly wider commercial relationships is the key to progress. The Prebisch or ECLAC strategy did not conceive the common market as an end in itself but rather as an instrument for facilitating progress towards *new forms of integration into the world economy based on international competitiveness and reciprocal trade in industrial products with the centres.*

It can be argued that, owing precisely to the industrialization achieved by the Central American Common Market, and in spite of all its limitations and the ground lost in the 1980s, in the 1990s Central America may be able to benefit from such greater integration into the industrial centres anticipated by Prebisch. This topic is developed in section IV.

Global plans versus consensus-building. All-embracing approaches and comprehensive programmes, with their inherent danger of exaggerated abstraction and grandiosity, must be set aside, together with the lineal models of classic economic integration theory, which proposed successive stages of progress towards increasingly greater integration. This perspective must be replaced by a more versatile rationality and a more pragmatic approach which will take into account the diversity of existing conditions, respect national strategic policies and seek to achieve partial advances, through persistent encouragement, towards consensus-building processes which reveal areas for joint action.[12] Consensus-building, inside and among countries, encompasses a whole style of planning and is the basis for making a regional development programme viable through integration. As ECLAC has noted:

[12] This approach has been proposed by various analysts. See Guerra-Borges (1988), Lizano (1989), ECLAC (1990).

"There would seem to be a need to further improve and consolidate what already exists, move forward where possible [...] and continue to consolidate a network of integration efforts rather than trying to respond to the preconceived notion that commitments must be fulfilled in linear order until a final goal is reached" (ECLAC, 1990a: 158).

Realistic expectations. Integration must be seen as a process of support for national strategic policies and domestic efforts, and not the opposite. Several authors have noted that the common-market crisis was more a crisis of expectations than of achievements (Rosenthal, 1983; Lizano, 1989; Fuentes, 1989). Too high hopes were vested in the integration process and it came to be thought of as synonymous with development, when actually integration could not solve problems for which it was not conceived. As a result, the problems of Central American societies and economies led to disenchantment with integration which, in its turn, generated a series of myths and misconceptions about the "evils" of integration: unequal income distribution; persistent concentration of land ownership; penetration by transnational corporations; excessive protectionism; and other phenomena which, as Fuentes has noted, would have occurred to a greater or lesser degree with or without the common market (Fuentes, 1989: 19). The solution to many devel- opment problems depends, in the first place, on domestic economic and social policies, which integration and joint action can support but never replace.

Defined in these new terms, integration can be effective for the new development strategy based on international competitiveness and greater integration into world markets, for two sets of fundamental reasons.

First, a symbiosis between regional demand and the demand of other markets may be generated to the extent to which trade among common-market countries is significantly reactivated and certain aspects of macroeconomic policies are brought into harmony. This can occur in various ways: i) for a series of already established import-substitution industries, the regional market would allow for covering a high percentage of fixed production costs and exporting at marginal costs; ii) the regional market may serve as a testing ground for innovations involving products and processes at less cost and risk so that extraregional markets are penetrated at a second stage; iii) the regional market offers greater complementarity and specialization opportunities than individual economies for developing and exploiting comparative advantages; and finally, iv) a wide field looms ahead for joint action to improve regional competitiveness, for example, in joint export schemes, selective investment acquisition, shared use of duty-free zones, improvement of common infrastructure, development and strengthening of regional science and technological policy, development of a regional market for specialized consulting services, coordination of agricultural policies, capital and labour mobility, etc.[13] Some of these actions in support of competitiveness are described in section V.

Secondly, joint action gives strategic advantages in negotiations on trade, finance and international cooperation with other countries or economic blocs –advantages that are difficult or impossible to obtain on a basis of individual negotiation. In section IV, the advantages of joint strategies for integration into world markets are analysed.

Beforehand, however, it must be emphasized that a prior condition for advancing toward regional development through integration is the reactivation of intraregional trade in the short term, the prospects for which are reviewed below.

[13] See Rodríguez (ed.) (1990a) and ECLAC (1990a).

III
Reactivation of intraregional trade

Reactivation of Central American Common Market trade depends on several basic factors: first, on success in increasing the inflows of foreign currencies; second, on restoring the smooth operation of the system of payments and free convertibility; third, on dismantling or significantly reducing the trade barriers which Central American countries applied in the 1980s. The last two factors form part of the Plan for the Reactivation of Intra-Central American Trade, agreed upon by the Central American and the European Economic Community countries.

1. *Increasing the foreign-currency supply*

In spite of the degree of industrialization achieved, the region is still specializing very largely in primary products and it is clear that the dynamics of its growth are still rooted in the pace of its primary-export growth (Siri, 1980). A drop in export earnings soon puts pressure on the domestic financial systems, depleting foreign-currency reserves and reducing real demand, imports and intraregional trade.

For this reason, the acquisition of foreign currencies through exports of traditional (bananas, coffee, meat, cotton, sugar) and non-traditional (melons, ornamental plants, papayas, pineapples, etc.) primary products is the key to maintaining the level of intraregional activity and trade within the integrated market, and is also in line with the comparative advantages deriving from the natural resources of the region. In Nicaragua, for example, one of the quickest ways to acquire foreign currencies and provide employment is to restore its capacity to export traditional products. Costa Rica, in spite of the rapid growth of its non-traditional exports in response to the incentives applied for these exports, has implemented a plan to promote banana production aimed at increasing foreign sales from 60 million to 90 million cases and is continuing with the programmes to improve the productivity and quality of its coffee and other products.

The foreign-currency supply will also be greatly helped by daring schemes for reducing the debt burden.[14] Costa Rica recently set a precedent by buying back a large part of its debt with commercial banks under the Brady Plan. One component of the Bush initiative is concerted action in this area. The Central American Plan for Economic Action provides for the establishment of a regional-level consultation and coordination forum to deal with the external debt.

2. *New system of payments and settlement of intraregional debts*

The Central American Monetary Council (CMCA) and Central American economic authorities have been considering various proposals in this connection.[15] With the technical and financial assistance of the European Economic Community, there are now two basic mechanisms: a new Central American Payment System, beginning operations in October 1990; and a Special Foreign-Currency Fund for relatively less developed countries with chronic intraregional trade deficits (Nicaragua and Honduras).

With the assistance of the United Nations Development Programme (UNDP), the Central American Monetary Council is working on a solution for the problem of old accumulated debts, which the Governments agreed to deal with separately from the new Central American Payment System.

This new system reactivates the Central American Clearing House, but in a new configuration acceptable to all member countries. The system is supplied from two sources of funds: an Intraregional Export Support Fund of 120 million European monetary units provided by the European Economic Community, which will finance part of the foreign-currency requirements per extraregional imported component of the regional enterprises which export to the region; and a network of credit lines among participating central banks. A "quota" is being established for each bank which sets the maximum debit or credit allowed to each member bank. Monthly multilateral clearing balances are financed

[14] On the indebtedness of Central American countries, see Feinberg (1989) and Caballeros (1987).

[15] These include: the Central American Import Law; the Parallel Mechanism; and the Special Fund for Intra-regional Trade. The description of the Central American System is based on a document of the Central American Monetary Council (1990), the Framework Agreement for the Reactivation of Intra-Central American Trade, and conversations with Carlos Luis Solórzano of the Monetary Council, to whom we are grateful for clarifying this matter.

by creditor banks of the system through "automatic loans". Each monthly clearing period, debt balances are limited to an eighth of the respective bank's quota.

The limit for automatic loans to any one bank is equivalent to that bank's quota. However, before reaching that limit, the bank may apply for a "special loan" from the Monetary Council responsible for administering the system, which involves a detailed analysis of the economic situation of the country concerned, and of its adjustment efforts in relation to its regional trade partners. The special loans, which are also limited to the amount of the quota, are to be used in their entirety to pay off automatic loans so that the bank concerned can continue to operate in the system as before.

The foreign-currency resources of the Central American Payment System are used in exchange operations for national currencies in the following manner: 10% of the payments for exports channelled through this system in each monthly clearing period is deposited payable to the central bank of the exporting country to account of the Intraregional Export Support Fund. Each central bank, on receiving funds from the Support Fund, will proceed to credit the equivalent amount in its national currency to the Central American Payment System. All the holdings generated in this way constitute the Counterpart Fund. Automatic loans are financed chargeable to the network of credit lines, while the special loans are financed chargeable to the Counterpart Fund.

The new Central American Payment System has several advantages: i) it separates the problem of old debts accumulated among countries from the new payment system. The problem of accumulated debts is attacked with another instrument; ii) it manages creditor-debtor relations multilaterally so that each central bank is a debtor or creditor of the System and not of other banks, with the result that the bilateral friction which affected Clearing House operations in the past is avoided; iii) it is supported by a foreign-currency fund, the Intraregional Export Support Fund, which helps countries to cope with the imported component associated with their exports; iv) it programmes the financing of resultant balances and allows for debt rescheduling under a system that permits "suggesting" adjustments to the macro-economic policy for each country in terms of its trade results; v) it promotes exports to the region via specific incentives in the form of foreign-currency availability, to be complemented by the Special Foreign Currencies Fund.

The Special Foreign Currencies Fund, with an initial supply of 30 million European monetary units to assist the relatively less developed countries with chronic intraregional trade deficits, is equipped with a mechanism for strengthening the productive sector, increasing its exports, and thus reinforcing the soundness of the Central American Payment System and encouraging the gradual elimination of trade barriers. It will finance the working capital and the purchase of extraregional inputs for enterprises and activities capable of improving the exportable supply.

3. *Programme for dismantling trade barriers*[16]

This programme, the immediate implementation of which was approved at the economic summit as a preparatory step towards bringing the Central American Payment System into force, includes, *inter alia*, the following commitments together with a defined schedule for implementation:

- A realistic and non-discriminatory exchange rate shall be established between the Central American peso and the respective national currencies.
- Costa Rica, El Salvador and Guatemala undertake to revoke the provision of not selling foreign currencies for imports coming from Nicaragua; and Costa Rica, El Salvador and Honduras undertake to revoke the provision requiring prepayment for exports to Nicaragua.
- In all member countries, the central bank permits of licenses required for imports and exports to and from Central America paid for through the Central American Payment System shall be revoked. Moreover, these transactions shall not be subject to advances or to prior or guarantee deposits.
- The bilateral trade agreements between Honduras and the other countries shall become multilateral by the end of 1992 for the purpose of achieving free trade in accordance with the General Treaty for Central American Economic Integration.
- Quotas and other quantitative controls on products originating in Central America and all import surcharges affecting intrazonal trade shall abolished and no further controls of this nature shall be established.

[16] See annex 3 of the financing agreement between EEC and Central America, 30 April 1990.

— Finally, there is a series of commitments: to eliminate non-tariff trade barriers relating to transport; to improve physical installations and communication facilities; to simplify frontier-post formalities; and to coordinate standards, regulations and procedures relating to animal and plant health control.

IV
The strategy of economic openness and entry into world markets

The objective of greater Central American economic entry into world markets calls for reflection and strategic decisions on the part of the Central American Governments and private sectors. The international economy is experiencing the most rapid and profound political, economic and technological changes since the Second World War. One aspect of this process is the formation and strengthening of worldwide consumer and producer blocs. The reunification of Germany and the opening up of the countries of Eastern Europe, plus the European Economic Community programme for 1992, are strengthening and expanding the European bloc enormously, giving it new competitive advantages. The 1992 plan alone constitutes an integrated common market of nearly 380 million people. In Asia, a commercial bloc, with Japan and the "small tigers" in the lead, has been taking shape, with a second line of export platforms (China, the Philippines, Thailand, Indonesia, Malaysia), whose competitive advantages have been a source of friction with the United Sates and Europe.[17]

The challenges presented at the global level by the formation of these economic blocs has prompted the United States to reinforce the economic and strategic ties on its own continent. On the one hand, a North American bloc is being formed by the Free Trade Agreement (Canada-United States), into which the second largest economy of Latin America, Mexico, will be incorporated, according to recent announcements. On the other hand, on 27 June 1990, the United States Government proposed the Enterprise for the Americas, supported by three pillars: trade expansion, increased investment and reduction of the debt burden. As for trade, the latest proposal calls for the formation of a continental free-trade zone, immediately making partial advances to dismantle trade barriers through bilateral and subregional agreements and concerted efforts in GATT. The text of the Bush initiative states that such far-reaching changes may require years of preparation and difficult negotiations, but that the reward, in terms of mutual prosperity, is well worth the effort (Bush, 1990).

What are the implications of all these changes for Central America and how can they be put to the best advantage? Should every effort be made to consolidate a single Latin American common market or is it more to the advantage of Central America and the Caribbean in the immediate future to redefine the terms of its integration into the North American bloc, now enlarged by Mexico, without prejudice to attractive trade and financial schemes with the rest of Latin America? What is the role of trade and financial relations with the European and Asian blocs? These are some of the most relevant questions today and are the subject of the following commentary.

1. *Adjustments in trade strategy*

In the 1980s, Central American integration into world markets was characterized by individual and unilateral policies of openness and trade liberalization, in some cases under programmes of structural adjustment individually negotiated with international agencies, and by a rather passive group movement towards greater integration into the North American bloc, based on the Caribbean Basin Initiative. It can be argued that both elements constitute a relatively inefficient strategy of integration into the world economy and, at the same time, that Central America would benefit from the following adjustments in its trade strategy: joint negotiation of its economic openness strategy *vis à vis* other trade blocs and within GATT; greater economic integration with the United States and the North American bloc, but within a framework different from that of the Caribbean Basin Initiative.[18]

[17] See Ernst (1989), Gereffi (1989), Hillcoat and Quenan (1989), "Reshaping Europe", *Business Week*, December 1988.

[18] The Caribbean Basin Initiative has been evaluated by Ray (1987), Tucker (1989), Rodríguez and others (1989) and Salazar and Vargas (1989).

With respect to the first element, it is to be hoped that, in the 1990s, the openness and trade liberalization processes of all Central American economies will continue, since they are part of the new strategy to promote exports adopted by all countries of the region. However, inasmuch as openness is achieved unilaterally, the opportunity to negotiate beneficial trade and financial concessions with the North American bloc would be lost. Mexico, for example, unilaterally liberalized its economy and, by doing so, lost part of the negotiating power it would have had if, instead of liberalizing, it had negotiated concessions from the United States within the framework of the recently announced trade agreement. A similar argument can be made for incorporation into GATT and participation in the Uruguay Round.[19]

Moreover, the diverse evaluations of the commercial repercussions of the Caribbean Basin Initiative coincide in noting how limited this scheme is as an instrument for promoting industrial and agricultural exports from Central America and the Caribbean to the United States. Salazar and Vargas (1988: 219) find that, five years after implementation of the plan, exports to the United States from the countries that signed the Caribbean Area Economic Recovery Act are on the decline. Ray (1987) argues and demonstrates that the Caribbean Basin Initiative is not managing to promote imports of consumer goods and agricultural products of the region, while systematically discouraging imports of textile products. Tucker (1989: 361) concludes that it was hoped that, with the Caribbean Basin Initiative and the consequent collapse of trade barriers, the full economic potential of the region would be realized. He adds that, unfortunately and unsurprisingly, the "unblocking" of trade has produced minimum results.

Motivated in part by these limited results, Stephen Lande and Nellis Crigler (1990) recently presented an innovative proposal consisting in the transformation of the Caribbean Basin Initiative into a fair trade agreement with the United States, which would transform the relation with that country from a donor/recipient relationship into a strategic economic alliance. The following are some further reasons which would justify that strategic decision:

[19] See SIECA (1988), De La Ossa (1988) and Lobo (1987).

a) Although the recently announced Bush initiative calms the fears of a possibly diminished private and public United States interest in the region, Lande and Crigler detect tendencies in the international economy which may make investing in Central American countries less attractive. The opening up of Eastern Europe poses a threat, to the extent that those countries have wage levels which are competitive with those of Central America, a skilled labour force, a relatively developed industrial base and access to the integrated European market, all of which makes them attractive to investment from the United States, Europe and Japan, thus limiting resources which, in other circumstances, could be invested in Central America. Moreover, as the Sanford Commission has repeated, there is the possibility that, once the hostilities are over, external economic assistance will be suspended and the doors now open to Central American exports will be closed, because the region will then no longer constitute a zone of geopolitical crisis (INCEP, 1989).

b) Secondly, unless the Central American countries together exercise their negotiating power, their region's share in obtaining trade preferences could be reduced by the extension of similar preferences to the countries of Eastern Europe and Mexico, and by other sweeping concessions made in the context of the Uruguay Round. Moreover, this share could be limited by the Bush initiative itself, to the extent that other Latin American countries carrying greater economic and political weight make use of the plan. This shows the importance of carrying out joint negotiations and of establishing mechanisms that will increase Northern bloc and European Economic Community preferential treatment of the Central American region, within the context of the GATT.

To sum up, joint negotiation of trade openness within the framework of an agreement, be it a "fair trade" agreement as Lande and Crigler propose or a variation thereof the context of the Bush Plan, would have several advantages:

— It would allow for coordinating the economic openness processes and achieving, in exchange beneficial concessions for the region, thus improving the preferential treatment of the Central American region with the Northern bloc and, potentially, other economic blocs.
— It would ensure an orderly transition, with frequent consultation of the Central American private sector, which would take increased

competitiveness into account when gauging the pace of openness.

- It would avoid the vulnerability and asymmetry of schemes such as the Caribbean Basin Initiative which, while making unilateral concessions, also allow the "donor" to eliminate or modify such preferences unilaterally.
- The foregoing factors would generate greater security in trade and economic relations and a better climate for investment than would be achieved by individual and uncoordinated openness processes.
- It would allow for periodic reviews and renegotiations which would improve the agreement benefits and include other issues such as investment, non-tariff barriers and financial assistance.

2. *Technology and patterns of global and regional integration*

The tendency towards creating consumer and producer blocs is the result not only of geopolitical but also of economic and technological factors. The current technological revolution, based on information, know-how, flexibility and adaptability, demands a revolution in the forms of organization for extracting the maximum benefit from the new technologies. The impact of this revolution is of such magnitude that it is argued that we live in a period of transition to a new techno-economic and organizational pattern with which new managerial and organizational models are associated and which demands global social changes. There are several interpretations and a full debate about the implications of this new pattern for peripheral countries, their possibilities of closing the technological gap and the way in which they can adapt themselves successfully to the opportunities being created by the rapid comparative and absolute advantages caused by the new technologies (Ernst, 1989; Antonelli, 1989; Pérez, 1988).

The most optimistic outlook[20] suggests, especially for countries which have already achieved a certain level of industrial development and are equipped with a critical mass of skills and knowledge in their labour force, that the new technologies and the period of transition between models open "windows of opportunity" for "skipping over stages" and joining the current industrial revolution even though they missed the previous one.

[20] Antonelli (1989); Pérez and Soete (1988).

Competitiveness in many products and dynamic sectors is increasingly more often based on factors unrelated to price (design, innovation and product differentiation) and demand (quality). At the same time, the traditional factors of supply (economies of scale, mass production and lines of homogeneous goods) are completely redefined in the new model. For example, the scale of factories is, in many cases, independent of market size. It is possible to achieve very high levels of efficiency while manufacturing a wide array of different products, with frequent changes of model and variable volumes. This transforms the factors that determine competitiveness and redefines the barriers to entry, lowering them for many products and processes, which makes the proliferation of highly competitive small and medium-sized businesses possible. Activities which acquire great importance are: "economies of scope" (optimization of the range of products), "economies of place, time and motion" (based on proximity, response speed, integration of design-production-administration phases, "just in time" management of inventories and of delivery, etc.), and "economies of specialization" (based on narrow market segments).

The current transition toward a new techno-economic and organizational model raises two important issues for the strategy of productive transformation and integration of Central America into the world economy.

First, optimism with respect to the possibilities of encouraging the spread of technical progress and technological development in Central America is justified. Propagation of the new model throughout the production system requires the conversion and restructuring of the well-established industries in the developed countries as well: established products are redesigned, new products and industries emerge, important parts of the present industrial estate become technically and organizationally obsolete. In other words, the requirements of the technological learning process and industrial retrofitting are felt not only in developing countries but also in developed countries. Pérez and Soete argue that, during transition periods between models, there are two types of conditions conducive to closing the technology gap. First, there is time to learn while all the others are learning; second, given a reasonable level of productive capacity and an advantageous site, together with an adequate supply of human resources skilled in the new technologies, a temporary window of opportunity is opened, with low barriers to entry where this is most important (Pérez and Soete, 1988: 477).

Second, these technological factors influence the formation of economic blocs linking centres and peripheries situated near to each other, and they determine the international competitiveness of regions such as Central America and the Caribbean basin. The main centres of global growth and innovation will continue to be in the blocs of developed countries; nevertheless, according to the technological outlook suggested here, if Central American internal conditions are sufficient for coordinated trade negotiation efforts to be made and for efforts to be focused on development and integration, greater integration into these blocs –especially the North American bloc– could boost the region's economy and improve its possibilities for growth and development.

V

Joint action for the development of international competitiveness and the conversion of productive sectors

Greater integration into the world economy presents not only opportunities but also threats. It is possible to lessen the impact of the transition and to make the most of these opportunities through coordinated action in the public and private sectors to hasten the transformation of productive sectors and encourage international competitiveness and interlinked production. Joint Central American fields of action towards these goals can be grouped into several categories: action to harmonize motivating systems and other market policies; action to use economic integration as a source of competitive advantages through specialization and productive complementarity; action to develop structural competitiveness; and action to promote efficient import substitution and conversion of the industrial base.

1. *Harmonized incentives and market policies*

The liberalization of intraregional trade can find itself limited or distorted, if active steps are not taken to harmonize incentives, together with passive measures such as dismantling tariff barriers. Active steps are important in the following areas:

a) *Non-tariff barriers*

As noted above, the Programme for Dismantling Intra-regional Trade Barriers includes a number of commitments to dismantle non-tariff barriers connected with obstacles to transport; improvement of physical installations; communication facilities and speeding up frontier-post formalities; standardization of rules, regulations and procedures for animal and plant health control. Fulfilment of these commitments is important for the free movement of merchandise in the region.

b) *Export incentives*

Lack of harmony in this area can have a number of negative consequences: countries with fewer incentives will be less attractive for investment; there is the risk of wars incentives to attract more investment; intraregional trade flows may be distorted toward the exploitation of the benefits accruing from the use of those countries offering greater incentives as a base for exporting.

c) *Common external tariff*

At the present time, the common external tariff has two problems: uniformity was broken by measures taken by individual countries (e.g., surcharges, duties, excise taxes, duty-free treatments, etc.) and the tariff level is ineffectual because it has not been adjusted to the requirements of export promotion and efficient import substitution. These objectives make it necessary to bring down the common external tariff gradually to a low and uniform level.

2. *Mechanisms for exploiting the competitive advantages of specialization and complementarity at the regional level*

Gereffi (1990) distinguishes four roles, played by recently industrialized countries in the world economy, which are useful to bear in mind when contemplating the Central American export strategy, the relations between economic integration and exports, and possible avenues for joint action in the area of exports and the promotion of investment. These are the roles of exporters of primary products; export platforms (foreign-owned, labour-intensive manufactures processed in duty-free zones); international subcontractors (consumer goods, finished on the part of enterprises whose output is distributed and marketed by the main centre and its agencies, the principal niche occupied by the recently industrialized Asian countries); suppliers of components (production of components in the capital-intensive and technology-intensive peripheral industries for subsequent export and final assembly in the central country; a characteristic of this procedure is that it generates a higher degree of technology transfer).[21]

a) *Combined exports*

Combined Central American exports can help to generate competitive advantages and production-export-marketing chains in several ways:

i) As regards economies of scale, it could be possible to have available minimum quantities of some products for a large volume of trade that is beyond the reach of a single country; in other cases, a relatively high output could even allow Central American enterprises to adopt dynamic trade strategies, especially in the case of some non-traditional agricultural products for which the countries have similar comparative advantages.

ii) The differences in information, contacts and external trade experience among Central American countries, especially the advantages of those more advanced in the export process, can be put to good use (through fairs, conferences and other information exchanges) for mutual benefit instead of being a source of competition among entrepreneurs in related fields. In the case of many products, the size of overseas markets offers Central American entrepreneurs opportunities to leave their competitive behaviour behind and begin to collaborate.

[21] In the last 15 years, the front-line recently industrialized Asian countries (the Republic of Korea and Taiwan) have been yielding their role as export platforms or processing zones established on the basis of low wages to China, the Philippines, Thailand, Indonesia, Malaysia, and have achieved greater success as international subcontractors and component suppliers.

iii) It is easier to exploit the advantages and benefits of specialization at the regional level than in individual countries. Liberalization of intraregional trade opens up opportunities for subcontracting export schemes at the regional level, either through leading enterprises in each country under new joint export schemes or in conjunction with foreign capital. These schemes are more advantageous than export platforms based in duty free-zones, because they are less vulnerable to changing costs and open the way to production of exportable goods that make intensive use of technology and are very specialized. In other words, economic integration offers competitive advantages to countries which opt to serve as suppliers of components. Separately, those countries would probably tend more to serve as export platforms based on in-bond assembly.

b) *Studies, information and follow-up*

A first step toward achieving the above would be to carry out in each country a series of detailed and comparative diagnoses in each subsector for the purpose of identifying, on the one hand, complementarity possibilities and, on the other, the potential leading enterprises which, in each subsector, could make the export grade and coordinate regional subcontracting. Several studies of this kind have already been carried out by the Permanent Secretariat of the General Treaty for Central American Economic Integration (SIECA, 1986). A second step would be to bring the entrepreneurs in branches having the greatest identified potential together in order to discuss possible specific joint export projects and the coordinating mechanisms necessary in each case. The Federation of Central American and Panamanian Private Entities has plans to proceed in this direction (Rodríguez, 1990b).

The data bases of such institutions as CINDE, in Costa Rica, and FUSADES, in El Salvador, are very useful for identifying enterprise networks which could participate in sectoral joint export initiatives in the Central American region. However, the export effort implies creating and coordinating the capacity to compile and transmit information, to follow up and to prepare technical studies in each country.

These information and follow-up systems can also include exchanges for joint ventures, sectoral strategies and cases of industrial restructuring. Availability of the means necessary for exchanging experiences and information on competitive and retrofitting strategies, at the subsectoral and specific enterprise level, would strengthen these processes in the region.

c) *Flexible specialization and subcontracting at the regional level*

The success of the industrial districts in Italy, formed by networks of small and independent enterprises organized on the basis of an external division of labour among them, is a model which teaches important lessons about production organization and the export potential of Central America as a whole. This model has been very competitive in international markets, offering distinctive and innovative products at low prices. A shared characteristic of these districts is the stability of their social environment: all are linked to areas with long traditions of craftsmanship in specific sectors, together with a solid agricultural base and an array of trade-related activities. All are near middle-sized towns, with good study and training centres, connected by highway networks. Local government assistance in infrastructure has been substantial in some cases: several textile districts have opened centres for design and forecasting fashion trends; in several cases, export consortia have been promoted; in most cases, the leading enterprises determine production standards, control quality and organize the strategic aspects of production, distribution and marketing.

In fact, the strategies for the industrial reorganization of large European and United States enterprises have included the decentralization and subcontracting of products and processes. Industrial subcontracting allows an enterprise to acquire parts or intermediate goods at a lower cost than if it produced them itself, because it avoids investment in space, machinery and equipment, raw materials and working capital. Other benefits include greater quality control and greater flexibility in the light of changes in technology and in the quantities and characteristics of demand.

Useful mechanisms for promoting regional subcontracting in Central America are the subcontracting exchanges. Carlos Martín Alcalá (1990) has analysed some of their operational characteristics, defining them as intermediary entities, generally in the private sector, often linked to an industrialists' trade association. He adds that the Central American countries are among those which have most need of these subcontracting exchanges, precisely because their industries, for the most part, grew vertically, "doing a bit of everything". These exchanges can be an effective mechanism for retroffiting, contributing to the modernization of networks of small enterprises and exploiting to the full the advantages of flexible specialization at the regional level.

CINDE, in Costa Rica, is developing subcontracting schemes among the leading enterprises in the textile and metal-transforming industries. Rodrigo Ortiz (1990) and Elmer Arias (1990) have stressed the potential advantages of developing Central American complementarity through subcontracting schemes. For example, in the metal-transforming sector El Salvador has a number of processes more developed than in the rest of Central America: basic aluminium and iron industries, metal-extending processes, casting and light forging processes. Costa Rica, in its turn, has advantages in in-bond assembly and precision engineering. A subcontracting exchange for the metal-transforming industry would have information on the types of products and the advantages of each country and would make that facility available to all the other countries of Central America. In this way, as Rodrigo Ortiz (1990) notes, if an entrepreneur arrives in Costa Rica wishing to make telephones, it can import plastic products from Mexico, buy wire in Costa Rica, and El Salvador and Honduras can make their contribution. In those conditions, any telephone manufacturer will be interested in producing them in Costa Rica, instead of going to Taiwan.

The subcontracting schemes for exports or the regional market, to be used by leading enterprises, whether assisted by private institutions such as FUSADES in El Salvador or CINDE in Costa Rica, or developed through subcontracting exchanges, have intraregional free trade as a prerequisite. In this sense, economic integration means progressing towards forms of production, of exportable supply and of products and processes which make intensive use of technology and are very specialized. This is to say that integration offers greater opportunities for surpassing the in-bond assembly stage and exploiting the competitive advantages associated with flexible specialization and the supply of components by Central American enterprises. To the extent that important sectors of small and medium-sized enterprises are made to participate, progress would be made towards greater equity in regional development.

d) *Complementarity and s pecialization in duty-free zones*

It was recently suggested that the complementary export effort in Central America could be begun more rapidly through duty-free zones. On this point, Ortiz notes that the advantages are obvious because new legislation would not be necessary; no talk of treaties is necessary nor must projects be submitted to the legislative assembly of any Congress; nor are bilateral agreements required; nor would balance of payments arise because payments would not have to pass through the Central American Clearing House. Moreover, employment would rise, which is the goal in these times, foreign investment would increase, as the countries of the region and the region as a whole became more attractive, exports would increase and joint enterprises would emerge (Ortiz, 1990).

e) *Investment promotion*

The goals of international competitiveness, greater coordination of the production apparatus and regional complementarity, together with clarification of the economic functions perfomed by recently industrialized countries in the integration of the world economy, as described by Gereffi (1989), constitute a solid basis for defining dynamic and selective criteria to guide investment-promoting policies. In this way, it will be possible to arrive at a set of temporarily selective criteria for guiding the productive transformation of each country and the region as a whole.

Rodríguez (1990b) proposed three major centres of specialization for Costa Rica and, more recently, offered them as a working hypothesis at the regional level (Rodríguez, 1990b). The first centre consists of the metal-transforming, electronics and plastics industries. This includes a wide spectrum of products and processes which combine products from the three sectors, contains a high percentage of leading categories in the world market's expansion and offers ample opportunities for complementarity and regional specialization. A second specialization centre consists of farming, agro-industry and the production of inputs and machinery for these two sectors. The third comprises the service sector, especially information science and tourism. Selective investment promotion could encourage coordination of production in these three areas in a regional context. Among other advantages, this would generate competitive advantages within the integrated market more quickly than could be achieved by any one country alone; it would also surpass the in-bond assembly stage and move on to industries and processes which would make intensive use of know-how, with a greater regional content and a larger transferred-technology component in the investments. In other words, it would mean progress in Central America towards the role of first-line recently industrialized countries.

Rodrigo Ortiz, General Manager of the CINDE Investment Promotion Programme, describes the programme's evolution in Costa Rica and its progress towards this type of criteria, for which they are initiating processes of "complex contracting" and retrofitting (action to transform enterprises into efficient exporters with technical assistance in diverse aspects such as ranging from estimating prices to designing and exporting products), together with activities designed to encourage joint ventures. Ortiz comments that the model (based in the past on the in-bond assembly industry) is fragile because small wage or exchange-rate adjustments may remove a country from international competition, adding that, even though the in-bond assembly industry has been very successful in Costa Rica, other areas are being given priority over textile assembly industries, as the country is seeking for internal and regional integration (Ortiz, 1990: 4).

3. *Mechanisms for developing structural competitiveness*

Competitiveness is the guiding economic concept for the new Central American development strategy, but it is a complex concept which implies action and strategy at three levels: the individual enterprise level; the subsectoral or branch level; and the level of the economy as a whole or of various integrated economies. At the last two levels, competitiveness is greater than the average competitiveness of each enterprise and depends on a number of structural, economic and institutional factors such as scientific and technological capacity; the supply of skilled human resources; the communications and transport infrastructure; and the development of capital markets and the quality of financial intermediation. All these elements give rise to the concept of structural competitiveness and point to the systemic nature of competitiveness. Below, several types of joint action which Central American countries can take in the first and last areas are suggested.

a) *Science and technology policy*

The systemic character of technological development and of competitiveness, implying interrelationships among very diverse institutions and enterprises, suggests that emphasis for joint efforts in the area of technological policy should be placed on the creation of information networks, contacts and agreements at the regional level in order to promote an intense exchange of information, personnel, goods and services in the technological field, and the development of joint projects. Space does not allow more than a list of suggestions of the kinds of action which can be developed in this area.[22]

– Formal development commitments and harmonization of certain policies related to foreign investment, the development and standardization of technical norms, State purchases, and mid-level and higher education.

– Modernization and standardization of legislation on the protection of industrial property, which can contribute to greater technological integration. For example, simultaneous recognition of patents and brands would eliminate bureaucratic obstacles in the way of enterprises operating at the regional level. The adoption of a common position in the Uruguay Round discussions on intellectual property can be the beginning of a regional task force on these topics.

– The similarities existing among a great variety of agricultural and industrial products and the costs of research and development make the development of joint scientific and technological projects one of the most attractive areas for collaboration. These projects can give priority to such areas as animal and plant health control, quality procedures and norms for exports, biotechnology, information science, etc. State aid and subsidies for research and development are amply justified by economic theory and the experience of developed countries. This effort must include close collaboration among universities, research centres and businesses, together with legal mechanisms for guaranteeing the use and economic appropriation of the know-how generated.

– Over and above personal contact in seminars and conferences –one of the most effective mechanisms for the development and transfer of technology– obstacles should be removed and the mobility and movements of skilled personnel should be encouraged.

– Application of the powerful, modern information technologies should be promoted at the regional level in order to achieve rapid communication that will link the regional scientific and technological system internally and with the rest of the world. This system ought to include modern methods of technological forecasting.

– A regional market of specialized industrial consulting services in the areas of design, publicity, marketing, finance, engineering, etc., ought to be created and developed through the elimination of national and professional barriers to the transfer of skilled personnel, together with the creation of "contracting exchanges", registration and selection mechanisms.

– Training in the modern conduct of business and management techniques, both for private entrepreneurs and for the managerial levels of public administration, is one of the main instruments for changing attitudes and inducing the organizational changes required by the new technologies and international competitiveness.

– The technological element is central to programmes of retrofitting which should concentrate the efforts in selected sectors. The development of selective retrofitting policy, directed towards certain sectors common to several countries, ought to integrate the best human and institutional resources of the regional scientific and technological system. Costa Rica has begun a pilot project on technology and information science for retrofitting with external technical and financial support which could serve as a model for similar efforts throughout the region.

b) *Capital markets and productive investment*

Retrofitting, which in some countries means reconstruction, the development of international competitiveness and increased exports require a steady rate of investment in new generations of equipment, products and infrastructure. One prerequisite for this is the creation of a climate of greater confidence in investment and a coherent and stable macroeconomic framework. Given such conditions, foreign investment and international cooperation could play an important role in financing

[22] Several points in this section have been taken from ECLAC (1990), chapter VI, where some of them are developed in greater detail.

the new investments. However, the greater effort in the area of savings and investment should be domestic. Several areas of action are important for achieving this end:

1. The correction of fiscal disequilibria is essential for a stable monetary and exchange policy. Moreover, in terms of monetary policy and financial strategy, certain basic rules should be adopted, such as: a) establishing positive, real interest rates that will avoid distortions in the financial markets, attract more savings and promote "deeper financial analysis". However, care must be taken to ensure that greater linkage of the domestic financial system with international markets does not create instability and does not sacrifice productive sectors by maintaining upwardly distorted interest rates; b) subsidized and selective credit is a necessary instrument in certain sectors and areas, but it is sound policy to ensure that such subsidies are financed by the national budget and not by financial institutions; c) currency exchange control is justified so long as strong fiscal distortions persist (McKinnon and Mathieson, 1982); d) financial strategy ought to promote an institutional framework with a strong dose of long-term financing and improved access for small and medium-sized enterprises which characteristically suffer from segmentation in capital markets (Ffrench-Davis, 1990: 30). The most important challenge for Central American financial systems will be to render large segments of the population access to financial services.

Although monetary and fiscal policies are matters within the purview of Governments, regional coordination of macroeconomic policy can help to generalize this type of objective and rules.

2. The objective of promoting exports requires the rapid establishment of quick-acting financing mechanisms for foreign trade which will include working capital, new investments and technical support for export projects. Fitzgerald and Croes (1990) have proposed the creation of a regional fund, supported by an intergovernmental institution, to finance Central American foreign trade. This could be managed by the Central American Economic Integration Bank (BCIE) or become a new specialized financial agency. Seed capital for this fund could come from foreign-debt reconversion operations. Another alternative, in line with the search for greater economic integration into the large trade blocs, could consist in expanding the Bank's capital by incorporating the United States, European, Latin American or other countries as Bank members,[23] which would strenghten and increase international confidence, in the Bank. Another institutional framework would consist in establishing foreign-trade trust funds in each country of Central America, as is now being done in Costa Rica with the support of the United States Agency for International Development. These schemes are not exclusive. Their implementation requires technical and financial cooperation at the regional and external levels.

3. Retrofitting and the new efficient import-substitution industries, the creation of which will be boosted by revitalizing intraregional trade and lowering common external tariffs, also require financing. As a complement to national credit schemes, a regional retrofitting fund could also be considered, with suitable instalments and interest terms and the flexibility necessary for assisting specific sector and enterprise conversions. The institutional options are similar to those for the foreign-trade fund. For this fund long-term capital and indirect credit schemes for financing networks of small and medium-sized businesses, in support of the subcontracting schemes outlined above, is of particular importance. In this way, the retrofitting fund could function as a "second-floor bank"[24] for credit transacted directly by non-governmental and professional institutions in each country.

4. The process of upgrading capital markets and financing industrial modernization must not be limited to payment and credit mechanisms. It is important to promote, on the one hand, greater integration by developing and strengthening national stock exchanges and, on the other, new sources of savings and financing, by encouraging the development of stock markets. In Central America, there are only two national stock exchanges which deal almost exclusively in fixed-income-bearing securities: that of Guatemala, in operation for only two years, and that of Costa Rica, 12-years-old, with a daily trade volume of about US$12 million. However, the registered stock of only 40 companies is traded in the latter market and stock transactions account for only 1% of the total transactions. There are informal markets in the other countries and national stock exchanges are being formed in El Salvador and Honduras.

[23] Taiwan recently made a capital contribution as an extraregional member of BCIE and advanced talks are under way with Spain and Germany.

[24] This scheme was proposed by Olaso (1990) and Salaverri (1990) to finance retrofitting in Costa Rica.

The free movement of capital through stock exchanges and stock markets is a long-term objective which, however, opens up a very wide field for joint action, including the upgrading and coordination of tax incentives for opening up the capital of regional enterprises; the creation of institutions specializing in technical and financial services for subscribing to shares; the creation of cash funds to activate the primary and secondary stock markets; legislation to protect minority stockholders properly; legislation to facilitate institutional stock investments (for example, pension funds), and workers' participation in the capital stock of enterprises.[25]

Opening up business capital in Central America is more than can be realistically hoped for in this decade, but rapid capital flows through that channel would be a powerful instrument for economic integration and would contribute to profitable transformation, together with the advantage that it encourages greater fairness to the extent that it facilitates broad-based participation in the capital stock of important regional enterprises. The processes for privatizing public enterprises underway in several countries can be used to promote the development of stock markets and educate the public in this matter.

5. Finally, upgrading and integrating capital markets calls for bringing the framework for regulating financial institutions and sectors at the regional level into alignment, including similar rules for the supervision of loan portfolios, financial statement disclosures, auditing practices; and other mechanisms for achieving transparency at the national and regional levels.

4. *Mechanisms for promoting the conversion of the existing industrial base*

In the Central American Plan for Economic Action, the presidents of Central America agreed to promote a policy of gradual and selective retrofitting. Most of the activities for achieving international competitiveness mentioned here imply implementation of a regional-level retrofitting policy. However, there are strong reasons for adopting subsectoral industrial policies, based on an explicit effort to bring the business, scientific, technological, financial and other supportive governmental and non-governmental institutional efforts together into line with coherent retrofitting or industry-restructuring strategies. The aim would be to develop subsectoral cooperation in selected branches.

It is clear that sectors with one or only a few large enterprises, having substantial foreign-capital participation and strong international technological, financial and market contacts will determine their own retrofitting strategy.

However, it is in the sectors with predominantly domestic capital resources, or which are characterized by a large number of relatively uncoordinated small and medium-sized enterprises, that greater benefits from consensus-building processes and support measures for competitive and restructuring strategies at the subsectoral level will arise. These measures could include all the mechanisms mentioned above such as subcontracting exchanges connecting leading enterprises with the networks of small enterprises, exchanges for co-investment projects, combined exports, mechanisms for market information and follow-up, financial mechanisms for promoting modernization, support for technological activities, etc.

The objectives of this retrofitting approach would be: to facilitate the process of adjusting the different sectors to the new economic conditions; to increase productivity and competitiveness and to generate a system for consensus-building to solve problems and formulate plans and strategies for industrial restructuring.

The essence of the retrofitting approach is to focus attention selectively on the development of subsectoral strategies. The joint and coordinated formulation of subsectoral strategies accelerates the learning pace of participating agencies, improves the decision-making process so as to "manage the complexity" of developing competitiveness and is in itself one of the best mechanisms for the rapid and efficient dissemination of information (Salazar-Xirinachs, 1990; Salazar-Xirinachs and Doryan, 1990).

[25] See CODESA (1989), Salazar-Xirinachs (1990), Rodríguez (1990).

VI
Final observations

In spite of the economic and social "disintegration" of Central America in the 1980s and the presence of great political, economic and military obstacles, the Central American Common Market has managed to endure and is on the threshold of an important reactivation.

Recently, big steps towards the consolidation of peace and democracy have been taken. Moreover, the Central American Governments and private sectors are both currently committed to an extraordinary effort to define the areas of cooperation in the economic sector and to move ahead towards development and regional economic integration. This means that, of the three possible scenarios for the 1990s –further disintegration, growth with limited integration, and accelerated development with integration– favourable conditions for the third possibility are being generated.

The present global tendency to form consumer and producer blocs is determined by technological, economic and geopolitical factors. In Central America, it is necessary to begin with an understanding of the international environment in order to make the most of these transformations. Two factors can contribute thereto: greater integration into trade blocs, especially that of North America; and joint implementation of the openness and trade strategy.

Taking international competitiveness as the guiding economic concept, several forms and mechanisms whereby regional economic integration together with greater mobility in goods, services and factors and specific policies for transforming the productive sectors, can complement and strengthen the strategy for greater openness and insertion into the world economy, have been reviewed in this article. The technological revolution offers opportunities which can be turned to account only through a regional effort in the field of science and technology and the use of mechanisms for exploiting the competitive advantages of specialization and complementarity at the regional level.

The Central American Plan for Economic Action includes various strategic areas for joint action not analysed here but which are of great importance for Central American development and strengthening integration: agricultural policy, the fight against poverty, and strengthening integration institutions. In all these efforts, foreign economic and technical cooperation is essential as an input for the current process of consensus-building and joint policy formulation.

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CEPAL REVIEW No. 42

Economies of difficult viability

*Arturo Núñez del Prado**

The diversity of the economies of the region –a qualification that usually precedes any overall interpretations of its underdevelopment– in fact expresses an idea going far beyond a simple statement of dissimilar situations. Thus, it is crucial not only to qualify and quantify this disparity, but also to understand the reasons why it is so pronounced. Countries abundantly endowed with natural resources have not managed to generate vigorous and continuing industrial processes nor, even less, have they been able to develop a social cohesion compatible with a consolidated national State. This would seem to be the nub of the problem. What obstacles explain this slow process of consolidation as nations? What past events have caused their democratic periods to be usually ephemeral and subject to violent regressions? And how can the marginality of a significant portion of their societies be explained?

Any prospective attempt to study these trends confirms a disturbing increase in these disparities to the extent that greater segmentation can be expected if these tendencies are not corrected. It is, therefore, once again necessary to point out that a sub-periphery is forming in the region, made up of countries of little or no growth, where the exclusion of large segments of their populations is a dominant characteristic.

Among the studies which must be carried out, primary importance must be given to an examination of ethnical and cultural heterogeneity and the identification of unresolved conflicts in this area. The shortage of surplus funds and of ways to acquire and use them results in degrees and extents of poverty whose background is dominated by cultural confrontation where the appearance of hybrid social groups further disrupts the social structure in their legitimate aspiration to a share of the insufficient income. Priority must be given to an attack on the problem of poverty and the segregation of the rural populations. This has become the central goal of the marginally viable economies, in order to remove the main difficulties in the way of a faster consolidation of their nations.

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Introduction

For some time the author has been insisting that more attention be given to those economies which because of their size and individual features are not reflected in the diagnoses and interpretations made for the region. In fact, most of the analyses concentrate on the more highly industrialized countries or those with larger economies, i.e., those which have a decisive effect on regional averages. The other countries have usually been given only subordinate attention, if not completely ignored. Their characteristics and problems are so individual that they need another type of approach and even different methods of analysis.

The term, marginally viable economies, is intended to focus attention on their serious structural problems which make it impossible for neo-liberal approaches to start them on the way to dynamic, equitable and self-sustainable development. There are serious limitations to their embarking on dynamic strategies and achieving a more solid place in the international economy. Their low level of productivity and the small size of their domestic markets result in inadequate income levels and, therefore, extremely limited investment capacities which are even more reduced by the flight of capital. Social mobility and equity seem too remote and the discretional operation of the market only reproduces the well-known vicious circle of poverty. The characteristic structural heterogeneity is reflected not only in extreme differences in productivity, but also in open conflict between the various social groups.[1]

It is, therefore, only fair to demand special consideration of their particular characteristics, particularly since the studies made for the region as a whole, concentrated as they are on the more advanced countries, have little or no validity in this case.

The identification of the causes of and impediments to their consolidation as nations really does seem a priority and should precede any project for modernization or change in production intended to improve their international standing. The problem of inequity, which becomes increasingly acute as poverty reaches intolerable levels and coverage,

[1] A more detailed description of this type of economy can be found in another article by the same author (1988), "Economies of difficult viability: an option to be examined", *CEPAL Review*, No. 36 (LC/G.1537-P), Santiago, Chile, December.

becomes an obstacle which will have to be dealt with before the other components of the strategy. In countries where two-thirds of the population are socially, economically, ethnically, and culturally excluded, it is very difficult to reach agreements and achieve responsible participation for political projects which do not make this problem their central and motivating factor.

I
Confronting a different world . . .

Marginally viable countries are facing previously unknown circumstances, both in their external environment and in their internal functioning. No observer of the contemporary world can ignore the transcendental changes which are occurring, particularly in the socialist region. Certainly, no forecast can deny that these changes will bring about corresponding changes in policy in the established capitalist countries and –which is particularly significant– in the behaviour of their transnational enterprises.

Simultaneously with this political about-face, a technical revolution has come of age whose every sign and indication leave no room for doubt about the different way the world economy will function. Not only because of the new technologies and materials available, but also because of the potentially massive and drastic effect they will have in their application to the more dynamic production and distribution processes, we are today facing a world which, during the 1990s will increasingly less resemble the world of a decade ago.

These political earthquakes, together with the equally spectacular technological changes, are shaking the very foundations of political, economic and social structures. It is not a question of a change in inflection or cyclical phase, nor is it a readjustment of the major parts of the machine which drives the world economic and political system. It is really the inception of a different world with a different pattern of strength and power relationships.[2] In a more extended environment of hegemonic struggle, scientific and technological knowledge will be directed less than before to warfare and more to winning market space, and will lead to other kinds of antagonisms and produce a dynamism which will be very difficult to measure. This will obviously be a great challenge for the economies dealt with in this study, particularly if the countries at the centre are expected to change their focus of interest.

With these major changes in the functioning of the economic and political system these economies find themselves in a very difficult situation. The acute and growing degree of their extreme poverty and the greater exogenous limitations which can be expected, make it difficult to adopt strategic positions to meet both fronts. Minimum levels of investment, limited or negative inflow of foreign funds and markets reluctant to receive their exports reveal a panorama of deficits and difficulties. On the other hand, the demands and claims of large masses of their populations constitute very complex management limitations.

The respective governments are, of course, aware of the seriousness of these phenomena. They know that their democracies will be subjected to hard tests and that, now more than ever, they must devise strategies to meet these adversities and regain their historic expansion rhythms, this time with greater equity.

[2] See Latin American and Caribbean Institute for Economic and Social Planning (ILPES) (1989), *ILPES: External Insertion, Development and Planning* (LC/IP/G.49), document presented at the Seventh Conference of Ministers and Heads of Planning of Latin America and the Caribbean, Montevideo, May.

II
An introspective view

A profound reassessment of economic integration and a study of the potential for economic complementarity are imperatively central tasks. The conclusion that these have been far from what they were thought to be only leads to the obligation to come up with a reformulation. A possible decrease in attention to Latin America and even more to the weaker economies on the part of the countries at the centre makes it necessary to take a much closer look at the possibilities which a new conception of economic complementarity could offer. Perhaps such tremendous challenges have been necessary to improve viability, but lurking dangers and potential problems are not sufficient to cause a spontaneous integrating force. A conceptual review of the integrating mechanisms and, above all, a commitment to political solidarity are also necessary for motivating the energy and conduct of those involved.

The approaches presently found in the region and the new approaches being developed take into account the need to raise the average level of productivity as the prime requisite for a more dynamic, self-sustaining development. This need, given that the outside world has little interest in marginally viable economies, turns the view inward and revalidates the central idea of integration seen, not as an end, but as another means to achieve greater and better stages of development. Certainly, this does not mean an introspective move towards autarchy, but there is no doubt that the internal possibilities for better intra-Latin American interchange have not been even remotely exploited.[3]

Any proposal for the full use of these possibilities makes the renewal of integration an extraordinarily pivotal task. The proposed structural change in each country depends strongly on the situation in this area of national political projects. In small economies which urgently need to increase productivity, the evaluation of new forms of economic complementarity with neighbouring areas could be fruitful.

No matter how many obstacles are identified and efforts made to achieve economic expansion, the consideration of equity will have to govern the idea of development even in the medium and short term. The signals from the forgotten populations in these economies are all too evident. Where elections are held, the demand for greater social justice breaks out vehemently and those who promise to tackle this question receive decided support and votes. There are cases where the contradictions between the haves and the have-nots are so glaring that, out of desperation, some social groups erupt and get out of control without waiting for the next elections.

As already said, in these times of reformulating development ideas, the correct value must be put on the idea of equity and a sense of solidarity, not only for ethical reasons but also for the elementary assurance of viability and to guarantee daily living and security. We cannot stand back and allow the social scientists to establish new categories for identifying degrees of poverty. The extreme domination no longer serves to illustrate, perhaps through the insensibility of habit, the dramatic lack of ability to satisfy basic needs. Before we accept that the category of misery takes shape in the analyses of population segmentation in these economies and before extreme poverty loses its dramatic character as a result of the development of worse stages, we must call a halt and reflect carefully. Just as in the socialist world it was time to call a halt and choose a different path, in these capitalistic societies for other reasons, equally or more valid, accumulated social energy resulting from lack of satisfaction and contradictions will be let loose. Those resigned to being overlooked, irrespective of ideologies, cannot continue to be isolated. This is not a hasty prophecy; it is an elementary conclusion from observing the social phenomena occurring in these countries.[4]

[3]See Economic Commission for Latin America and the Caribbean (ECLAC) (1989), *Integración regional: desafíos y opciones* (LC/G.1568), document prepared for the project Integración y Cooperación Regionales, of the International Trade and Development Division, Santiago, Chile, June.

[4]See ILPES/ISS/ILDIS (1990), *Necesidades básicas y desarrollo*, Carlos Toranzo (ed.), La Paz, Talleres Hisbol, March.

In this context of adverse changes in the external parameters and functions and of tasks in the internal social order which cannot be denied or delayed, it is not only difficult but necessary to have strategic propositions which suitably rank the goals in both areas. Depending on the situation in each country, a careful listing is needed of goals, measures and tools for achieving greater social justice and solidarity and, as a result, a strengthening of the external sector. Any strategy to overcome underdevelopment will have as its central goal, an attack on the problems of poverty which should determine the solution of other problems.[5] Truly, if the dominant characteristic of these economies has been exclusion from the international economy as well as the exclusion of a significant portion of their populations, the strategic answer to these problems is that we must pause and rethink new means for achieving growth and development.

III
Structural change

There does not seem to be much doubt about the need to introduce changes and transformations in the growth processes in these economies. The central task is to study the viable alternatives for changing their production structures.

In the region, a transformation of the production structure is taking place which to some extent results from efforts to meet and overcome the crisis. The nature of this crisis produces various indicators: correct and wrong, sporadic and persistent, temporary and structural. One of the first tasks is to clarify the internal and foreign obstacles to be overcome in order to be able to develop the outlines of a new production structure which would support more rapid and simultaneously more equitable economic expansion. Otherwise, there is the risk of change occurring as a result of pursuing emergency goals even though worthy of attention, such as attaining price stability or a trade surplus. Moreover, if the anti-inflationary or trade balance policies fail, the result could be even weaker, more erratic and contradictory production structures than those which were in crisis; on the other hand, if they were successful, this would usually be at the cost of greater recession and higher unemployment. The attainment of production structures which guarantee self-sustainable and equitable growth cannot result from reflex actions in the face of isolated problems. They must first of all be the result of a deliberate understanding of the limitations imposed by growth and equity which takes into account internal operation and the resulting participation in the outside world.

It is certainly a very complex task given its multidimensional nature and dangerous to generalize because of the diversity of the marginally viable economies. Their natural and human resource endowments make it unthinkable that extreme poverty and unemployment have reached such extremely high levels as are seen in most of these economies. There is clearly a malfunctioning of their social and economic systems which is grounded to a significant extent in the existing production structure.

Some positions on changing the production structure can be typified by their points of view on internal and external factors. Although all the positions demand a rise in the level of productivity in the socio-economic process, the weight they give to external and internal factors clearly distinguishes them. At one extreme, priority is given to participation in the international economy as a means of producing beneficial effects in the domestic economy; at the other extreme, weight is mainly given to the internal economic structure and international participation is seen as a requirement to facilitate this. The middle position proposes a careful balance between the external and the internal, based on the interaction of the two spheres. Nevertheless, it must be admitted that such positions are only attempts to express intentions and, including those now in operation, are still far from constituting completed ideas of practical use for government action. For the time being, they have been useful only for identifying the main lines of neo-liberalism and neo-structuralism; a more complete conceptual statement is still a long way off.

[5] On the seriousness of this phenomenon see ECLAC/UNDP (1990), *Magnitud de la pobreza en América Latina en los años ochenta* (LC/L.533), Santiago, Chile, May.

In the marginally viable economies the emphasis must be put on the search for a greater degree of equity, thus fulfilling the primordial need to speed up the consolidation of the nations. The permanent conflict in their societies originates mainly in various forms of segregation which are manifested not only in great imbalances in distribution but also in serious restrictions on economic expansion.

IV
Factors which determine production structure

The shape of a production structure is the result of a set of very diverse factors. The weighting of each varies, of course, in each particular case; nevertheless, the main factors tend to reappear persistently.

From the historical point of view, we must identify the factors related to the cultural origins of the population. The existence of pre-Columbian civilizations which occupied the geographic spaces in which a production structure existed and the kind and amount of migrations into these spaces are factors which have determined the development of socio-economic activity which subsequently shaped the existing production structures. The size of the indigenous populations and the degree to which they were subjugated, as well as the amount of migrations and, above all, their effective presence as agents of the existing economic process make this factor significant. The considerable structural diversity of the marginally viable economies is usually explained to a significant extent by the weight and existence of these two components of their populations.

The natural resource endowment of a territory is another factor which obviously shapes, over time, a production structure. For various reasons, the sequence of natural resource exploitation has determined the various cycles in the formation and transformation of the production structures. The maximum development, depletion, or substitution of a specific resource has been very significant in the behaviour of these economies.

The evolution of foreign demand and particularly the activities carried out by direct foreign investment has undoubtedly helped to define the production, distribution, and reproduction apparatus of these economies. In spite of the evolution of the terms of trade, the capacity of the workers in the peripheral countries to withstand hard times and the difficulty of rapidly reconverting activities tied to foreign trade have made these factors permanently influential, although they are largely exogenous, and, in some peak periods, they have had a very decisive effect on the production structure.

Another factor which determines the shape of the production structure is government management and activity in directing the economic process. In fact, the development policies applied in the past, the economic policy which gave them shape, as well as the functioning of the public sector and its relationship with the private sector, make up another set of factors which explain the process from the initial situation of a specific economy, through the efforts of government management to the final phase of implementation, i.e., the formation, the social articulation and the coordination of the commercial and financial network which facilitates its operation.

It is clear that government intentions and actions reflect a specific power structure. Various groups exert pressure or, where they can, share directly in the decision-making process. In the case of development policy matters, they operate through trade unions or political parties. With respect to the effective management of economic policy and the operation of the system, they also defend their particular interests as strongly as their position in the power-structure allows. Their behaviour generates the environment in which a production structure comes into effect and operates. In the economies which are the subject of this paper, the existence of numerous oppressed indigenous populations was decisive in the persistence of the power structure over a long period. The dominant groups had no effective opposition and only in the middle of this century have social and political changes occurred to modify this situation.

There is not much sense in suggesting that the production and power structures are closely related, or that modifications to one imply modifications to the other. The relationship is much closer than that; they are inseparable entities, making up a fusion of actual processes and only for analytical purposes is it useful to refer to one or the other. Nevertheless, it must be remembered that this dissection weakens the analysis and the interdisciplinary approach will rarely prove so useful.

At this stage it is almost superfluous to repeat that the factors indicated as the main determinants of the production structure affect each other and mutually influence changes in their relative significance over time. Ultimately, the interpretation of trends in the production structure is an interpretation of development and the formulation of guidelines for changing them is the formulation of a different kind of development.

V
Structural change and development

If the concept of production structure outlined above is accepted, as well as the factors which determine it, it must be admitted that changes which can be recommended ultimately imply the proposal of a different kind of development in the future in the marginally viable economies. The tendency to associate the production structure mainly with the physical aspects of the economic process tends to relegate behavioural and power-structure studies to second place, i.e., to the socio-political sphere. Their interaction generally occurs in the process of seeking specific justifications by the more powerful participants and groups and, sometimes, is included within the activities of the public administration. Therefore, it is worthwhile to point out the real extent of a contemplated change in the production structure and to recognize that it is a deliberate attempt at imagining a different kind of development. How different and in what way will depend on the circumstances and possibilities of each economy and of the political plans supporting it.

Since social, political, and economic factors are fused in the operation of a production structure, any plan to change it must consider the kind of society desired for the future and the production structure on which that society should be based. By definition there is a clear priority: to effect changes and transformations in the social structure which will lead to a more equitable and cohesive society, and one which is economically and politically democratic. This preliminary definition will lead to a study of the necessary changes in the economic sphere and a national project or the resulting strategy could be outlined in a series of approximations. Obviously, these are intentions and procedures which in practice will need to be modified or even corrected. The practical situation will sometimes change timetables and modify specific priorities, but a social compact will exist for the guidance of the public administration and the behaviour of the participants.

In spite of the great uncertainty in the situation facing the various agents as a result of the crisis period and the consequent delay in decisions on capital formation, the crisis has forced them to adopt positions on the basis of parameters determined largely by external phenomena rather than by a strategy agreed to in the context of the national economy. In other words, the most capable agents, particularly the entrepreneurs associated with transnational capital, have already begun to adjust to the new conditions they see in the world economy, although the potential economic and social effects of their activities cannot yet be calculated. The search for higher levels of international competition seems to be one of the most frequent goals of official policies and one most readily financed.

It is particularly worrying that the transformation of production structures is being brought about without government leadership and the agreements which could direct it to serve national goals. A change may meet the requirements of some agents, but will probably impede the achievement of other equally or more important goals, such as manpower absorption, the satisfaction of basic needs, and the problem of extreme poverty. The early years of the 1990s are witnessing some transformations being planned or initiated which will condition the shape of future development. In fact, even where phenomena can be clearly seen which are leading to undesirable production structures, the ability to redirect them appears to be very limited. Public policy priorities do not lie specifically in this area and even if they did, they would encounter difficulties resulting from the lack of a clearly defined alternative development policy.

In the more backward countries, the defence mechanisms deployed by the agents do not yet seem to be threatening the production structure. In fact, in those countries where an open economy is supported by official policy, industrial entrepreneurs are prescribing a kind of reconversion, decreasing the productive activities and replacing them with imports. However, a significant dismantling of the industrial infrastructure has not yet occurred as they wait for the clarification of uncertainties. Uncertainty has paralysed where it has not decreased industrial investment and this will undoubtedly have undesirable effects on the future development of these countries. In these economies it is more appropriate to consider the direction that changes in the production structure could take. Obviously, overall consideration would be only relatively useful; the examination and evaluation of the alternatives in each case will help to shape a new development model for each one of these countries.

VI
Basic definitions

Before we discuss the outlines of a change in the production structure, we must come to a decision on certain basic questions which are a prerequisite for determining its direction and content.

It has been said repeatedly that the aim of a production structure is to guarantee in the future a dynamic economic expansion with greater equity. The overall conditions this new model should achieve have also been pointed out: selectivity, austerity, efficiency, participation, agreement, etc. On these matters, neo-structuralists usually agree; the literature does not reveal discrepancies or contradictions, but it must be recognized that in the countries we are discussing these positions are in their infancy and facing neo-liberal movements with strong political support and both internal and external financing. Also, the political sectors which could support them are dispersed and confused, as a result of well-known political changes.

The first and most basic definition must be of the commitment to consolidate democracy and of the ways and means of achieving this goal. Among the many tasks which this implies, it is extremely important, as we have already said, to consider how to meet the problem of extreme poverty, the degree and extent of which appears to be a potential source of disturbances in the functioning of these societies. Any estimate or prediction of the behaviour of the marginal population reveals the danger of a breakdown of democratic institutions if these people remain outside the socio-economic process.

In dealing with a specific economy, without the abstractions imposed by generalization, we should try to define the main beneficiaries of economic expansion. The social groups for whom the fruits of growth are intended must be identified. This will provide useful information for estimating the changes to be made in consumption levels and in the structure of production, at least as regards the most immediate needs. Here lies the essence of what the other kind of development could be.[6]

Another essential definition concerns the selection of non-traditional export products to be encouraged in the future and the anticipated amount of traditional exports. These definitions will require a knowledge of foreign demand and its probable future evolution, a very difficult task in changing times, but certainly indispensable. The identification of the dynamic comparative advantages which the country could exploit or generate according to its resource base, its location, its indigenous population and other special characteristics, takes on increasing priority as the foreign market becomes more difficult and competitive. In this way, another set of factors conditioning change in the production structure will be available.

The identification of the main projects which will respond directly and indirectly to the consumption structure and the new export base will allow an evaluation of alternatives by pressure groups or members of the power structure associated with the resulting production changes. In other words, it should be possible to anticipate behavioural changes within the power groups or the rearrangement implied in the desired structural change. The resulting definition is related to the political support and to the nature of the consensus favouring the national transformation project.

[6] An interesting attempt at identifying beneficiaries and products is found in Iván Finot (1989), *Redistribución del ingreso y necesidades básicas. Simulación y proyecciones para Bolivia* (LC/IP/R.80), Santiago, Chile, December.

VII
Political viability

Clearly, changes in the production structure will not be exclusively the result of vertical decrees of government policy. Compacts and agreements must be established among those who exercise power. The very persistence and depth of the crisis has made the positions of the traditional antagonists more mature and it is neither utopian nor naive to admit that there are some points of agreement and some mutual interests.

In some of these economies perceptions of the future on the part of the entrepreneurs have arisen which seem to have considerably softened their previous apathetic distributive postures. It can be seen clearly that the spread of extreme poverty and unemployment leads to non-viable social living conditions, where the danger to property and even to life is an insupportable risk. Young entrepreneurs are stating more frequently that they will not accept the criterion of the omnipresence of capital and that, conversely, they support democratic goals of "preserving a nation for everyone". It is not apparent how much of this is social conscience and how much an instinct for self-preservation; it is clear, however, that room for negotiation is opening which will be much more productive than mere statements. The very small size of many of the marginally viable economies also means that the number of leading agents is fewer, which will make it easier in studying policy projects to identify the different positions and come up with some compromises.

In these same countries, the trade union leadership also seems to have changed. Previous sectoral interests are giving way to an understanding of what can be done in the matter of redistribution. The crisis has hit the working class so hard that it has become aware that permanent confrontation could lead to even worse conditions. In the most politicized unions, there is an awareness that power brings greater responsibilities and they are also demanding compromises in order to avoid socio-economic chaos.

The motivation for these attempts to come to agreements seems to have been partly an awareness of the very low levels of productivity characteristic of a large part of the economic activity and the hostility of the outside world with respect to prices and financing. On the other hand, as the people face their daily frustrations with no sign of any solution they have directed their attention to more distant horizons and have become aware of the possibility that their living conditions could deteriorate even further. Some anticipate more difficult times if changes in direction are not made soon. Although in these countries and in their trade unions, the theme of structural change is not yet being studied, there is no doubt that here is fertile ground for proposing ideas and encouraging the development of proposals. Maybe, by discussing this theme, we can ascertain to what extent effective agreements can be worked out.

The indications of compromise between entrepreneurs and trade unions influence the behaviour of the more representative political parties. Most of them are drawing attention in their statements to the theme of extreme poverty. In any event, it cannot be denied that in various parts of society there are visible indications of convergence and unmistakable signs of a predisposition towards broad socio-political agreements. To the extent that these thoughts on the transformation of the production structure in the direction of equity and self-sustainable development on the basis of advances in productivity levels can take shape in national political projects, we can hope that the power structure will support these changes. Undoubtedly, this is a domestic task for the citizens of the countries which decide to modify their growth patterns and development style; exogenous contributions can only be relevant in the context of information about the probable future external world, the evaluation of economic viability and the degree to which the needs of development are met.

VIII
Planning and management

As has been said above, in recent years, a rethinking of underdevelopment has been taking place in the region. Faced with the emergence of new problems and changes in the old problems, analyses and interpretations of most social and economic problems are usually novel or unprecedented. The reiteration of these qualifications in numerous studies is precisely what emphasizes the singular nature of the phenomenon which is causing universal concern. The maginally viable economies have not been unaffected by such changes and attempts to reinterpret their development processes are taking place there as well.

As an almost natural result of this concern, the need also arises for a rethinking of planning. For this study a series of considerations are available which partly originate in what planning was in the past and in what it was thought to be. On the other hand, considerations also exist which arise from the greater complexity of today's world and the need to face the serious problems of the region and problems which it is easy to predict for the future.

In such fragmented societies, the possibilities of government are usually directed towards obligation, regulation, and vertical pressure, with almost always ephemeral and partial, if not counter-productive, results. A broadening of this capacity requires commitments to respond to the most urgent needs of the overlooked population and policies whose realism lends them credibility. The national policies will have to be adapted to the new directions of political controversy, where the identification of concrete problems needing solution and the ways of doing this are necessary to gain political support.

In the marginally viable economies, the tasks of government in this decade will demand new proposals from planning, directly aimed at solving the problems affecting their populations and at increasing the capacity of their political leadership to govern.[7] The crisis years are showing that long-term plans must be made and that the serious gaps in social policy must be filled. No matter how successful the association with the outside world, internal contradictions will persist if not worsen. The search for unconventional alternatives in the midst of a vast range of serious limitations could pave the way for the indolence of neo-liberalism and the temptation it has for some of the agents of the system. It is not simply a question of controlling the excesses of the market and compensating for its deficiencies. It is much more than that. It is a question of achieving a community of interests which will, on the one hand, fairly distribute the returns on capital, intellect, and work, and, on the other hand, clarify the uncertainties of the future, commit society as a whole to the pursuit of a politically viable solution, which is socially equitable and economically sustainable. In this respect, new functions and responsibilities for planning will undoubtedly emerge in order to increase government capacity.

Among the various preoccupations reflected in efforts to renew planning in these economies the analysis of the management problem and proposals to solve it seems to constitute a genuine and legitimate priority. Various assessments of past planning conclude that the intentions of the plans were not transformed into concrete actions and policies. It will no longer be acceptable in future evaluations of planning processes to admit that plan and reality were not the same because the plan did not take into account the limitations of reality and that the reality created by pressure groups was ignored by the plan. To avoid this, the plan must cover the management problem at all levels and extend into the area of economic policy, State action, and administrative procedure. In fact, the management of the plan, the functioning of the public administration and the behaviour of private initiative must all be compatible with the purposes of the plan.

In the past, the execution of the plan was a separate phase and not the responsibility of the planning agency. This led to inevitable divergencies between intentions and activities. It is now proposed that the plan should include economic policy regulations and that the planning agency directors should make their presence felt and participate in the taking of decisions. In this way, public and private activity should have the necessary coherence. In studying the management question, attention is usually focused on the problem of policy coordination which is certainly very important, but in considering priorities, there are other management questions which must also be tackled.

[7] See ILPES (1990), *New Guidelines for Work in 1990-1991 and Summary of Activities in 1988-1989* (LC/G.1607(SES.23/11) (LC/IP/G.54) especially chapter I, Santiago, Chile, March.

IX
The scope of management

In the marginally viable economies, inadequate management largely explains the extremely low productivity levels. In fact, the average level of productivity is close to that of the most inefficient operators in the system. The great efforts and sacrifices of some public or private economic units are frequently frustrated by inefficient and contradictory economic operations, which are absolutely unacceptable. Subordinate public agencies complicate operational sequences; struggles between ministries neutralize and impede decision-making; economic units which fail to meet anticipated deadlines slow down the pace of production; archaic laws, out-of-date legal procedures, and obsolete administrative procedures constitute irrational obstacles to the adoption of decisions. These hindrances largely explain the low yields of the performance of these economies.

To seriously confront the management problem in these particular economies, a more integrated view of the problem is needed, distinguishing between different areas of management. Management in the political area is closely related to the achievement of compromises and agreements, both on the strategic outlines of the national project, and on development policy and the management of the more delicate details of the economic policy. In this area the agency responsible for planning will have to play a crucial role in initiating dialogue and discussion, guaranteeing seriousness and thoroughness in the consideration of alternatives. Through the assessment of such alternatives, the planning agency can help to achieve the desired agreements. This is certainly a new role for planning, which will doubtless give it a very special central place in making decisions. The task of systematically evaluating the alternatives arising from the interests of the parties concerned will make it possible to reach a consensus both at the strictly trade union level and also among the more representative political groups. In mixed economies, such as are being dealt with here, discussion and agreements between the entrepreneurs and the trade unions are indispensable prerequisites if the plan is going to conform to reality.

As for the functioning of the socio-economic system, management should cover both the performance of public and private enterprise as well as the coordination of public policy with a view to meeting the goals of the plan. Public administrative management is intimately tied to economic management. There is no doubt that a management system which includes public order, trade unions and social compacts, the working of economic units, the coordination of public policy and the State administration, will make planning an effective tool for directing economic, social, and political processes. In this way, the planning agency will gain renewed strength within the public system as a key element in the decision-making process.

The ideas of efficiency and increasing productivity levels are directly related to the subject of socio-economic management. It is recognized that the productivity of an economic system depends on a series of factors such as price levels and the pricing system, the quality and competence of the human resources, the availability of natural resources with dynamic markets, the selection of technologies, operational modernization and so on. But a factor not always given sufficient weight is precisely management, particularly with respect to the coordination of public policy, the synchronization of the economic processes of the main production units and the compatible functioning of the administrative machinery.

X

Productivity and the allocation of responsibility

Raising the quality of management in the marginally viable economies depends basically, on a precise identification of the leaders, agents, and operators of the system, to cover the three areas mentioned: the political, the socio-economic and the administrative. It also depends on allocating and accepting specific responsibilities for the objectives, goals, timetables, procedures, etc. There is no doubt that from the point of view of public judgement the principle of recognizing success and criticizing failure to meet obligations could be a valuable complement to the system of incentives and deterrents commonly used in personnel administration.

An essential aspect of management is the allocation of responsibilities. In the marginally viable economies, one of whose characteristics is their small size, it is not difficult to identify the main nerve centres, i.e., the key factors which govern the political, socio-economic and administrative processes which through their interrelationships have a decisive influence on the rest of the activity in the system. The identification and selection of the nerve centres in these economies cannot be divorced from the development style sought or, of course, the content of the plan backing it. These supporting considerations are the origin of the criteria for selecting these centres and identifying their most important interrelationships.

Each nucleus will be made up of one or more economic units producing goods or services, the respective trade union and entrepreneurial organizations, and the State agencies directly associated with their activity. Then, the responsible and influential agents in each one of these nerve centres must be identified and described together with their best-known affiliates. The preparation of this map of agents and operators forms the basis of a serious and thorough task which will make it possible to detect management weaknesses in the marginally viable economies. Government capacity depends very directly on understandings and agreements, etc., which can be tested against the above-mentioned map. Nevertheless, the acceptance of responsibility and the certainty of having to account to society for failure, is the other side of the coin which certainly broadens government capacity and the running of the socio-economic system.

Given the variety of matters on which agreement should be reached, a distinction must be made between those at the one extreme who commit the highest levels of the political parties and trade unions, and those at the other extreme who need a wide public consensus. The preparation of a development strategy, for example, begins with a small intellectual and politically élite group, whereas a government programme requires extensive discussion with the participation of a wide range of directors, agents, and operators in the system who must reconcile their various points of view in order to achieve viability and public support. This is the work of strictly political management. The identification and selection of specific projects and economic policy measures to make the socio-economic system work along the lines of the preconceived strategy is another management sphere which requires agreements and consensus. The operation and performance of public and private economic units, as well as of the relevant administrative machinery, also requires a degree of acceptance of compromise and responsibility.

The marginally viable economies are usually faced with a limited choice of alternatives. The scarcity of resources and the extent of their extreme poverty concentrates their strategic positions in a confined area where the list of possibilities in the three areas of management is not made up of unmanageable numbers. Similarly, the map of directors, agents and operators is on a small scale. Therefore, it is a question of linking both kinds of information together and establishing negotiation agendas at each level. It will be clearer now, why the planning agency could play such a decisive role. There does not seem to be another agency in the public sector with the same advantages and capabilities for simultaneously evaluating the long-term alternatives, the allocation of resources, the medium-term objectives, the management of economic policy and the operation of the administrative machinery.

XI
The nerve centres and poverty

This broad view of management is synonymous with a planning methodology which, as well as taking sectors and regions into account, precisely identifies the so-called nerve centres and their most important economic units. In traditional planning, the "implementation and follow-up" of the plan occurred after and separate from its conception and normally served to show that it was not being carried out. In the new approach, the management theme, or its practical operation by means of a series of agreements, must be included in the design of the plan. A different path will be followed involving successive approximations between the objectives, the degree and speed of completion, and the agreements achieved. The plan will have less literature and many more tables incorporating quantitative and qualitative variables as well as specific undertakings. The coherent and coordinated functioning of the various nerve centres, in the directions predicted and agreed in the plan, will guarantee its completion and also make it possible to allocate responsibility for mistakes and failures. It will also allow the appropriate social censure and the necessary corrections.

No matter how much progress is made in this direction and in the allocation of responsibility, it must be admitted that, because of exogenous and unforeseen events, such as failure to meet obligations, justifiably or not, it will be necessary to correct timetables and even to review the actual objectives of the plan. The ability to anticipate such events increases when disaggregated variables related to the nerve centres are closely monitored. In fact, while planning was limited to considering the macroeconomic variables, there was no possibility of checking up early on the execution of the plan, and even less of a timely correction of its performance. The relationship between the physical variables of the plans and the tools of economic policy was an insoluble problem because they were in different categories. Conversely, the disaggregation resulting from planning by nerve centres makes this relationship possible and, with respect to the economic units involved, the real significance of the management of each tool of economic policy can be evaluated. In this way the timetables of the planning can proceed coherently and interdependently. Plan and management, planners and managers, intentions and actions will all form part of a coordinated process with the main emphasis on compatibility.

Since the main problem of marginally viable economies, is the extent and severity of their extreme poverty, political, socio-economic and administrative management will be directed towards massive social projects in which community participation will reach decisive levels. This makes the management theme specific. Political and social agreements for a decisive attack on poverty cannot be ignored by those in power, but there must be a guarantee that these agreements take the form of real commitments and concrete actions. Although immutable laws, such as the law of gravity, have no parallel in the social sciences, when problems become acute and threaten to engulf the continent, forces seem to arise which, without obeying universal laws, can reproduce on a large scale the epiphenomenon of *Crónica de una muerte anunciada* by García Márquez. In these societies, the more powerful agents seem to have become aware of the potential non-viability of their economic apparatus and the precarious social living conditions if a solution is not found to the problem of extreme poverty. It can be seen everywhere and to a degree that troubles the conscience to the point that agreements considered utopian yesterday have today become needs and tomorrow will be obligations.

The force with which the theme of decentralization has burst in upon these societies is another indication that demands for greater equity are spreading territorially and are difficult to control. It does not seem far-fetched to suggest that the 1990s will be characterized by numerous efforts and processes of deconcentration, decentralization and economic democratization. A new spatial dimension, the product of the new importance of the regions, can be understood as an indispensable condition for achieving a greater degree of equity.

This decisive attack on the problem of extreme poverty does not imply any disregard for the other aspects which can guarantee viability. As already indicated, the technological revolution is eliminating the traditional comparative advantages of these economies and their external sectors, already very vulnerable, have an even worse prognosis. They must search for and generate new comparative advantages as a natural means of defence against the hostility of the outside world. It is certainly a difficult task and even more so in economies plagued by ills which impede their expansion and modernization. In this field, the theme of economic and administrative management becomes crucial with respect to competitiveness and the penetration of foreign markets. The demands of management impose on these economies, standards of efficiency which are not compatible with the slow tempo of their production, distribution and administration apparatus.

The attainment of competitive prices and quality, the fulfilment of schedules and the continuity of supply to foreign markets require economic and administrative management which is not readily available in the usual processes in these economies. Ad hoc operations are necessary, which imply production and distribution networks as well as special regulations. Probably this is an area where management will have to be more ingenious and where procedures can only be rationalized by conceiving of a procedure superimposed on the existing network of conventional activities. This will be a major challenge for the planning agency entrusted with management as an essential function in the planning of the future.

XII
Management and the absorption of technology

The technological revolution occurring in the industrialized centres, part of whose results is already evident, has harmful implications for the developing world, from one point of view, although from another, it could provide interesting alternatives. Nevertheless, when the pros and cons are summed up, the cons are more numerous, seem to carry more weight, and automatically affect the economies. Conversely, to gain some advantage requires daring efforts. Certainly, the outside world will be more hostile and it is clear that the marginally viable economies will face dilemmas difficult to overcome in their efforts to avoid being even more excluded from the world of the future if at the same time they have to absorb productively their huge contingent of unemployed and underemployed population.[8]

The identification and evaluation of technological processes for their adaptation to these economies are vital tasks because they affect the essence of both the productivity of the economic machinery and also the equitable functioning of the society. The first task will be to enhance their capacity to keep their better trained talents and professionals at home; the second, will be to select carefully the activities which will have to be adapted to high technology and those which can be modernized with mature technology. Finally, the selection and adaptation of the technological processes to the various activities selected will complete the cycle of improvements subjected to extremely severe limitations.

Without doubt, the scarcity of financing and of qualified human resources is the main limitation and makes strict selectivity imperative. Because of the diversity and nature of technological innovation, whose effects will significantly modify production and distribution processes, these countries must adopt a strategic position. It is unnecessary to point out the effects of this technological revolution on the production units, their management, organization, costs, and new networks. The production structures of the marginally viable economies are compelled to undergo changes. The lack of a policy to effect these changes could result in distortions even more contradictory and perverse than those now existing. In this situation, management, particularly in the areas of production and administration, must be studied from the point of view of the changes and the complexity implied by this technological revolution.

Space for the scientific research needed for technological advances in the countries themselves is extremely limited and should be reserved for very

[8]See Carlota Pérez (1986), "Las nuevas tecnologías, una visión de conjunto", C. Ominami (ed.), *La tercera revolución industrial. Impactos internacionales del actual viraje tecnológico*, Buenos Aires, Grupo Editor Latinoamericano (GEL) and the Programme of Joint Studies on the International Relations of Latin America (RIAL).

specialized fields. In any case, it would be reasonable to concentrate on the selection and adaptation of those fields already mentioned. If this effort were successful, it would be an important achievement, when we remember how far away from this objective the economies studied in this paper are at present. Selectivity and optimization with an eye to the future are concepts inherent in planning and, in this argument, synonymous with management tasks. To launch a specific policy for this purpose is another challenge to which these economies should give priority. The failures experienced in this area have been caused by exaggerated expectations which have soon been frustrated and by weakness in carrying them out in pragmatic policies. It is more appropriate in designing a specific policy to slow down the rate of emigration of talented and highly qualified professionals and to facilitate the evaluation of technologies to be selected and adapted. The achievement of this goal through proper management is essential and has become a priority in the marginally viable economies.

XIII
Concluding thoughts

If a list is made of the priorities dealt with above, it will be seen that they contain contradictory alternatives which could neutralize or even work against their effectiveness. In fact, the attack on the problem of extreme poverty by productively absorbing excess manpower, the achievement of a firmer international position by generating dynamic comparative advantages, the choice of suitable technologies in the face of a new industrial revolution, and the fulfilment of all these tasks in the context of restrictions on productivity and competitiveness in extremely depressed economies and disorientated and frustrated societies, are extraordinarily difficult from any point of view. Moreover, if we add the need to consolidate democracy, critics may say that these proposals are a search for the impossible. Nevertheless, as we face these difficult tasks, we must recognize that one of the functions of planning is precisely to examine and reflect upon possible alternatives for meeting this set of goals, establishing priorities, sequences, postponements and even sacrifices. We must also consider whether the limitations are really insurmountable with respect, of course, to the main object of combating poverty. This would seem to be the main task occupying the attention of planning in the 1990s. And once again we must stress that the attainment of agreements through effective compromises and the incorporation of the management theme in the daily activities of planners certainly opens up a new perspective in the social and economic administration of these economies. The discussion of alternatives at different levels and their careful assessment will represent a technical and political contribution to increasing government capacity in the marginally viable economies.

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The Mexican economy at the end of the century

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At the end of the 1940s, Raúl Prebisch, in *Economic Survey of Latin America: 1949* (CEPAL, 1951), identified the main problems of Latin American economies on the basis of an analysis of their evolution during the first half of the century. The present study refers back to that analysis and compares its findings with contemporary development challenges and limitations.

For nearly 40 years, Mexico, like other countries of the region, implemented a process of import-substitute industrialization, with an important degree of government intervention and an active and increasing role for private enterprise. Until the end of the 1970s, this process benefited from the fact that the country did not depend on only one export product. With this growth model, Mexico did achieve a large number of the objectives established by its post-war development policy. Even so, some of the central problems pointed out by Prebisch were not solved satisfactorily, while other problems emerged which, under the pressure of the crisis of the early 1980s, have become considerable obstacles to development.

Since 1983, a policy of macroeconomic correction, structural change, and foreign debt renegotiation has been in effect, as explained in this study. This policy has generated an economic and social modernization project that takes the transformed international environment into account and proposes new relations with it.

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Introduction

The global economy is in the midst of an intense process of change that affects economic relations among nations, the directions of commercial and financial flows, and the production structures resulting from the technological advances of the last 10 or 15 years. This set of transformations has led to changes in the dynamics and logic of post-war global economic growth and has consequently transformed development paradigms.[1] This new situation calls into question the validity of conventional economic analyses as well as the efficacy of those economic policies that ignore the effects of interdependence among the still so-called "national economies".

The end of the period of inward-looking development in Latin America led to a situation of crisis of diverse content and varying intensity in each country of the region within which different policies have emerged to face it. This cycle of crises now faces new international conditions which would seem to oblige Latin American countries to renew their relationship with the international economy.

Mexico, having been one of the countries that pioneered debt renegotiation and because of its geographical position, seems more exposed than other countries of the region to global change. As the 1990s begin, government and diverse social sector efforts are centred on the search for ways to achieve economic recovery on the basis of a change in overseas relations, along with stabilization and internal corrective policies.

[1] "The 1950s and 1960s were a period of global expansion of production and trade, one of the most pronounced and lasting periods of prosperity in world history, with full employment and low inflation in the industrialized countries. This was a favourable environment for the developing nations, including those which gained their independence at that time . . ."

In the context of economic theory, "disproportionate and almost exclusive importance was attached to the accumulation of physical capital. The Keynesian consensus reigned unopposed, and the neo-Keynesian development model, embodied in the Harrod-Domar formula, insisted on the accumulation of capital as the source of growth (the capital/output ratio, included in the denominator of the formula, was considered relatively constant)" (Singer, 1989, p. 603).

I

The view of Raúl Prebisch and the mexican economy during the period of inward-looking growth[2]

Prebisch began his analysis with an examination of the international post-war economic situation. As is known, Prebisch observed that the technical progress promoted by the countries that "created" capitalism had been the motor of their development. The consequences of the spread of that progress for Latin American economies could be seen in the way they came to be situated within the international division of labour: foreign demand for primary agricultural and mineral products was the determining factor for Latin American growth during that period. On this point, Prebisch noted:

"... the economic development of the peripheral countries is one more stage in the world-wide spread of the new forms of productive technique or, if preferred, in the organic development of world economy ... Latin America has, therefore, entered a new stage in the world-wide spread of technique, though technical methods are still far from having been assimilated completely in primary production, for ... new productive methods tend to be adopted in activities connected in one way or another with the exportation of foodstuffs and raw materials rather than in other activities" (CEPAL, 1951, pp. 3 and 4).

Prebisch postulated that the initial forms of Latin American articulation with the world economy marked its subsequent development and, on that basis, defined the principal obstacles and limitations that would impede a process of development similar to that of advanced countries.The definition of those restrictions, which Prebisch discovered in the evolution of the Mexican economy of that time, still shed light on the current Latin American development process.

The first restriction has to do with the persistent scarcity of capital, i.e., the lack of capital of sufficient magnitude to allow for efficient use of the region's abundant human and natural resources and for financing the capitalization of the economy at the rate required by demographic growth.This chronic scarcity is explained by insufficient internal savings and low capitalization, arising in turn from the structure of imports and the transfer of resources overseas required by direct foreign investments.

[2] The influence of Raúl Prebisch on Mexican development policy has been analysed in Sandoval and Arroyo, 1989.

The second limitation arose from the tendency toward external imbalances, derived both from a lack of dynamism in exports which depend on demand in advanced countries and from the high coefficient of imports which grow as total income increases but which cannot be financed with further exports. This produces the region's chronic payment imbalance.

The third factor is linked to the effects of technical progress on employment and its distribution across the spectrum of economic activities. Prebisch established that, in central countries, as technology spread from primary activities, displaced workers were absorbed into industrial and tertiary activities, a process that also allowed natural population growth to be absorbed into productive activity, thus eliminating problems of unemployment and sub-employment of those productive factors.

Together with these restrictions, the fact that this process did not occur in Latin America impeded the achievement of production levels comparable to those of advanced economies. Prebisch argued that, according to prevalent economic theory, the solution to this problem lay in making the productive factors truly mobile:

"It has already been seen that when technical progress is extended to primary production, it produces a surplus of gainfully employed population in that sector which can be absorbed by industry and other activities. If these other activities were not developed in the periphery, they would automatically have to develop in the centres which would consequently have to absorb the surplus manpower, in addition to that part of the natural increase in population which could not be absorbed in their own primary production.

"This presupposes complete mobility of population; in other words it would mean not only that the unemployable surplus of the population must be willing to emigrate from the periphery, overcoming a rooted unwillingness, but also that the countries of the centre must be prepared to admit large masses of immigrants who, accustomed to relatively low wages, would compete to advantage with the workers of the centre" (CEPAL, 1951, p. 13).

On this basis, in the chapter on Mexican economic development, Prebisch noted:

"For some time now, Mexico's balance of payments had been subjected to severe strains emphasizing once again the fundamental incompatibility of growth and equilibrium within the free play obtaining in the economy of a country in full development... Such an examination reveals that in Mexico, as in other Latin American countries, the effort made to speed up economic development and raise the standard of living of the population has been curbed from the start by a limited capacity to import" (CEPAL, 1951, p. 391).

It is worth recalling that, at that time, the Mexican economy achieved an average annual GDP growth rate of 6%, a rate that was maintained for nearly 20 years, although not without inflationary costs (an average of 9% annually) and monetary instability. In 1948-1949, it was necessary to devaluate the peso in order to absorb balance-of-payments disequilibria (Solís, 1972).

In his examination of 50 years of Mexican economic growth in this century, Prebisch underscored the decisive role played by the exportation of primary products –first petroleum and, later, industrial minerals– in order to finance the demands of capital.

Prebisch noted the existence of a kind of conflict between vigorous growth and the restrictions affecting importation:

"It is manifest that the country cannot maintain this rate of expansion and at the same time continue to import on such a large scale. Mexico is consequently confronted with a clear and conclusive choice of alternatives: either it must radically reduce the rate of development of its economy or else make a determined effort to modify the structure of its imports and adjust their coefficient in accordance with the rise in the national income, at the same time restricting foreign purchases to the limits set by the country's real capacity to pay for them" (CEPAL, 1951, p. 391).

Among the structural restrictions analysed, Prebisch underscored those relating to low levels of capitalization, due in part to the commercial deficit and the payment of incentives for foreign investment; the lack of infrastructure, especially railroads, which were nearly obsolete; and "precapitalist" farming, characterized by low productivity, excessive subdivision of the land with migration to the cities of great numbers of farm workers who could not all be absorbed into other economic activities. He also included as a structural limitation the impossibility of covering the need for capital goods to be used in modern farming and industry due to lack of resources. Prebisch proposed import substitution as a way to face these problems so that import capacity would be mainly used for capital goods and payment of foreign investment financial services, thus reducing disequilibrium pressures on the balance of payments. However, he also pointed out:

"An intensive development of industrialization is of paramount urgency in order to relieve the pressure of population in the rural areas and provide, together with industry's related activities, new sources of employment for the natural increase of the urban population. The limited capacity to import is one of the greatest obstacles to industrial expansion. This capacity is determined primarily by exports and by the terms of trade, followed by foreign investments and receipts from tourism, the latter having been considerable in the past few years" (CEPAL, 1951, p. 397).

In one of his last public statements, Raúl Prebisch raised a number of questions about possible changes in the world economic environment arising from the re-emergence of policies that favour market mechanisms for resource allocation. At the same time, with reference to foreign debt, he expressed concern over the attitude of governments and creditor banks in developed countries, as well as over the recommendations of the International Monetary Fund for correcting the economies of developing countries.

It was foreseeable that, "given the inequality between centres and peripheries", Prebisch would not agree with the policy of opening the economy that, in his judgement, did not coincide with Latin American interests. He believed that the region could only form part of the world economy when it had acquired the economic and technological density necessary for participating in the unending creation of goods and services (Prebisch, 1987). His analysis was based on the observation that Latin America had only learned to export what he called "simple produce", demand for which grows slowly.

To what extent is this approach valid today? Clearly, there are new factors that change the terms of reference, such as: the tertiarization of the international economy, especially that of the United States; the growing weight of South-East Asian countries that produce high technology goods efficiently; the impossibility of maintaining the old protectionist system with its high levels of State intervention and impossibly large public sector deficits; and, lastly, the emergence of economic blocs or of countries linked by free-trade treaties.

In the face of new pressures on developing countries to open up their economies to these new international trends, it is worth recalling that Prebisch noted that liberalization has very different meanings when used with respect to centres or peripheries, although it could also be said that this depends on the use of the term with respect to different areas of production or service.

II

Results of the 1983-1988 macroeconomic correction programme

Mexican development achieved on the basis of import substitution has been widely analysed by many foreign and national specialists both in terms of success (for example, growth of the domestic product, employment, product diversification, and technological expansion) and problems unsatisfactorily resolved, such as sector integration, the incapacity of industrial activities to generate jobs at the rate demanded by the rapidly growing population, and the low competitive level of national industries.

The crisis of the early 1980s and the subsequent period of adjustment, within the context of the search for viable economic policies, have called for the very rapid reconsideration of finance mechanisms for development, the degree of openness of the economy, and the regulatory role of the State and its participation in the production of goods and services.

In 1983, as in nearly all of Latin America, Mexico began a corrective programme to reduce balance-of-payments disequilibria produced by the expanding transfer of funds overseas which, in 1982, had amounted to US$10.5 billion, equivalent to more than 6% of the domestic product. The programme consisted in measures designed to strengthen public finances, increase the primary surplus, contain monetary growth and credit, achieve an exchange rate coherent with domestic and foreign interest rates, and begin to open up the national commercial economy.

In contrast to other efforts, this programme, together with orthodox measures, faced the need to combat the fundamental disequilibria of the Mexican economy through the implementation of the so-called structural change strategy (Poder Ejecutivo Federal, 1983) that consisted in measures designed to: redirect and modernize the production and distribution apparatus in order to create an industrial sector integrated internally and competitive internationally; increase domestic savings; rationalize public spending; decentralize productive activities and public administration throughout the country; and strengthen the role of the State in the promotion of development.

It was thought that both kinds of measures could be implemented simultaneously but the conditions in which the strategy was created changed in a little less than two years, accentuating macroeconomic imbalances and thus forcing the authorities to intensify short-term corrections.

Some conclusions with respect to the adjustment and its results in the 1983-1988 period[3] are:

– The adjustment period was longer than initially expected. At first, it was thought that a few measures to correct fiscal disequilibria, halt imports, promote overseas sales, and reduce inflation would be sufficient. When they proved to be insufficient, it was necessary to adopt more severe measures.

– The adjustment was unavoidable. The situation up to 1983 could not, in fact, be sustained; the economic and social costs of the adjustment have been, to a certain degree, inevitable.

– As long as in-depth measures to adjust the economy and correct the public deficit were not taken, attempts to stimulate growth (such as that of 1985) were premature and could not be sustained.

– The public deficit created by excessive spending became a public deficit arising from excessive interest payments on public domestic debt. This makes clear the need to distinguish between public operational accounts (considering only current account expenses) and financial accounts (taking into account interest on public debt).

[3] For a detailed evaluation of the successes and limitations of the economic adjustment, see Alberro and Cambiazo, 1989 and Poder Ejecutivo Federal, 1989.

– Foreign debt renegotiations also became progressively more sweeping. The Mexican renegotiations gradually convinced the international financial community and the United States Government of the necessity to change their perspective in order to admit creditor bank co-responsibility for the debt problem.

– The Mexican stock market crisis of October 1987 demonstrated, among other things, that the Mexican financial market is much more closely linked to overseas markets now than in the past, due either to the weight of expectations or to greater capital flow interdependence.

– Since the end of 1987, government efforts were centred on reducing inflation. In December of that year, the first of a series of agreements, still in effect, was signed. That first agreement, called the Economic Solidarity Pact, combined orthodox and heterodox adjustment measures.

– As the adjustment was deepened, new measures were taken to open up the economy further to foreign competition. Export permits were substituted more rapidly for tariffs and official import prices were gradually eliminated. Only areas such as the automotive, pharmaceutical, petroleum, and agricultural sectors remained subject to permits.

– The greater openness of the economy achieved in 1988 played its part in controlling inflation. This is demonstrated by the greater inflation since then in non-tradeable goods, such as construction, education, and housing costs.

In short, the post-war growth cycle, as experienced by the Latin American economy, has come to an end, as has the use of public spending to promote aggregate demand. It is now necessary to remove or resolve the disequilibria that block sustained and balanced development (Sunkel, 1989).

At this point, the 1988-1994 period poses the challenge to consolidate the successes of the adjustment and to broaden those measures that will promote structural change, beyond those designed for short-term stabilization. This is precisely the objective of the modernization programme of the Carlos Salinas de Gortari Government.

III

Economic modernization in the 1990s

1. *The new administration: accelerate the rate of change*

As the new decade begins, the Government of Carlos Salinas de Gortari is broadening the process of change. Domestically, the following steps are being taken: economic deregulation as a way to encourage private investment in key areas; consolidation of commercial openness in order to stimulate exports and increase productive efficiency; restructuring of the public sector, both in size and functions, in order to put government finances on a sound footing, improve public expense allocation, and increase social efficiency. Internationally, new types of relations with other countries are being sought in the context of establishing blocs or economic regions.

After nearly seven years of economic stagnation, in 1989, the first year of the new administration, the Mexican economy is beginning to show other signs: the domestic product growth rate rose to 2.9%, a result that coincided with an important drop in the annual inflation rate, to 20%. Private investment registered a real increase of 8.3%, achieving the highest percentage of GDP in the last eight years, while private consumption rose 2.9% in real terms with respect to the previous year. Non-petroleum exports grew nearly 9% in comparison to 1988, a year in which they doubled 1985 figures, while the national accounts deficit was US$5.58 billion due to increased imports (12%) and the still high foreign debt service payments of US$9.4 billion (6% more than in 1988).

In public finances, a primary economic surplus (excluding domestic debt interest) of 8.6% of GDP was obtained that allowed for a financial deficit drop of nearly 50% in real terms with respect to 1988 and 7 percentage points less of GDP.

In the international arena, the Government has allowed for the growing interdependence among national economies which can be observed in current commercial and financial trends, the impact of technology on productive processes, and the new character of transnational companies which tend to adapt their subsidiaries to the reality of each country.

On the domestic scene, the problems diagnosed by Raúl Prebisch and many Mexican economists after him have again become central government concerns. They include underdevelopment in the farm sector, lack of basic infrastructure, the role of public companies, the general slump in the economy, and unequal income distribution (Poder Ejecutivo Federal, 1989, pp. 84-88).

Along with these macroeconomic problems, there is an urgent need to meet the demands of a population that has undergone a rapid qualitative transformation in the last few years. All of this indicates new investment needs that require financing radically different from that which prevailed during the period of stabilizing development. For example, demographic projections indicate that the population will reach 94 million in the next five years and, toward the end of the century, around 110 million. There are also changes in the age structure: due to the extraordinary growth rates (on the order of 3% yearly) that prevailed until at least the mid-1970s, the younger population has gained greater relative weight, contributing yearly slightly more than 850 000 persons to the work force.

2. *The modernization project's central propositions*

The modernization project had four basic lines of thrust: a) State reform to guarantee the success of the fundamental development objectives; b) economic policy coherent with the objective to make the most efficient use possible of natural and investment resources; c) greater openness to the new trends in the global economic environment; and d) active consensus-building with national groups, both those of the private sector and among those with lower incomes, including greater government presence in peripheral urban neighbourhoods.

a) *State reform*

The reform of the State includes, among other elements, the revision of its constitutional attributes with respect to some aspects of development and the review of its executive faculties for the purpose of both deregulating economic activities and reducing State intervention. The reform, therefore, seeks to introduce changes in the nature and structure of relations between the Government and the diverse sectors of society. In political terms, these changes imply the consolidation of democracy.

Toward these ends, during 1989 and 1990, various decisions have already been taken. In terms of the privatization process, since 1989 to date, the Government has disposed of nearly 40 companies and enterprises as important as Teléfonos de México (TELMEX), Minera Cananea, and the iron and steel producing complex Las Truchas, among others, are being sold.

In terms of deregulation, progress has been made in the areas of nation-wide truck and multimodal shipping, in packaging regulations, export promotion activities, technology transfer, and the petrochemical industry, as well as in the marketing of sugar, cocoa, and coffee. Customs laws have been changed; aquiculture has been integrated into the private sector; and the fishing products market has been deregulated to a degree. At the same time, regulations for the petroleum products industry have been modified and the use of telecommunications terminal equipment has been liberalized. The purpose of these measures is to eliminate privileges and such monopolies as had arisen from excessive regulation.

On the other hand, the Presidential initiative of 2 May, 1990, which reinstated the mixed property system for banks –nationalized in September 1982 at the height of the exchange and financial crisis– has reopened the way for private investment in commercial banking. This measure seeks to strengthen a climate of confidence and stability as it prepares the Mexican financial system for the new conditions of international openness. Later, in July of that year, Congress approved a new law regulating the Mexican banking industry that establishes the conditions and foundations for the financial system within the new economic conditions.

b) *Changes in economic policy*

The economic strategy has two main goals: to recover an economic growth rate of around 6% by 1994 and to consolidate economic stability by seeking to reduce inflation to rates compatible with those of the country's main commercial partners.

To reach these goals, the 1989-1994 development plan has been designed according to two central guidelines: the progressive stabilization of the economy and increased availability of resources for investment in production.

The progressive stabilization of the economy involves increasing public revenues, limiting public spending in accordance with the availability of non-inflationary financing, promoting price stability, strengthening domestic savings, and supporting prices through exchange-rate policy (Poder Ejecutivo Federal, 1989, pp. 57-63).

For these purposes, a firm fiscal reform was implemented that modified the tax base and eliminated special tax havens that had become unjustified "fiscal paradises". Moreover, the overall subsidy system is being revised and public goods and services tariffs and prices have been modified in order to bring them gradually up to their real market prices.

Within the financial system, competition among banks has been promoted by permitting the free determination of rates and time periods, eliminating excessive regulation, and diversifying deposit instruments. Development banking remains in the hands of the State, although its functions have been redirected toward banking services of secondary importance. Moreover, efforts are being made to strengthen the capital market so that it will be more flexible in response to the needs of growth financing and will be competitive internationally in the acquisition of foreign capital.

Increased resource availability for investment in production (Poder Ejecutivo Federal, 1989, pp. 63-69) involves strengthening both public and private savings and reducing the transfer of resources overseas, a task within which an important role is played by the foreign debt renegotiation agreement [4] between Mexico and creditor banks, international organizations, and the Club of Paris, an agreement that crowned an intense process of 14 months of proposal analysis and negotiations. In it, the net principal owed was reduced by around US$21 billion, a reduction in annual resource transfer of an average of US$4 billion, and a change in the expiration date profile to a horizon of 30 years when a single payment of US$35 billion will be made. In this way, during the 1989-1994 period, transfers of funds overseas will represent an average of 2% of the domestic product in contrast with the 6% level of the 1980s.

[4] A detailed evaluation of the renegotiation process and its impact on the Mexican economy is found in Ministry of Finance and Public Credit, 1990.

c) *Efficient integration into the new international arena*

According to the plan (Poder Ejecutivo Federal, 1989, pp. 84-88), the foreign trade policy objectives are: to promote non-petroleum exports; to achieve greater uniformity in the effective protection of diverse industries; to lessen the distortions arising from non-tariff restrictions on commerce; increase exports and orient foreign investment, technology transfer and use of foreign resources towards the achievement of national commerce policy goals.

With respect to direct foreign investment, procedures for the authorization of new investments have been simplified thanks to new regulations in the respective law.

d) *Consensus-building: the change in the relationship between government and society*

The idea of consensus-building among diverse social groups is to promote an attitude of shared responsibility for development throughout society. According to this new concept, the Government now fulfills the institutional function of creating conditions in which society can achieve its objectives.

It is worth recalling here that President Carlos Salinas himself has stated that, in this sense, Mexico's problem has not been that of a small weak State but rather that of a State which, as it grew ever larger, became weak. Problems were exacerbated as the State grew in disproportionate and disorderly fashion, concentrating its efforts on the search for resources to maintain its own size in detriment to public service and the improvement of its capacity to defend the nation. The reform that will make the State flexible and efficient requires freeing resources that today are locked into public companies and concentrating political attention on the urgent demands of justice (Salinas de Gortari, 1990).

With this orientation, public efforts have concentrated on building consensus in three directions: a) to stabilize the economy through social pacts; b) to promote new finance systems for key economic areas such as highway infrastructure, mines, basic petrochemical services, and cellular telephones; and c) to overcome extreme poverty through the National Solidarity Programme which operates with its own budget and functions in a decentralized fashion in conjunction with municipal governments and community organizations. In 1990, resources dedicated to this programme amounted to 3.5 trillion pesos, that is, around US$1.2 billion.

IV

Terms of reference for renewed integration into the world economy

On the threshold of the twenty-first century, as in the 1950s, the foreign sector constitutes a crucial element in the development of the Mexican economy. There are, nevertheless, differences between these two periods that basically lie both in the new dynamics of international economics and in the type of industrial installation that characterizes the country's economy after four decades of inward growth.

The transition process begun by Mexico in its relations with the rest of the world, i.e., the effort to eliminate the traditional anti-export bias of the productive sector and open up a market that has been captive for nearly half a century, while overseas sales are converted into a motor for growth is made more complex and delicate by the fact that global transformations are occurring simultaneously with internal stabilization efforts and structural changes. The new direction for growth implies significant changes in resource allocation, both at the level of businesses and in the definition of the role of the State and of the kind of economic policy to be applied in the coming years.

In this context, the decision to establish a free trade agreement with the United States, a topic only recently being discussed, focuses on a complex set of problems, in particular the need to overcome economic stagnation and redefine the role of the State in the transition.

1. *Recent developments in the Mexican foreign trade sector*

In a little less than 15 years, Mexican foreign economic relations have undergone fundamental changes that have, in turn, affected the country's growth, conditioning its direction and rhythm to an important degree. In this section, the transformation undergone by the foreign sector of the Mexican economy will be analysed in the light of the most significant changes in the structure of foreign commerce, the foreign debt and its service, the inbond assembly industries (maquiladoras) and their influence, the composition of direct foreign investment, and the characteristic traits of integration occurring between Mexico and the United States.

a) *Changes in the structure of foreign commerce*

During the entire post-war period before the marked expansion of petroleum sales, there was a balance-of-payments deficit in the national accounts that was covered by agricultural and mineral sales, manufacturing (for a relatively modest amount), tourism income, and finally by foreign loans. During this period, the domestic market was protected by a system of high tariffs and the rigid and discretionary management of import permits, together with fixed exchange parity. At the end of 1976, it was necessary to devalue the peso in order to correct balance-of-payments disequilibria.

Since 1978, due to the oil boom, the structure of foreign commerce changed drastically: between 1978 and 1982, oil sales rose to account for an average of 45% of trade account income, while agricultural and tourism sales accounted for a lower percentage of total income, although their total value remained more or less constant. The new availability of resources and false expectations caused imports to grow threefold between 1977 and 1981. Moreover, the structure of imports also changed: capital goods imports rose from 26% of total imports in 1977 to 31% in 1982, while consumer goods imports rose rapidly from 8.8% in 1977 to 13% in 1980, dropping off to 10% in 1982. This behaviour was the consequence of the rate of growth of the domestic product which reached an annual average of 8% during the years prior to the crisis.

As a result of the implementation of the adjustment programme, in 1983 imports dropped by around 40% with respect to their 1982 level and 65% with respect to 1981 as part of the adjustment of domestic demand designed to stabilize the economy and counteract the effects of the drop in oil prices.

The moment was seized to introduce structural changes in this important variable in Mexican development through a gradual rationalization of trade policy that was linked to transformations of industrial infrastructure designed to make it more competitive internationally and to enable it to serve as a source of income. Between 1983 and 1985, oil sales continued to represent an average of 50% of total income, a contribution that was used to cover debt-service and payments on the short-term principal and to maintain high-priority imports. At the end of 1985, other events, such as the hike in real international interest rates, a new drop in oil prices, and the effects of the earthquake in Mexico City in September of that year, led to a radical change in the dynamics of the openness of the Mexican economy.

In this situation, the reduction of the number of tariff segments subject to control, of the range of tax rates, and of the average import tariff initiated the dismantling of domestic market protectionism. Added to this, in July 1986, the decision was taken to enter the General Agreement on Tariffs and Trade (GATT), for the purpose of consolidating multilateral trade relations. This resolution modified an earlier (1979) decision not to enter that organism, when the outlook abroad was completely different.

In 1990, Mexican foreign commerce presents a radically different image from that of a decade ago: 80% of tariff segments are no longer subject to permits; tax rates have been integrated into five levels, in contrast with the 20 levels of 1983; the average tariff is 9.5%, as opposed to 16.4% in 1982.

The structure of merchandise exports also registered substantial changes: between 1982 and 1989 non-petroleum exports grew at the annual average rate of 20%, rising from US$4 753 million to US$14 889 million. These sales accounted for 65% of commercial income in 1989, as opposed to the 22% they represented in 1982. Exports of manufactured goods accounted for 60% of the total in this area, within which the automotive, food-processing, chemical and mineral-processing sectors are the most dynamic, accounting for 35% of overseas manufactured goods sales in 1989.

During a first stage, from 1985 to 1987, growth of manufactured goods exports occurred within a stagnant economy in which the manufacturing GDP did not grow (Gitli, 1990, pp. 16-20 and 45), although there was a considerable rise in imports of intermediate goods which, by 1986, accounted for 65% of total imports. This implies that the implementation of a model oriented toward exports calls immediately for greater integration into the international economy.

b) *The inbond assembly industry*

The United States inbond assembly plants were installed in Mexico in the 1970s, a time during which the industrialization of the Mexican border was being promoted in order to exploit, on the one hand, the advantages arising from proximity to the market in the United States and, on the other, as a means of retaining within Mexico the population from the centre and south of the country that emigrated in search of higher income and better work conditions. Until the end of the 1970s, the level of employment and the number of plants was relatively low: each plant occupied an average of 165 workers. Beginning in the 1980s, exploiting the additional advantages arising from devaluations and the cost of Mexican labour, a considerable increase took place: around 1985, 620 plants occupied 124 000 workers, i.e., five times as many as in 1970.

Beginning in 1985, these industries acquired a new impetus. Since then, they have been diversified and have grown all along the border with the United States. Bureaucratic procedures were eliminated in order to facilitate temporary imports (i.e., those necessary for the subsequent exportation of finished products) and to encourage greater use of national inputs. Between 1985 and 1988, 870 plants were installed, employing 232 000 workers and, in 1989, another 310, bringing the number of businesses to 1 700, which carried out total commercial operations of approximately US$12 billion and gave work to slightly more than 450 000 workers and office staff (an average of 265 persons per plant), a figure equivalent to 17% of Mexican manufacturing industry employment.

A number of analysts have characterized this process as an example of the complementarity and integration being achieved by the manufacturing industries of these two countries.

c) *Direct foreign investment*

It is interesting to note that, in spite of Mexico's economic problems both before and during the crisis, direct foreign investment (DFI) continued, although at lower rates of growth. For example, cumulative direct investment up to 1989 amounted to US$26 billion, five times the accumulated investment in 1975 and two and a half that of 1982, representing, however, a small percentage of GDP: scarcely 2%. The following is its distribution pattern: 67% in industry; 25% in services; 7% in commerce and less than 2% in extractive activities and others. s for origin, 63% came from the United States, 6.7% from Great Britain, 6.3% from West Germany, 5% from Japan, 4.5% from Switzerland, and the rest from other countries.

The traditional protectionist policies of stabilizing development, particularly rigid legislation on investments controlled by foreign majorities, and the option taken prior to the crisis of using foreign debt to cover the financial needs of the economy instead of foreign investment, all contributed to the relatively low weight of DFI.

At the present time, the idea that it is better to have partners than creditors is gaining ground. This has become even more evident after it became necessary to resort to reconversion or exchange of foreign debt for investment, a mechanism that, although it involves reducing the size of the debt, implies exaggerated subsidies for foreign investments which probably would have been made without that procedure. Moreover, the mechanism has inflationary consequences that are particularly delicate at a time when a reduced rate of price hikes is a central economic policy objective.

d) *Foreign debt*

The explanation of the behaviour of the foreign debt lies in the decision to give artificial life to the old system of development that prevailed in the country since the beginning of the 1970s, a time when there were abundant resources in the international markets, available at negative real interest rates that made debt attractive. Public foreign debt grew 4.5 times between 1970 and 1976, rising from US$4.3 billion to US$19.6 billion. Moreover, interest payments amounted to 10% of total balance-of-payment outlays at that time, rising to nearly 14% in 1975 and 1976.

From 1977 onwards, the expectations created by the oil boom led to intensified debt accumulation: by 1982, the debt had grown to three times its 1976 volume, rising from US$19.6 billion to US$59 billion. Furthermore, from 1977, there was a substantial difference from earlier debt: service payments amounted to nearly a quarter of commercial balance spending, 21.6%, with a tendency to rise that moved from 18.3% in 1977 to 35.7% in 1982.

In spite of good intentions, the governments from 1972 to 1982 led the Mexican economy into domestic financial disorder, with a weakened currency, unrestrained inflation, and practically unmanageable foreign debt. Furthermore, at the end of the 1970s and beginning of the 1980s, the economy once again faced its old problem: the deterioration of the terms of export exchange, aggravated by rising international interest rates.

During the period of macroeconomic adjustment after 1983, the international banks stopped the flow of foreign resources while the debt was being renegotiated. Even so, after various renegotiations, debt service was maintained together with a certain level of basic goods importation.

While the foreign debt of private companies was managed adequately with government assistance (through the system called Foreign Exchange Risk Coverage Trust Fund (FICORCA)), public debt continued to grow, although at a lower rate than in previous years: between 1983 and 1988, it rose from US$62.5 billion to US$94 billion. This amounted to an increase of 51%, with debt service accounting for 34% of total outlays during the period, a percentage equivalent to slightly more than US$10 billion per year or, in other terms, 6% of GDP. That level of transfer was a drain on the country's economic growth.

2. *The free trade agreement and greater interdependence with the United States economy*

The last quarter of the twentieth century has been characterized by abrupt change. The growing weight of Japan and other Asian countries, the new consciousness with respect to energy resources, the debt crisis, the tendency among countries to form trading blocs, technological changes, the failure of the centrally-planned economies and of Keynesianism in the rest of the world, among other phenomena, require new responses from Latin American economies.

Overcoming the crisis and advancing in macroeconomic adjustments, the Mexican economy has moved ahead in the search for new ways to recover a process of sustained development and general welfare. On examining the consequences of renewed insertion of the Mexican economy into the world economy and, more specifically in connection with the United States economy, it is useful, in general, to consider two factors.

Above all, it is necessary to take into account the important differences in the levels of development that exist between Mexico and the United States and, by the same token, in the levels of welfare and salaries. This explains the strong flow of emigrants toward that country. Independently of decisions taken in matters of a new commercial relationship, migratory pressure will continue.[5]

[5]The flow of illegal migrants varies, according to different estimates, between 500 000 and one million persons annually.

Secondly, both economies are tending toward greater interdependence, a fact that can be demonstrated in different ways: for example, 70% of Mexico's foreign commerce is with the United States. In 1989, this amounted to US$52 billion, that is, double the amount of 1982.[6] Furthermore, 60% of domestic debt is in the hands of United States banks, while 65% of foreign investment comes from that country.

Many analysts speak of a "silent integration" between the two countries: the literature on the diverse aspects of this reality is ample and is being produced, nearly daily, by different centres and government sources, by the private and academic sectors. It is not possible here to discuss all the stages and aspects of this process. Whether one is for or against, it is a phenomenon that cannot be ignored, one that is evolving at a fairly rapid pace, as well.[7]

From the Mexican point of view, the proposal for a free trade agreement (FTA) with the United States arises from the conditions generated by the most recent national economic developments, that is, once the first stage of macroeconomic stabilization was over. As the first liberalization measures were adopted, after 1985, it became clear that export sales were limited by diverse types of United States protectionism. It soon became evident, as well, that the same problem was being resolved further to the north, through the Free Trade Agreement between the United States and Canada that has been in effect since January, 1989. It can be concluded that, if it is true that import substitution was more a historical necessity than a deliberate policy choice, as Aldo Ferrer has noted, the same is true now for the openness of the Mexican economy.

On the United States side, the FTA is favoured by government and private groups concerned with recovering global economic leadership for the United States and with stabilizing economic relations and migratory flows with their neighbour to the south. The United States, or at least important circles within that country, are reacting in the same way to the formation of the European bloc and to the new role being assumed by the nations of South-East Asia.

[6] This is still far less than the volume of commerce between the United States and Canada, which, in 1989, was nearly US$220 000 million.

[7] To illustrate the growing importance of the Mexican presence in the southern United States, it is sufficient to mention that 60% of the Hispanic population, around 20 million persons, is estimated to be Mexican.

In a first approximation, this would seem to explain the so-called Initiative for the Americas of the United States Government, a proposal which apparently calls for a new framework of relations with all of Latin America, based on three main lines of thrust: trade, investment and debt.[8] The characteristics and ramifications of this proposal will be the subject of far-reaching debate, the duration and conclusions of which are difficult to foresee.

a) *The background of the free trade agreement between the United States and Mexico*

Economic relations between Mexico and the United States have unfolded within a complex process of negotiations which have occasionally been affected by non-economic factors, advancing through situations, at times, of conflict and, at times, of mutual understanding. In terms of commerce, actions taken prior to the proposed free trade treaty have their roots in the 1970s, when the United States imposed the Generalized System of Preference (GATT) in 1974, as part of the protectionist reaction that followed on the 1973 oil shock. With this system, the United States could control exports from developing countries by imposing quotas and demanding compliance with discretionary regulations and other para-tariff measures.

The growth of Mexican foreign trade was thus subjected to those determinations. Since then, it has been necessary to proceed within a framework of negotiations limited to those specific areas in which Mexico is relatively competitive.

In 1975, both countries signed a textile agreement –renewed, since then, on five occasions– under which Mexico gains access to the United States market, even though restrictions remain for certain products which pose risks for the United States textile industry. The last renewal took place in January 1988, and remains in effect until December 1991.

In 1984, an agreement was signed to establish steel export quotas within the context of the Voluntary Restriction Accords which protect the United States market. Under this agreement, Mexican exports could amount to between 0.31% and 0.46% of the apparent national consumption in the United States. This agreement was renewed in October, 1989, for a period of 30 months, with a quota of 0.95% for the first 15 months and 1.1% for the remaining 15 months.

[8] See George Bush's speech, "Initiative for the Americas", Washington, D.C., 27 June 1990, published in *El Nacional*, Mexico City, June 1990, pp. 8 and 10.

In 1985, a bilateral understanding was reached on the matters of subsidies and compensatory rights for the purpose of reducing frictions arising from the unproven claim put forward by some United States merchants that Mexican exports were being subsidized. This accord was renewed for a further three years, beginning in 1988.

By 1987, the negotiations under way within the general agreement or bilateral understanding about consultation on matters of trade or investment covered a range of industries and areas of mutual interest (steel, electronics, textiles, agriculture, tariffs, foreign investment, intellectual property, insurance, and transportation). In March 1989, this agreement was ratified and study groups were formed for each area.

In October 1989, both countries signed a new framework agreement designed to incorporate other areas, given the prevalent interest in promoting trade and investment in those areas within the overall negotiations. The new agreement refers to areas such as the petrochemical industry, a group of farm products, and loan regulations and standards.

On the basis of these agreements, in October 1989, a joint committee for the promotion of investment and trade was formed for the purpose of stimulating investment and exports in the agreed-upon areas, within a general framework that supersedes negotiation by sector or in terms of diverse products and allows for greater interdependence between the two economies. In a first stage, this committee will promote investment projects in the petrochemical, telecommunications, textile, electronics and food-processing industries.

b) *The basic contents of the free trade agreement*

In June 1990, both Governments initiated conversations aimed at establishing a free trade treaty which will cover the following points:

– Promotion of investment and goods and services trade through the gradual elimination of tariffs;

– Elimination or maximum reduction of all possible non-tariff barriers, such as quotas, import permits and technical barriers to commerce;

– Creation of effective mechanisms for the protection of intellectual property, patents, trademarks and trade secrets;

– Implementation of efficient mechanisms for the resolution of controversies.

Both countries have already initiated the formalities mandated by their respective legislatures. Even so, several months will pass before detailed negotiations will begin. Although the agreement set for December 1900, between Canada and the United States required several years of negotiations and studies, the agreement with Mexico is being advanced through more expeditious channels on the initiative of both Governments.

c) *Some terms of reference*

On examining the possible motivations and determinant conditions for a free trade agreement with the United States, the following terms of reference seem to emerge with respect to the new insertion of Mexico into the global economy:

– The need to give order and direction to the process of growing interdependence between the two economies. For example, inbond assembly activities and migration have grown in an uncontrolled fashion, principally in the border areas of both countries and in certain industries (such as the automotive, electronics, textile, furniture, and the electric and electronic supplies industries) and not, as yet, within the emerging joint framework for both economics. The agreement would allow for amplifying the effects in the production infrastructure of both economies, as well as in other regions of their territories.

– The need for bilateral regulation of those economic matters which are currently managed in discretional fashion. That is, more even-handed negotiations are necessary, not only between governments, but among business people.

– The need to obtain fresh capital to finance Mexican development, both for increasing industrial capacity and modernizing economic infrastructure.

– The need to make the Mexican economy more competitive and efficient as a way of gaining more space in world markets, not only in the United States. In this sense, the basic aim seems to be that of changing relations with the global economy on the basis of a new relationship with that of the United States.

– The need to create jobs and respond more rapidly to those social demands made more acute by nearly seven years of economic stagnation. This will become a means of both slowing emigration and of generating new income for the Mexican people. The position of the Mexican Government has been: "We wish to export merchandise, not workers".

The advantages and risks involved in a project of such a nature and dimensions depend on many economic and non-economic factors. Among the advantages would seem to be the current characteristics and structural restrictions of the country's productive capacity, limitations that are not altogether different from those observed by Raúl Prebisch a long time ago but which, today, are in a process of profound change.

A relatively short-term effect could be the influx of capital in the form of financial investment, which would enter into play with a banking system in the process of being re-privatized and a stock market in a process of revitalization. In a second stage, mid-term production projects to take advantage of the new rules of the game should be generated.In this way, a broader market for the products of both countries would gradually take shape.

Another positive effect has to do with the creation of a new, more propitious economic environment which would allow for more secure and longer-range investment planning; this would entail overcoming the current situation of sectoral and product-specific negotiations. Matters, such as greater technological transfer, improved business management systems, and new possibilities for joint ventures by businesses of both countries, would be covered.

At the same time, United States products could become more competitive thanks to the low cost of Mexican labour. The transfer of businesses to Mexico would allow United States manufacturers to supply products both for the local and international markets with an advantage over other countries.

Within these negotiations, it is foreseeable that the United States Government will exert pressure for the liberalization of services, especially financial services (currently limited to citizens by the law for credit institutions, recently modified in July 1990), and for greater flexibility in foreign investment regulations for the purpose of ensuring a stable capital market for United States private investors. This would give that country an advantage in the negotiations of these matters within the General Agreement on Tariffs and Trade (GATT), in the Uruguay Round. A topic requiring special care will be negotiations with respect to Mexican energy resources, given the foreseeable interest of the United States in ensuring access to alternative energy sources and the reluctance of the Mexican Government to include that matter in the agreement.

Within the conversations, mention has been made of the objective to duplicate the volume of trade between the two countries, in order to reach US$100 billion in five or six years, depending on when the agreement enters into effect. This would imply average annual growth of 15% which, judging from the trade growth rates of recent years (around 20% annually), does not seem impossible.

Moreover, given the different interests of the United States and Japan in commercial matters, Mexico could become an investment alternative for Japanese merchants who would be seeking to consolidate their position within the United States market, although this possibility could be expressly rejected by the United States Government in the negotiations. Japanese investors seem to be waiting for Mexican business access to the United States market before embarking on investment projects in Mexico, together with the satisfaction of their demands for reform of Mexican law in order to protect investments from Japan.

With respect to the range of interests within each country, both favourable and opposing positions can be observed. Part of United States society is concerned about the intensification of migratory flows of workers into their country and will energetically oppose the legalization of labour mobility. Certain United States labour union groups have expressed fears in the face of the foreseeable displacement of workers which the emigration to Mexico of capital directed principally towards labour-intensive endeavours would occasion. In this context, it is worth while to mention Rudiger Dornbusch,[9] who reminded United States public opinion that competition among low-salary countries has been occurring for some time and that the tendency of United States businesses has been to produce in other countries, mainly in Asia, and subsequently increase the flow of exports to the United States. Within the context of a free-trade treaty with Mexico, he observes that we should ask ourselves, as jobs move abroad, whether we prefer them moving south or to Asia.

For its part, in Mexico, opposition politicians, certain union representatives, and small business people have also raised criticisms of the agreement.

[9] See the series of articles "Commercial Relations: the United States-Mexico", *El Nacional*, Mexico City, 25-28 June 1990.

d) *What will the future bring?*

Above all, it is necessary to recognize that we are witnessing a long-term process: the fruits of the FTA will not be seen immediately, nor have the effects of greater economic openness since 1985 come to light rapidly. Since then, major changes have taken place in the country's export base: non-petroleum exports grew, between 1982 and 1989, at a rate of 20% annually, rising from US$4 753 million to US$14 889 million. Manufacturing exports now account for 60% of non-petroleum sales and acted as a motor for the rest of the economy during 1989 and part of 1990.

On the whole, it will be necessary to moderate the urge to concentrate overseas sales only in businesses with foreign participation and to exert influence on all productive areas within the country so that the new development will be not only sustained but will also maintain certain social, sectoral, and regional balances.

To date, economic openness has had more benefits than costs, mainly for two reasons: the depth of the crisis of the 1980s which undermined the foundations of the style of growth of the past and the new international conditions which independently exerted pressure in favour of a different direction for growth.

Nevertheless, it will be necessary to be alert to costs which will appear as the process of commercial integration advances. It is also possible that juridical controversies will arise which will be difficult to resolve, given the possibilities and advantageousness of change in certain Mexican laws.

In very general terms, several economic policy recommendations can be derived from this discussion:

– Support certain industrial areas during the transition;

– Provide financial support for the commercial disequilibria occasioned by increased imports, principally of intermediate goods;

– Define policies and specific support mechanisms for agriculture, rural employment, and food processing activities; and

– Implement emergency measures to provide jobs for those workers who will be displaced during the transition.

In any case, there must be no doubt about the necessity of entering into a new relationship with the global economy in the greater interests of long-term Mexican development.

V
Conclusion

This study has covered a wide range of topics for the purpose of presenting a profile of the situation of the Mexican economy at the end of a difficult phase in terms of its limits and potentialities in the new circumstances. Surely, the evolution among countries and regions will be very different in the immediate future than during the post-war period. In this context, the path that Mexico is beginning to travel can only be dimly discerned.

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CEPAL REVIEW No. 42

Economics and happiness

*María Conceição Tavares**

This article was originally conceived as an argument against the illusions of the ultra-liberal Anglo-Saxon school, which always preaches, with its Victorian morality, that the right way to achieve happiness is via austerity and the free market. Later it became a tribute to Raúl Prebisch, the first Latin American political economist to have a critical view of the dominant economic thinking and to propose a framework for interpreting the "historical situation of the periphery".

However, the objective of this article is not to pick up the clew of Ariadne left behind by Prebisch, but rather to evaluate as concisely as possible –touching on key points of political economy– the chaos in which social thought finds itself today. The ultimate objective is to reach the same questions that Prebisch asked at the end of his life; they need to be asked again concerning this *terra incognita* which Latin America has become after so many failed developmentalist and reformist experiments.

No certainties exist. But there is an almost unanimous intuition that the so-called lost decade of the 1980s was not so lost, at least for those who greatly appreciate the democratic transitions that took place in the continent and believe that only on a basis of the struggle for democracy can progress be sought in the economy and happiness of our peoples.

A partial discussion of these issues, with the same title of "Economics and happiness", was held in a seminar at São Paulo in 1988. The title was kept because, in the author›s opinion, Don Raúl would have liked it that way. He fought so hard for the two terms to become compatible.

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Wealth, consumption, labour, progress: these are the main themes of political economy which the human mind associates with the notion of happiness. They can be associated positively or negatively, but here they are, ever since the active and not the contemplative life, the natural and not the divine order, the bourgeois and not the feudal order came to govern human destiny, that is, since the Modern Age.

Political economy, from the classics onwards, was always impregnated with a moral philosophy propounding happiness and freedom as feasible objectives of human society. The classical liberal school searched for "general happiness" or the common good, which was to be achieved through freedom of the market and contracts whereby selfish interests would lead, through competition, to the harmony of the "invisible hand", to the balance of the natural order or to the common interest of the social contract.

Likewise, the critique of political economy, beginning with Marx, propounded that human happiness and freedom could be achieved by overcoming not individual conflicts but the contradictions of capitalist society, which would lead to the metahistory of a classless and stateless society or at least to a society with a State reduced to administering things.

Later, in the twentieth century, it would be dramatically shown that it was human beings and not things that the State (socialist, social or liberal) would have to "administer", always in the name of "true freedom": the recognition of need, the common good or the public good.

Now at the end of the century, when the crisis of the nation States, especially the imperial States, could endanger the very survival of society (good or bad), the individual, rationality, private and general happiness, and freedom of the market are all being seriously discussed again. Is this just a neo-liberal wave? I think not, because the debate crosses the frontiers of scientific disciplines and the borders between political and social systems. Moral philosophy is back in style, even though it is actually warmed-over Victorian philosophy. The flexible organization of work and leisure time is a dominant concern, given the rigidity of the vast urban industrial concentrations and new techniques. The active political participation of common citizens has become desirable again, as opposed to the apathy of the masses.

I
"Introduction to chaos"

Part of the contemporary debate is centred on the uncertainty and lack of transparency of social structures, but also on the crisis of the intellectual and scientific "models" of our transition period. Theoretically speaking, a situation is called a "chaos" when its structural complexity is such that, for different reasons, a systemic vision is impossible. The most important situation of that nature seems to be when it is impossible to integrate micro and macro structural aspects, and this prevents determining systemic trends and presents a good deal of uncertainty about possible courses of action.[1]

Thus, unlike many pessimists who, on the basis of apparent "convergences" towards the final victory of a social system or development pattern, speak of the "end of history", whereas history appears to be more open than ever. Since the time when the world was "upside down", in the felicitous words of the English historian Christopher Hill, that is, from the seventeenth century, there has been no other historical period so rich in changes unexpected and unforeseen by scientists of all hues.

Of all the authors I chose to base my reflections on, only one was an economist, Hirschman, a kind of intellectual counterpart of Prebisch in the North, whose thinking enlightened my reflections on development. The rest comprise a heterogeneous group of thinkers who touched on crucial points of the contemporary social condition and who have thrown light, at least for me, on the classical themes of political economy: labour, consumption, technical progress and time (historical and abstract). They are all concerned, implicitly or explicitly, with either individual or collective human happiness. Moreover, their view of the world does not belong to the positivist tradition but rather to the great tradition of Western modernity –"critical reason".

[1] For the new science of chaos, which began with meteorology and physics, see James Gleick, *CHAOS - Making a New Science,* New York, Viking Press, 1988.

In a heroic attempt to cut a long story short, I shall present what seems to me the essence of the issues raised by those authors, as follows:

The questions: What have the results of progress done for citizen consumers? (Hirschman); What kind of State is the contemporary State? (Habermas); Human Freedom (Arendt and Lash).

The answers: instability; unpredictability; lack of transparency.

The return to Paradise Lost: illuminist reason (Rouanet); socialist reason (Gorbachev); free labour (Gorz); the Iberian matrix (Morse).

And finally –so as not to leave this introduction to *chaos* without some quotation from one of the few winners of the Nobel award for economics who do not put the "corporation" or the "dismal science" to shame –here are the words of Wassily Leontief: "Before being expelled from Paradise, Adam and Eve enjoyed a high standard of living without working. After their expulsion, they had to live miserably, working from morning to night. The history of technical progress over the last two centuries is the history of a tenacious effort to rediscover the road to Paradise. Nevertheless, even if all the riches were to be offered to us without having to work for a wage, we would die of hunger in Paradise, unless we could respond with a new income policy for the new technical situation." This quotation was the best one I could find to illustrate the debate on "economics and happiness" in the developed world.

I am adding this piece of information only for those who see in the accumulation of wealth an important source of (un) happiness: the data available at the end of 1987 indicated that close to US$8 trillion were in international financial circulation, and were rotating at a frightening speed in the computers of the international private agencies. What Keynes called "casino economics" is no more than a children's game compared with the instability of the so-called market for overnight deposits. For a person who does not know what that means on a world-wide scale and has only a vague and spurious idea of how this fantastic technological invention works, I must add that that idea disproves the major finding concerning the temporality of modern physics, classical economics, history and the human condition, namely, that time is irreversible. For the overnight market, time is reversible; it depends on the time zone in which the speculator finds himself and the network of operators to which he belongs.

I must mention that no one today knows how much the dollar is worth, or what the value is of the aggregate debts or credits of families, enterprises or nation States that have climbed aboard this "financial merry-go-round". One day's losses on the great world exchanges in November 1988 were around US$1 trillion, and in spite of that, the private financial system did not collapse.

Meanwhile, 20 million unemployed in Europe have to eat and are out of work. No one knows how many of them want to work, but they dream of a united Europe of peoples and capital: an apparent contradiction that would distress André Gorz but leaves people happy and gives a new meaning to the "utopian energies" which preoccupy Habermas.

South of the equator, where there is no sin but where "flying fish" exist, history is different. Here the debate about the future, happiness and economics seems to be a bit "out of place", even in the universities which, after all, should be the place where ideas circulate or are "rejected". And why? Because in the peripheral economies the discussion on the domain of human freedom does not conform to any principle of moral philosophy, when the basic needs of millions of human beings remain unfulfilled. Here then –and may I be pardoned by all my liberal and libertarian friends of all hues who hate the "philosophy of history" –freedom is still a recognition of need, even when the "élites" have every right to their individual freedoms.

Political economy was once a "modern science" *par excellence*; it actually contended with physics for the privilege of inaugurating the Modern Age. After it distanced itself from politics and opted for the rationality of economic calculation, it became a "dismal science" for market self-regulation. I quote this here, because it seems to me more and more true, a paragraph from the thesis I wrote more than 10 years ago in order to become a full professor:[2] "Modern physicists did not have to see sun bursts in order to formulate their laws of matter and energy. They did not have to split the atom to produce new theories. They have no desire to plug the black holes of the universe with old equations (nor do they treat dissipation with immutable laws).[3] Economists saw the growing seriousness of the crises of capitalism; they saw what caused the separation of the "orbits" of production, of the circulation of goods and money; they saw the "sun" burst at least once in their lives, but they carry on, tied to their Newtonian physics".

Faced with the financial and administrative crisis of the nation States in the 1980s, conservative thinkers enthusiastically embraced the watchword of deregulation, while "progressive" thinkers eagerly discussed capitalism's theory of regulation. Until we are told otherwise, it seems better to hand over the care of "human happiness" to the psychologists and professional politicians who, at least, are always inventing new therapies and do not obsessively recommend "abstinence" and work to people who are both starving of hunger and unemployed.

[2] M.C. Tavares, "Ciclo e crise, O movimento recente de industrialização brasileira", Universidade Federal do Rio de Janeiro (UFRJ), Rio de Janeiro, 1978, *mimeo*.

[3] For the crisis of science, especially physics, see Ilya Prigogine, *A nova aliança*, Brasilia, University of Brasilia Press.

II

The historical and theoretical dissolution of political economy

The liberal models appear to have been abandoned in the early twentieth century, when the theory and practice of warfare, imperialism and the repeated crises of capitalism prompted the rebellious "élites" of the Western world to cast doubt on the bourgeois order, that same order which had begun so auspiciously with the collapse of the *ancien régime* and the slogans of the French Revolution: freedom, equality and fraternity. The liberal and democratic dream of the United States, the highest expression of the new society, ended in 1888 with the invasion of the Philippines.[4] From that time on, up to the crisis of the 1930s and the emergence of Nazi fascism, liberal thought did not concern itself with libertarian slogans or the common good, and only after the war would it come to discover that consumption and happiness are equivalent.

Political concerns in the period between the wars revolved around the terms order, discipline and power. The liberals' economic concerns were centred on the end of the gold standard, which threatened the world-wide value of capitalist wealth. The discussion of human happiness was handed over to utopian socialists of every stripe, who obviously emphasize the "value" of free labour and not of consumption.

The dream of the Socialist International came to an end in 1914. The glorious revolution of the masses, doomed for a long time to socialism in a single country, ended by giving rise to an authoritarian State, which administered human beings but not things with a rule of iron. Western Marxism, threatened by fascism, abandoned the critique of political economy and dedicated itself to *Kultur Kritik*, and from then on, to philosophy.

Between the wars, political economy produced two great theoreticians of the capitalist crisis, Keynes and Schumpeter, whose teachings survive to these days. Unfortunately, Keynes' disciples, especially in the United States, are making a *pastiche* of his theory, to the point that neo-classical thought is becoming dominant again.

After the Second World War, the liberal order of imperial capitalism and that of authoritarian socialism became the new ideological banners dividing the Western world. In the meanwhile a new reality appeared, the welfare State, which owed less to Keynesianism than to the reformers and social-democrats of northern Europe. They reverted to concern for human happiness, this time not just individual but collective happiness. The right to work (full employment) and the right to social consumption (health care, education, social security) are duties, supplied by the social welfare State to its citizens.

For the first time, the ambiguity between public and private consumption and between citizens' individual and social rights became very clear. To the State citizens appeared to be bearers of a triad of contradictory rights: the political right of universal suffrage (legitimation), the social right of organized workers (challenge), and the diffuse or segmented right of consumers (clientele). Obviously, this Holy Trinity, intended to guarantee widespread happiness, created problems for the State, but generated an unprecedented legitimating social impetus of which the Marxist and Latin American Left became aware only when the crisis of the welfare State was at its height.[5]

Social democracy was slow in coming to power in the heart of Europe and, when it did so, the economic regulation of capitalism and the dissemination of mass consumption were already well advanced. In the case of authoritarian socialism, the victory of the Soviet Union extended the empire of real socialism, but confirmed the Soviet bureaucracy in its centralizing role of an insuperable Power, reinforced by the permanent threat of the external enemy. Within the country, dissident intellectuals attacked forced industrialization, the deprivation of consumption, the deprivation of individual freedoms, but did not manage intellectually to confront the model of Western philosophy, reinforced by circumstances, the true freedom of which was the recognition of need.[6]

[4] See Barbara Tuckman, *The Proud Tower*, New York, Bantam Books, 1985.

[5] For the critique of the crisis of the welfare State, see "A nova intransferência. A crise do Estado de Bem-Estar Social e o esgotamento das energias utópicas", *Revista do CEBRAP, Novos Estudos*, No. 18, December 1987.

[6] For the relation between freedom and necessities and its recurrence in the history of Western philosophy, see Hannah Arendt, *The Human Condition*, University of Chicago Press.

Nevertheless, the bureaucratic socialist State operated by an internal logic of accumulating heavy industry, which had nothing to do with any philosophy but rather with two basic facts of political economy. First, it was a country late in industrializing which had to incorporate vast rural masses into a process of socialized labour and patterns of minimum urban consumption. The second fact was military confrontation with another system. Thus the industrial production of capital goods and armaments became the basic priority of the State, not the collective or private consumption of citizens.[7]

It is striking to note how long it took for the discussion to arise in the Soviet Union about the nature of social consumption and the character of its organization. Yet private consumption ended as if it were what the Russian people wanted, even before the failure of the "dream" of technological superiority and the bureaucratic organization of socialized labour. Gorbachev's recent self-criticism of the Soviet socialist model for organizing and managing the State and the economy recognizes the need for a new economic policy. This criticism refers again to the classical elements of efficiency and a certain freedom of markets, which has led its detractors and liberals of all shades to point out a possible "peaceful transition" from socialism to capitalism.

The dominant ideology in the Western world seeks to liberalize the two basic markets of capitalism: the labour market and the money market. For its part, the discussion on the new "democratic socialism" centres on questions of a new social organization of production, labour and political participation, and neither on the "reign of individual market freedoms", as the liberals would like, nor on the "reign of free labour", as the utopian socialists would prefer.

The new socialist realities, with respect to political freedoms and the acceptance of democracy as a fundamental rather than an instrumental value, are nourished by the "old utopias" of human society. It is not yet clear which *new "utopian energies"* will feed the transition from the relations of labour and production to a new type of real socialism.

But let us go back to the crisis of the capitalist political economy in order to confront, finally, its present state of dissolution.

From Adam Smith up to the present day, political economy concerns labour, production, productivity, as necessities for economic development, subject to natural or historical laws, and rationalizes the technical process as a source of human progress in general. At the same time, it criticizes conspicuous consumption, the idleness of the leisure classes, unemployment, which are the "natural" result according to some, and the historical result according to others, of this system of capitalist or industrial production, depending on the perception of the schools to which the economists belong. They all have a moral philosophy: progress is good in itself; only its results can be bad. People are good in themselves; it is their ways of association that may be wrong. The struggle between passions and interests is the driving force of human history, but its results are generally good and progressive. Those who dare to doubt this have been categorized as alarmist or irrational.

Given this implicit philosophy of "natural progress", it is not surprising that political economy is in crisis. A discipline which seeks to be scientific should abandon a moral philosophy that preaches abstinence, saving, austerity, and postulates equilibrium, while the accumulation of wealth, waste, conspicuous consumption, inequalities and imbalances are the registered trademarks of history and the motive power of capitalism. Political economy should rather face up to the criticism of a system in which capital accumulation is an end in itself and leads technical progress down the wrong roads which are far from constituting plain "creative destruction", as Schumpeter thought.

Nevertheless, liberal economic thought did not confront reality; it liberated itself from reality. By continuing to postulate market equilibrium, it began to measure happiness in terms of the ordered (or revealed) preferences of individuals and to free itself from anxiety by selling "happiness" in psychologists' offices, often as merchandise.[8]

[7] This industrial strategy to make up for the delay was also followed at one time by the two most economically successful countries in Asia today: Japan up to the disaster of the Second World War and Korea from 1950 to 1960.

[8] A sound critique of this subject is found in the works of Christopher Lash, *O mínimo eu*, Ed. Brasiliense and *Cultura do narcisismo*, Ed. Imago.

With the transformation of political economy into a moral philosophy or a capitalist apologetic, we arrive at the true model of contemporary "economic science", i.e., the so-called economic analysis of general equilibrium. Contemporary neo-classical economists include therein all human activities, in an economistic totalization that is a supreme manifestation of the arrogance and emptiness to which our "dismal science" has arrived. Labour analysis leads to a theory of human capital and consumption analysis to a theory of consumer preferences in a situation of scarce resources. Thus the individual consumer must classify his preferences by priority and compare them with relative prices in order to attain an optimum position.

The observation that every activity requires time, which is generally scarce, is basic for the idea that all human activities fit into neo-classical economic analysis. The analysis of time as a "finite good" is the touchstone for understanding the most varied aspects of human behaviour "from the economic point of view". Time is money, said United States businessmen a long time ago. That is why consumers' preferences from one time to another encompass all goods visible and invisible, from money to oil, from friendship to war, from work to idleness and finally, why not, to happiness. This last point was confirmed when sociologists discovered that it is possible to ask people if they are happy, not happy or very happy, happier now than last year, etc., and to relate such revelations not only with income but also with a series of other variables, such as autonomy, self-esteem, etc. With the help of behavioural psychologists, human action and the uncertainty of the future are reduced to a series of predictable ways of behaving.[9]

This quest in search of rationality and the market as the "sovereign kingdom of freedom" reached its peak, in the middle of the crisis of all scientific models, with the triumphal arrival of the "new classicals", as the United States neo-classical economists of the most recent generation pedantically call themselves. They have no doubts about the world or science, nor is rationality in crisis, as far as they are concerned. Expectations are rational, the probable future can be predicted, equilibrium is a perfectly feasible economic course of development, depending only on a complex mathematical treatment of the models and a rapid and reliable treatment of information. This presents no technological problem; the computers are there for that purpose.

Thus a technological revolution, informatics, which has given so many headaches to scientists and social philosophers, besides causing the practical problems of "regulating" the labour market and the money market, is inadvertently emerging "for these new apostles of positive economics". For them, the central questions on the development of technological progress and the evolution of the present crisis do not lead to the answers indicated in the introduction to this essay –instability, unpredictability, lack of transparency– but rather to the opposite. Seriously, they lead to the Biblical prayer, "Lord, lead us not into temptation".

They are not tempted to "return to Paradise lost"; they find politics abominable and strictly speaking, if they could, they would eliminate human action as something that subverts logic. Samuelson, irritated by the return of the neo-classical economists (and their notorious consultancies for the military regimes of Latin America), called this attitude market fascism.

III

The negative relation between economics and happiness

Labour and consumption seem to be, throughout almost two centuries, one of the "keys" to the problem of the negative association between economics and happiness. Labour is either lacking or overabundant; consumption likewise. Labour is socially necessary, but alienating; individual consumption is indispensable but, beyond a certain limit, it is waste, ostentation, foolish happiness. More than a problem that is formulated and resolved dialectically, it appears to be an "ambiguity". It is an ambiguity of many facets: the public or private character of labour or consumption, the free and

[9] For a more profound critique and a different analysis of consumption, see Hirschman, *De consumidor a cidadão. Atividade privada e participação na vida pública*, Ed. Brasiliense.

necessary character of human activity, general happiness or unhappiness, which desires or rejects labour and consumption as a curse or a blessing.

These ambiguities also pervade all currents of economic thought, from the liberal to the Marxist, and almost always generate a moral philosophy which upsets the most rigorous analyses. That is why a rise in the levels of material consumption was always seen as an evil by all the great thinkers of the past, from Adam Smith up to Veblen (the first great critic of consumerism). This moral rejection has become so widespread in our time that there is practically no author, conservative or progressive, who does not attack consumerism. In his interesting book *From Consumer to Citizen*, especially in chapter II, Hirschman artfully criticizes this hostility: "New material wealth, then, is caught in a dilemma: if the masses have access to it, the conservatives rebel because the social order is threatened; if it remains out of reach for the masses, the progressives are infuriated by the growing disparity between patterns of consumption. Since data are never free of ambiguity, new wealth and new products can be, and have often been, accused and cursed by both sides."

The same ambiguity occurs with the concept of labour, whether socially necessary labour or free labour. A considerable part of Marxist or simply progressive literature has been dedicated untiringly to this issue. Unfortunately, the results obtained can be called unsatisfactory. The meanderings of Marx's labour-value theory have been made worse up till now by his disciples.

I take the liberty of repeating here some of the paragraphs of the essay I wrote in 1978, even though they obviously do not resolve the question of ambiguity. "Given the growing fragmentation of the 'labour market' and the impossibility of standardizing the social conditions of production, an attempt is still being made to recover, for the purpose of a contemporary analysis of wages, the concept of the 'reproduction cost' of the labour force. In the effort to rationalize the intolerable reality of capitalism and its decaying 'order', the discussion centres on the personal earnings of 'free labour', converted into bureaucratic subjection in the organized services of the State, in terms of productivity. The work of doctors and teachers employed by the State is discussed as if it were 'productive labour'. Being subject to the same general regime for exploiting paid labour, all 'special jobs' are considered as if they were governed by the regulations concerning a working day that involves machine work. It would be better instead to examine their social usefulness or *use value*, and try to negotiate their 'exchange value', not arbitrarily, but in line with the real conditions of power and *legitimation* by society."

The "politicizing" of prices is rejected, even the most visibly politicized one, which is the price of labour in services that do not fit into categories such as productivity or scarcity. There is no awareness of the fact that the basic difference between a "lumpen association" and a "corporation of university-trained labour" lies in the differences of political power and social status. There is no admission that the system of valuation is different, that the system of ranking in the labour process no longer coincides with the technical and productive differentiation of capital; that in modern social organizations, the superstructure of the contemporary capitalist system has its own valuation rules, in which political power and legitimation count more than capital movements, in disorderly expansion.

Labour, if capital dispenses with it, is, in its "freedom", temporarily downgraded to the status of immigrants, or is forced to create organizations for its survival. It is obliged to wage a political struggle, periodically lost, in a society that is falling apart, pending a transition to a new society.

Hannah Arendt's interesting reflections on *animal laborans* also do not dispense with the ambiguity of labour and its relation to action and the human condition. The following is a quotation from a paragraph of her analysis of the consumer society, which seems to me relevent to this essay because of its explicit reference to happiness.

"The rather uncomfortable truth of all this is that the triumph of the modern world over necessity is due to emancipation of the labour force, that is, to the fact that *animal laborans* can occupy a public sphere, and that nevertheless, so long as *animal laborans* continues to possess that sphere, there can be no genuinely public sphere but only private activities exhibited in public. The result is what is euphemistically called mass culture; and its deep-lying problem is universal unhappiness, due on the one hand to upsetting the equilibrium between labour and consumption, and on the other, to the persistent demand of *animal laborans* to attain a happiness which can be achieved only when the vital processes of exhaustion and regeneration, pain and relief of pain, are in perfect balance. A universal demand for happiness and unhappiness, so common in our societies (and which are no more than the two sides of the same coin), are some of the more persuasive symptoms that we have already begun to live in a working society that does not have enough work to keep it happy. For only *animal laborans* –and not the craftsman or the man of action– never asked to be happy or thought that mortal men could be happy."

Gorz's reflections are more specific and aim to solve the problem.[10] However, despite his critique and his proposal of a lifelong income independent of employment, the ambiguity of free labour is not resolved in his text. He says some naive things, similar to those of the neo-classicals: instead of a self-regulated market, self-regulated free labour. Conflict and politics evaporate from his writings, as in the case of our neo-classicals. His faith in automation and in the freedom to come and go recalls the naiveté of *laissez faire, laissez passer* of the early liberals.

Thus at the end of his most stimulating chapter, "Leaving capitalism behind", he says: "the comings and goings between heteronomous labour, optional microsocial activities and autonomous personal activities constitute the guarantee of equilibrium and the freedom of each person. The complexity, the vagueness, the overlaps keep open the spaces where initiative and imagination can be exercised. These are the richness of life".

Thus, given automation, "economic logic" would no longer have anything to do, according to Gorz's way of thinking and –I would add– the organization of socially necessary work would disappear. And, in short, the reign of individual freedom and general happiness. So let, utopian energy come!

IV

Latin America: neither Finland Station nor a Secure Port; terra incognita

So far we approached the relationship between economics and happiness from different theoretical perspectives, with a brief look at its historical context from the view of the "central" countries. For the wealthy and democratic societies, this problem took on philosophical and technological dimensions that gave rise to a very substantial and pertinent debate, especially if the arms race were to be separated from the central concerns of humanity. For the authoritarian and less technologically advanced socialist societies, the problem seems about to be discussed with the self-criticism of the "old society" and the attempts to build a new society in which the basic problems are still democracy and efficiency, two old friends of Western thought since the beginning of the Modern Age. But what can we say of the peripheral societies, so heterogeneous in their economic, social, cultural and political patterns, most of whose peoples still lack the basic necessities of life?

In Latin America, the concept of *modernity* still obsesses the intellectual élites, liberal-conservatives or progressives. Reading *Prospero's Mirror* of Richard Morse tempts one to re-examine the concept of modernity in the light of our Iberian matrix.

The nucleus of the theory of Latin American underdevelopment, formulated by Raúl Prebisch in his seminal essay of 1949,[11] seems to have been forgotten or reduced to academic formalizations, at most as part of the history of Latin American thought. Only a few disciples and friends who are still alive continue the struggle. However, several Latin American economists have reverted to the earliest concepts of the modernization theories prevalent in Latin America in the 1950s, before the contribution made by José Medina Echavarría and his disciples.

But the basic question, in my judgement, is not the gap between modernity and backwardness, or between growth and stagnation. We had 50 years of

[10] See André Gorz, *Les chemins du paradis. L'agonie du capital*, Ed. Galilée.

[11] Raúl Prebisch, "El desarrollo económico de la América Latina y algunos de sus principales problemas". *Boletín económico de América Latina*, Economic Commission for Latin America and the Caribbean (ECLAC), vol. VII, No. 1, Santiago, Chile.

continuous growth in Brazil and several decades of conservative modernization, and yet the unequal structural matrix of capitalism is still intact. José Serra and I wrote an essay in 1970 on the driving force of capital accumulation and structural heterogeneity, inspired by Aníbal Pinto. I took up that question again in the early 1980s.[12]

We tried to show that the reason why we were in this situation of flagrant social injustice was not a lack of material progress! All in vain! The "progressives' " current idea is their insistence on modernization, dynamic international insertion, and the efficiency of the State, as conditions for returning to growth. First grow, then distribute. Once again it is the old theory of slicing the pie. And what happened to the discussion on development styles? And who will guarantee that the basic necessities of the population will be covered?

The left's adoption of the "dependence" concept led to no better results. Actually the Latin American left had to waste a lot of energy and pay for their acceptance of the "old utopia" of democracy with many lives. They learned, at their own cost, from seeing the political and ideological effects of dictatorships on our peoples that democracy is a permanent and not an instrumental value. At least most of them learned the lesson before the fall of the Berlin Wall.

Nonetheless, the Latin American school of thought suffered a considerable defeat in the field of political economy. This is where neo-liberal ideology wrought havoc among the younger generations. Their elders concentrated on discussing the external debt and achieved an apparent victory in terms of growing ideological acceptance, culminating in the creditor countries' recognition that it was impossible to pay the debt on the terms in which it was contracted and those on which it was being negotiated.

However, the basic analyses and recommendations on internal adjustment processes are generally accepted, despite their terrifying theoretical poverty and conservatism: putting "the house in order", reducing the amount of the deficit through conventional monetary and fiscal adjustments, opening the economy in order to increase competition and attracting foreign capital to modernize our backward economy. Do not miss the "train of history" which runs through Europe and Japan! There is no possible theoretical critique for such trivialities! The intellectuals of the left know that the "train" no longer runs beyond Finland Station, but the crisis of real socialism and of Latin American capitalism has left them more perplexed and weakened than they were throughout the 1980s.

But what is happening to Latin American societies? Are they witnessing defencelessly the "end of history", prophesied by tired intellectuals and weary élites who buried the French Revolution with pomp? Certainly not. South American society moved fitfully, with a tremendous energy never seen before, throughout the post-war period, but without a visible political structure. Throughout the 1980s we witnessed demonstrations of discontent, the struggle for redemocratization, gigantic elections, rage, joy and creativity of the young urban masses. "A land at a critical junction", Glauber Rocha would say. "Deep rivers", would be Arguedas' description. The poets are, as always, in the vanguard.

Terra incognita. One must navigate, said the Portuguese poet in the distant past. The Safe Haven does not exist; the masses "disembarked" a long time ago on this American continent. What some of our "sociologists" have still not discovered is that neither Europe's past nor its present will be Latin America's future. They want to disembark directly into the present social democracy of Mitterrand and Felipe González, without considering the existence of the wretched masses and the enormous conflict that prevents any "social pact" from being any more than a democratic political pact. Passing from political democracy to social democracy involves building institutions and much broader consensuses than those that will make it possible to reject the terror of authoritarian States.

The economists, descendants of the old ECLAC and the critical thought of Prebisch, Furtado and Aníbal Pinto, have dedicated themselves to the critique of Latin American capitalism and are making a strong effort to understand the adjustment processes of contemporary capitalism, in its accelerated transformation, and ask the basic questions: Does global transnationalization effectively eliminate any possible reaction by the nation States of the periphery? Can Latin America put up a joint defence

[12] José Serra (ed.), "Além da estagnação", *Ensaios de interpretação da América Latina*, Ed. Paz e Terra; M.C. Tavares, "Problemas estructurales en países de industrialización tardía y periférica", *Revista de política económica latinoamericana*, Centro de Investigaciones y Docencia Económica (CIDE), Mexico City, 1981.

as regards the external debt and partial economic integrations, at least in the Southern Cone? Is it possible to change production patterns with equity?

Economists of almost all hues wash their hands of the question of organizing wretched masses and the democratic State, and refer the problem to the sociologists or metahistory. They are far behind our esteemed leader Prebisch who, in the last years of his life, postulated specifically political action and the search for a democratic-socialist model.[13] Repositioning theories on these matters is only the beginning. The roads and projects depend on the struggling capacity and political coordination of Latin American society. The struggle that started a long time ago is being taken up again, but in very adverse objective and subjective conditions.

"Democracy is compatible with poverty and violence", a famous international sociologist said recently in Campinas when discussing the prospects for the late twentieth century. There was meagre applause, but general bewilderment paralysed the discussion. Perhaps what he meant was that our recently reconquered political freedoms were not in danger, that there was no risk of going back despite the degree of social conflict. But he was unaware of the negative effect of the categorical statement, especially at the symbolic and psychological level.

For us, and as a tribute to the life and work of Raúl Prebisch, the starting point has to be elsewhere; poverty and violence cannot be accepted alongside democracy. Moreover, they will be overcome only by intensifying the struggle for democracy, inspired by a long-term view of the objectives to be attained.

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Guidelines for contributors to *CEPAL Review*

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

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

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

— Papers should not be longer than 33 double-spaced letter-size pages (U.S. quarto), but shorter articles will also be considered. The original and one copy should be submitted, as should the diskettes, if any (in IBM or compatible WordPerfect format).

— All contributions should be accompanied by a note clearly indicating the title of the paper, the name of the author, the institution he belongs to, and his address. Authors are also requested to send in a short summary of the article (no more than 250 words) giving a brief description of its subject matter and main conclusions.

— Footnotes should be kept to the minimum, while bibliographical references and direct quotations should be carefully checked, since they are the responsibility of the author. It is also recommended that the number of tables and figures should be reduced to the minimum and that they should not duplicate information given in the text.

— Special attention should be paid to the bibliography. All the necessary information must be correctly stated in each case (name of the author or authors, complete title (including any subtitle), publisher, city, month and year of publication and, in the case of a series, the title and corresponding volume number or part, etc.).

— The editorial board of the Review reserve the right to make any necessary revision or editorial changes required by the articles.

— Authors will receive a courtesy copy of the Review in which their article appears, plus 30 offprints of the article, both in Spanish and in English, at the time of publication in each language.

Recent ECLAC publications

Industrialization in Latin America: From the "black box" to the "empty box" (LC/G.1534/Rev.1-P). Cuadernos de la CEPAL series, No. 60, Santiago, Chile: August 1990 (176 pp.).

In previous works the author of this study, Fernando Fajnzylber, has argued that the Latin American countries need to modify the pattern of industrialization which has been the basis for their production structure in recent decades. Here, he discusses in greater depth both the pattern which must be changed and the direction, requirements and policy guidelines that need to be followed in order to do so.

In discussions concerning the development of Latin America, the question is often raised as to whether the region is a suitable unit of analysis. In view of the diversity of situations and processes which the different States have gone through in their development, it might seem that the only appropriate typology would be one which included the same number of cases as the number of countries concerned. However, since no theory of development has yet satisfactorily explained the overall transformations which take place in economies and societies, many questions would remain even if each country's case were studied separately.

Although theories come and go, governments have to take action, and they are not immune to the intellectual fads which periodically permeate the social sciences. There is a useful expedient for dealing with this which, although not offering a real solution, does mitigate some of the more negative effects of this fact, and that is to recognize the prevailing circumstances, both domestic and international, even though no logical explanation for them may be found.

Past experience appears to indicate that one of the salient features of economic development processes in many different regions is that they seem to be a combination of a learning process, using the more advanced societies as models, and of economic and social inventiveness in the less advanced countries which permits them to adopt innovations within the context of their own shortcomings and potentialities. This accounts for the well-known fact that the channels of change vary widely in content, in direction and in regard to the institutions involved. In the case of the industrialization process, which is a pivotal element of economic development because of the contribution it makes to technical progress and increased productivity, the combination of learning and innovation becomes even more important. One of the characteristics of industrialization in Latin America so far has, in fact, been the asymmetry between a large component of imitation (the stage prior to learning) and a very small component of economic and social innovation.

In the first chapter, the author describes the Latin American industrialization process in terms of its contribution to the achievement of the objectives of economic growth and equity, identifying those features which are common to the different countries and those which are unique to individual countries and thus account for the diversity of the region. It also includes a brief description of the characteristics of what has been called the industrial crisis of the 1980s.

The second chapter focuses on what seems to be one of the main characteristics of the patterns followed in the industrialization and development of Latin America, i.e., its inability to absorb and creatively adopt technical progress in a manner consistent with the region's shortcomings and potentialities. The author also describes the relationship between technical progress and the industrial sector, and the contribution of macroeconomics, as well as summarizing the technological changes that have taken place on the international scene and discussing their implications for Latin America.

On the basis of the observations set forth in the first two chapters, in the third chapter an analytical scheme is proposed for the study of this relationship –which serves as the leitmotif for the study– between the pattern of industrialization and development and the achievement of the objectives of economic growth and equity.

In chapter four, the analytical scheme is discussed against the background of the actual situation of the three advanced industrial countries (the United States, Japan and Germany), which to a large extent set the prevailing international pattern of consumption, production, communications, transport and energy use.

In chapter five, attention is centered on Europe, which is divided into two subregions: the large Western countries, with which the American countries, especially the southern Latin American ones, have always had close relations, and the small Northern European countries, with which relations have been based on the availability of natural resources, specialized industries geared towards the international market and a sound system of participatory democracy.

In chapter six, the author's attention turns back to Latin America, this time with a view to comparing this region with certain recently industrialized countries whose industrial performance seems to be more satisfactory. Thus, he compares the situation of the three largest Latin American countries –Argentina, Brazil and Mexico with that of South Korea, Spain and Yugoslavia. Finally, some comments are made regarding the lessons which can be learned from this comparative study, with a view to drawing up more accurate guidelines for the internal changes the Latin American countries must make in order to face the challenge that lies ahead, i.e., to come closer to the hitherto empty box in which economic growth converges with equity.

Los recursos hídricos de América Latina y el Caribe: planificación, desastres naturales y contaminación (Water resources in Latin America and the Caribbean: planning, natural disasters and pollution) (LC/G.1559-P). Estudios e informes de la CEPAL series, No. 77, Santiago, Chile: September 1990 (266 pp.).

Following the 1977 United Nations Water Conference in Mar del Plata, Argentina, ECLAC was given the task of reporting on the implementation of the Mar del Plata Action Plan which had been approved at that meeting. This volume contains that report as well as a review of developments in the field of water resource management in Latin America and the Caribbean.

The book examines three issues: the design of national water resource plans, natural water-related hazards, and water pollution. These three subjects were singled out for attention because very little information had hitherto been compiled on these topics, which are, moreover, of great current interest.

The first section examines the design of water resource management plans in Latin America and the Caribbean with a view to exploring the prospects for an exchange of experiences in this field within the region.

This analysis is based on a comparative study of a number of national and regional water resource management plans which are currently at different stages in the design process. The focus is on the comparison of multisectoral water use plans, although the report analyses various sectoral plans as well, most of which relate to population, energy and agriculture.

An attempt is made to determine the relative usefulness of the formulation of such plans, the way in which social and economic development plans relate to water management plans, and the way in which national plans are linked with plans applying to hydrographic regions and river basins. The study includes an analysis of the way in which water resource plans incorporate the environmental dimension. No attempt is made, however, to evaluate how the plans, once completed, have been or are to be implemented.

The principal observations made in the study lead to the conclusion that, generally speaking, those countries which have undertaken the design of such plans have found it to be a useful exercise. The main benefits include: the compilation of more information about the water supply in those countries and in their respective regions; improved inter-agency co-ordination in respect of water resources; a more thorough understanding of the various possible means of balancing the supply and demand for water and the identification of a greater number of alternatives in that respect; a greater awareness of present and potential conflicts associated with the development of water resources; a greater possibility that environmental considerations will be incorporated; and the almost immediate creation of a large number of options for improving the operation of water works and projects.

The conclusions reached indicate that the design of such plans permits the countries to develop water policies that are in keeping with their social and economic development objectives, although there is clearly no certainty or guarantee that those policies will be implemented or taken into account in the decision-making process.

The second section of the report focuses on the regional situation with respect to water-related natural disasters. It includes an analysis of the characteristics of such disasters in terms of their impact in Latin America and the Caribbean, experiences with recent disasters, their effects on economic and social development and on the environment, and disaster-control measures that have been adopted in the region.

Water-related natural disasters have done very serious damage to the economy of the region and have produced high death tolls, and the devastation they cause appears to be increasing. There are a number of reasons for this trend. The growth of the population in the region continues, as does migration to the cities and other more hazardous areas. In addition, population growth has been accompanied by an increase in capital investment and in the construction of housing and other structures in hazardous zones. Yet another factor is that the severity of some types of water-related natural disasters has been exacerbated by the harmful impact which man has had on his environment.

The seriousness of natural disasters in Latin America and in the Caribbean could be reduced if precautionary measures are taken. Structural measures are the means most often chosen for providing some degree of flood protection. Attempts to mitigate the impact of droughts have focused on increasing the available water supply through the storage or utilization of groundwater. Efforts have also been made to make water use and the utilization of non-traditional sources more efficient. The construction of breakwaters and jetties helps to lessen the impact of storms. However, structural measures are often capital intensive, and their wider use is therefore hampered by the shortage of financial resources.

Non-structural measures which have been used in the countries of Latin America and the Caribbean include warning systems, emergency plans, land-use controls and building codes. Regional forecasting and warning systems are particularly important in the Caribbean and in Central America, where the Hurricane Commission co-ordinates national and regional efforts to provide early warning of hurricanes and floods. Extensive co-operation is also taking place with respect to flood warnings in the River Plate basin and to tidal wave (tsunami) warnings and the forecasting of droughts along the Pacific coast. To a limited extent, measures which include the formulation of special legislation and emergency plans, the construction of disaster centres, etc., have also been adopted to deal with such emergency situations. Although measures involving land use planning have thus far been applied only in isolated cases in urban areas, their utilization appears to be on the increase. Building codes are also being used in the region as a means of mitigating the effects of natural disasters, but their impact is limited.

The third section focuses on the fact that one of the most influential events relating to the use of the water resources of Latin America and the Caribbean during the latter part of the twentieth century has been the appearance of pollution as a major and alarming problem in many bodies of water. In some locations, this problem has already reached critical proportions. The chief causes of the increase in pollution include rapid population growth, the expansion of drinking water supply and sewerage services, the expansion of industry and the technological modernization of agriculture –all of which have occurred without a concomitant development of waste treatment and pollution control capabilities.

Despite the growing seriousness of water pollution in the region, there has been no systematic evaluation of this phenomenon, of its impact on the well-being of the population or of its economic implications. Nor is much known about the overall effect of water pollution. On the basis of earlier studies and reports, this study attempts to fill that vacuum by undertaking a comprehensive analysis of the mounting problems posed by water pollution and the steps being taken by the countries to combat it.

The main sources of water pollution in the region are the direct dumping of domestic and industrial wastes, while the chief cause of such pollution is the lack, except in the case of the most toxic industrial wastes, of waste-water treatment plants. As a result, almost all effluents are discharged into the nearest body of water without any treatment whatsoever.

The available information suggests that domestic wastes are the greatest cause of concern from the standpoint of health. Many bodies of water, especially those near large urban areas, are now heavily polluted. Recent studies indicate that, in the aggregate, pollution from fecal coliforms in the rivers of Central and South America is probably higher than in any other region in the world. The main sources of industrial waste water in the region are paper and pulp mills, chemical and petrochemical plants, oil refineries and metallurgical industries, food processing plants and textile mills. Pollution from mining and oil production also affects many rivers and some coastal zones, and pollutants released by mining activities pose a very severe problem in the Andean countries. The use of fertilizers and toxic chemicals in agriculture is a major and growing source of pollution, although the use of these substances continues to be much lower in the region than in developed countries. Pollution from these products is frequently aggravated by abuses in their local application and improper use, partly as a result of a lack of knowledge about soil management techniques.

Water pollution has a serious impact on the well-being of the population and, to a more limited degree, on the economic development of the countries of Latin America and the Caribbean. The pollution of surface watercourses from sewage poses severe health problems in many countries, particularly for the urban population. It is a generally accepted fact that the high rate of infant mortality and the prevalence of various intestinal infections are at least partly attributable to water pollution from human wastes. There is also some evidence that water pollution from agricultural chemicals and industrial effluents represent a human health hazard in various parts of the region as well. The use of polluted water for irrigation is another serious problem. Groundwater reservoirs, which in many areas are an important source of drinking and irrigation water, are also becoming increasingly polluted.

In the past 10 years the countries of Latin America and the Caribbean have taken a number of steps, including legislative measures, the supervision of water quality and the expansion of waste water treatment facilities, in an effort to deal with water pollution.

Generally speaking, however, despite the steps that have been taken in the region to reduce water pollution, it is clear that the Latin American and Caribbean countries continue to witness a gradual deterioration of water quality in many areas. The laws in force are not strictly enforced because the necessary funding is lacking, and there is a widespread attitude that the preservation of water quality is no more than a secondary priority. As a result, efforts to halt this deterioration are still in their infancy.

La apertura financiera en Chile y el comportamiento de los bancos transnacionales (Financial liberalization in Chile and the behaviour of transnational banks) (LC/G.1599-P). Estudios e informes de la CEPAL series, No. 78, Santiago, Chile: December 1989 (130 pp.).

The chief aim of this study is to analyse the importance of the role played by transnational banks in the financial and economic development of Chile following the financial reforms instituted in the 1970s.

The first section is devoted to a discussion of these financial reforms. The arguments in support of this reform process are presented along with a description of its objectives and of the sequence in which the main policy measures in this respect were adopted. The results of this effort are then evaluated, especially with respect to the issues of financial deepening, the mobilization of savings and efficiency.

The second section outlines the past and present performance of transnational banks in Chile. The history of their activities since the 1970s is traced with the help of various indicators. The discussion then turns to a review of the current laws on banking and foreign investment. An analysis is also made of the operations conducted by their head offices and of the transnational banks' non-banking activities.

The third section deals with the transnational banks' contributions to the country's development. This analysis –based on a comparison between transnational and national banks– addresses the subjects of the mobilization of savings, financial and non-financial behaviour patterns, the role played by transnational banks in raising efficiency, and their overall performance.

Policy recommendations are set forth in the final section. The report also includes three annexes: the first concerns the quantitative limits of banking operations, the second deals with the costs of financial repression and financial liberalization, and the third contains statistical tables.

The study concludes that the performance of the transnational banks during the past two decades has produced mixed results. To their credit, they have had a positive impact in terms of the development of various aspects of the financial system, but they have also exhibited shortcomings and have had some negative effects as well.

Their main positive effects have been to raise the overall system's levels of competitiveness and efficiency; the channelling of resources coming into the country from abroad, especially during the 1970s; the recycling of external and domestic resources during the crisis and the period immediately thereafter; and the improvement of the credit standing and stability of the financial system as a whole.

These banks' shortcomings and negative impacts include their relative disinterest in the transfer of new technologies from abroad and in the incorporation of new products and services into the local market; their reluctance to assume direct risks in the local market and their preference for operations involving the intermediation of financial instruments and other low-risk ventures; the selectiveness of their operations, which has often led to an over-concentration of their activities in certain geographic regions, market sectors, and products and services; and their acceptance of above-normal risks in direct lending to national banks and businesses by their head offices or other offices located outside the country.

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CEPAL Review first appeared in 1976 as part of the Publications Programme of the Economic Commission for Latin America and the Caribbean, its aim being to make a contribution to the study of the economic and social development problems of the region. The views expressed in signed articles, including those by Secretariat staff members, are those of the authors and therefore do not necessarily reflect the point of view of the Organization.

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